Georgian Railway JSC

Consolidated Financial Statements for 2016

Contents

KPMG

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Independent Auditors' Report

To the Management Board of Georgian Railway JSC

Opinion

We have audited the consolidated financial statements of Georgian Railway JSC (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

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

Basis for Opinion

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

Key Audit Matters

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

Recoverability of construction of Tbilisi Bypass project	
Please refer to the Note 11 in the consolidated financial statements.	
The key audit matter	***How the matter was addressed in our audit***
Tbilisi Bypass project has been suspended since October 2013. The related construction in progress represents 9% of the balance sheet total and significant judgment is involved in assessing its recoverability. Therefore, it is a key audit matter.	Our audit procedures included: – assessing the physical condition of the construction in progress with the involvement of an independent management expert; – assessing whether there are necessary plans in place to undertake the construction under various scenarios discussed between the Government of Georgia and the Group. This included analysis of the decisions made by the Government of Georgia and the Group in respect of the Tbilisi Bypass project and review of the agreements signed with the main third party construction companies;

Recoverability of construction of Tbilisi Bypass project	
Please refer to the Note 11 in the consolidated financial statements.	
The key audit matter	***How the matter was addressed in our audit***
	– assessing whether there are necessary resources in place to undertake the construction by analyzing the Group's cash flow forecasts; – considering the adequacy of the Group's disclosures about the uncertainties relating to the construction of Tbilisi Bypass project.

Impairment test of non-current assets	
Please refer to the Note 11 in the consolidated financial statements.	
The key audit matter	***How the matter was addressed in our audit***
In 2016, the Group experienced a significant decline in revenues and operating cash flows compared to the prior year. Consequently, the Group determined that there is an indication of impairment and conducted an impairment test of the Group's non-current assets. Although the recoverable amount of the Group's non-current assets was determined to be higher than its carrying amount, the impairment test includes a number of critical estimates and management judgment. Also considering the magnitude of the Group's property, plant and equipment on the balance sheet, we consider the impairment test a key audit matter.	Our audit procedures included: – evaluating the main assumptions and methodology used for the impairment test with the involvement of our valuation specialists; – evaluating the consistency of the main inputs used in the impairment test with the Group's existing contracts and publicly available information on future trends in the industry and growth in economy both in Georgia and in the region. Main inputs include, but are not limited to, discount rate, terminal growth rate, forecasted volumes of transported goods, EBITDA margins and capital expenditure; – considering the adequacy of the Group's disclosures about the impairment test of non-current assets.

Fair value of the property transferred to the Government of Georgia	
Please refer to the Note 18 in the consolidated financial statements.	
The key audit matter	***How the matter was addressed in our audit***
Determination of the fair value of the property transferred to the Government of Georgia involves significant judgment and estimates. Other income resulting from that transfer represents 46% of the results from operating activities. Therefore, it is a key audit matter.	Our audit procedures included: – evaluating the competence, capabilities and objectivity of the management expert commissioned for the measurement of the fair value; – evaluating the assumptions and methodologies used for the valuation of the transferred property, in particular, those that are based on unobservable inputs, such as size and location adjustments, with the involvement of our valuation specialists. – testing a sample of positions was performed by our valuation specialists with referance to alternative comparable property items. The results of the testing by our valuation specialists was compared to that calculated by the management expert; – considering whether the financial statement disclosures appropriately reflect the Group's approach for the measurement of the fair value of the property.

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report but does not include the consolidated financial statements and our auditors' report thereon. The Annual Report is expected to be made available to us after the date of this auditors' report.

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

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

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

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

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

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

Irina Gevorgyan

KPMG Georgia LLC
5 May 2017

'000 GEL	Note	2016	2015
Assets			
Property, plant and equipment	11	2,623,594	2,483,393
Deferred tax assets	10	-	1,094
Loans receivable	12	35,717	-
Other non-current assets	13	147,565	147,998
Non-current assets		**2,806,876**	**2,632,485**
Inventories	14	29,752	34,768
Loans receivable	12	3,974	38,341
Tax assets		7,129	10,993
Trade and other receivables	15	99,649	70,645
Prepayments and other current assets	16	350	11,901
Cash and cash equivalents	17	277,953	294,784
Current assets		**418,807**	**461,432**
Total assets		**3,225,683**	**3,093,917**
Equity			
Share capital	18(a)	1,053,004	1,052,605
Non-cash owner contribution reserve	18(b)	98,312	34,214
Retained earnings		447,960	384,391
Total equity		**1,599,276**	**1,471,210**
Liabilities			
Loans and borrowings	20	1,361,602	1,193,301
Advance received from the Government	18(c)	73,809	221,788
Trade and other payables		-	52
Deferred tax liabilities	10	-	43,928
Non-current liabilities		**1,435,411**	**1,459,069**
Loans and borrowings	20	57,172	44,855
Trade and other payables	21	109,638	89,258
Liabilities to the Government	18(c)	8,399	8,009
Provisions	22	8,547	8,325
Dividend payable	18(d)	-	2,762
Other current liabilities		7,240	10,429
Current liabilities		**190,996**	**163,638**
Total liabilities		**1,626,407**	**1,622,707**
Total equity and liabilities		**3,225,683**	**3,093,917**

The consolidated statement of financial position is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 11 to 44.

'000 GEL	Note	2016	2015
Revenue	6	439,922	574,773
Income from the transferred property	18(e)	80,294	7,503
Other income		19,122	23,268
Employee benefits expense		(146,626)	(148,625)
Depreciation and amortization expense		(106,267)	(104,416)
Electricity, consumables and maintenance costs	7	(47,289)	(60,927)
Other expenses	8	(63,668)	(73,205)
Results from operating activities		**175,488**	**218,371**
Finance income	9	23,882	20,932
Finance costs	9	(173,103)	(315,355)
Net finance costs		**(149,221)**	**(294,423)**
Profit /(loss) before income tax		**26,267**	**(76,052)**
Income tax benefit	10	38,859	10,555
Profit /(loss) and total comprehensive income/(loss) for the year		**65,126**	**(65,497)**

These consolidated financial statements were approved by the Management Board on 5 May 2017 and were signed on its behalf by:

Mamuka Bakhtadze
General Director

Tamaz Jgerenaia
Chief Accountant

The consolidated statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 11 to 45.

