

**STATE OIL COMPANY OF THE
AZERBAIJAN REPUBLIC**

**International Financial Reporting Standards
Consolidated Financial Statements**

31 December 2012

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Independent Auditors' Report

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Independent Auditors' Report to Management of the State Oil Company of the Azerbaijan Republic:

We have audited the accompanying consolidated financial statements of the State Oil Company of the Azerbaijan Republic (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young Holdings (CIS) B.V.

25 June 2013

State Oil Company of the Azerbaijan Republic
Consolidated Statement of Financial Position

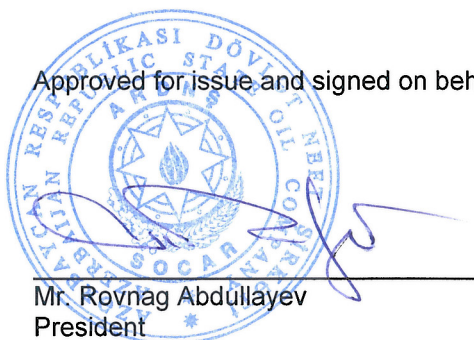
(Amounts presented are in thousands of Azerbaijani Manats)

	Note	31 December 2012	31 December 2011 (reclassified)
ASSETS			
Current assets			
Cash and cash equivalents	8	1,223,439	1,157,744
Restricted cash	9	97,765	94,370
Deposits	8	78,503	-
Trade and other receivables	10	5,034,295	2,690,373
Corporate income tax prepayments		11,457	-
Inventories	11	1,273,186	784,801
Other current financial assets	13	136,395	-
Total current assets		7,855,040	4,727,288
Non-current assets			
Property, plant and equipment	14	10,776,896	9,065,173
Goodwill	36	203,169	103,248
Intangible assets other than goodwill	15	576,355	405,491
Investments in jointly controlled entities	16	437,973	392,399
Investments in associates	17	1,165,020	1,186,370
Deferred tax asset	33	491,887	483,483
Other long-term financial assets	13	158,310	88,396
Other long-term assets	12	201,122	310,192
Loan receivable from jointly controlled entity	18	-	178,484
Total non-current assets		14,010,732	12,213,236
TOTAL ASSETS		21,865,772	16,940,524
EQUITY			
Charter capital	27	1,084,990	1,059,258
Additional paid-in-capital	27	1,014,809	784,809
Retained earnings		7,233,978	6,749,596
Cumulative translation differences		(40,275)	(77,272)
Equity attributable to equity holders of the Group		9,293,502	8,516,391
Non-controlling interest		558,587	732,229
TOTAL EQUITY		9,852,089	9,248,620


State Oil Company of the Azerbaijan Republic
Consolidated Statement of Financial Position (Continued)
(Amounts presented are in thousands of Azerbaijani Manats)

	Note	31 December 2012	31 December 2011 (reclassified)
LIABILITIES			
Current liabilities			
Trade and other payables	19	5,142,444	2,806,900
Short-term and current portion of long-term borrowings	20	1,873,202	761,518
Taxes payable	21	595,282	433,708
Corporate income tax payable		5,504	4,595
Other provisions for liabilities and charges	23	90,923	66,124
Deferred acquisition consideration payable	26	65,169	-
Total current liabilities		7,772,524	4,072,845
Non-current liabilities			
Long-term borrowings	20	2,617,561	2,218,770
Asset retirement obligations	22	620,864	468,384
Other provisions for liabilities and charges	23	229,437	246,765
Deferred income	24	91,043	94,401
Deferred tax liability	33	561,368	506,336
Other non-current liabilities	25	120,886	84,403
Total non-current liabilities		4,241,159	3,619,059
TOTAL LIABILITIES		12,013,683	7,691,904
TOTAL LIABILITIES AND EQUITY		21,865,772	16,940,524

Approved for issue and signed on behalf of the Group on 25 June 2013.



Mr. Rovnag Abdullayev
President



Mr. Suleyman Gasymov
Vice-President for Economic Affairs

State Oil Company of the Azerbaijan Republic
Consolidated Statement of Comprehensive Income
(Amounts presented are in thousands of Azerbaijani Manats)

	Note	2012	2011 (reclassified)
Revenue	28	17,138,832	8,132,731
Cost of sales	29	(14,009,861)	(4,996,038)
Gross profit		3,128,971	3,136,693
Distribution expenses	29	(412,484)	(382,744)
General and administrative expenses	29	(671,555)	(401,444)
Losses on disposal of property, plant and equipment, net		(24,412)	(25,731)
Social expenses		(232,992)	(278,342)
Exploration and evaluation expenses	29	(41,376)	(16,945)
Other operating expenses	29	(564,026)	(637,405)
Other operating income	30	151,506	149,003
Operating profit		1,333,632	1,543,085
Finance income	31	34,104	72,400
Finance costs	32	(188,435)	(210,950)
Foreign exchange gains and losses, net		35,832	(412,888)
Share of result of jointly controlled entities	16	19,513	19,221
Share of result of associates	17	199,770	173,976
Profit before income tax		1,434,416	1,184,844
Income tax expense	33	(479,422)	(375,251)
Profit for the year		954,994	809,593
Other comprehensive income:			
Currency translation differences		80,334	(111,586)
Total comprehensive income for the year		1,035,328	698,007
Profit is attributable to:			
Equity holders of the Group		976,424	953,749
Non-controlling interest		(21,430)	(144,156)
		954,994	809,593
Total comprehensive income attributable to:			
Equity holders of the Group		1,013,421	981,572
Non-controlling interest		21,907	(283,565)
		1,035,328	698,007

State Oil Company of the Azerbaijan Republic
Consolidated Statement of Changes in Equity
(Amounts presented are in thousands of Azerbaijani Manats)

	Note	Additional paid-in capital	Charter capital	Retained earnings	Currency translation difference	Total	Non-controlling interest	Total equity
Balance at 1 January 2011		236,526	632,732	6,691,653	(105,095)	7,455,816	704,279	8,160,095
Profit/(loss) for the year		-	-	953,749	-	953,749	(144,156)	809,593
Other comprehensive income / (loss)		-	-	-	27,823	27,823	(139,409)	(111,586)
Total comprehensive income / (loss) for 2011		-	-	953,749	27,823	981,572	(283,565)	698,007
Acquisition of non-controlling interest in subsidiary	36	-	-	(381,057)	-	(381,057)	269,629	(111,428)
Contribution in charter capital of subsidiaries by non-controlling shareholder		-	-	-	-	-	13,524	13,524
Establishment of subsidiary		-	-	-	-	-	32,622	32,622
Increase in charter capital	27	(236,526)	426,526	-	-	190,000	-	190,000
Additional paid-in-capital	27	784,809	-	-	-	784,809	-	784,809
Distribution to the Government	27	-	-	(514,749)	-	(514,749)	-	(514,749)
Dividends declared by subsidiary		-	-	-	-	-	(4,260)	(4,260)
Balance at 31 December 2011		784,809	1,059,258	6,749,596	(77,272)	8,516,391	732,229	9,248,620
Profit/(loss) for the year		-	-	976,424	-	976,424	(21,430)	954,994
Other comprehensive income		-	-	-	36,997	36,997	43,337	80,334
Total comprehensive income for 2012		-	-	976,424	36,997	1,013,421	21,907	1,035,328
Acquisition of non-controlling interest in subsidiary	36	-	-	55,132	-	55,132	(193,806)	(138,674)
Contribution in charter capital of subsidiaries by non-controlling shareholder		-	-	-	-	-	11,462	11,462
Establishment of subsidiary		-	-	-	-	-	1,014	1,014
Increase in charter capital		-	25,732	(25,732)	-	-	-	-
Additional paid-in-capital	27	230,000	-	-	-	230,000	-	230,000
Distribution to the Government	27	-	-	(521,442)	-	(521,442)	-	(521,442)
Dividends declared by subsidiary		-	-	-	-	-	(14,219)	(14,219)
Balance at 31 December 2012		1,014,809	1,084,990	7,233,978	(40,275)	9,293,502	558,587	9,852,089

State Oil Company of the Azerbaijan Republic
Consolidated Statement of Cash Flows
(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

	Note	2012	2011 (reclassified)
Cash flows from operating activities			
Profit before income tax		1,434,416	1,184,844
Adjustments for:			
Depreciation of property, plant and equipment	29	670,733	614,717
Amortisation on intangible assets	15	21,429	15,295
Impairment of property, plant and equipment	14	227,872	499,642
Impairment of trade and other receivables	29	74,854	155,268
Change in provisions	29	54,593	(154,996)
Change in asset retirement obligations recognised in profit or loss		93,942	21,691
Losses on disposals of property, plant and equipment		24,412	25,731
Finance income	31	(34,104)	(72,400)
Finance costs	32	188,435	210,950
Foreign exchange rate differences		(60,309)	419,669
Share of result of associates and joint ventures	16,17	(219,283)	(193,197)
Gain on release of payables	30	(1,443)	(25,709)
Other non-cash transactions		(25,050)	(6,853)
Operating cash flows before working capital changes		2,450,497	2,694,652
Decrease / (increase) in trade and other receivables		197,484	(378,625)
Decrease / (increase) in inventories		119,773	(194,124)
Increase in trade and other payables		1,686	374,246
Increase in taxes payable		98,870	237,904
Utilization of provisions	23	(71,933)	(45,541)
Increase in other assets and decrease in other long-term liabilities		-	(40,166)
Cash generated from operations		2,796,377	2,648,346
Income taxes paid		(512,261)	(472,657)
Interest paid		(127,316)	(143,530)
Net cash from operating activities		2,156,800	2,032,159
Cash flows from investing activities			
Acquisitions of subsidiary (net of cash acquired), additional share in jointly controlled assets, additional contribution in associates and jointly controlled entities		(301,408)	(466,660)
Purchase of property, plant and equipment		(2,080,661)	(1,856,489)
Purchase of intangible assets	15	(39,411)	(14,090)
Deposits	8	(78,503)	(56,055)
Collection of loans provided to third parties		7,428	-
Financing provided to third parties		(9,500)	-
Interest received		29,594	53,489
Dividends received	16,17	203,589	171,274
Purchase consideration paid		-	(272,935)
Proceeds from sale of property, plant and equipment		20,720	59,000
Prepayment for acquisition of subsidiary		-	(35,758)
Financing provided to jointly controlled entities		(7,408)	(6,031)
Net cash used in investing activities		(2,255,560)	(2,424,255)
Cash flows from financing activities			
Proceeds from borrowings		1,268,073	1,898,881
Repayment of borrowings		(725,403)	(965,471)
Acquisition of share from non-controlling shareholder	36	(138,674)	(111,428)
Contribution in subsidiary by non-controlling shareholder		12,476	46,146
Increase in charter capital and additional paid-in capital	27	230,000	190,000
Change in restricted cash related to borrowings		-	8,805
Dividends paid		(14,219)	(4,260)
Distribution to the Government	27	(475,286)	(420,411)
Net cash provided by financing activities		156,967	642,262
Net foreign exchange difference on cash and cash equivalents		7,488	(54,183)
Net increase in cash and cash equivalents		65,695	195,983
Cash and cash equivalents at the beginning of the year	8	1,157,744	961,761
Cash and cash equivalents at the end of the year	8	1,223,439	1,157,744

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").

In July 2012, SOCAR acquired 100 per cent of voting equity shares of Esso Switzerland, which owns the Esso branded retail service chain network in Switzerland. Total consideration paid for this acquisition equalled USD 313 million (AZN 257,713). Following the acquisition, Esso Switzerland was renamed to SOCAR Switzerland Group ("SOCAR Switzerland") (Note 36). In November 2012, SOCAR obtained control over Supra Holding Limited, previously SOCAR's associate. Following the acquisition, Supra Holding Limited was renamed to SOCAR Trading Holding Ltd ("SOCAR Trading") (Note 36).

SOCAR's registered address is 73 Neftchiler avenue, AZ 1000 Baku, the Azerbaijan Republic.

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 for consolidation. The consolidated financial statements comprise the financial statements of the Group and its subsidiaries as at 31 December 2012.

Subsidiaries are all entities (including special-purpose entities) over which the Group has control, being the power to govern the financial and operating policies so as to obtain benefits from its activities, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised 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 interest 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, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses. When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

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

2 Basis of preparation and significant accounting policies (continued)

Business combinations (continued)

Transactions with non-controlling interest

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

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. Associates are all entities over which the Group has significant influence but not control. Investment in the associate is carried in the statement of financial position at cost plus post acquisition changes in the Group's share of net assets of the associate less accumulated impairment of investments. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The Group's share of its associates' post-acquisition profits or losses is recognized in profit or loss, the Group's share of changes in net assets recognised in other comprehensive income or loss is recognised in other comprehensive income or loss. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any receivables, regarded to be in substance the extension of the Group's investment in the associate, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates related to transfer of assets are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

Interests in joint ventures. The Group has interests in joint ventures, which are jointly controlled entities, whereby the venturers have a contractual arrangement that establishes joint control over the economic activities of the entity.

A joint venture is a contractual arrangement whereby two or more parties (venturers) undertake an economic activity that is subject to joint control. Joint control exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the venturers. A jointly controlled entity is a joint venture that involves the establishment of a company, partnership or other entity to engage in economic activity that the Group jointly controls with its fellow venturers.

The results, assets and liabilities of a jointly controlled entity are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, the investment in a jointly controlled entity is carried in the statement of financial position at cost plus post-acquisition changes in the Group's share of net assets of the jointly controlled entity, less distributions received and less any impairment in value of the investment. The Group's statement of comprehensive income reflects the Group's share of the profit or loss of the jointly controlled entity and any income and expense recognised by the jointly controlled entity in other comprehensive income or loss.

Financial statements of jointly controlled entities are prepared for the same reporting period as the Group. Where necessary, adjustments are made to those financial statements to bring the accounting policies used into line with those of the Group.

2 Basis of preparation and significant accounting policies (continued)

Interests in joint ventures (continued). The Group ceases to use the equity method of accounting of the date from which it no longer has joint control over joint venture or significant influence in the associate, or when the interest becomes held for sale. Certain of the Group's upstream activities which are governed by Production Sharing Agreements ("PSAs") are conducted through joint ventures where the venturers have a direct ownership interest in and jointly control the assets of the venture. Such activities are accounted for as jointly controlled assets. Accordingly, the Group recognises its share of the jointly controlled assets and its share in liabilities, income and expenses related to jointly controlled assets in proportion to the Group's interest.

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 will take 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.

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 recognised 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 amortisation 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 thousands 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 23 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 ("YTL") are considered the functional currency of the Group's certain subsidiaries, associates and jointly controlled entities 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 not already measured in the functional currency of respective Group entity are translated into the functional currency of that entity at the appropriate exchange rates prevailing at the statement of financial position date.

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

2 Basis of preparation and significant accounting policies (continued)

Foreign currency translation (continued). The results and financial position of the Group entities which functional currency differ from the presentation currency of the Group and not already measured in the Group's presentation currency (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 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 recognised as a separate component of equity – currency translation difference.

At 31 December 2012 the principal rate of exchange used for translating foreign currency balances was USD 1 = AZN 0.7850, EUR 1 = AZN 1.0377, CHF 1 = AZN 0.8594, GEL 1 = AZN 0.4744, UAH 1 = AZN 0.0975, YTL 1 = AZN 0.4387, JPY 100 = AZN 0.9126 (2011: USD 1 = AZN 0.7865, EUR 1 = AZN 1.0178, CHF 1 = AZN 0.8357, GEL 1 = AZN 0.4692, UAH 1 = AZN 0.0978, YTL 1 = AZN 0.4102, JPY 100 = AZN 1.0146).

