Southern Gas Corridor
Closed Joint-Stock Company

Consolidated financial statements

31 December 2016

Contents

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Independent auditor's report

Opinion

We have audited the consolidated financial statements of the Southern Gas Corridor Closed Joint Stock Company (the "Company") and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with 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. For the matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to this matter. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Impairment of non-current assets

We considered this matter to be one of most significance in our audit due to the significance of the balances of non-current assets (such as oil and gas properties, construction in progress and development assets, long-term prepayments) to the financial statements, high level of subjectivity in respect of assumptions underlying the impairment analysis and significant judgements and estimates made by management. In addition, drop in oil prices in 2016 might have affected the Group's business prospects and thus could have potentially resulted in impairment of the Group's assets.

Significant assumptions included discount rates, forecast prices of natural gas and condensate products, production forecasts, future capital expenditure and oil and gas reserves available for development and production.

The impairment test was performed by management as of 30 June 2016 and did not result in any impairment loss. We analysed the model the Group used for impairment test. We compared condensate and gas prices used in the model to the available market forecasts. We involved our business valuation specialists to assess the discount rates used in the models. We compared forecasted production in the model with the Company's business plan. We tested the mathematical accuracy of the impairment models and sensitivity analysis.

Management performed analysis of impairment indicators and did not identify any external or internal factors triggering impairment of non-current assets as of 31 December 2016.
We assessed the analysis made and factors that may trigger impairment.

Information on the impairment test of non-current assets is disclosed in Note 3.

Responsibilities of management and the Supervisory board for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, 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.

The Supervisory board is responsible for overseeing the Group's financial reporting process.

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

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

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

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

We communicate with the Supervisory board 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.

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

From the matters communicated with the Supervisory board, 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 auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The partner in charge of the audit resulting in this independent auditor's report is Nargiz Karimova.

Ernst & Young Holdings (CIS) B.V.

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16 June 2017

Consolidated statement of financial position

(Amounts presented are in thousands of US dollars)

	Note	31 December 2016 Audited	31 December 2015 Audited
Assets			
Non-current assets			
Oil and gas properties	6	449,091	490,333
Construction in progress and development costs	7	5,036,901	2,564,393
Advance payments	8	1,841,943	1,636,491
Investment in associate	9	90,378	60,740
Loan receivables	10	355,559	137,497
Other non-current assets		2,012	2,003
Total non-current assets		**7,775,884**	**4,891,457**
Current assets			
Cash and cash equivalents	11	400,384	254,560
Accounts receivable	12	9,477	19,004
Inventories	13	10,159	9,335
Accrued revenue	19	1,996	3,119
Other current assets	14	29,410	37,924
Total current assets		**451,426**	**323,942**
Total assets		**8,227,310**	**5,215,399**
Equity and liabilities			
Equity			
Share capital	15	1,740,800	1,444,900
Additional paid in capital	15	631,768	–
Other reserves	15	(45,176)	(45,176)
Cumulative translation differences		(35,506)	(23,516)
Retained earnings		(30,635)	31,703
Equity attributable to the Group's equity holders		**2,261,251**	**1,407,911**
Non-controlling interest	15	683,961	339,995
Total equity		**2,945,212**	**1,747,906**
Non-current liabilities			
Long-term borrowings	16	3,773,228	2,191,873
Government grant	16	667,116	683,281
Decommissioning liabilities	17	82,709	52,066
Deferred revenue	19	2,321	5,283
Deferred tax liability	21	7,759	8,060
Other non-current liabilities		11,914	10,001
Total non-current liabilities		**4,545,047**	**2,950,564**
Current liabilities			
Trade and other payables	18	231,475	197,025
Short-term and current portion of long-term borrowings	16	195,231	–
Accrued liabilities	18	308,849	318,759
Income tax payable		1,496	1,145
Total current liabilities		**737,051**	**516,929**
Total equity and liabilities		**8,227,310**	**5,215,399**

Signed and authorized on behalf of the Group

Afgan Isayev, General Director 16 June 2017

Adil Pashayev, Finance Director 16 June 2017

Azərbaycan Respublikası Qapalı Səhmdar Cəmiyyəti Cənub Qaz Dəhlizi Southern Gas Corridor Closed Joint Stock Company Azerbaijan Republic

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

Consolidated statement of comprehensive income

(Amounts presented are in thousands of US dollars)

	Note	Year ended 31 December 2016 Audited	Year ended 31 December 2015 Audited
Revenue	19	111,489	151,473
Cost of sales	20	(69,950)	(69,944)
Gross profit		**41,539**	**81,529**
General and administrative expenses		(10,802)	(12,510)
Transportation tariffs		(3,388)	(4,613)
Other income		17,495	16,190
Operating profit		**44,844**	**80,596**
Interest income		7,252	4,895
Finance costs	10, 16, 17	(80,757)	(56,110)
Share of result of associates	9	(4,022)	(5,856)
Foreign exchange loss, net		(26,811)	(85)
(Loss)/profit before income tax		**(59,494)**	**23,440**
Income tax expenses	21	(1,629)	(3,781)
(Loss)/profit for the year/period		**(61,123)**	**19,659**
Other comprehensive loss			
Other comprehensive loss to be reclassified to profit or loss in subsequent period			
Exchange differences on translation of foreign operations		(9,997)	(6,411)
Exchange differences on translation of foreign associate	9	(1,993)	(6,001)
Other comprehensive loss for the year/period		**(11,990)**	**(12,412)**
Total comprehensive (loss)/income for the year/period		**(73,113)**	**7,247**
(Loss)/profit attributable to:			
Equity holders of the Group		(62,338)	18,495
Non-controlling interest		1,215	1,164
		(61,123)	**19,659**
Total comprehensive (loss)/income attributable to:			
Equity holders of the Group		(74,328)	6,083
Non-controlling interest		1,215	1,164
		(73,113)	**7,247**

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

Consolidated statement of cash flows

(Amounts presented are in thousands of US dollars)

	Note	Year ended 31 December 2016 Audited	Year ended 31 December 2015 Audited
Operating activities			
(Loss)/profit before income tax		(59,494)	23,440
Non-cash adjustments to reconcile profit before tax to net cash flows			
Finance costs	10, 16, 17	80,757	56,110
Depreciation and depletion	20	60,591	53,858
Share of result of associate	9	4,022	5,856
Other income		(17,495)	(16,190)
Interest income		(7,252)	(4,895)
Foreign exchange loss		27,342	(164)
Working capital adjustments			
Accounts receivable		9,527	12,638
Inventories		(824)	3,817
Accrued revenue		1,123	9,999
Other assets		8,505	622
Deferred revenue		(2,962)	(2,379)
Trade and other payables		5,511	(16,267)
Accrued liabilities		(2,996)	8,406
Cash generated from operations		**106,355**	**134,851**
Income tax paid		(1,525)	(2,497)
Interest received		4,519	4,895
Net cash flows from operating activities		**109,349**	**137,249**
Investing activities			
Placement of deposits	11	–	(350,000)
Proceeds from withdrawal of deposits	11	–	383,246
Financing provided to third party	10	(93,950)	(27,950)
Financing provided to associate	10	(147,000)	(45,556)
Advance payments for acquisition of shares	8	(290,988)	(548,594)
Investments in oil and gas properties		(18,174)	(20,234)
Additions to construction in progress and development costs		(2,194,932)	(1,313,628)
Investment in associate	9	(38,900)	(17,500)
Net cash used in investing activities		**(2,783,944)**	**(1,940,216)**
Financing activities			
Contribution from shareholders	15	295,900	1,344,900
Increase in additional paid-in capital	15	631,768	–
Contribution in subsidiary by non-controlling shareholders	15	342,751	–
Proceeds from borrowings	16	1,611,186	234,780
Interest paid		(34,375)	–
Proceeds from sale of shares in subsidiary	15	–	265,649
Net cash flows from financing activities		**2,847,230**	**1,845,329**
Net foreign exchange translation differences		(26,811)	–
Net increase in cash and cash equivalents		**145,824**	**42,362**
Cash and cash equivalents as at inception	11	254,560	212,198
Cash and cash equivalents at the end of the year	11	**400,384**	**254,560**

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

Consolidated statement of changes in equity

(Amounts presented are in thousands of US dollars)

	Attributable to the equity holders of the parent							
	Share capital	Additional paid-in capital	Other reserves	Cumulative translation differences	Retained earnings	Total	Non-controlling interest	Total equity
At 31 December 2014	**100,000**	**–**	**–**	**(11,104)**	**13,208**	**102,104**	**–**	**102,104**
Profit for the year	–	–	–	–	18,495	**18,495**	1,164	**19,659**
Other comprehensive loss	–	–	–	(12,412)	–	**(12,412)**	–	**(12,412)**
Total comprehensive income/(loss)	**–**	**–**	**–**	**(12,412)**	**18,495**	**6,083**	**1,164**	**7,247**
Contribution from shareholders to the charter capital (Note 15)	1,344,900	–	–	–	–	**1,344,900**	–	**1,344,900**
Sale of share in subsidiary (Note 15)	–	–	(45,176)	–	–	**(45,176)**	338,831	**293,655**
At 31 December 2015	**1,444,900**	–	**(45,176)**	**(23,516)**	**31,703**	**1,407,911**	**339,995**	**1,747,906**
Loss for the year	–	–	–	–	(62,338)	**(62,338)**	1,215	**(61,123)**
Other comprehensive loss	–	–	–	(11,990)	–	**(11,990)**	–	**(11,990)**
Total comprehensive income/(loss)	**–**	**–**	**–**	**(11,990)**	**(62,338)**	**(74,328)**	**1,215**	**(73,113)**
Contribution from shareholders to the charter capital (Note 15)	295,900	–	–	–	–	**295,900**	–	**295,900**
Increase in additional paid-in capital (Note 15)	–	631,768	–	–	–	**631,768**	–	**631,768**
Contribution in charter capital of subsidiary by non-controlling shareholders (Note 15)	–	–	–	–	–	–	342,751	**342,751**
At 31 December 2016	**1,740,800**	**631,768**	**(45,176)**	**(35,506)**	**(30,635)**	**2,261,251**	**683,961**	**2,945,212**

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

(Amounts presented are in thousands of US dollars, unless otherwise stated)

1. Corporate information

Southern Gas Corridor Closed Joint-Stock Company (the “Company” or “SGC CJSC”) was established by the Presidential Decree No. 287 dated 25 February 2014. It was incorporated on 31 March 2014 in accordance with Azerbaijani legislation. 51% of the Company is owned by the Republic of Azerbaijan (the “State”), which is represented by the Ministry of Economy of the Republic of Azerbaijan (“ME”), whereas 49% belongs to the State Oil Company of Azerbaijan Republic (“SOCAR”). The Company is domiciled in the Republic of Azerbaijan. The registered address is located at 73 Neftchilar Avenue, Baku, AZ 1000, the Republic of Azerbaijan.

The Company was established for consolidating, managing and financing the State’s interests in the full-field development of the Shah Deniz gas-condensate field, the expansion of the South Caucasus Pipeline (“SCP”), implementation of Trans-Anatolian Natural Gas Pipeline (“TANAP”) and Trans Adriatic Pipeline (“TAP”) projects (together the “Projects”).

