

**State Oil Company of  
the Azerbaijan Republic**

**International Financial Reporting Standards  
Consolidated financial statements**

*31 December 2017*

## Contents

### Independent auditor's report

### Consolidated financial statements

Consolidated statement of financial position .....	1
Consolidated statement of profit or loss and other comprehensive income .....	3
Consolidated statement of changes in equity .....	4
Consolidated statement of cash flows .....	5

### Notes to the consolidated financial statements

1. The Group and its operations .....	6
2. Basis of preparation and significant accounting policies .....	6
3. Critical accounting estimates and judgments .....	23
4. Adoption of new or revised standards and interpretations and new accounting pronouncements .....	27
5. Segment Information .....	32
6. Financial risk management .....	37
7. Balances and transactions with related parties .....	44
8. Cash and cash equivalents and deposits .....	47
9. Restricted cash .....	47
10. Available-for-sale investments .....	47
11. Trade and other receivables .....	48
12. Inventories .....	49
13. Other current assets .....	49
14. Other non-current assets .....	49
15. Other non-current financial assets .....	50
16. Property, plant and equipment .....	51
17. Intangible assets other than goodwill .....	52
18. Investments in joint ventures .....	53
19. Investment in associates .....	56
20. Trade and other payables .....	60
21. Borrowings .....	60
22. Taxes payable .....	64
23. Asset retirement obligations .....	64
24. Other provisions for liabilities and charges .....	65
25. Deferred income .....	66
26. Other current and non-current liabilities .....	66
27. Deferred acquisition consideration payable .....	67
28. Charter capital, additional paid-in capital, retained earnings and gain on sale of subsidiary share .....	67
29. Analysis of revenue by categories .....	69
30. Analysis of expenses by nature .....	69
31. Other operating income .....	69
32. Finance income .....	70
33. Finance costs .....	70
34. Income taxes .....	70
35. Advances received for sale of interest .....	73
36. Put option liabilities .....	73
37. Significant non-cash investing and financing activities .....	74
38. Changes in liabilities arising from financing activities .....	74
39. Contingences, commitments and operating risks .....	74
40. Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business, acquisition of interests in PSA, goodwill and intangible asset with indefinite useful life .....	82
41. Material partly-owned subsidiaries .....	86
42. Events after reporting date .....	89

## Independent auditor's report

To the Management of the State Oil Company of the Azerbaijan Republic

### **Opinion**

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

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

### **Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **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 each 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 these matters. 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.

Key audit matter	How our audit addressed the key audit matter
<p><b><i>Impairment of oil and gas assets</i></b></p> <p>We considered this matter to be one of most significance in the audit due to significance of the balances of the Group's oil and gas assets, the high level of subjectivity in respect of assumptions underlying impairment analysis and significant judgements and estimates made by management. In addition, volatility in oil prices over the last few years impacts the Group's operations and cash flows and triggers potential impairment.</p> <p>Details of key assumptions used by management and results of impairment tests are disclosed in Note 3 to the consolidated financial statements.</p>	<p>We evaluated the change in risk profile of the group's assets and assessed impairment indicators. We involved our internal valuation experts and compared assumptions used in impairment testing such as oil prices forecast, reserves and resources volumes and discount rates with available external data. We also checked mathematical accuracy of impairment models and sensitivity analysis. We compared calculated amounts of impairment charge and unsuccessful exploration assets write offs to amounts recorded in the Company's accounting records.</p>
<p><b><i>Estimation of oil and gas reserves</i></b></p> <p>The estimate of oil and gas reserves has a significant impact on the impairment test and depreciation and decommissioning provisions. The Group involved internationally recognized independent reserves engineers to evaluate its oil and gas reserves.</p> <p>Information on oil and gas reserves disclosed in Note 3 to the consolidated financial statements.</p>	<p>We compared the assumptions used by the reserve engineers with the Group's approved budget and historical data. We assessed the underlying assumptions and compared estimates of reserves and resources provided by reserves engineers to the amounts included in the calculation of impairment, depreciation, depletion and amortization and decommissioning provisions.</p>

### ***Other information included in the Group's 2017 Annual Report***

Other information consists of the information included in the Group's 2017 Annual Report other than the consolidated financial statements and our auditor's report thereon. Management is responsible for the other information. The Group's 2017 Annual Report is expected to be made available to us after the date of this auditor's report.

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.



### ***Responsibilities of management and the Management 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 Management Board is responsible for overseeing the Group's financial reporting process.

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

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with 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 Management 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.

We also provide the Management 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 Management 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.*

Ernst & Young Holdings (CIS) B.V.  
Branch in the Republic of Azerbaijan

7 June 2018

Azerbaijan, Baku, 153 Neftchilar Avenue

**Consolidated statement of financial position***(Amounts presented are in millions of Azerbaijani Manats)*

	Note	31 December 2017	31 December 2016 (reclassified*)
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	8	5,217	4,163
Restricted cash	9	265	121
Deposits	8	218	1,039
Available-for-sale investments	10	174	82
Trade and other receivables	11	10,007	8,618
Inventories	12	4,810	4,968
Other current assets	13	1,614	1,564
<b>Total current assets</b>		<b>22,305</b>	<b>20,555</b>
<b>Non-current assets</b>			
Property, plant and equipment	16	25,669	20,116
Goodwill	40	327	342
Intangible assets other than goodwill	17	739	689
Investments in joint ventures	18	5,022	4,555
Investments in associates	19	4,571	4,442
Deferred tax assets	34	905	841
Other non-current financial assets	15	685	578
Other non-current assets	14	1,124	889
<b>Total non-current assets</b>		<b>39,042</b>	<b>32,452</b>
<b>Total assets</b>		<b>61,347</b>	<b>53,007</b>
<b>Equity</b>			
Charter capital	28	3,036	1,802
Additional paid-in capital	28	4,541	2,159
Retained earnings		7,357	6,265
Other capital reserves		(6)	(46)
Put option on company's shares		(1,310)	(1,305)
Gain on sale/purchase of subsidiary share	28	1,181	1,280
Cumulative translation differences		5,806	6,292
<b>Equity attributable to equity holders of the Group</b>		<b>20,605</b>	<b>16,447</b>
Non-controlling interests		1,370	1,257
<b>Total equity</b>		<b>21,975</b>	<b>17,704</b>

\* Certain amounts shown here do not correspond to the 2016 financial statements and reflect reclassifications made as detailed in Note 2.

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



**Consolidated statement of financial position (continued)***(Amounts presented are in millions of Azerbaijani Manats)*

	Note	31 December 2017	31 December 2016 (reclassified*)
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables	20	12,450	9,692
Short-term and current portion of long-term borrowings	21	5,998	6,717
Taxes payable	22	487	616
Other provisions for liabilities and charges	24	70	45
Deferred acquisition consideration payable	27	147	153
Deferred income	25	41	98
Other current liabilities	26	653	1,052
<b>Total current liabilities</b>		<b>19,846</b>	<b>18,373</b>
<b>Non-current liabilities</b>			
Long-term borrowings	21	9,513	8,210
Asset retirement obligations	23	1,067	968
Other provisions for liabilities and charges	24	94	148
Deferred income	25	63	74
Deferred tax liabilities	34	1,209	1,272
Advances received for the sale of shares	35	4,076	2,897
Put option liabilities	36	2,719	2,832
Other non-current liabilities	26	785	529
<b>Total non-current liabilities</b>		<b>19,526</b>	<b>16,930</b>
<b>Total liabilities</b>		<b>39,372</b>	<b>35,303</b>
<b>Total liabilities and equity</b>		<b>61,347</b>	<b>53,007</b>

\* Certain amounts shown here do not correspond to the 2016 financial statements and reflect reclassifications made as detailed in Note 2.

Approved for issue and signed on behalf of the Group on 7 June 2018.



Mr. Rovnag Abdullayev  
President

Mr. Suleyman Gasymov  
Vice-President for Economic Affairs



**Consolidated statement of profit or loss and other comprehensive income***(Amounts presented are in millions of Azerbaijani Manats)*

	<b>Note</b>	<b>2017</b>	<b>2016</b>
Revenue	29	92,571	51,905
Cost of sales	30	(87,352)	(47,387)
<b>Gross profit</b>		<b>5,219</b>	<b>4,518</b>
Distribution expenses	30	(864)	(814)
General and administrative expenses	30	(1,267)	(1,092)
Loss on disposal of property, plant and equipment and intangible assets		(26)	(34)
Social expenses		(125)	(148)
Exploration and evaluation expenses	30	(38)	(35)
Other operating expenses	30	(1,326)	(1,196)
Other operating income	31	949	697
<b>Operating profit</b>		<b>2,522</b>	<b>1,896</b>
Finance income	32	117	189
Finance costs	33	(890)	(841)
Foreign exchange gains and losses, net		110	(1,284)
Share of result of joint ventures	18	523	767
Share of result of associates	19	134	209
<b>Profit before income tax</b>		<b>2,516</b>	<b>936</b>
Income tax expense	34	(424)	(586)
<b>Profit for the year</b>		<b>2,092</b>	<b>350</b>
<b>Other comprehensive (loss)/income</b>			
Other comprehensive (loss)/income to be reclassified to profit or loss in subsequent periods – currency translation differences, gain on available-for-sale financial assets, loss on cash flow hedges, net of tax		(576)	1,784
<b>Other comprehensive (loss)/income for the year, net of tax</b>		<b>(576)</b>	<b>1,784</b>
<b>Total comprehensive income for the year</b>		<b>1,516</b>	<b>2,134</b>
<b>Profit is attributable to:</b>			
Equity holders of the Group		1,748	147
Non-controlling interests		344	203
		<b>2,092</b>	<b>350</b>
<b>Total comprehensive income attributable to:</b>			
Equity holders of the Group		1,318	1,978
Non-controlling interests		198	156
		<b>1,516</b>	<b>2,134</b>

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

**Consolidated statement of changes in equity***(Amounts presented are in millions of Azerbaijani Manats)*

	Note	Attributable to the equity holders of the parent							Non-controlling interests	Total equity
		Charter capital	Additional paid-in capital	Put option on an entity's own shares	Gain on (purchase) / sale of subsidiary share	Other capital reserves	Retained earnings	Currency translation difference		
<b>Balance at 1 January 2016</b>		<b>1,617</b>	<b>1,423</b>	<b>(1,305)</b>	<b>1,234</b>	<b>(12)</b>	<b>6,191</b>	<b>4,427</b>	<b>1,073</b>	<b>14,648</b>
Profit for the year		-	-	-	-	-	147	-	203	350
Currency translation differences, net of tax		-	-	-	-	-	-	1,865	(47)	1,818
Other comprehensive loss		-	-	-	-	(34)	-	-	-	(34)
<b>Total comprehensive income for 2016</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(34)</b>	<b>147</b>	<b>1,865</b>	<b>156</b>	<b>2,134</b>
Sale of shares to non-controlling shareholder		-	-	-	46	-	-	-	172	218
Registration of share issue	28	185	(185)	-	-	-	-	-	-	-
Additional paid-in capital	28	-	921	-	-	-	-	-	-	921
Contribution in charter capital of subsidiaries by non-controlling shareholder		-	-	-	-	-	-	-	10	10
Distribution to the Government	28	-	-	-	-	-	(73)	-	-	(73)
Dividends declared by subsidiary		-	-	-	-	-	-	-	(154)	(154)
<b>Balance at 31 December 2016</b>		<b>1,802</b>	<b>2,159</b>	<b>(1,305)</b>	<b>1,280</b>	<b>(46)</b>	<b>6,265</b>	<b>6,292</b>	<b>1,257</b>	<b>17,704</b>
Profit for the year		-	-	-	-	-	1,748	-	344	2,092
Currency translation differences, net of tax		-	-	-	-	-	-	(470)	(146)	(616)
Other comprehensive income		-	-	-	-	40	-	-	-	40
<b>Total comprehensive income for 2017</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>40</b>	<b>1,748</b>	<b>(470)</b>	<b>198</b>	<b>1,516</b>
Acquisition of non-controlling interest in subsidiary	28	-	-	-	(113)	-	-	(2)	44	(71)
Sale of shares to non-controlling shareholder	28	-	-	-	14	-	-	(14)	87	87
Put option reserve		-	-	(5)	-	-	-	-	5	-
Registration of share issue	28	1,234	(1,234)	-	-	-	-	-	-	-
Additional paid-in capital	28	-	3,616	-	-	-	-	-	-	3,616
Contribution in charter capital of subsidiaries by non-controlling shareholder		-	-	-	-	-	-	-	53	53
Distribution to the Government	28	-	-	-	-	-	(656)	-	-	(656)
Dividends declared by subsidiary		-	-	-	-	-	-	-	(274)	(274)
<b>Balance at 31 December 2017</b>		<b>3,036</b>	<b>4,541</b>	<b>(1,310)</b>	<b>1,181</b>	<b>(6)</b>	<b>7,357</b>	<b>5,806</b>	<b>1,370</b>	<b>21,975</b>

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

**Consolidated statement of cash flows***(Amounts presented are in millions of Azerbaijani Manats)*

	<b>Note</b>	<b>2017</b>	<b>2016</b>
<b>Cash flows from operating activities</b>			
Profit before income tax		2,516	936
<i>Adjustments for:</i>			
Depreciation of property, plant and equipment	30	1,065	1,014
Amortisation of intangible assets	17	41	40
Impairment of property, plant and equipment	16	468	322
Impairment of trade and other receivables and other financial assets	30	239	493
Change in provisions	30	(11)	18
Change in asset retirement obligations recognized in profit or loss		(6)	2
Loss on disposals of property, plant and equipment and intangible assets		26	34
Finance income	32	(117)	(189)
Finance costs	33	890	841
Foreign exchange rate differences		26	1,011
Share of result of associates and joint ventures	18, 19	(657)	(976)
Other non-cash transactions		(408)	(69)
<b>Operating cash flows before working capital changes</b>		<b>4,072</b>	<b>3,477</b>
Increase in trade and other receivables		(1,660)	(2,329)
Decrease/(increase) in inventories		222	(2,628)
Increase in trade and other payables		2,665	2,816
Change in other assets and liabilities		51	148
Utilization of provisions		(33)	(28)
<b>Cash generated from operations</b>		<b>5,317</b>	<b>1,456</b>
Income taxes paid		(635)	(472)
Interest paid		(647)	(743)
<b>Net cash flows from operating activities</b>		<b>4,035</b>	<b>241</b>
<b>Cash flows from investing activities</b>			
Acquisitions of subsidiary (net of cash acquired), additional share in joint operations, additional contribution in associates and joint ventures		(817)	(941)
Purchase of property, plant and equipment		(4,271)	(3,526)
Purchase of intangible assets	17	(29)	(22)
Withdrawal/(placement) of deposits		813	(892)
Interest received		117	195
Dividends received from associates and joint ventures		221	190
Proceeds from sale of property, plant and equipment		58	12
Advances received for sale of interest		1,310	466
Purchase of available-for-sale assets		(51)	-
Change in restricted cash related to construction	9	(129)	-
Loans issued to joint ventures and associates		(313)	(63)
Loans issued to third parties		(6)	(9)
<b>Net cash flows used in investing activities</b>		<b>(3,097)</b>	<b>(4,590)</b>
<b>Cash flows from financing activities</b>			
Proceeds from borrowings		9,480	6,751
Repayment of borrowings		(8,559)	(4,261)
Contribution in subsidiary by non-controlling shareholder		26	10
Proceeds from sale of non-controlling interests	28	87	218
Increase in charter capital and additional paid-in capital	28	243	921
Dividends paid to non-controlling interests		(252)	(154)
Distribution to the Government	28	(656)	(73)
Acquisition of share from non-controlling shareholder	28	(71)	-
Change in restricted cash related to borrowings		(8)	81
<b>Net cash flows from financing activities</b>		<b>290</b>	<b>3,493</b>
Net foreign exchange difference on cash and cash equivalents		(174)	138
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>1,054</b>	<b>(718)</b>
Cash and cash equivalents at the beginning of the year	8	4,163	4,881
<b>Cash and cash equivalents at the end of the year</b>	<b>8</b>	<b>5,217</b>	<b>4,163</b>

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



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 1. The Group and its operations

The State Oil Company of the Azerbaijan Republic ("SOCAR") was established by the Presidential Decree on 13 September 1992 in accordance with Azerbaijani legislation and is domiciled in the Azerbaijan Republic. SOCAR is involved in upstream, midstream and downstream operations. SOCAR's main functions pertain to the extraction, refining, transportation of oil, gas and gas condensates, and sale of gas and oil and gas products. SOCAR is 100 per cent owned by the Government of the Azerbaijan Republic (the "Government").

SOCAR's registered address is 121 Heydar Aliyev Avenue, AZ 1029 Baku, Azerbaijan Republic.

### Information about subsidiaries

The consolidated financial statements of the Group include the following material subsidiaries:

Name	Principal activities	Country of incorporation	% equity interest	
			2017	2016
SOCAR Turkey Enerji A.Ş.	Refinery	Turkey	100%	100%
Azerbaijan (ACG) Ltd	Oil production	Cayman Islands	100%	100%
Azerbaijan (Shah Deniz) Ltd	Gas production	Cayman Islands	100%	100%
Caspian Drilling Company (CDC)	Drilling operations	Azerbaijan	92%	92%
SOCAR Energy Georgia LLC	Sales and Distribution	Georgia	76%	51%
SOCAR Overseas LLC	Sales and Distribution	UAE	100%	100%
SOCAR Trading Holding	Sales and Distribution	Malta	100%	100%
Azerbaijan (BTC) Ltd	Sales and Distribution	Cayman Islands	100%	100%
Cooperative Menkent U.A.	Sales and Distribution	Netherlands	100%	100%
SOCAR Energy Holdings AG	Sales and Distribution	Switzerland	100%	100%
SOCAR Energy Ukraine	Sales and Distribution	Ukraine	100%	100%
Azerbaijan (SCP) LTD	Sales and Distribution	Cayman Islands	100%	100%
SOCAR Petroleum ("CJSC")	Sales and Distribution	Azerbaijan	100%	100%
Baku Shipyard Company	Construction	Azerbaijan	65%	65%
SOCAR Polymer LLC	Chemicals production	Azerbaijan	57%	71%
BOS Shelf LLC	Construction	Azerbaijan	90%	90%

## 2. Basis of preparation and significant accounting policies

### Basis of preparation

These consolidated financial statements of SOCAR and its subsidiaries, associates and joint ventures (collectively referred to as "the Group") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented.

### Basis of consolidation

The consolidated financial statements comprise the financial statements of the Group and its subsidiaries as at 31 December 2017.

Subsidiaries are all entities (including special-purpose 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.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Basis of consolidation (continued)

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(s) 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 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.

Total comprehensive income within a subsidiary is attributed to the non-controlling interests even if that results in 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, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the acquirer measures the non-controlling interests in the acquiree 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 re-measured to fair value at the acquisition date through profit or loss.

#### *Transactions with non-controlling interests*

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 recognized directly in equity and attributed to the owners of the Group.

#### *Business combinations with entities under common control*

The Group applies acquisition method of accounting for business combinations with entities under the common control.

### Investments in associates and joint ventures

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.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

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

### **Investments in associates and joint ventures (continued)**

A joint venture ("JV") is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The considerations made in determining significant influence or joint control is similar to those necessary to determine control over subsidiaries.

The Group's investments in its associate and joint venture are accounted for using the equity method. Under the equity method, the investment in an associate or a joint venture is initially recognized at cost. The carrying amount of the investment is adjusted to recognize changes in the Group's share of net assets of the associate or joint venture since the acquisition date. Goodwill relating to the associate or joint venture 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 or joint venture. Any change in other comprehensive income ("OCI") of those investees is presented as part of the Group's OCI. Any gain or loss on sale of share that was recognized directly in the equity of the associate or joint venture is reflected as a gain or loss within the Group share of associate's or joint venture's profit or loss. Unrealised gains and losses resulting from transactions between the Group and the associate or joint venture are eliminated to the extent of the interest in the associate or joint venture.

The aggregate of the Group's share of profit or loss of an associate and a joint venture 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 or joint venture.

The financial statements of the associate or joint venture 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.

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

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

### **Investments in Production Sharing Agreements ("PSAs")**

Certain of the Group's upstream activities are governed by the PSAs. According to the terms of PSAs, the Group owns the portion of project's assets and 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 PSA's by recognizing the portion of underlying assets, liabilities, expenses incurred and income earned by the projects using undivided interest method.

PSA is the method to execute exploitation of mineral resources by taking advantage of the expertise of a commercial oil and gas entity. The Government retains title to the mineral resources (whatever the quantity that is ultimately extracted) and often the legal title to all fixed assets constructed to exploit the resources. The Government takes a percentage share of the output which may be delivered in product or paid in cash under an agreed pricing formula. The contracting parties may only be entitled to recover specified costs plus an agreed profit margin. It may have the right to extract resources over a specified period of time. Operating company is a legal entity created by one or more contracting parties to operate PSA.



*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

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

### **Investments in Production Sharing Agreements ("PSAs") (continued)**

As a contracting party to various PSAs the Group evaluates and accounts for the PSAs in accordance with the substance of the arrangement. It records only its own share of oil and gas under a PSA as revenue. Neither revenue nor cost is recorded by the Group for the oil and gas extracted and sold on behalf of the Government. The Group acts as the Government's agent to extract, deliver or sell the oil and gas and remit the proceeds.

Costs that meet the recognition criteria as intangible or fixed assets in accordance with IAS 38 and IAS 16, respectively, are recognized where the entity is exposed to the majority of the economic risks and has access to the probable future economic benefits of the assets. Acquisition, development and exploration costs are accounted for in accordance with policies stated herein.

Assets subject to depreciation, depletion or amortization are expensed using the appropriate depletion or depreciation method stipulated by the present accounting policies over the shorter of the PSA validity period or the expected useful life of the related assets.

### **Foreign currency translation**

All amounts in these consolidated statements are presented in millions of Azerbaijani Manats ("AZN"), unless otherwise stated.

The functional currencies of the Group's consolidated entities are the currencies of the primary economic environments in which the entities operate. The functional currency of SOCAR and its 22 business units and the Group's presentation currency is the national currency of the Azerbaijan Republic, AZN. However, US Dollar ("USD"), Swiss Franc ("CHF"), Georgian Lari ("GEL"), Ukrainian Hryvnia ("UAH") and Turkish Lira ("TRY") are considered the functional currency of the Group's certain subsidiaries, associates and joint ventures as majority of these investments' receivables, revenues, costs and debt liabilities are either priced, incurred, payable or otherwise measured in these currencies.

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 denominated in foreign currencies other than 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.

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 (functional currency of none of these entities is a currency of a hyperinflationary economy) 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 2017, the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 1.7001, EUR 1 = AZN 2.0307, CHF 1 = AZN 1.7374, GEL 1 = AZN 0.6514, UAH 1 = AZN 0.0605, TRY 1 = AZN 0.4499, JPY 100 = AZN 1.5079 (2016: USD 1 = AZN 1.7707, EUR 1 = AZN 1.8644, CHF 1 = AZN 1.7351, GEL 1 = AZN 0.6663, UAH 1 = AZN 0.0653, TRY 1 = AZN 0.5023, JPY 100 = AZN 1.5168).

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Financial instruments – key measurement terms

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

*Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability, or in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or the most advantageous market must be accessible 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 economic best 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 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 recognized in the financial statements at fair value 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.

*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 recognized 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 statement of financial position items.

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

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Financial instruments – key measurement terms (continued)

The effective interest rate discounts cash flows of variable interest instruments to the next interest re-pricing 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

The Group classifies its financial assets in the following measurement categories: a) financial assets at fair value through profit or loss; b) loans and receivables; c) financial assets held-to-maturity and d) available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

The subsequent measurement of financial assets depends on their classification, as follows:

- (a) *Financial assets at fair value through profit or loss.* Financial assets at fair value through profit or loss are financial assets held for trading (a financial asset is classified in this category if acquired principally for the purpose of selling in the short term) and financial assets designated upon initial recognition as at fair value through profit or loss. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.
- (b) *Loans and receivables.* Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the reporting date. These are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the statement of financial position.
- (c) *Held-to-maturity financial assets.* This classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both the intention and ability to hold to maturity. Management determines the classification of investment securities held-to-maturity at their initial recognition and reassesses the appropriateness of that classification at each reporting date.
- (d) *Available-for-sale financial assets.* Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the reporting date.

Regular purchases and sales of financial assets are recognized on the trade date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the statement of profit or loss and other comprehensive income. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables, investment securities held-to-maturity are carried at amortized cost using the effective interest rate method.

Gains or losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are presented in the statement of profit or loss and other comprehensive income within other gains/(losses) in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the statement of profit or loss and other comprehensive income as part of other income when the Group's right to receive payments is established.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortized cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognized in profit or loss; translation differences on non-monetary securities are recognized in equity. Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognized in equity.



*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

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

### **Financial assets (continued)**

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the statement of profit or loss and other comprehensive income as gains and losses from investment securities. Interest on available-for-sale securities calculated using the effective interest rate method is recognized in the statement of profit or loss and other comprehensive income as part of other income. Dividends on available-for-sale equity instruments are recognized in the statement of profit or loss and other comprehensive income as part of other income when the Group's right to receive payments is established.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in other comprehensive income – is removed from equity and recognized in the statement of profit or loss. Impairment losses recognized in the statement of profit or loss and other comprehensive income on equity instruments are not reversed through the profit or loss.

### **Financial liabilities**

The Group classifies its financial liabilities into the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. Liabilities held for trading are carried at fair value with changes in value recognized in the consolidated statement of profit or loss and other comprehensive income in the period in which they arise. Other financial liabilities are carried at amortised cost.