Financial instruments – key measurement terms. Depending on their classification financial instruments are carried at fair value, or amortised cost as described below.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques such as discounted cash flows models or models based on recent arm's length transactions or consideration of financial data of the investees are used to fair value certain financial instruments for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data.

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

2 Basis of preparation and significant accounting policies (continued)

Financial instruments – key measurement terms (continued). *The effective interest rate method* is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest 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 statement of financial position 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 statement of financial position date. Investment securities held-to-maturity are carried at amortised cost.

(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 statement of financial position 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 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 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 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 comprehensive income as part of other income when the Group's right to receive payments is established.

2 Basis of preparation and significant accounting policies (continued)

Financial assets (continued). Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analyzed 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.

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 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 comprehensive income as part of other income. Dividends on available-for-sale equity instruments are recognized in the statement of 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 statement of financial position 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 profit or loss. Impairment losses recognized in the statement of 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 recognised in the consolidated statement of comprehensive income in the period in which they arise. Other financial liabilities are carried at amortised cost.

Derecognition of financial assets. The Group derecognises 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 derecognises 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 a 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 are recognized in 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 recognised 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 recognised less cumulative amortisation.

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, recognised 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 recognised 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 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 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 derecognised upon cash receipts from customers and borrowers or other similar settlement.

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 recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

Borrowings. All borrowings are initially recognised 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.

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.

2 Basis of preparation and significant accounting policies (continued)

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 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 recognised in the statement of comprehensive income. An impairment loss recognised 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 recognised in profit or loss.

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 47 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 statement of financial position date.

2 Basis of preparation and significant accounting policies (continued)

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 recognised for non-controlling interest 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 recognised 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.

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 recognised in the statement of 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 rights over the dam, factory site, port site, site development, site and the water transmission line. Intangible assets obtained at the acquisition of Petkim Petrokimya Holding A.Ş. ("Petkim") (Note 15) were initially recognised 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 recognised 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 acquisition (Note 15).

Customer relationships acquired as part of net assets of SOCAR Switzerland were initially recognised at their fair values in accordance with IFRS 3 as at 30 June 2012.

2 Basis of preparation and significant accounting policies (continued)

Intangible assets (continued)

c) Petkim trade name

Petkim trade name acquired at the Petkim acquisition was initially recognised 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 15).

d) Water rights

Water rights acquired with the Petkim acquisition were initially recognised 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 acquisition (Note 15).

e) Development projects

Development projects acquired with the Petkim acquisition were initially recognised 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 acquisition. Cost incurred on development projects (relating to the design and testing of new or improved products) are recognised 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 recognised as 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.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each statement of financial position 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 statement of financial position date. The income tax charge comprises current tax and deferred tax and is recognised on the profit or loss unless it relates to transactions that are recognised, 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 statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

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

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

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

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).

2 Basis of preparation and significant accounting policies (continued)

Government grants. Grants from the Government are recognised 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.

Government grants relating to income are deferred and recognised in profit or loss over the period necessary to match with the costs that they are intended to compensate.

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 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 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 recognised 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 recognised 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 recognised 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 recognised at the carrying value of transferred assets.

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).

2 Basis of preparation and significant accounting policies (continued)

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 statement of financial position date. VAT related to sales which have not been settled at the statement of financial position date (VAT deferral) is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT where applicable. The related VAT deferred liability 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 statement of financial position date. VAT recoverable is reclaimable against VAT on sales upon payment for the purchases.

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 recognised 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 recognised 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 recognised at the point of transfer of risks and rewards of ownership of the goods.

Sales of services are recognised 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 recognised on a time-proportion basis using the effective interest rate method.

Overlift/underlift of crude oil. Overlift or underlift of crude oil occurs when the volume of oil lifted by a partner in a joint venture 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 ten percent or more of all the segments are reported separately.

2 Basis of preparation and significant accounting policies (continued)

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 21.

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 have been recovered.

Depending on the terms of the carried interest agreements the Group recognises 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.

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.

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 recognise any carry related transactions and balances in the consolidated financial statements.

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

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

Reclassifications. Certain reclassifications have been made to the prior year's Consolidated Statement of Financial Position, Consolidated Statement of Comprehensive Income, Consolidated Statement of Cash Flows and corresponding notes to conform to the current year's presentation. There was no material impact on the Group's financial position, results of operations and equity as a result of these reclassifications.

2 Basis of preparation and significant accounting policies (continued)

Reclassifications (continued)

Consolidated Statement of Financial Position

	Prior to reclassification	Reclassification	After reclassification
<i>Reclassification from Inventories to Property, plant and equipment and from Property, plant and equipment to Other long-term financial assets</i>			
Property, plant and equipment	8,919,860	145,313	9,065,173
Inventories	936,145	(151,344)	784,801
Other long-term financial assets	82,365	6,031	88,396

The above reclassifications mainly relate to inventories held by the Group for the purposes of planned construction works on the Group's fields which were further capitalized in oil and gas properties.

Reclassification from Trade and other receivables to Other long-term assets, from Corporate income tax payable to Taxes payable and from Taxes payable to Trade and other receivables

Other long-term assets	279,149	31,043	310,192
Trade and other receivables	2,740,803	(50,430)	2,690,373
Corporate income tax payable	(22,169)	17,574	(4,595)
Taxes payable	(435,521)	1,813	(433,708)

Consolidated Statement of Comprehensive Income

	Prior to reclassification	Reclassification	After reclassification
<i>Reclassification from Cost of sales, Distribution and Social expenses to General and administrative and Other operating expenses</i>			
Cost of sales	5,391,983	(395,945)	4,996,038
General and administrative expenses	296,458	104,986	401,444
Distribution expenses	437,154	(54,410)	382,744
Social expenses	308,353	(30,011)	278,342
Other operating expenses	262,025	375,380	637,405

In 2012 the Group revised its policy for cost allocation and started application of activity based costing for calculation of production costs. Application of revised methodology did not have significant impact on the Group's net assets as of 31 December 2012 and 2011. In addition the Group changed presentation of certain expenditures (such as impairment of non-monetary and monetary assets, certain administrative expenditures of production units and others). As a result, certain prior year expenditure items were reclassified in order to conform to current year presentation.

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 recognised in this 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 comprehensive income.

3 Critical accounting estimates and judgments (continued)

Estimation of oil and gas reserves (continued). 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.

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 2011 were based on reports prepared by independent reservoir engineers in accordance with Society of Petroleum Engineers rules. For subsequent periods, the Company updated its reserves information based on work performed by its in-house geologists.

Asset retirement obligations. As further discussed in Note 22, 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 recognised as a provision is the best estimate of the expenditures required to settle the present obligation at the statement of financial position 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 620,864 at 31 December 2012 (2011: 468,384). 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 2012 was 5.97 per cent (2011: 6.86 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 158,588 lower / AZN 264,394 higher, respectively.

3 Critical accounting estimates and judgments (continued)

Environmental obligations. As further discussed in Note 23, 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 recognised as a provision is the best estimate of the expenditures required to settle the present obligation at the statement of financial position 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 2012 amounted to AZN 195,484 (2011: AZN 231,323). Changes in any of these conditions may result in adjustments to provisions recorded by the Group.

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 2012 was 7.13 per cent (2011: 8.46 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 4,355 lower / AZN 4,519 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 will increase the depreciation charge where useful lives are less than previously estimated lives, or it will write-off or write-down technically obsolete assets that have been abandoned or sold. The useful lives are reviewed at least at each financial year-end. Changes in any of the above conditions or estimates may result in adjustments to future depreciation rates.

Deferred income tax asset recognition. The net deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded on the 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 at 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.

3 Critical accounting estimates and judgments (continued)

Impairment of non-financial assets (continued). In 2012, as the result of underperformance of some cash generating units (CGU) the Group carried out a review of the recoverable amounts of those CGUs resulting in impairment charge amounting to AZN 227,872 (2011: AZN 499,642). These assets are used in the Group's oil and gas segment. 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.

Key assumptions used in value-in-use calculations

The calculation of value-in-use for oil 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 15 years, this would not result in additional impairment charge.

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.

Discount rate: The pre-tax discount rate applied to the cash flow projections was in range of 14.27 – 15.58 per cent for different CGUs (2011: 15.3 – 19.85 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 / lower than management's estimate, the aggregate amount of impairment loss would have been AZN 14,195 higher / AZN 10,049 lower, respectively (2011: AZN 21,467 higher / AZN 22,873 lower, respectively).

Inflation rate estimates: Rates used are Global Insight (GI) forecasts.

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

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.

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 amendment to IFRS effective as of 1 January 2012:

IAS 12, Income Taxes – Deferred Taxes: Recovery of Underlying Assets (issued in December 2010 and effective for annual periods beginning on or after 1 January 2012). The amendment clarified the determination of deferred tax on investment property measured at fair value and introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. It includes the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 should always be measured on a sale basis. There was no effect on the Group's financial position, performance or its disclosures.

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

Amendments to IAS 1, Presentation of Items of Other Comprehensive Income (issued in June 2011 and effective for annual periods beginning on or after 1 July 2012). The amendments to IAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, net gain on hedge of net investment, exchange differences on translation of foreign operations, net movement on cash flow hedges and net loss or gain on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, actuarial gains and losses on defined benefit plans and revaluation of land and buildings). The amendment affects presentation only and will have no impact on the Group's financial position or performance.

IAS 19, Employee Benefits (revised in June 2011 and effective for annual periods beginning on or after 1 January 2013). The IASB has issued numerous amendments to IAS 19. These range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording.

IAS 28, Investments in Associates and Joint Ventures (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013). As a consequence of the new IFRS 11 *Joint Arrangements*, and IFRS 12 *Disclosure of Interests in Other Entities*, IAS 28 *Investments in Associates*, has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates.

Amendments to IAS 32, Offsetting Financial Assets and Financial Liabilities (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). These amendments clarify the meaning of "currently has a legally enforceable right to set-off". The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. These amendments are not expected to impact the Group's financial position or performance.

Amendments to IFRS 1, Government Loans (issued in March 2012 and effective for annual periods beginning on or after 1 January 2013). These amendments require first-time adopters to apply the requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, prospectively to government loans existing at the date of transition to IFRS. Entities may choose to apply the requirements of IFRS 9 (or IAS 39, as applicable) and IAS 20 to government loans retrospectively if the information needed to do so had been obtained at the time of initially accounting for that loan. The exception would give first-time adopters relief from retrospective measurement of government loans with a below-market rate of interest. The amendment has no impact on the Group.

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

Amendments to IFRS 7, Disclosures — Offsetting Financial Assets and Financial Liabilities (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. These amendments will not significantly impact the Group's financial position or performance.

IFRS 9, Financial Instruments: Classification and Measurement (issued in December 2011 and effective for annual periods beginning on or after 1 January 2015). IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but *Amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but will not have an impact on classification and measurements of financial liabilities. The Group will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.

IFRS 10 Consolidated Financial Statements, IAS 27 Separate Financial Statements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013). IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also addresses the issues raised in SIC-12 *Consolidation — Special Purpose Entities*. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. Based on the preliminary analyses performed, IFRS 10 is not expected to have significant impact on the currently held investments of the Group.

IFRS 11, Joint Arrangements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013). IFRS 11 replaces IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly-controlled Entities — Non-monetary Contributions by Venturers*. IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

IFRS 12, Disclosure of Interests in Other Entities (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013). IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required, but has no impact on the Group's financial position or performance.

IFRS 13, Fair Value Measurement (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013). IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Group is currently assessing the impact that this standard will have on the financial position and performance, but based on the preliminary analyses, no material impact is expected.

IFRIC 20, Stripping Costs in the Production Phase of a Surface Mine (issued in October 2011 and effective for annual periods beginning on or after 1 January 2013). This interpretation applies to waste removal (stripping) costs incurred in surface mining activity, during the production phase of the mine. The interpretation addresses the accounting for the benefit from the stripping activity. The new interpretation will not have an impact on the Group.

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

IFRIC Interpretation 21 Levies (issued in May 2013 and effective for annual periods beginning on or after 1 January 2014). The interpretation was developed by the IFRS Interpretations Committee and issued by the IASB. The interpretation clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be recognised before the specified minimum threshold is reached. Based on the preliminary analysis performed, the Group does not expect significant impact on the Group's financial position or performance.

Annual Improvements to IFRSs May 2012

These improvements will not have an impact on the Group, but include:

IFRS 1 First-time Adoption of International Financial Reporting Standards

This improvement clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS.

IAS 1 Presentation of Financial Statements

This improvement clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative information is the previous period.

IAS 16 Property Plant and Equipment

This improvement clarifies that major spare parts and servicing equipment that meet the definition of property, plant and equipment are not inventory.

IAS 32 Financial Instruments, Presentation

This improvement clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 Income Taxes.

These improvements are effective for annual periods beginning on or after 1 January 2013.

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

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

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 2012 is set out below:

	Oil and gas	Refining	Construction	Sales and distribution	Unallocated (*)	Eliminations (**)	Total
2012							
Revenues							
External customers	3,067,791	2,039,404	205,407	11,796,798	29,432	-	17,138,832
Inter-segment	676,322	461,792	693,618	1,238,980	310,814	(3,381,526)	-
Total revenue	3,744,113	2,501,196	899,025	13,035,778	340,246	(3,381,526)	17,138,832
Other operating income	17,927	21,890	38,487	39,685	65,727	(32,210)	151,506
Finance income	8,722	19,229	335	6,869	756,336	(757,387)	34,104
Foreign exchange gains/losses (net)	(3,906)	48,785	(848)	9,744	(17,914)	(29)	35,832
Raw materials and consumables used	(723,964)	(1,783,935)	(314,734)	(12,111,569)	(59,783)	2,532,846	(12,461,139)
Depreciation of property, plant and equipment	(423,875)	(116,883)	(63,784)	(75,200)	(61,911)	70,920	(670,733)
Wages, salaries and social security costs	(233,926)	(163,669)	(201,149)	(172,096)	(181,505)	145,959	(806,386)
Transportation and vehicle maintenance	(165,262)	(3,009)	(83,854)	(24,098)	(18,526)	134,192	(160,557)
Repairs and maintenance expenses	(183,230)	(31,383)	(125,875)	(31,287)	(25,700)	216,442	(181,033)
Impairment of property, plant and equipment	(181,167)	-	-	-	(46,705)	-	(227,872)
Mining tax	(113,708)	-	-	-	-	1,606	(112,102)
Utilities expense	(12,814)	(184,287)	(4,052)	(5,937)	(3,953)	2,252	(208,791)
Taxes other than on income	(58,852)	(11,056)	(6,750)	(16,214)	(8,092)	351	(100,613)
Amortization expense	(16)	(11,969)	-	(5,528)	(3,916)	-	(21,429)
Impairment of trade and other receivables	(69,919)	(2,741)	-	(2,194)	-	-	(74,854)
Change in Other provisions for liabilities and charges	(9,821)	(10,002)	(19,570)	(6,755)	(8,445)	-	(54,593)
Other	(391,959)	(134,651)	(53,091)	(185,400)	(120,090)	265,991	(619,200)
Gains less losses on disposals of property, plant and equipment	(22,294)	(8,775)	3,075	(2,135)	642	5,075	(24,412)
Finance cost	(57,855)	(52,649)	(4,145)	(26,131)	(65,662)	18,007	(188,435)
Social expenses	(10,952)	(14,338)	(7,345)	(835)	(205,463)	5,941	(232,992)
Share of result of jointly controlled entities	1,327	-	14,440	265	3,481	-	19,513
Share of result of associates	-	-	-	196,089	3,681	-	199,770
Income tax expense	(339,082)	29,591	(22,862)	(189,756)	42,687	-	(479,422)
Net profit for the year	769,487	91,344	47,303	433,295	385,135	(771,570)	954,994

(*) - 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.