The Company has the following subsidiaries:

		% equity interest	
Name	**Country of incorporation**	**31 December 2016**	**31 December 2015**
SGC Upstream LLC	Azerbaijan	100%	100%
SGC Midstream LLC	Azerbaijan	100%	100%
TANAP Doğalgaz Iletim A.Ş.	Turkey	58%	58%
AzTAP GmbH	Switzerland	100%	100%

The Company holds 20% share in Trans Adriatic Pipeline AG (“TAP AG”), through AzTAP GmbH.

On 13 April 2015 the Company sold its 30% share in TANAP Doğalgaz İletim A.Ş. (“TANAP A.Ş.”) to Boru Hatları ile Petrol Taşıma A.Ş. (“BOTAS”). On 16 April 2015 the Company sold further 12% share in TANAP A.Ş. to BP Pipelines (TANAP) Limited (BP). Further details are disclosed in Note 10.

2. Significant accounting policies

Basis of preparation

These consolidated financial statements of the Company and its subsidiaries (collectively referred to as “the Group”) for the year ended 31 December 2016 have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by International Accounting Standards Board (“IASB”). The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

Going concern

The going concern basis assumes that the Group will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. As at 31 December 2016 the Group had net current liabilities in the amount of US dollars 285,625. In addition, as at 31 December 2016, the Group had certain commitments which would require significant cash outflows in foreseeable future (see Note 24).

The Group’s ability to continue as a going concern depends on the ability to generate sufficient cash inflows from financing provided by third parties and its shareholders.

The Group’s management expects to receive sufficient amount of proceeds from hydrocarbons sales under current Shah Deniz Production Sharing Agreement, contributions from State Oil Fund of the Republic of Azerbaijan (“SOFAZ”) and capital injections by the shareholders as well as through funds raised by external debt. The Group management believes that the funds obtained from the above sources will be sufficient for meeting its financial commitments and the Group will be able to continue as a going concern for the foreseeable future.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Basis for consolidation

The consolidated financial statements comprise the financial statements of the Group and its subsidiaries as at 31 December 2016.

Subsidiaries are all entities (including structured entities) over which the Group has control. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- Exposure, or rights, to variable returns from its involvement with the investee; and
- The ability to use its power over the investee to affect its returns.

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee;
- Rights arising from other contractual arrangements;
- The Group's voting rights and potential voting rights.

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary.

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated but considered as an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Profit or loss and each component of other comprehensive income are attributed to the equity holders of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance.

Business combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses. When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss.

Transactions with non-controlling interest

Changes in the Group's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (i.e. transactions with owners in their capacity as owners). In such circumstances the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Group.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Business combinations (continued)

Business combinations with entities under common control

The Group applies pooling of interest method of accounting for business combinations with entities under the common control from the date when the combination took place.

The pooling of interests method includes the following:

- The assets and liabilities of the combining entities are reflected at their carrying amounts. No adjustments are made to reflect fair values, or recognise any new assets or liabilities, at the date of the combination. The only adjustments that are made are to align accounting policies.
- No "new" goodwill is recognised as a result of the combination. The only goodwill that is recognised is any existing goodwill relating to either of the combining entities. Any difference between the consideration paid/transferred and the net assets acquired is reflected within equity.
- Total comprehensive income reflects the results of the combining entities from the period when the combination took place.

Acquisition of an entity that is not a business

When the Group acquires an entity that is not a business, it allocates the cost of acquisition between the individual identifiable assets and liabilities of the acquired entity on the basis of their relative fair values as following:

- Monetary assets and monetary liabilities are recognized at their fair value;
- The cost of acquisition remained after deduction of the fair value of monetary assets and monetary liabilities is allocated to non-monetary assets and non-monetary liabilities on the basis of their fair value at the date of acquisition.

Investment in associate

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The Group's investment in its associate is accounted for using the equity method. Under the equity method, the investment in an associate is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the associate since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The statement of profit or loss reflects the Group's share of the results of operations of the associate. Any change in other comprehensive income ("OCI") of those investees is presented as part of the Group's OCI. In addition, when there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

The aggregate of the Group's share of profit or loss of an associate is shown on the face of the statement of profit or loss outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate.

The financial statements of the associate are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Investment in associate (continued)

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investment in its associate. At each reporting date, the Group determines whether there is objective evidence that the investment in the associate is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value, and then recognises the loss as “Share of profit of an associate” in the statement of profit or loss.

Upon loss of significant influence over the associate, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in profit or loss.

Investments in SD PSA, SCP and AGSC

According to the terms of SD PSA, the Group owns the portion of project’s assets and is liable for its portion of project’s liabilities. At the same time the Group is entitled to its portion of expenses incurred and revenues earned by the whole project. Therefore, the Group accounts for its investment in SD PSA by recognizing its interest portion of underlying assets, liabilities, expenses incurred and income earned by the project.

Participating interest of the Group in the SCP Project is treated by the Group as undivided interest related to the investment in South Caucasus Pipeline Company Limited (“SCPC”) and accounted by recognizing its interest portion of underlying assets, liabilities, expenses incurred and income earned by the project.

The Group holds an interest in the Azerbaijan Gas Supply Company Limited (“AGSC”), a company established together with the other Contractor Parties of the Shah Deniz Project and the Ministry of Energy of the Republic of Azerbaijan. AGSC is special structured entity established for marketing, accounting, billing, payment and reporting of other administrative activities related to the sales of Shah Deniz gas and operates on a no gain, no loss basis.

Foreign currency translation

The consolidated financial statements are presented in US dollars (“USD”) and all values are rounded to the nearest thousands, except when otherwise indicated.

The functional currency of the Company, subsidiaries and associate are the following:

SGC CJSC	USD
SGC Upstream LLC	USD
SGC Midstream LLC	USD
TANAP A.Ş.	USD
AzTAP GmbH	EUR
TAP AG	EUR

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

Monetary assets and liabilities not already measured in the functional currency of respective Group entity are translated into the functional currency of that entity at the appropriate exchange rates prevailing at the reporting date.

Foreign exchange gains and losses resulting from the re-measurement into the functional currencies of respective Group’s entities are recognized in profit or loss.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Foreign currency translation (continued)

The results and financial position of the Group entities which functional currency differ from the presentation currency of the Group and not already measured in the Group's presentation currency are translated into the presentation currency of the Group as follows:

(i) Assets and liabilities for each statement of financial position are translated at the closing rate at the date of that statement of financial position;

(ii) Income and expenses for each statement of profit or loss and other comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) All resulting exchange differences are recognized as a separate component of equity – currency translation difference.

At 31 December 2016 the principal rate of exchange used for translating foreign currency balances was USD 1.0529 per EUR 1 (31 December 2015: 1.0931).

Financial instruments – key measurement terms

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

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability, or in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or the most advantageous market must be accessible to by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their best economic interest.

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

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

Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;

Level 2 – valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;

Level 3 – valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

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

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition and includes transaction costs. Measurement at cost is only applicable to investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Financial instruments – key measurement terms (continued)

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest rate method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the consolidated statement of financial position.

The effective interest rate method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Financial assets

Initial recognition and measurement

Financial assets are classified, at initial recognition, as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. All financial assets are recognized initially at fair value.

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

Subsequent measurement

The subsequent measurement of financial assets depends on their classification:

Loan receivables

This category is the most relevant to the Group. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortized cost using the effective interest rate method, less impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the effective interest rate method.

The effective interest rate method amortization is included in finance income in the consolidated statement of comprehensive income. The losses arising from impairment are recognized in the consolidated statement of comprehensive income.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Financial assets (continued)

Cash and cash equivalents

Cash and cash equivalents comprise cash at banks and at hand and short-term deposits with an original maturity of three months or less.

Accounts receivable

Accounts receivables which generally have 30-90 days' terms are recognized and carried at original invoice amount less an allowance for any uncollectible amounts.

De-recognition

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

- The rights to receive cash flows from the asset have expired, or;
- The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a "pass through" arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Impairment of financial assets

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

Financial assets carried at amortized cost

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

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

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Financial liabilities

Initial recognition and measurement

Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

All financial liabilities are recognized initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

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

Subsequent measurement

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

Loans and borrowings

This category is most relevant to the Group. After initial recognition, interest bearing loans and borrowings which have a fixed contractual repayment schedule are subsequently measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the consolidated statement of comprehensive income when the liabilities are derecognized as well as through the effective interest rate method amortization process.

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

Borrowings with no pre-defined contractual repayment schedules are measured in accordance with actual contractual terms.

Trade and other payables

Trade and other payables are accrued when the counterparty performed its obligations under the contract. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

De-recognition

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated statement of comprehensive income.

Offsetting of financial instruments

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

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Oil and gas properties

Oil and gas properties are stated at cost, less accumulated depreciation and provision for impairment, where required. Such cost includes the cost of replacing part of the oil and gas properties and borrowing costs for long-term construction projects if the recognition criteria are met.

Costs of minor repairs and maintenance are expensed when incurred. Cost of replacing major parts or components of oil and gas properties items are capitalised and the replaced part is retired.

At the end of each reporting period management assesses whether there is any indication of impairment of oil and gas properties. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognised for an asset in prior years is reversed where appropriate if there are indicators that impairment loss may no longer exist or may have decreased.

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

Construction in progress

All costs directly or indirectly attributable to the projects to construction and expansion the capacity of the pipeline systems are capitalized as a construction in progress. The construction in progress is stated at a cost and not depreciated. The construction in progress is transferred to the property, plant and equipment upon completion.

Depreciation, depletion and amortization

Depreciation, depletion and amortization of capitalized costs of oil and gas properties is calculated using the units-of-production method based on proved reserves for the cost of property acquisitions and proved developed reserves for exploration and development costs.

The cost of an off-shore production platform, terminal and other development costs incurred in connection with a planned group of development wells is reduced for the portion of development costs related to wells which have not been drilled yet in determining the asset base subject to the unit-of-production amortization rate until the additional development wells are drilled. Similarly, in computing the depletion rate, those proved reserves that will be produced only after significant additional development costs are incurred are excluded from proved developed reserves.

Depreciation, depletion and amortization of capitalized costs of the pipeline systems are calculated using the straight line method for the period of useful life of pipelines. The estimated useful life of the SCP pipeline is thirty years from 25 November 2006 when the pipeline was officially put in use. The estimated useful life of the TANAP pipeline system will be the period from the date when the pipeline is officially put in use till the year 2061.

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

Oil and natural gas development expenditure

The Group follows the successful efforts method of accounting for oil and natural gas development activities. Costs to acquire mineral interests, to determine the technical feasibility, assess commercial viability of an identified resource and to drill and equip exploratory wells that find proved reserves are capitalized within exploration and evaluation assets. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Oil and natural gas development expenditure (continued)

When proved reserves of oil and natural gas are identified and development is sanctioned by management, the relevant capitalized expenditure is first assessed for impairment and (if required) any impairment loss is recognized, then the remaining balance is transferred to oil and gas properties. No amortization is charged during the exploration and evaluation phase.