### **Derecognition of financial assets**

The Group derecognizes financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

### **Derecognition of financial liabilities**

The Group derecognizes financial liability when the obligation under the liability is discharged, cancelled or expires. Where 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 the derecognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts, together with any costs or fees incurred is recognized in the statement of profit or loss.

### **Financial guarantee contracts**

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

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Derivative financial instruments and hedge accounting

Oil and Gas derivative financial instruments, including paper and physical contracts, are initially measured at fair value through profit or loss as well as subsequent changes in fair value.

Financial assets or financial liabilities at fair value through profit or loss includes financial assets or financial liabilities held for trading that do not meet the hedge accounting criteria as defined by IAS 39 *Financial Instruments: Recognition and Measurement* and derivatives (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument) within the scope of IAS 39.

Financial instruments are differentiated as quoted in an active market and when there is no active market. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. If no active market, fair value has to be established using valuation techniques, including:

- ▶ Recent transaction prices;
- ▶ The current fair value of similar instruments;
- ▶ Discounted cash flow analysis;
- ▶ Option pricing models (e.g. Black & Scholes model).

Current market conditions, credit and liquidity risk are also considered by the Group in the determination of fair value.

For the purpose of hedge accounting, hedges are classified as:

- ▶ Fair value hedges when hedging the exposure to changes of a recognized asset or liability or an unrecognized firm commitment.
- ▶ Cash flow hedges when hedging the exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction or the foreign currency risk in an unrecognized firm commitment.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the effectiveness of changes in the hedging instrument's fair value in offsetting the exposure to changes in the hedged item's fair value. Such hedges are expected to be highly effective in achieving offsetting changes in fair value and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

#### *Fair value hedges*

When hedges meet the strict criteria for hedge accounting and an unrecognized firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognized as an asset or liability with a corresponding gain or loss recognized in the income statement.

#### *Cash flow hedges*

The effective portion of the gain or loss on the hedging instrument is recognized in OCI in the cash flow hedge reserve, while any ineffective portion is recognized immediately in the statement of profit or loss as other operating expenses. Amounts recognized as OCI are transferred to profit or loss when the hedged transaction affects profit or loss, such as when the hedged financial income or financial expense is recognized or when the forecast sale or expense occurs.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

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

### **Trade and other receivables**

Trade and other receivables are carried at amortised cost using the effective interest rate method. The Group first assesses 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.

A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of provision is recognized in profit or loss. The primary factors that the Group considers when determining whether a receivable is impaired is its overdue status and realisability or related collateral, if any.

The following other principal criteria are also used to determine whether there is an objective evidence that an impairment loss has occurred:

- ▶ The counterparty experiences a significant financial difficulty as evidenced by its financial information that the Group obtains;
- ▶ The counterparty considers bankruptcy or a financial reorganisation;
- ▶ There is an adverse change in the payment status of the counterparty as a result of changes in the national or local economic conditions that impact the counterparty;
- ▶ The value of collateral, if any, significantly decreases as a result of deteriorating market conditions.

Trade and other receivables are derecognized upon cash receipts from customers and borrowers or other similar settlements.

### **Cash and cash equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

### **Restricted cash**

Restricted cash is presented separately from cash and cash equivalents. Restricted balances are excluded from cash and cash equivalents for the purposes of cash flow statement.

### **Trade payables**

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

### **Borrowings**

All borrowings are initially recognized at fair value of the proceeds received net of issue costs associated with the borrowing. Borrowings are carried at amortised cost using the effective interest rate method.

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

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

### **Property, plant and equipment**

The Group elected to measure property, plant and equipment at the date of transition to IFRS (1 January 2007) at their fair value and use that fair value as their deemed cost at that date. Fair value was determined by reference to market-based evidence and by using the depreciated replacement cost method. Subsequent to transition to IFRS, property, plant and equipment are stated at cost as described below, less accumulated depreciation and provision for impairment, where required.

The initial cost of an asset purchased after 1 January 2007 comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of decommissioning obligation, if any, and, for qualifying assets, borrowing costs. The assets held under finance lease are also included within property, plant and equipment. Non-recoverable value-added tax related with acquisition of property, plant and equipment is capitalized by the Group. Non-recoverable value-added tax related with operational activities is charged to profit or loss.

### **Exploration and evaluation costs**

Property leasehold acquisition costs are capitalised until the determination of reserves is evaluated. If a commercial discovery has not been achieved, these costs are charged to expense. Capitalisation is made within property, plant and equipment or intangible assets according to the nature of the expenditure.

The Group accounts for exploration and evaluation activities, capitalizing exploration and evaluation costs until such time as the economic viability of producing the underlying resources is determined.

Exploration and evaluation costs related to resources determined to be not economically viable are expensed through operating expenses in the consolidated statement of profit or loss and other comprehensive income.

### **Development tangible and intangible assets**

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of commercially proven development wells is capitalised within tangible and intangible assets according to nature. When development is completed on a specific field, it is transferred to production assets (oil and gas properties).

The present value of the estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, are recognized when the obligation is incurred and are included within the carrying value of property, plant and equipment, subject to depletion using unit-of-production method.

All minor repair and maintenance costs are expensed as incurred. Cost of replacing major parts or components of property, plant and equipment items are capitalized and the replaced part is retired.

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

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

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

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

### Depreciation

Property, plant and equipment related to oil and natural gas properties are depreciated using a unit-of-production method.

Depreciation of oil and gas assets is computed on a field-by-field basis over proved developed reserves or over total proved reserves, as appropriate. Shared oil and gas properties and equipment (e.g. internal delivery systems, processing units, etc.) are depleted over total proved reserves.

Land is not depreciated. Property, plant and equipment other than oil and gas properties and equipment, are depreciated on a straight-line basis over their estimated useful lives. Assets under construction are not depreciated.

The estimated useful lives of the Group's property, plant and equipment (other than oil and gas properties) are as follows:

Buildings and constructions	12 to 40 years
Plant and machinery	3 to 50 years
Vessels	25 years

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

The residual value of an asset is the estimated amount that the Group would currently 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 residual value of an asset is nil if the Group expects to use the asset until the end of its physical life unless scrap value is significant. The assets' residual values are reviewed, and adjusted if appropriate, at each reporting date.

### Operating leases

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

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

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

### Goodwill

Goodwill is initially measured at cost being (the excess of the aggregate of the consideration transferred and the amount recognized for non-controlling interests) over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss. After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Intangible assets

Intangible assets are stated at cost, less accumulated amortization and accumulated impairment losses. Intangible assets include rights and computer software, patents, licences, customer relationships, trade name, water rights and development projects.

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

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

#### (a) Rights and computer software

Software is carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method over the estimated useful lives of such assets. Land property rights consist of the rights over the dam, factory site, port site, site development, site and the water transmission line. Land property rights obtained at the acquisition of Petkim Petrokimya Holding A.Ş. ("Petkim") (Note 17) were initially recognized at their fair values in accordance with IFRS 3 as at 30 May 2008 and amortised over their remaining useful lives commencing from the date of acquisition, except for the water transmission line which is not amortised as it is deemed to have an indefinite useful life.

#### (b) Customer relationships

Customer relationships acquired as part of net assets of Petkim were initially recognized at their fair values in accordance with IFRS 3 as at 30 May 2008 and amortised over their remaining useful lives of 22 years commencing from the date of the acquisition (Note 17).

Customer relationships acquired as part of net assets of SOCAR Switzerland were initially recognized at their fair values in accordance with IFRS 3 as at 30 June 2012 and amortised over their remaining useful lives commencing from the date of acquisition. The estimated useful life of retail card end customers is 18 years, retail distribution network and fuel customers are 30 years.

#### (c) Petkim trade name

Petkim trade name acquired at the Petkim acquisition was initially recognized at its fair value in accordance with IFRS 3 as at 30 May 2008. Petkim trade name is not amortised as it is deemed to have an indefinite useful life (Note 17).

#### (d) Water rights

Water rights acquired with the Petkim acquisition were initially recognized at their fair value in accordance with IFRS 3 as at 30 May 2008 and amortised over their remaining useful lives of 47 years commencing from the date of the acquisition (Note 17).

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Intangible assets (continued)

#### (e) Development projects

Development projects (design and testing of new or improved products) acquired with the Petkim acquisition were initially recognized at their fair value in accordance with IFRS 3 as of 30 May 2008 and amortised on a straight-line basis over their remaining useful lives of 5 years commencing from the date of the acquisition. Cost incurred on development projects (relating to the design and testing of new or improved products) are recognized as intangible assets when it is probable that the project will be operational considering its commercial and technological feasibility, and only if the cost can be measured reliably. Other expenditures on research and development activities are recognized as an expense in the period in which they incurred. When there is an impairment, the carrying values of the intangible assets are written down to their recoverable amounts. Intangible assets with indefinite useful lives are not amortized, however are tested for impairment annually.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

### Corporate income taxes

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

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

Deferred income tax is provided in full, 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, joint ventures 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 tax relating to items outside profit or loss is recognized either in OCI or directly in equity.

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.

### Inventories

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

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

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

### **Government grants**

Grants from the Government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred income and are credited to profit or loss on a straight line basis over the expected lives of the related assets.

When the grant relates to an expense item, it is recognized as income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed.

### **Asset retirement obligations**

Liabilities for asset retirement obligation costs are recognized when the Group has an obligation to dismantle and remove a facility or an item of plant and to restore the site on which it is located, and when a reasonable estimate of that liability can be made. Where an obligation exists for a new facility, such as oil and natural gas production or transportation facilities, this will be on construction or installation. An obligation for asset retirement may also crystallize during the period of operation of a facility through a change in legislation. The amount recognized is the present value of the estimated future expenditure determined in accordance with local conditions and requirements.

The cost of property, plant and equipment is also adjusted for amounts of estimated liabilities for asset retirement obligations.

Any change in the present value of the obligation resulting from changes in estimates of the amounts or timing of future expenditures is reflected as an adjustment to the provision and the corresponding capitalized costs within property, plant and equipment. Changes in estimates of the amounts or timing of future expenditures to dismantle and remove fully depreciated plant or facility is recognized in the statement of profit or loss and other comprehensive income. Changes in the present value of the obligation resulting from unwinding of the discount are recognized as finance costs in the statement of profit or loss and other comprehensive income.

### **Provisions for liabilities and charges**

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

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

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

### **Distribution to the Government**

Distribution to the Government represent cash distributions or financing which the Group may be required to make to the state budget, various government agencies and projects administered by the Government based on the particular decisions of the Government.

Such distributions are recorded as a reduction of equity. Distributions in the form of transfers of non-monetary assets are recognized at the carrying value of transferred assets.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Contributions by the Government

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

### Value-added tax

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

#### *VAT payable*

VAT payable represents VAT related to sales that is payable to tax authorities upon recognition of sales to customers, net of VAT on purchases which have been settled at the reporting date. VAT related to sales which have not been settled at the reporting date (VAT deferral) is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT where applicable. The related VAT payable is maintained until the debtor is written off for tax purposes.

#### *VAT recoverable*

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

In accordance with ACG, Shah Deniz and Absheron PSA provisions, Azerbaijan (ACG) Limited ("AzACG"), Azerbaijan Shah Deniz Limited ("AzSD") and SOCAR Absheron LLC are charged with zero per cent VAT effective in the Azerbaijan Republic for a contractor party under the respective PSAs according to a VAT certification issued by tax authorities and effective until 19 September 2019, 3 June 2026 and 22 May 2034, respectively.

### Revenue recognition

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

Revenues from sales of crude oil are recognized at the point of transfer of risks and rewards of ownership of the crude oil, normally when the oil is loaded into the oil tanker or other transportation facilities. Revenues from sales of petroleum products are recognized at the point of transfer of risks and rewards of ownership of the petroleum products, normally when the products are shipped. Revenue from sales of natural gas are recorded on the basis of regular meter readings (monitored on a monthly basis) and estimates of customer usage from the last meter reading to the end of the reporting period. Natural gas prices and gas transportation tariffs to the final consumers in the Azerbaijan Republic are established by the Tariff Council of the Azerbaijan Republic.

Revenues from sales of other goods are recognized at the point of transfer of risks and rewards of ownership of the goods.

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

Interest income is recognized on a time-proportion basis using the effective interest rate method.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Overlift/underlift of crude oil

Overlift or underlift of crude oil occurs when the volume of oil lifted by a partner in a joint operation differs from its participating interest in the production. 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.

### Employee benefits

Wages, salaries, contributions to the Social Protection Fund of the Azerbaijan Republic, 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.

### 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 10 per cent or more of all the segments are reported separately.

### Related parties

Related parties are defined in IAS 24 *Related Party Disclosures*.

Governmental economic and social policies affect the Group's financial position, results of operations and cash flows. The Government imposed an obligation on the Group to provide an uninterrupted supply of oil and gas to customers in the Azerbaijan Republic at government controlled prices. Transactions with the state include taxes which are detailed in Note 22.

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.

### Carried interest arrangements

A carried interest arrangement where the Group participate as carried party is an agreement under which the carrying party agrees to pay for a portion or all of the pre-production costs of the carried party on a project in which both parties own participating interest. If the project is unsuccessful then the carrying party will not be reimbursed for the costs that it has incurred on behalf of the carried party. If the project is successful then the carrying party will be reimbursed either in cash out of proceeds of the share of production attributable to the carried party, or by receiving a disproportionately high share of the production until the carried costs are fully recovered.

Depending on the terms of the carried interest agreements the Group recognizes them either as financing-type arrangement or purchase / sale-type arrangement.

The finance-type arrangements presume that carrying party provides funding to the carried party and receives a lender's return on the funds provided, while the right to additional production acts as a security that underpins the arrangement.



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Carried interest arrangements (continued)

In the purchase/sale-type arrangement, the carried party effectively sells an interest or a partial interest in a project to the carrying party. The carrying party will be required to fund the project in exchange for an increased share of any proceeds if the project succeeds, while the carried party retains a much reduced share of any proceeds. The Group does not have any purchase/sale-type arrangement recognized in these consolidated financial statements.

During exploration stage of projects when the outcome of projects and probability of the carrying party to recover costs incurred on behalf of the carried party are not certain the Group does not recognize any carry related transactions and balances in the consolidated financial statements.

### 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 as following:

- ▶ For identifiable asset and liability initially measured at an amount other than cost, an entity initially measures that asset or liability at the amount specified in the applicable IFRS Standard;
- ▶ The entity deducts from the transaction price of the acquired entity the amounts allocated to the assets and liabilities initially measured at an amount other than cost, and then allocates the residual transaction price to the remaining identifiable assets and liabilities based on their relative fair values at the date of the acquisition.

#### *Step-acquisition of subsidiary that is not a business*

Step-acquisition of subsidiary which has been previously accounted for as investment in associates and joint ventures ("the investee") are recognized in the amount being the carrying value under the equity method related to the original interest in the investee plus cost of additional investments made by the Group in order to obtain control over the investee ("deemed cost"). Upon obtaining control over the investee it becomes subsidiary of the Group and deemed cost is allocated to the individual identifiable assets and liabilities of the subsidiary applying the same approach used for acquisition of an entity that is not a business.

### Non-current assets held for sale or for distribution to equity holders of the parent and discontinued operations

The Group classifies non-current assets and disposal groups as held for sale or for distribution to equity holders of the parent if their carrying amounts will be recovered principally through a sale or distribution rather than through continuing use. Such non-current assets and disposal groups classified as held for sale or as held for distribution are measured at the lower of their carrying amount and fair value less costs to sell.

The criteria for held for distribution classification is regarded as met only when the distribution is highly probable and the asset or disposal group is available for immediate distribution in its present condition. Actions required to complete the distribution should indicate that it is unlikely that significant changes to the distribution will be made or that the decision to distribution will be withdrawn. Management must be committed to the distribution expected within one year from the date of the classification. Similar considerations apply to assets or a disposal group held for sale.

Property, plant and equipment and intangible assets are not depreciated or amortised once classified as held for sale or as held for distribution. Assets and liabilities classified as held for sale or for distribution are presented separately as current items in the statement of financial position.

A disposal group qualifies as discontinued operation if it is:

- ▶ Represents a separate major line of business or geographical area of operations;
- ▶ Is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- ▶ Is a subsidiary acquired exclusively with a view to resale.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

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

### Non-current assets held for sale or for distribution to equity holders of the parent and discontinued operations (continued)

Discontinued operations are excluded from the results of continuing operations and are presented as a single amount as profit or loss after tax from discontinued operations in the statement of profit or loss. All notes to the consolidated financial statements include amounts for continuing operations.

### Reclassifications

The following reclassification has been made to the prior year's consolidated statement of financial position, corresponding notes and corresponding cash flow lines within operating activities to conform to the current year's presentation.

### Consolidated statement of financial position

	As reported	Reclassification	As reclassified
Trade and other payables	9,662	30	9,692
Other provisions for liabilities and charges (current)	74	(29)	45
Other provisions for liabilities and charges (non-current)	149	(1)	148

The reclassification amounts represent unused vacation provision balances which were included in other provisions for liabilities and charges as of 31 December 2016.

## 3. Critical accounting estimates and judgments

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgments, apart from those involving estimations, in the process of applying the accounting policies. Judgments that have the most significant effect on the amounts recognized in these consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities at reporting date include:

### Estimation of oil and gas reserves

Oil and gas reserves are key elements in the Group's investment decision-making process. They are also an important element of testing for impairment. Changes in proved oil and gas reserves, particularly proved developed reserves, will affect unit-of-production depreciation charges in the statement of profit or loss and other comprehensive income.

Proved oil and gas reserves are the estimated quantities of crude oil and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e. prices and costs as of the date the estimate is made. Proved developed reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Estimates of oil and gas reserves are inherently imprecise, require the application of judgment and are subject to future revision.

Accordingly, financial and accounting measures (such as depletion and amortization charges and provision for asset retirement obligations) that are based on proved developed or proved reserves are also subject to change. Proved reserves are estimated by reference to available reservoir and well information. All proved reserves estimates are subject to revision, either upward or downward, based on new information, such as from drilling and production activities or from changes in economic factors, including product prices, contract terms or development plans. In general, changes in the technical maturity or hydrocarbon reserves resulting from new information becoming available from development plans. In general, changes in the technical maturity of hydrocarbon reserves resulting from new information becoming available from development and production activities have tended to be the most significant cause of annual revisions.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 3. Critical accounting estimates and judgments (continued)

#### Estimation of oil and gas reserves (continued)

In general, estimates of reserves for undeveloped or partially developed fields are subject to greater uncertainty over their future life than estimates of reserves for fields that are developed and being depleted. As a field goes into production, the amount of proved reserves will be subject to future revision once additional information becomes available through, for example, the drilling of additional wells or the observation of long-term reservoir performance under producing conditions. As those fields are further developed, new information may lead to revisions.

Proved reserves of the SOCAR as of 1 January 2018 were based on reports prepared by independent reservoir engineers in accordance with Petroleum Resources Management System rules. For certain assets proved reserves are based on estimation of internal engineers.

#### Asset retirement obligations

As further discussed in Note 23, management makes provision for the future costs of decommissioning oil and gas production and storage facilities, pipelines and related support equipment and site restoration based on the estimates of future cost and economic lives of those assets. Estimating future asset retirement obligations is complex and requires management to make estimates and judgments with respect to removal obligations that will occur many years in the future. Changes in the measurement of existing obligations can result from changes in estimated timing, future costs or discount rates used in valuation.

The Group assesses its asset retirement obligation liabilities in accordance with the guidelines of International Financial Reporting Interpretations Committee ("IFRIC") 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the reporting date based on current applicable legislation and regulations, and is also subject to changes because of modifications, revisions and changes in laws and regulations and respective interpretations thereof. Governmental authorities are continually considering applicable regulations and their enforcement. Consequently, the Group's ultimate asset retirement liabilities may differ from the recorded amounts. As a result of the subjectivity of these provisions, there is uncertainty regarding both the amount and estimated timing of incurring such costs. Estimated liability of dismantling oil and gas production and storage facilities, including abandonment and site restoration costs, amounted to AZN 1,067 at 31 December 2017 (2016: AZN 968). Changes in any of these conditions may result in adjustments to provisions recorded by the Group.

Management determines discount rates used for discounting abandonment and site restoration costs as a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. The discount rate used as at 31 December 2017 was in range of 5.66-8.02 per cent (2016: 5.59-8.24 per cent). Management believes that this discount rate appropriately reflects all risks and uncertainties pertaining to oil and gas exploration, evaluation, development and distribution in Azerbaijan as of the reporting date.

If the estimated discount rate used in the calculation had been 1 per cent higher/lower than management's estimate, the carrying amount of the provision would have been AZN 209 lower / AZN 300 higher, respectively.

#### Environmental obligations

As further discussed in Note 24, the Group records a provision in respect of estimated costs of remediation of the damage historically caused to the natural environment primarily in the Absheron area both by the activities of the Group and its legacy operations in periods preceding the formation of the Group.

The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the reporting date based on current applicable legislation and regulations, and is also subject to changes because of modifications, revisions and changes in laws and regulations and respective interpretations thereof. Governmental authorities are continually considering applicable regulations and their enforcement. Consequently, the Group's ultimate liability for environmental remediation may differ from the recorded amounts. As a result of the subjectivity of these provisions, there is uncertainty regarding both the amount and estimated timing of incurring such costs. Estimated liability for environmental remediation as of 31 December 2017 amounted to AZN 58 (2016: AZN 76). Changes in any of these conditions may result in adjustments to provisions recorded by the Group.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

### **3. Critical accounting estimates and judgments (continued)**

#### **Environmental obligations (continued)**

Management determines discount rate used for discounting environmental remediation costs as pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability as of the reporting date. The discount rate used as at 31 December 2017 was 8.27 per cent (2016: 8.73 per cent). Management believes that this discount rate appropriately reflects all risks and uncertainties pertaining to oil and gas exploration, evaluation and development industry in Azerbaijan.

Changes in any of these conditions may result in adjustments to provisions recorded by the Group. If the estimated discount rate used in the calculation had been 1 per cent higher/lower than management's estimate, the carrying amount of the provision would have been AZN 0.2 lower / AZN 0.2 higher, respectively.

#### **Useful lives of property, plant and equipment and intangible assets**

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

#### **Deferred income tax assets recognition**

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

#### **Impairment of non-financial assets**

Management assesses whether there are any indicators of possible impairment of all non-financial assets each reporting date based on events or circumstances that indicate the carrying value of assets may not be recoverable. Such indicators include changes in the Group's business plans, changes in commodity prices leading to unprofitable performances, changes in product mixes, and for oil and gas properties, significant downward revisions of estimated proved reserves. Goodwill and other indefinite life intangibles are tested for impairment annually and at other times when impairment indicators exist. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable.

When value in use calculations are undertaken, management estimates the expected future cash flows from the asset or cash generating unit and chooses a suitable discount rate in order to calculate the present value of those cash flows. In 2017, as the result of underperformance of some Cash Generating Units ("CGUs") the Group carried out a review of the recoverable amounts of those CGUs resulting in impairment charge amounting to AZN 468 (2016: AZN 322). These assets are used in the Group's oil and gas, construction and refinery segments. In assessing whether impairment is required in the carrying value of a potentially impaired asset, its carrying value is compared with its recoverable amount.

The recoverable amount is the higher of the asset's fair value less costs to sell and value-in-use. Given the nature of the Group's activities, information on the fair value of an asset is usually difficult to obtain unless negotiations with potential purchasers are taking place.

Consequently, unless indicated otherwise, the recoverable amount used in assessing the impairment charges described below is value-in-use. The Group generally estimates value-in-use using a discounted cash flow model from financial budgets approved by management.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 3. Critical accounting estimates and judgments (continued)

#### Key assumptions used in value-in-use calculations

The calculation of value-in-use for property, plant and equipment fields is most sensitive to the following assumptions:

##### *Production volumes*

Estimated production volumes of SOCAR operated fields are based on detailed data for the fields and take into account development plans for the fields agreed by management as part of the long-term planning process. It is estimated that, if all production were to be reduced by 10 per cent for the whole of the next 20 years, this would result in additional impairment charge of AZN 418.

##### *Operating expenses*

Operating expenses are based on previous year's actual figures. These are increased over the budget period for anticipated inflation rate.

##### *Gross margins*

Gross margins are based on previous year's actual figures. These are increased over the budget period for anticipated inflation rate.

##### *Capital expenditures*

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

##### *Crude oil price*

Forecast commodity prices are publicly available.

##### *Natural gas price*

Natural gas prices are calculated based on the long-term sales contracts provisions and are either fixed or depend on crude oil prices and other inputs.

##### *Discount rate*

The pre-tax discount rate applied to the cash flow projections was in range of 16.92-18.77 per cent for different CGUs (2016: 13.01-19.29 per cent). The discount rate calculation is based on the specific circumstances of the Group and its operating segments and derived from its weighted average cost of capital (WACC). In calculating WACC the cost of equity was estimated using peer group data and the cost of debt is based on interest bearing borrowings, the Group is obliged to service. Specific risks are incorporated by applying individual beta factors, market risk and size of the Group. The beta factors are evaluated annually based on publicly available market data. If the estimated WACC used in the calculation had been 1 per cent higher than management's estimate, no additional impairment loss would be recognized.

##### *Inflation rate estimates*

Rates used are Oxford Economics and Economic Intelligence Unit forecasts.

##### *Excise taxes, road taxes and export duties*

Excise taxes, road taxes and export duties on oil and gas and petroleum products are an important factor for oil and gas properties and equipment and are forecasted based on enacted tax and duty rates.



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 3. Critical accounting estimates and judgments (continued)

#### Impairment provision for trade receivables

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

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

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

#### Disability provision

As further discussed in Note 24, the Group records a provision in accordance with Azerbaijan Labour Code and has an obligation to pay compensation for employees damaged at work. Estimated liability for disability remediation as of 31 December 2017 amounted to AZN 106 (2016: AZN 117).