'000 GEL	Share capital	Non-cash owner contribution reserve	Retained earnings	Total equity
Balance at 1 January 2015	1,052,202	34,214	476,335	1,562,751
Total comprehensive loss for the year				
Loss and total comprehensive loss for the year	-	-	(65,497)	(65,497)
Transactions with owners, recorded directly in equity				
Dividends to equity holders (note 18(d))	-	-	(25,537)	(25,537)
Net non-cash contributions by and distributions to owners (note 18(a))	403	-	(910)	(507)
Total transactions with owners, recorded directly in equity	**403**	**-**	**(26,447)**	**(26,044)**
Balance at 31 December 2015	**1,052,605**	**34,214**	**384,391**	**1,471,210**
Balance at 1 January 2016	1,052,605	34,214	384,391	1,471,210
Total comprehensive income for the year				
Profit and total comprehensive income for the year	-	-	65,126	65,126
Transactions with owners, recorded directly in equity				
Increase in share capital (note18 (a))	399	122	-	521
Non-cash owner contribution from owners (note 18 (d))	-	1,631	-	1,631
Reversal of deferred tax asset (note 10 (c))	-	-	(1,557)	(1,557)
Transfer of the property to the Government (note 18 (e))	-	62,345	-	62,345
Total transactions with owners, recorded directly in equity	**399**	**64,098**	**(1,557)**	**62,940**
Balance at 31 December 2016	**1,053,004**	**98,312**	**447,960**	**1,599,276**

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 11 to 44.

'000 GEL	Note	2016	2015
Cash flows from operating activities			
Cash receipts from customers		456,742	564,849
Cash paid to suppliers and employees		(264,102)	(260,232)
Cash flows from operations before income taxes paid		**192,640**	**304,617**
Income tax paid		(5,229)	(5,121)
Net cash from operating activities		**187,411**	**299,496**
Cash flows from investing activities			
Acquisition of property, plant and equipment		(200,274)	(156,993)
Proceeds from sale of property, plant and equipment		3,350	-
Interest received		22,435	20,992
Dividends received		1,075	-
Issuance of the loans		(32,563)	(38,507)
Repayment of the issued loans		37,838	-
Net cash used in investing activities		**(168,139)**	**(174,508)**
Cash flows from financing activities			
Proceeds from borrowings		42,349	-
Repayment of borrowings		-	(62,514)
Interest paid		(91,948)	(85,731)
Dividends paid		(1,607)	(21,852)
Net cash used in financing activities		**(51,206)**	**(170,097)**
Net decrease in cash and cash equivalents		**(31,934)**	**(45,109)**
Cash and cash equivalents at 1 January		294,784	300,983
Effect of exchange rate fluctuations on cash and cash equivalents		15,103	38,910
Cash and cash equivalents at 31 December	17	**277,953**	**294,784**

The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 11 to 44.

1. Reporting entity

(a) Georgian business environment

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

(b) Organisation and operations

Georgian Railway JSC (the "Company") and its subsidiaries (the "Group") comprise Georgian joint stock and limited liability companies as defined in the Civil Code of Georgia. The Company was established as a state-owned enterprise in December 1998 by the Decree of the President of Georgia # 929 as an entity engaged in the provision of railway transportation services in Georgia.

The Company's registered office is 15 Queen Tamar Avenue, Tbilisi 0112, Georgia.

The Group's principal activity is the operation of a nationwide railway system providing freight and passenger transportation services, freight forwarding services, maintenance and development of railway infrastructure and construction of railway lines within Georgia.

The Company is wholly owned by Partnership Fund JSC, a wholly state-owned company. The ultimate controlling party of the Group is the Government of Georgia. Related party transactions are disclosed in note 28.

2. Basis of accounting

Statement of compliance

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

3. Functional and presentation currency

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

4. Use of estimates and judgments

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

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

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

- Note 30 (h)(iii) – useful lives and residual values of property, plant and equipment;
- Note 23 (b)(ii) – impairment allowances for trade and other receivables;
- Note 17 – classification of deposits with original maturities of more than three months as cash and cash equivalents;
- Note 18 (e) – fair value of the land plots transferred to the Government of Georgia.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year is included in the following notes:

- Note 11 (a) – recoverability of construction of Tbilisi Bypass project;
- Note 11 (b) - impairment test: key assumptions underlying the recoverable amount of non-current assets;
- Note 23 (b)(ii) – recoverability of loans issued.

Measurement of fair values

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

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

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

Further information about the assumptions made in measuring fair values is included in the following notes:

- Note 23 (a) – fair value of financial assets and liabilities;
- Note 18 (e) – fair value of the land plots transferred to the Government of Georgia.

5. Operating segments

The Group has two reportable segments, as described below, which are the Group's strategic business units. The strategic business units offer different products and services, and are managed separately because they require different technology and marketing strategies. For each of the strategic business units, the Group's Management Board reviews internal management reports on at least a quarterly basis. The following summary describes the operations in each of the Group's reportable segments:

- *Freight transportation*. Includes transportation of goods and commodities and related services.
- *Passenger transportation*. Includes transportation of passengers.

There are no inter-segment charges.

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit before infrastructure costs, which are the cost of maintaining the rail network used by both reportable segments, central overheads, interest and income tax, as included in the internal management reports that are reviewed by the Group's Management Board. Segment profit is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries. The Group's Management Board does not monitor segment liabilities.

(i) Information about reportable segments

	Freight transportation		Passenger transportation		Total	
'000 GEL	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
External revenues	412,116	552,298	18,007	15,487	430,123	567,785
Depreciation and amortization	(41,638)	(42,411)	(9,345)	(9,144)	(50,983)	(51,555)
Reportable segment profit/(loss) before infrastructure costs, net interest cost and income tax	249,699	378,494	(16,946)	(18,810)	232,753	359,684
Reportable segment assets	369,903	361,759	163,350	113,206	533,253	474,965
Capital expenditure and other additions to non-current assets	20,504	36,449	55,998	3,860	76,502	40,309

(ii) Reconciliations of reportable segment revenues, profit or loss, assets and other material items

'000 GEL	**2016**	**2015**
Revenues		
Total revenue for reportable segments	430,123	567,785
Other revenue	9,799	6,988
Consolidated revenue	**439,922**	**574,773**
Profit or loss		
Total profit or loss for reportable segments	232,753	359,684
Employee benefits expense – infrastructure and headquarters	(58,266)	(58,539)
Depreciation expenses – infrastructure and headquarters	(55,284)	(52,861)
Net finance costs	(149,221)	(294,423)
Other net unallocated income/ (expenses)	56,285	(29,913)
Consolidated profit /(loss) before income tax	**26,267**	**(76,052)**
Assets		
Total assets for reportable segments	533,253	474,965
Property, plant and equipment - infrastructure and headquarters	2,128,459	2,033,350
Other unallocated assets, principally cash and non-current assets	563,971	585,602
Consolidated total assets	**3,225,683**	**3,093,917**

(iii) *Other material items 2016*

'000 GEL	Reportable segment totals	Infrastructure and headquarters	Consolidated totals
Capital expenditure and other additions to non-current assets	76,502	178,859	255,361
Depreciation and amortization	50,983	55,284	106,267

(iv) *Other material items 2015*

'000 GEL	Reportable segment totals	Infrastructure and headquarters	Consolidated totals
Capital expenditure and other additions to non-current assets	40,309	154,049	194,358
Depreciation and amortization	51,555	52,861	104,416

(v) *Geographical information*

Approximately 90% of the Group's revenue is generated in Georgia with the remainder generated in CIS countries. The non-current assets of the Group are located in Georgia.