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, the drilling and equipment of development wells, including unsuccessful development or delineation wells, is capitalized within oil and gas properties. Oil and gas properties are stated at cost less accumulated depreciation and accumulated impairment losses.

Advance payments

Advance payments are recognized and carried at the original amount of payment less provision for any amount at risk of non-performance by the counterparty. Advance payments made for non-current assets as well as payments which will be settled during more than one-year period are non-current advance payments.

Borrowing costs

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

Impairment of oil and gas properties, construction in progress, development costs and other non-financial assets

The Group assesses at each statement of financial position date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash generating unit's ("CGU") fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

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

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost of producing crude oil is accounted on weighted average basis. This cost includes all costs incurred in the normal course of business in bringing each product to its present location and condition. The cost of crude oil is the production cost, the appropriate proportion of depletion and depreciation charges and overheads. Net realizable value of crude oil is based on estimated selling price in the ordinary course of business less any costs expected to be incurred to completion and disposal.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Decommissioning liabilities

Under the provisions of the SD PSA, the Contractor Parties to the SD PSA are obligated to finance the ultimate abandonment of oil and gas production properties employed in petroleum operations within the contract area. The maximum amounts of abandonment funds cannot exceed 10% of the capital costs in accordance with the SD PSA. The Group estimates its share of total decommissioning liabilities based on SD PSA provisions by applying the 10% limit to all capital costs incurred in petroleum operations in the contract area as at the year-end. The present value of the decommissioning liabilities is recorded by the Group as a liability at the time the assets are installed or placed in service. The amount of liability equals the present value of the future decommissioning liabilities discounted at pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability rate, which equals 5.59% at 31 December 2016 (31 December 2015: 5.95%). A corresponding tangible fixed asset of an amount equivalent to the liability is also created and included in the cost of oil and gas production properties. This amount is subsequently depreciated as part of the oil and gas production properties and charged against income using the unit-of-production method based on proved reserves. Changes in the estimated timing of decommissioning or decommissioning cost estimates are dealt with prospectively by recording an adjustment to the provision, and a corresponding adjustment to oil and gas production properties. The unwinding of the discount on the decommissioning provision is included as a finance cost.

According to the Host Government Agreement ("HGA") signed with the Georgian and Azerbaijan Governments, no later than 30 days after the termination of the HGA, SCPC must submit a decommissioning plan to these Governments addressing its obligations to retire the pipeline. The amount of asset retirement obligation is capitalized by shareholders of SCPC.

In accordance with HGA signed with the Government of Turkey, the Group shall comply with all its decommissioning obligations following the expiry of HGA (2061). The Group started construction works in March 2015. At the date of the consolidated financial statements, the Group had performed works related to backfilling activities, placement of compressors and SCADAs, which require decommissioning works. The Group recognized decommissioning liability, which represents the management's best estimate of the expenditures required to settle the present obligation at the reporting date.

Government grants

Government grants are recognized when there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant related to an asset, it is recognized as income in equal amounts over the expected useful life of the related asset.

The benefit of a governmental bond at a below market rate of interest is treated as a government grant. Such benefit is measured as the difference between the initial fair value of the issued bond and the proceeds received.

Income taxes

Income taxes have been provided for in the consolidated financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge comprises current tax and deferred tax and is recognised in profit or loss for the year unless it relates to transactions that are recognised, in the same or a different period, in other comprehensive income or directly in equity.

The Group is liable for financing of its 6.67% share in the tax liabilities of SCPC, namely Azerbaijani income tax, Georgian income tax and Georgian minimum tax liabilities.

According to the provisions of SD PSA, contractor parties are liable for profit taxes. However, according to the SD PSA, respective government entity of the Republic of Azerbaijan is liable for payment of profit taxes of each contractor party from the proceeds from sales of crude oil and natural gas. Accordingly, the Group recognizes profit taxes and related revenue in the consolidated statement of profit and loss.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Income taxes (continued)

In accordance with HGA signed with the Government of Turkey and the Government of Azerbaijan, the Group will be subject to income tax in respect of TANAP project after the pipeline will be put in use. Accordingly, the Group is not subject to income tax during the construction phase.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income taxes are provided in full on temporary differences arising on recognition and subsequent measurement of provision for asset retirement obligation and related adjustments to cost of property, plant and equipment.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Group's chief operating decision maker. Segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, or receivable, taking into account contractually defined terms of payment net of discounts, returns, value added taxes and other taxes or duty.

Revenues associated with sales of crude oil (condensate) and gas are recorded at the point when the significant risks and rewards of ownership are transferred, which is when title to the extracted oil and gas passes to the customer based on the terms of the SD PSA and based on the proportion of its share in total crude oil and gas entitlement. The actual volume of oil received by the Group may differ from the entitled volume resulting in an over/under lifting. Underlift is recognized as a sale of crude oil at the point of lifting by the underlifter to the overlifter. Overlift is recognized as a purchase of oil by the overlifter from the underlifter. The extent of underlift is reflected by the Group as an asset in the statement of financial position, and the extent of overlift is reflected as a liability. The initial measurement of the overlift liability or underlift asset is at the market price of crude oil at the date of lifting. Subsequent measurement of overlift/underlift liabilities and assets depends on the settlement terms of the related operating agreements. If such terms allow for a cash settlement of the overlift/underlift balances between the parties, the balances are remeasured at fair value at reporting dates subsequent to initial recognition. The overlift/underlift balances that are settled through delivery of physical quantities of crude oil are measured at the lower of carrying amount and fair value at reporting dates subsequent to initial recognition.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

Revenue recognition (continued)

BP Exploration (Shah Deniz) Limited, the Operator of the SD PSA (the "SD Operator"), provides the Contractor Parties of SD PSA on a quarterly basis with the Shah Deniz Petroleum Entitlement Report, that contains, inter alia, the final net back price figure which is applied when determining the final petroleum volume that each SD PSA party is entitled to receive. When the actual Shah Deniz Petroleum Entitlement Report is not available, the Group recognizes the revenue based on a provisional Shah Deniz Petroleum Entitlement Report issued by the SD Operator. The revenue recognized may be further revised in the event that actual net back price differs from the provisional net back price used for revenue calculation. The Group treats such revision of revenue, if any, as a change in estimate and reflects in the current year statement of comprehensive income.

Employee benefits

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

Transactions with related parties

For the purposes of these consolidated financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

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

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements unless it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made. A contingent asset is not recognized in the consolidated financial statements but disclosed when an inflow of economic benefits is probable.

New and amended standards and interpretations

The Group applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2016. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

Although these new standards and amendments applied for the first time in 2016, they did not have a material impact on the consolidated financial statements of the Group. The nature and the impact of each new standard or amendment is described below:

Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests

The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business, must apply the relevant IFRS 3 *Business Combinations* principles for business combination accounting. The amendments also clarify that a previously held interest in a joint operation is not re-measured on the acquisition of an additional interest in the same joint operation if joint control is retained. In addition scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are applied prospectively. These amendments do not have any impact on the Group as there has been no interest acquired in a joint operation during the period.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

New and amended standards and interpretations (continued)

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortization

The amendments clarify the principle in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is a part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortize intangible assets. The amendments are applied prospectively and do not have any impact on the Group, given that it has not used a revenue-based method to depreciate its non-current assets.

Annual improvements 2012-2014 cycle

These improvements include:

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Assets (or disposal groups) are generally disposed of either through sale or distribution to the owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. This amendment is applied prospectively.

IFRS 7 Financial Instruments: Disclosures

(i) Servicing contracts

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures need not be provided for any period beginning before the annual period in which the entity first applies the amendments.

(ii) Applicability of the amendments to IFRS 7 to condensed interim financial statements

The amendment clarifies that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report. This amendment is applied retrospectively.

IAS 19 Employee Benefits

The amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used. This amendment is applied prospectively.

IAS 34 Interim Financial Reporting

The amendment clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the interim financial report (e.g., in the management commentary or risk report). The other information within the interim financial report must be available to users on the same terms as the interim financial statements and at the same time. This amendment is applied retrospectively.

These amendments do not have any impact on the Group.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

2. Significant accounting policies (continued)

New and amended standards and interpretations (continued)

Amendments to IAS 1 Disclosure Initiative

The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- The materiality requirements in IAS 1;
- That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated;
- That entities have flexibility as to the order in which they present the notes to financial statements;
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments do not have any impact on the Group.

Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception

The amendments address issues that have arisen in applying the investment entities exception under IFRS 10 *Consolidated Financial Statements*. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value.

Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 *Investments in Associates and Joint Ventures* allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries.

These amendments are applied retrospectively and do not have any impact on the Group as the Group does not apply the consolidation exception.

3. Significant accounting judgments, estimates and assumptions

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

On an on-going basis, management evaluates their estimates, including those related to revenue recognition and contingencies. Management bases their estimates on various market-specific assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making assumptions about the carrying values of assets that are not readily apparent from other sources. Actual results may differ significantly from these estimates using different assumptions or conditions.

The key assumptions concerning the future and other key sources of estimation uncertainty at the date of consolidated financial statements that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

3. Significant accounting judgments, estimates and assumptions (continued)

Reserve estimates

Estimates of recoverable quantities of proven and probable reserves reported include judgmental assumptions regarding commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows. It also requires interpretation of complex geological and geophysical models in order to make an assessment of the size, shape, depth and quantity of reservoirs, and their anticipated recoveries. The economic, geological and technical factors used to estimate reserves may change from period to period; changes in reported reserves can impact provision of decommissioning liabilities due to changes in expected future cash flows. Reserves are integral to the amount of depreciation, depletion and amortization charges to the consolidated statement of comprehensive income.

Natural gas and condensate reserves depend on price fluctuations as a result of change in production entitlement split between the State and contractor parties. Natural gas prices are calculated based on the long-term sales contracts provisions and depend on crude oil prices and other inputs. The current long-term Brent FOB oil price assumption used in the estimation of reserves is sixty eight dollars fifteen cents per barrel (US dollars 68.15) as at the consolidated statement of financial position date.

The level of estimated commercial reserves is also a key determinant in assessing whether the carrying value of any of the Group's development and production assets has been impaired.

Decommissioning liabilities

As discussed in Note 2, under the terms of the SD PSA the Group will have to make contributions to the abandonment fund when seventy percent (70%) of petroleum reserves of the Shah Deniz field are recovered. Decommissioning liabilities are stated in the amount of expected contributions related to the currently employed assets discounted at a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. This valuation requires the Group to make estimates about timing of expected future cash flows and adjustment to the discount rate, and hence they are subject to uncertainty. The estimation of the decommissioning liabilities is based on the assumption that contributions to the abandonment fund will start in 2027. Further details are disclosed in Note 17.

If the estimated discount rate used in the calculation had been 1% higher/lower than management's estimate, the carrying amount of the provision would have been US dollar 9,049 lower / US dollars 10,543 higher, respectively.