5 Segment information (continued)

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

	Oil and gas	Refining	Construction	Sales and distribution	Unallocated (*)	Eliminations (**)	Total
Investment in associates	-	-	-	1,147,121	17,899	-	1,165,020
Investment in joint ventures	227,270	-	24,433	57,799	128,471	-	437,973
Other reportable segment assets	7,913,142	3,527,900	1,634,846	9,713,664	7,073,565	(9,600,338)	20,262,779
Total reportable segment assets	8,140,412	3,527,900	1,659,279	10,918,584	7,219,935	(9,600,338)	21,865,772
Other reportable segment liabilities	(2,964,164)	(2,230,047)	(1,033,669)	(9,564,730)	(3,094,245)	6,873,172	(12,013,683)
Total reportable segment liabilities	(2,964,164)	(2,230,047)	(1,033,669)	(9,564,730)	(3,094,245)	6,873,172	(12,013,683)
Capital expenditure (***)							
Additions – SOCAR	1,097,544	65,672	152,782	452,236	235,700	(152,118)	1,851,816
Additions - subsidiaries	357,937	129,560	185,041	317,525	14,593	-	1,004,656
Acquisitions through business combination	104,454	-	-	263,682	741	-	368,877
Total capital expenditures	1,559,935	195,232	337,823	1,033,443	251,034	(152,118)	3,225,349

(*) - 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.

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 2011 is set out below:

	Oil and gas	Refining	Construction	Sales and distribution	Unallocated (*)	Eliminations (**)	Total
2011							
Revenues							
External customers	2,960,332	2,000,208	212,957	2,939,990	19,244	-	8,132,731
Inter-segment	694,320	474,086	600,463	333,212	237,379	(2,339,460)	-
Total revenue	3,654,652	2,474,294	813,420	3,273,202	256,623	(2,339,460)	8,132,731
<i>Other operating income</i>	7,223	22,133	51,818	197,978	527,386	(657,535)	149,003
<i>Finance income</i>	25,927	17,857	18	2,704	874,613	(848,719)	72,400
Raw materials and consumables used	(736,997)	(1,668,947)	(348,081)	(2,415,036)	(197,544)	1,650,726	(3,715,879)
Depreciation of property, plant and equipment	(353,344)	(115,452)	(78,782)	(67,935)	(88,040)	88,836	(614,717)
Wages, salaries and social security costs	(192,691)	(151,702)	(168,102)	(108,340)	(144,684)	136,576	(628,943)
Transportation and vehicle maintenance	(137,366)	(2,511)	(74,245)	(20,473)	(13,386)	118,829	(129,152)
Repairs and maintenance expenses	(168,748)	(37,112)	(61,599)	(35,587)	(37,955)	156,004	(184,997)
Impairment of property, plant and equipment	(300,605)	-	(1,989)	-	(197,100)	52	(499,642)
Mining tax	(118,771)	-	-	-	(104)	653	(118,222)
Utilities expense	(17,941)	(186,753)	(5,667)	(2,895)	(3,993)	442	(216,807)
Taxes other than on income	(33,317)	(15,764)	(5,193)	(13,030)	(9,831)	-	(77,135)
Amortization expense	-	(15,295)	-	-	-	-	(15,295)
Impairment of trade and other receivables	(97,416)	(280)	-	(53,958)	(3,614)	-	(155,268)
Change in Other provisions for liabilities and charges	122,859	28,600	(10,664)	1,790	12,411	-	154,996
Other	(149,705)	(121,652)	(61,298)	(215,952)	(540,358)	855,450	(233,515)
Gains less losses on disposals of property, plant and equipment	(27,172)	25,027	945	(18,053)	(6,478)	-	(25,731)
Finance cost	(57,971)	(97,805)	(2,503)	(19,882)	(45,743)	12,954	(210,950)
Foreign exchange losses (net)	(5,131)	(394,431)	(75)	1,396	(14,647)	-	(412,888)
Social expenses	(6,601)	(18,195)	(2,864)	(16)	(257,343)	6,677	(278,342)
Share of result of jointly controlled entities	4,966	-	10,906	1,159	2,190	-	19,221
Share of result of associates	-	-	-	172,957	1,019	-	173,976
Income tax expense	(255,103)	(31,588)	(10,508)	(116,158)	38,106	-	(375,251)
Net profit for the year	1,156,748	(289,576)	45,537	563,871	151,528	(818,515)	809,593

(*) - 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.

5 Segment information (continued)

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

	Oil and gas	Refining	Construction	Sales and distribution	Unallocated (*)	Eliminations (**)	Total
Investment in associates	-	-	-	1,175,453	10,917	-	1,186,370
Investment in joint ventures	191,609	-	16,658	48,368	135,764	-	392,399
Other reportable segment assets	7,380,527	3,340,159	1,340,178	4,505,602	5,899,543	(7,104,254)	15,361,755
Total reportable segment assets	7,572,136	3,340,159	1,356,836	5,729,423	6,046,224	(7,104,254)	16,940,524
Other reportable segment liabilities	(2,573,881)	(2,003,255)	(814,674)	(4,742,070)	(2,270,096)	4,712,072	(7,691,904)
Total reportable segment liabilities	(2,573,881)	(2,003,255)	(814,674)	(4,742,070)	(2,270,096)	4,712,072	(7,691,904)
Capital expenditure (***)							
Additions – SOCAR	888,969	87,443	231,377	1,330,241	316,966	(61,108)	2,793,888
Additions - subsidiaries	323,317	104,943	52,552	91,487	1,607	-	573,906
Increase of share in jointly controlled assets	381,641	-	-	-	-	-	381,641
Total capital expenditures	1,593,927	192,386	283,929	1,421,728	318,573	(61,108)	3,749,435

(*) - 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:

	2012	2011
Azerbaijan	4,400,098	4,140,795
UAE	6,566,788	1,323,722
Switzerland	3,331,695	-
Turkey	1,907,483	1,848,774
Georgia	626,637	679,153
Other	306,131	140,287
Total consolidated revenues	17,138,832	8,132,731

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

5 Segment information (continued)

Geographical information (continued)

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:

	2012	2011
Azerbaijan	10,524,311	9,327,572
UAE	26,701	4,241
Switzerland	390,117	116,769
Turkey	1,995,974	1,815,537
Georgia	231,041	155,362
Other	154,471	43,392
Total	13,322,615	11,462,873

The analysis is based on location of assets.

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, recognised 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. There has been no significant devaluation of USD against AZN during the year ended 31 December 2012.

Management does not hedge the Group's foreign exchange risk.

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

2012	Change in rates(+/-)	Effect on post- tax profit
USD/AZN	3.82%	(14,766) / 14,766
JPY/AZN	5.65%	(5,650) / 5,650
EUR/AZN	11.49%	(14,629) / 14,629
USD/YTL	10%	(67,843) / 67,843

6 Financial risk management (continued)

Financial risk factors (continued)

2011	Change in rates(+/-)	Effect on post- tax profit
USD/AZN	5.09%	1,706 / (1,706)
JPY/AZN	7.85%	(9,048) / 9,048
EUR/AZN	14.55%	(2,616) / 2,616
USD/YTL	10%	(68,142) / 68,142

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

(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 2012, whereby if oil future prices had moved, as illustrated in the table below, with all other variables held constant, post tax profit after the impact of hedge accounting and equity (excluding the effect of net profit) would have been as follows:

	Change in yearend price	Effect on profit before tax	Effect on equity
2012	5% / (5%)	(6,448) / 6,448	(6,448) / 6,448
2011	5% / (5%)	- / -	- / -

(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.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates on loans and borrowings payable and receivable.

6 Financial risk management (continued)

Loans and borrowings, net of loans receivable	Increase/decrease in basis points	Effect on post- tax profit
2012	+5/-5	757 / (757)
2011	+15/-15	2,019 / (2,019)

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:

	2012	2011
Cash and cash equivalents (Note 8)	1,218,309	1,157,538
Restricted cash	94,243	75,493
Deposits (Note 8)	78,503	-
Trade and other receivables (Note 10)	4,415,656	2,081,644
Loan receivable from jointly controlled entity	-	178,484
Other current financial assets (Note 13)	136,395	-
Other long-term financial assets (Note 13)	158,310	88,396
Other long-term assets	-	3,837
Financial guarantees given (Note 35)	91,464	51,930
Total maximum exposure to credit risk	6,192,880	3,637,322
Financial guarantees—amounts of guarantees of indebtedness of others (Note 35)	(372,955)	(336,787)
Total exposure to credit risk net of guarantees received	5,819,925	3,300,535

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 restricted cash held with the IBA at 31 December 2012 was AZN 662,839 (2011: AZN 835,805). The Group continually monitors the status of the banks where its accounts are maintained.

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 Azerenerji JSC and Azal JSC, 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. The 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 2012, letters of guarantee and bank guarantees in total amount of AZN 357,923 (YTL 815,871,402) (2011: AZN 303,172 (YTL 739,083,379)) were received from certain domestics and foreign customers of SOCAR Turkey Energy A.S ("STEAS").

6 Financial risk management (continued)

The Group categorized its financial receivables as follows:

31 December 2012	Standard	Sub-standard	Past due but not impaired	Individually impaired
Trade receivables	3,614,833	99,424	701,399	200,769
Other short-term financial assets (Note 13)	-	77,600	-	-
Other long-term financial assets (Note 13)	-	109,601	48,709	-
Total	3,614,833	286,625	750,108	200,769

31 December 2011	Standard	Sub-standard	Past due but not impaired	Individually impaired
Trade receivables	2,155,203	100,118	41,716	215,393
Other long-term financial assets (Note 13)	-	88,396	-	-
Loan receivable from jointly controlled entity (Note 18)	-	-	178,484	-
Total	2,155,203	188,514	220,200	215,393

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.

All of the Group's financial liabilities represent non-derivative financial instruments. The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period from the statement of financial position date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months approximate their carrying values, as the impact of discounting is not significant.

The maturity analysis of financial liabilities as of 31 December 2012 and 2011 is as follows:

At 31 December 2012	less than 3 months	3-12 months	1-5 years	more than 5 years	Total
Trade and other financial payables	4,955,480	-	-	-	4,955,480
Deferred acquisition consideration payable	-	65,169	-	-	65,169
Interest bearing borrowings	1,215,574	739,793	2,330,533	620,360	4,906,260
Other financial liabilities	-	36,927	9,544	-	46,471
Total undiscounted financial liabilities	6,171,054	841,889	2,340,077	620,360	9,973,380

6 Financial risk management (continued)

At 31 December 2011	less than 3 months	3-12 months	1-5 years	more than 5 years	Total
Trade and other financial payables	2,682,464	-	-	-	2,682,464
Interest bearing borrowings	234,305	602,356	1,741,785	760,873	3,339,319
Other financial liabilities	-	39,765	3,731	-	43,496
Total undiscounted financial liabilities	2,916,769	642,121	1,745,516	760,873	6,065,279

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:

	2012	2011
Total borrowings (Note 20)	4,490,763	2,980,288
Total equity attributable to the Group's equity holders	9,263,502	8,516,391
Less: cash and cash equivalents	(1,223,439)	(1,157,744)
Total capital under management	12,530,826	10,338,935

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.

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

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

	31 December 2012	
	Carrying amounts	Fair values
Cash and cash equivalents (Note 8)	1,223,439	1,223,439
Deposits (Note 9)	78,503	78,503
Restricted cash	94,243	94,243
Trade receivables and other receivables (Note 10)	4,415,656	4,415,656
Other current assets	136,395	136,395
Other long-term financial assets (Note 13)	158,310	158,310
Total financial assets	6,106,546	6,106,546
Total financial payables (Note 19)	(4,955,480)	(4,955,480)
Short-term and current portion of long-term borrowings (Note 20)	(1,873,202)	(1,873,202)
Long-term borrowings (Note 20)	(2,617,561)	(2,636,099)
Deferred acquisition consideration payable	(65,169)	(65,169)
Other non-current liabilities	(46,471)	(46,471)
Total financial liabilities	(9,557,883)	(9,576,421)

6 Financial risk management (continued)

	31 December 2011	
	Carrying amounts	Fair values
Cash and cash equivalents	1,157,744	1,157,744
Restricted cash	75,493	75,493
Trade receivables and other receivables (Note 10)	2,081,644	2,081,644
Loan receivable from jointly controlled entity (Note 18)	178,484	178,484
Other long-term assets	3,837	3,837
Other long-term financial assets (Note 13)	88,396	88,396
Total financial assets	3,585,598	3,585,598
Total financial payables	(2,682,464)	(2,682,464)
Short-term and current portion of long-term borrowings (Note 20)	(761,518)	(761,518)
Long-term borrowings (Note 20)	(2,218,770)	(2,202,591)
Other non-current liabilities	(43,496)	(43,496)
Total financial liabilities	(5,706,248)	(5,690,069)

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

- (i) Short-term financial assets and liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments;
- (ii) Long-term fixed-rate and variable-rate receivables / borrowings are evaluated by the Group based on parameters such as interest rates, specific country risk factors, individual creditworthiness of customers and the risk characteristics of the financed project.

7 Balances and transactions with related parties

Key management compensation. Key management of the Group includes the President of SOCAR and its ten 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 2012 compensation of key management personnel totalled to AZN 465 (2011: AZN 282).

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 2012, the outstanding balances with related parties were as follows:

	Note	Government and entities under government control	Associates, joint ventures
Gross amount of trade receivables		334,130	109,665
Impairment provisions for trade and other receivables		(63,828)	-
Other receivables		-	28,959
Cash and cash equivalents		240,786	-
Deposit		425,575	-
VAT and other taxes receivable		390,321	-
Prepayments to vendors		10,112	-
Borrowings from IBA (at fixed rates varying from 3 to 3.5 per cent and floating interest rates varying from LIBOR plus 2 per cent to LIBOR plus 3.5 per cent)		(571,316)	-
Borrowings from the Ministry of Finance of Azerbaijan Republic		(155,473)	-
Trade and other payables		(81,156)	(567,063)
Taxes payable to State Oil Fund of Azerbaijan Republic (SOFAZ)	21	(123,324)	-
Bond payable to SOFAZ		(353,530)	-
Payable to State SOFAZ		(1,429,450)	-
Other taxes payable		(381,672)	-
Corporate income tax payable		(3,123)	-

7 Balances and transactions with related parties (continued)

The transactions with related parties for the year ended 31 December 2012 were as follows:

	Note	Government and entities under government control	Associates and joint ventures
Sales of natural gas		234,217	-
Sales of oil products		246,176	581,585
Sales of crude oil		-	6,495,541
Service rendered		25,817	95,393
Interest income on deposits		1,251	-
Interest on loans to related parties		929	3,114
Corporate income tax		(502,980)	-
Excise tax	28	(482,043)	-
Price margin tax		(440,757)	-
Mining tax	29	(112,106)	-
Other taxes		(154,433)	-
Utilities costs		(51,460)	(3,221)
Other operating expenses		(44,682)	(19,979)
Social security deductions		(135,235)	-
Social expenses		(510,641)	-
Transportation expenses		(6,311)	(457)
Ecology service and environmental security		(1,262)	(11,804)
Impairment of loan receivable from jointly controlled entity		-	(68,762)
Purchases of PPE and inventory		(7,249,083)	(1,233,811)
Dividends received from jointly controlled entities	16	-	13,789
Dividends received from associates	17	-	189,800

In addition to the above disclosed related party balances and transactions during the year the Group obtained a loan from other related parties in the amount of AZN 12,948 and provided a loan to other related parties in the amount of AZN 13,345 which were outstanding as at 31 December 2012.