(vi) *Major customer*

In 2016 one customer of the Group's freight transportation segment represented approximately 13% of the Group's total revenue (GEL 57,190 thousand). In 2015 one customer of the Group's freight transportation segment represented approximately 22% of the Group's total revenue (GEL 125,727 thousand).

6. Revenue

'000 GEL	2016	2015
Freight traffic	345,586	471,951
Logistic services*	52,582	56,086
Passenger traffic	18,007	15,487
Freight car rental	13,948	24,261
Other	9,799	6,988
	439,922	**574,773**

* In 2016 the Group separated revenue generated from logistic services from the freight traffic revenue. As a result, comparatives were also amended.

Railroad transportation in Georgia is a natural monopoly; however the prices are not subject to government regulation. According to clause 64 of the Railway Code of Georgia, which came into force on 1 July 2005, the Government of Georgia allowed the Group to set the prices for all services provided, including freight transportation, freight transportation-related additional services and passenger transportation.

Tariffs for freight transportation are based on the International Rail Transit Tariff. The Group is a co-signatory of the Tariff Agreement together with CIS countries, Latvia, Lithuania and Estonia. The parties to the Agreement hold annual conferences to determine the tariff policy for the following year; each party declares tariffs denominated in Swiss Francs (CHF) for railway transportation and states the general rules that apply to and modify tariffs. The agreed tariffs indicate the maximum level of tariffs applicable.

7. Electricity, consumables and maintenance costs

'000 GEL	2016	2015
Electricity	21,687	20,424
Materials	14,121	19,276
Repair and maintenance*	7,175	15,420
Fuel	4,306	5,807
	47,289	**60,927**

* During 2016 the Group reclassified repair and maintenance costs from other expenses to electricity, consumables and maintenance costs. This presentation is more consistent with the structure of the Group's operations. As a result, comparatives were also amended.

8. Other expenses

'000 GEL	2016	2015
Taxes other than income tax	26,474	25,969
Logistic services	14,270	17,197
Security	8,928	8,734
Freight car rental	4,407	11,210
Other	9,589	10,095
	63,668	**73,205**

9. Finance income and finance costs

'000 GEL	2016	2015
Recognised in profit or loss		
Interest income	23,882	20,932
Finance income	**23,882**	**20,932**
Impairment loss on trade receivables (note 23 (b)(ii))	(7,972)	(28,627)
Interest expense	(52,822)	(59,891)
Net foreign exchange loss	(112,309)	(226,837)
Finance costs	**(173,103)**	**(315,355)**
Net finance costs recognised in profit or loss	**(149,221)**	**(294,423)**

10. Income tax benefit

(a) Amounts recognized in profit or loss

The Group's applicable income tax rate is the income tax rate of 15% for Georgian companies.

'000 GEL	2016	2015
Current tax expense		
Current year	5,532	5,052
	5,532	**5,052**
Deferred tax benefit		
Origination and reversal of temporary differences	-	(15,607)
Change in recognised temporary differences (due to change in the legislation)	(44,391)	-
	(38,859)	**(10,555)**

Reversal of previously recognized deferred tax assets and liabilities is attributable to changes in Georgian tax legislation. On 13 May 2016 the Parliament of Georgia passed a bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly transfers the moment of taxation from when taxable profits are earned to when they are distributed. The law is effective for tax periods starting after 1 January 2017. Considering that the change in the Georgian Tax Code was enacted before the reporting date, the Group has recognized the full effect of the change by derecognizing previously recognized deferred tax assets and liabilities through either the current period consolidated statement of profit or loss or through the retained earnings, depending on where the deferred tax was initially recognized. The deferred tax assets and liabilities initially recognized in equity as part of the Group's transition to IFRSs was reversed through the consolidated statement of profit or loss.

Reconciliation of effective tax rate:

	2016		2015	
	'000 GEL	%	'000 GEL	%
Profit /(loss) before income tax	26,267	100	(76,052)	100
Income tax at applicable tax rate	3,940	15	(11,408)	15
Net non-deductible expenses	-	-	853	(1)
Change in recognised temporary differences (due to change in the legislation)	(42,799)	(163)	-	-
	(38,859)	**(148)**	**(10,555)**	**14**

(b) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
'000 GEL	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
Property, plant and equipment	-	-	-	(102,133)	-	(102,133)
Other non-current assets	-	-	-	(297)	-	(297)
Inventories	-	10,919	-	-	-	10,919
Trade and other receivables	-	21,136	-	-	-	21,136
Prepayments and other current assets	-	1,636	-	-	-	1,636
Loans and borrowings	-	6,277	-	-	-	6,277
Trade and other payables	-	120	-	-	-	120
Provisions	-	1,249	-	-	-	1,249
Other current liabilities	-	1,041	-	-	-	1,041
Tax loss carry-forwards	-	17,218	-	-	-	17,218
Tax assets/(liabilities)	-	**59,596**	-	**(102,430)**	-	**(42,834)**
Set off of tax	-	(58,502)	-	58,502	-	-
Net tax assets/(liabilities)	-	**1,094**	-	**(43,928)**	-	**(42,834)**

(c) Movement in temporary differences during the year

'000 GEL	1 January 2016	Recognised in profit or loss	Recognised directly in equity	31 December 2016
Property, plant and equipment	(102,133)	103,690	(1,557)	-
Other non-current assets	(297)	297	-	-
Inventories	10,919	(10,919)	-	-
Trade and other receivables	21,136	(21,136)	-	-
Prepayments and other current assets	1,636	(1,636)	-	-
Loans and borrowings	6,277	(6,277)	-	-
Trade and other payables	120	(120)	-	-
Provisions	1,249	(1,249)	-	-
Other current liabilities	1,041	(1,041)	-	-
Tax loss carry-forwards	17,218	(17,218)	-	-
	(42,834)	**44,391**	**(1,557)**	-

'000 GEL	1 January 2015	Recognised in profit or loss	31 December 2015
Property, plant and equipment	(95,270)	(6,863)	(102,133)
Other non-current assets	46	(343)	(297)
Inventories	10,516	403	10,919
Trade and other receivables	15,688	5,448	21,136
Prepayments and other current assets	1,636	-	1,636
Loans and borrowings	4,966	1,311	6,277
Trade and other payables	673	(553)	120
Provisions	967	282	1,249
Other current liabilities	780	261	1,041
Tax loss carry-forwards	1,557	15,661	17,218
	(58,441)	**15,607**	**(42,834)**