Deferred and accrued revenue

In the valuation of the Group's over-lift and under-lift position under the Shah Deniz PSA as at the year-end the Group uses fifty four dollars ninety four cents per barrel (US dollars 54.94) market price for crude oil as at 31 December 2016.

Recoverability of oil and gas assets

The Group assesses each CGU every reporting period to determine whether any indication of impairment exists. Where an indicator of impairment exists, a formal estimate of the recoverable amount is made, which is considered to be the higher of the fair value less costs to sell and value in use. These assessments require the use of estimates and assumptions such as long-term oil prices, discount rates, operating costs, future capital requirements, decommissioning costs, exploration potential, reserves and operating performance (which includes production and sales volumes). These estimates and assumptions are subject to risk and uncertainty. Therefore, there is a possibility that changes in circumstances will impact these projections, which may impact the recoverable amount of assets and/or CGUs.

Given the nature of the Group's activities, information on the fair value of an asset or CGU is not practicable to identify. Consequently, the recoverable amount used in performing the impairment test described below is value-in-use. 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. The Group generally estimates value-in-use using a discounted cash flow model from financial budgets approved by management.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

3. Significant accounting judgments, estimates and assumptions (continued)

Key assumptions used in value-in-use calculations

The calculation of value-in-use for oil fields is most sensitive to the following assumptions:

Identification of CGU

CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets of group of assets. The management assesses that SCP, TANAP and TAP projects are being constructed with the ultimate goal of the delivering Shah Deniz field natural gas to the Georgian, Turkish and European markets. Therefore, all these projects have been considered as one CGU and impairment test is performed on the level of the whole Group.

Capital expenditures

Capital expenditures necessary to maintain estimated production volumes are based on long-term development plans for particular field.

Commitments under DSPA

As disclosed in Note 24, the Group is committed to make progress payments under the terms of the DSPA. The parties to the DSPA have intention to revise progress payments which will result in decrease of cash outflows by the Group. The Group expects that the respective amendment to DSPA will be signed in 2017. Accordingly the Group used revised progress payments in calculation of undiscounted cash flows.

Crude oil price

Commodity prices used in the forecasts are publicly available.

If the forecasted prices used in the calculation had been five dollars (US dollars 5.0) lower than management's estimate, this would not result with any impairment loss.

Discount rate

The post-tax discount rate applied to the cash flow projections of CGU was 6%. The discount rate calculation is based on the specific circumstances of the Group and derived from its incremental borrowing rate adjusted to the specific risks associated with the asset's estimated cash flows. If the estimated discount rate used in the calculation had been 1% higher than management's estimate, this would not result in impairment loss.

The last impairment test was performed by the Group as of 30 June 2016 and did not result in any impairment loss. Management did not identify impairment indicators as of 31 December 2016.

Contingencies

By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgment and estimates of the outcome of future events.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

4. Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* that replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. IFRS 9 brings together all two aspects of the accounting for financial instruments project: classification and measurement, and impairment. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted.

The Group plans to adopt the new standard on the required effective date.

During 2016, the Group has performed a high-level impact assessment of all three aspects of IFRS 9. This preliminary assessment is based on currently available information and may be subject to changes arising from further detailed analyses or additional reasonable and supportable information being made available to the Group in the future. Overall, the Group expects no significant impact on its balance sheet and equity except for the effect of applying the impairment requirements of IFRS 9. The Group expects a higher loss allowance resulting in a negative impact on equity and will perform a detailed assessment in the future to determine the extent.

(a) Classification and measurement

The Group does not expect a significant impact on its balance sheet or equity on applying the classification and measurement requirements of IFRS 9.

Loans as well as trade receivables are held to collect contractual cash flows and are expected to give rise to cash flows representing solely payments of principal and interest. Thus, the Group expects that these will continue to be measured at amortized cost under IFRS 9. However, the Group will analyze the contractual cash flow characteristics of those instruments in more detail before concluding whether all those instruments meet the criteria for amortized cost measurement under IFRS 9.

(b) Impairment

IFRS 9 requires the Group to record expected credit losses on all of its debt securities, loans and trade receivables, either on a 12-month or lifetime basis. The Group expects to apply the simplified approach and record lifetime expected losses on all trade receivables. The Group expects a significant impact on its equity due to unsecured nature of its loans and receivables, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

IFRS 15 Revenue from Contracts with Customers

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

The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. Early adoption is permitted.

The Group plans to adopt the new standard on the required effective date using the full retrospective method. During 2016, the Group performed a preliminary assessment of IFRS 15, which is subject to changes arising from a more detailed ongoing analysis. Furthermore, the Group is considering the clarifications issued by the IASB in April 2016 and will monitor any further developments.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

4. Standards issued but not yet effective (continued)

Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the conflict between IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture, is recognized in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognized only to the extent of unrelated investors' interests in the associate or joint venture. The IASB has deferred the effective date of these amendments indefinitely, but an entity that early adopts the amendments must apply them prospectively.

IAS 7 Disclosure Initiative – Amendments to IAS 7

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

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces 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*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognize a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognize the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to re-measure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognize the amount of the re-measurement of the lease liability as an adjustment to the right-of-use asset.

IFRS 16 also requires lessees to make more extensive disclosures than under IAS 17.

In 2017, the Group plans to assess the potential effect of IFRS 16 on its consolidated financial statements.

IFRIC 22 Foreign Currency Transactions and Advance Consideration

The interpretation clarifies that in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it), or on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of the transaction for each payment or receipt of advance consideration.

The amendments are effective from 1 January 2018 and may be applied on a fully retrospective basis; prospectively to all assets, expenses and income in its scope that are initially recognised on or after the beginning of the reporting period in which the entity first applies the interpretation; or, the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation. The Group intends to adopt the amendments on the effective date, and does not expect the impact of adoption of the interpretation to be material.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

4. Standards issued but not yet effective (continued)

IFRIC 23 – Uncertainty over Income Tax Treatments

This Interpretation issued in June 2017 clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. In such a circumstance, an entity shall recognise and measure its current or deferred tax asset or liability applying the requirements in IAS 12 based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying this Interpretation. This interpretation is effective for annual reporting periods beginning on or after 1 January 2019.

5. Segment information

Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the management of the Group and for which discrete financial information is available.

The Group is organized into business units based on their products and services and has two reportable segments as follows:

- Oil and gas – representing extraction of natural gas and gas condensate;
- Distribution – representing transportation of natural gas and gas condensate.

No operating segments have been aggregated to form the above reportable operating segments.

The Group's segments are strategic business units that focus on different customers. Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Transfer prices between operating segments are either on an arm's length basis or non-arm's length basis.

Information about reportable segment profit or loss, assets and liabilities

Segment information for the reportable segments for the year ended 31 December 2016 is set out below:

	Oil and gas	**Distribution**	**Unallocated (*)**	**Eliminations (**)**	**Total**
Revenues					
External customers	111,489	–	–	–	**111,489**
Inter-segment	–	22,496	–	(22,496)	**–**
Total revenue	**111,489**	**22,496**	**–**	**(22,496)**	**111,489**
Depreciation and depletion	(57,173)	(3,418)	–	–	**(60,591)**
Other costs	(7,596)	(2,867)	–	1,104	**(9,359)**
Transportation tariffs	(25,884)	–	–	22,496	**(3,388)**
General and administrative expenses	(6,937)	(662)	(3,203)	–	**(10,802)**
Other operating income	1,323	7	16,165	–	**17,495**
Interest income	–	1,087	105,511	(99,346)	**7,252**
Finance costs	(41,853)	(17,713)	(77,652)	56,461	**(80,757)**
Share of result of associates	–	(4,022)	–	–	**(4,022)**
Foreign exchange loss, net	(25)	(13,103)	(28,471)	14,788	**(26,811)**
Income tax expense	–	(1,629)	–	–	**(1,629)**
Net profit/(loss) for the year	**(26,656)**	**(19,824)**	**12,350**	**(26,993)**	**(61,123)**

(*) These numbers include unallocated transactions managed and recognized at the group level.

(**) Inter-segment revenues and expenses are eliminated on consolidation. Amounts shown as eliminations include intercompany transactions.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

5. Segment information (continued)

Information about reportable segment profit or loss, assets and liabilities (continued)

	Oil and gas	Distribution	Unallocated (*)	Eliminations (**)	Total
Investment in associates	–	90,378	–	–	**90,378**
Other reportable segment assets	2,646,217	4,856,224	5,289,398	(4,654,907)	**8,136,932**
Total reportable segment assets	**2,646,217**	**4,946,602**	**5,289,398**	**(4,654,907)**	**8,227,310**
Other reportable segment liabilities	(2,602,131)	(3,351,386)	(3,923,669)	4,595,088	**(5,282,098)**
Total reportable segment liabilities	**(2,602,131)**	**(3,351,386)**	**(3,923,669)**	**4,595,088**	**(5,282,098)**
Capital expenditure (***)					
Additions	289,672	2,202,255	(70)	–	**2,491,857**
Additions – investment in associate	–	38,900	–	–	**38,900**
Advance payments for acquisition of shares	226,599	64,389	–	–	**290,988**
Advance payments related to construction works	(4,494)	(81,042)	–	–	**(85,536)**
Total capital expenditures	**511,777**	**2,224,502**	**(70)**	**–**	**2,736,209**

(*) These numbers include unallocated assets and liabilities managed and recognized at the group level.

(**) Inter-segment balances are eliminated on consolidation. Amounts shown as eliminations include intercompany balances.

(***) Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

Segment information for the reportable segments for the year ended 31 December 2015 is set out below:

	Oil and gas	Distribution	Unallocated (*)	Eliminations (**)	Total
Revenues					
External customers	151,473	–	–	–	**151,473**
Inter-segment	–	20,046	–	(20,046)	**–**
Total revenue	**151,473**	**20,046**	**–**	**(20,046)**	**151,473**
Depreciation and depletion	(50,446)	(3,412)	–	–	**(53,858)**
Other costs	(12,932)	(3,968)	–	814	**(16,086)**
Transportation tariffs	(23,845)	–	–	19,232	**(4,613)**
General and administrative expenses	(7,976)	(2,796)	(1,738)	–	**(12,510)**
Other operating income	1,758	14	14,418	–	**16,190**
Interest income	–	2,241	38,577	(35,923)	**4,895**
Finance costs	(24,292)	(9,700)	(53,981)	31,863	**(56,110)**
Share of result of associates	–	(5,856)	–	–	**(5,856)**
Foreign exchange loss, net	(79)	(6,961)	(3,568)	10,523	**(85)**
Income tax expense	–	(3,781)	–	–	**(3,781)**
Net profit/(loss) for the period	**33,661**	**(14,173)**	**(6,292)**	**6,463**	**19,659**

(*) These numbers include unallocated transactions managed and recognized at the group level.