Management determines discount rate used for discounting disability provision as pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability as of the reporting date. The discount rate used as at 31 December 2017 was 7.94 per cent (2016: 8.13 per cent). In addition, the Group estimated a life expectancy as 71 and 76 for men and women, respectively for the purpose of calculation of the lifetime payments to injured employees. Changes in any of these conditions may result in adjustments to provisions recorded by the Group.

If the estimated discount rate used in the calculation had been 1 per cent higher/lower than management's estimate, the carrying amount of the provision would have been AZN 6 lower / AZN 7 higher, respectively.

### 4. Adoption of new or revised standards and interpretations and new accounting pronouncements

The accounting policies adopted are consistent with those of the previous financial year, except for the following amendments to IFRS effective beginning on or after 1 January 2017:

#### *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. The Group has provided the information for current period in Note 38.

#### *IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12*

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of deductible temporary difference related to unrealised losses. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount.

The Group applied amendments retrospectively. However, their application has no effect on the Group's financial position and performance as the Group has no deductible temporary differences or assets that are in the scope of the amendments.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

#### **4. Adoption of new or revised standards and interpretations and new accounting pronouncements (continued)**

##### ***Annual improvements 2014-2016 cycle***

These improvements include:

##### ***IFRS 1 First-time Adoption of International Financial Reporting Standards – Deletion of short-term exemptions for first-time adopters***

Short-term exemptions stated in IFRS 1 were deleted because they have now served their intended purpose. The amendment is effective from 1 January 2018. This amendment is not applicable to the Group.

##### ***IAS 28 Investments in Associates and Joint Ventures – Clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice***

The amendments clarify that:

- ▶ An entity that is a venture capital organisation, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss;
- ▶ If an entity, that is not itself an investment entity, has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which: (a) the investment entity associate or joint venture is initially recognised; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent.

The amendments should be applied retrospectively and are effective from 1 January 2018, with earlier application permitted. If an entity applies those amendments for an earlier period, it must disclose that fact. These amendments are not applicable to the Group.

##### ***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.

##### ***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.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

#### 4. Adoption of new or revised standards and interpretations and new accounting pronouncements (continued)

##### *Annual improvements 2014-2016 cycle (continued)*

##### *Amendments to 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.

##### **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 consolidated 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 three aspects of the accounting for the financial instruments project: classification and measurement; impairment; and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required, but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

The Group plans to adopt the new standard on the required effective date and will not restate comparative information. During 2017, the Group has performed a detailed impact assessment of all three aspects of IFRS 9. This assessment is based on currently available information and may be subject to changes arising from further reasonable and supportable information being made available to the Group in 2018 when the Group will adopt IFRS 9. Overall, the Group expects no significant impact on its statement of financial position and equity except for the effect of applying the impairment requirements of IFRS 9.

##### *(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. It expects to continue measuring at fair value all financial assets currently held at fair value. Quoted equity shares currently held as available-for-sale (AFS) with gains and losses recorded in OCI will, instead, be measured at fair value through profit or loss, which will increase volatility in recorded profit or loss. The AFS reserve currently presented as accumulated OCI will be reclassified to opening retained earnings. Debt securities are expected to be measured at fair value through OCI under IFRS 9 as the Group expects not only to hold the assets to collect contractual cash flows, but also to sell a significant amount on a relatively frequent basis.

The equity shares in non-listed companies are intended to be held for the foreseeable future. No impairment losses were recognized in profit or loss during prior periods for these investments. The Group will apply the option to present fair value changes in OCI, therefore, the application of IFRS 9 will not have a significant impact.

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 amortised cost under IFRS 9. However, the Group will analyse the contractual cash flow characteristics of those instruments in more detail before concluding whether all those instruments meet the criteria for amortised cost measurement under IFRS 9.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

#### **4. Adoption of new or revised standards and interpretations and new accounting pronouncements (continued)**

##### **Standards issued but not yet effective (continued)**

###### *(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 the unsecured nature of its loans and receivables, but it will need to perform a more detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact.

###### *(c) Hedge accounting*

The Group determined that all existing hedge relationships that are currently designated in effective hedging relationships will continue to qualify for hedge accounting under IFRS 9. The Group has chosen not to retrospectively apply IFRS 9 on transition to the hedges where the Group excluded the forward points from the hedge designation under IAS 39. As IFRS 9 does not change the general principles of how an entity accounts for effective hedges, applying the hedging requirements of IFRS 9 will not have a significant impact on Group's financial statements.

##### *IFRS 15 Revenue from Contracts with Customers*

IFRS 15 was issued in May 2014, and amended in April 2016, and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. Early adoption is permitted. The Group plans to adopt the new standard using the modified retrospective method by recognizing the cumulative transition effect in opening retained earnings on 1 January 2018, without restating comparative information. During 2016, the Group performed a preliminary assessment of IFRS 15, which was continued with more detailed analysis in 2017. The Group still analyses expected changes of IFRS 15 on shipment contracts.

To date, the Group has identified the following issues that require consideration:

###### *(a) Recording of revenue under the entitlement method*

Revenue from the production of oil and gas, in which the Group has an interest with other producers, is recognised based on the Group's working interest and the terms of the relevant PSAs. Differences between oil lifted and sold and the Group's share of production have historically been significant. The Group's accounting policy will be reviewed to assess whether the current practice of recording revenue based on entitlement rather than based on actual invoiced sales is in accordance with the requirements of IFRS 15.

###### *(b) Recording of revenue from PSAs*

The Group's entitlement to revenue from oil fields subject to PSA terms is governed by the PSA. As IFRS 15 only applies to revenue from contracts with customers, the Group will consider whether the PSAs are within the scope of IFRS 15.

###### *(c) Presentation and disclosure requirements*

The presentation and disclosure requirements in IFRS 15 are more detailed than under current IFRS. The presentation requirements represent a significant change from current practice and significantly increases the volume of disclosures required in the Group's financial statements. Many of the disclosure requirements in IFRS 15 are new and the Group expects that the notes to the financial statements will be expanded.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

#### 4. Adoption of new or revised standards and interpretations and new accounting pronouncements (continued)

##### 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 recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised 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. The Group will apply these amendments when they become effective.

##### *IFRS 2 Classification and Measurement of Share-based Payment Transactions – Amendments to IFRS 2*

The IASB issued amendments to IFRS 2 *Share-based Payment* that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. The amendments are effective for annual periods beginning on or after 1 January 2018, with early application permitted.

These amendments are not expected to have any impact on 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 recognise 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 recognise 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 recognise the amount of the re-measurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases. IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17. IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs. In 2018, the Group plans to assess the potential effect of IFRS 16 on its consolidated financial statements.



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

#### **4. Adoption of new or revised standards and interpretations and new accounting pronouncements (continued)**

##### **Standards issued but not yet effective (continued)**

###### *Transfers of Investment Property – Amendments to IAS 40*

The amendments clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. Entities should apply the amendments prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. An entity should reassess the classification of property held at that date and, if applicable, reclassify property to reflect the conditions that exist at that date. Retrospective application in accordance with IAS 8 is only permitted if it is possible without the use of hindsight. Effective for annual periods beginning on or after 1 January 2018. Early application of the amendments is permitted and must be disclosed. The Group will apply amendments when they become effective. However, since Group's current practice is in line with the clarifications issued, the Groups does not expect any effect on its consolidated financial statements.

#### **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 organised into business units and subsidiaries based on their products and services and has four reportable segments as follows:

- ▶ Oil and gas – representing extraction of oil and gas products;
- ▶ Refining – representing refining of crude oil and gas condensate;
- ▶ Construction – representing construction of administrative premises and assets for extraction of oil and gas condensate;
- ▶ Sales and distribution – representing transportation and marketing of crude oil, natural gas, oil products and gas condensate.

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

The Group's segments are strategic business units and subsidiaries that focus on different customers. Management monitors the operating results of its business units and subsidiaries 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.

Management evaluates performance of each segment based on profit after tax.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 5. Segment information (continued)

### Information about reportable segment profit or loss, assets and liabilities

Segment information for the reportable segments for the year ended 31 December 2017 is set out below:

	Oil and gas	Refining	Construc- tion	Sales and distribu- tion	Unalloca- ted (*)	Adjust- ments and elimina- tions (**)	Total
<b>2017</b>							
Revenues							
External customers	2,052	4,979	1,000	84,523	17	–	<b>92,571</b>
Inter-segment	2,260	583	581	18,815	450	(22,689)	<b>–</b>
<b>Total revenue</b>	<b>4,312</b>	<b>5,562</b>	<b>1,581</b>	<b>103,338</b>	<b>467</b>	<b>(22,689)</b>	<b>92,571</b>
Other operating income	472	49	17	359	167	(115)	<b>949</b>
Finance income	11	126	–	118	1,467	(1,605)	<b>117</b>
Foreign exchange gains/(losses) (net)	(37)	(66)	22	106	187	(102)	<b>110</b>
Raw materials and consumables used	(876)	(3,896)	(295)	(101,166)	(87)	21,575	<b>(84,745)</b>
Depreciation of property, plant and equipment	(515)	(177)	(116)	(216)	(75)	34	<b>(1,065)</b>
Wages, salaries and social security costs	(198)	(305)	(242)	(461)	(226)	113	<b>(1,319)</b>
Transportation and vehicle maintenance	(377)	(26)	(133)	(518)	(34)	411	<b>(677)</b>
Repairs and maintenance expenses	(257)	(12)	(131)	(43)	(9)	174	<b>(278)</b>
Impairment of property, plant and equipment	(431)	(1)	(31)	(5)	–	–	<b>(468)</b>
Mining tax	(123)	–	–	–	–	–	<b>(123)</b>
Utilities expense	(17)	(229)	(2)	(91)	(3)	1	<b>(341)</b>
Taxes other than on income	(63)	(27)	(3)	(27)	(79)	1	<b>(198)</b>
Amortization expense	(1)	(15)	–	(18)	(8)	1	<b>(41)</b>
Impairment of trade and other receivables and other financial assets	(2)	(3)	(1)	(232)	(1)	–	<b>(239)</b>
Change in other provisions for liabilities and charges	19	3	3	(1)	(13)	–	<b>11</b>
Other	(336)	(191)	(589)	(475)	(195)	422	<b>(1,364)</b>
Gains/(losses) on disposals of property, plant and equipment	42	(11)	(2)	(12)	(43)	–	<b>(26)</b>
Finance cost	(91)	(155)	(26)	(231)	(636)	249	<b>(890)</b>
Social expenses	(13)	(11)	(3)	(6)	(92)	–	<b>(125)</b>
Share of result of joint ventures	9	388	90	3	33	–	<b>523</b>
Share of result of associates	–	–	–	135	(1)	–	<b>134</b>
Income tax expense	(221)	(125)	(21)	(85)	28	–	<b>(424)</b>
<b>Net profit/(loss) for the year</b>	<b>1,307</b>	<b>878</b>	<b>118</b>	<b>472</b>	<b>847</b>	<b>(1,530)</b>	<b>2,092</b>

(\*) These numbers include unallocated revenues and expenses related to research and development, IT, security and other functions that are not managed at the group level.

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

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

**5. Segment information (continued)****Information about reportable segment profit or loss, assets and liabilities (continued)**

	Oil and gas	Refining	Construc- tion	Sales and distribu- tion	Unalloca- ted (*)	Adjust- ments and elimina- tions (**)	Total
Investments in associates	–	–	–	4,555	16	–	<b>4,571</b>
Investments in joint ventures	33	4,697	238	4	50	–	<b>5,022</b>
Other reportable segment assets	21,582	10,436	2,290	21,637	16,559	(20,750)	<b>51,754</b>
<b>Total reportable segment assets</b>	<b>21,615</b>	<b>15,133</b>	<b>2,528</b>	<b>26,196</b>	<b>16,625</b>	<b>(20,750)</b>	<b>61,347</b>
Other reportable segment liabilities	(9,092)	(7,437)	(1,523)	(22,523)	(12,840)	14,043	<b>(39,372)</b>
<b>Total reportable segment liabilities</b>	<b>(9,092)</b>	<b>(7,437)</b>	<b>(1,523)</b>	<b>(22,523)</b>	<b>(12,840)</b>	<b>14,043</b>	<b>(39,372)</b>
<b>Capital expenditure (***)</b>							
Additions – business units, JV and associates	716	1,030	37	339	170	(43)	<b>2,249</b>
Additions – subsidiaries	1,062	1,610	58	534	3	–	<b>3,267</b>
Acquisition of additional interest in ACG PSA (Note 40)	3,059	–	–	–	–	–	<b>3,059</b>
Acquisition of 80 per cent interest in UBEP (Note 40)	506	–	–	–	–	–	<b>506</b>
<b>Total capital expenditures</b>	<b>5,343</b>	<b>2,640</b>	<b>95</b>	<b>873</b>	<b>173</b>	<b>(43)</b>	<b>9,081</b>

(\*) These numbers include unallocated assets and liabilities related to research and development, IT, security and other functions that are not managed 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, deferred tax assets and post-employment benefit assets.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 5. Segment information (continued)

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

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

	Oil and gas	Refining	Construc- tion	Sales and distribu- tion	Unalloca- ted (*)	Adjust- ments and elimina- tions (**)	Total
<b>2016</b>							
Revenues							
External customers	1,808	3,069	1,518	45,488	22	–	<b>51,905</b>
Inter-segment	1,881	301	416	16,867	428	(19,893)	<b>–</b>
<b>Total revenue</b>	<b>3,689</b>	<b>3,370</b>	<b>1,934</b>	<b>62,355</b>	<b>450</b>	<b>(19,893)</b>	<b>51,905</b>
Other operating income	(1)	30	401	192	139	(64)	<b>697</b>
Finance income	10	160	1	34	543	(559)	<b>189</b>
Foreign exchange losses (net)	(12)	(106)	(69)	(107)	(689)	(301)	<b>(1,284)</b>
Raw materials and consumables used	(666)	(2,082)	(247)	(60,118)	(55)	18,903	<b>(44,265)</b>
Depreciation of property, plant and equipment	(507)	(147)	(119)	(203)	(78)	40	<b>(1,014)</b>
Wages, salaries and social security costs	(183)	(248)	(271)	(468)	(221)	94	<b>(1,297)</b>
Transportation and vehicle maintenance	(349)	(15)	(116)	(523)	(44)	333	<b>(714)</b>
Repairs and maintenance expenses	(151)	(6)	(121)	(44)	(5)	138	<b>(189)</b>
Impairment of property, plant and equipment	(144)	(37)	(138)	(3)	–	–	<b>(322)</b>
Mining tax	(103)	–	–	–	–	–	<b>(103)</b>
Utilities expense	(13)	(216)	(2)	(75)	(3)	2	<b>(307)</b>
Taxes other than on income	(73)	(10)	(3)	(26)	(66)	–	<b>(178)</b>
Amortization expense	–	(15)	–	(20)	(5)	–	<b>(40)</b>
Impairment of trade and other receivables and other financial assets	(4)	(75)	–	(407)	(7)	–	<b>(493)</b>
Change in other provisions for liabilities and charges	(3)	(3)	(9)	(3)	–	–	<b>(18)</b>
Other	(427)	(314)	(508)	(671)	(320)	656	<b>(1,584)</b>
Gains/(losses) on disposals of property, plant and equipment	47	(3)	(2)	(7)	(69)	–	<b>(34)</b>
Finance cost	(75)	(218)	(23)	(156)	(449)	80	<b>(841)</b>
Social expenses	(9)	(6)	(3)	(7)	(123)	–	<b>(148)</b>
Share of result of joint ventures	(55)	752	34	5	31	–	<b>767</b>
Share of result of associates	–	–	–	190	19	–	<b>209</b>
Income tax expense	(237)	(14)	(182)	(5)	(148)	–	<b>(586)</b>
<b>Net profit/(loss) for the year</b>	<b>734</b>	<b>797</b>	<b>557</b>	<b>(67)</b>	<b>(1,100)</b>	<b>(571)</b>	<b>350</b>

(\*) These numbers include unallocated revenues and expenses related to research and development, IT, security and other functions that are not managed at the group level.

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

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 5. Segment information (continued)

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

	Oil and gas	Refining	Construc- tion	Sales and distribu- tion	Unalloca- ted (*)	Adjust- ments and elimina- tions (**)	Total
Investments in associates	–	–	–	4,410	32	–	4,442
Investments in joint ventures	333	3,900	218	54	50	–	4,555
Other reportable segment assets	15,935	8,157	2,766	20,711	14,194	(17,753)	44,010
<b>Total reportable segment assets</b>	<b>16,268</b>	<b>12,057</b>	<b>2,984</b>	<b>25,175</b>	<b>14,276</b>	<b>(17,753)</b>	<b>53,007</b>
Other reportable segment liabilities	(7,121)	(5,712)	(1,715)	(21,795)	(11,111)	12,151	(35,303)
<b>Total reportable segment liabilities</b>	<b>(7,121)</b>	<b>(5,712)</b>	<b>(1,715)</b>	<b>(21,795)</b>	<b>(11,111)</b>	<b>12,151</b>	<b>(35,303)</b>
<b>Capital expenditure (***)</b>							
Additions – business units, JV and associates	561	693	44	994	105	(20)	2,377
Additions – subsidiaries	904	974	372	247	10	–	2,507
<b>Total capital expenditures</b>	<b>1,465</b>	<b>1,667</b>	<b>416</b>	<b>1,241</b>	<b>115</b>	<b>(20)</b>	<b>4,884</b>

(\*) These numbers include unallocated assets and liabilities related to research and development, IT, security and other functions that are not managed 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, deferred tax assets and post-employment benefit assets.

### Geographical information

Revenues for each individual country for which the revenues are material are reported separately as follows:

	2017	2016
Switzerland	78,633	40,438
Azerbaijan	5,382	5,171
Turkey	4,925	3,479
UAE	1,324	1,156
Georgia	1,185	1,046
Other	1,122	615
<b>Total consolidated revenues</b>	<b>92,571</b>	<b>51,905</b>

The analysis is based on the country of incorporation of the selling entity.

Non-current assets other than financial instruments, deferred tax assets, post-employment benefit assets and rights arising under insurance contracts for each individual country for which it is material is reported separately as follows:

	2017	2016
Azerbaijan	27,883	22,383
Turkey	7,595	6,949
Switzerland	1,030	856
Georgia	599	526
UAE	141	52
Other	204	267
<b>Total</b>	<b>37,452</b>	<b>31,033</b>

The analysis is based on location of assets.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 6. Financial risk management

### Financial risk factors

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

#### (i) Foreign exchange risk

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

The majority of the Group's borrowings and sales as well as receivables from foreign customers are denominated in USD.

The following table demonstrates the sensitivity to a reasonably possible change in the USD, JPY, EUR, TRY, GEL, CHF exchange rates, with all other variables held constant, of the Group's post-tax profit:

2017	Change in rates (+/-)	Effect on post-tax profit
USD/AZN	11.30%/-11.30%	(362)/362
JPY/AZN	1.02%/-1.02%	(1)/1
EUR/AZN	13.50%/-13.50%	(89)/89
GEL/AZN	1.53%/-1.07%	(1)/1
USD/TRY	10.00%/-10.00%	(124)/124
EUR/TRY	10.00%/-10.00%	(15)/15
USD/GEL	13.50%/-9.50%	(31)/22
EUR/USD	12.50%/-7.50%	(40)/24
USD/CHF	7.50%/-7.50%	1/(1)
GEL/USD	13.50%/-9.50%	3/(2)
2016	Change in rates (+/-)	Effect on post-tax profit
USD/AZN	20.00%/-20.00%	(438)/438
JPY/AZN	2.60%/-2.60%	(4)/4
EUR/AZN	20.00%/-20.00%	(117)/117
GEL/AZN	2.80%/-1.40%	(1)/1
USD/TRY	10.00%/-10.00%	(182)/182
EUR/TRY	10.00%/-10.00%	(8)/8
USD/GEL	14.00%/-7.00%	(42)/21
EUR/USD	10.00%/-10.00%	4/(4)
USD/CHF	8.00%/-8.00%	(27)/27
GEL/USD	1.75%/-1.05%	(3)/2

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

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 6. Financial risk management (continued)

### Financial risk factors (continued)

#### (ii) Commodity price risk

The Group is exposed to certain price risk due to volatility of oil market prices. Due to the risk the Group's management has developed and enacted a risk management strategy regarding oil price risk and its mitigation.

Based on forecasts about oil purchases and sales, the Group hedges the price using futures and sales contracts, options and contracts for difference.

The following sensitivity analysis is based upon derivative price exposures that existed at 31 December 2017, whereby if oil future prices had moved, as illustrated in the table below, with all other variables held constant, pre-tax profit after the impact of hedge accounting and equity would have been as follows:

	Change in year-end price	Effect on profit before tax	Effect on equity
2017	5%/(5%)	112/(112)	112/(112)
2016	5%/(5%)	47/(47)	47/(47)

#### (iii) Interest rate risk

The Group is subject to interest rate risk on financial liabilities and assets with variable interest rates. To mitigate this risk, the Group's management performs periodic analysis of the current interest rate environment and depending on that analysis management makes decisions whether it would be more beneficial to obtain financing on a fixed-rate or variable-rate basis. In case where the change in the current market fixed or variable interest rates is considered significant management may consider refinancing a particular debt on more favourable interest rate terms.

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

The floating rate for majority of interest bearing liabilities and assets exposes the Group to fluctuation in interest payments and receipts mainly due to changes in LIBOR and EURIBOR.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates on loans and borrowings, net of loans receivable:

	Increase/ decrease in basis points	Effect on post-tax profit
<b>2017</b>		
<b>Loans and borrowings, net of loans receivable</b>		
USD	+70/-8	27/(3)
EUR	+25/-1	1/(1)
<b>2016</b>		
<b>Loans and borrowings, net of loans receivable</b>		
USD	+60/-8	15/(2)
EUR	+12/-8	1/(1)



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 6. Financial risk management (continued)

### Credit risk and concentration of credit risk

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

The Group's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, including restricted cash, trade receivables and loans receivable.

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

	2017	2016
Cash and cash equivalents excluding cash on hand (Note 8)	5,205	4,148
Restricted cash	241	112
Deposits (Note 8)	218	1,039
Trade and other receivables	8,094	7,398
Available-for-sale investments (Note 10)	174	82
Other current assets	1,534	1,564
Other non-current financial assets	685	578
Financial guarantees given (Note 39)	1,171	604
<b>Total maximum exposure to credit risk</b>	<b>17,322</b>	<b>15,525</b>
Financial guarantees – amounts of guarantees of indebtedness of others (Note 39)	(976)	(580)
<b>Total exposure to credit risk net of guarantees received</b>	<b>16,346</b>	<b>14,945</b>

The Group places its cash with reputable financial institutions in the Azerbaijan Republic. The Group's cash is mainly placed with the International Bank of Azerbaijan ("IBA") which is controlled by the Azerbaijani Government. The balance of cash and cash equivalents and deposit held with the IBA at 31 December 2017 was AZN 1,505 (31 December 2016: AZN 1,154). The Group continually monitors the status of the banks where its accounts are maintained. In addition, the Group's restricted cash balance in the amount of AZN 24 (31 December 2016: AZN 9) is placed in Government treasury account.

Trade receivables consist primarily of balances with local and foreign customers, including related parties, for crude oil, oil products and natural gas sold. SOCAR has an obligation to secure uninterrupted supply of crude oil, oil products and natural gas to certain customers under control of the Azerbaijani Government, including such companies as Azerenergy OJSC, Azal CJSC and Azerbaijan State Caspian Shipping Company which operate important public infrastructure facilities in the Azerbaijan Republic. Actual settlement terms applicable to the Group's relationships with these customers are affected to a large extent by the social and economic policies of the Government of the Azerbaijan Republic. The Group's credit risk arising from its trade balance with private sector and other third-party unrelated customers is mitigated by continuous monitoring of their creditworthiness. Management of the Group believes that the Group is not exposed to high credit risk as the impairment provision has already been accrued in the accompanying consolidated financial statements for all debtors which are not expected to be recovered in a future.

As at 31 December 2017, letters of guarantee and bank guarantees in total amount of AZN 882 (TRY 1,960 million) (2016: AZN 749 (TRY 1,492 million)) were received from certain domestic and foreign customers of SOCAR Turkey Energy A.S ("STEAS").

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 6. Financial risk management (continued)

### Credit risk and concentration of credit risk (continued)

The Group categorized its financial assets as follows:

31 December 2017	Standard	Sub-standard	Past due but not impaired	Individually impaired
Cash and cash equivalents excluding cash on hand	3,700	1,505	–	–
Restricted cash	241	–	–	–
Deposits (Note 8)	218	–	–	–
Trade and other receivables	6,524	248	1,322	815
Available-for-sale investments (Note 10)	–	174	–	–
Other current assets	–	1,534	–	–
Other non-current financial assets	–	685	–	–
<b>Total</b>	<b>10,683</b>	<b>4,146</b>	<b>1,322</b>	<b>815</b>

31 December 2016	Standard	Sub-standard	Past due but not impaired	Individually impaired
Cash and cash equivalents excluding cash on hand	2,994	1,154	–	–
Restricted cash	112	–	–	–
Deposits (Note 8)	1,039	–	–	–
Trade and other receivables	5,571	195	1,632	588
Available-for-sale investments (Note 10)	–	82	–	–
Other current assets	–	1,564	–	–
Other non-current financial assets	–	578	–	–
<b>Total</b>	<b>9,716</b>	<b>3,573</b>	<b>1,632</b>	<b>588</b>

Standard grade represents receivables from borrowers having a minimal level of credit risk, normally with a credit rating on or close to sovereign level or very well collateralized. Sub-standard grade represented by receivables from other borrowers with good financial position and good debt service which are neither past due nor impaired.

### Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. In managing liquidity risk, the Group maintains adequate cash reserves and debt facilities, continuously monitors forecast and actual cash flows.

Prudent liquidity risk management includes maintaining sufficient working capital and the ability to close out market positions. Management monitors rolling forecasts of the Group's liquidity reserve on the basis of expected cash flows.

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

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 6. Financial risk management (continued)

### Liquidity risk (continued)

The maturity analysis of financial liabilities as of 31 December 2017 and 2016 is as follows:

<b>At 31 December 2017</b>	<b>Less than 3 months</b>	<b>3-12 months</b>	<b>1-5 years</b>	<b>More than 5 years</b>	<b>Total</b>
Trade and other financial payables	11,974	–	–	–	<b>11,974</b>
Deferred acquisition consideration payable	–	147	–	–	<b>147</b>
Other current liabilities	–	653	–	–	<b>653</b>
Interest bearing borrowings	4,517	1,884	6,496	5,642	<b>18,539</b>
Other non-current liabilities	–	–	624	52	<b>676</b>
Put option liabilities	–	–	3,337	–	<b>3,337</b>
Financial guarantees given	–	–	1,171	–	<b>1,171</b>
<b>Total undiscounted financial liabilities</b>	<b>16,491</b>	<b>2,684</b>	<b>11,628</b>	<b>5,694</b>	<b>36,497</b>

<b>At 31 December 2016</b>	<b>Less than 3 months</b>	<b>3-12 months</b>	<b>1-5 years</b>	<b>More than 5 years</b>	<b>Total</b>
Trade and other financial payables	9,272	–	–	–	<b>9,272</b>
Deferred acquisition consideration payable	–	153	–	–	<b>153</b>
Other current liabilities	–	1,052	–	–	<b>1,052</b>
Interest bearing borrowings	5,351	1,566	4,330	5,671	<b>16,918</b>
Other non-current liabilities	–	–	397	–	<b>397</b>
Put option liabilities	–	–	3,469	–	<b>3,469</b>
Financial guarantees given	–	–	604	–	<b>604</b>
<b>Total undiscounted financial liabilities</b>	<b>14,623</b>	<b>2,771</b>	<b>8,800</b>	<b>5,671</b>	<b>31,865</b>

### Capital management

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

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

	<b>2017</b>	<b>2016</b>
Total borrowings (Note 21)	15,511	14,927
Total equity attributable to the Group's equity holders	20,605	16,447
Less: cash and cash equivalents (Note 8)	(5,217)	(4,163)
<b>Total capital under management</b>	<b>30,899</b>	<b>27,211</b>

The Group is periodically mandated to contribute to the state budget and finance various projects undertaken by the Government of the Azerbaijan Republic. There were no changes to the Group's approach to capital management during the year.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 6. Financial risk management (continued)

### Fair value of financial instruments

The fair value of the financial assets and liabilities is included at 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.

<b>31 December 2017</b>			
	<table> <tr> <th>Carrying amounts</th><th>Fair values</th></tr> </table>	Carrying amounts	Fair values
Carrying amounts	Fair values		
Cash and cash equivalents (Note 8)	5,217 5,217		
Deposits (Note 8)	218 218		
Restricted cash	265 265		
Trade and other receivables	8,094 8,094		
Available-for-sale investments (Note 10)	174 174		
Other current assets	1,534 1,534		
Other non-current financial assets	685 618		
<b>Total financial assets</b>	<b>16,187 16,120</b>		
Trade and other payables (Note 20)	(11,974) (11,974)		
Other current liabilities (Note 26)	(653) (653)		
Short-term borrowings and current portion of long-term borrowings (Note 21)	(5,998) (5,998)		
Long-term borrowings (Note 21)	(9,513) (9,279)		
Deferred acquisition consideration payable	(147) (147)		
Other non-current liabilities	(647) (543)		
Put option liabilities (Note 36)	(2,719) (2,719)		
<b>Total financial liabilities</b>	<b>(31,651) (31,313)</b>		

  

<b>31 December 2016</b>			
	<table> <tr> <th>Carrying amounts</th><th>Fair values</th></tr> </table>	Carrying amounts	Fair values
Carrying amounts	Fair values		
Cash and cash equivalents (Note 8)	4,163 4,163		
Deposits (Note 8)	1,039 1,039		
Restricted cash	121 121		
Trade and other receivables	7,398 7,398		
Available-for-sale investments (Note 10)	82 82		
Other current assets	1,564 1,564		
Other non-current financial assets	578 553		
<b>Total financial assets</b>	<b>14,945 14,920</b>		
Trade and other payables (Note 20)	(9,272) (9,272)		
Other current liabilities (Note 26)	(1,052) (1,052)		
Short-term borrowings and current portion of long-term borrowings (Note 21)	(6,717) (6,717)		
Long-term borrowings (Note 21)	(8,210) (7,996)		
Deferred acquisition consideration payable	(153) (153)		
Other non-current liabilities	(368) (336)		
Put option liabilities (Note 36)	(2,832) (2,832)		
<b>Total financial liabilities</b>	<b>(28,604) (28,358)</b>		

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 6 Financial risk management (continued)

### Fair value of financial instruments (continued)

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, individual creditworthiness of customers and the risk characteristics of the financed project.

### Fair value hierarchy

The following table provides the fair value measurement hierarchy of the Group's assets and liabilities as at 31 December 2017:

	Total	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets measured at fair value</b>				
Other current assets	689	8	681	–
Available-for-sale investments	174	174	–	–
<b>Liabilities measured at fair value</b>				
Other current liabilities	(593)	(200)	(393)	–
Other non-current liabilities	(138)	–	(138)	–
<b>Assets for which fair value are disclosed</b>				
Cash and cash equivalents	5,217	5,217	–	–
Restricted cash	265	265	–	–
Deposits	218	–	–	218
Trade and other receivables	8,094	–	–	8,094
Other current assets	845	–	–	845
Other non-current financial assets	618	–	–	618
<b>Liabilities for which fair values are disclosed</b>				
Trade and other payables	(11,974)	–	–	(11,974)
Other current liabilities	(60)	–	–	(60)
Short-term borrowings and current portion of long-term borrowings	(5,998)	–	–	(5,998)
Long-term borrowings	(9,279)	–	–	(9,279)
Deferred acquisition consideration payable	(147)	–	–	(147)
Other non-current liabilities	(405)	–	–	(405)
Put option liabilities	(2,719)	–	–	(2,719)

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 6 Financial risk management (continued)

### Fair value hierarchy (continued)

The following table provides the fair value measurement hierarchy of the Group's assets and liabilities as at 31 December 2016:

	Total	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>Assets measured at fair value</b>				
Other current assets	444	18	426	–
Available-for-sale investments	82	82	–	–
<b>Liabilities measured at fair value</b>				
Other current liabilities	(1,017)	(539)	(478)	–
<b>Assets for which fair value are disclosed</b>				
Cash and cash equivalents	4,163	4,163	–	–
Restricted cash	121	121	–	–
Deposits	1,039	–	–	1,039
Trade and other receivables	7,398	–	–	7,398
Other current assets	1,120	–	–	1,120
Other non-current financial assets	553	–	–	553
<b>Liabilities for which fair values are disclosed</b>				
Trade and other payables	(9,272)	–	–	(9,272)
Other current liabilities	(35)	–	–	(35)
Short-term borrowings and current portion of long-term borrowings	(6,717)	–	–	(6,717)
Long-term borrowings	(7,996)	–	–	(7,996)
Deferred acquisition consideration payable	(153)	–	–	(153)
Other non-current liabilities	(336)	–	–	(336)
Put option liabilities	(2,832)	–	–	(2,832)

There were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into or out of Level 3 fair value measurements during 2017 and 2016.

## 7. Balances and transactions with related parties

### Transactions outside the entity's normal course of business

On 28 April 2017 the Group entered into sales and purchase agreement ("SPA") with Aqrarkredit CJSC, state-owned bank to purchase Methanol Plant ("the Plant") which did not constitute a business. According to SPA, total consideration amount of the Plant was AZN 810 out of which AZN 666 was immediately payable. Payment of remaining portion in the amount of AZN 144 is deferred over 28 years with interest rate of 0.16 per cent per annum. The Group's accounting policy is to recognize property, plant and equipment ("PPE") purchased in the transaction under common control of the Government at cost. Therefore, the Group recognized the Plant at cost of AZN 726 which is sum of cash paid in the amount of AZN 644, the amount which is immediately payable in the amount of AZN 22 and present value of deferred consideration in the amount of AZN 60. The Group calculated present value of deferred consideration by discounting future expected cash outflows using market rate of 8.15 per cent.

### Key management compensation

Key management of the Group includes the President of SOCAR and its twelve Vice-Presidents. All of the Group's key management are appointed by the President of the Azerbaijan Republic. Key management individuals are entitled to salaries and benefits of SOCAR in accordance with the approved payroll matrix as well as to compensation for serving as members of the Boards of directors for certain Group companies. During 2017, compensation of key management personnel totalled to AZN 1.153 (2016: AZN 0.717).

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 7. Balances and transactions with related parties (continued)

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

At 31 December 2017, the outstanding balances with related parties were as follows:

	Note	Government and entities under government control	Associates, joint ventures
Gross amount of trade receivables		151	127
Impairment provisions for trade and other receivables		(99)	(2)
Other receivables		–	13
Other non-current financial assets		–	250
Cash and cash equivalents		1,529	–
Restricted cash		234	–
VAT and other taxes receivable		534	–
Advances received		(100)	–
Advances received for the sale of shares	35	–	(4,076)
Borrowings from IBA (at fixed rates varying from 3 to 4 per cent)		(326)	–
Borrowings from the Ministry of Finance of Azerbaijan Republic		(1,194)	–
Deferred consideration payable for Methanol Plant		(62)	–
Bond payable to Azerbaijan Investment Company ("AIC")		(157)	–
Trade and other payables		(248)	(1,457)
Taxes payable to State Oil Fund of Azerbaijan Republic ("SOFAZ")	22	(255)	–
Bond payable to SOFAZ		(784)	–
Other payables to SOFAZ		(1,902)	–
Taxes payable		(86)	–

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

	Note	Government and entities under government control	Associates and joint ventures
Sales of natural gas		673	180
Sales of oil products		479	9
Service rendered		3	120
Interest on loans due to related parties		(67)	–
Corporate income tax		(264)	–
Excise tax	29	(440)	–
Price margin tax		(177)	–
Mining tax	30	(123)	–
Other taxes		(426)	–
Utilities costs		(64)	(3)
Other operating expenses		(28)	(15)
Other operating income		250	–
Social security deductions		(134)	–
Social expenses		(29)	–
Transportation expenses		(104)	(292)
Ecology service and environmental security		–	(1)
Security expenses		(10)	–
Purchases of PPE and inventory		(9,069)	(691)
Dividends received from joint ventures	18	–	147
Dividends received from associates	19	–	104

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 7. Balances and transactions with related parties (continued)

At 31 December 2016, the outstanding balances with related parties were as follows:

	Note	Government and entities under government control	Associates, joint ventures
Gross amount of trade receivables		399	68
Impairment provisions for trade and other receivables		(83)	–
Other receivables		–	86
Other current assets		–	10
Other non-current financial assets		–	105
Cash and cash equivalents		1,163	–
Restricted cash		27	–
Deposit		3	–
VAT and other taxes receivable		567	–
Advances received		(164)	–
Advances received for the sale of shares	35	–	(2,897)
Borrowings from IBA (at fixed rates varying from 3 to 4 per cent)		(1,303)	–
Borrowings from the Ministry of Finance of Azerbaijan Republic		(177)	–
Bond payable to AIC		(158)	–
Trade and other payables		(125)	(985)
Taxes payable to SOFAZ	22	(266)	–
Bond payable to SOFAZ		(889)	–
Other payables to SOFAZ		(1,083)	–
Taxes payable		(74)	–

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

	Note	Government and entities under government control	Associates and joint ventures
Sales of natural gas		349	150
Sales of oil products		362	22
Sales of crude oil		–	4
Service rendered		2	324
Interest income on deposits		1	–
Interest on loans due to related parties		(51)	–
Corporate income tax		(266)	–
Excise tax	29	(423)	–
Price margin tax		(175)	–
Mining tax	30	(103)	–
Other taxes		(337)	–
Utilities costs		(51)	(5)
Other operating expenses		(42)	(12)
Social security deductions		(126)	–
Social expenses		(50)	–
Transportation expenses		(85)	(255)
Ecology service and environmental security		–	(2)
Security expenses		(10)	–
Purchases of PPE and inventory		(7,187)	(827)
Dividends received from joint ventures	18	–	102
Dividends received from associates	19	–	88



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 7. Balances and transactions with related parties (continued)

### Terms and conditions of transactions with related parties

The sales to and purchases from the Government and entities under government control are made at prices regulated by the Azerbaijani Government. Outstanding balances at the year-end are unsecured and settlement occurs in cash. There have been no guarantees provided for any related party receivables or payables.

## 8. Cash and cash equivalents and deposits

	2017	2016
USD denominated bank balances	4,167	2,594
AZN denominated bank balances	461	718
TRY denominated bank balances	213	249
CHF denominated bank balances	129	137
EUR denominated bank balances	100	378
Other denominated bank balances	135	72
Cash on hand	12	15
<b>Total cash and cash equivalents</b>	<b>5,217</b>	<b>4,163</b>

Included in AZN denominated bank balances as at 31 December 2017 are three call deposits in total amount of AZN 34 placed with Xalq Bank. Interest rate on these deposits for the year ended 31 December 2017 equalled 3 per cent.

At 31 December 2016, a call deposit of AZN 21 placed with Xalq Bank. Interest rate on this deposit for the year ended 31 December 2016 equalled 3 per cent.

### Deposits

At 31 December 2017, term deposits included placements in the total amount of AZN 218 with maturity ranging from six months to one year, under fixed contractual interest rates ranging from 1 per cent to 6 per cent per annum.

At 31 December 2016, term deposits included placements in the amount of AZN 1,039 with maturity ranging from three months to one year, under fixed contractual interest rates ranging from 2.5 per cent to 6 per cent per annum.

All the bank balances in the amount of AZN 5,205 (31 December 2016: AZN 4,148) and deposits in the amount of AZN 218 (31 December 2016: AZN 1,039) are neither past due nor impaired.

## 9. Restricted cash

At 31 December 2017, restricted cash was mainly represented by three cash collateral accounts. The Group has restricted cash in the amount of AZN 129 in International Bank of Azerbaijan (31 December 2016: nil) as a collateral for the foreign purchases related to modernization process of Azerkimya plant. In addition, the Group has restricted cash in the amount of AZN 63 (USD 37 million) in Deutsche Bank (31 December 2016: AZN 66) as a guarantee of minimum return payments payable to Goldman Sachs International ("GSI") according to the Put Option Agreement in relation to 13 percent shares of STEAS. The Group also had account in the amount of AZN 10 (31 December 2016: AZN 19) which held as collateral for the letter of credit.

## 10. Available-for-sale investments

At 31 December 2017, available-for-sale investments were represented by quoted equity instruments in the amount of AZN 174 (31 December 2016: AZN 82).

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 11. Trade and other receivables

	2017	2016
Trade receivables	8,647	7,764
Less impairment loss provision	(801)	(570)
<b>Total trade receivables</b>	<b>7,846</b>	<b>7,194</b>
VAT recoverable	967	672
Prepayments	771	364
Other receivables	192	216
Receivables for underlift of oil	127	109
Other taxes receivable	119	81
Less impairment loss provision (other receivables)	(15)	(18)
<b>Total trade and other receivables</b>	<b>10,007</b>	<b>8,618</b>

Trade receivables are mainly represented by receivables from sales of crude oil, oil products and natural gas sold to customers of the Group. The Group does not hold any collateral as security, except as described further in this note. At 31 December 2017 financial receivables of AZN 5,928 (31 December 2016: AZN 6,806) were denominated in foreign currencies, mainly in USD.

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

Movements of the provision for impairment of trade and other receivables are as follows:

	2017	2016
<b>At 1 January</b>	<b>588</b>	<b>294</b>
Net change in provision charged to profit and loss	239	293
Translation to presentation currency	(11)	1
<b>At 31 December</b>	<b>816</b>	<b>588</b>

The impaired receivables mainly relate to overdue debts (in excess of 360 days) for oil, natural gas and oil products supplied to state-owned entities.

An analysis of the age of financial assets that are past due, but not impaired:

	2017	2016
1-30 days overdue	892	950
1-3 months overdue	160	192
Over 3 months overdue	270	490
<b>Total overdue receivables</b>	<b>1,322</b>	<b>1,632</b>

At 31 December 2017, trade receivables of AZN 1,322 (31 December 2016: AZN 1,632) were past due. The Group had overdue receivable from Azerenergy OJSC in the amount of AZN 254 as at 31 December 2016. In 2017 Azerenergy OJSC issued two state guaranteed promissory notes with total value of AZN 258 in a favour of the Group for the repayment of outstanding debts, which were fully repaid as at 31 December 2017.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 12. Inventories

	2017	2016
Goods in transit	2,526	1,459
Finished goods	1,188	883
Raw materials and spare parts	547	374
Crude oil	395	2,134
Work in progress	124	97
Other	30	21
<b>Total inventories</b>	<b>4,810</b>	<b>4,968</b>

The Group acquired inventory with fair value of AZN 84 as part of acquisition of additional 13.35 per cent interest in ACG PSA (Note 40).

## 13. Other current assets

### Other current financial assets

At 31 December 2017 and 2016, other current financial assets mainly comprised of loan receivables from third parties, derivative instruments and receivables from PSA parties.

At 31 December 2017, the Group had short-term loan receivables from third parties in the amount of AZN 12 (31 December 2016: AZN 16).

At 31 December 2017, the Group had balances related to margin deposits and financial derivatives in the amount of AZN 917 (31 December 2016: AZN 1,528).

Based on amended and restated ACG PSA agreement, on 20 November 2017 the Group acquired additional participation interest of 13.35 per cent in ACG PSA (Note 40). ACG PSA Contractor Parties signed "AzACG ATD" on 14 September 2017 and agreed to compensate the Group for the difference between its initial participating interest of 11.65 per cent and adjusted participating interest of 25 per cent related to 2017 activities. As a result, the Group recognized receivables from ACG PSA Contractor Parties in the amount of AZN 578 (USD 339 million).

### Disposal group held for sale

According to sale and purchase agreement subject to certain conditions and dated on 27 December 2017, the Group agreed to sell its 50 per cent ownership interest in and loan receivable from its joint venture, SOCAR Aurora Terminal ("SATSA"), to Global Terminal Holding B LP for the total consideration of AZN 80 (USD 47 million) effective from 10 January 2018 (Note 42). At 31 December 2017, investment in joint venture and loan receivable balances of SATSA were classified as disposal group held for sale. Disposal group was recognized at the lower of carrying value and fair value less cost to sell as at 31 December 2017 and impairment loss from re-measurement to fair value was charged to profit or loss:

Carrying value of investment in SATSA at transaction date	51
Carrying value of long-term receivable at transaction date	43
<b>Total</b>	<b>94</b>
Fair value of disposal group	80
<b>Impairment loss</b>	<b>14</b>

## 14. Other non-current assets

At 31 December 2017, other non-current assets were mainly represented by long-term prepayments for purchase of property, plant and equipment in the amount of AZN 1,033 (31 December 2016: AZN 733), long-term prepaid expenses in the amount of AZN 34 (31 December 2016: AZN 28), net defined benefit assets in the amount of AZN 27 (31 December 2016: AZN 5).

At 31 December 2016, other non-current assets were also represented by advances for vessel hire in the amount of AZN 35, long-term VAT receivable in the amount of AZN 62, which were mainly utilized during 2017.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

## **15. Other non-current financial assets**

At 31 December 2017 and 2016, other non-current financial assets mainly comprised of loan receivables from third parties and related parties, long-term deposit and derivative instruments.

At 31 December 2017, carrying value of loan receivables from third parties equalled to AZN 12 (31 December 2016: AZN 186).

At 31 December 2016, the loan with the carrying value of AZN 157 was secured by certain assets pledged by the borrower. In 2017, due to financial and legal difficulties faced by borrower, the Group concluded that total loan balance of AZN 157 was not recoverable and created provision for the full amount.

During 2017, the Group provided loan to its joint venture in the amount of AZN 170 with the interest rate of 3 per cent per annum with maturity date in 2023. Nominal interest rate of the loan was equal to market rate at inception date. At 31 December 2017 carrying value of this loan equalled to AZN 170.

In addition, during 2017, the Group provided loan to its associate in the amount of AZN 71 with the interest rate of 6 per cent per annum with maturity date in 2034. Nominal interest rate of the loan was equal to market rate at inception date. At 31 December 2017 the carrying value of this receivable equalled to AZN 71.

As mentioned in Note 13, in December 2017 the Group decided to sell loan receivable from its JV (SATSA) to a third party with carrying value of AZN 43. The loan balance was classified as disposal group held for sale as at 31 December 2017.

At 31 December 2016, carrying value of loan receivables from other related parties equalled to AZN 63, bearing annual interest rate within range of 4-4.785 per cent.

At 31 December 2017, the Group also had long-term deposit contracts with two banks in the amount of AZN 54 (31 December 2016: AZN 53).

The Group has entered into a series of commodity swaps, commodity futures and foreign exchange futures to hedge risks. At 31 December 2017 the Group recognized unrealized fair value gains on physical positions in the amount of AZN 345 (2016: AZN 203), which is result of the asset on fair value hedge accounting for the one of the Group's gas supply contract. The fair value was determined based on the difference between the market value and contracted fixed value of buy and sell contracts.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 16. Property, plant and equipment

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

	Buildings and constructions	Oil & gas properties and equipment	Plant and machinery	Vessels and port facilities	Other	Development costs	Construction in progress	Total
<b>Cost</b>								
<b>At 1 January 2016</b>	<b>2,415</b>	<b>15,071</b>	<b>3,459</b>	<b>75</b>	<b>1,633</b>	<b>1,837</b>	<b>2,596</b>	<b>27,086</b>
Additions	589	672	111	137	80	551	1,283	3,423
Disposals	(17)	(35)	(36)	–	(11)	–	(16)	(115)
Transfers	32	626	134	258	26	–	(1,076)	–
Translation to presentation currency	144	936	(78)	3	(13)	307	45	1,344
<b>At 31 December 2016</b>	<b>3,163</b>	<b>17,270</b>	<b>3,590</b>	<b>473</b>	<b>1,715</b>	<b>2,695</b>	<b>2,832</b>	<b>31,738</b>
Additions	78	1,070	800	322	33	484	1,585	4,372
Acquisition of additional interest in ACG PSA (Note 40)	–	3,059	–	–	–	–	–	3,059
PPE related to 80 per cent interest in UBEP (Note 40)	–	401	–	–	–	–	–	401
Disposals	(63)	(30)	(43)	(4)	(29)	–	(32)	(201)
Transfers	447	285	286	41	(5)	(11)	(1,043)	–
Translation to presentation currency	(99)	(336)	(151)	(20)	(90)	(113)	(80)	(889)
<b>At 31 December 2017</b>	<b>3,526</b>	<b>21,719</b>	<b>4,482</b>	<b>812</b>	<b>1,624</b>	<b>3,055</b>	<b>3,262</b>	<b>38,480</b>
<b>Depreciation and impairment</b>								
<b>At 1 January 2016</b>	<b>(779)</b>	<b>(6,606)</b>	<b>(1,535)</b>	<b>(7)</b>	<b>(633)</b>	<b>–</b>	<b>(290)</b>	<b>(9,850)</b>
Depreciation charge for the year	(126)	(555)	(277)	(2)	(93)	–	–	(1,053)
Disposal	4	26	28	–	6	–	2	66
Impairment	(141)	(74)	–	–	–	–	(107)	(322)
Transfers	1	(3)	1	–	1	–	–	–
Translation to presentation currency	(57)	(405)	24	–	(25)	–	–	(463)
<b>At 31 December 2016</b>	<b>(1,098)</b>	<b>(7,617)</b>	<b>(1,759)</b>	<b>(9)</b>	<b>(744)</b>	<b>–</b>	<b>(395)</b>	<b>(11,622)</b>
Depreciation charge for the year	(134)	(568)	(299)	(37)	(65)	–	–	(1,103)
Disposal	43	25	25	1	25	–	–	119
Impairment	(68)	(394)	–	–	(2)	–	(4)	(468)
Transfers	7	(5)	(1)	–	(1)	–	–	–
Translation to presentation currency	34	143	69	–	17	–	–	263
<b>At 31 December 2017</b>	<b>(1,216)</b>	<b>(8,416)</b>	<b>(1,965)</b>	<b>(45)</b>	<b>(770)</b>	<b>–</b>	<b>(399)</b>	<b>(12,811)</b>
<b>Net book value</b>								
<b>At 1 January 2016</b>	<b>1,636</b>	<b>8,465</b>	<b>1,924</b>	<b>68</b>	<b>1,000</b>	<b>1,837</b>	<b>2,306</b>	<b>17,236</b>
<b>At 31 December 2016</b>	<b>2,065</b>	<b>9,653</b>	<b>1,831</b>	<b>464</b>	<b>971</b>	<b>2,695</b>	<b>2,437</b>	<b>20,116</b>
<b>At 31 December 2017</b>	<b>2,310</b>	<b>13,303</b>	<b>2,517</b>	<b>767</b>	<b>854</b>	<b>3,055</b>	<b>2,863</b>	<b>25,669</b>

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 16. Property, plant and equipment (continued)

During 2017, the Group capitalized finance costs in the amount of AZN 77 which was directly attributable to the construction and production of assets (31 December 2016: AZN 36).