11. Property, plant and equipment

'000 GEL	Land	Buildings and constructions	Rail track infrastructure	Transport, machinery, equipment and other	Construction in progress	Total
Cost or deemed cost						
Balance at 1 January 2015	543,952	134,427	871,680	887,394	637,859	3,075,312
Additions	401	1,792	-	23,520	186,624	212,337
Disposals and write offs	(122)	(6,984)	(14,485)	(36,278)	(47)	(57,916)
Transfers	1,240	768	46,357	27,589	(75,954)	-
Balance at 31 December 2015	**545,471**	**130,003**	**903,552**	**902,225**	**748,482**	**3,229,733**
Balance at 1 January 2016	545,471	130,003	903,552	902,225	748,482	3,229,733
Additions	206	681	700	70,640	182,052	254,279
Disposals and write offs	(3,917)	(1,041)	(12,423)	(10,646)	(1,372)	(29,399)
Transfers	102	198	48,437	5,845	(54,582)	-
Balance at 31 December 2016	**541,862**	**129,841**	**940,266**	**968,064**	**874,580**	**3,454,613**
Depreciation						
Balance at 1 January 2015	-	30,175	264,891	402,018	-	697,084
Depreciation for the year	-	4,062	40,910	59,396	-	104,368
Disposals and write offs	-	(5,034)	(14,365)	(35,713)	-	(55,112)
Balance at 31 December 2015	-	**29,203**	**291,436**	**425,701**	-	**746,340**
Balance at 1 January 2016	-	29,203	291,436	425,701	-	746,340
Depreciation for the year	-	4,210	44,025	57,853	-	106,088
Disposals and write offs	-	-	(12,167)	(9,242)	-	(21,409)
Balance at 31 December 2016	-	**33,413**	**323,294**	**474,312**	-	**831,019**
Carrying amounts						
At 1 January 2015	543,952	104,252	606,789	485,376	637,859	2,378,228
At 31 December 2015	**545,471**	**100,800**	**612,116**	**476,524**	**748,482**	**2,483,393**
At 31 December 2016	**541,862**	**96,428**	**616,972**	**493,752**	**874,580**	**2,623,594**

(a) Construction in progress

During the year ended 31 December 2010 the Group started two large capital projects (included in construction in progress): the Main Line Modernization and the Tbilisi Bypass and started to incur expenditures for the projects in September 2010 and November 2010 respectively. To partly finance the projects the Group issued unsecured bonds in 2010. In 2012, the Group redeemed the bonds issued in 2010 by issuing new bonds for general corporate and liquidity management purposes (see note 20).

All the borrowing costs of the 2010 unsecured bonds allocated to each project on a 59%/41% basis were capitalized upon starting to incur expenditures for the projects. The interest on the bonds issued in 2012 was capitalized to the two projects in proportion to the costs incurred on the projects based on a capitalization rate of 8% (2015: 8%). Capitalised borrowing costs during 2016 related to the Main Line Modernization project amounted to GEL 42,536 thousand (2015: GEL 33,310 thousand).

In June 2013 the Group announced a decision to redesign the Tbilisi Bypass project. The Group held negotiations with the Government of Georgia and with the main third party construction companies to agree a plan for the conservation of the project for the period of redesigning. All construction works in progress were substantially completed by the end of October 2013 and further construction was suspended. No borrowing costs are capitalised after October 2013.

In March 2014, the Government of Georgia decided that the suspension of the construction of Tbilisi Bypass project will last for 18 months until the final modified project is presented.

During 2015 and 2016, the Group was in discussion with the Tbilisi City Hall and the Government of Georgia about various scenarios of completing the project. The most recent scenarios under discussion include an option envisaging a change of the original bypass location, because of which the existing bypass infrastructure may become redundant. As at 31 December 2016 and the date these consolidated financial statements were authorized for issue, no decision was made by the Government of Georgia about the redesign of the Tbilisi Bypass project. The Group has not yet developed the plan how this redundant infrastructure may be used in future in case the above mentioned scenario is approved by the Government. Currently, an independent management expert is performing feasibility study for the most recent scenarios of the completion of the Bypass project discussed with the Government. The feasibility study also includes determination of the future use of the existing infrastructure, should it become redundant. The options of future use of the infrastructure are bypass automobile road, light rail/ extension of the Tbilisi Metro System, freight depot. The feasibility study is not completed as at the date these consolidated financial statements were authorized for issue.

The Group extended construction contract with the main third party construction companies to allow for the final decision to be made with regards to the project.

(b) Impairment test

At 31 December 2016, due to decline of net operating cash flows in 2016 compared to prior year, the Group determined that there is an indication of impairment of the Group's non-current assets (referred as "the CGU"). The recoverable amount of the CGU was based on its value in use, determined by discounting future cash flows to be generated from the continuing use of the CGU. The recoverable amount of the CGU was determined to be higher than its carrying amount and, respectively, no impairment loss was recognized.

The following key assumptions are used in the estimation of the recoverable amount:

- Cash flows are projected based on actual operating results and the Group's five-year business plan. A long-term growth rate for the terminal period is determined as approximate long- term economy growth forecast for Georgia and the region affecting the Group's operations;
- Cash flows include annual maintenance capital expenditure and payments for the finalization of the modernization project and bypass project under original scenario;
- A pre-tax discount rate of 9.9% is applied in determining the recoverable amount of the CGU. The discount rate reflects the required rate of return for the cash flows on the invested capital of similar companies denominated in USD.

The above estimates are particularly sensitive towards changes in the discount rate. An increase of 1% point in the discount rate used would have resulted in an impairment loss of approximately GEL 100 million.

(c) Capital contributions

The Government of Georgia contributes certain property, plant and equipment in the form of an increase in share capital. In 2016 and 2015 the share capital has been increased by the fair value of these assets of GEL 521 thousand and GEL 402 thousand respectively (see note 18 (a)).

(d) Security

At 31 December 2016 property with a carrying amount of GEL 52,330 thousand (2015: none) is pledged in respect of the secured loan (see note 20).

12. Loans receivable

This note provides information about the contractual terms of the Group's interest-bearing loans receivable, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and credit risk, see note 23.

