Georgian Railway JSC

Consolidated Financial Statements for 2017

Contents

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Independent Auditors' Report

To the Shareholder 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 2017, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

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

Basis for Opinion

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

Key Audit Matters

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

Impairment of Tbilisi Bypass Project

The key audit matter	How the matter was addressed in our audit
As described in note 11 (b) to the consolidated financial statements, Tbilisi Bypass Project (the Project) has been suspended since October 2013. Due to significant uncertainties associated with the continuation of the Project, the Group has determined that there is an indication of impairment and assessed the recoverable amount of the Project. The Project related construction in progress to date amounted to GEL 397 million and its impairment is therefore a Key Audit Matter.	We have performed the following audit procedures to address the key audit matter: - Obtained a schedule of work performed on the Tbilisi Bypass Project to date and evaluated the existence and completeness of that population, including the assessment of the physical obsolescence of those assets through carrying out a physical inspection of sections of the Project; - Assessed the existence of necessary plans, envisaging the construction under various scenarios, through the inquiries with the Group Management including requesting a copy of the latest feasibility study that was in progress as of the date the prior year consolidated financial statements were authorized for issue to assess the findings of that study; - Analysed alternative scenarios for the continuation of the Project; - Confirmed with management that there was no credible alternative to discontinuation of the Project; - Challenged management's assessment that the Group would not generate any benefit from either the continuing use or sale of the Project assets, except for the sellable land plots under the Project; - Involved our own valuation specialists to challenge the key assumptions and judgements used in the determination of the recoverable amount of the Project; - In particular, we evaluated the valuation technique applied by the management to estimate the fair value of Land plots located under the Project; and - Evaluated the adequacy of the disclosures made in Note 11 (b) of the consolidated financial statements by reference to the requirements of IAS 36 – Impairment of Assets and IAS 1 – Presentation of financial statements.

Impairment of Property, Plant and Equipment (except for Tbilisi Bypass Project)

The key audit matter	How the matter was addressed in our audit
As described in note 1 (b) and note 11 (c) to the consolidated financial statements, the Group experienced a continuing decline in the cargo volumes and revenues compared to the prior years. Consequently, the Group determined that there is an indication of an impairment and conducted an impairment test of the Group's property, plant and equipment.	We have performed the following audit procedures to address the key audit matter: - Performed inquiries of management to obtain an understanding of the process for the impairment analysis; - Evaluated the design and implementation of the processes and internal controls of the Group, surrounding the preparation of the impairment model, to assess the reliability and accuracy of the Group's forecasting and budgeting process; - Involved our own valuation specialists to challenge the key assumptions and judgements underpinning the impairment-testing model, such as inflation rate,

The impairment of property, plant and equipment is a Key Audit Matter due to the level of judgement involved in our evaluation of Management's impairment analysis and increased inherent estimation uncertainties involved in the forecasting and discounting future cash flows related to the impairment model assessment.	discount rate, period of cash flow projections (to 2037), annual maintenance capital expenditure, payments for the finalisation of the Main Line Modernization project and liquid and dry cargo growth rates; - We compared the current year's actual results with the figures for the same period included in the impairment model prepared as at 31 December 2016, to assess management's ability to accurately budget the expected results; - We obtained the Group's budget for the year ending 31 December 2018 and assessed whether expected cash flows in that budget are comparable with those included in the prior year and current year's impairment model; - We obtained and evaluated the Market Study and Traffic Forecast feasibility study confirming the increased cargo flow, resulting from the completion of Anaklia Deep Sea Port; - We have obtained and evaluated Protocol of meeting between Georgian and Azerbaijan railways supporting the expected increase in cargo flow, resulting from the cooperation of those railways. - We evaluated the sensitivity of the impairment model outcomes by considering the downside scenarios against reasonably plausible changes to the key assumptions; and - We evaluated the adequacy of the disclosures made in Note 1 (b) and Note 11 (c) of the consolidated financial statements by reference to the requirements of IAS 36 –Impairment of Assets and IAS 1 – Presentation of financial statements.