At 31 December 2011, the outstanding balances with related parties were as follows:

	Note	Government and entities under government control	Associates, joint ventures
Gross amount of trade receivables		272,964	731,643
Impairment provisions for trade and other receivables		(79,797)	-
Other receivables		-	17,574
Cash and cash equivalents		456,269	463
Deposit		398,138	-
VAT and other taxes receivable		416,357	-
Prepayments to vendors		2,094	60
Prepayment for corporate income tax		-	-
Receivable from a jointly controlled entity	18	-	178,484
Borrowings from IBA (at fixed rates varying from 3 to 3.5 per cent and floating interest rates varying from LIBOR plus 2 per cent to LIBOR plus 3.5 per cent)		(688,118)	-
Borrowings from the Ministry of Finance of the Azerbaijan Republic		(179,010)	-
Trade and other payables		(67,205)	(687,567)
Taxes payable to SOFAZ	21	(123,324)	-
Bond payable to SOFAZ	20	(381,452)	-
Payable to SOFAZ		(1,098,129)	-
Other taxes payable		(291,551)	-

7 Balances and transactions with related parties (continued)

The transactions with related parties for the year ended 31 December 2011 were as follows:

	Note	Government and entities under government control	Associates and joint ventures
Sales of natural gas		215,740	-
Sales of oil products		243,754	286,480
Sales of crude oil		-	1,323,722
Service rendered		22,313	94,733
Interest income on deposits		33,244	-
Interest on loans to related parties	31	-	16,468
Corporate income tax	33	(461,254)	-
Excise tax	28	(440,769)	-
Price margin tax		(449,075)	-
Mining tax	29	(118,222)	-
Other taxes		(128,713)	-
Utilities costs		(65,177)	(180)
Other operating expenses		(70,825)	(25,385)
Social security deductions		(116,153)	-
Social expenses		(569,931)	(627)
Transportation expenses		(5,864)	(5,345)
Repair and construction works		-	-
Ecology service and environmental security		(4,676)	(22,406)
Impairment of loan receivable from jointly controlled entity		-	(101,219)
Purchases of PPE and inventory		(1,365,212)	(1,271,770)
Dividends received from jointly controlled entities	16	-	11,362
Dividends received from associates	17	-	159,912

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

	2012	2011
USD denominated bank balances	892,631	872,472
CHF denominated bank balances	115,692	30,869
AZN denominated bank balances	74,948	162,724
YTL denominated bank balances	70,561	20,382
EUR denominated bank balances	39,828	62,071
Other denominated bank balances	24,649	9,020
Cash on hand	5,130	206
Total cash and cash equivalents	1,223,439	1,157,744

Included in USD denominated bank balances as at 31 December 2012 is a call deposit of AZN 282,080 placed with IBA (2011: AZN 269,426). Interest rate on this deposit for the years ended 31 December 2012 and 31 December 2011 equalled 70 per cent of overnight rate published by Reuters. Call deposit has original maturity of less than three months.

At 31 December 2011 the Group's bank balances included call deposit of AZN 78,650, which was withdrawn in the first half of 2012.

Deposits. At 31 December 2012 term deposits mainly included placements in the amount of AZN 78,500 with maturity ranging from three to six months, under fixed contractual interest rates ranging from 2.5 per cent to 3.75 per cent per annum (31 December 2011: nil). All the bank balances and deposits are neither past due nor impaired.

9 Restricted cash and deposits

	2012	2011
Deposit account with IBA in USD	62,814	62,260
Other restricted cash	34,951	32,110
Total short-term restricted cash and deposits	97,765	94,370

At 31 December 2012 short-term restricted deposits are represented by two time deposits with IBA in the amount of AZN 31,400 (2011: AZN 31,460) and AZN 31,414 (2011: nil) pledged to collateralize the Group's obligations to IBA under the loan facility obtained in May 2010 and maturing in May 2013. The deposits bear interest of 2.85 per cent per annum.

Short-term restricted deposits at 31 December 2011 also included part of another deposit in the amount of AZN 78,650 placed with IBA pledged to collateralize the Group's obligations to IBA under the loan facilities obtained in May 2010 and maturing in May 2012 in the amount of AZN 30,800, which were drawn down in the first half of 2012 (Note 8).

10 Trade and other receivables

	2012	2011
Trade receivables	4,517,001	2,196,918
Less impairment loss provision	(149,143)	(162,952)
Total trade receivables	4,367,858	2,033,966
VAT recoverable	378,231	349,079
Other taxes receivable	19,037	126,402
Prepayments	167,568	112,500
Other receivables	138,788	100,119
Less impairment loss provision (other receivables)	(51,626)	(52,441)
Receivable for underlift of oil	14,439	20,748
Total trade and other receivables	5,034,295	2,690,373

Receivables mainly represent receivables for 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 2012 trade and other receivables of AZN 4,115,821 (2011: AZN 1,860,164) were denominated in foreign currencies, mainly in USD.

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

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

	2012	2011
At 1 January	215,393	180,727
Receivables written off during the year as uncollectible net of recovery	(20,716)	(19,383)
Net change in provision	6,092	54,049
At 31 December	200,769	215,393

10 Trade and other receivables (continued)

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

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

	2012	2011
1-30 days overdue	357,607	7,939
1-3 months overdue	76,299	3,358
Over 3 months overdue	267,493	30,419
Total overdue receivables	701,399	41,716

At 31 December 2012 trade receivables of AZN 701,399 (2011: AZN 41,716) were past due. The Group holds guarantee letters in total amount of AZN 5,603 (2011: AZN 19,260) for these receivables.

11 Inventories

	2012	2011
Finished goods	367,964	230,895
Raw materials and spare parts	363,231	405,652
Crude oil	306,455	67,287
Goods in transit	150,434	16,459
Work in progress	76,296	58,264
Other	8,806	6,244
Total inventories	1,273,186	784,801

12 Other long-term assets

At 31 December 2012 other long-term assets were mainly represented by long-term prepayments for purchase of property, plant and equipment in the amount of AZN 80,805 (2011: AZN 229,069) and VAT receivable in the amount of AZN 39,340 (2011: AZN 12,758).

At 31 December 2011 the balance of long-term assets included prepayment of AZN 35,758 made as part of purchase consideration for SOCAR Switzerland, which was acquired during 2012 (see Note 36).

13 Other financial assets

Current

At 31 December 2012 other current financial assets were mainly represented by short-term loans receivable from third parties in the amount of AZN 77,600 (2011: nil) and balances relating to margin deposits and derivatives in the amount of AZN 52,220 (2011: nil).

Non-current

In accordance with the loan agreement with Palmali dated 5 October 2009, as amended on 6 November 2009 and 30 March 2010, the Group provided a loan in the amount of USD 120 million (AZN 95,748) bearing annual interest rate of LIBOR plus 4.5 per cent and maturing on 30 September 2015. The principal and interest are payable on a quarterly basis.

13 Other financial assets (continued)

At 31 December 2012 and 2011 the carrying value of loan receivable from Palmali equaled to AZN 74,249 and AZN 82,365, respectively.

In accordance with the Share Pledge Agreement and Corporate Guarantee dated 7 October 2009, signed between the Group and owners of Palmali, the latter pledged 340 shares out of total authorized and issued 514 shares and any related equity interests in Palmali as a security for its obligations under the above-mentioned loan agreement. In addition, Palmali has assigned in favor of the Group all of its rights and interests in all proceeds and funds received or receivable by Palmali under the transportation services agreement signed with one of the Group subsidiaries on 20 March 2008 in relation to transportation of crude oil and oil products. The above security arrangements shall remain in force until Palmali fully repays its liabilities to the Group.

At 31 December 2012 the Group also had receivable and interest receivable from Egyptian General Petroleum Company ("EGPC"), a governmental entity, under the refining agreement between SOCAR Trading (newly acquired subsidiary of the Group) and EGPC in the amount of AZN 48,709 (2011: nil).

State Oil Company of the Azerbaijan Republic
Notes to the Consolidated Financial Statements (continued)
(Amounts presented are in thousands of Azerbaijani Manats, unless otherwise stated)

14 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	Exploration and evaluation assets	Construction in progress	Total
Cost:								
At 1 January 2011	1,136,266	5,833,570	1,921,131	456,228	1,129,340	78,238	1,021,061	11,575,834
Additions	61,448	646,483	170,063	43,196	162,404	39,913	1,071,312	2,194,819
Increase in share of jointly controlled assets	-	381,641	-	-	-	-	-	381,641
Disposals	(18,105)	(47,126)	(27,560)	(7,319)	(27,554)	-	(143,206)	(270,870)
Transfers	37,221	384,807	64,435	17	4,574	-	(491,054)	-
Translation to presentation currency	(14,782)	(27,104)	(208,931)	-	(133,688)	(1,270)	(27,802)	(413,577)
At 31 December 2011	1,202,048	7,172,271	1,919,138	492,122	1,135,076	116,881	1,430,311	13,467,847
Additions	19,486	874,154	175,893	40,788	117,128	54,352	1,165,340	2,447,141
Acquisition through business combination	162,034	24,282	24,698	3,677	17,072	-	6,297	238,060
Disposals	(49,709)	(89,486)	(22,602)	(2,762)	(33,107)	-	(79,695)	(277,361)
Transfers	343	498,589	35,566	-	33,666	-	(568,164)	-
Translation to presentation currency	6,433	(3,124)	58,933	(7)	36,968	(266)	10,076	109,013
At 31 December 2012	1,340,635	8,476,686	2,191,626	533,818	1,306,803	170,967	1,964,165	15,984,700
Depreciation and impairment:								
At 1 January 2011	(284,173)	(2,015,813)	(529,670)	(124,085)	(130,241)	-	(239,122)	(3,323,104)
Depreciation charge for the year	(72,085)	(353,312)	(155,773)	(52,501)	(66,692)	-	-	(700,363)
Disposal	8,514	25,537	12,998	775	4,807	-	17,767	70,398
Impairment	(6,442)	(92,346)	(39,786)	(133,610)	(9,391)	-	(218,067)	(499,642)
Transfers	(2,090)	(118,603)	274	-	(23)	-	120,442	-
Translation to presentation currency	1,731	5,737	40,968	-	1,601	-	-	50,037
At 31 December 2011	(354,545)	(2,548,800)	(670,989)	(309,421)	(199,939)	-	(318,980)	(4,402,674)
Depreciation charge for the year	(72,885)	(408,393)	(158,017)	(26,548)	(84,675)	-	-	(750,518)
Disposal	44,939	80,575	18,517	2,531	18,597	-	20,914	186,073
Impairment	(686)	(77,282)	(4,274)	(39,607)	(902)	-	(105,121)	(227,872)
Transfers	8,019	(161,827)	(4,286)	-	(8,134)	-	166,228	-
Translation to presentation currency	(476)	1,005	(12,917)	-	(425)	-	-	(12,813)
At 31 December 2012	(375,634)	(3,114,722)	(831,966)	(373,045)	(275,478)	-	(236,959)	(5,207,804)
Net book value:								
At 31 December 2012	965,001	5,361,964	1,359,660	160,773	1,031,325	170,967	1,727,206	10,776,896
At 31 December 2011	847,503	4,623,471	1,248,149	182,701	935,137	116,881	1,111,331	9,065,173
At 1 January 2011	852,093	3,817,757	1,391,461	332,143	999,099	78,238	781,939	8,252,730

14 Property, plant and equipment (continued)

Acquisition through business combination mainly represents property, plant and equipment acquired through acquisition of SOCAR Switzerland, Carlina and ITERA in amounts of AZN 102,792, AZN 99,910 and AZN 17,628, respectively.

Included in the disposed property, plant and equipment during the year ended 31 December 2012 were assets with net book value of AZN 46,156 (2011: AZN 94,338) which were transferred to governmental entities as part of social program approved by the government and recognised in the distribution to the Government (Note 27). Due to the fact that the assets are constructed/acquired and disposed to the Government within the same year, management believes that their fair value at the date of transfer to the Government approximate cost of construction/acquisition.

In 2011, the Group acquired additional 1.65 per cent participation interest in ACG PSA (Note 36). As a result of this acquisition the Group's share in ACG PSA equalled to 11.65 per cent. This transaction represents increase of share in jointly controlled assets.

15 Intangible assets other than goodwill

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

	Land and property rights	Water rights	Trade name	Customer relationship	Other intangible assets	Total
Cost:						
At 1 January 2011	163,495	196,114	37,393	99,548	44,360	540,910
Additions	-	-	-	-	14,090	14,090
Translation to presentation currency	(33,401)	(40,033)	(7,546)	(20,582)	(1,700)	(103,262)
At 31 December 2011	130,094	156,081	29,847	78,966	56,750	451,738
Acquisitions through business combinations	9,415	-	-	114,251	7,151	130,817
Additions	13,259	-	-	-	26,152	39,411
Disposal	-	-	-	-	(744)	(744)
Impairment	(6,593)	(266)	-	-	-	(6,859)
Translation to presentation currency	9,342	10,839	2,074	9,432	9,063	40,750
At 31 December 2012	155,517	166,654	31,921	202,649	98,372	655,113
Amortization and impairment:						
At 1 January 2011	(10,216)	(11,460)	-	(11,538)	(7,883)	(41,097)
Amortization charge for the year	(3,419)	(3,814)	-	(4,324)	(3,738)	(15,295)
Translation to presentation currency	2,914	3,266	-	3,511	454	10,145
At 31 December 2011	(10,721)	(12,008)	-	(12,351)	(11,167)	(46,247)
Amortization charge for the year	(3,171)	(3,537)	-	(6,864)	(7,857)	(21,429)
Translation to presentation currency	(753)	(844)	-	(1,016)	(8,469)	(11,082)
At 31 December 2012	(14,645)	(16,389)	-	(20,231)	(27,493)	(78,758)
Net book value:						
At 31 December 2012	140,872	150,265	31,921	182,418	70,879	576,355
At 31 December 2011	119,373	144,073	29,847	66,615	45,583	405,491
At 1 January 2011	153,279	184,654	37,393	88,010	36,477	499,813

At 31 December 2012 included in the carrying value of intangible assets was AZN 31,921 (2011: AZN 29,487) trade name of Petkim acquired through business combination in May 2008.

15 Intangible assets other than goodwill (continued)

The carrying value of Petkim trade name at December 31, 2012 has been tested for impairment through comparison with its recoverable amount. Recoverable amount has been determined based on the relief from royalty approach. In applying this methodology, the Group estimated the value of the trade name by capitalising the royalties saved due to Petkim owning the trade name. The royalty rate of 0.2 per cent (2011: 0.2 per cent) was used in the calculations and the discount rate of 9.7 per cent (2011: 9.7 per cent) was applied in the impairment study based on the WACC for 11 years. As a result of the test performed, no impairment on the Petkim trade name was identified.

Acquisition through business combination mainly represents intangible assets other than goodwill acquired through acquisition of SOCAR Trading, SOCAR Switzerland, Atikva Estate LLC and Carlina in the amounts of AZN 3,610, AZN 115,800, AZN 9,415 and AZN 1,866, respectively (Note 36).

During 2012, total amortization expense amounting to AZN 21,429 (2011: AZN 15,295) have been allocated to cost of sales by AZN 16,013 (2011: AZN 7,234), marketing, selling and distribution expenses by AZN 3,890 (2011: AZN 4,121), and general administrative expenses by AZN 1,526 (2011: AZN 3,940).

16 Investments in jointly controlled entities

The table below summarises movements in the carrying amount of the Group's investment in jointly controlled entities.