'000 GEL	2016	2015
Non-current assets		
Entity managed by the Group*	18,901	-
Parent company	16,816	-
	35,717	-
Current assets		
Entity managed by the Group*	3,974	-
State controlled entity	-	38,341
	3,974	**38,341**

(a) Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

				31 December 2016		31 December 2015	
'000 GEL	Currency	Nominal interest rate	Year of maturity	Face value	Carrying amount	Face value	Carrying amount
State controlled entity	USD	10.5%	2016	-	-	38,341	38,341
Entity managed by the Group*	USD	10%	2023	22,875	22,875	-	-
Parent company	USD	9.75%	2021	16,816	16,816	-	-
Total interest-bearing assets				**39,691**	**39,691**	**38,341**	**38,341**

* The loan is issued to a terminal storage company, which is under the management of the Group until 2023.

13. Other non-current assets

'000 GEL	2016	2015
Prepayments for non-current assets	100,976	88,341
Construction materials	43,457	56,232
Goodwill	46	46
Other	3,086	3,379
	147,565	**147,998**

14. Inventories

'000 GEL	2016	2015
Materials	26,727	30,347
Fuel	2,105	2,086
Rails	1,499	2,109
Other	2,857	4,203
	33,188	38,745
Allowance for inventory obsolescence	(3,436)	(3,977)
	29,752	**34,768**
Reversal of previous write-down of inventories	540	227

15. Trade and other receivables

'000 GEL	2016	2015
Trade receivables	227,117	210,519
Impairment allowance on trade receivables	(151,372)	(140,846)
	75,745	**69,673**
Receivable from the Government (note 18 (e))	23,690	-
Other receivables	214	972
	99,649	**70,645**

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables are disclosed in note 23.

16. Prepayments and other current assets

'000 GEL	2016	2015
Taxes, other than on income	-	10,906
Advances paid to suppliers	350	995
	350	**11,901**

17. Cash and cash equivalents

'000 GEL	2016	2015
Current accounts in banks	222,047	142,953
Call deposits	55,837	151,770
Petty cash	69	61
Cash and cash equivalents in the consolidated statement of financial position and the consolidated statement of cash flows	**277,953**	**294,784**

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

The Group's exposure to interest rate risk is disclosed in note 23.

18. Equity and liabilities to the Government

(a) Share capital

Number of shares	Ordinary shares	
	2016	**2015**
In issue at 1 January	1,052,604,503	1,052,202,448
Issued for property, plant and equipment (see note 11 (c))	399,172	402,055
In issue at 31 December, fully paid	**1,053,003,675**	**1,052,604,503**
Authorised shares - par value	1	1

All ordinary shares rank equally with regard to the Company's residual assets.

Ordinary shares

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

(b) Non-cash owner contribution reserve

The difference between the nominal amount of registered share capital for non-cash assets contributed by the owner and the fair value of the contributed assets is recognised in the non-cash owner contribution reserve.

(c) Liabilities to the Government

Liabilities to the owners represent liabilities in the form of property, plant and equipment which are withdrawn as a reduction in share capital but not yet transferred formally to the owners. These liabilities are recorded at the carrying amount of assets to be transferred to the owner.

'000 GEL	2016	2015
Liabilities to the Government	8,399	8,009

(d) Dividends

In 2015, the Company declared and paid dividends of GEL 25,537 thousand (GEL 0.02 per issued share) and GEL 21,852 thousand, respectively. In 2016 no dividends were declared. In 2016, according to the Government's decision, the dividend payable of GEL 1,631 thousand was set off with the costs incurred by the Group on the construction of Batumi Station infrastructure and was recognized directly in equity as a non-cash owner contribution. The remaining dividend payable was set off with the Group's payment for the acquisition of the property and equipment for the state controlled entity, as decided by the Government.

(e) Advance received from the Government

In April 2012, the Company and the Government entered into the Bypass Project Memorandum. According to the Bypass Project Memorandum the Government is interested and aims to purchase from the Group approximately 701,281 square meter land plots with attached constructions which will be freed up as a result of the removal of railway infrastructure from Tbilisi city center and construction of a new bypass railway route for the purposes of further development of the land plots. The Government agrees to pay to the Group CHF 138 million equivalents in national currency through the reduction in the amount of dividends payable to the Government.

In 2012, the Company declared dividends of GEL 231,592 thousand (CHF 138 million). Subsequently, the Company agreed with the Government that the declared dividend amount would represent a consideration due from the Government for the future sale of the land plots in accordance with the Bypass Project Memorandum. As a result, the dividend payable was classified as an advance received from the Government for the sale of land.

(i) *Transfer of the property to the Government*

In 2016 and 2015 the Company transferred 89,166 and 3,266 square meter land plots with attached constructions, respectively, to the Government within the framework of the Bypass Project Memorandum. The fair value of these land plots with attached constructions was determined by an independent appraiser based on announced asking prices of similar properties in the similar location and physical condition. The fair value estimate is categorized into Level 3 of the fair value hierarchy, because of significant unobservable adjustments used in the valuation methods. The significant unobservable inputs related to the differences in the characteristics of the properties, such as size, location, access to the property and discount achieved through negotiation, for which the appraiser applied 0% to 15% adjustments to observed asking prices.

The difference between the fair value and the carrying value of the transferred property was recognized as income in the consolidated statement of profit or loss. The difference between the cost of the transferred property, as agreed between the Group and the Government and used for the reduction of advances received from the Government, and the fair value of the transferred property was recognized directly in equity as a non-cash owner contribution reserve.

'000 GEL	2016	2015
Cost of the transferred property, as agreed between the Group and the Government	147,979	7,588
Less: fair value of the transferred property	(85,634)	(7,588)
Recognized in non-cash owner contribution reserve	**62,345**	-
Fair value of the transferred property	85,634	7,588
Less: carrying value of the transferred property	(5,340)	(85)
Recognized as income from the transferred property	**80,294**	**7,503**

The Group has recognized receivable of GEL 23,690 thousand (see note 15) as a result of the transfer of the property to the Government, as according to the Bypass Project Memorandum, the Government will reimburse the Group for the value added tax payable incurred on such transfers.

19. Capital management

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

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

20. Loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 23.

'000 GEL	2016	2015
Non-current liabilities		
Secured loan	42,788	-
Unsecured bonds	1,318,814	1,193,301
Loans and borrowings	**1,361,602**	**1,193,301**
Current liabilities		
Secured loan	6,959	-
Current portion of unsecured bonds	50,213	44,855
Loans and borrowings	**57,172**	**44,855**

Terms and debt repayment schedule

Terms and conditions of outstanding loans and borrowings were as follows:

				31 December 2016		31 December 2015	
'000 GEL	Currency	Nominal interest rate	Year of maturity	Face value	Carrying amount	Face value	Carrying amount
Unsecured bonds	USD	7.8%	2022	1,369,027	1,369,027	1,238,156	1,238,156
Secured loan	USD	Libor +1.25%	2026	49,747	49,747	-	-
Total interest-bearing liabilities				**1,418,774**	**1,418,774**	**1,238,156**	**1,238,156**

In July 2012 the Group carried out the issuance, placement and registration (listing) on the London Stock Exchange of unsecured bonds of USD 500 million and the early redemption of the unsecured bonds of USD 250 million due in 2015 issued by the Group in July 2010 (the 2010 Notes). As a result of the above transaction, the Group has issued USD 500 million 7.75% Notes due 2022 and redeemed 88.99% of the outstanding 2010 Notes with a face value of USD 222 million. The 2010 Notes were fully repaid in 2015.