(**) Inter-segment revenues and expenses are eliminated on consolidation. Amounts shown as eliminations include intercompany transactions.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

5. Segment information (continued)

Information about reportable segment profit or loss, assets and liabilities (continued)

	Oil and gas	Distribution	Unallocated (*)	Eliminations (**)	Total
Investment in associates	–	60,740	–	–	**60,740**
Other reportable segment assets	2,241,496	2,584,868	3,537,638	(3,209,343)	**5,154,659**
Total reportable segment assets	**2,241,496**	**2,645,608**	**3,537,638**	**(3,209,343)**	**5,215,399**
Other reportable segment liabilities	(2,169,421)	(1,852,488)	(2,638,603)	3,193,019	**(3,467,493)**
Total reportable segment liabilities	**(2,169,421)**	**(1,852,488)**	**(2,638,603)**	**3,193,019**	**(3,467,493)**
Capital expenditure (***)					
Additions	352,157	1,255,842	64	–	**1,608,063**
Additions – investment in associate	–	17,500	–	–	**17,500**
Advance payments for acquisition of shares	432,610	115,984	–	–	**548,594**
Advance payments related to construction works	8,021	136,742	–	–	**144,763**
Total capital expenditures	**792,788**	**1,526,068**	**64**	**–**	**2,318,920**

(*) These numbers include unallocated assets and liabilities managed and recognized at the group level.

(**) Inter-segment balances are eliminated on consolidation. Amounts shown as eliminations include intercompany balances.

(***) Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

Geographical information

All revenue is generated from sales of natural gas and gas condensate produced in Azerbaijan.

Non-current assets other than financial instruments and deferred tax assets for each individual country for which it is material is reported separately as follows:

	2016	2015
Azerbaijan	3,218,769	2,594,078
Turkey	3,729,780	1,756,526
Georgia	381,397	342,616
Switzerland	90,378	60,740
Total	**7,420,324**	**4,753,960**

The analysis is based on location of assets.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

6. Oil and gas properties

Movements in the carrying amount of oil and gas properties consisted of the following:

	Oil and gas production properties	Pipeline assets	Decommis-sioning costs	Total
Cost				
At 31 December 2014	**442,698**	**74,473**	**16,366**	**533,537**
Additions	29,858	845	1,084	**31,787**
At 31 December 2015	**472,556**	**75,318**	**17,450**	**565,324**
Additions	17,460	714	1,175	**19,349**
At 31 December 2016	**490,016**	**76,032**	**18,625**	**584,673**
Accumulated depletion and depreciation				
At 31 December 2014	**(19,182)**	**(1,402)**	**(549)**	**(21,133)**
Charge for the year	(49,226)	(3,398)	(1,234)	**(53,858)**
At 31 December 2015	**(68,408)**	**(4,800)**	**(1,783)**	**(74,991)**
Charge for the year	(55,279)	(3,418)	(1,894)	**(60,591)**
At 31 December 2016	**(123,687)**	**(8,218)**	**(3,677)**	**(135,582)**
Net book value				
At 31 December 2016	**366,329**	**67,814**	**14,948**	**449,091**
At 31 December 2015	**404,148**	**70,518**	**15,667**	**490,333**

Oil and gas production properties

Oil and gas production properties are represented by the Group's 6.67% share in oil and gas production properties of Shah Deniz ("SD") project.

Pipeline assets

The pipeline cost represents the Group's 6.67% share in cost of construction and capitalized maintenance expenses on SCP pipeline.

Decommissioning costs

The capitalized decommissioning costs are represented by the Group's 6.67% share in costs related to decommissioning of assets employed for the purposes of SD and SCP projects. Refer to Note 17 for details.

7. Construction in progress and development costs

Movements in the carrying amount of oil and gas properties consisted of the following:

	Development costs	Construction in progress	Decommis-sioning costs	Total
At 31 December 2014	**557,853**	**409,567**	**20,697**	**988,117**
Additions	309,783	1,254,682	11,811	**1,576,276**
At 31 December 2015	**867,636**	**1,664,249**	**32,508**	**2,564,393**
Additions	256,149	2,190,675	25,684	**2,472,508**
At 31 December 2016	**1,123,785**	**3,854,924**	**58,192**	**5,036,901**
Net book value				
At 31 December 2016	**1,123,785**	**3,854,924**	**58,192**	**5,036,901**
At 31 December 2015	**867,636**	**1,664,249**	**32,508**	**2,564,393**

(Amounts presented are in thousands of US dollars, unless otherwise stated)

7. Construction in progress and development costs (continued)

Development costs

Development costs are represented by costs incurred in respect of Shah Deniz Stage 2 Development project.

Construction in progress

As at 31 December 2016 this amount includes cost directly related to the construction of TANAP and expansion of SCP pipeline system in the amount of US dollars 3,612,708 (31 December 2015: US dollars 1,501,908) and US dollars 242,216 (31 December 2015: US dollars 162,341), respectively. The amount related to construction of TANAP includes costs for project management services, early work expenses, land acquisition costs, personnel expenses and other costs directly attributable to the construction of pipeline.

Capitalized borrowing cost

As at 31 December 2016 the Group capitalized borrowing cost in the amount of US dollars 195,937 as part of construction in progress and development costs (2015: 54,003). Refer to Note 16 for further details.

8. Advance payments

Advance payments consisted of the following at 31 December:

	2016	2015
Advance payments for acquisition of shares	1,635,870	1,344,882
Other payments related to construction works	206,073	291,609
	1,841,943	**1,636,491**

Advance payments for acquisition of shares

Advance payments for acquisition of shares represents advances paid in the amount of US dollars 1,114 million (31 December 2015: US dollars 887 million) to AzSD and US dollars 522 million (31 December 2015: US dollars 458 million) to AzSCP for acquisition of their 10% interests in the SD PSA and SCP projects, respectively, and treated as non-financial assets. Refer to Note 24 for further details.

9. Investment in associate

At 31 December 2016 the Group held twenty percent (20%) interest in TAP AG. TAP AG is responsible for the development and operation of the gas transportation infrastructure from the Greece/Turkey border to Southern Italy in order to deliver Shah Deniz natural gas to European countries. The Group exercises significant influence over the entity by participating in its financial and operating decisions.

The Group acquired investment in TAP AG through acquisition of 100% shares of AzTAP GmbH in 2014 (Note 23).

The table below summarizes the movements in the carrying amount of the Group's investment in TAP AG:

	2016	2015
Opening carrying amount	**60,740**	**56,432**
Additions to investment in associate	38,900	17,500
Share of after tax results of associate	(4,022)	(5,856)
Other	(3,247)	(1,335)
Exchange differences	(1,993)	(6,001)
Closing carrying amount	**90,378**	**60,740**

(Amounts presented are in thousands of US dollars, unless otherwise stated)

9. Investment in associate (continued)

The following table illustrates summarized financial information of the Group's investment in TAP AG at 31 December:

	2016	2015
Current assets	86,935	160,736
Non-current assets	1,718,253	604,796
Current liabilities	(284,292)	(109,262)
Non-current liabilities	(1,142,058)	(434,211)
Net assets	**378,838**	**222,059**
Group's interest in net assets	**75,768**	**44,412**
Goodwill recognized upon acquisition	18,872	18,872
Exchange differences on translation of goodwill	(1,015)	(1,209)
Other	(3,247)	(1,335)
Carrying value	**90,378**	**60,740**

Share of associate's results for the period ended 31 December:

	2016	2015
Revenue	–	–
Operating expenses	26,444	36,391
Other income	(2,694)	(592)
Loss before tax	**23,750**	**35,799**
Income tax benefit	(3,638)	(6,517)
Net loss for the period since acquisition of associate	**20,112**	**29,282**
Group's share of net loss	**4,022**	**5,856**

10. Loan receivables

Loan receivables consisted of receivable from TAP AG in the amount of US dollars 224,696 (31 December 2015: US dollars 84,977) and receivables from BOTAS in the amount of US dollars 130,863 (31 December 2015: US dollars 52,520). The loan to TAP bears interest at the rate of EUR rate for cross border shareholders loans as published by the Swiss federal tax authorities plus 1% margin and was equal to 2% in 2016 (2015: 2%). The loan matures in July 2043. Interest income earned during the year ended 31 December 2016 was US dollars 2,946 (2015: US dollars 1,335).

Receivables from BOTAS represent deferred consideration in the amount of US dollars 30,002 (31 December 2015: US dollars 28,987) and loan receivable in the amount of US dollars 100,861 (31 December 2015: US dollars 23,533). As discussed in Note 1, in accordance with the sale and purchase agreement, on 13 April 2015 the Group sold its 30% shares in TANAP A.Ş. to BOTAS for cash consideration of US dollars 168,226 and deferred consideration of US dollars 33,645. The deferred consideration does not bear interest and is expected to be repaid during 2020-2021. At initial recognition fair value of the deferred consideration was calculated as the present value using the market borrowing rate for similar financial instruments (3.5%) in the amount of US dollars 28,006. Income earned in respect of the deferred consideration from BOTAS during the year ended 31 December 2016 was US dollars 1,015 (2015: US dollars 981) and was recognized within interest income.

As discussed in Note 24, according to the Funding Agreement, following the sale of 30% shares of TANAP A.Ş., the Group financed cash call requirements of BOTAS equivalent to 5% shares in TANAP A.Ş. in the amount of US dollars 93,950 (2015: US dollars 27,950). The loan does not bear interest and is expected to be repaid in 2021-2023. At initial recognition, the present value was calculated using 4% market borrowing rate for similar financial instruments (2015: 3.5%) in the amount of US dollars 74,139 (2015: US dollars 22,737) and the difference between the fair value and carrying amount of loan in the amount of US dollars 19,811 (2015: US dollars 5,213) was recognized in profit and loss. Interest income earned in respect of the loan receivable from BOTAS during the year ended 31 December 2016 was US dollars 3,189 (2015: 796).

(Amounts presented are in thousands of US dollars, unless otherwise stated)

11. Cash and cash equivalents, deposits

Cash and cash equivalents consisted of the following at 31 December:

	2016	**2015**
Cash at bank, USD	184,251	254,228
Cash at bank, AZN	216,056	–
Cash at bank, EUR	26	332
Cash at bank, other	51	–
Total cash and cash equivalents	**400,384**	**254,560**

Cash at bank includes time deposits in the amount of US dollars 544 (31 December 2015: US dollars 535) with maturity of up to one month and bearing effective interest rate of 0.1% (31 December 2015: 1.95%).

Deposits

During 2015, the Group placed time deposit in the amount of US dollars 350 million with the maturity period of one year. The whole balance of deposit was fully utilized as at 31 December 2015.

12. Accounts receivable

Accounts receivable consisted of the following at 31 December:

	2016	**2015**
Receivable from AGSC	4,061	9,760
Receivable from the SD Operator	–	4,401
Receivable from SOCAR MO	4,792	3,606
Other receivables	624	1,237
Total accounts receivable	**9,477**	**19,004**

Receivables from the SD Operator represent the inception-to-date excess of cash calls paid by the Group to the SD Operator over the actual expenditures reported by the SD Operator. The Group has payable to the SD Operator in the amount of US dollars 1,238 as at 31 December 2016.

According to the crude oil sales agency agreement, the Group appointed SOCAR MO, a subsidiary of SOCAR, as its trading and marketing agent in respect of Shah Deniz PSA petroleum. SOCAR MO charges the Group commission fees for agency and marketing services at 0.5% (value added tax (“VAT”) inclusive) of the value of crude oil sold. Receivables from SOCAR MO represent a petroleum sold to a third party, for which no consideration was transferred to the Group as at 31 December 2016.