	Note	2012	2011
Carrying amount at 1 January 2012		392,399	265,894
Additions to investments in jointly controlled entities		54,662	84,504
Share of after tax results of jointly controlled entities		19,513	19,221
Dividends received from jointly controlled entities	7	(13,789)	(11,362)
Exchange differences		(592)	670
Other		(14,220)	33,472
Carrying amount at 31 December 2012		437,973	392,399

At 31 December 2012, the Group's interests in its principal jointly controlled entities 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
Azgerneft MMC	24,132	33,588	(18,290)	-	39,154	12,805	40%	Azerbaijan
Azəri-Fuqro	11	114	(77)	-	914	(121)	60%	Azerbaijan
AZFEN	53,042	12,949	(22,779)	-	130,612	21,881	60%	Azerbaijan
Bosshelf LLC	20,498	831	(18,245)	-	70,372	466	90%	Azerbaijan
Azturqaz	287	871	(1,125)	-	568	(21)	50%	Azerbaijan
Azəri M.İ. Drilling Fluids	54,505	5,389	(44,930)	-	114,318	12,090	51%	Azerbaijan
Oil and Gas Proservice	10,870	258	(2,136)	(236)	4,630	3,279	30%	Azerbaijan
Ekol Engineering Services	6,032	9,912	(1,958)	(319)	17,465	(12)	51%	Azerbaijan
Caspian Shipyard Company	12,679	881	(863)	-	24,689	6,556	20%	Azerbaijan
SOCAR KPS	7,473	6,705	(14,145)	-	6,136	(23)	50%	Azerbaijan
SOCAR Petroleum CSJC	35,547	85,432	(29,496)	(69,293)	518,765	653	51%	Azerbaijan
SOCAR-UGE	709	12,105	(3,413)	-	-	(2,141)	97%	Azerbaijan
SOCAR Umid	1,880	301,843	(49,920)	-	-	(4,744)	80%	Azerbaijan
Sarmatia	1,468	-	(1,393)	-	27	(454)	27%	Poland
SOCAR Baglan LLC	32	15,704	(8,603)	(9,533)	270	(1,798)	51%	Azerbaijan
SOCAR AQS	368,292	3,799	(127,800)	(52,253)	89,779	(18,876)	51%	Azerbaijan
AGRI LNG Project Company SRL	619	1	(19)	-	-	(66)	33%	Romania
SOCAR CAPE	2,328	102	(2,733)	-	9,409	(402)	51%	Azerbaijan
Star Gulf FZCO	8,237	8,348	(11,081)	-	19,148	(721)	80%	UAE
SOCAR Foster Viler Mühəndislik Xidmətləri	1,257	187	(999)	(445)	593	(205)	65%	Azerbaijan
Total	609,898	499,019	(360,005)	(132,079)	1,046,849	28,146		

16 Investments in jointly controlled entities (continued)

At 31 December 2011, the Group's interests in its principal associates 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
Azeri Fugro	165	47	(13)	-	1,340	53	60%	Azerbaijan
Azeri M.I. Drilling Fluids	44,473	4,975	(38,002)	-	85,127	7,385	51%	Azerbaijan
Azfen	34,751	8,595	(11,993)	-	87,952	17,521	60%	Azerbaijan
Azgerneft	24,585	26,563	(15,639)	-	39,524	15,310	40%	Azerbaijan
Azturqaz	324	873	(1,119)	-	661	(107)	50%	Azerbaijan
Bosshelf LLC	14,759	426	(12,567)	-	80,361	2,210	50%	Azerbaijan
Carlina Overseas Corp.	19,347	115,962	(384,550)	(2,247)	34,117	(13,931)	51%	BVI
Caspian Shipyard Company	14,081	1,089	(3,431)	-	22,022	1,966	20%	Azerbaijan
Ekol Engineering Services	6,294	10,332	(2,502)	(395)	26,830	(897)	51%	Azerbaijan
Oil and Gas Proservice	6,724	168	(1,243)	-	3	1,893	30%	Azerbaijan
Sarmatia	(1,224)	-	(15)	-	70	(275)	25%	Poland
SOCAR AQS	346,822	4,636	(60,463)	(80,082)	145,285	65,631	51%	Azerbaijan
SOCAR Baglan LLC	113	24,283	(5,287)	(20,433)	8	737	51%	Azerbaijan
SOCAR CAPE	5,325	5	(6,439)	-	9,344	(1,895)	51%	Azerbaijan
SOCAR - KPS	5,261	4,270	(9,475)	-	3,794	(12)	50%	Azerbaijan
SOCAR Petroleum CJSC	26,152	70,448	(13,396)	(61,667)	289,659	660	51%	Azerbaijan
SOCAR-UGE	12,463	298	(1,219)	-	-	(2,318)	97%	Azerbaijan
SOCAR Umid	354	224,156	(15,432)	-	-	(1,448)	80%	Azerbaijan
Total	560,769	497,126	(582,755)	(164,824)	826,097	92,483		

Investments where the Group's share is more than 50 per cent and which are jointly controlled by venturers are recognized as investments in jointly controlled entities.

During 2012, the Group has made additional contributions in share capital of its jointly controlled entities, SOCAR Petroleum CJSC, SOCAR Umid LLC and SOCAR-UGE LLC in the amount of AZN 12,311 (2011: 17,627), AZN 37,939 (2011: 63,751) and AZN 3,685 (2011: 1,205), respectively, and insignificant contributions to other jointly controlled entities.

On 17 January 2012, the Group obtained control over its jointly controlled entity Carlina. Accordingly, from this date Carlina was consolidated (Note 36).

On 30 June 2012, the subsidiary of the Group, SOCAR Overseas acquired 80 per cent of Star Gulf FZCO, which owns 50 per cent of Bosshelf LLC. As a result of this transaction, the Group's effective participating interest in Bosshelf LLC increased to 90 per cent. BosShelf is considered as a joint venture of the Company, since its operations are under joint control.

17 Investments in associates

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

	Note	2012	2011
Carrying amount at 1 January		1,186,370	351,085
Additions to investments in associates		87,238	984,830
Share of after tax results of associates		199,770	173,976
Dividends received from associates	7	(189,800)	(159,912)
Acquisition of control over associate (Note 36)		(119,964)	(160,675)
Derecognition of associates		-	(2,767)
Exchange differences		(1,932)	(167)
Other		3,338	-
Carrying amount at 31 December		1,165,020	1,186,370

17 Investments in associates (continued)

At 31 December 2011 the Group had 50 per cent interest in Supra Holding Limited. In August 2012 the Group has acquired additional 30 per cent share of Supra Holding Limited, for a consideration of AZN 60,641 from other shareholder. Due to the fact that strategic and operating decisions related to Supra Holding Limited activity require the unanimous consent of all shareholders, as a result of this acquisition, the Group did not obtain control over this investee. At the date of this acquisition fair value of investment in associate approximated its carrying value. In November 2012 the Group acquired additional 20 per cent share of Supra Holding Limited for a consideration of AZN 43,764. As a result of this acquisition, the Group's participation in Supra Holding Limited has increased to 100 per cent and the Group has obtained control over Supra Holding Limited in November 2012 (Note 36).

At 31 December 2012, the Group's interests in its principal associates 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	31,462	(23,848)	32,465	200	10%	Azerbaijan
Azerbaijan Gas Supply Company	377,071	(376,911)	1,188,150	-	8%	Cayman Islands
Azerbaijan John Brown	118	(32)	378	(14)	20%	Azerbaijan
AzLab	872	(234)	1,071	164	50%	Azerbaijan
BTC Co	4,087,522	(963,393)	1,281,674	854,292	25%	Cayman Islands
Caspian Geophysical	20,795	(9,169)	35,961	7,683	45%	Azerbaijan
Caspian Pipe Coatings LLC	5,567	(1,995)	8,647	(60)	50%	Azerbaijan
Cross Caspian Oil and Gas Logistics	15,247	(15,120)	110,182	27	34%	Azerbaijan
SOCAR International DMCC	47,855	(3,695)	4,145,696	43,663	50%	UAE
South Caucasus Pipeline Company ("SCPC")	1,040,045	(165,036)	138,673	39,497	10%	Cayman Islands
South Caucasus Pipeline Company Hold Co ("SCPC Hold Co.")	18,118	(829)	790	761	10%	Cayman Islands
Total	5,644,672	(1,560,262)	6,943,687	946,213		

At 31 December 2012 the Group had investments in associates with total carrying value of AZN 24,844 acquired through business combination of SOCAR Switzerland (Note 36). The Group has not disclosed total assets, total liabilities, revenue and profit/loss information for these companies in the above table due to impracticability of their calculation. The results of operations of these associates are immaterial.

At 31 December 2011, the Group's interests in its principal associates 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	19,964	(14,945)	18,727	(2,048)	10%	Azerbaijan
Azerbaijan Gas Supply Company	405,399	(405,242)	1,138,607	-	8%	Cayman Islands
Azerbaijan John Brown	132	(32)	531	14	40%	Azerbaijan
AzLab	917	(279)	1,029	143	50%	Azerbaijan
BTC Co	4,168,399	(1,172,373)	522,303	493,099	25%	Azerbaijan
Caspian Geophysical	10,023	(4,430)	18,864	2,324	45%	Azerbaijan
Caspian Pipe Coatings LLC	8,880	(1,582)	7,636	199	50%	Azerbaijan
Cross Caspian Oil and Gas Logistics	8,180	(8,059)	103,454	22	34%	Azerbaijan
SOCAR International DMCC	660,279	(651,482)	1,332,777	8,387	50%	UAE
SCPC	1,018,965	(105,535)	156,483	52,709	10%	Cayman Islands
SCPC Hold Co.	18,480	(394)	1,054	1,022	10%	Cayman Islands
Supra Holding Limited	3,232,528	(3,074,719)	26,571,500	23,848	50%	Malta
Total	9,552,146	(5,439,072)	29,872,965	579,719		

At 31 December 2012 and 2011 the Group held 8 per cent interest in the Azerbaijan Gas Supply Company ("AGSC"). AGSC was established together with the Ministry of Fuel and Energy of the Azerbaijan Republic and contractor parties of Shah Deniz Production Sharing Agreement ("Shah Deniz PSA") related to the Exploration, Development and Production of gas field on Caspian Sea where the Group has 10 per cent participating interest. AGSC is established for marketing, accounting, billing, payment and reporting of other administrative activities related to the sales of Shah Deniz gas and operates on no gain / no loss basis. The Group exercises a significant influence over AGSC.

17 Investments in associates (continued)

On 22 July 2011 the Group acquired remaining 77.44 per cent of Azerbaijan BTC Ltd ("AzBTC") shares. As a result of this transaction, SOCAR became sole 100 per cent shareholder of AzBTC. Accordingly, from 22 July 2011 AzBTC was transferred from associates to subsidiary. Upon acquisition of control in AzBTC, the Group recognized 25 per cent interest of AzBTC in BTC Co shares as investment in associate (Note 36).

In June 2011 the Group entered into agreement with other participants to establish an associated entity named SOCAR International DMCC. Total equity of the entity is AZN 1,030 and the Group's share is 50 per cent.

The Group exercises a significant influence over SCPC and SCPC Hold Co. All significant decisions of SCPC and SCPS Hold Co are made at Shah Deniz PSA Steering Committee, where the Group has 50 per cent stake.

The Group exercises a significant influence over Ateshgah Insurance Company by participating in the financial and operating policy decisions of the associate.

18 Loan receivable from jointly controlled entity

Loan receivable from jointly controlled entity at 31 December 2011 represents balances due from Carlina in accordance with terms of the loan agreement signed on 28 December 2006 between Carlina and Azerbaijan (ACG) Limited ("AzACG"), a subsidiary of the Group. At 31 December 2011 the carrying value of the receivable from Carlina equalled to AZN 178,484. In accordance with the Share Pledge and Retention Agreement dated 28 December 2006 and Share Charge and Retention Agreement dated 12 April 2007 between the owners of Carlina and the Group, the owners of Carlina pledged in favour of the AzACG all of their rights and interest in all proceeds and funds received or receivable by Carlina, and all of their shares and any other equity interests in Carlina.

On 17 January 2012, the other owners of Carlina transferred their shares to the Group and the Group's interest increased to 100 per cent. Accordingly, from the date when control was obtained in Carlina, it has been consolidated by the Group (Note 36).

19 Trade and other payables

	2012	2011
Trade payables	3,383,681	2,582,245
Accrued liabilities	1,530,129	66,956
Other payables	41,670	33,263
Total financial payables	4,955,480	2,682,464
Liabilities for overlift of oil	66,423	32,539
Advances from customers	65,743	48,487
Payable to employees	54,798	43,410
Total trade and other payables	5,142,444	2,806,900

Financial payables of AZN 4,315,122 (2011: AZN 1,840,407) 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, represents the Group's obligation to deliver physical quantities of oil out of its share of future production.

20 Borrowings

As at 31 December 2012, short-term borrowings of the Group were represented by the following facilities:

Facilities	Interest rate	Maturity date	Total borrowed in original currency (in thousands)	Balance as at 31 December 2012
Short-term facilities in USD	0.2% - 16%	February 2013 – November 2013	1,396,382	1,089,800
Short-term facilities in EUR	EURIBOR+1.25%	November 2013	56,660	57,863
Short-term facilities in AZN	3% - 4%	March 2013	91,000	82,600
Short-term facilities in CHF	LIBOR+0.18%	January 2013	30,000	25,782
Short-term facilities in GEL	10% - 13%	January 2013 – March 2013	63,000	26,460
Short-term facilities in other currencies	0% - 4%	January 2013 – December 2013		21,805
Current portion of long-term borrowings				568,892
Total short-term borrowings and current portion of long-term borrowings				1,873,202

As at 31 December 2012, long-term borrowings of the Group were represented by the following facilities:

Facilities	Interest rate	Maturity date	Balance as at 31 December 2012	
			Non-current portion	Current portion
AZN 750 million	3.15%	July 2016	375,000	125,000
USD 500 million	5.45%	February 2017	383,825	8,675
USD 130 million	LIBOR+2.6%	April 2014	25,163	51,517
USD 110 million	LIBOR+3%	August 2015	85,136	1,168
USD 200 million	LIBOR+2.55%	April 2014	30,996	63,269
USD 100 million	LIBOR+3%	October 2015	77,337	568
USD 100 million	LIBOR+3%	November 2015	77,278	261
USD 100 million	LIBOR+2.4%	October 2015	61,475	16,098
USD 75 million	LIBOR+2.3%	May 2014	16,612	33,738
USD 50 million	LIBOR+3.75%	May 2013	-	8,840
USD 100 million	LIBOR+3.65%	July 2013	-	26,167
USD 75 million	LIBOR+3.85%	July 2013	-	29,803
USD 50 million	LIBOR+3.5%	December 2013	-	26,141
USD 27 million	LIBOR+2%	March 2017	12,584	3,126
AZN 100 million	4%	August 2015	100,443	-
USD 17 million	7.79%	July 2016	1,620	1,668
YEN 15,462 million	1.5%	April 2039	121,573	3,409
AZN 9 million	0%	December 2013	-	2,861
USD 485 million	LIBOR+1%	December 2024	299,140	54,390
USD 200 million	LIBOR+1.34%	December 2027	157,000	-
USD 18 million	4%	December 2027	13,738	-
USD 7 million	4%	December 2027	5,495	-
EUR 20 million	EURIBOR+3.5%	June 2014	4,070	16,911
EUR 30 million	EURIBOR+3.5%	December 2014	23,814	6,902
USD 35 million	LIBOR+4%	December 2013	-	18,358
USD 20 million	LIBOR+4%	August 2015	15,996	-
USD 200 million	LIBOR+2.5%	August 2016	130,740	24,886
USD 300 million	LIBOR+2.30%	August 2018	218,145	12,204
USD 330 million	LIBOR+4.88%	August 2019	242,362	16,096
USD 170 million	LIBOR+4.88%	August 2019	123,616	8,160
USD 7 million	LIBOR+3.75%	June 2015	2,346	1,555
USD 10 million	LIBOR+3.75%	June 2016	5,306	2,123
Other long-term borrowings			6,751	4,998
Total long-term borrowings			2,617,561	568,892