At 31 December 2017, the Group's impairment charge is mainly represented by write-down of investments in the non-profitable oil fields in the amount of AZN 391 (2016: AZN 154) and impairment of carrying value of the Group's drilling rig in the amount of AZN 31 (2016: AZN 137). Recoverable amounts of oil fields and drilling rig were nil (2016: nil) and AZN 7 (2016: AZN 46), respectively. The Group does not expect future economic benefits from non-profitable fields. Recoverable amount of drilling rig is determined as fair value less cost to sell. Impaired oil fields and drilling rig relates to oil and gas and construction segments, respectively.

## 17. Intangible assets other than goodwill

Movement of intangible assets other than goodwill and related accumulated amortization was as follows:

	Land and property rights	Water rights	Trade name	Customer relation- ship	Licence	Other intangible assets	Total
<b>Cost</b>							
<b>At 1 January 2016</b>	<b>191</b>	<b>204</b>	<b>39</b>	<b>324</b>	–	<b>158</b>	<b>916</b>
Additions	2	–	–	–	–	20	<b>22</b>
Disposal	–	–	–	–	–	(5)	<b>(5)</b>
Translation to presentation currency	(10)	(13)	(2)	17	–	4	<b>(4)</b>
<b>At 31 December 2016</b>	<b>183</b>	<b>191</b>	<b>37</b>	<b>341</b>	–	<b>177</b>	<b>929</b>
Additions	–	–	–	–	–	29	<b>29</b>
Licence related to 80 per cent interest in UBEP (Note 40)	–	–	–	–	105	–	<b>105</b>
Disposal	–	–	–	–	–	(3)	<b>(3)</b>
Translation to presentation currency	(18)	(20)	(4)	(14)	–	(1)	<b>(57)</b>
<b>At 31 December 2017</b>	<b>165</b>	<b>171</b>	<b>33</b>	<b>327</b>	<b>105</b>	<b>202</b>	<b>1,003</b>
<b>Amortization and impairment</b>							
<b>At 1 January 2016</b>	<b>(35)</b>	<b>(34)</b>	–	<b>(69)</b>	–	<b>(62)</b>	<b>(200)</b>
Amortization charge for the year	(5)	(4)	–	(16)	–	(15)	<b>(40)</b>
Disposals amortization	–	–	–	–	–	2	<b>2</b>
Translation to presentation currency	2	2	–	(2)	–	(1)	<b>1</b>
Impairment	(2)	–	–	–	–	(1)	<b>(3)</b>
<b>At 31 December 2016</b>	<b>(40)</b>	<b>(36)</b>	–	<b>(87)</b>	–	<b>(77)</b>	<b>(240)</b>
Amortization charge for the year	(5)	(5)	–	(14)	–	(17)	<b>(41)</b>
Disposals amortization	–	–	–	–	–	1	<b>1</b>
Translation to presentation currency	4	4	–	4	–	4	<b>16</b>
Impairment	–	–	–	–	–	–	–
<b>At 31 December 2017</b>	<b>(41)</b>	<b>(37)</b>	–	<b>(97)</b>	–	<b>(89)</b>	<b>(264)</b>
<b>Net book value</b>							
<b>At 1 January 2016</b>	<b>156</b>	<b>170</b>	<b>39</b>	<b>255</b>	–	<b>96</b>	<b>716</b>
<b>At 31 December 2016</b>	<b>143</b>	<b>155</b>	<b>37</b>	<b>254</b>	–	<b>100</b>	<b>689</b>
<b>At 31 December 2017</b>	<b>124</b>	<b>134</b>	<b>33</b>	<b>230</b>	<b>105</b>	<b>113</b>	<b>739</b>

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 17. Intangible assets other than goodwill (continued)

At 31 December 2017 carrying value of intangible assets included licence of "Umid, Babek Exploration and Production Company" ("UBEP") in the amount of AZN 105 (31 December 2016: nil) and trade name of Petkim in the amount of AZN 33 (31 December 2016: AZN 37) acquired through business combination in August 2017 and May 2008, respectively. These intangible assets has indefinite useful life and were tested for impairment as part of recoverability analysis of related CGUs (Note 40).

During 2017, total amortization expense amounting to AZN 41 (2016: AZN 40) have been allocated to general administrative and research and development expenses by AZN 21 (2016: AZN 20), cost of sales by AZN 15 (2016: AZN 14), and to marketing, selling and distribution expenses by AZN 5 (2016: AZN 6).

## 18. Investments in joint ventures

The table below summarizes movements in the carrying amount of the Group's investment in joint ventures:

	2017	2016
<b>Carrying amount at 1 January</b>	<b>4,555</b>	<b>3,171</b>
Additions to investments in joint ventures	592	260
Share of after tax results of joint ventures	523	767
Dividends received from joint ventures	(147)	(102)
Derecognition of joint ventures	(385)	–
Exchange differences	(163)	445
Other	47	14
<b>Carrying amount at 31 December</b>	<b>5,022</b>	<b>4,555</b>

At 31 December 2017, the summarized financial information of the Group's principal joint ventures, based on their IFRS financial statements, and reconciliation with the carrying amount of the investment in consolidated financial statements are set out below:

	Azgerneft LLC	AZFEN	Azeri MI Drilling Fluids	SOCAR AQS	Azerbaijan Rigs	SOCAR CAPE	STYAS
Country of incorporation	Azerbaijan	Azerbaijan	Azerbaijan	Azerbaijan	Azerbaijan	Azerbaijan	Turkey
Current assets	51	235	81	295	205	42	1,011
<i>including cash and cash equivalents</i>	–	69	–	5	54	5	936
Non-current assets	57	30	6	201	891	24	11,208
Current liabilities	(30)	(125)	(45)	(228)	(7)	(20)	(250)
<i>including current financial liabilities (except trade and other payables and provisions)</i>	–	–	–	(12)	–	(5)	(138)
Non-current liabilities	–	–	–	(5)	–	(8)	(4,121)
<i>including non-current financial liabilities (except other payables and provisions)</i>	–	–	–	(5)	–	–	(3,927)
<b>Net assets</b>	<b>78</b>	<b>140</b>	<b>42</b>	<b>263</b>	<b>1,089</b>	<b>38</b>	<b>7,848</b>
Proportion of the Group's ownership	40%	60%	51%	13.4%	10%	51%	60%
<b>Interest in the net assets</b>	<b>31</b>	<b>84</b>	<b>21</b>	<b>35</b>	<b>109</b>	<b>19</b>	<b>4,709</b>
Adjustments	2	–	2	–	(1)	1	(12)
<b>Carrying value</b>	<b>33</b>	<b>84</b>	<b>23</b>	<b>35</b>	<b>108</b>	<b>20</b>	<b>4,697</b>

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

**18. Investments in joint ventures (continued)**

	Azgerneft LLC	AZFEN	Azeri MI Drilling Fluids	SOCAR AQS	Azerbaijan Rigs	SOCAR CAPE	STYAS
Revenue	51	796	201	288	–	141	–
Cost of sales	(23)	(545)	(156)	(200)	–	(100)	–
<i>including depreciation</i>	(5)	(9)	(1)	(6)	(1)	–	(3)
General and administrative expenses	–	(6)	(3)	(10)	–	(4)	(35)
Other income	–	–	–	–	–	–	10
Other expense	–	(10)	–	(6)	–	–	–
Forex loss	–	(17)	(2)	–	(1)	–	–
Finance income	–	–	–	5	–	–	28
Finance costs	–	–	–	–	–	(1)	(40)
<b>Profit/(loss) before tax</b>	<b>28</b>	<b>218</b>	<b>40</b>	<b>77</b>	<b>(1)</b>	<b>36</b>	<b>(37)</b>
Income tax (expense)/benefit	(6)	(41)	(8)	(5)	–	(10)	685
<b>Profit/(loss) for the year</b>	<b>22</b>	<b>177</b>	<b>32</b>	<b>72</b>	<b>(1)</b>	<b>26</b>	<b>648</b>
<b>Group's share of profit for the year</b>	<b>9</b>	<b>106</b>	<b>16</b>	<b>37</b>	<b>–</b>	<b>13</b>	<b>389</b>
Adjustment	–	–	–	–	–	–	–
<b>Group's share of profit for the year</b>	<b>9</b>	<b>106</b>	<b>16</b>	<b>37</b>	<b>–</b>	<b>13</b>	<b>389</b>

At 31 December 2017, the Group's interests in other joint ventures that are not significant both individually and in aggregate and their summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Current assets	Non- current assets	Current liabilities	Non- current liabilities	Revenue	Profit/ (loss)	Interest held	Country of incorporation
Oil and Gas Proserve	17	–	(6)	(3)	1	(1)	30%	Azerbaijan
Caspian Shipyard								
Company	4	–	–	–	–	(59)	20%	Azerbaijan
SOCAR Construction	–	11	(1)	–	–	(1)	97%	Azerbaijan
SOCAR Baglan LLC	1	14	(13)	(6)	–	–	51%	Azerbaijan
SOCAR Foster Wheeler								
Engineering	1	–	(1)	–	4	(1)	65%	Azerbaijan
Sarmatia LLC	1	–	(2)	–	–	(1)	27%	Poland
SOCAR DALGIC LLC	3	16	(1)	(17)	7	–	51%	Azerbaijan
SOCAR KBR	25	–	(25)	–	44	1	51%	Azerbaijan
AAS – Ekol	4	1	(1)	–	10	3	48%	Azerbaijan
SOCAR Fugro	18	1	(14)	–	30	5	51%	Azerbaijan
SOCAR Uniper	1	–	–	–	–	–	51%	Azerbaijan
<b>Total</b>	<b>75</b>	<b>43</b>	<b>(64)</b>	<b>(26)</b>	<b>96</b>	<b>(54)</b>		



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 18. Investments in joint ventures (continued)

At 31 December 2016, the summarized financial information of the Group's principal joint ventures, based on their IFRS financial statements, and reconciliation with the carrying amount of the investment in consolidated financial statements are set out below:

	Azgerneft LLC	AZFEN	Azeri MI Drilling Fluids	SOCAR Umid	SOCAR AQS	Azerbaijan Rigs	SOCAR Aurora Terminal	STYAS
Country of incorporation	Azerbaijan	Azerbaijan	Azerbaijan	Azerbaijan	Azerbaijan	Azerbaijan	Panama	Turkey
Current assets <i>including cash and cash equivalents</i>	46	327	83	211	268	118	12	261
Non-current assets	2	52	3	8	–	15	11	77
Current liabilities <i>including current financial liabilities (except trade and other payables and provisions)</i>	59 (33)	41 (205)	7 (47)	269 (107)	12 (228)	757 –	174 (21)	9,505 (195)
Non-current liabilities <i>including non-current financial liabilities (except other payables and provisions)</i>	– –	– –	– –	– (3)	(14) –	– –	(15) (47)	(47) (3,054)
<b>Net assets</b>	<b>72</b>	<b>163</b>	<b>43</b>	<b>370</b>	<b>52</b>	<b>875</b>	<b>118</b>	<b>6,517</b>
Proportion of the Group's ownership	40%	60%	51%	80%	51%	10%	50%	60%
<b>Interest in the net assets</b>	<b>29</b>	<b>98</b>	<b>22</b>	<b>296</b>	<b>27</b>	<b>88</b>	<b>59</b>	<b>3,910</b>
Adjustments	–	–	–	8	(1)	(1)	(9)	(10)
<b>Carrying value</b>	<b>29</b>	<b>98</b>	<b>22</b>	<b>304</b>	<b>26</b>	<b>87</b>	<b>50</b>	<b>3,900</b>

  

	Azgerneft LLC	AZFEN	Azeri MI Drilling Fluids	SOCAR Umid	SOCAR AQS	Azerbaijan Rigs	SOCAR Aurora Terminal	STYAS
Revenue	39	1,019	203	–	150	–	30	–
Cost of sales <i>including depreciation</i>	(22) –	(819) (14)	(156) (1)	– –	(244) –	– –	(13) –	– –
General and administrative expenses	–	(5)	(4)	(2)	(8)	–	(2)	(31)
Other income	–	–	–	1	–	–	2	10
Other expense	–	(1)	–	(73)	(6)	–	–	–
Forex gain/(loss)	–	29	(1)	–	–	4	–	–
Finance income	–	–	–	–	37	–	–	8
Finance costs	–	–	–	(1)	(55)	–	(4)	(67)
<b>Profit/(loss) before tax</b>	<b>17</b>	<b>223</b>	<b>42</b>	<b>(75)</b>	<b>(126)</b>	<b>4</b>	<b>13</b>	<b>(80)</b>
Income tax (expense)/ benefit	(4)	(48)	(9)	–	5	(1)	–	1,333
<b>Profit/(loss) for the year</b>	<b>13</b>	<b>175</b>	<b>33</b>	<b>(75)</b>	<b>(121)</b>	<b>3</b>	<b>13</b>	<b>1,253</b>
<b>Group's share of profit/(loss) for the year</b>	<b>5</b>	<b>105</b>	<b>17</b>	<b>(60)</b>	<b>(62)</b>	<b>–</b>	<b>7</b>	<b>752</b>
Adjustments	–	–	(1)	–	–	–	(2)	–
<b>Group's share of profit/(loss) for the year</b>	<b>5</b>	<b>105</b>	<b>16</b>	<b>(60)</b>	<b>(62)</b>	<b>–</b>	<b>5</b>	<b>752</b>

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 18. Investments in joint ventures (continued)

At 31 December 2016, the Group's interests in other joint ventures that are not significant both individually and in aggregate and their summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Current assets	Non-current assets	Current liabilities	Non-current liabilities	Revenue	Profit/(loss)	Interest held	Country of incorporation
Oil and Gas Preserve Caspian Shipyard Company	17	–	(5)	(2)	2	(1)	30%	Azerbaijan
SOCAR KPS	77	14	(43)	–	215	24	20%	Azerbaijan
SOCAR Construction	29	1	(31)	–	1	(1)	50%	Azerbaijan
SOCAR Baglan LLC	4	8	(1)	–	1	–	97%	Azerbaijan
SOCAR CAPE	1	14	(13)	(6)	–	–	51%	Azerbaijan
SOCAR Foster Wheeler Engineering	48	34	(44)	(17)	156	27	51%	Azerbaijan
SOCAR CNG	4	–	(3)	–	7	–	65%	Azerbaijan
SOCAR KBR	1	10	(26)	–	2	(4)	51%	Azerbaijan
AAS – Ekol	11	–	(11)	–	13	–	51%	Azerbaijan
SOCAR Fugro	4	1	(1)	–	10	3	50%	Azerbaijan
	9	2	(8)	–	16	1	51%	Azerbaijan
<b>Total</b>	<b>205</b>	<b>84</b>	<b>(186)</b>	<b>(25)</b>	<b>423</b>	<b>49</b>		

During 2017, the Group has made additional contributions in share capital of its joint ventures, SOCAR TURKEY YATIRIM A.Ş. ("STYAS") and Azerbaijan Rigs LLC in the amount AZN 542 (2016: AZN 198) and AZN 22 (2016: AZN 17), respectively.

In 2015, the Group signed letters of credit agreements in relation to the construction of Star Refinery complex (subsidiary of STYAS). Commission and interest expenses paid by the Group in total amount of AZN 28 (2016: AZN 44) were recognized as additional investment in STYAS.

On 7 August 2017 SOCAR and Nobel Oil, another shareholder of SOCAR Umid has terminated joint venture and established joint operation, Umid, Babek Exploration and Production Company to exploit Umid and Babek fields. As a result, the Group derecognized carrying value of its investment in SOCAR Umid in the amount of AZN 304 (Note 40).

On 25 December 2017 Nobel Oil obtained 73.77 per cent ownership interest in SOCAR AQS by contributing PPE with fair value in the amount of AZN 139 to charter of the joint venture. As a result, SOCAR's share in SOCAR AQS decreased from 51 per cent to 13.38 per cent and the Group derecognized carrying value of 37.62 per cent interest in the amount of AZN 46 and recognized loss on deemed disposal in the amount of AZN 27.

On 27 December 2017 the Group signed sales and purchase agreement with Global Terminal Holdings B LP to sell its 50 per cent interest in SATSA with carrying value of AZN 51 (31 December 2016: AZN 50). The transaction was closed on 10 January 2018 (Note 42). The Group classified investment in SATSA as disposal group held for sale at 31 December 2017 (Note 13).

## 19. Investment in associates

The table below summarizes movements in the carrying amount of the Group's investment in associates.

	2017	2016
<b>Carrying amount at 1 January</b>	<b>4,442</b>	<b>2,838</b>
Additions to investments in associates	238	797
Share of after tax results of associates	134	209
Dividends received from associates	(104)	(88)
Other	–	(4)
Exchange differences	(139)	690
<b>Carrying amount at 31 December</b>	<b>4,571</b>	<b>4,442</b>

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 19. Investments in associates (continued)

At 31 December 2017, the summarized financial information of the Group's principal associates, based on their IFRS financial statements, and reconciliation with the carrying amount of the investment in consolidated financial statements are set out below:

2017	South Caucasus Pipeline Company	BTC Co	Southern Gas Corridor
Country of incorporation	Cayman Islands	Cayman Islands	Azerbaijan
Current assets	212	191	323
Non-current assets	8,450	9,149	18,525
Current liabilities	(299)	(978)	(763)
Non-current liabilities	(389)	(1,256)	(12,446)
<b>Net assets attributable to the Group</b>	<b>7,974</b>	<b>7,106</b>	<b>3,886</b>
Net assets attributable to the NCI	–	–	1,753
Proportion of the Group's ownership	10%	25%	49%
<b>Interest in the net assets</b>	<b>797</b>	<b>1,777</b>	<b>1,904</b>
Adjustments	–	(1)	50*
<b>Carrying value</b>	<b>797</b>	<b>1,776</b>	<b>1,954</b>

\* At 31 December 2017, the adjustment includes the amount of AZN 34 which represents over financing to Southern Gas Corridor ("SGC") by the Group and the rest of the amount represents the Group's share in loss on sale of its additional interests in Shah Deniz PSA to SGC in 2015.

2017	South Caucasus Pipeline Company	BTC Co	Southern Gas Corridor
Revenue	633	1,595	218
Cost of sales	(172)	(756)	(129)
General and administrative expenses	–	–	(29)
Distribution expenses	–	–	(6)
Other income	–	–	35
Finance income	1	1	34
Finance costs	(1)	(86)	(269)
Forex loss	–	–	(10)
Share of results of associates	–	–	(7)
<b>Profit/(loss) before tax</b>	<b>461</b>	<b>754</b>	<b>(163)</b>
Income tax expense	(106)	–	(19)
<b>Profit/(loss) for the year</b>	<b>355</b>	<b>754</b>	<b>(182)</b>
<b>Group's share of profit/(loss) for the year</b>	<b>36</b>	<b>189</b>	<b>(89)</b>
Adjustments	1	–	(1)
<b>Total</b>	<b>37</b>	<b>189</b>	<b>(90)</b>

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 19. Investments in associates (continued)

At 31 December 2017, the Group's interests in other associates that are not significant both individually and in aggregate and their summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	Profit/(loss)	Interest held	Country of incorporation
Ateshgah Insurance Company	43	(30)	41	(2)	10%	Azerbaijan
Azerbaijan Gas Supply Company	501	(500)	2,719	–	28%	Cayman Islands
AzLab	5	–	2	–	50%	Azerbaijan
Caspian Geophysical	12	–	–	(6)	45%	Azerbaijan
Caspian Pipe Coatings LLC	22	(6)	15	3	50%	Azerbaijan
Cross Caspian Oil and Gas Logistics LLC	3	(2)	4	–	34%	Azerbaijan
South Caucasus Pipeline Company Hold Co (“SCPC Hold Co.”)	136	(1)	–	–	10%	Cayman Islands
Tankanlagen Mellingen AG (“TAMAG”)	13	(3)	5	–	33%	Switzerland
Tanklager Taegerschen AG (“TLT”)	2	–	2	–	21%	Switzerland
SOGEP AG	6	(5)	6	–	34%	Switzerland
UBAG AG	38	(32)	26	3	24%	Switzerland
SAPPRO SA	5	(3)	19	–	13%	Switzerland
SARACO SA	19	(16)	22	1	20%	Switzerland
Electrogas Malta	1,279	(1,364)	251	(83)	33%	Malta
Octogone	53	(31)	2	(1)	20%	Benin
CI GNL	15	(30)	–	(14)	26%	Ivory Coast
<b>Total</b>	<b>2,152</b>	<b>(2,023)</b>	<b>3,114</b>	<b>(99)</b>		

During 2017, the Group has made additional contributions in share capital of its associates, SCPC and SGC in the amount of AZN 98 (2016: AZN 104) and AZN 140 (2016: AZN 693), respectively.

At 31 December 2016, the summarized financial information of the Group's principal associates, based on their IFRS financial statements, and reconciliation with the carrying amount of the investment in consolidated financial statements are set out below:

2016	South Caucasus Pipeline Company	BTC Co	Southern Gas Corridor
Country of incorporation	Cayman Islands	Cayman Islands	Azerbaijan
Current assets	243	204	799
Non-current assets	7,536	9,772	13,769
Current liabilities	(477)	(1,093)	(1,305)
Non-current liabilities	(367)	(1,879)	(8,048)
<b>Net assets attributable to the Group</b>	<b>6,935</b>	<b>7,004</b>	<b>4,004</b>
Net assets attributable to the NCI	–	–	1,211
Proportion of the Group's ownership	10%	25%	49%
<b>Interest in the net assets</b>	<b>694</b>	<b>1,751</b>	<b>1,962</b>
Adjustments	(2)	–	(21)*
<b>Carrying value</b>	<b>692</b>	<b>1,751</b>	<b>1,941</b>

\* At 31 December 2016, the adjustment includes the amount of AZN 37 which represents over financing to SGC by the government and the rest of the amount represents the Group's share in loss on sale of its additional interests in Shah Deniz PSA to SGC in 2015.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 19. Investments in associates (continued)

2016	South Caucasus Pipeline Company	BTC Co	Southern Gas Corridor
Revenue	565	1,575	178
Cost of sales	(153)	(691)	(112)
General and administrative expenses	–	–	(12)
Distribution expenses	–	–	(5)
Other income	–	–	28
Finance income	–	–	12
Finance costs	(1)	(69)	(138)
Forex loss	–	–	(43)
Share of results of associates	–	–	(6)
<b>Profit/(loss) before tax</b>	<b>411</b>	<b>815</b>	<b>(98)</b>
Income tax expense	(87)	–	(3)
<b>Profit/(loss) for the year</b>	<b>324</b>	<b>815</b>	<b>(101)</b>
<b>Group's share of profit/(loss) for the year</b>	<b>32</b>	<b>204</b>	<b>(49)</b>
Adjustments	–	2	–
<b>Total</b>	<b>32</b>	<b>206</b>	<b>(49)</b>

At 31 December 2016, the Group's interests in other associates that are not significant both individually and in aggregate and their summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Total assets	Total liabilities	Revenue	Profit/ (loss)	Interest held	Country of incorporation
Ateshgah Insurance Company	42	(27)	40	–	10%	Azerbaijan
Azerbaijan Gas Supply Company	550	(551)	2,304	–	28%	Cayman Islands
AzLab	5	(4)	2	–	50%	Azerbaijan
Caspian Geophysical	40	(2)	67	34	45%	Azerbaijan
Caspian Pipe Coatings LLC	33	(13)	34	9	50%	Azerbaijan
Cross Caspian Oil and Gas Logistics LLC	3	(2)	8	–	34%	Azerbaijan
SCPC Hold Co.	121	(1)	–	–	10%	Cayman Islands
TAMAG	13	(3)	–	–	33%	Switzerland
TLT	2	–	–	–	21%	Switzerland
SOGEP AG	6	(5)	–	–	34%	Switzerland
UBAG AG	38	(32)	–	–	24%	Switzerland
SAPPRO SA	7	(5)	–	–	13%	Switzerland
SARACO SA	20	(20)	–	–	20%	Switzerland
Electrogas Malta	778	(781)	1	(2)	33%	Switzerland
<b>Total</b>	<b>1,658</b>	<b>(1,446)</b>	<b>2,456</b>	<b>41</b>		

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 20. Trade and other payables

	2017	2016 (reclassified)
Trade payables	6,337	5,568
Accrued liabilities	4,607	3,061
Other payables	1,030	643
<b>Total financial payables</b>	<b>11,974</b>	<b>9,272</b>
Advances from customers	358	208
Payable to employees	108	160
Liabilities for overlift of oil	10	52
<b>Total trade and other payables</b>	<b>12,450</b>	<b>9,692</b>

Financial payables in the amount of AZN 7,909 (31 December 2016: AZN 7,207) are denominated in foreign currencies, mainly in USD. Trade payables mainly represent payables for crude oil, oil products, gas, construction, drilling, transportation and utilities provided by vendors of the Group.

Accrued liabilities of the Group represent obligations occurred for purchase of crude oil and oil products, for which invoices have not yet been received.

Liabilities for overlift relate to the oil lifted by the Group in excess of its participating interest in ACG PSA and Shah Deniz PSA and thus, represent the Group's obligation to deliver physical quantities of oil out of its share of future production.

The Group acquired trade payables with fair value of AZN 57 as part of acquisition of additional 13.35 per cent interest in ACG PSA (Note 40).