13. Inventories

As at 31 December 2016 and 2015 inventories are represented by the Group’s share of inventories reported by the SD Operator.

14. Other current assets

Other current assets represent the following at 31 December:

	2016	**2015**
VAT receivable	23,752	31,637
Other assets	5,658	6,287
Total other current assets	**29,410**	**37,924**

(Amounts presented are in thousands of US dollars, unless otherwise stated)

15. Share capital, additional paid-in capital, other reserves and non-controlling interest

Share capital

During the year ended 31 December 2016 the Group received additional contribution in share capital in the amount of US dollars 295,900. As at 31 December 2016 and 2015 the Company had authorized, issued and fully paid 100 ordinary shares at par USD 17,408 and USD 14,449, respectively. Each share entitles one vote to the shareholder.

Additional paid-in capital

During the year ended 31 December 2016 SOCAR and ME have approved the decision to increase charter capital in the amount of US dollars 675,000 through cash contribution. The Group received additional contribution in the amount of US dollars 631,768. These contributions were not registered as of 31 December 2016 and recognized as additional paid-in capital.

Other reserves and non-controlling interest

As discussed in Note 1, on 13 April 2015 the Group sold its 30% shares in TANAP A.Ş. to BOTAS. Total consideration comprised of cash consideration paid by BOTAS in the amount of US dollars 168,226 and fair value of deferred consideration in the amount of US dollars 28,006 (Note 10). In addition, on 16 April 2015 the Group sold its 12% shares in TANAP A.Ş. to BP for cash consideration of US dollars 97,423. The difference between the net book value of shares sold (US dollars 338,831) and the fair value of considerations received from BOTAS and BP was recognized as loss on sale of share in subsidiary in other reserves in the amount of US dollars 45,176. During 2016 BOTAS and BP made cash contribution in the total amount of US dollars 342,751 to the charter capital of TANAP.

16. Borrowings and Government grant

Bonds issued to SOFAZ

In accordance with the Presidential Decree dated 25 February 2014 SOFAZ, a governmental fund established for funding of important socio-economic projects, was assigned to finance the Group's acquisitions of interests in the projects described in Note 1. Following this Decree, in 2014 the Group issued bonds to SOFAZ in the aggregate amount of US dollars 2,516,996 with maturity period of 10 years. Interest rate implicit in bond prospectus is 1% + 6 months LIBOR. The repayment of interest shall be made in semiannual installments effective from 2021 till 2024.

At initial recognition, the Group calculated the fair value of the bond using market rate for similar financial instruments (4.5% + 6 months LIBOR) and recognized US dollars 704,270 of difference between fair value and nominal amount of the bond as government grant in its consolidated statements of financial position.

Total interest accrued during the year ended 31 December 2016 was US dollars 115,102 (31 December 2015: US dollars 99,641). The Group capitalized US dollar 58,742 of borrowing cost as part of construction in progress and development costs during the year ended 31 December 2016 (2015: 50,852).

During the year ended 31 December 2016 the Group recognized income from government grant in the amount of US dollars 16,165 which was recognized within other income (31 December 2015: US dollars 14,418).

Loan from BOTAS and BP

In accordance with Term Loan Facility Agreement signed in 2015, shareholders of TANAP A.Ş undertake to make available a loan facility for financing of their shares of the capital expenditures relating to the TANAP project. TANAP plans to start the repayments of interests in 2020 and repayment of principal in 2022. During the year ended 31 December 2016, total amount of loans from BOTAS and BP were US dollars 318,877 (2015: US dollars 167,700) and US dollars 127,551 (2015: US dollars 67,080), respectively. The loans bear interest at the rate of 5.5% + 1 month LIBOR. Total interest charges incurred during the year ended 31 December 2016 amounted US dollars 31,067 (2015: US dollars 3,151), which were capitalized as part of cost of asset.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

16. Borrowings and Government grant (continued)

Eurobond emission

In March 2016 the Company issued US dollars 1 billion senior unsecured notes guaranteed by the Republic of Azerbaijan ("Notes"). The Notes bear interest rate of 6.875 per cent per annum payable semi-annually in arrears on 24 March and 24 September in each year until maturity. The Notes mature on 24 March 2026 and are listed on the Irish Stock Exchange. The Notes were issued at discount and the Group received US dollars 991,120 from the issued Notes. Transaction costs incurred in respect of Notes equaled to US dollars 2,362.

Total interest accrued on bonds during the year ended 31 December 2016 was US dollars 53,606, including US dollars 52,125 capitalized as part of construction in progress and development costs.

As at 31 December 2016 current portion of long-term borrowings represents the accrued interest in the amount of US dollars 19,231.

Loan from IBA

On 30 December 2016 the Group borrowed a loan from the International Bank of Azerbaijan ("IBA") in the amount of US dollars 176,000 with interest rate of 1.75% per annum for financing of its projects. The loan was due on 28 February 2017. Refer to Note 26.

17. Decommissioning liabilities

The Group has a legal and constructive obligation with respect to decommissioning of oil and gas production and pipeline assets. Movements in provisions for the related asset retirement obligations are as follows:

	31 December 2016	31 December 2015
Opening carrying amount	**52,066**	**37,063**
Additional liability during the period	20,249	14,336
Unwinding of present value discount	3,105	2,108
Effect of discount rate revision	7,289	(1,441)
Closing carrying amount	**82,709**	**52,066**

Under the provisions of the SD PSA, SCP and TANAP Host Government Agreements ("HGA") all Contractor Parties will have to make contributions to an abandonment fund, which will be used to finance the decommissioning and dismantling of constructed assets after the maturity of the SD PSA, SCP and TANAP.

The maximum amount of decommissioning fund cannot exceed 10% of the capital costs in accordance with SD PSA. Decommissioning liability is estimated based on capital expenditures incurred in respect of assets already employed as at the end of each financial year. The Group share of the estimated undiscounted cost to abandon the production facilities employed in SD PSA was US dollar 157,481 as at 31 December 2016 (31 December 2015: US dollars 132,759).

The Group's share of expected undiscounted cost to decommission the SCP pipeline facilities at 31 December 2016 was US dollars 19,826 (31 December 2015: US dollars 10,301). The Group used a 2.5% (31 December 2015: 2.5%) inflation rate in its estimate of the retirement obligation upon termination of HGA and used a pre-tax rate that reflects current market assessments of the time value of money to discount the obligation.

The Group's share of expected undiscounted cost to decommission the TANAP pipeline facilities at 31 December 2016 was US dollars 39,229 (31 December 2015: US dollars nil). The Group used a 3% inflation rate in its estimate of the retirement obligation upon termination of HGA and used a pre-tax rate that reflects current market assessments of the time value of money to discount the obligation.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

18. Trade and other payables, accrued liabilities

Trade and other payables and accrued liabilities mainly consist of payables related to Shah Deniz Stage 2 development, expansion of SCP and construction of TANAP pipeline systems as at 31 December 2016 and 31 December 2015.

19. Revenue, accrued revenue and deferred revenue

The Group's revenue consisted of the following for the year ended 31 December:

	2016	2015
Revenue from sale of gas	62,497	95,847
Revenue from sale of crude oil	48,992	55,626
	111,489	**151,473**

According to the provisions of the SD PSA the profit oil and gas is shared between the Government and the Contractor Parties depending on cumulative after-tax real rate of return achieved as at the end of each calendar quarter by the Contractor Parties. During four quarters of 2016 the profit oil and gas was shared at a ratio of 55% to 45% in favor of the Contractor Parties. During three quarters of 2015 the profit oil and gas was shared at a ratio of 55% to 45% in favor of the Government. In the fourth quarter of 2015 the split was 55% to 45% in favor of the Contractor Parties.

Accrued revenue

Accrued revenue balance of US dollars 1,996 at 31 December 2016 (31 December 2015: US dollars 3,119) represents the Group's underlift of crude oil resulted from a difference between the volumes lifted and entitled at Ceyhan terminal.

Deferred revenue

Deferred revenue balance of US dollars 2,321 at 31 December 2016 (31 December 2015: US dollars 5,283) represents the Group's overlift of crude oil resulted from a difference between the volumes lifted and entitled at Baku-Tbilisi-Ceyhan route ("BTC").

20. Cost of sales

The Group's cost of sales consisted of the following for the year ended 31 December:

	Note	2016	2015
Depreciation and depletion	6	60,591	53,858
Other costs		9,359	16,086
		69,950	**69,944**

21. Taxation

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

In accordance with Azerbaijani tax legislation, tax losses arising in one period can be carried forward for five years. SGC CJSC has accumulated losses in the amount of US dollars 168,268 in 2016 statutory books (2015: US dollars 33,654), which are not expected to be utilized within five years. The Group did not recognize deferred tax assets on these losses.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

21. Taxation (continued)

Taxation under the Shah Deniz Project

According to the provisions of SD PSA, the contractor parties are liable to pay income taxes related to the operations under the SD Project. According to the same provisions the respective state body of the Republic of Azerbaijan remits to the State Budget income taxes of each contractor party and reimburses the respective amount from condensate and natural gas attributable to the State. Accordingly, as a contractor party to SD PSA, the Group is liable for Azerbaijani income taxes and at the same time is entitled to additional profit petroleum. During the year ended 31 December 2016 and 2015 the Group had no income taxes from the activities in SD PSA.

The Group is exempt from certain ordinary operational taxes including Azerbaijani value added taxes in accordance with provision of SD PSA.

Taxation under the SCP project

SGC Midstream LLC elected SCPC to represent it in all tax issues before the tax authorities, so that the Group is a non-tax electing shareholder in accordance with the terms of Azerbaijani HGA. SCPC is liable for Azerbaijani income tax and Georgian minimum tax with respect to the income and deductions of, and natural gas transported by, SCPC, which are allocable to non-tax electing shareholders, including the Group.

The following taxes have been enacted:

- Azerbaijani income tax at a fixed rate of 27%;
- Georgian income tax at a fixed rate of 25%;
- Georgian minimum tax (the “GMT”) at a fixed rate of US dollars 2.50 per thousand of cubic meters of gas delivered to Georgian-Turkey border.

Georgian income tax and minimum tax

According to Georgian HGA, SCPC is liable for the income tax at a fixed rate of 25% for income generated from operations in Georgia. In case SCPC does not generate taxable income during a fiscal year, it shall be liable for GMT. The GMT for the preceding periods can be carried forward without limitation and credited against future income tax liability of SCPC in Georgia. The Group estimates that the GMT will exceed the income tax under Georgian HGA.

The provision for income taxes mainly comprised of the Group’s share in Azerbaijan income tax expense, Georgian minimum tax expense and deferred tax expense of SCPC for the year ended 31 December 2016.

Deferred tax liabilities of SCPC are calculated on the temporary differences arising from the differences in accounting under IFRS and HGA (accrual versus cash basis).