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 scepticism throughout the audit. We also:

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

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

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

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

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

Andrew Coxshall:

KPMG Georgia LLC
3 July 2018

’000 GEL	Note	2017	2016
Assets			
Property, plant and equipment	11	2,368,380	2,623,594
Loans receivable	12	18,113	35,717
Other non-current assets	13	123,562	147,565
Non-current assets		**2,510,055**	**2,806,876**
Inventories	14	32,807	29,752
Loans receivable	12	-	3,974
Tax assets		2,360	7,129
Prepayments and other current assets		383	350
Trade and other receivables	15	73,614	99,649
Cash and cash equivalents	16	243,018	277,953
Current assets		**352,182**	**418,807**
Total assets		**2,862,237**	**3,225,683**
Equity			
Share capital	17 (a)	1,053,271	1,053,004
Non-cash owner contribution reserve	17 (b)	98,192	98,312
Retained earnings		93,385	447,960
Total equity		**1,244,848**	**1,599,276**
Liabilities			
Loans and borrowings	19	1,374,363	1,361,602
Advance received from the Government	17 (e)	46,594	73,809
Non-current liabilities		**1,420,957**	**1,435,411**
Loans and borrowings	19	58,809	57,172
Trade and other payables	20	112,221	109,638
Liabilities to the Government	17 (c)	7,592	8,399
Provisions	21	7,953	8,547
Other current liabilities		9,857	7,240
Current liabilities		**196,432**	**190,996**
Total liabilities		**1,617,389**	**1,626,407**
Total equity and liabilities		**2,862,237**	**3,225,683**

The consolidated statement of financial position is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 12 to 47.

’000 GEL	**Share capital**	**Non-cash owner contribution reserve**	**Retained Earnings**	**Total equity**
Balance at 1 January 2016	1,052,605	34,214	384,391	1,471,210
Profit and total comprehensive income for the year	-	-	65,126	65,126
Transactions with owner, recorded directly in equity				
Increase in share capital (note 17 (a))	399	122	-	521
Non-cash contribution from owner	-	1,631	-	1,631
Reversal of deferred tax asset (note 10 (b))	-	-	(1,557)	(1,557)
Transfer of the property to the Government (note 17 (e))	-	62,345	-	62,345
Total transactions with owner, 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**
Balance at 1 January 2017	1,053,004	98,312	447,960	1,599,276
Loss and total comprehensive loss for the year	-	-	(354,100)	(354,100)
Transactions with owner, recorded directly in equity				
Increase in share capital (note17 (a))	267	-	-	267
Non-cash distribution to owner	-	(120)	(475)	(595)
Total transactions with owner, recorded directly in equity	**267**	**(120)**	**(475)**	**(328)**
Balance at 31 December 2017	**1,053,271**	**98,192**	**93,385**	**1,244,848**

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 12 to 47.

'000 GEL	Note	2017	2016
Revenue	6	434,534	439,922
Income from the transferred property	17 (e)	23,417	80,294
Other income		15,560	19,122
Impairment loss on property, plant and equipment	11 (b) (c)	(382,616)	-
Employee benefits expense		(148,302)	(146,626)
Depreciation and amortization expense		(109,703)	(106,267)
Electricity, consumables and maintenance costs	7	(41,490)	(47,289)
Other expenses	8	(71,868)	(63,668)
Results from operating activities		**(280,468)**	**175,488**
Finance income	9	43,281	23,882
Finance costs	9	(116,265)	(173,103)
Net finance costs		**(72,984)**	**(149,221)**
(Loss) / profit before income tax		**(353,452)**	**26,267**
Income tax (expense) / benefit	10	(648)	38,859
(Loss) / profit and total comprehensive (loss) / income for the year		**(354,100)**	**65,126**

These consolidated financial statements were approved by the Management Board on 03 July 2018 and were signed on its behalf by:

David Peradze
General Director

Tamazi 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 12 to 47.

’000 GEL	Note	2017	2016
Cash flows from operating activities			
Cash receipts from customers		447,510	456,742
Cash paid to suppliers and employees		(268,593)	(264,102)
Cash flows from operations before income taxes paid		**178,917**	**192,640**
Income tax paid		(2,685)	(5,229)
Net cash from operating activities		**176,232**	**187,411**
Cash flows from investing activities			
Acquisition of property, plant and equipment		(165,265)	(200,274)
Proceeds from sale of property, plant and equipment		5,133	3,350
Interest received		14,805	22,435
Dividends received		-	1,075
Issuance of loans		-	(32,563)
Repayment of issued loans		-	37,838
Net cash used in investing activities		**(145,327)**	**(168,139)**
Cash flows from financing activities			
Proceeds from borrowings	19 (b)	50,248	42,349
Repayment of borrowings	19 (b)	(10,996)	-
Interest paid	19 (b)	(103,126)	(91,948)
Dividends paid		-	(1,607)
Net cash used in financing activities		**(63,874)**	**(51,206)**
Net decrease in cash and cash equivalents		**(32,969)**	**(31,934)**
Cash and cash equivalents at 1 January		277,953	294,784
Effect of exchange rate fluctuations on cash and cash equivalents		(1,966)	15,103
Cash and cash equivalents at 31 December	16	**243,018**	**277,953**

The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 12 to 47.