## 21. Borrowings

At 31 December 2017, short-term borrowings of the Group were represented by the following facilities:

Facilities	Interest rate	Maturity date	Total borrowed in original currency	Balance as at 31 December 2017
Short-term facilities in USD	1.7%-14%	January 2018 – December 2018	2,280	3,864
Short-term facilities in TRY	9.66%-15.35%	January 2018 – December 2018	617	275
Short-term facilities in GEL	10.25%-15.5%	January 2018 – December 2018	108	58
Short-term facilities in other currencies	0.7%-20%	January 2018 – September 2018	361	481
Current portion of long-term borrowings				1,320
<b>Total short-term borrowings and current portion of long-term borrowings</b>				<b>5,998</b>

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

**21. Borrowings (continued)**

At 31 December 2017, long-term borrowings of the Group were represented by the following facilities:

Facilities	Interest rate*	Maturity date	Balance as at 31 December 2017	
			Non-current portion	Current portion
USD 1000 million	4.75%	March 2023	1,663	20
USD 750 million	6.95%	March 2030	1,224	27
USD 489 million	LIBOR + 6.95%	July 2025	758	15
USD 300 million	LIBOR + 3.25%	March 2022	502	7
USD 260 million	LIBOR + 4.3% + 1.25%	December 2022	431	–
USD 485 million	LIBOR + 1%	December 2024	353	131
EUR 251 million	EURIBOR + 3.03%	June 2028	308	1
USD 200 million	LIBOR + 1.335%	December 2027	286	14
AZN 378 million	3.5%	October 2024	283	107
EUR 249 million	EURIBOR + 0.95%	June 2028	265	1
AZN 600 million	4%	July 2022	260	66
AZN 350 million	3%	June 2023	250	110
USD 100 million	5%	October 2021	170	2
USD 100 million	LIBOR + 3.25%	February 2022	168	4
USD 100 million	LIBOR + 3.25%	April 2022	167	2
USD 106 million	LIBOR + 4.675%	March 2028	163	17
USD 106 million	5%	March 2028	163	17
JPY 15,398 million	1.5%	April 2039	161	8
USD 78 million	4%	December 2027	157	–
USD 101 million	LIBOR + 2.8%	April 2022	138	34
USD 100 million	LIBOR + 2.33%	June 2020	114	57
AZN 98 million	3.5%	December 2028	98	–
USD 50 million	4.81%	December 2019	85	–
AZN 100 million	3.5%	January 2026	80	23
USD 65 million	6.25%	December 2024	80	19
USD 150 million	LIBOR + 1.8%	November 2019	74	73
USD 150 million	LIBOR + 1.8%	December 2019	74	73
USD 100 million	LIBOR + 2.4%	May 2020	73	49
USD 55 million	LIBOR + 5.25%	September 2024	71	14
EUR 35 million	LIBOR + 0.063%	December 2026	71	–
AZN 70 million	4%	January 2027	63	10
EUR 35 million	LIBOR + 0.072%	November 2025	62	9
USD 29 million	4%	December 2027	59	–
AZN 144 million	0.16% (0.15% + 0.01%)	January 2045	55	8
USD 38 million	4.01%	December 2023	54	10
EUR 40 million	EURIBOR + 2.25%	December 2020	54	27
USD 50 million	LIBOR + 2.2%	July 2020	48	25
CHF 22 million	LIBOR + 0.0714% or 0%	January 2019	38	–
USD 150 million	LIBOR + 2.5%	March 2019	37	74
USD 150 million	LIBOR + 2.2%	May 2019	37	73
USD 24 million	4.26%	December 2022	32	8
EUR 20 million	1.64%	October 2023	31	6
EUR 20 million	LIBOR + 0.872%	September 2023	31	6
USD 52 million	6%	January 2020	30	–
USD 50 million	LIBOR + 1.8%	November 2019	29	29
USD 50 million	LIBOR + 1.8%	December 2019	25	24
GEL 51 million	14%	July 2020	20	13
USD 10 million	5%	October 2020	17	–
USD 35 million	LIBOR + 2.35%	April 2020	13	9
EUR 12 million	LIBOR + 3%	March 2022	11	3
USD 20 million	LIBOR + 2%	April 2023	10	–
USD 5 million	5%	Jun 2020	9	–
USD 6 million	4.26%	December 2022	7	2
USD 5 million	4.26%	December 2022	7	2
EUR 7 million	LIBOR + 3%	March 2022	7	2
USD 4 million	4.26%	December 2022	6	1
USD 6 million	4.01%	February 2020	5	5
USD 4 million	4.26%	December 2022	5	1
EUR 5 million	LIBOR + 3%	March 2022	5	1
USD 150 million	LIBOR + 2.5%	November 2018	–	73
Other long-term borrowings			16	8
<b>Total long-term borrowings</b>			<b>9,513</b>	<b>1,320</b>

(\*) LIBOR and EURIBOR vary from 3 to 12 months.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 21. Borrowings (continued)

At 31 December 2016, short-term borrowings of the Group were represented by the following facilities:

Facilities	Interest rate	Maturity date	Total borrowed in original currency	Balance as at 31 December 2016
Short-term facilities in USD	0.25%-14%	January 2017 – December 2017	2,700	4,776
Short-term facilities in TRY	12.75%-14.7%	January 2017 – September 2017	292	148
Short-term facilities in GEL	11%-14.8%	January 2017 – December 2017	111	55
Short-term facilities in other currencies	3%-12%	January 2017 – November 2017	299	547
Current portion of long-term borrowings				1,191
<b>Total short-term borrowings and current portion of long-term borrowings</b>				<b>6,717</b>



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 21. Borrowings (continued)

At 31 December 2016, long-term borrowings of the Group were represented by the following facilities:

Facilities	Interest rate*	Maturity date	Balance as at 31 December 2016	
			Non-current portion	Current portion
USD 1,000 million	4.75%	March 2023	1,757	25
USD 750 million	6.95%	March 2030	1,318	27
USD 489 million	LIBOR + 6.95%	July 2025	468	–
USD 485 million	LIBOR + 1%	December 2024	429	134
AZN 600 million	4%	July 2022	362	44
AZN 472 million	3.65%	October 2024	330	47
USD 200 million	LIBOR + 1.335%	December 2027	312	14
AZN 750 million	3.15%	July 2023	300	50
USD 106 million	LIBOR + 4.675%	March 2028	188	–
USD 100 million	LIBOR + 2.33%	June 2020	177	–
JPY 15,398 million	1.5%	April 2039	169	8
USD 90 million	5%	March 2028	160	–
USD 78 million	4%	December 2027	158	–
USD 150 million	LIBOR + 1.8%	December 2019	152	76
USD 150 million	LIBOR + 1.8%	November 2019	152	77
USD 100 million	5%	October 2021	147	2
USD 100 million	LIBOR + 2.4%	May 2020	126	51
USD 150 million	LIBOR + 2.5%	March 2019	115	78
USD 150 million	LIBOR + 2.2%	May 2019	114	77
USD 65 million	6.25%	December 2024	96	19
USD 52 million	6%	January 2020	92	–
USD 50 million	4.44%	December 2018	89	–
USD 55 million	5.58%	September 2024	84	14
AZN 198 million	3.5%	June 2026	80	20
USD 150 million	LIBOR + 2.5%	November 2018	77	77
USD 50 million	LIBOR + 2.2%	July 2020	75	14
EUR 40 million	EURIBOR + 2.25%	December 2020	74	–
AZN 1,292 million	4%	August 2027	70	1
EUR 35 million	LIBOR + 0.731%	November 2025	65	–
USD 50 million	LIBOR + 1.8%	November 2019	59	30
USD 29 million	4%	December 2027	59	–
USD 50 million	LIBOR + 1.8%	December 2019	51	25
USD 24 million	4.26%	December 2022	42	1
EUR 20 million	LIBOR + 0.872%	September 2023	34	3
EUR 20 million	1.64%	October 2023	34	3
USD 18 million	LIBOR + 2.8%	April 2022	31	2
USD 20 million	LIBOR + 2%	April 2023	31	7
USD 17 million	LIBOR + 2.8%	March 2022	28	2
USD 35 million	LIBOR + 2.35%	April 2020	22	9
EUR 12 million	LIBOR + 3%	March 2022	13	3
USD 6 million	4.26%	December 2022	10	–
USD 5 million	4.26%	December 2022	9	–
EUR 7 million	LIBOR + 3%	March 2022	8	2
USD 4 million	4.26%	December 2022	7	–
USD 4 million	4.26%	December 2022	7	–
EUR 5 million	LIBOR + 3%	March 2022	6	1
USD 6 million	LIBOR + 8.5%	October 2018	5	5
USD 6 million	LIBOR + 8.5%	February 2019	3	9
USD 500 million	5.45%	February 2017	–	175
CHF 22 million	LIBOR + 0.0714% or 0%	January 2017	–	38
USD 16 million	LIBOR + 1.7%	June 2017	–	7
Other long-term borrowings			15	14
<b>Total long-term borrowings</b>			<b>8,210</b>	<b>1,191</b>

(\*) LIBOR and EURIBOR vary from 3 to 12 months.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 22. Taxes payable

	Note	2017	2016
Payable to SOFAZ	7	255	266
Corporate income tax payable		52	144
Social security contributions		2	2
Other taxes payable		178	204
<b>Total taxes payable</b>		<b>487</b>	<b>616</b>

In 2008 apart from regular export tax the Group was liable to transfer a certain share of proceeds from sales of crude oil priced at the level exceeding the price determined by the government (USD 50 per barrel for 2009) to SOFAZ. No such taxes were imposed on the Group in 2009-2017.

Taxpayers operating under the Azerbaijani tax legislation are eligible for offsetting their taxes payable with taxes receivable and tax prepayments. Other taxes payable balance consists of VAT, property, excise tax, personal income tax, price margin tax liabilities offset with tax receivables and prepayments.

## 23. Asset retirement obligations

The Group has a legal and constructive obligation with respect to decommissioning of oil and gas production and storage facilities and environmental clean-up. Movements in provisions for the related asset retirement obligations are as follows:

	Note	2017	2016
<b>Carrying amount at 1 January</b>		<b>968</b>	<b>748</b>
Additions		77	83
Acquisition of additional interest in ACG PSA	40	293	–
Unwinding of the present value discount	33	61	48
Effect of change in estimates		(306)	2
Exchange differences		(26)	87
<b>Carrying amount at 31 December</b>		<b>1,067</b>	<b>968</b>

The Group makes provision for the future cost of oil and natural gas production facilities retirement and related pipelines on a discounted basis on the installation of those facilities. The provision has been estimated using existing technology, at current prices and discounted using pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the liability as of the reporting date. These costs are expected to be incurred over the useful life of the fields and properties ranging between 6 and 65 years from the reporting date.

Asset retirement obligations related to the PSAs are determined with reference to capital costs incurred by contractor parties and they are limited to the maturities of respective PSAs.

Governmental authorities are continually reviewing regulations and their enforcement. Consequently, the Group's ultimate liabilities may differ from the recorded amounts.

The maximum estimated cost to Azneft PU operated by the Group to abandon the production facilities employed was AZN 1,924 as at 31 December 2017 (2016: AZN 1,933). The Company used 8.02 per cent rate to discount this obligation (2016: 8.24 per cent).

The maximum estimated cost to AzACG to abandon the production facilities employed in ACG project was AZN 1,582 at 31 December 2017 (2016: AZN 743). The Company used 5.66 per cent rate to discount this obligation (2016: 6.34 per cent).

The maximum estimated cost to AzSD to abandon the production facilities employed in Shah Deniz project was AZN 469 as at 31 December 2017 (31 December 2016: AZN 422). The Company used 5.66 per cent rate to discount this obligation (2016: 5.59 per cent).

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 23. Asset retirement obligations (continued)

The maximum estimated cost to the Group to abandon the production facilities employed in Absheron PSA project was AZN 89 as at 31 December 2017 (31 December 2016: nil). The Company used 5.66 per cent rate to discount this obligation.

Estimated costs of dismantling oil and gas production facilities, pipelines and related processing and storage facilities, including abandonment and site restoration costs related to other projects where the Group is contractor party amounting to AZN 477 at 31 December 2017 (2016: AZN 392) are included in the cost of oil and gas properties and equipment.

The following inflation rates were applied in calculation of discounted cash flows:

Year	2018	2019	2020	2021	2022	2023 and later
Inflation rate	6.25%	4.90%	4.30%	4.45%	4.20%	4.00%

While the provision is based on the best estimate of future costs and the economic lives of the facilities and pipelines, there is uncertainty regarding both the amount and timing of incurring these costs.

### 24. Other provisions for liabilities and charges

Movements in other provisions for liabilities and charges are as follows:

	Note	Environmental obligations	Disability payments	Total
<b>Carrying amount at 1 January 2016</b>		<b>88</b>	<b>100</b>	<b>188</b>
(Disposals)/additions		(5)	21	16
Utilisation		(15)	(13)	(28)
Unwinding of the present value discount	33	7	8	15
Effect of change in estimates		1	1	2
<b>Carrying amount at 31 December 2016 (reclassified)</b>		<b>76</b>	<b>117</b>	<b>193</b>
of which:				
Current		29	16	45
Non-current		47	101	148
<b>Carrying amount at 1 January 2017 (reclassified)</b>		<b>76</b>	<b>117</b>	<b>193</b>
Effect of change in utilization date		(7)	–	(7)
Disposals		–	(6)	(6)
Utilisation		(17)	(16)	(33)
Unwinding of the present value discount	33	6	9	15
Effect of change in estimates		–	2	2
<b>Carrying amount at 31 December 2017</b>		<b>58</b>	<b>106</b>	<b>164</b>
of which:				
Current		55	15	70
Non-current		3	91	94

Under the Presidential Decree numbered 1697 dated 28 September 2006 the Group prepared and approved Action Plan for Environmental Restoration with respect to the damage caused to the environment as a result of the Group's activities within Absheron area. In 2014 the Group amended the Action Plan in accordance with the Presidential Decree dated 27 February 2014, extending period to be covered up to 2018 and including other additional regions of Azerbaijan to be restored, as well as Absheron area. Corresponding provision is recognized at the present value of future costs to be incurred for the environmental remediation, discounted at the rate of 8.27 per cent (2016: 8.73 per cent).

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 24. Other provisions for liabilities and charges (continued)

The Group has an obligation to compensate its employees for the damage caused to their health at workplace up to January 2012 (payments to employees injured after January 2012 are made by insurance company, based on insurance contract), as well as to compensate dependants of died employees. The compensations provided are linked to the salaries paid to the affected employees. The Group calculated the present value of the disability payments to employees using a discount rate of 7.94 per cent (2016: 8.13 per cent). For the purpose of calculation of the lifetime payments to injured employees, the Group estimated a life expectancy as 71 and 76 for men and women, respectively.

The inflation rates in Note 23 were applied to reflect the escalation in average salaries.

## 25. Deferred income

	2017	2016
<b>Carrying amount at 1 January</b>	<b>172</b>	<b>79</b>
Received during the year	–	203
Released to the statement of profit or loss	(68)	(110)
<b>Carrying amount at 31 December</b>	<b>104</b>	<b>172</b>
of which:		
Current	41	98
Non-current	63	74

Current

As at 31 December 2017, current portion of deferred income comprised of government grants as a compensation of losses expected to be incurred from sale of natural gas and heating oil for the purpose of meeting local demand in the country. The Group did not receive government grants for compensation of losses during year ended on 31 December 2017 (2016: AZN 203).

### Non-current

As at 31 December 2017, non-current portion of deferred income mainly comprised of government grants obtained for the purpose of gasification of Baku sub-urban area and regions of the Azerbaijan Republic in 2006.

## 26. Other current and non-current liabilities

Other liabilities comprise the following:

	2017	2016
Derivative liabilities	791	1,245
Liabilities under carried interest arrangement	479	172
Provision for employment termination benefits	66	76
Advances received from related parties	66	70
Other liabilities	36	18
<b>Total other liabilities</b>	<b>1,438</b>	<b>1,581</b>
Less other current liabilities	(653)	(1,052)
<b>Total other non-current liabilities</b>	<b>785</b>	<b>529</b>

The Group has financial liabilities related to margin calls and funds held on trading in the amount of AZN 50 (31 December 2016: AZN 83), unrealized losses on paper positions in the amount of AZN 565 (2016: AZN 913) and unrealized losses on physical positions in the amount of AZN 176 (2016: AZN 249). Current portion of these liabilities as of 31 December 2017 was AZN 653 (31 December 2016: AZN 1,052).

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 26. Other current and non-current liabilities (continued)

The Group's 40 per cent participating interest in Absheron Offshore 2 PSA ("Absheron PSA") was carried by other parties to the arrangement, TOTAL Absheron and Engie. In February 2017, exploration and evaluation stage of Absheron PSA was completed successfully and the Group started to recognize its liability under the carried arrangement after the commencement of development stage. On 23 June 2017, Absheron PSA parties signed Deed of Assignment whereby Engie withdrew from PSA and assigned its 20 per cent participating interest to other parties for free of charge. Pursuant to Absheron PSA, the Group liability to Engie was released and at 31 December 2017 the Group's carried liability under Absheron PSA was AZN 334. At 31 December 2017 the Group's carried liability under other PSAs was AZN 145 (31 December 2016: AZN 172).

Under *Turkish Labour Law*, the Group is required to pay termination benefits to each employee who has completed one year of service and whose employment is terminated without due cause, is called up for military service, dies or who retires after completing 25 years of service (20 years for women) and achieves the retirement age (58 for women and 60 for men). The liability is not funded, as there is no funding requirement. The provision is calculated by estimating the present value of the future probable obligation of the Group arising from the retirement of the employees. IAS 19 requires actuarial valuation methods to be developed to estimate the enterprises' obligation under defined benefit plans. Accordingly, the following actuarial assumptions were used in the calculation of the total liability:

	2017	2016
Discount rate (per cent)	4.39	3.61
Probability of retirement (per cent)	100	100

The principal assumption is that the maximum liability for each year of service will increase in line with inflation. Thus the discount rate applied represents the expected real rate after adjusting for the anticipated effects of future inflation.

Movement of the provision for employment termination benefits were as follows:

	2017	2016
<b>Carrying amount at 1 January</b>	<b>76</b>	<b>83</b>
Actuarial loss and service cost	12	4
Payments during the year	(13)	(8)
Return on plan assets	(10)	(10)
Other	5	5
Translation to presentation currency	(4)	2
<b>Carrying amount at 31 December</b>	<b>66</b>	<b>76</b>

## 27. Deferred acquisition consideration payable

The Group has deferred cash consideration payable in the amount of AZN 65 (31 December 2016: AZN 67) for the purchase of remaining 49 per cent shares of SOCAR Petroleum CJSC from other shareholder. Additionally, the Group has deferred acquisition consideration payable in the amount of AZN 65 (31 December 2016: AZN 68) for acquisition of SOCAR Trading.

## 28. Charter capital, additional paid-in capital, retained earnings and gain on sale of subsidiary share

### Charter capital

SOCAR as a holding company of the Group has a legal status of a state enterprise. Increase in the amount of AZN 1,234 in charter capital was registered during 2017 and accordingly the amount was reclassified from additional paid-in capital to charter capital (2016: AZN 185).

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

## **28. Charter capital, additional paid-in capital, retained earnings and gain on sale of subsidiary share (continued)**

### **Additional paid-in capital ("APIC")**

During 2017, the Government contributed to the charter capital of the Group in the amount of AZN 243 (2016: AZN 921). The increase in charter capital was not registered as of 31 December 2017 and recognized as APIC.

The Group recognized difference between a) fair value of acquired 13.35 per cent interest in ACG PSA in the amount of AZN 3,373 and b) consideration transferred (which was zero) as APIC by Government (Note 40).

### **Distribution to the Government**

Based on decisions of the Government, the Group is periodically mandated to make direct cash contributions or finance construction and repair works for the Government (including transfer of assets), various government agencies and projects administered by the Government. During 2017, such direct cash transfers to the Government and financing (made in the form of payments to sub-contractors of governmental entities) amounted to AZN 567 and AZN 89, respectively (2016: AZN 56 and AZN 17, respectively), mainly for repair and reconstruction of existing, as well as construction of new recreational, transport, educational and medical infrastructure of the Azerbaijan Republic.

### **Sale of shares to non-controlling shareholder**

On 8 March 2017, the Group sold its 1.32 per cent shares of Petkim Petrokimya Holding A.Ş for consideration in the amount of AZN 42 (TRY 88 million) to non-controlling shareholder and recognized gain directly in equity in the amount of AZN 12. As a result, the Group's controlling ownership in Petkim Petrokimya Holding A.Ş. decreased from 52.32 per cent to 51 per cent.

On 28 August 2017, the Group sold its 19 per cent shares of SOCAR Polymer Investments LLC for consideration in the amount of AZN 45 (USD 26 million) to non-controlling shareholder and recognized gain directly in equity in the amount of AZN 2. As a result, the Group's controlling ownership in SOCAR Polymer Investments LLC decreased from 76 per cent to 57 per cent.

### **Acquisition of non-controlling interest in subsidiary**

On 25 January 2017, the Group became 100 per cent owner of SOCAR Turkey Petrol Enerji Dagitim through purchase of remaining 30 per cent ownership interest. Moreover, on 14 June 2017 the Group purchased 21.5 per cent shares of SOCAR Turkey Gaz Dagitim and became 100 per cent owner of the latter. As a result of mentioned transactions, the Group recognized loss in total amount of AZN 32.

On 29 May 2017 and 10 October 2017, the Group purchased 16.34 per cent and 8.17 per cent shares of SOCAR Energy Georgia ("SEG") from Intersun and EVENTUS, respectively for total consideration of AZN 58 (USD 34 million) and recognized loss in the amount of AZN 79. As a result, the Group's controlling ownership in SEG increased from 51 per cent to 75.51 per cent.

On 5 June 2017, the Group increased its ownership in SOCAR Polymer Investments LLC by 4.97 per cent through repayment of share of increase in capital allocated to Azerbaijan Paper and Paperboard Production Complex LLC and recognized gain in the amount of AZN 8.

On 31 August 2017, the Group purchased 49 per cent in Quetzal and Chernomorservis for consideration in the amount of AZN 1 (RUB 25 million) and AZN 12 (USD 7 million), respectively. Thereby, the Group recognized loss in the total amount of AZN 10. As a result, the Group's controlling ownership in mentioned companies increased from 51 per cent to 100 per cent.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

## 29. Analysis of revenue by categories

	2017	2016
Crude oil, net	56,592	29,613
Oil products, net	24,808	11,686
Petrochemicals	3,881	2,643
Natural gas	2,670	1,990
Other revenue	4,620	5,973
<b>Total revenue</b>	<b>92,571</b>	<b>51,905</b>

Revenue from crude oil sales is stated net of price margin tax which is levied in the Azerbaijan Republic on the margins between the international market price and internal state-regulated price on crude oil. The difference between the market price and the internal state-regulated price is taxed at the rate of 30 per cent and the amount of tax is transferred to the State Budget.

Revenue from oil product sales is stated net of excise tax of AZN 440 (2016: AZN 423).

Revenue from sales of crude oil produced under ACG PSA and condensate produced under Shah Deniz PSA is not subject to excise and price margin taxes mentioned above.

## 30. Analysis of expenses by nature

	Note	2017	2016
Raw materials and consumables used		84,745	44,265
Wages, salaries and social security costs		1,319	1,297
Depreciation of property, plant and equipment		1,065	1,014
Transportation and vehicle maintenance		677	714
Impairment of property, plant and equipment	16	468	322
Utilities expense		341	307
Repairs and maintenance expenses		278	189
Impairment of trade and other receivables and other financial assets		239	493
Taxes other than on income		198	178
Mining tax	7	123	103
Amortization expense	17	41	40
Change in other provisions for liabilities and charges	24	(11)	18
Other		1,364	1,584
<b>Total cost of sales, exploration and evaluation, distribution, general and administrative and other operating expenses</b>		<b>90,847</b>	<b>50,524</b>

## 31. Other operating income

	Note	2017	2016
Gain on re-measurement to fair value of investment in JV	40	257	–
Subsidy received from the Government		250	–
Government grant	25	68	110
Gain on release of liabilities under carry arrangements		54	–
Sales of other goods and services rendered		35	18
Assets received free of charge		–	387
Other		285	182
<b>Total other operating income</b>		<b>949</b>	<b>697</b>

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 32. Finance income

	2017	2016
Interest income on deposits and bank accounts	71	151
Other	46	38
<b>Total finance income</b>	<b>117</b>	<b>189</b>

### 33. Finance costs

	Note	2017	2016
Interest expense		814	778
Provisions for asset retirement obligations: unwinding of the present value discount	23	61	48
Environmental provision: unwinding of the present value discount	24	6	7
Provision for disability payments: unwinding of the present value discount	24	9	8
<b>Total finance costs</b>		<b>890</b>	<b>841</b>

### 34. Income taxes

Income tax expense comprises the following:

	2017	2016
Current tax expense	500	537
Deferred tax (benefit)/charge	(76)	49
<b>Income tax expense reported in the statement of profit or loss</b>	<b>424</b>	<b>586</b>

Reconciliation between the expected and the actual taxation charge is provided below:

	2017	2016
<b>Profit before tax</b>	<b>2,516</b>	<b>936</b>
<b>Theoretical tax charge at statutory rate of 20 per cent</b>	<b>503</b>	<b>187</b>
Effects of different tax rates for certain subsidiaries (25 and 27 per cent)	35	22
Tax effect of items which are not deductible or assessable for taxation purposes:		
- Income which is exempt from taxation	(209)	(236)
- Non-deductible expenses	108	176
Deferred tax asset not recognized	73	294
Current income tax on non-resident dividends (overseas subsidiaries)	6	38
Recognition of previously unrecognized deferred tax asset	(45)	(48)
Income not recognized in IFRS	-	15
Unused investment incentives on which deferred income tax assets recognized	(25)	(48)
Potential income tax on retained profit of subsidiaries, associates and joint ventures	(38)	137
Other	16	49
<b>Income tax expense reported in the statement of profit or loss</b>	<b>424</b>	<b>586</b>

Non-deductible expenses are mainly comprised of the social and employee-related expenses, as well as the provision for impaired receivables which are not expected to be deductible from taxable income in future. Allowance for deferred tax assets mainly relates to the current year tax losses of the Group's subsidiaries which are not expected to utilize these losses.