Taxation under TANAP project

As per HGA signed between the Government of Turkey and the Government of Azerbaijan, it was determined that the corporate income taxation of TANAP will only be based on the amount of natural gas transmitted from the pipeline after the pipeline will be put in use. Therefore, the Group is not subject to corporate income tax during construction phase. There is no temporary difference between statutory and IFRS books of TANAP that are subject to deferred tax.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

22. Transactions with related parties

Transactions with related parties consisted of the following:

Related party	For the year ended 31 December 2016 Long-term borrowings	Advance payments	Accounts receivable	Receipts from related parties	Settlements with related parties
SOFAZ (Note 16)	2,069,044	–	–	–	–
AzSD	–	1,113,871	–	–	226,599
AzSCP	–	521,999	–	–	64,389
SOCAR MO	–	–	4,792	–	197
AGSC	–	–	4,061	65,099	–
Total	**2,069,044**	**1,635,870**	**8,853**	**65,099**	**291,185**
Total category	**3,773,228**	**1,841,943**	**9,477**		

Related party	For the year ended 31 December 2015 Long-term borrowings	Advance payments	Accounts receivable	Receipts from related parties	Settlements with related parties
SOFAZ (Note 16)	1,953,942	–	–	–	–
AzSD	–	887,272	–	21,554	432,611
AzSCP	–	457,610	–	–	115,983
SOCAR MO	–	–	3,606	–	253
AGSC	–	–	9,760	69,851	–
Total	**1,953,942**	**1,344,882**	**13,366**	**91,405**	**548,847**
Total category	**2,191,873**	**1,636,491**	**19,004**		

AzSD

Settlements with AzSD (a subsidiary of SOCAR) for the year ended 31 December 2016 are represented by US dollars 226,599 advances paid for acquisition of 10% share in SD PSA and 8% share in AGSC under the DSPA (31 December 2015: US dollars 432,611). Refer to Note 24.

AzSCP

Settlements with AzSCP (a subsidiary of SOCAR) for the year ended 31 December 2016 are represented by US dollars 64,389 advances paid for acquisition of 10% shares in SCPC under the DSPA (31 December 2015: US dollars 115,983). Refer to Note 24.

AGSC

AGSC is a company established by the contractor parties of the SD PSA for marketing, accounting, billing, payment and reporting of other administrative activities related to the sales of Shah Deniz gas. Receipts from AGSC represent cash received in the amount of US dollars 65,099 (31 December 2015: US dollars 69,851) from sale of gas to AGSC.

SOCAR and ME

During the year ended 31 December 2016 SOCAR and ME made additional cash contribution to the Group in the amount of US dollars 432,509 (2015: US dollars 659,001) and US dollars 495,159 (2015: US dollars 685,899), respectively. As at 31 December 2016, total cash contribution by SOCAR and ME were amounted to US dollars 1,140,510 (31 December 2015: US dollars 708,001) and US dollars 1,232,058 (31 December 2015: US dollars 736,899), respectively.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

22. Transactions with related parties (continued)

Key management personnel

The senior management group consisted of the Group's General Director, Deputy General Director and three department directors as at 31 December 2016 (31 December 2015: General Director, Deputy General Director and three department directors). The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category was:

	31 December 2016	31 December 2015
Aggregate remuneration	160	121
Number of persons	5	5

The Group also incurred expenses for management services provided by SOCAR Upstream Management International LLC and SOCAR Midstream Operations LLC in the total amount of US dollars 1,473 during the year ended 31 December 2016 (31 December 2015: US dollars 3,193) under the Operator Services Agreement signed in December 2014.

23. Financial risk management objectives and policies

Financial risk factors

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

(i) Interest rate risk

The Group holds significant interest bearing assets and liabilities as described in Note 10 and Note 16. Interest rates on existing borrowings are implicit in respective agreements and, except Eurobonds and loan from IBA, depend on fluctuations in LIBOR and/or EUR rate for cross border shareholders loans published by the Swiss federal tax authorities (ESTV).

The table below summarizes effect on profit before tax of the following shift in LIBOR and EUR rate per ESTV as at 31 December 2016 and 31 December 2015:

	Change in floating variable		Effect on profit before tax	
2016	**Increase**	**Decrease**	**After increase**	**After decrease**
LIBOR	+0.6	-0.08	(14,759)	2,022
EUR rate per ESTV	+0.5	-0.5	615	(697)

	Change in floating variable		Effect on profit before tax	
2015	**Increase**	**Decrease**	**After increase**	**After decrease**
LIBOR	+0.5	-0.12	(9,900)	2,400
EUR rate per ESTV	+0.5	-0.5	297	(297)

(Amounts presented are in thousands of US dollars, unless otherwise stated)

23. Financial risk management objectives and policies (continued)

Financial risk factors (continued)

(ii) Credit risk

Financial instruments involve, to varying degrees, credit risks. The Group is subject to credit risk from its portfolio of loan receivable, cash and cash equivalents, deposits and accounts receivable and would be exposed to losses in the event of non-performance by counterparties.

The Group's exposure to credit risks arises from default of the counterparty, with a maximum exposure of US dollars 765,420 and US dollars 406,660 as at 31 December 2016 and 31 December 2015, respectively.

The Group places its cash with high credit quality financial institutions. The Group trades only with recognized, creditworthy third parties. It is the Group's policy that all customers who wish to trade for condensate on credit terms are subject to credit verification procedures. Gas sales are made through AGSC to entities with strong financial position.

(iii) Liquidity risk

The Group monitors its risk to a shortage of funds by reviewing its net financial debt indicator on a regular basis. The net financial debt represents the difference between total financial liabilities and cash and cash equivalents. The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of loans.

The tables below summarize the maturity profile of the Group's financial liabilities at 31 December 2016 and 31 December 2015 based on contractual undiscounted payments:

2016	**On demand**	**3 to 12 months**	**1 to 5 years**	**>5 years**	**Total**
Trade and other payables	–	231,475	–	–	**231,475**
Accrued liabilities	–	308,849	–	–	**308,849**
Short-term and current portion of long-term borrowings	–	195,231	–	–	**195,231**
Long-term borrowings	–	–	–	4,488,742	**4,488,742**
	–	**735,555**	**–**	**4,488,742**	**5,224,297**

2015	**On demand**	**3 to 12 months**	**1 to 5 years**	**>5 years**	**Total**
Trade and other payables	–	197,025	–	–	**197,025**
Accrued liabilities	–	318,759	–	–	**318,759**
Long-term borrowings	–	–	–	2,896,144	**2,896,144**
	–	**515,784**	**–**	**2,896,144**	**3,411,928**

(Amounts presented are in thousands of US dollars, unless otherwise stated)

23. Financial risk management objectives and policies (continued)

Financial risk factors (continued)

(iv) Capital management

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

The Group considers total capital under management to be as follows:

	31 December 2016	31 December 2015
Long-term borrowings (Note 16)	3,773,228	2,191,873
Short-term and current portion of long-term borrowings (Note 16)	195,231	–
Less: cash and cash equivalents (Note 11)	(400,384)	(254,560)
Net debt	**3,568,075**	**1,937,313**
Equity	2,261,251	1,407,911
Capital and net debt	**5,829,326**	**3,345,224**
Gearing ratio	**61%**	**58%**

(vi) Fair value of financial instruments

The fair value of the financial assets and liabilities is included in the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value of financial instruments.

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

	31 December 2016	
	Carrying amounts	Fair values
Cash and cash equivalents (Note 11)	400,384	400,384
Accounts receivables (Note 12)	9,477	9,477
Loan receivables (Note 10)	355,559	351,448
Total financial assets	**765,420**	**761,309**
Trade and other payables (Note 18)	(231,475)	(231,475)
Accrued liabilities (Note 18)	(308,849)	(308,849)
Short-term and current portion of long-term borrowings (Note 16)	(195,231)	(195,231)
Long-term borrowings (Note 16)	(3,773,228)	(3,771,128)
Total financial liabilities	**(4,508,783)**	**(4,506,683)**

(Amounts presented are in thousands of US dollars, unless otherwise stated)

23. Financial risk management objectives and policies (continued)

Financial risk factors (continued)

	31 December 2015	
	Carrying amounts	**Fair values**
Cash and cash equivalents (Note 11)	254,560	254,560
Accounts receivables (Note 12)	14,603	14,603
Loan receivables (Note 10)	137,497	137,497
Total financial assets	**406,660**	**406,660**
Trade and other payables (Note 18)	(197,025)	(197,025)
Accrued liabilities (Note 18)	(318,759)	(318,759)
Long-term borrowings (Note 16)	(2,191,873)	(2,197,326)
Total financial liabilities	**(2,707,657)**	**(2,713,110)**

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

(i) Current financial assets and liabilities approximate their carrying amounts largely due to the current maturities of these instruments;

(ii) Long-term fixed-rate and variable-rate receivables/borrowings are evaluated by the Group using Level 3 inputs based on parameters such as interest rates, specific country risk factors, and individual creditworthiness of customers and the risk characteristics of the financed project.

24. Commitments and contingencies

Commitments related to participating interest in Shah Deniz PSA

On 17 December 2013 Shah Deniz consortium announced the final investment decision for Stage 2 development of Shah Deniz gas field in the Azerbaijan Sector of the Caspian Sea and signed Sixth, Seventh and Eighth Addendums to Shah Deniz PSA. The Group is committed to finance expenditures related to Shah Deniz project based on its share of interest.

As of 31 December 2016 the Shah Deniz PSA operator has entered into a number of capital commitments and operating leases. The Group estimated its 6.67% share of these capital commitments and operating leases in the amount of US dollars 689,881 and US dollars 33,251, respectively (31 December 2015: US dollars 966,064 and US dollars 21,727, respectively). The total of future minimum lease payments under non-cancellable operating leases for each of the following periods is as follows:

Operating leases	**31 December 2016**	**31 December 2015**
Not later than one year	13,679	6,852
Later than one year and not later than five years	19,572	14,175
Later than five years	–	700
	33,251	**21,727**

Commitment related to SCP Expansion

Shah Deniz PSA Contractor Parties announced the final investment decision on SCP Expansion project on 17 December 2013. SCP Expansion project objective is to expand the existing SCP system capacity. Due to SCP Expansion additional facilities will be constructed in Georgia for the purposes of interconnection with TANAP. The Group has the commitment to fund the SCP Expansion project equivalent to its 6.67% shares throughout the construction and initial operational phase. As at 31 December 2016 the remaining budget for SCP Expansion is estimated in the amount of US dollars 1,607,212 with the Group's share of these commitments in the amount of US dollars 107,201 (31 December 2015: US dollars 2,799,000 and US dollars 186,693, respectively).

(Amounts presented are in thousands of US dollars, unless otherwise stated)

24. Commitments and contingencies (continued)

Commitment related to TANAP

Construction of TANAP

At the financial statement date, the Group has capital commitment to fund the construction of TANAP system. The remaining budget for construction of TANAP system is estimated in the amount of US dollars 5,028,058 (31 December 2015: US dollars 8,111,736).

Commitment related to TAP

Construction of TAP

The Group has the commitment to fund construction of TAP system. The remaining budget for construction of the TAP system is estimated in the amount of US dollars 3,121,163 (31 December 2015: US dollars 4,337,700). The Group’s share of commitment at the financial statement date was US dollars 624,233 (31 December 2015: US dollars 867,540).