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 registration number is 03/4-965.

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.

Most of the Group's revenue is derived from the freight transportation and freight forwarding services. Accordingly, the Group's results are particularly sensitive to the cargo flows through Georgia. Due to continued pressure from a challenging market environment, the Group's transportation volumes have been declining for the last 5 years from 5,899 million metric-ton per kilometer of cargo in 2012 to 3,073 million metric-ton per kilometer of cargo in 2017).
As a result, management identified indicators that the recoverable amount of the Group's cash-generating unit might be lower than its carrying value (see note 11 (c)).

However, management expect volumes in 2018 to be relatively stable before increasing significantly (21%) in 2019 as a result of signing a co-operation agreement with CJSC Azerbaijan Railways. Management also expect an increase in volumes from 2023 as a result of the Anaklia Deep Sea Port becoming operational.

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. Partnership Fund JSC produces publicly available consolidated financial statements.

Related party transactions are disclosed in note 26.

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 Group'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 11 (b) – impairment of Tbilisi Bypass Project;
- Note 11 (c) – impairment of property, plant and equipment (excluding Tbilisi Bypass Project);
- Note 12 (a) – impairment loss for loans receivable;
- Note 15 – impairment allowances for trade and other receivables;
- Note 17 (e) – fair value of the land plots transferred to the Government of Georgia.
- Note 28 (h) (iii) – useful lives and residual values of property, plant and equipment;

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 (c) – sensitivity of impairment of property, plant and equipment (excluding Tbilisi Bypass Project);

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 17 (e) – fair value of the land plots transferred to the Government of Georgia.
- Note 22 (a) – fair value of financial assets and liabilities;

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	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
External revenues	403,515	412,116	22,843	18,007	426,358	430,123
Depreciation and amortization	(41,939)	(41,638)	(9,245)	(9,345)	(51,184)	(50,983)
Reportable segment profit/(loss) before infrastructure costs, net impairment, interest cost and income tax	244,690	249,699	(10,104)	(16,946)	234,586	232,753
Reportable segment assets	314,442	369,903	204,211	163,350	518,653	533,253
Capital expenditure and other additions to non-current assets	5,098	20,504	60,881	55,998	65,979	76,502

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

'000 GEL	**2017**	**2016**
Revenues		
Total revenue for reportable segments	426,358	430,123
Other revenue	8,176	9,799
Consolidated revenue	**434,534**	**439,922**

’000 GEL	**2017**	**2016**
Profit or loss		
Total profit or loss for reportable segments	234,586	232,753
Employee benefits expense – infrastructure and headquarters	(60,190)	(58,266)
Depreciation expenses – infrastructure and headquarters	(58,519)	(55,284)
Impairment – Infrastructure and headquarters	(382,616)	-
Net finance costs	(72,984)	(149,221)
Other net unallocated (expenses)/income	(13,729)	56,285
Consolidated (loss)/profit before income tax	**(353,452)**	**26,267**
Assets		
Total assets for reportable segments	518,653	533,253
Property, plant and equipment - infrastructure and headquarters	1,878,568	2,128,459
Other unallocated assets, principally cash and non-current assets	465,016	563,971
Consolidated total assets	**2,862,237**	**3,225,683**

(iii) Other material items 2017

’000 GEL	**Reportable segment totals**	**Infrastructure and headquarters**	**Consolidated totals**
Capital expenditure and other additions to non-current assets	65,979	153,214	219,193
Depreciation and amortization	51,184	58,519	109,703

(iv) 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

(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 2017, one customer of the Group’s freight transportation segment represented approximately 8% of the Group’s total revenue (2016: 13%).

6. Revenue

’000 GEL	2017	2016
Freight traffic	312,960	345,586
Logistic services *	73,774	52,582
Passenger traffic	22,844	18,007
Freight car rental	16,780	13,948
Other	8,176	9,799
	434,534	**439,922**

* On 28 September 2017, GR Transit LLC concluded a Ship-or-Pay Agreement (SoP) with foreign company, according to which foreign company had to transport at least 1,200,000 metric tons of crude oil and oil and gas condensate (Cargo) until the end of 2017 using the Group railway infrastructure. Included in the logistics services during 2017 is the revenue recognised in the above regards, amounting to GEL 26,440 thousand.