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 34. Income taxes (continued)

At 31 December 2017, cumulative balance of unrecognized deferred tax asset is AZN 1,234 (31 December 2016: AZN 1,206).

At 31 December 2017, the Group recognized deferred income tax asset on the portion of unused investment incentive for which the realization of the related tax benefit through the future taxable profit has deemed probable with respect to its projections.

At 31 December 2017, benefits arising from previously unrecognized deferred tax assets were used during the year to reduce deferred tax and current tax expenses by the amount of AZN 19 (2016: AZN 39) and AZN 26 (2016: AZN 9), respectively.

At 31 December 2017 and 2016, the Group recognized deferred income tax benefit in the amount of AZN 10 and AZN 19, respectively, on the exchange differences arising on translation of the financial statements of foreign operations and charged to OCI.

As at 31 December 2017, the Group has not recognised deferred tax liability in the amount of AZN 56 (31 December 2016: AZN 61) in respect of taxable temporary differences associated with investments in subsidiaries as the Group is able to control the timing of the reversal of those temporary differences and it is not expected to reverse them in the foreseeable future.

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

	1 January 2017	Credited/ (charged) to profit or loss	Credited/ (charged) to OCI	31 December 2017
<b>Tax effect of deductible/(taxable) temporary differences</b>				
Carry forward tax losses	80	23	(5)	98
Investments in associates and joint ventures	1	(2)	–	(1)
Trade and other payables	(5)	16	16	27
Trade and other receivables	60	(23)	(4)	33
Inventory	16	(7)	–	9
Property, plant and equipment	443	73	4	520
Provisions for liabilities and charges	73	2	–	75
Unused Investment incentives	129	(2)	(14)	113
Employment termination benefits	8	–	1	9
Other	36	(14)	–	22
<b>Deferred tax assets</b>	<b>841</b>	<b>66</b>	<b>(2)</b>	<b>905</b>
	1 January 2017	Credited/ (charged) to profit or loss	Credited/ (charged) to OCI	31 December 2017
<b>Tax effect of deductible/(taxable) temporary differences</b>				
Accruals	(2)	(4)	2	(4)
Investments in associates and joint ventures	(101)	(3)	3	(101)
Intangible assets	(43)	2	–	(41)
Trade and other payables	6	7	–	13
Trade and other receivables	(38)	34	1	(3)
Inventory	(25)	2	1	(22)
Property, plant and equipment	(895)	(52)	44	(903)
Provisions for liabilities and charges	137	8	(12)	133
Other	(311)	16	14	(281)
<b>Deferred tax liabilities</b>	<b>(1,272)</b>	<b>10</b>	<b>53</b>	<b>(1,209)</b>

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 34. Income taxes (continued)

	1 January 2016	Credited/ (charged) to profit or loss	Credited/ (charged) to OCI	31 December 2016
<b>Tax effect of deductible/(taxable) temporary differences</b>				
Carry forward tax losses	42	40	(2)	80
Investments in associates and joint ventures	8	(7)	–	1
Trade and other payables	12	(15)	(2)	(5)
Impairment provision for receivables	4	(4)	–	–
Trade and other receivables	39	18	3	60
Inventory	13	3	–	16
Property, plant and equipment	412	26	5	443
Provisions for liabilities and charges	68	5	–	73
Unused investment incentives	89	48	(8)	129
Employment termination benefits	9	–	(1)	8
Other	16	21	(1)	36
<b>Deferred tax assets</b>	<b>712</b>	<b>135</b>	<b>(6)</b>	<b>841</b>

	1 January 2016	Credited/ (charged) to profit or loss	Credited/ (charged) to OCI	31 December 2016
<b>Tax effect of deductible/(taxable) temporary differences</b>				
Accruals	22	(27)	3	(2)
Investments in associates and joint ventures	(97)	6	(10)	(101)
Intangible assets	(43)	4	(4)	(43)
Trade and other payables	7	(1)	–	6
Trade and other receivables	(25)	(10)	(3)	(38)
Inventory	(22)	–	(3)	(25)
Property, plant and equipment	(796)	(35)	(64)	(895)
Provisions for liabilities and charges	114	5	18	137
Other	(197)	(126)	12	(311)
<b>Deferred tax liabilities</b>	<b>(1,037)</b>	<b>(184)</b>	<b>(51)</b>	<b>(1,272)</b>

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.

The Group is a participant to ACG PSA through its subsidiary AzACG. However, AzACG was not explicitly defined as a contractor party in the ACG PSA. As a result, its tax-payer status was not clearly determinable. During 2017, AzACG accrued and paid its income tax at the rate of 25 per cent in accordance with ACG PSA provisions. This assumption was based on communication with relevant tax authorities according to which management concluded that AzACG carries a tax-payer status under the provision of ACG PSA. On 14 September 2017, AzACG, SOCAR and ACG PSA Contractor parties amended and restated ACG PSA. As part of this agreement, ACG PSA Contractor parties also amended ACG PSA Joint Operation Agreement according which AzACG is defined as a new contractor party starting from effective date of amended ACG PSA, 1 January 2018.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

### **34. Income taxes (continued)**

The governments of the Azerbaijan Republic, Turkey and Georgia together with the Group's subsidiary AzBTC and other BTC Project participants entered into Host Government Agreements ("HGAs"). The HGAs set out the legal and fiscal regime for the BTC Project and the mutual rights and obligations of the parties, including grants of rights and guarantees from the respective Countries to the investors in respect of matters necessary to ensure the success of the BTC Project. In accordance with the provisions of the HGAs, the BTC Project participants are individually liable for income taxes in Georgia and the Azerbaijan Republic and are responsible for filing returns for each taxable period. Accordingly, the Company is liable for Azerbaijani income taxes arising from participation in the BTC Project. In accordance with the provisions of the HGA, Azerbaijani income tax rate is twenty-seven per cent (27 per cent) which was effective at 31 December 2017 and 2016.

In addition, the Group is a participant to Shah Deniz PSA through its subsidiary AzSD. According to the provisions of Shah Deniz PSA, AzSD is liable for corporate income tax payments. However, in accordance with PSA, the Government makes profit tax payments on behalf of contractor parties from the proceeds from sales of profit petroleum attributable to the Government. AzSD was in loss position in 2017 and 2016, therefore, no corporate income tax related to Shah Deniz project was recognized for 2017 and 2016. At 31 December 2017 and 2016, deferred tax balance of AzSD was nil. AzSD is also exempt from certain ordinary operational taxes in the Azerbaijan Republic.

The Group operates in the tax environment of Turkey through its subsidiary, STEAS. Income tax rate in Turkey is 20 per cent as of 31 December 2017. According to new amendments on tax legislation of Turkey, 22 per cent corporate tax rate will be applied to the profits of the companies related to 2018, 2019 and 2020 tax periods. Corporate income taxes are payable quarterly. Besides that there are many exemptions in Corporate Tax Law of Turkey regarding corporations including deduction of investment incentives from fiscal gains during determination of tax base up to 25 per cent. In accordance with the tax legislation of Turkey dividends paid to overseas corporations located outside Turkey, which have a place of business in Turkey are not subject to withholding tax that is 15 per cent.

The Group's subsidiaries – SOCAR Overseas LLC, Azerbaijan (SCP) LTD, Baku Shipyard LLC, Sermaye Investment Limited, SOCAR Polymer LLC and SOCAR Absheron LLC are exempt from taxation.

### **35. Advances received for sale of interest**

In July 2014, the Company signed a Deferred Sales Purchase Agreement ("DSPA") to sell SOCAR's 10 per cent interest in Shah Deniz PSA and 10 per cent interest in SCPC (together referred as "Interest"). According to the terms of this agreement SGC shall pay advance for these acquisitions to SOCAR while control will pass to SGC in 2023 upon meeting of conditions preceding sale. As of 31 December 2017, total consideration, received for the interest in Shah Deniz PSA and SCPC amounted AZN 4,076 (USD 2,398 million) (2016: AZN 2,897 (USD 1,636 million)). In addition, DSPA specifies certain progress payments related to acquisition consideration payable annually till the end of 2020.

### **36. Put option liabilities**

On 12 August 2015, 891 million newly issued shares, representing 13 per cent of capital of STEAS, a subsidiary of the Group, were purchased by GSI in exchange for AZN 1,364 (USD 1,300 million).

At the same time, the Group entered into a put option agreement with GSI, whereby the Group has committed to purchase back the shares held by GSI, at a specified price, in case if the planned initial public offering of STEAS does not occur, or to settle the put option in case if certain conditions provided by the put option agreement are not met. Put option provided by the Group to GSI will be valid for 6 years following the signing of the put option agreement and represents non-current financial liability. As at 31 December 2017, carrying value of put option liability over 13 per cent STEAS shares equals to AZN 2,209 (31 December 2016: AZN 2,300).

The Group also has put option liability in the amount of AZN 510 (USD 300 million) (31 December 2016: AZN 532 (USD 300 million)) related to the put option agreement signed between STEAS and GSI in 2014 regarding 30 per cent shares of Petlim Limancılık Ticaret A.S.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 37. Significant non-cash investing and financing activities

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

	2017	2016
<b>Non-cash investing and financing activities</b>		
Capital expenditures under carried interest arrangement	475	57
Capitalized decommissioning costs	70	83
Purchase of PPE through long-term loans	60	–
Transfer of loan to charter by NCI	27	–
Purchase of PPE through finance lease	16	–
Construction of Carbamide Plant through factoring arrangement	–	197
Transfer of account receivables to charter capital of joint venture	–	114
<b>Non-cash investing and financing activities</b>	<b>648</b>	<b>451</b>

### 38. Changes in liabilities arising from financing activities

	1 January 2017	Cash flows	Interest paid	Finance cost	Foreign exchange movement	Other	31 December 2017
Long-term and short-term borrowings	14,927	921	(504)	659	(420)	(72)	15,511
Put option liabilities	2,832	–	–	–	(113)	–	2,719
Dividend payable to NCI	–	(252)	–	–	–	274	22
<b>Total liabilities from financing activities</b>	<b>17,759</b>	<b>669</b>	<b>(504)</b>	<b>659</b>	<b>(533)</b>	<b>202</b>	<b>18,252</b>

The other movement of long-term and short-term borrowings represents repayment of factored invoices (AZN 124) related to construction of Carbamide Plant, which is presented under “cash flows from investing activities” line, and long-term loan payable to Aqrarkredit CJSC (AZN 60) for the purchase of Methanol Plant, which is non-cash transaction (Note 37). The other movement of dividend payable represents dividend declared amount to non-controlling shareholders during 2017.

### 39. Contingences, commitments and operating risks

#### Operating environment

The Group's operations are mainly conducted in the Azerbaijan Republic. Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks. The future stability of the Azerbaijan economy is largely dependent upon these reforms and the effectiveness of economic, financial and monetary measures undertaken by the government as well as crude oil prices and stability of Azerbaijani Manat.

The Azerbaijan economy has been negatively impacted by decline of oil prices and devaluation of Azerbaijani Manat during 2015. This resulted in reduced access to capital, a higher cost of capital, inflation and uncertainty regarding economic growth. In response to these challenges, Azerbaijani government announced plans to accelerate reforms and support financial system. On 6 December 2016 President of the Republic of Azerbaijan approved “Strategic road maps for the national economy and main economic sectors of Azerbaijan”. The road maps cover 2016-2020 development strategy, long-term outlook up to 2025 and vision beyond.

Furthermore, during 2017 the government continued tight monetary policy as well as allocated foreign currency resources which stabilized Azerbaijani Manat. This policy is expected to continue in 2018 with the aim of maintaining macroeconomic stability.

The Company's management is monitoring economic 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.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

### **39. Contingences, commitments and operating risks (continued)**

#### **Operating environment (continued)**

International credit rating agencies regularly evaluate credit rating of the Azerbaijan Republic and the Group. Fitch evaluated rating of the Group and rating of the Azerbaijan Republic as “BB+”, however, S&P evaluated the Azerbaijan Republic with “BB+” and the Group with “BB-”. Moody’s Investors Service set “Ba2” credit rating for Azerbaijan and for the Group.

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.

The Group’s activities in Ukraine are exposed to, amongst others, low levels of liquidity in the capital markets and the existence of currency controls which cause the national currency to be illiquid outside of Ukraine. The stability of the Ukrainian economy will be significantly impacted by the Government’s policies and actions with regard to administrative, fiscal, legal, and economic reforms. As a result, operations in Ukraine involve risks that are not typical for developed markets. The Ukrainian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world.

Significant changes occurred in operating environment and political situation in Ukraine at the end of 2013 – beginning of 2014, which resulted in political and economic instability and continued to deteriorate significantly further. Following the significant deterioration in 2014 and 2015, the current political and economic situation in Ukraine remains unstable.

The weakness of the national currency (UAH), which experienced more than triple devaluation against major foreign currencies (US Dollar and EUR) since the beginning of 2014, combined with cross border settlement restrictions, negative external trade balance, along with continued volatility in the country’s traditional export commodity markets, and high inflation represent key risks to the stabilisation of the Ukrainian operating environment in the near future. From 1 January 2017 to 31 December 2017, the Ukrainian Hryvnia (the “UAH”) depreciated against major foreign currencies by approximately 3 and 18 per cent calculated based on the National Bank of Ukraine’s (“NBU”) exchange rates of UAH to US Dollar and Euro, respectively (from 1 January 2016 to 31 December 2016: 12 and 8 per cent respectively).

The Ukrainian government continues to pursue a comprehensive structural reform agenda aiming at the removal of the existing imbalances in the economy, public finance and governance, fighting corruption, reforming judiciary system, etc. with the ultimate goal to secure conditions for the economic recovery in the country. Management is monitoring these developments in the current environment and taking actions where appropriate. Further negative developments, including the political unrest, could adversely affect the Group’s subsidiary, SOCAR Energy Ukraine’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.

#### **Legal proceedings**

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

#### **Tax legislation**

Azerbaijan tax, currency and customs legislation is subject to varying interpretations, and changes, which may occur frequently. Management’s interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

### **39. Contingences, commitments and operating risks (continued)**

#### **Tax legislation (continued)**

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

The Group's management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained and potential tax liabilities of the

Group will not exceed the amounts recorded in these consolidated financial statements. Accordingly, at 31 December 2017 and 2016 no provision for potential tax liabilities had been recorded.

#### **Environmental matters**

The enforcement of environmental regulation in the Azerbaijan Republic is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognized immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage above environmental obligation provision currently made by the Group (Note 24).

The Group is subject to numerous national and local environmental laws and regulations concerning its products, operations and other activities. These laws and regulations may require the Group to take future action to remediate the effects on the environment of prior disposal or release of chemicals or petroleum substances by the Group or other parties. Such contingencies may exist for various sites including refineries, chemical plants, oil fields, service stations, terminals and waste disposal sites. In addition, the Group may have obligations relating to prior asset sales or closed facilities. The ultimate requirement for remediation and its cost are inherently difficult to estimate. However, the estimated cost of known environmental obligations has been provided in the consolidated financial statements in accordance with the Group's accounting policies. While the amounts of future costs could be significant and could be material to the Group's results of operations in the period in which they are recognized, it is not practical to estimate the amounts involved. The Group does not expect these costs to have a material effect on the Group's financial position or liquidity.

The Group also has obligations to decommission oil and natural gas production facilities and related pipelines. Provision is made for the estimated costs of these activities, however there is uncertainty regarding both the amount and timing of these costs, given the long-term nature of these obligations.

The Group believes that the impact of any reasonably foreseeable changes to these provisions on the Group's results of operations, financial position or liquidity will not be material.

#### **Compliance with financial covenants**

At 31 December 2017, the Group had loans payable in total amount of AZN 15,511 which were received for financing its investing and operating activity. The Group is subject to certain financial covenants related to these borrowings. Non-compliance with such covenants may result in negative consequences for the Group including growth in the cost of borrowings and declaration of default. Management believes that, as of 31 December 2017 and 2016 the Group was in compliance with all applicable financial covenants.

#### **Commitments of Petkim**

During 2015, Petlim Limancılık Ticaret A.Ş., where Group subsidiary Petkim owns 70 per cent shares, has signed a project finance credit agreement with AKBANK T.A.Ş. in the amount of USD 212 million (AZN 360) which has 13 years of maturity with no repayment during first 3 years period, for the external funding of the container port project. Petkim has pledged its shares in Petlim amounting to TRY 105 million (AZN 47) and a mortgage amounting to USD 350 million (AZN 595) as a guarantee for the loan repayment. The project has financial covenants that are valid during the operating period.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 39. Contingences, commitments and operating risks (continued)

#### Guarantee received and given by Petkim

The following table demonstrates guarantees received and given by the Group at 31 December 2017

	2017	2016
<b>Guarantees received</b>		
Bank guarantees within the context of direct order collection system (DOCS)	285	247
Letters of guarantee received from customers	203	145
Letters of credit received	173	48
Receivable Insurance	142	42
Letters of guarantee received from suppliers	94	96
Other	79	2
<b>Total guarantees received</b>	<b>976</b>	<b>580</b>
<b>Guarantees given</b>		
Letters of guarantee given	1,171	604
<b>Total guarantees given</b>	<b>1,171</b>	<b>604</b>

#### Ongoing cases against Petkim

On 25 August 2017, Petkim was notified by Turkish Tax Authority about the additional VAT charge and fine which was calculated based on Special Consumption Tax ("SCT") regime as a result of the investigation related to pyrolysis gasoline ("pygas") consumption during 2014. Three ongoing legal cases with respect to the application of SCT regime for pygas, have been recently resulted in favour of the Petkim. Accordingly the management and its legal consultants believe the base for noted fine will be deemed as invalid, and so no financial exposure is deemed probable.

#### Bank guarantees of Azfen

As of 31 December 2017 Azfen has bank guarantees given in favour of third parties in the aggregate amount of USD 130 million (AZN 221) (31 December 2016: USD 115 million (AZN 204)). The Group's share of commitments as of 31 December 2017 was USD 78 million (AZN 137) (31 December 2016: USD 69 million (AZN 122)).

#### Commitment of Azerigas PU

Based on Presidential Decree number 118 dated 27 February 2014, directed to social-economic development of Baku area and regions of the Republic of Azerbaijan, Azerigas PU has certain commitments with respect to improvement of gasification options in mentioned areas for years 2014-2018. According to this decree, Azerigas PU would be engaged in restoration of old local gas pipelines, continue gasification of new residential communities/regions/far locations, and renewal of old industrial and personal meters for physical customers.

Management believes that these expenditures will continue to be financed by the Government through contributions into capital.

#### Gas purchase commitment

Based on the Gas Sales and Purchase Agreement signed on 27 February 2003 between Azerbaijan Gas Supply Company ("AGSC") and the Ministry of Energy of the Azerbaijan Republic (currently purchase rights under this agreement are executed by the Group), the Group has obligation to purchase seller's minimum annual quantity as indicated in the agreement for the period beginning from signing of the contract up to the termination date of Shah Deniz PSA.

Additional two agreements were signed between AGSC and SOCAR on 17 December 2013. The Group agreed to buy additional volumes of (with a possibility to export certain part of it to Turkey) gas from Shah Deniz field during the period of 2014-mid 2018 under one agreement and in 2019, with the parties' right to extend the supplies till 2021, under another one. The former agreement was amended in 2015 to allow optionality for delivery of part of the volumes to Georgia. SOCAR is obliged to buy the above mentioned volumes at a price established in the contract.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 39. Contingences, commitments and operating risks (continued)

#### Gas purchase commitment (continued)

##### SOCAR – AGSC Gas sales agreement

The Group is obliged under the agreement signed with AGSC to purchase minimum annual quantity of gas as indicated in the agreement during the period 1 May 2019 – 31 December 2020 (or earlier termination of the agreement in accordance with provisions of the agreement) at a price which is stipulated in the contract.

#### Participating interest in ACG PSA

Azerbaijan International Operating Company, the Operator of the ACG PSA has entered into a number of capital commitments as at 31 December 2017. The Group estimated its 25 per cent (2016: 11.65 per cent) share of these commitments to be USD 411 million (AZN 699) (2016: USD 238 million (AZN 421)).

#### Operating Lease Commitments

The Group's certain joint operations and subsidiaries have entered into number of operating lease agreements which created commitments, as follows:

At 31 December 2017, The Group has following operating lease commitments:

<b>31 December 2017</b>	<b>Within one year</b>	<b>After one year but no later than five years</b>	<b>More than five years</b>
Shah Deniz	30,089	39,460	–
ACG	54,837	38,667	–
SOCAR Switzerland	20,528	47,934	105,570
SOCAR Trading	83,641	49,529	11,761
<b>Total</b>	<b>189,095</b>	<b>175,590</b>	<b>117,331</b>

At 31 December 2016, The Group has following operating lease commitments:

<b>31 December 2016</b>	<b>Within one year</b>	<b>After one year but no later than five years</b>	<b>More than five years</b>
Shah Deniz	48,182	68,939	–
ACG	15,561	23,274	–
SOCAR Switzerland	20,770	49,557	107,127
SOCAR Trading	60,383	50,198	–
<b>Total</b>	<b>144,896</b>	<b>191,968</b>	<b>107,127</b>

#### Commitments related to participating interest in Shah Deniz

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 certain Addendums to Shah Deniz Exploration and Development and Production Sharing Agreement (“SD EDPSA”). According to the Eighth Addendum to SD EDPSA the parties agreed to extend the development and production period up to 46 years ending on 6 March 2047 subject to certain conditions precedent. This extension is conditional upon execution of the additional work program where Contractor parties shall spend no less than USD 25 million (AZN 43) by 31 December 2018.

BP Exploration Shah Deniz Limited, the Operator of the Shah Deniz PSA has entered into a number of capital commitments as at 31 December 2017. The Group estimated its 13.27 per cent share of these capital commitments through its subsidiary and associate to be USD 764 million (AZN 1,299) (2016: USD 1,372 million (AZN 2,430)).



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### 39. Contingences, commitments and operating risks (continued)

#### Commitments related to participating interest in AGSC

As indicated in Note 19, the Group holds 28 per cent direct interest in AGSC and indirect 2.62 per cent through its associate. In accordance with the agreements of AGSC the Group has the following commitments relating to AGSC's activity:

##### *BOTAS SPA 1*

AGSC is obliged under the gas contract signed on 12 March 2001 to make available a maximum of approximately 6.6 billion Contract cubic meters (bCcm) of gas annually from 2018 till April 2021 at a price calculated based on a formula established by the gas contract.

##### *BOTAS SPA 2*

On 25 October 2011 the Group and BOTAS executed a gas Sale and Purchase Agreement ("BOTAS SPA 2") with respect to the sale by the Group to BOTAS of certain volumes of Shah Deniz Stage 2 Gas (6 bCcm plateau period). In December 2012 the Group transferred and assigned the rights and obligations under the Stage 2 SPA to AGSC. The anticipated commencement of the first gas delivery under Stage 2 BOTAS SPA is mid-2018.

##### *Botas contract for BTC fuel gas (BIL GSA)*

AGSC is obliged under the agreement with BOTAS dated 25 October 2011 to make available 0.15 bCcm of gas annually at a price which is calculated based on a formula established in the contract.

##### *Georgian Supplemental Gas SPA with GOGC*

AGSC is obliged under the agreement signed with Georgian Oil and Gas Corporation ("GOGC") and the government of Georgia to make available 0.5 billion Standard cubic meters (bScm) of gas annually in 2018 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 OptionCo to make available gas during each contract year a maximum of five percent of the volumes transported in the previous calendar years by AGSC via the SCP pipeline through territory of Georgia, at a price which is calculated based on a formula established in the contract

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

AGSC is obliged under the Fuel Gas Sales and Purchase Agreement between AGSC and BTC Co, dated 30 November 2007 ("BTC SPA") to make 0.16 bScm during the following years at a price which is calculated based on a formula established in the contract.

##### *Shah Deniz Stage 2 EU Long term Gas Sales Agreements ("GSA")*

In September 2013, ten EU GSA were signed by the Group with nine EU Buyers (DEPA, Bulgargaz Shell, Uniper, Axpo, ENGIE, Gas Natural Fenosa, Enel, Hera) and in December 2013 the GSA were assigned to AGSC until Shah Deniz PSA expiry with re-assignment to the Group. The commencement date will be firmed up through funnelling mechanism as defined in the GSA.

##### *Transportation agreement with SCPC*

AGSC is party to SCPC Gas Transportation Agreement ("GTA"), dated 27 February 2003 which was subsequently amended and re-stated ("SCP GTA") with effect from 17 December 2013 in order to provide additional transportation services in respect of Shah Deniz Stage 2 volumes. AGSC is obliged to pay certain tariffs, as calculated in accordance with the agreement, to SCPC starting from the commencement date, which is 1 October 2006. AGSC is obliged to provide SCPC, free of charge, the natural gas necessary to fill and pressurize the pipeline to its designed operating pressure and used as fuel gas.

##### *Framework agreement*

A fully-termed Framework Agreement related to novation of long-term GSAs and transfer of GTA capacity between SOCAR and AGSC after 2036 was executed on 19 October 2015.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### **39. Contingences, commitments and operating risks (continued)**

#### **Commitments related to participating interest in AGSC (continued)**

##### *Trans Anatolian Pipeline Gas Transportation Agreement (TANAP GTA)*

AGSC is a party to TANAP GTA with annual reserved capacity as defined in the contract. The start date will be set through a funnelling mechanism.

##### *Trans Adriatic Pipeline Gas Transportation Agreement (TAP GTA)*

AGSC and SOCAR is a party to TAP GTA with annual capacity as defined in the contract. The planned commencement date is between 1 January 2020 – 31 December 2020.