Commitments related to participating interest in AGSC, TANAP, TAP and SCPC

BOTAS gas contract

AGSC is obliged under the gas contract signed with BOTAS to make available a maximum of approximately 6.6 bcm of gas annually from 2017 till 2021 at a price calculated based on the formula established by the gas contract.

Stage 2 gas contract

On 25 October 2011, SOCAR and BOTAS executed a gas sale and purchase agreement (“Stage 2 SPA”) with respect to the sale by SOCAR to BOTAS of certain volumes of Shah Deniz Stage 2 gas (2 bcm first delivery year, 4 bcm second delivery year, 6 bcm plateau period). In December 2012 SOCAR transferred and assigned the rights and obligations under the Stage 2 SPA to AGSC. The anticipated commencement of first gas delivery under Stage 2 BOTAS SPA is July 2018.

BOTAS contract for BTC fuel gas

AGSC is obliged under the agreement with BOTAS to make available 0.16 bcm of gas annually at a price which is calculated based on the formula established in the contract.

Azerbaijan gas obligation

AGSC is obliged under the agreement signed with SOCAR to make available a minimum of approximately 1.5 bcm of gas in 2017 and onwards at a price calculated based on the formula established in the agreement.

Georgian gas obligation

AGSC is obliged under the agreement signed with Georgian Oil and Gas Corporation (“GOGC”) and the government of Georgia to make available 0.5 bcm of gas in 2017 and onwards, at a price which is calculated based on a formula established in the contract.

Sale and purchase agreement with OptionCo

AGSC is obliged under the agreement signed with South Caucasus Pipeline Option Gas Company Limited (“OptionCo”) to make available 0.29 bcm of gas during the contract year starting on 1 October 2015 and ending 1 September 2016. Thereafter, AGSC is obliged to deliver during the next contract year, which starts on 1 October 2016 and ends 30 September 2017, a maximum of five percent of the volumes transported by AGSC through Georgia via the SCP in the previous contract year, at a price which is calculated based on a formula established in the contract.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

24. Commitments and contingencies (continued)

Commitments related to participating interest in AGSC, TANAP, TAP and SCPC (continued)

Shah Deniz Stage 2 EU Long term Gas Sales Agreements ("GSAs")

In September 2013 ten EU GSAs were signed by SOCAR with nine EU Buyers and in December 2013 the GSAs were assigned to AGSC until Shah Deniz PSA expiry with re-assignment to SOCAR as Shah Deniz Production declines. The commencement date will be firmed up through funnelling mechanism within a 1 year window between 1 January 2020 and 1 January 2021 for DEPA, Shell, Axpo (PSV) and E.ON (now Uniper); 1 July 2020 and 1 July 2021 for Axpo (WTB), GDF Suez (now Engie), Gas Natural Fenosa, Enel, Hera and Bulgargaz. The GSAs assume 2-3 year build-up periods, as defined in the contracts, with the following peak annual delivery obligations: AXPO (PSV) 0.48 bcm, GDF Suez (now Engie) 2.64 bcm, Gas Natural Fenosa 0.99 bcm, E.ON (now Uniper) 1.45 bcm, Shell 0.95 bcm, Hera 0.3 bcm, Enel 0.48 bcm, AXPO (WTB) 0.96 bcm, Bulgargaz 0.94 bcm, DEPA 1 bcm.

Trans Anatolian Pipeline Gas Transportation Agreement (TANAP GTA)

AGSC is a party to TANAP GTA with annual reserved capacity during the build-up period, as defined in the contract, of 6.1 bcm, 6.2 bcm, 7.2 bcm and plateau of 10.5 bcm after 18 months with 100% ship or pay on the capacity reservation. The start date will be set through a funnelling mechanism inside the first window period between 1 July 2019 and 1 July 2021.

Trans Adriatic Pipeline GTA (TAP GTA)

AGSC is a party to TAP GTA with annual capacity of 9.08 bcm and additional annual regulated capacity of 0.46 bcm booked under TAP First Booking Phase ("FBP"). The planned commencement date is inside the second window period between 1 January 2020 and 31 December 2020.

TAP Deferral Gas Sales Agreement

AGSC is obliged under the agreement signed with SOCAR to make available gas during the period 1 May 2019 – 31 December 2020 (with earlier termination or possible extension of the agreement in accordance with provisions of the agreement) in the volume of maximum 3.66 bcm in 2019 and 6.4 bcm in 2020, at a price which is stipulated in the contract.

Sale and purchase agreement with Baku-Tbilisi-Ceyhan Pipeline Company ("BTC Co")

AGSC is obliged under an agreement signed with BTC Co to make available 0.16 bcm during the following years until the termination of the contract subject to the right of BTC Co to reduce annual off-take, at a price which is calculated based on the formula established in the contract.

Debottlenecking SPA

AGSC is obliged under the agreement signed with SOCAR to make available gas during the period 1 January 2017 – 30 June 2018 as follows: 1.3 bcm for 2017 and 0.64 bcm in 2018, at a price which is stipulated in the contract.

BOTAS Gas Transportation Agreement (BOTAS GTA)

TANAP is a party to BOTAS GTA and with annual reserved capacity during the build-up period, as defined in the contract, of 1.9 bcm (12 month period commencing on start date), 3.8 bcm (next 12 month period) and plateau of 5.7 bcm 24 months after the start date. The start date will be within the period from and including 1 May 2018 to and including 30 June 2018.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

24. Commitments and contingencies (continued)

Commitments related to participating interest in AGSC, TANAP, TAP and SCPC (continued)

SOCAR Gas Transportation Agreement (SOCAR GTA)

Based on this GTA, from and including the start date (06 March 2036) SOCAR shall pay to TAP AG the amount of actual monthly charge in relation of each booking of reserved capacity at each entry point and exit point at a price which is calculated based on the formula established in the contract. TAP AG shall make available to SOCAR for transportation of natural gas at the applicable entry point and exit point(s) as described below, a reserved capacity equal to the following maximum flow rates expressed in kilowatt hours (kWh) per gas day: Entry point at Kipoi − 287,318,605 kWh per gas day; Exit point at SRG tie in − 242,999,147 kWh per gas day; Exit point at Komotini − 44,319,458 kWh per gas day.

Framework agreement

On 17 December 2013, AGSC executed a Term Sheet for GSA Novation and Capacity Transfer Framework Agreement with SOCAR ("Term Sheet"). A fully-termed Framework Agreement was negotiated with SOCAR to give effect to the Term Sheet. Framework Agreement relates to novation of long-term GSAs and transfer of GTA capacity from AGSC to SOCAR after 2036. The Framework Agreement was executed on 19 October 2015.

Commitment under the Deferred Sale and Purchase Agreement ("DSPA")

In July 2014 the Group signed the DSPA for the acquisition of 10% participating interest in Shah Deniz project and 8% shares in AGSC from AzSD and 10% shares in SCPC from AzSCP. According to the terms of this agreement the Group shall make advance payments for these acquisitions to AzSD and AzSCP, while control will pass to the Group in March 2023, provided that certain conditions precedent are satisfied. As of 31 December 2016, the Group had commitments for payments in the amount of US dollars 535,032 (31 December 2015: US dollars 536,087) to AzSD and has to make progress payments equaled to Shah Deniz Stage 2 Development cash call requirements of AzSD till 31 December 2020. In addition, the Group has to make progress payments equaled to SCP Expansion project related cash calls requirements of AzSCP till 31 December 2020.

Commitment under the funding agreement with BOTAS (the "Funding Agreement")

On 26 May 2014 SOCAR and BOTAS signed Funding Agreement for financing BOTAS's 5% shares in TANAP A.Ş., upon acquisition of shares in TANAP A.Ş. by BOTAS. On 13 March 2015, the Group signed novation agreement with SOCAR and BOTAS, where all rights and obligations under the Funding Agreement were transferred from SOCAR to the Group. According to agreement with BOTAS, the Group has commitment for providing interest free loan to BOTAS for financing its 5% share in TANAP A.Ş.'s future cash call requirements till TANAP becomes operational.

25. Current business environment

Azerbaijan economy

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

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

(Amounts presented are in thousands of US dollars, unless otherwise stated)

25. Current business environment (continued)

Azerbaijan economy (continued)

As a result of significant drop in crude oil prices, on 21 February 2015, Azerbaijani Manat was devalued against US dollar and other major currencies by 34%. The exchange rates before and after devaluation were AZN 0.786 and AZN 1.050 to US dollar 1, respectively. On 21 December 2015 Azerbaijani Manat devalued against major currencies by a further 47%. Following the second devaluation, the Central Bank of Republic of Azerbaijan announced the move to a floating exchange rate. During the year ended 31 December 2016 Azerbaijani Manat fluctuated between AZN 1.5594 and AZN 1.7707 for US dollar 1.

There continues to be uncertainty regarding economic growth, access to capital and cost of capital which could adversely affect the Company's future results and financial position and business prospects in a manner not currently determinable. During subsequent period, crude oil prices were subject to significant volatility. Any further significant drop in crude oil prices could negatively affect the Company's future liquidity position, results of operations and might result in an impairment loss on oil and gas assets.

Azerbaijani government announced plans to accelerate reforms and support to economic environment in response to current challenges.

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

Turkish economy

The strong performance of the Turkish economy, as clearly demonstrated in economic indicators of previous years, was impacted to some degree by the sluggish European markets that Turkey is most dependent on. The Turkish government began to implement new policies and measures to revive domestic demand in order to compensate for the slowdown in foreign markets.

While management believes it is taking appropriate measures to support the sustainability of Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable.

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

26. Events after the reporting date

Increase in share capital

During subsequent period SOCAR made equity contribution of USD 74,713 to the Group, which included a reimbursement of foreign exchange losses incurred by the Group in the amount of US dollars 31,481 in respect of portion of previous contribution made in Azerbaijani manat.

Additional borrowings

In January 2017, the Group signed loan agreement with the International Bank for Reconstruction and Development for the total amount of US dollars 400,000 for financing of TANAP project.

In 26 January 2017, the Group signed loan agreement with the Asian Infrastructure Investment Bank for the total amount of US dollars 600,000 for financing of TANAP project.

(Amounts presented are in thousands of US dollars, unless otherwise stated)

26. Events after the reporting date (continued)

Additional borrowings (continued)

In March 2017 the Company issued a further US dollars 1 billion senior unsecured notes guaranteed by the Republic of Azerbaijan ("Further Notes") which consolidated to form a single series with the Notes. The Further Notes were issued at premium of US dollars 74,690 and bear interest rate of 6.875 per cent per annum payable semi-annually in arrears on 24 March and 24 September in each year until maturity. The Further Notes mature on 24 March 2026 and are listed on the Irish Stock Exchange.

In May 2017 the Group signed the facility agreement with Asian Development Bank in the principle amount of US dollars 500,000 for financing of SD project.

Repayment of borrowings

On 28 February 2017 the Group repaid the loan borrowed from IBA in the amount of US dollars 176,000. Refer to Note 16.