Notwithstanding the above, no Cargo was transported during 2017, however, foreign company should still pay for the service, regardless of the Cargo transportation, as stipulated by the SoP (see note 15).

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	2017	2016
Electricity	20,868	21,687
Materials	11,565	14,121
Repair and maintenance	3,820	7,175
Fuel	5,237	4,306
	41,490	**47,289**

8. Other expenses

’000 GEL	**2017**	**2016**
Property and Land tax	27,043	26,474
Logistic services	12,996	14,270
Security	8,918	8,928
Other Tax	7,752	-
Freight car rental	4,095	4,407
Other *	11,064	9,589
	71,868	**63,668**

* Included in the other above are the fees paid to the audit firms of about GEL 220 thousand, for the provision of audit and other professional services.

9. Finance income and finance costs

’000 GEL	**2017**	**2016**
Recognised in profit or loss		
Interest income	17,793	23,882
Net foreign exchange gain	25,488	-
Finance income	**43,281**	**23,882**
Impairment loss on trade receivables (note 22 (b) (ii); note 15)	(39,330)	(7,972)
Impairment loss on loan receivables (note 12 (a))	(23,502)	-
Interest expense	(53,433)	(52,822)
Net foreign exchange loss	-	(112,309)
Finance costs	**(116,265)**	**(173,103)**
Net finance costs recognised in profit or loss	**(72,984)**	**(149,221)**

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	2017	2016
Current tax expense		
Current year	648	5,532
	648	**5,532**
Deferred tax benefit		
Change in recognised temporary differences (due to change in the legislation) *	-	(44,391)
	648	**(38,859)**

* 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 of 31 December 2016, the Group has recognized the full in 2016 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:

	2017		2016	
	’000 GEL	**%**	**’000 GEL**	**%**
Dividends declared / Profit before income tax	-	100	26,267	100
Income tax at applicable tax rate	-	-	3,940	15
Income tax on other non-deductible expenses	648	-	-	-
Change in recognised temporary differences (due to change in the legislation)	-	-	(42,799)	(163)
	648	**-**	**(38,859)**	**(148)**

(b) Movement in temporary differences during 2016

’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)**	**-**

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 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**
Balance at 1 January 2017	541,862	129,841	940,266	968,064	874,580	3,454,613
Additions	319	61	255	65,710	181,133	247,478
Disposals and write offs	(3,622)	(3,468)	(25,853)	(5,251)	-	(38,194)
Transfers	125	3,626	41,470	2,828	(51,306)	(3,257)
Balance at 31 December 2017	**538,684**	**130,060**	**956,138**	**1,031,351**	**1,004,407**	**3,660,640**
Depreciation and impairment loss						
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**
Balance at 1 January 2017	-	33,413	323,294	474,312	-	831,019
Depreciation for the year	-	3,934	47,976	57,563	-	109,473
Disposals and write offs	-	(1,326)	(25,316)	(4,206)	-	(30,848)
Impairment loss	32,101	-	-	-	350,515	382,616
Balance at 31 December 2017	**32,101**	**36,021**	**345,954**	**527,669**	**350,515**	**1,292,260**
Carrying amounts						
At 1 January 2016	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**
At 31 December 2017	**506,583**	**94,039**	**610,184**	**503,682**	**653,892**	**2,368,380**

(a) Construction in progress

By the end of 2010, the Group started two large capital projects:

- The Main Line Modernisation; and
- Tbilisi Bypass Project.

The Group commenced the initiation of the above projects in September 2010 and November 2010, respectively. The Group issued unsecured bonds in 2010 to partly finance the projects above. During 2012, the Group redeemed the bonds issued in 2010 by issuing new bonds for general corporate and liquidity management purposes (see note 19).

The borrowing costs of 2010 unsecured bonds were allocated to each of the project on a 59%/41% basis and were capitalized upon commencement of the above projects. The interest on the bonds issued in

2012 was capitalized on the above two projects in proportion to the costs incurred on those projects based on a capitalization rate of 8% (2016: 8%). Capitalised borrowing costs of GEL 50,687 thousand during 2017 relates to the Main Line Modernization project (2016: GEL 42,536 thousand).