Under the above mentioned agreements, AGSC is obliged to make available maximum of approximately 25 bCcm of gas annually (plateau period) until the end of Shah Deniz PSA.

#### **Deferred Sale and Purchase Agreement with SGC**

According to Deferred Sale and Purchase Agreement (“DSPA”) signed with SGC Upstream LLC and SGC Midstream LLC the Group agrees to sell its whole interest in Shah Deniz PSA, AGSC and SCPC in March 2023 upon meeting of the following conditions preceding sale:

- ▶ The full and unconditional repayment of the notes and fulfilment of other obligations under the Eurobonds agreements by SOCAR; and
- ▶ Confirmation of the payment of full consideration amount in accordance with agreement terms.

#### **Oil shipment commitment**

On 1 August 2002 the Group and other participants under the ACG PSA (the “Shipper Group”) have entered into the ACG Field Production Transportation Agreement (“ACG TA”) with the BTC Co which was amended on 3 February 2004. Under this Agreement, the Shipper Group have committed to ship through the BTC Pipeline all of their crude oil entitlement from the ACG field, other than any production which each participant may ship through the Western Export Route. The Group has agreed to transport its crude oil by rail unless BTC Co is operating at its full capacity. In accordance with ACG TA the Group has agreed not to use other transportation options if capacity of the BTC Co is sufficient. The BTC Pipeline was put into operation in May 2006.

The BTC Pipeline, with a throughput capacity of more than 1,200,000 barrels per day, is used as the Shipper Group’s main export route. In accordance with the Transportation Agreement, the Shipper Group, the Group representative, the lenders and security trustee to BTC Co, and the lenders and security trustee to certain participants of the ACG Shipper Group have agreed that payment of BTC Co tariff has a first priority claim on oil sale proceeds.

#### **Commitments of Baku Shipyard LLC**

As at 31 December 2017, the Group had capital commitments to third parties in the amount of AZN 46 (2016: AZN 46) in respect of construction contracts.

#### **Commitment of SEG**

As of 31 December 2017 SEG had guarantees to banks in the total amount of AZN 15 in favour of third parties that engaged in the gasification process.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

### **39. Contingences, commitments and operating risks (continued)**

#### **Commitments of SOCAR Trading**

SOCAR Trading has entered into number of letter of credit agreements with different banks against various operations. The outstanding amount as of 31 December 2017 is AZN 911 (USD 536 million) (2016: AZN 921 (USD 520 million)).

#### **Commitments of SOCAR Switzerland**

The Group has number capital commitments for the next years. The Group estimated its capital commitments to be CHF 9 million (AZN 15) (2016: zero)

#### **Commitments of SOCAR Polymer**

During 2015, SOCAR Polymer Investments LLC signed agreements for provision of design, engineering, procurement, all onshore work and offshore assistance required for commissioning and testing for the polypropylene plant, high density polyethylene plant and utilities and off-sites. Total contract price of agreements is USD 508 million (AZN 863). During 2017, the SOCAR Polymer Investments LLC incurred cost of USD 463 million (AZN 787) on the mentioned services.

#### **Commitments of SOCAR Overseas**

The Group has entered into number of letter of credit agreements during 2017 with different banks (UBS, ING, BNP, Societe Generale and etc.) against various shipments. The outstanding amount as of 31 December 2017 is USD 257 million (AZN 438).

#### **Commitments of SOCAR Head Office**

According to Equity Subscription Support and Retention Agreement ("ESSRA") which had been signed as a part of STAR Project Finance deal, the Group concluded letter of credit facility agreements in the total amount of USD 1,429 million (AZN 2,228) with certain banks (The Lenders).

The letter of credits are intended to provide security to the Lenders for the unpaid portion and to serve as the credit support of the Project in case there would be cost overruns exceeding the contingency amount designated in the Project budget. The outstanding amount of letter of credits as of 31 December 2017 was USD 514 million (AZN 874) (31 December 2016: USD 514 million (AZN 910)).

#### **Feedstock supply agreement**

On 20 June 2014 the Group and SOCAR Polymer signed a feedstock supply agreement according to which the Group bears obligation to supply ethylene and propylene at 44 per cent and 40 per cent discount of market price, respectively. SOCAR Polymer expects to start its production process in 2018.

#### **Commitment related to SCP Expansion**

Shah Deniz PSA Contractor Parties made the final investment decision on SCP Expansion project on 17 December 2013. SCP Expansion project objective is to expand the existing SCP pipeline 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 throughout the construction and initial operational phase.

The Group's share in the remaining construction budget of the SCP Expansion is estimated in the amount of USD 103 million (AZN 175) (2016: USD 213 million (AZN 378)).

#### *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 USD 2,797 million (AZN 4,755) (2016: USD 5,028 million (AZN 8,903)). The Group's share through its associate at 31 December 2017 was USD 795 million (AZN 1,351) (2016: USD 1,429 million (AZN 2,530)).

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

### **39. Contingences, commitments and operating risks (continued)**

#### **Commitment related to SCP Expansion (continued)**

##### *Construction of TAP*

At the financial statement date, the Group has capital commitment to fund the construction of TAP system. The remaining budget for construction of TAP system is estimated in the amount of USD 2,469 million (AZN 4,197) (2016: USD 3,121 million (AZN 5,526)). The Group's share through its associate at 31 December 2017 was USD 242 million (AZN 412) (2016: USD 1,429 million (AZN 2,530)).

#### **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 per cent shares in TANAP A.Ş., upon acquisition of shares in TANAP A.Ş. by BOTAS. Following the sale of TANAP to SGC, on 13 March 2015, the Group signed novation agreement with SGC and BOTAS, where all rights and obligations under the Funding Agreement were transferred from SOCAR to the SGC. According to agreement with BOTAS, the SGC has commitment for providing interest free loan to BOTAS for financing its 5 per cent share in TANAP A.Ş.'s future cash call requirements till TANAP becomes operational. The Group commitment in this financing equals to its share in SGC.

#### **SOCAR Gas Transportation Agreement (SOCAR GTA)**

Based on this GTA, from and including the start date (6 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.

### **40. Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business, acquisition of interests in PSA, goodwill and intangible asset with indefinite useful life**

#### **Acquisition of additional shares in ACG PSA**

Up to 20 November 2017, AzACG managed SOCAR's 11.65 per cent participating interest in the Agreement on the Joint Development and Production Sharing for the Azeri and Chirag Fields and the Deep Water Portion of the Gunashli Field in the Azerbaijan Sector of the Caspian Sea (the "ACG PSA"), which was enacted by the legislature of the Azerbaijan Republic giving it the full force of law in the Azerbaijan Republic and which became effective on 12 December 1994 with a 30-year validity.

On 20 November 2017, ACG PSA was amended and restated whereby AzACG's interest in the PSA increased by 13.35 per cent which became effective from 1 January 2018. No consideration was paid by the Group for the acquired shares.

ACG PSA Contractor Parties signed ATD on 14 September 2017 and agreed to compensate the Group for the difference between its initial participating interests of 11.65 per cent and adjusted participating interests of 25 per cent related to 2017 activities. As a result, the Group has a right to 25 per cent share of revenue and is liable for 25 per cent of expenses for the period from 1 January 2017 to 31 December 2017. The Group recognized receivables from ACG PSA Contractor Parties in the amount of AZN 578 (USD 339 million).

As per amended and restated ACG PSA agreement, increase in participation interest of the Group to 25 per cent was to the detriment of participation interest of ACG PSA Contractor Parties. The right to extension of the PSA was granted to ACG PSA Contractor Parties by the Government and effectively, the Group's interest in PSA increased. Ultimately the Group acquired additional interest in ACG PSA in the transaction under common control of the Government without transfer of any consideration. The Group's accounting policy is to account for such transactions at fair value with difference between consideration amount and fair value of acquired asset recognized within equity as APIC (Note 28).

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

**40. Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business, acquisition of interests in PSA, goodwill and intangible asset with indefinite useful life (continued)**

**Acquisition of additional shares in ACG PSA (continued)**

Fair values of the assets and liabilities related to, acquired 13.35 per cent interest in ACG PSA are presented below:

	<b>Note</b>	<b>Fair value recognized on acquisition of additional interest in ACG PSA</b>
<b>Assets</b>		
Property, plant and equipment	16	3,059
Receivable from contractor parties	13	578
Inventory	12	84
Trade and other receivables		2
		<b>3,723</b>
<b>Liabilities</b>		
Trade and other payables	20	(57)
Asset retirement obligations	23	(293)
		<b>(350)</b>
<b>Total net assets at fair value</b>	<b>28</b>	<b>3,373</b>

**Acquisition of 10 per cent interest in Absheron PSA**

On 23 June 2017, contractor parties to Absheron PSA, the Group, TOTAL Absheron and Engie signed Deed of Assignment whereby Engie withdrew from PSA and assigned its 20 per cent participating interest to other parties for free of charge. As a result of transaction the Group's participating interest increased to 50 per cent. The Group applied acquisition method for accounting of the increase in participating interest in Absheron PSA which constitutes a business. As a result of provisional purchase price allocation, the Group recognized acquired oil and gas property at fair value of AZN 48 and respective gain within other operating income.

**Accounting of 80 per cent shares in UBEP**

SOCAR Umid LLC ("Umid" or "JV") was joint venture between the Group and Nobel Oil with ownership interest of 80 per cent and 20 per cent, respectively. Main objective of Umid was exploration, development and production of Umid field. Despite of the commencement of production phase, Umid did not have licence for sale of gas and condensate.

Shareholders of Umid decided to restructure joint venture and establish joint operation that would be party to Risk Service Agreement ("RSA") dated on 12 January 2017, which was ratified by the Parliament on 2 May 2017.

On 7 August 2017, based on Share Swap Agreement, parties transferred all assets and liabilities of Umid (except for property, plant and equipment) to the Group. PPE of JV was transferred for use of UBEP. SOCAR and Nobel Oil continued their operations in UBEP with ownership interest 80 per cent and 20 per cent, respectively.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

**40. Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business, acquisition of interests in PSA, goodwill and intangible asset with indefinite useful life (continued)**

**Accounting of 80 per cent shares in UBEP (continued)**

This transaction was recognized as “acquisition of joint operation that is business” in accordance with IFRS 3 and IFRS 11. Excess amount of fair value of net identifiable assets of UBEP over fair value of assets transferred was recorded as a gain on bargain transaction in the amount of AZN 84.

	<b>Note</b>	<b>Fair value of 80 per cent shares in UBEP</b>
<b>Assets</b>		
Group's share in property, plant and equipment	16	401
Group's share in intangible asset – licence	17	105
<b>Total identifiable net assets at fair value</b>		<b>506</b>
<b>Fair value of assets transferred</b>		
Fair value of acquirer's previously held equity interest in JV		561
Less: fair value of assets and liabilities of JV transferred to the Group		(139)
<b>Total transferred assets at fair value</b>		<b>422</b>
<b>Gain on bargain transaction</b>		<b>84</b>

There were no cash outflows as a result mentioned transactions and the transactions resulted in cash inflow in the amount of AZN 13.

As mentioned above, according to the Share Swap Agreement, all assets and liabilities of Umid, except for property plant and equipment, transferred to the Group. The Group accounted for this transfer at fair value as an adjustment to transferred assets.

The Group re-measured previously held equity interest in Umid to fair value and recognized it as part of assets transferred:

	<b>Note</b>	
Fair value of investment in JV at transaction date		561
Carrying value of investment in JV at transaction date	18	304
<b>Gain on re-measurement to fair value of investment in JV</b>	31	<b>257</b>

**Goodwill and intangible assets with indefinite useful lives**

For impairment testing goodwill acquired through business combinations and intangible assets with indefinite useful lives were allocated to CGUs at 31 December 2017 and 2016 as following:

	<b>SOCAR Trading</b>		<b>SOCAR Switzerland</b>		<b>Petkim</b>		<b>UBEP</b>		<b>Other</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Goodwill</b>	106	110	116	116	88	98	–	–	17	18
<b>Trade name</b>	–	–	–	–	33	37	–	–	–	–
<b>Licence with indefinite useful life</b>	–	–	–	–	–	–	105	–	–	–

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

**40. Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business, acquisition of interests in PSA, goodwill and intangible asset with indefinite useful life (continued)**

**Goodwill and intangible assets with indefinite useful lives (continued)**

Movement in the carrying amount of goodwill was as follows:

	2017	2016
<b>Carrying amount at 1 January</b>	<b>342</b>	<b>275</b>
Translation difference	(15)	67
<b>Carrying amount at 31 December</b>	<b>327</b>	<b>342</b>

The carrying amounts of goodwill as of 31 December 2017 and 2016 include an accumulated goodwill impairment of AZN 3.

**Testing of the carrying value of goodwill and trade name related to Petkim**

The carrying value of the goodwill and Petkim trade name at 31 December 2017 has been tested for impairment through comparison with its recoverable amount. Recoverable amount has been determined in the amount of AZN 5,371 based on the value-in-use calculations of Petkim. Pre-tax cash flows projections used for this purpose are based on financial budgets approved by management covering 11-year period. Cash flows for 11-year period are based on existing long-term projects with duration until 2028. Cash flow projections beyond 11-year period are extrapolated by the terminal growth rates of 3 per cent and then discounted to their net present value. The following key assumptions were used for impairment test of the goodwill:

The valuation exercises are highly sensitive to the WACC, which was taken into account by the Group as 9.5 per cent during forecasted period of 11 years.

As a result of the test performed, no impairment has been identified.

A sensitivity analysis is conducted by changing the assumptions used in the estimation of Petkim carrying amount of the value in use in relation to the key parameters that are described below:

- ▶ If the estimated discount rate used in the calculation had been 0.4 per cent higher/lower than management's estimate, the value in use would have been AZN 397 lower / AZN 462 higher, respectively;
- ▶ If the terminal growth rate used in the calculation had been 0.5 per cent higher/lower than management's estimate, the value in use would have been AZN 337 higher / AZN 289 lower, respectively.

As a result of the sensitivity analysis, no impairment losses were identified.

**Testing of the carrying value of goodwill related to acquisition of SOCAR Switzerland**

The carrying value of the goodwill at 31 December 2017 has been tested for impairment through comparison with its recoverable amount. Recoverable amount has been determined based on the value-in-use calculations of SOCAR Energy Switzerland GmbH and its subsidiaries as AZN 869 as of 31 December, 2017. Pre-tax cash flows projections used for this purpose are based on annual business plan approved by management covering 5-year period. Management believes that the underlying cash flows projections represent accurate and reliable forecast. Cash flow projections beyond 5 year period are extrapolated by terminal growth rates of 1.5 per cent and then discounted to their net present value, applying WACC, used as a discount factor of 6 per cent. As a result of the test performed, no impairment has been identified.

If the estimated discount rate used in the calculation had been 1 per cent higher/lower than management's estimate, the value in use would have been AZN 158 lower / AZN 248 higher, respectively.

If the terminal growth rate used in the calculation had been 0.25 per cent higher/lower than management's estimate, the value in use would have been AZN 42 higher / AZN 38 lower, respectively.

As a result of the sensitivity analysis, no impairment losses were identified.

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

#### 40. Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business, acquisition of interests in PSA, goodwill and intangible asset with indefinite useful life (continued)

##### Testing of the carrying value of goodwill related to acquisition of SOCAR Trading

The carrying value of the goodwill attributable to the acquisition of SOCAR Trading at 31 December 2017 has been tested for impairment through comparison with its recoverable amount. Recoverable amount has been determined based on the value-in-use calculations of SOCAR Trading and its subsidiaries as AZN 1,625 as of 31 December 2017. Cash flow projections used for this purpose are based on financial forecast approved by management covering 5-year period. Cash flows for that period are based on existing and new projects and discounted to their net present value. Management believes that these cash flow projections represent accurate and realistic forecast. Cash flow projections beyond 5-year period have terminal growth rate of 1 per cent. The following key assumptions were used for impairment test of the goodwill:

- ▶ Valuation exercise is sensitive to the WACC, which was taken into account by the Group, as 12 per cent;
- ▶ Valuation is also sensitive to terminal growth rate which is taken into account by the Group as 1 per cent.

As a result of the test performed, no impairment has been identified.

If the estimated discount rate used in the calculation had been 0.25 per cent higher/lower than management's estimate, the value in use would have been AZN 35 lower / AZN 37 higher, respectively.

If the terminal growth rate used in the calculation had been 0.25 per cent higher/lower than management's estimate, the value in use would have been AZN 16 higher / AZN 15 lower, respectively.

As a result of the sensitivity analysis, no impairment losses were identified.

##### Testing of the licence related to UBEP

The licence of UBEP gives right to the Group to produce and sell natural gas and condensate of Umid field and exploit Babek field. Carrying value of licence at 31 December 2017 has been tested for impairment through comparison with its recoverable amount. Recoverable amount has been determined based on the value-in-use calculations of UBEP as AZN 543 as of 31 December 2017. Cash flow projections used for this purpose are based on financial forecast covering PSA life which is 28 years. As a result of the test performed, no impairment was identified.

The valuation exercises are sensitive to the change in WACC, which was taken into account by the Group, as 16 per cent throughout the projection period.

If WACC used in the calculation had been 1 per cent higher/lower than management's estimate, the value in use would have been AZN 28 lower / AZN 30 higher, respectively. As a result of the sensitivity analysis, no impairment was identified.

#### 41. Material partly-owned subsidiaries

Financial information of subsidiaries that have material non-controlling interests is provided below:

Proportion of equity interest held by non-controlling interests:

Name	Country of incorporation	Country of operation	2017	2016
Petkim	Turkey	Turkey	49%	48%
Star Gulf FZCO	UAE	Azerbaijan	20%	20%

Accumulated balances of material non-controlling interests:

Name	2017	2016
Petkim	1,255	1,206
Star Gulf FZCO	33	87



(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

#### 41. Material partly-owned subsidiaries (continued)

Profit allocated to material non-controlling interests:

Name	2017	2016
Petkim	299	161
Star Gulf FZCO	49	79

The summarised financial information of these subsidiaries is provided below. This information is based on amounts before inter-company eliminations:

Summarised statement of profit or loss for 2017:

	Petkim	Star Gulf FZCO
Revenue	3,474	223
Cost of Sales	(2,636)	(69)
General and administrative expenses	(101)	(1)
Distribution expenses	(28)	–
Other operating income	131	91
Other operating expense	(84)	–
Finance income	306	–
Finance costs	(322)	–
Foreign exchange gain	–	6
<b>Profit before tax</b>	<b>740</b>	<b>250</b>
Income tax expense	(128)	(7)
<b>Profit for the year from continuing operations</b>	<b>612</b>	<b>243</b>
Other comprehensive loss to be reclassified to profit or loss in subsequent periods – currency translation differences	(279)	(10)
<b>Total comprehensive income</b>	<b>333</b>	<b>233</b>
Attributable to non-controlling interests	162	47
Dividends paid to non-controlling interests	138	101

Summarised statement of profit or loss for 2016:

	Petkim	Star Gulf FZCO
Revenue	2,392	506
Cost of Sales	(1,924)	(95)
General and administrative expenses	(82)	(1)
Distribution expenses	(23)	–
Other operating income	78	10
Other operating expense	(81)	–
Finance income	239	–
Finance costs	(237)	–
Foreign exchange loss	–	(4)
<b>Profit before tax</b>	<b>362</b>	<b>416</b>
Income tax expense	(26)	(22)
<b>Profit for the year from continuing operations</b>	<b>336</b>	<b>394</b>
Other comprehensive (loss)/income to be reclassified to profit or loss in subsequent periods – currency translation differences	(148)	41
<b>Total comprehensive income</b>	<b>188</b>	<b>435</b>
Attributable to non-controlling interests	90	92
Dividends paid to non-controlling interests	114	37

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

**41. Material partly-owned subsidiaries (continued)**

Summarised statement of financial position as at 31 December 2017:

	<b>Petkim</b>	<b>Star Gulf FZCO</b>
<b>Current assets</b>	<b>1,895</b>	<b>336</b>
including:		
<i>Cash and cash equivalents</i>	657	226
<i>Trade and other receivables</i>	790	48
<i>Inventories</i>	404	2
<i>Other current assets</i>	44	60
<b>Non-current assets</b>	<b>2,588</b>	<b>8</b>
including:		
<i>Property, plant and equipment</i>	2,083	7
<i>Intangible assets</i>	333	1
<i>Other non-current assets</i>	172	–
<b>Current liabilities</b>	<b>(1,056)</b>	<b>(181)</b>
including:		
<i>Short-term borrowings and current portion of long-term borrowings</i>	(362)	–
<i>Trade and other payables</i>	(694)	(181)
<b>Non-current liabilities</b>	<b>(866)</b>	<b>–</b>
including:		
<i>Long-term borrowings</i>	(607)	–
<i>Deferred income</i>	(61)	–
<i>Other provisions for liabilities and charges</i>	(46)	–
<i>Deferred tax liabilities</i>	(152)	–
<b>Total equity</b>	<b>2,561</b>	<b>163</b>
<b>Attributable to:</b>		
Equity holders of parent	1,306	130
Non-controlling interests	1,255	33

Summarised statement of financial position as at 31 December 2016:

	<b>Petkim</b>	<b>Star Gulf FZCO</b>
<b>Current assets</b>	<b>1,340</b>	<b>484</b>
including:		
<i>Cash and cash equivalents</i>	637	281
<i>Trade and other receivables</i>	354	201
<i>Inventories</i>	307	2
<i>Other current assets</i>	42	–
<b>Non-current assets</b>	<b>2,949</b>	<b>19</b>
including:		
<i>Property, plant and equipment</i>	2,188	18
<i>Intangible assets</i>	383	1
<i>Other non-current assets</i>	378	–
<b>Current liabilities</b>	<b>(903)</b>	<b>(66)</b>
including:		
<i>Short-term borrowings and current portion of long-term borrowings</i>	(260)	–
<i>Trade and other payables</i>	(643)	(66)
<b>Non-current liabilities</b>	<b>(873)</b>	<b>–</b>
including:		
<i>Long-term borrowings</i>	(589)	–
<i>Deferred income</i>	(65)	–
<i>Other provisions for liabilities and charges</i>	(50)	–
<i>Deferred tax liabilities</i>	(169)	–
<b>Total equity</b>	<b>2,513</b>	<b>437</b>
<b>Attributable to:</b>		
Equity holders of parent	1,307	350
Non-controlling interests	1,206	87

(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)

#### 41. Material partly-owned subsidiaries (continued)

Summarised cash flow information for year ended 31 December 2017:

	<b>Petkim</b>	<b>Star Gulf FZCO</b>
Operating	553	304
Investing	(361)	39
Financing	(95)	(394)
Net foreign exchange difference on cash and cash equivalents	(5)	–
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>92</b>	<b>(51)</b>

Summarised cash flow information for year ended 31 December 2016:

	<b>Petkim</b>	<b>Star Gulf FZCO</b>
Operating	387	195
Investing	(214)	3
Financing	(307)	(118)
Net foreign exchange difference on cash and cash equivalents	95	–
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(39)</b>	<b>80</b>

#### 42. Events after reporting date

##### Acquisition of SGC's share in TANAP by STEAS

On 9 February 2018, purchase and sale agreement was signed between STEAS and SGC in relation to sales of SGC's 7 per cent share in TANAP A.Ş. The transaction took place in March 2018.

##### Disposal of SATSA

The Group signed sale and purchase agreement on 27 December 2017 for sale of its 50 per cent ownership in and loan receivable from its joint venture SATSA for the total consideration of AZN 80 (USD: 47 million). The Group received total consideration amount from the acquirer on 10 January 2018.

##### Bond Issuance

On 26 January 2018, Petkim issued AZN 850 (USD 500 million) Eurobonds with a maturity date of 26 January 2023, a fixed coupon rate of 5.875 per cent per annum and an issue price of 99.467 per cent that is listed on Irish Stock Exchange.

##### New Loans

During subsequent period, in March 2018, the Group obtained short-term and long-term loans from Ministry of Finance of Azerbaijan Republic in the amount of AZN 102 (USD 60 million) and AZN 98, respectively.

During subsequent period, the Group obtained short-term and long-term loans from several Georgian local banks in the amount of AZN 156 (GEL 239 million) and AZN 16 (GEL 24 million), respectively.

During subsequent period, the Group received tranche in the amount of AZN 47 (EUR 23 million) from several international banks for Carbamide Plant.

##### Loan Repayments

During subsequent period, the Group repaid its outstanding loans in the amount of AZN 417 (USD 245 million), AZN 6 (EUR 3 million) and AZN 187 (GEL 271 million) to several international and local banks and AZN 65 (USD 38 million) to SOFAZ.

*(Amounts presented are in millions of Azerbaijani Manats, unless otherwise stated)*

## **42. Events after reporting date (continued)**

### **Purchase of Vessels**

During subsequent period, the Group purchased four vessels from Credit Europe Bank for the consideration transferred in the aggregate amount of AZN 115 (USD 68 million).

### **Additional Paid In Capital**

During subsequent period, Vitol Black Sea V.L.L LLC and Ecoland LLC which are other shareholders of SOCAR Polymer Investments LLC, made additional equity injection to charter capital of SOCAR Polymer Investments LLC in amount of AZN 61 (USD 36 million) and AZN 22 (USD 13 million), respectively.

### **Letter of Credit**

During subsequent period, shareholders of STAR Refinery LLC made capital injections of AZN 102 (USD 60 million), which decreased letter of credits balance to AZN 772 (USD 454 million) (31 December 2017: AZN 874 (USD 514 million)) (Note 39).

### **Settlement of receivables from ACG Contractor Parties**

During subsequent period, the Group received total amount of AZN 578 (USD 339 million) from ACG Contractor Parties (Note 13).