20 Borrowings (continued)

As at 31 December 2011, short-term borrowings of the Group were represented by the following facilities:

Facilities	Interest rate	Maturity date	Total borrowed in original currency (in thousands)	Balance as at 31 December 2011
Short-term facilities in USD	0% - 16%	January 2012- November 2012	340,456	163,383
Short-term facilities in EUR	EURIBOR+3.5%	June 2012 - December 2012	3,378	3,378
Short-term facilities in AZN	3% - 3.15%	March 2012 – May 2012	86,000	78,059
Short-term facilities in GEL	14% - 14.5%	February 2012 – June 2012	45,395	28,030
Short-term facilities in other currencies	6.5%	March 2012		2,856
Current portion of long-term borrowings				485,812
Total short-term borrowings and current portion of long-term borrowings				761,518

As at 31 December 2011, long-term borrowings of the Group were represented by the following facilities:

Facilities	Interest rate	Maturity date	Balance as at 31 December 2011	
			Non-current portion	Current portion
AZN 750 million	3.2%	July 2016	500,000	125,000
USD 130 million	LIBOR+2.6%	April 2014	75,597	25,561
USD 200 million	LIBOR+2.55%	April 2014	93,064	62,920
USD 75 million	LIBOR+2.3%	May 2014	50,009	8,427
USD 50 million	LIBOR+3.75%	May 2013	8,677	17,460
USD 100 million	LIBOR+3.65%	July 2013	50,886	26,190
USD 75 million	LIBOR+3.85%	July 2013	29,275	29,494
USD 50 million	LIBOR+3.5%	December 2013	25,868	13,095
USD 200 million	LIBOR+4%	March 2013	52,061	104,762
USD 17 million	7.79%	July 2016	4,129	106
JPY 15,462 million	1.5%	April 2039	138,951	5,122
AZN 9 million	0%	December 2013	3,009	2,506
AZN 4 million	0%	June 2014	1,985	1,401
USD 485 million	LIBOR+1%	December 2024	326,959	54,493
EUR 20 million	EURIBOR+3.5%	June 2014	20,052	-
EUR 30 million	EURIBOR+3.5%	December 2014	30,128	-
USD 35 million	LIBOR+4%	December 2013	27,472	-
USD 330 million	LIBOR+4.88%	August 2019	248,651	2,820
USD 170 million	LIBOR+4.88%	August 2019	126,912	2,634
USD 200 million	LIBOR+2.5%	August 2016	152,407	-
USD 300 million	LIBOR+2.3%	August 2018	228,610	-
USD 5 million	LIBOR+3.75%	June 2015	2,767	1,107
USD 7 million	LIBOR+3.75%	June 2015	3,874	1,550
USD 5 million	LIBOR+3.75%	June 2015	2,912	1,164
USD 10 million	LIBOR+3.75%	Jun-16	7,361	-
Other long-term borrowings			7,154	-
Total long-term borrowings			2,218,770	485,812

On 14 May 2010, IBA provided a credit line to the Group amounting to USD 40 million (AZN 31,460) which was collateralised by the Group's deposits with IBA in the amount of AZN 31,400 (Note 9). In May 2012 an amendment to this contract was signed and the maturity of the contract was prolonged till 14 May 2013. The loan bears an annual interest rate of 3 per cent. The amount outstanding under this facility as at 31 December 2012 was AZN 23,079 (2011: 19,427).

20 Borrowings (continued)

Included in short-term borrowings there is a USD 40 million facility, which is collateralized by a cash deposit of USD 40 million (AZN 31,414) placed with IBA (Note 9). This facility bears annual interest rate of 3 per cent and matures on 16 May 2013. The amount outstanding under this facility as at 31 December 2012 and 31 December 2011 was AZN 30,800.

21 Taxes payable

	Note	2012	2011
Payable to SOFAZ	7	123,324	123,324
Social security contributions		1,235	1,568
Other taxes payable		470,723	308,816
Total taxes payable		595,282	433,708

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 state budget (USD 50 per barrel for 2009) to SOFAZ. No such taxes were imposed on the Group in 2009-2012.

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 corporate income tax, VAT, property, excise tax, personal income tax, price margin tax liabilities offset with tax receivables and prepayments.

22 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	2012	2011
Carrying amount at 1 January		468,384	324,632
Additions		4,058	47,275
Unwinding of the present value discount	32	28,930	22,473
Effect of change in discount rate		121,156	77,481
Exchange differences		(1,664)	(3,477)
Carrying amount at 31 December		620,864	468,384

The Group makes full 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 12 and 70 years from the reporting date.

Included within the asset retirement obligations at 31 December 2012 was AZN 187,189 (2011: AZN 133,445) relating specifically to estimated site restoration liabilities. Estimated costs of dismantling oil and gas production facilities, pipelines and related processing and storage facilities, including abandonment and site restoration costs amounting to AZN 259,951 at 31 December 2012 (2011: AZN 293,465) are included in the cost of oil and gas properties and equipment.

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.

22 Asset retirement obligations (continued)

The maximum estimated cost to AzSD to abandon the production facilities employed at 31 December 2012 in Shah Deniz project was AZN 64,144 as at 31 December 2012 (as at 31 December 2011: AZN 55,020). The Company used 5.97 per cent rate to discount this obligation (in 2011: 5.47 per cent).

The maximum estimated cost to AzACG to abandon the production facilities employed at 31 December 2012 in AzACG project was AZN 2,193,857, as at 31 December 2012 (as at 31 December 2011: AZN 1,985,010). The Company used 5.97 per cent rate to discount this obligation (in 2011: 5.47 per cent).

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

Year	2013	2014	2015	2016	2017-2020	2021 and later
Inflation rate	4.29%	4.88%	5.43%	5.29%	4.90%-3.40%	3.00%

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.

23 Other provisions for liabilities and charges

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

	Note	Environmental obligations	Disability payments	Unused vacation	Total
Carrying amount at 1 January 2011		416,419	56,546	8,306	481,271
Change in estimate, except for change in discount rate		(178,047)	26,135	6,505	(145,407)
Utilisation		(25,199)	(10,767)	(9,575)	(45,541)
Unwinding of the present value discount	32	28,250	3,905	-	32,155
Discount rate change		(10,100)	511	-	(9,589)
Carrying amount at 31 December 2011		231,323	76,330	5,236	312,889
of which:					
Current		48,158	12,730	5,236	66,124
Non-current		183,165	63,600	-	246,765
Carrying amount at 1 January 2012		231,323	76,330	5,236	312,889
Change in estimate, except for change in discount rate		(20,176)	24,287	38,260	42,371
Utilisation		(41,008)	(10,541)	(20,384)	(71,933)
Unwinding of the present value discount	32	19,573	5,238	-	24,811
Discount rate change		5,772	6,450	-	12,222
Carrying amount at 31 December 2012		195,484	101,764	23,112	320,360
of which:					
Current		54,840	12,971	23,112	90,923
Non-current		140,644	88,793	-	229,437

Under the Presidential Decree number 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 2009 the Group amended the Action Plan in accordance with the Presidential Decree dated 14 April 2009. Corresponding provision is recognized at the present value of future costs to be incurred for the environmental remediation. In 2011 the Group revised the estimates related to the Action Plan based on the actual expenses incurred in prior years. In addition, the Group extended the period covered by this Action Plan till 2016.

23 Other provisions for liabilities and charges (continued)

The Group has an obligation to compensate its employees for the damage caused to their health during their employment, as well as to compensate the families of the employees died at work. 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 5.97 per cent (6.86 per cent at 31 December 2011). 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 22 were applied to reflect the escalation in average salaries.

24 Deferred income

The Group obtained government grants aimed at gasification of Baku suburban area and regions of the Azerbaijan Republic and recognised them as deferred income:

	2012	2011
Carrying amount at 1 January	94,401	101,183
Amortisation of deferred income to match related depreciation	(3,358)	(6,782)
Carrying amount at 31 December	91,043	94,401

25 Other non-current liabilities

Other non-current liabilities comprise the following:

	2012	2011
Provision for employment termination benefits	33,772	31,732
Liabilities under carried interest arrangement	46,471	43,496
Provision for seniority incentive bonus	1,377	1,446
Other liabilities	39,266	7,729
Total non-current liabilities	120,886	84,403

Under the 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, or who is called up for military service, dies or retires after completing 25 years of service (20 years for women). The amount payable consists of one month's salary limited to a maximum of AZN 1 for each year of service as of 31 December 2012 and 31 December 2011.

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:

	2012	2011
Discount rate (%)	3.84	6.07
Probability of retirement (%)	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.

25 Other non-current liabilities (continued)

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

	2012	2011
Carrying amount at 1 January	31,732	39,529
Actuarial loss and service cost	7,348	1,818
Payments during the year	(6,615)	(11,531)
Other	1,307	1,916
Carrying amount at 31 December	33,772	31,732

The total of actuarial loss and the service cost amounting to AZN 7,348 (2011: AZN 1,818) was included in general administrative expenses.

Other liabilities mainly relate to the Group's payable to its partners under various oil and gas projects.

26 Deferred acquisition consideration payable

In 2012, the Group acquired additional 50 per cent shares of SOCAR Trading from other shareholders. The Group deferred cash consideration in the amount of USD 83 million (AZN 65,169) payable to one of the shareholders for this acquisition.

27 Charter capital, additional paid-in-capital and retained earnings

Charter capital

Parent company of the Group, SOCAR, has a legal status of a state enterprise. During 2011 the Group's charter capital increased by AZN 190,000. This increase partially relates to increase in the charter capital of Azerigaz PU in the amount of AZN 150,000 by the Government. The remaining increase of AZN 40,000 is related to establishment of "Karbamid Plant".

Additional paid-in capital

During 2012 the Group's additional paid-in-capital increased by AZN 230,000. This increase relates to the increase in the charter capital of Azerigaz PU by the Government, which was not registered as of 31 December 2012.

In 2011 the Government has transferred 77.44 per cent of shares in Azerbaijan (BTC) Limited previously belonged to the Ministry of Economic Development of the Azerbaijan Republic ("MED"). As of 31 December 2011 this transfer was recognized as additional paid in capital at fair value of transferred shares in the amount of AZN 784,809.

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 2012, such direct cash transfers to the Government and financing (made in the form of payments to sub-contractors of governmental entities and transfer of assets constructed by the Group) amounted to AZN 261,539 and AZN 259,903, respectively (2011: AZN 250,642 and AZN 264,107, respectively), mainly for repair and reconstruction of existing, as well as construction of new recreational, transport, educational and medical infrastructure of the Azerbaijan Republic. Financing in the form of transfer of assets constructed by the Group amount to AZN 46,156 as of 31 December 2012 (2011: AZN 94,338).

28 Analysis of revenue by categories

	2012	2011
Crude oil, net	10,126,222	2,716,988
Oil products, net	3,318,135	2,077,482
Petrochemicals	2,029,524	2,002,327
Natural gas	1,106,713	967,219
Other revenue	558,238	368,715
Total revenue	17,138,832	8,132,731

Revenue from crude oil sales is stated net of price margin tax which is levied 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 482,043 (2011: AZN 440,769).

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.

29 Analysis of expenses by nature

	Note	2012	2011
Raw materials and consumables used		12,461,139	3,715,879
Depreciation of property, plant and equipment		670,733	614,717
Wages, salaries and social security costs		806,386	628,943
Transportation and vehicle maintenance		160,557	129,152
Repairs and maintenance expenses		181,033	184,997
Impairment of property, plant and equipment	14	227,872	499,642
Mining tax		112,102	118,222
Utilities expense		208,791	216,807
Taxes other than on income		100,613	77,135
Amortization expense	15	21,429	15,295
Impairment of trade and other receivables		74,854	155,268
Change in other provisions for liabilities and charges	23	54,593	(154,996)
Other		619,200	233,515
Total cost of sales, exploration and evaluation, distribution, general and administrative and other operating expenses		15,699,302	6,434,576

During 2012 the Group reduced its estimate of provision for environmental obligations and included the resulting change in other operating expenses of Consolidated Statement of Comprehensive Income.

During 2012 the Group recognized impairment loss provision in the amount of AZN 68,762 (2011: AZN 101,219) related to the loan receivable from jointly controlled entity (Note 18).

30 Other operating income

	2012	2011
Sales of other goods and services rendered	71,994	63,014
Gain on release of payables	1,443	25,709
Other	78,069	60,280
Total other operating income	151,506	149,003

31 Finance income

	2012	2011
Interest income on deposits and bank accounts	22,422	53,489
Interest on loans to related parties	-	16,468
Other	11,682	2,443
Total finance income	34,104	72,400

32 Finance costs

	Note	2012	2011
Interest expense		134,694	156,322
Provisions for asset retirement obligations: unwinding of the present value discount	22	28,930	22,473
Environmental provision: unwinding of the present value discount	23	19,573	28,250
Provision for disability payments: unwinding of the present value discount	23	5,238	3,905
Total finance costs		188,435	210,950

33 Income taxes

Income tax expense comprises the following:

	2012	2011
Current tax expense	504,281	461,254
Deferred tax benefit	(24,859)	(86,003)
Income tax expense for the year	479,422	375,251

A reconciliation between the expected and the actual taxation charge is provided below:

	2012	2011
Profit before tax	1,434,416	1,184,844
Theoretical tax charge at statutory rate of 20 per cent	286,883	236,969
Effects of different tax rates for certain subsidiaries (25 and 27 per cent)	40,909	33,775
Dividends income taxable at 10 per cent	(1,379)	(12,712)
Tax effect of items which are not deductible or assessable for taxation purposes:		
- Income which is exempt from taxation	(37,141)	(53,832)
- Non-deductible expenses	134,356	140,579
Allowance for deferred tax asset	67,551	109,800
Reversal of allowance for deferred tax	(8,229)	(79,837)
Correction of previous years current tax	2,103	616
Other	(5,631)	(107)
Income tax expense for the year	479,422	375,251

33 Income taxes (continued)

Non-deductible expenses are mainly comprised of the expenses related to non-deductible operations including 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 relate to the accumulated tax losses of the Group's subsidiaries which are not expected to utilize these losses.

At 31 December 2012 and 2011 cumulative balance of unrecognized deferred tax asset is AZN 304,252 and AZN 244,930, respectively.

The benefits arising from a previously unrecognised deferred tax assets were used during the year to reduce deferred tax and current tax expenses by the amount of 6,012 and 2,217, respectively (2011: 79,837 and nil, respectively).