The secured loan was obtained for the sole purpose of the acquisition of passenger trains. The secured loan is collateralized by the underlying passenger trains of GEL 52,330 thousand (see note 11 (d)).

21. Trade and other payables

'000 GEL	2016	2015
Trade payables	91,252	73,064
Advances received from customers	18,386	16,194
	109,638	**89,258**

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 23.

22. Provisions

'000 GEL	2016	2015
Balance as at 1 January	8,325	6,447
Net provisions made during the year	222	1,878
Balance at 31 December	**8,547**	**8,325**

The Group recognised a provision for the estimated cash outflow required to settle legal cases against the Group existing as at 31 December 2016 as well as to settle the legal obligations towards the employees injured during the performance of their duties.

23. Fair values and risk management

(a) Fair value of financial assets and liabilities

The estimates of fair value are intended to approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realizable in an immediate sale of the assets or transfer of liabilities.

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

Management's estimate of the fair value of the unsecured bonds yielded a range of values from a fair value approximately equal to the carrying amount to a fair value approximately 10% higher than the carrying amount.

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

(b) Financial risk management

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

- credit risk;
- liquidity risk;
- market risk.

(i) Risk management framework

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

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group's Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group's Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

(ii) Credit risk

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

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

	Carrying amount	
'000 GEL	**2016**	**2015**
Cash and cash equivalents	277,884	294,723
Trade receivables	75,745	69,673
Loans receivable	39,691	38,341
Receivable from the Government	23,690	-
	417,010	**402,737**

Cash and cash equivalents

The Group usually holds the funds with the banks with good credit ratings. As at 31 December 2016, approximately 48% of the bank balances are held with five largest Georgian banks with short-term default rating of B, rated by Fitch Ratings.

The Group does not expect any counterparty to fail to meet its obligations.

Trade receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the factors that may influence the credit risk of the Group's customer base, including the default risk of the industry and country, in which customers operate, particularly in the currently deteriorating economic circumstances. Approximately 13% (2015: 22%) of the Group's revenue is attributable to sales transactions with a single customer.

Credit risk is managed by requesting prepayments from freight and passenger transportation customers. Accordingly the Group's trade receivables mainly consist of receivables from foreign railway companies. Credit risk related to receivables from foreign railway companies is managed through the monthly monitoring of receivable balances and requiring immediate repayment of a debt when the balance approaches specific limits set for each individual counterparty.

More than 90% of the Group's foreign railway customers have been transacting with the Group for several years, and losses have occurred infrequently. In monitoring customer credit risk, customers are grouped according to their credit characteristics, including aging profile, maturity and existence of previous financial difficulties.

No collateral in respect of trade receivables is generally required.

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

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

	Carrying amount	
'000 GEL	**2016**	**2015**
CIS countries	57,152	54,544
Domestic	18,593	15,129
	75,745	**69,673**

The Group's two most significant customers account for GEL 55,880 thousand of the trade receivables carrying amount as at 31 December 2016 (2015: GEL 41,143 thousand).

Impairment losses

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

'000 GEL	Gross 2016	Impairment 2016	Gross 2015	Impairment 2015
Past due 0-90 days	18,697	5,434	9,319	8,040
Past due 91-180 days	4,251	1,294	18,814	9,988
Past due 181-365 days	8,920	3,547	37,636	18,355
Past due more than one year	195,249	141,097	144,750	104,463
	227,117	**151,372**	**210,519**	**140,846**

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

'000 GEL	2016	2015
Balance at beginning of the year	140,846	104,463
Increase during the year	7,972	28,627
Write off during the year	(1,333)	-
Net foreign exchange loss	3,887	7,756
Balance at end of the year	**151,372**	**140,846**

In 2015 the Group recognized impairment loss of approximately GEL 13 million for the trade receivables from one counterparty that were originated in 2015. The Group believes that, at the origination date, it was probable that the economic benefits would flow to the Group. The corresponding revenue is included in freight traffic revenue for 2015.

Most of the impairment loss at 31 December 2016 relates to several customers that have indicated that they are not expecting to be able to pay their outstanding balances either because of economic circumstances or as a result of bankruptcy. The Group believes that the unimpaired amounts that are past due are still collectible, based on historic payment behaviour and analyses on the underlying customers' credit ratings, when available. In addition, receivables of GEL 44,721 thousand (2015: GEL 42,024 thousand) relate to freight car rental customers with which the Group incurs freight car rental expense and related payables. These receivables and payables are periodically net settled.

The allowance account in respect of trade receivables is used to record impairment losses until all possible opportunities for recovery have been exhausted; at that point the amounts are written off against the financial asset directly.

Based on historic default rates, the Group believes that, apart from the above, no impairment allowance is necessary in respect of trade receivables.

Loans receivable

As at 31 December 2016, the Group has issued loans to the parent company and the entity managed by the Group (see note 12). None of the loans are fully secured.

Management believes that the Group is not exposed to a significant amount of credit risk relating to the parent company loan, as the loan is neither past due nor impaired as at 31 December 2016 and there are no indications that the parent company will fail to meet its obligations, when they fall due.

Scheduled principal and interest payments of around GEL 1.5 million of the loan receivable from the entity managed by the Group are past due as at 31 December 2016. However, management believes, that as at 31 December 2016 the loan is fully recoverable and the counterparty will be able to follow the loan repayment schedule during 2017 and following years up to the loan maturity. Management bases own analysis on the subsequent payments made in 2017 and the improved financial results of the counterparty subsequent to the reporting date.

Receivable from the Government

The Group has incurred receivable of GEL 23,690 thousand as a result of the transfer of the property to the Government (note 18 (c)). Management believes that the Group is not exposed to a significant amount of credit risk relating to this receivable as the Government is legally committed to reimburse the value added tax payable on the transfer of the property within the framework of Bypass Project Memorandum.

(iii) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

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

As at 31 December 2016, the Group maintains a committed credit line of GEL 161,400 thousand.

The Group has significant contractual commitments to purchase property, plant and equipment (see note 26) for the Main Line Modernization and Tbilisi Bypass projects expected to be completed by the end of 2019 and 2020, respectively. Management believes that the cash and cash equivalents held by the Group and the future cash flows from operating activities will be sufficient to finance these two projects.