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 2012	Acquired through subsidiaries (Note 36)	Credited / (charged) to profit or loss	Translation difference	31 December 2012
Tax effect of deductible/(taxable) temporary differences					
Accrued revenue	8,339	-	(2,570)	-	5,769
Carry forward tax losses	76,081	-	(38,602)	-	37,479
Investments in associates and jointly controlled entities	(25)	-	17,016	-	16,991
Trade and other payables	1,612	-	(3,545)	(5)	(1,938)
Impairment provision for receivables	19,912	-	(27,134)	-	(7,222)
Inventory	6,418	-	22,802	(2)	29,218
Property, plant and equipment	241,572	-	6,521	26	248,119
Provisions for liabilities and charges	110,342	-	18,100	-	128,442
Other	19,232	6,858	11,986	(3,047)	35,029
Deferred tax asset	483,483	6,858	4,574	(3,028)	491,887

	1 January 2012	Acquired through subsidiaries (Note 36)	Credited/ (charged) to profit or loss	Translation difference	31 December 2012
Tax effect of deductible/(taxable) temporary differences					
Accruals	4,613	(6,947)	5,077	(10)	2,733
Employment termination benefits and seniority incentive bonus provision	6,873	-	511	479	7,863
Investments in associates and jointly controlled entities	(80,984)	(2,333)	14,260	(2,477)	(71,534)
Asset retirement obligation	-	-	6,768	(36)	6,732
Intangible assets	-	(22,950)	3	-	(22,947)
Trade and other payables	(2,996)	-	3,261	-	265
Impairment provision for receivables	(14,357)	(446)	(9,654)	20	(24,437)
Inventory	(876)	(8,394)	(9,149)	(112)	(18,531)
Property, plant and equipment	(447,118)	(12,390)	20,539	(19,706)	(458,675)
Provisions for liabilities and charges	16,609	-	4,308	36	20,953
Other	11,900	83	(15,639)	(134)	(3,790)
Deferred tax liability	(506,336)	(53,377)	20,285	(21,940)	(561,368)

33 Income taxes (continued)

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 2011	Credited / (charged) to profit or loss	Translation difference	31 December 2011
Tax effect of deductible/(taxable) temporary differences				
Accruals	727	7,612	-	8,339
Carry forward losses	129,686	(53,605)	-	76,081
Investments in associates and jointly controlled entities	-	(25)	-	(25)
Trade and other payables	3,863	(2,251)	-	1,612
Impairment provision for receivables	52,352	(32,440)	-	19,912
Inventory	29,324	(22,898)	(8)	6,418
Property, plant and equipment	133,148	108,426	(2)	241,572
Provisions for liabilities and charges	37,304	72,950	88	110,342
Other	22,569	(3,337)	-	19,232
Deferred tax asset	408,973	74,432	79	483,483

	1 January 2011	Acquired through subsidiaries	Credited/ (charged) to profit or loss	Translation difference	31 December 2011
Tax effect of deductible/(taxable) temporary differences					
Accruals	6,810	-	(2,108)	(89)	4,613
Carry forward tax losses	9,506	-	(8,718)	(788)	-
Employment termination benefits and seniority incentive bonus provision	8,454	-	143	(1,724)	6,873
Investments in associates and jointly controlled entities	(47,186)	(50,038)	16,233	7	(80,984)
Trade and other payables	-	-	(2,996)	-	(2,996)
Trade and other receivables	(18,433)	-	3,849	227	(14,357)
Inventory	(450)	-	(436)	10	(876)
Property, plant and equipment	(497,967)	-	(613)	51,462	(447,118)
Provisions for liabilities and charges	6,274	-	11,708	(1,373)	16,609
Other	23,852	-	(5,491)	(6,461)	11,900
Deferred tax liability	(509,140)	(50,038)	11,571	41,271	(506,336)

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.

33 Income taxes (continued)

The Group is a participant to ACG PSA through its subsidiary AzACG. However, AzACG is not explicitly defined as a contractor party in the ACG PSA. As a result, its tax-payer status is not clearly determinable. Based on current negotiations with relevant tax authorities, management believes that the status of the contractor party will be granted retrospectively and therefore AzACG has already assumed a tax-payer status. At the moment AzACG accrues and pays its income tax at the rate of 25 per cent in accordance with ACG PSA provisions. AzACG is charged with zero per cent VAT effective in the Azerbaijan Republic for a contractor party under the ACG PSA according to a VAT certification issued by tax authorities to AzACG and effective until 19 September 2019.

In addition, the Group is a participant to Shah Deniz PSA through its subsidiary Azerbaijan (Shah Deniz) Limited ("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 payments of the profit taxes on behalf of the contractor parties from the proceeds from sales of profit petroleum attributable to the Government. Accordingly, AZN 23,516 of corporate income tax related to Shah Deniz project for the year 2012 was recognized as revenue from sale of crude oil and natural gas and income tax expense in the statement of comprehensive income (2011: nil). At 31 December 2012 and 2011 deferred tax balance of AzSD was nil. AzSD is also exempt from certain ordinary operational taxes in the Azerbaijan Republic. AzSD is charged at zero per cent VAT effective in the Azerbaijan Republic for a contractor party under the Shah Deniz PSA according to a VAT certification issued to AzSD and effective until 3 June 2026.

The Group operates in the tax environment of Turkey through its subsidiary, STEAS. Income tax rate in Turkey is 20 per cent. In accordance with the tax legislation of Turkey dividends paid to non-resident corporations, which have a place of business in Turkey are not subject to withholding tax that is 15 per cent. 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.

34 Significant non-cash investing and financing activities

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

	2012	2011
Non-cash investing activities		
Offset loan due to IBA and deposits placed with the same bank	-	987,058
Capitalized decommissioning costs	27,593	103,965
Transfer of property, plant and equipment to the Government (Note 14)	46,156	94,338
Acquisition of Carlina, net of cash acquired (Note 36)	101,682	-
Non-cash investing activities	175,431	1,185,361

Other non cash transactions related to acquisition of subsidiaries are disclosed in Note 36.

35 Contingences, commitments and operating risks

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

Whilst there have been improvements in economic trends in the Azerbaijan Republic, the country continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Azerbaijan Republic. The tax, currency and customs legislation within the Azerbaijan Republic is subject to varying interpretations and changes.

35 Contingences, commitments and operating risks (continued)

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

The Azerbaijani economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. While the Azerbaijan Government has introduced a range of stabilization measures, there continues to be uncertainty regarding the access to capital and cost of capital for the Group and its counterparties, which could affect the Group's financial position, results of operations and business prospects. While Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable.

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.

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

The Group's management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained and potential tax liabilities of the Group will not exceed the amounts recorded in these consolidated financial statements. Accordingly, at 31 December 2012 and 2011 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 recognised 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. See Note 23.

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 recognised, 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.

35 Contingences, commitments and operating risks (continued)

Environmental matters (continued). 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 2012 the Group had loans payable in total amount of AZN 4,490,763 (Note 20) 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 2012 and 2011 the Group was in compliance with all applicable financial covenants.

For the loans in the amount of AZN 620,150 the 51 per cent of Petkim shares have been pledged in favour of the financial institutions.

Commitments of Petkim. Based on the Share Sales Agreement, the Group has accepted and committed to take the Administration's approval for any kind of stock transfer that will result in change in controlling interest of Petkim for the following three years after signing the Share Sales Agreement.

The Group has accepted and committed to make investments over a certain amount for infrastructure and services for Petkim harbour, increase production capacities of factories and establish new factories for the following three years after the Share Sales Agreement. The Group also has accepted and committed to continue production in the Ethylene Factory and produce a certain amount for at least three years after signing the Share Sales Agreement unless there are unforeseen situations that do not involve the Group.

The Group has committed to preserve the rights of union member personnel subject to Labor Law Article 4857 and to pay their employment termination benefits (including periods they have worked in other public institutions) along with all other rights they have earned. The Group has accepted and committed that Petkim has the responsibility to compensate for the unused vacation rights of the personnel whose service contracts are still valid and have the right to be transferred to other public institutions as of the effective date of the Share Sales Agreement.

The Group has a commitment to purchase 943,746,586 cubic meters of natural gas from BOTAS Petroleum Pipeline Corporation ("BOTAS") in 2013.

Guarantee received and given by Petkim. The following table demonstrate guarantees received and given by the Group at 31 December.

	2012	2011
Guarantees received		
Bank guarantees within context of direct order collection system (DOCS)	210,467	184,129
Letters of guarantee received	161,611	145,358
Other	877	7,300
Total guarantees received	372,955	336,787
Guarantees given		
Guarantee cheques given	-	28,714
Letters of guarantee given	91,464	23,216
Total guarantees given	91,464	51,930

Commitment of Azerigaz PU. Based on Presidential decree number 80 dated 14 April 2009 directed to social-economical development of Baku area and regions of the Azerbaijan Republic, Azerigaz CJSC has certain commitments with respect to improvement of gasification options in mentioned areas. According to this decree, Azerigaz CJSC would be engaged in restoration of old magisterial and local gas pipelines, gasification of new residential communities/regions/far locations, and renewal of old gas meters on magisterial gas traffic control points, industrial and personal meters for physical customers.

35 Contingences, commitments and operating risks (continued)

Commitment of Azerigaz PU (continued). Management estimates that during the year 2013 the Group will incur expenditures for implementation of this program in the amount of AZN 162,853.

Gas purchase commitment. Based on the Gas sales and purchase agreement signed on 27 February 2003 between AGSC and the Ministry of Fuel and 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. Monetary amount of commitment to purchase seller's minimum annual quantity is USD 86,840 thousands (AZN 68,169).

Participating interest in ACG PSA. Azerbaijan International Operating Company, the Operator of the ACG PSA has entered into a number of capital commitments and operating leases as at 31 December 2012. The Group estimated its 11.65 per cent (2011: 11.65 per cent) share of these commitments and operating leases to be USD 688,291 thousands (AZN 540,308) (2011: USD 930,203 thousands (AZN 731,605)) and USD 18,677 thousands (AZN 14,661) (2011: USD 11,847 thousands (AZN 9,318)), respectively.

Participating interest in Shah Deniz PSA. BP Exploration Shah Deniz Limited, the Operator of the Shah Deniz PSA has entered into a number of capital commitments and operating leases as at 31 December 2012. The Group estimated its 10 per cent share of these commitments and operating leases to be USD 300,773 thousands (AZN 236,107) (2011: USD 112,658 thousands (AZN 88,606)) and USD 37,496 thousands (AZN 29,434) (2011: USD 20,157 thousands (AZN 15,854)), respectively.

Commitments related to participating interest in AGSC. As discussed in Note 17, the Group holds 8 per cent interest in AGSC. In accordance with the agreements of AGSC the Group has the following commitments relating to AGSC's activity:

Gas Contract. AGSC is obliged under the agreement signed with BOTAS to make available a maximum of approximately 6.3 bcm from 2013 and onwards at a price calculated based on a formula established by the Gas Contract.

Georgian gas obligation. AGSC is obliged under an agreement signed with Georgian Oil and Gas Corporation and the government of Georgia to make available 0.5 bcm in 2013 and onwards, 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"). AGSC is obliged under an agreement signed with BTC to make available approximately 0.16 bcm in the contract year starting 2013 and during the following years until the termination of the contract, which is the Decline period, at a price which is calculated based on a formula established in the contract.

The performance of AGSC under the Gas Contract is guaranteed under the Agreement between the Republic of Turkey and the Azerbaijan Republic Concerning the "Delivery of Azerbaijan Natural Gas to the Republic of Turkey" signed on 12 March 2001, by the Government. Commitments indicated above in respect of gas volumes to be delivered by AGSC are covered by the Upstream Purchase Agreements signed with the Shah Deniz PSA contractor parties and the SOCAR (for and on behalf of the Azerbaijan Republic).

The Shah Deniz PSA contractor parties and the Group are obliged to deliver and sell to AGSC the necessary volumes of gas to fulfill AGSC's obligations listed above at a price resulting in neither a gain nor a loss to AGSC.

In addition to the above, the Shah Deniz PSA contractor parties and the Group are obliged to pay to AGSC all transportation charges and third party liabilities as stipulated in the UPAs.

Stage 2 Gas Contract. On 25 October 2011, the Group and BOTAS executed a gas sale and purchase agreement with respect to the sale by the Group to BOTAS of certain volumes of Stage 2 Shah Deniz Gas (2 bcm first delivery year, 4 bcm second delivery year, 6 bcm plateau period). The anticipated commencement of first gas delivery year under Stage 2 is June 2018.

35 Contingences, commitments and operating risks (continued)

Commitments related to participating interest in SCPC. Starting from 1 April 2012 SCPC committed to transport Shah Deniz Stage 2 natural gas through an expansion of SCPC pipeline system. Expected budget for 2013-2018 is around AZN 3.3 billion.

Commitments related to participating interest in BTC Co. On 24 October 2008 BTC Co, the Group's major associate, received two notices of arbitration from BOTAS International Limited ("BIL"). The first claim concerns a claim under Turkish HGA, and the second is a claim under the Agreement for the Operation of Facilities in Turkey (the "Operating Agreement") between BTC Co and BIL. In summary BIL is claiming in total USD 250 million (AZN 196,250).

To resolve these long standing issues, the BTC Co and BIL have negotiated and executed amendment to the Operating Agreement on 25 October 2011.

In addition to this, the BTC Co signed a separate Letter Agreement with BIL on the same date as a gesture of goodwill and without prejudice to its contractual rights under the Operating Agreement to provide BIL with funds capped USD 100 million (AZN 78,500) to repay BIL historical debt which as per BIL was incurred as a result of providing services to BTC Co under the Operating Agreement.

The amendment to Operating Agreement is subject to the satisfaction of certain conditions precedent, one of which is the withdrawal of BIL's arbitration claims. The parties have agreed to extend the current stay of the arbitration until 31 July 2013 in order to achieve satisfaction of the conditions precedent.

Management believes that the outcome of the litigation is going to be favourable for BTC Co and therefore no provisions have been made in the BTC Co financial statements and therefore there is no impact on the Group's consolidated financial statements at 31 December 2012.

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 Company which was amended on 3 February 2004. Under this Agreement, the Shipper Group (including the 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 Baku-Tbilisi-Ceyhan pipeline is operating at its full capacity. However, in accordance with ACG TA the Group has agreed not to use other transportation options if capacity of the BTC is sufficient.

The BTC pipeline was put into operation in May 2006. A total of 10 million barrels of oil from the ACG fields was used to fill the pipeline and the first tanker loaded with oil which had flowed through the BTC sailed away from the Ceyhan terminal on the Mediterranean coast of Turkey on 4 June 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, Direct Agreement entered into on 3 February 2004 by BTC, the Shipper Group, the Group Representative, the lenders and security trustee to BTC, and the lenders and security trustee to certain of the ACG Shipper Group, the parties have agreed that payment of BTC tariff has a first priority claim on oil and oil sale proceeds.

Commitments of SOCAR Switzerland. The Group has entered into a number of capital commitments and operating leases for the next years. The Group estimated its commitments and operating leases to be CHF 43,869 thousands (AZN 37,701) and CHF 81,149 thousands (AZN 69,739), respectively.

Commitments of SOCAR Trading. The Group has entered into a number of operating leases for the next years. The Group estimated its operating leases to be USD 149,268 thousands (AZN 117,265).

Commitments related to Black Sea Terminal LLC. In August 2007, the Group's subsidiary, Black Sea Terminal LLC ("Black Sea Terminal") entered into a sale and purchase agreement to purchase five land plots from Black Sea Industry LLC. These land plots were originally sold to Black Sea Industry LLC pursuant to a privatisation agreement entered into with the Ministry of Economic Development of Georgia in July 2007, for a total consideration of USD 7.25 million (AZN 5 million). The Ministry of Economic Development of Georgia consented to the transfer of the land plots to Black Sea Terminal on the condition that Black Sea Terminal and Black Sea Industry LLC are jointly and severally liable under the privatisation agreement for the implementation of the investment programme relating to the land plots.

35 Contingences, commitments and operating risks (continued)

Commitments related to Black Sea Terminal LLC (continued). The acquisition of title to the land plots is also contingent on the completion of the investment programme. This investment programme involves the investment of at least USD 250 million (AZN 198 million) for the construction of: (i) a liquid natural gas plant; (ii) oil processing facilities; (iii) seaport facilities; and (iv) a railroad. The privatisation agreement also includes certain commitments in relation to the employment of personnel during the construction period. The privatisation agreement sets out certain financial penalties in the event that the investment programme is not implemented within five years. The original deadline for implementation was 16 July 2012. Due to a lack of available funding, as a result of the global financial crisis and economic conditions in Georgia, the investment program has not been implemented by this deadline. The National Agency of Georgia on State Property has agreed to extend the deadline to 1 August 2013, and the Group is currently in the negotiations with the Georgian government in respect to the investment programme and related commitments and liabilities. Management believes that the outcome of these negotiations will be favorable and no penalties will be imposed on the Group.

36 Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business and goodwill

Acquisition of Carlina. As more fully discussed in the Note 18, on 17 January 2012 the Group has obtained 100 per cent control over Carlina, previously a jointly controlled entity with carrying value of nil. This transaction was accounted by the Group as a step acquisition.

Fair values of identifiable assets and liabilities of Carlina on 17 January 2012 were as follows:

	Fair value recognized on acquisition
Assets	
Property, plant and equipment	99,910
Intangible assets	1,866
Inventories	3,572
Trade and other receivables	1,586
Deferred tax asset	3,026
Cash and cash equivalents	8,040
Other assets	6,836
	124,836
Liabilities	
Trade and other payables	(13,648)
Other long term liabilities	(2,246)
	(15,894)
Total identifiable net assets at fair value	108,942

As mentioned above, the acquisition of Carlina was a result of Carlina's failures to repay the loan due to AzACG. The loan receivable by AzACG represented the pre-existing relationship for the purposes of business combination. Since no cash consideration was paid by AzACG, the deemed consideration for this acquisition equaled AZN 109,722 representing the fair value of the loan at acquisition date. No goodwill or gain was recognized as a result of settlement of this pre-existing relationship. Transaction costs incurred during the combination did not significantly impact the consolidated financial statements.

From the date of acquisition, Carlina has contributed AZN 23,307 of revenue and AZN 16,331 of loss to the net profit before tax of the Group. If the combination had taken place at the beginning of the year, the revenue and net profit from continuing operations would not be different from the respective amount recognized in the Consolidated Statement of Comprehensive Income.

The gross amount of trade receivables as of acquisition date is AZN 1,586. None of the trade receivables have been impaired and it is expected that the full contractual amounts can be collected.

36 Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business and goodwill (continued)

Acquisition of SOCAR Switzerland. On 1 July 2012, the Group acquired 100 per cent of voting equity shares of SOCAR Switzerland, which owns the Esso branded retail service chain network in Switzerland. This transaction was accounted for using the acquisition method of accounting. Based on the provisional purchase price allocation performed by the Group, fair values of identifiable assets and liabilities of SOCAR Switzerland on 1 July 2012 were as follows:

	Provisional fair value recognised on acquisition
Assets	
Cash and cash equivalents	18,928
Trade and other receivables	44,487
Corporate income tax prepayments	1,509
Inventories	45,817
Other current assets	25,577
Property, plant and equipment	102,792
Intangible assets	115,800
Deferred tax asset	3,832
Other long term financial assets	1,281
Investments in joint ventures	24,844
Other long-term assets	6,160
	391,027
Liabilities	
Trade and other payables	(86,637)
Other taxes payable	(31,688)
Other current liabilities	(7,022)
Other provisions	(6,760)
Deferred tax liability	(41,853)
Other non-current liabilities	(14,297)
	(188,257)
Total identifiable net assets at fair value	202,770
Goodwill arising on acquisition	54,943
Consideration, settled in cash	257,713

From the date of acquisition, SOCAR Switzerland contributed AZN 713,846 of revenue and AZN 18,496 of loss to the Group. If the combination had taken place at the beginning of 2012, the Group's revenue would have been AZN 17,907,530. The Group is not able to disclose its profit if the combination had taken place at the beginning of 2012 due to impracticability of its calculation. The gross amount of trade receivables as of acquisition date is AZN 44,721, including provision in the amount of AZN 234.

The Group acquired SOCAR Switzerland in order to expand its operations in Switzerland. The goodwill of AZN 54,943 comprises the fair value of expected synergies arising from this acquisition.

36 Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business and goodwill (continued)

Acquisition of Supra Holding Limited. As more fully discussed in the Note 17, in November 2012 the Group has obtained 100 per cent control over Supra Holding Limited, previously an associate of the Group with carrying value AZN 119,964. The acquisition-date fair value of the Group's equity interest in Supra Holding Limited held by the Group immediately before the acquisition date approximated its carrying value of AZN 119,964. After acquisition Supra Holding Limited was renamed to SOCAR Trading. Headquartered in Geneva, SOCAR Trading is the international marketing entity, which trades Group and third party crude oil and oil products in international markets. This transaction was accounted by the Group as a step acquisition. Fair values of identifiable assets and liabilities of SOCAR Trading as at acquisition date were as follows:

	Fair value recognised on acquisition
Assets	
Cash and cash equivalents	39,859
Trade and other receivables	2,423,631
Corporate income tax prepayments	1,126
Inventories	540,318
Other current assets	5,697
Other current financial assets	164,614
Property, plant and equipment	703
Intangible assets	3,610
Investments in associates	44
Other long-term financial assets	5,971
Other long-term assets	43,175
	3,228,748
Liabilities	
Trade and other payables	(2,145,794)
Short-term and current portion of long-term borrowings	(959,770)
Asset retirement obligation	(2,963)
Deferred tax liability	(10,010)
	(3,118,537)
Total identifiable net assets at fair value	110,211
Goodwill arising on acquisition	53,517
Fair value of previously held interest	119,964
Consideration, settled in cash	43,764

From the date of acquisition, SOCAR Trading contributed AZN 2,719,075 of revenue and AZN 4,331 of loss to the Group. If the combination had taken place at the beginning of 2012, the Groups revenue would have been AZN 42,464,072 and the profit would have been AZN 913,108. The gross amount of trade receivables as of acquisition date is AZN 2,423,631. None of the trade receivables have been impaired and it is expected that the full contractual amounts can be collected.

The Group acquired SOCAR Trading to expand its trading operations. The goodwill of AZN 53,517 comprises the fair value of expected synergies arising from this acquisition.

36 Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business and goodwill (continued)

Acquisition of Atikva Estate. On 1 October 2012 the Group acquired 100 per cent interest in "Atikva Estate" LLC comprising a network of 28 petrol stations and 1 petroleum storage depot. This transaction was accounted for using the acquisition method of accounting. Based on the provisional purchase price allocation performed by the Group, fair values of identifiable assets and liabilities of Atikva Estate as at acquisition date were as follows:

	Provisional fair value recognised on acquisition
Assets	
Cash and cash equivalents	1
Trade and other receivables	700
Inventories	18
Intangible assets	9,415
Property, plant and equipment	9,738
	19,872
Liabilities	
Trade and other payables	(2,349)
Deferred tax liability	(1,514)
	(3,863)
Total identifiable net assets at fair value	16,009
Goodwill arising on acquisition	2,489
Consideration, settled in cash	18,498

The effect of this acquisition on both revenue and net profit/loss of the Group for 2012 was not material. The gross amount of trade receivables as of acquisition date is AZN 1,352, including provision in the amount of AZN 652.

The goodwill of AZN 2,489 comprises the fair value of expected synergies arising from this acquisition.

Acquisition of ITERA. In September 2012 the Group through its subsidiary Alphard (Gas) Holdings B.V. acquired 51 per cent of ITERA, a gas distribution company operating in Georgia. Based on the provisional purchase price allocation performed by the Group, the difference in the amount of AZN 3,109 between the consideration paid of AZN 18,491 and net identifiable assets of ITERA of AZN 15,382 was recognized as goodwill. The goodwill comprises the fair value of expected synergies arising from acquisition.

Acquisition of shares from non-controlling shareholder of STEAS and Petkim. In 2012, the Group acquired additional 11.20 per cent of shares of Petkim pertaining to non-controlling shareholder for YTL 318 million (AZN 138,674). The difference of AZN 55,132 between the consideration and the carrying value of the interest acquired has been recognised in retained earnings within equity.

In 2011, the Group acquired 48.98 per cent of STEAS's shares pertaining to non-controlling shareholder for USD 86 million (AZN 67,804), and increased its investment in STEAS to 99.98 per cent.

In 2011, the Group also acquired 4.45 per cent of Petkim's shares pertaining to non-controlling shareholder for YTL 99,897 thousand (AZN 43,624).

As a result of acquisitions in STEAS and Petkim in 2011, the difference of AZN 381,057 between the consideration and the carrying value of the interest acquired has been recognised in retained earnings within equity.

36 Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business and goodwill (continued)

Acquisition of subsidiary, which is not a business. On 22 July 2011 according to the decision of Azerbaijan Republic President, 77.44 per cent of Azerbaijan (BTC) Limited ("AzBTC") shares, that previously belonged to MED, were transferred to SOCAR without any consideration. As a result SOCAR became sole shareholder of AzBTC. The Group has recognized this transaction as a step-acquisition of subsidiary which is not a business. At the date of obtaining control over AzBTC allocation of "deemed" cost of acquisition to the identifiable assets and liabilities of AzBTC was as following:

	Allocated cost
Cash and cash equivalents	345
Long-term receivable from related parties	23,372
Property, plant and equipment	23
Investments in associates	984,315
Deferred taxes payable	(50,038)
Other current liabilities	(12,534)
Net assets of subsidiary	945,483

Investments in associates represent 25 per cent of AzBTC in BTC Co which is accounted under equity method.

77.44 per cent of the fair value of AzBTC amounted AZN 784,809 transferred by the Government to SOCAR was recognized as additional paid-in capital in the Consolidated Statement of Changes in Equity.

Acquisitions of additional share in jointly controlled assets. On 6 July 2011, the Group acquired a further 1.65 per cent participating interest in the ACG PSA from BP. As a result, the Group's share in the ACG PSA was increased to 11.65 per cent. Consideration paid for this acquisition equalled to AZN 381,641. For the purposes of financing this transaction AzACG obtained financing in the amount of USD 485 million (AZN 381,452) maturing in 2024 from the SOFAZ (Note 7).

Goodwill. Movement in the carrying amount of goodwill is as follows:

	2012	2011
Carrying amount at 1 January	103,248	123,448
Acquisition of subsidiaries	114,058	-
Impairment	(3,109)	-
Translation difference	(11,028)	(20,200)
Carrying amount at 31 December	203,169	103,248

There was no accumulated goodwill impairment loss at the beginning of the reporting period.

Allocation of goodwill by CGUs at 31 December 2012 is as following:

	2012	2011
Petkim	85,455	79,903
SOCAR Switzerland	57,395	-
SOCAR Trading	48,837	-
Socar Energy Ukraine	11,482	23,345
Carrying amount at 31 December	203,169	103,248

36 Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business and goodwill (continued)

Goodwill (continued)

At 31 December 2011 goodwill mainly relates to the acquisition of Petkim. As a result of purchase of Petkim shares, the excess of consideration paid over the acquirer's interest in the fair value of assets, liabilities and contingent liabilities acquired in the business combination has been accounted as goodwill in the consolidated financial statements.

Testing of the carrying value of goodwill related to acquisition of Petkim. The carrying value of the goodwill at 31 December 2012 has been tested for impairment through comparison with its recoverable amount. Recoverable amount has been determined 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 2023. Cash flow projections beyond 11-year period are extrapolated by the expected growth rates 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 range of EBITDA/ Net Sales and the WACC, which were taken into account by the Group, as 6 per cent - 17.6 per cent between 2013 and 2023 and 9.7 per cent between 2013 and 2023, respectively. The growth rate have been taken into account by the Group as 1.8 per cent.
- The EBITDA / Net Sales ratio is in line with the Group's budget for the year 2013 and onwards; whereas the WACC is based on macroeconomic and sector specific parameters.

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:

- Net sales growth is estimated to be 1 per cent higher and lower than the sales estimation in projections;
- Gross Profit margin is estimated to be 1 per cent higher and lower than the projected gross profit margin;
- WACC is estimated to be 1 per cent higher and lower than the based WACC rates;
- Terminal growth rate forecast is estimated to be 1 per cent higher and lower than the long term growth rate estimation.

As the results of the sensitivity analysis, the carrying amount of the value in use of Petkim is estimated between AZN 2,267,640 and AZN 3,034,049.

Testing of the carrying value of goodwill related to acquisition of SOCAR Switzerland. The carrying value of the goodwill attributable to the acquisition of SOCAR Switzerland at 31 December 2012 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 Switzerland and its subsidiaries. Pre-tax cash flows projections used for this purpose are based on financial budgets approved by management covering 3-year period. Cash flows for 3-year period are based on existing long-term projects with duration up to 2015. Management believes that these cash flows projections represent more accurate and reliable forecast. Cash flow projections beyond 3-year period are extrapolated by expected growth rates of 1 per cent p.a. and then discounted to their net present value. The following key assumptions were used for impairment test of the goodwill:

- EBITDA/Net Sales ratio in terminal value – 2.5 per cent;
- EBITDA/Gross Margin ratio in terminal value – 9 per cent;
- Terminal growth rate used in the cash flow projections is 1 per cent;
- Discount rate used – 6.76 per cent.

36 Business combination, acquisition of non-controlling interests, acquisition of subsidiary which is not a business and goodwill (continued)

Goodwill (continued)

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 carrying amount of the value in use would have been AZN 12,742 lower / AZN 13,901 higher, respectively.

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 2012 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. Pre-tax cash flow projections used for this purpose are based on financial budgets approved by management covering 4-year period. Cash flows for that period are based on existing and new projects. Management believes that these cash flow projections represent accurate and realistic forecast. Cash flow projections beyond 3-year period are extrapolated by expected growth rates of 5 per cent p.a. for the period from 2017 through 2021 and nil per cent for the period from 2022 through 2027 and then discounted to their net present value. The following key assumptions were used for impairment test of the goodwill:

- Valuation exercise is sensitive to the range WACC, which were taken into account by the Group, as 12–18 per cent;
- Valuation is also sensitive to growth rate between 2017-2022, which were taken into account by the Group as 2-8 per cent;
- Terminal growth rate used in the cash flow projections is nil 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 1.50 per cent higher / lower than management's estimate, the carrying amount of the value in use would have been AZN 8,252 lower / AZN 7,903 higher, respectively.

37 Events after reporting date

Issue of notes

On 11 March 2013 the Group issued senior unsecured notes on London Stock Exchange in the amount of USD 1,000 million (AZN 785 thousand). The notes bear interest rate of 4.75 per cent per annum and mature on 11 March 2023. Interest expenses are payable on a semi-annual basis.

Loan repayment

During subsequent period the Group has repaid short and long term portions of the loans in the amounts of AZN 27,290 and AZN 376,698, respectively.

New loans

During subsequent period the Group has obtained long term loans in the amount of AZN 164,250.

Guarantees issued

During subsequent period the Group issued guarantees in the total amount of AZN 188,400.

IBA deposit

During subsequent period the Group has placed deposits in the amount of USD 47,000 thousands (AZN 36,895).

Baku-Novorossiysk pipeline agreement

In early May 2013 the Government of Russia revoked the 17 year old intergovernmental agreement to transport 5 million tons a year of Azerbaijani oil through the Baku-Novorossiysk pipeline for USD 15.67 (AZN 12.3) per ton of oil transit.

Increase in Charter Capital

During subsequent period the Group charter capital was increased by AZN 80,000.

37 Events after reporting date (continued)

Investments

During subsequent period the Group has acquired additional interests in several investees in the total amount of AZN 2,599. The amounts of each major class of assets acquired and liabilities assumed as of the acquisition date are not material for the Group purposes.