Exposure to liquidity risk

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements. It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

2016

'000 GEL	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
Secured loan	49,747	75,725	4,422	3,954	7,795	22,921	36,633
Unsecured bonds	1,369,027	1,938,781	51,282	51,282	102,564	307,691	1,425,962
Trade payables	91,252	91,252	91,252	-	-	-	-
Other current liabilities	7,240	7,240	7,240	-	-	-	-
	1,517,266	**2,112,998**	**154,196**	**55,236**	**110,359**	**330,612**	**1,462,595**

2015

'000 GEL	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
Unsecured bonds	1,238,156	1,847,066	46,401	46,401	92,802	278,407	1,383,055
Trade payables	73,116	73,116	73,064	-	-	52	-
Other current liabilities	10,429	10,429	10,429	-	-	-	-
	1,321,701	**1,930,611**	**129,894**	**46,401**	**92,802**	**278,459**	**1,383,055**

(iv) Market risk

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

Currency risk

The Group is exposed to currency risk to the extent that there is a mismatch between currencies in which sales, purchases and borrowings are denominated and the respective functional currencies of Group entities. The functional currencies of Group entities are the Georgian Lari (GEL). The currencies in which these transactions are primarily denominated and settled are U.S. Dollars (USD) and Swiss Francs (CHF).

Borrowings and related interest are denominated in currencies that match the cash flows generated by the underlying operations of the Group. This provides an economic hedge without a need to enter into derivatives contracts.

Exposure to currency risk

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

'000 GEL	USD - denominated 2016	CHF - denominated 2016	USD - denominated 2015	CHF - denominated 2015
Cash and cash equivalents	182,617	499	142,233	324
Loan receivable	39,691	-	38,341	-
Trade receivables	234	57,152	494	54,544
Secured loan	(49,747)	-	-	-
Unsecured bonds	(1,369,027)	-	(1,238,156)	-
Trade and other payables	(10,591)	-	(5,717)	-
Net exposure	**(1,206,823)**	**57,651**	**(1,062,805)**	**54,868**

The following significant exchange rates applied during the year:

in GEL	Average rate		Reporting date spot rate	
	2016	2015	2016	2015
USD 1	2.37	2.27	2.65	2.39
CHF 1	2.40	2.36	2.60	2.42

Sensitivity analysis

A reasonably possible weakening of the GEL, as indicated below, against all other currencies at 31 December would have affected the measurement of financial instruments denominated in a foreign currency and profit or loss by the amounts shown below. The analysis assumes that all other variables, in particular interest rates, remain constant and ignores any impact of forecast sales and purchases.

'000 GEL	Profit or loss
2016	
USD (10% weakening)	(120,682)
CHF (10% weakening)	5,765
2015	
USD (30% weakening)	(318,842)
CHF (30% weakening)	16,460

A strengthening of the GEL against the above currencies at 31 December would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

(v) ***Interest rate risk***

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

Exposure to interest rate risk

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

	Carrying amount	
'000 GEL	2016	2015
Fixed rate instruments		
Financial assets	95,527	190,111
Financial liabilities	(1,369,027)	(1,238,156)
	(1,273,500)	**(1,048,045)**
Variable rate instruments		
Financial liabilities	(49,747)	-
	(49,747)	-

Fair value sensitivity analysis for fixed rate instruments

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

Cash flow sensitivity analysis for variable rate instruments

A reasonably possible change of 100 basis points in interest rates at the reporting date would have affected profit or loss by GEL 497 thousand. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

24. Subsidiaries

Subsidiary	Country of incorporation	Principal activities	2016 Ownership/ voting	2015 Ownership/ voting
GR Property Management LLC (former Railway Property Management LLC)	Georgia	Property management and development	100%	100%
GR Logistics and Terminals LLC (former Trans Caucasus Terminals LLC)	Georgia	Container transportation	100%	100%
Georgian Railway Construction JSC	Georgia	Construction and other projects	100%	100%
Borjomi Bakuriani Railway LLC	Georgia	Transportation services	100%	100%
Georgia Transit LLC	Georgia	Transportation services	100%	100%
GR Transit Line LLC	Georgia	Transportation services	100%	100%
GR Trans Shipment LLC	Georgia	Transportation services	100%	100%
GR Transit LLC (former Georgian Transit LLC)	Georgia	Transportation services	100%	100%

25. Operating leases

Non-cancellable operating lease rentals are receivable as follows:

'000 GEL	2016	2015
Less than one year	4,499	4,832
Between one and five years	6,663	5,686
More than five years	19,288	17,754
	30,450	**28,272**

Operating leases relate to rent of other buildings, containers, locomotives and fittings owned by the Group with lease terms of mainly between 10 to 50 years. Lessees do not have an option to purchase the property at the end of the lease term.

26. Capital commitments

As at 31 December 2016 the Group had entered into contracts for the construction or purchase of property, plant and equipment of GEL 612,862 thousand (2015: GEL 601,905 thousand) mainly relating to the Main Line Modernization project of GEL 335,250 thousand (2015: GEL 396,012 thousand) and Tbilisi Bypass project of GEL 211,476 thousand (2015: GEL 196,662 thousand).

27. Contingencies

(a) Insurance

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

(b) Taxation contingencies

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

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

(c) Litigation

In the ordinary course of business, the Group is subject to legal actions, litigations and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations.

28. Related parties

(a) Parent and ultimate controlling party

At 31 December 2016 and 2015 the immediate and ultimate parent of the Group is Partnership Fund JSC. The ultimate controlling party of the Group is the Government of Georgia. Partnership Fund JSC produces publicly available consolidated financial statements.

(b) Transactions with key management personnel

(i) Key management remuneration

Key management received the following remuneration during the year, which is included in employee benefits expenses:

'000 GEL	2016	2015
Salaries and bonuses	**1,093**	1,132

(c) Other related party transactions

(i) Transactions with the Government

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

The Group's other related party transactions are disclosed below.

(ii) Revenue, purchases and expenses

The Group purchases electricity from a state-owned operator which amounted to GEL 1,379 thousand for 2016 (2015: GEL 1,376 thousand). The Group also purchases security services from a state agency which amounted to GEL 8,968 thousand for 2016 (2015: GEL 8,741 thousand). The Group usually does not have significant balances for these purchases.

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

(iii) Loans issued

'000 GEL	Transaction value for the year ended 31 December		Outstanding balance as at 31 December	
	2016	**2015**	**2016**	**2015**
Loans issued:				
Parent company	12,884	-	16,816	-
State controlled entity	-	38,507	-	38,341

During 2016 interest income of GEL 851 thousand (2015: GEL 22 thousand) was recognised in profit and loss in respect of related party loans.

(iv) Credit line

As at 31 December 2016 the Group has unused credit line of USD 7 million from the parent company (2015: none). The credit line bears interest rate of 10% per annum and matures in June, 2017.

29. Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that property, plant and equipment was revalued to determine deemed cost as part of the adoption of IFRSs.

30. Significant accounting policies

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

(a) Basis of consolidation

(i) Business combination

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group.

The Group measures goodwill at the acquisition date as:

- The fair value of the consideration transferred; plus
- The recognised amount of any non-controlling interests in the acquiree; plus
- If the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquire; less
- The net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss.
The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is recognised at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

(ii) Subsidiaries

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

(iii) Transactions eliminated on consolidation

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

(b) Revenue

(i) Transportation activities

Revenue from freight and passenger transportation is measured at the fair value of the consideration received or receivable. Freight and passenger transportation revenue is recognized in profit or loss according to the percentage of completed service method based on transit time of freight and passengers moving from the original location to the final destination.

Revenue from services rendered in stations is recognised in profit or loss when the service is rendered.

(ii) Commissions

When the Group acts in the capacity of an agent rather than as the principal in a transaction, the revenue recognised is the net amount of commission made by the Group.

(iii) Rental income

Rental income from investment property or other assets rented is recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

(c) Other expense

(i) Lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

(ii) Social expenditure

To the extent that the Group's contributions to social programs benefit the community at large and are not restricted to the Group's employees, they are recognised in profit or loss as incurred.

(d) Finance income and costs

The Group's finance income and finance costs include:

- interest income on bank deposits and loans receivable;
- interest expense on financial liabilities;
- impairment loss on trade receivables;
- the foreign currency gain or loss on financial assets and financial liabilities.

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

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

(e) Foreign currency

(i) Foreign currency transactions

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

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

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

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

(f) Income tax

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

(i) Current tax

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

On 13 May 2016 the Parliament of Georgia passed the bill on corporate income tax reform (also known as the Estonian model of corporate taxation), which mainly transfers the moment of taxation from when taxable profits are earned to when they are distributed. The law has entered into force in 2016 and is effective for tax periods starting after 1 January 2017 for all entities except for financial institutions (such as banks, insurance companies, microfinance organizations, pawnshops), for which the law will become effective from 1 January 2019.

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

The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared, regardless of the actual payment date or the period for which the dividends are paid.

(ii) Deferred tax

Due to the nature of the new taxation system described above, the entities registered in Georgia do not have any differences between the tax bases of assets and their carrying amounts and hence, no deferred income tax assets and liabilities arise.

(g) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the weighted average cost principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

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

(h) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. The cost of property, plant and equipment at 1 January 2007, the date of transition to IFRS, was determined by reference to its fair value at that date.

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

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

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

(ii) Subsequent costs

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

Maintenance and repair expenses are recognised as follows:

- Rolling stock:
  - current maintenance expenses during the useful life of equipment (repair work and replacement of unusable and missing parts) are recognised as operating expenses in profit or loss as incurred;
  - expenses under multi-year major overhaul programmes are capitalised as a separate overhaul component and depreciated separately from the main asset;
  - overhauls performed near the end of the useful life of an asset, together with refurbishment, are capitalised when they extend the useful life of the underlying asset.

- Fixed installations:
  - current maintenance and repair expenses (technical inspections, maintenance contracts, etc.) are recognised as operating expenses in profit or loss as incurred;
  - labour, materials and other costs (associated with the installation of rails, sleepers and ballast) under multi-year major building or infrastructure maintenance programmes are capitalised through the partial or total replacement of each component concerned;
  - costs associated with infrastructure improvements are capitalized to the extent that they increase the functionality (traffic working speed) of the asset.

(iii) Depreciation

Items of property, plant and equipment are depreciated from the date that they are installed and are ready for use, or in respect of internally constructed assets, from the date that the asset is completed and ready for use. Depreciation is based on the cost of an asset less its residual value. Residual values for rails, wagons and locomotives are assessed based on the estimated market price of scrap metal and the estimated weight of rails, wagons and locomotives less deinstallation costs.

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Land is not depreciated. Major scheduled capital repairs for wagons and locomotives, estimated at 20% of the cost, are considered as major components and depreciated separately for an average useful life of 7 to 15 years based on the expected timing of the capital repairs.

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

- buildings and constructions 30-44 years;
- rail track infrastructure 17-23 years;
- transport, machinery, equipment and other 12 years.

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

(i) Financial instruments

The Group classifies non-derivative financial assets into the following categories: loans and receivables and cash and cash equivalents.

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

(i) Non-derivative financial assets and financial liabilities – recognition and derecognition

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

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

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Group currently has a legally enforceable right to set off if that right is not contingent on a future event and enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the Group and all counterparties.

Loans and receivables

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

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

Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and highly liquid investments with maturities of three months or less from the acquisition date that are subject to insignificant risk of changes in their fair value. Call deposits represent term deposits with banks with maturities greater than three months from the acquisition date but for which the Group has the unilateral right to withdraw the deposits within a few days of providing notification without incurring significant penalties or loss of interest.

(ii) Non-derivative financial liabilities-measurement

The Group classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest method.

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

(iii) Share capital

Ordinary shares

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

Increase of share capital

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

Reduction of share capital

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

(j) Impairment

(i) Non-derivative financial assets

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

Objective evidence that financial assets are impaired can include:

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

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

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

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and receivables. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(ii) Non-financial assets

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

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU.

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

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

(k) Employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

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

(l) Provisions

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

(m) Segment reporting

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

Segment results that are reported to the Management Board include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly railway infrastructure, corporate assets (primarily the Group's headquarters), head office expenses, financial income and expenses, tax expenses and tax assets and liabilities. Items related to infrastructure are not allocated as the Group has not implemented systems for such allocations. The Group's Management Board does not monitor segment liabilities.

Segment capital expenditure is the total cost incurred during the year to acquire property, plant and equipment, and intangible assets.

31. New standards and interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2016, and have not been applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group's operations. The Group plans to adopt these pronouncements when they become effective.

- IFRS 9, published in July 2014, replaces the existing guidance in IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 9.

- IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes*. The core principle of the new standard is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The Group has not completed an initial assessment of the potential impact of the adoption of IFRS 15 on its consolidated financial statements.

- IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases. IFRS 16 replaces the existing lease accounting guidance in IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance* *of Transactions Involving the Legal Form of a Lease*. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019, early adoption is permitted if IFRS 15 *Revenue from Contracts with Customers* is also adopted. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 16.

- Disclosure Initiative (Amendments to IAS 7) requires disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. The amendments are effective for annual periods beginning on or after 1 January 2017, with early adoption permitted. To satisfy the new disclosure requirements, the Group intends to present a reconciliation between the opening and closing balances for liabilities with changes arising from financing activities.