(b) Impairment of Tbilisi Bypass Project (the Project)

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 since 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 2016 and 2015, the Group was in discussion with the Tbilisi City Hall and the Government of Georgia about various scenarios of completing the project. One of the scenarios under discussion included an option envisaging a change of the original bypass location, because of which the existing bypass infrastructure may become redundant. The alternative scenarios also included the determination of the future use of the existing infrastructure, should it become redundant. The options of future use of the infrastructure were bypass automobile road, light rail/extension of the Tbilisi Metro System, freight depot, etc., however, as at 31 December 2017 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.

Due to significant uncertainties associated with either the continuation of the existing Project or implementation of any other scenarios, envisaging the change in the existing use of the Project, and also considering the fact that Management does not expect that the Project will generate any future economic benefit to the Group either individually, or in combination with other non-current assets, the carrying value of the Project was written-down to its recoverable amount.

Selling price less cost to sell:

The carrying value of Tbilisi Bypass Project included the cost of land (Land located under the Project) and the costs incurred for the construction of the tunnels, bridges and other land related works (Specific Assets).

Due to the nature of these Specific Assets and the fact that the Group would not generate any benefit from either their continuing use or from their sale, or the cost to sell those assets would be higher than their selling price, the recoverable amount of those assets were deemed to be nil.

The selling price the Lands located under the Project was determined based on market prices in the recent transactions or announced asking prices of the similar assets. The significant unobservable inputs related to the differences in the characteristics of the land plots, such as, location and physical conditions, for which the Group applied 0% to 10% adjustments to observed asking or transactions prices.

As a result, the carrying amount of the Project of GEL 397,305 thousand was determined to be higher than its recoverable amount of GEL 14,689 thousand and the respective impairment loss of GEL 382,616 thousand was recognized in the impairment loss during 2017, which is included in the construction in progress heading above.

(c) Impairment of property, plant and equipment (excluding Tbilisi Bypass Project)

The impairment testing was carried out by the Group due to the significant decline in the volumes transported (from 5,899 million metric-ton per kilometer of cargo in 2012 to 3,073 million metric-ton per kilometer of cargo in 2017) and revenue (from USD 212,413 thousand in 2012 to USD 106,454 thousand in 2017). Revenue from freight transportation services represents about 65% of the total revenue generated for the past two years, which was considered as the indicator of the impairment.

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. Based on the analysis, it was concluded that no impairment was required.

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

- Cash flows are projected based on actual operating results and cash flows for a period up to 2037, with the further calculation of the terminal value. Due to the significant impact that the construction of Anaklia Port is expected to have on volumes in the future, the Group has determined that it is justified to use cash flow projections for a period of 20 years since the Group believe that the 20 year period will allow cash flows to stabilize after the Anaklia Port is constructed. The projections are prepared in nominal terms;

- Volumes are projected based on the actually transported quantities during 2017, adjusted for the Georgian GDP growth rate of 4.6% up to 2022. No volume growth is projected from 2023. Tariffs to be applied to the quantities above are projected based on the budgeted tariff per metric-ton per kilometer for 2018, adjusted for the changes in the US CPI forecast. The forecast resulted in an increase of 2.25% during the first two projected years and 1.7% increase during the remaining projected period;

- Cash flows include annual maintenance capital expenditure and payments for the finalization of the Main Line Modernization project. Projected cash flows include USD 95 million associated with the Modernization project above. The finalization of the above project is expected to decrease the projected electricity and material costs by 10% during 2019 and 2020;

- A pre-tax discount rate of 11.9% 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 long-term growth rate for the terminal period approximates to the long-term inflation forecast for USD, which is 1.9%.

Additional assumptions included in the estimation of the recoverable amount, which has the most significant effect on the determination of recoverable amount of the CGU is summarized below:

- Management expects that the completion of the Anaklia Deep Sea Port construction will result in increased cargo flows through Georgia. Accordingly, the projected cash flows include an increase in the container traffic of 9.2% from 2023, 5.7% from 2028 and 4.5% from 2033;

- The Group is in active discussions with CJSC Azerbaijan Railway based on which, management expects that the additional cargo will flow through Georgia, in the form of dry cargo and oil products. The projected cash flows include an increase in the specific dry cargo and oil products of 1,920 million tonnes per annum, starting from 2019. This represents an increase of 25% over the projected 2018 figures for dry cargo and oil products.

The key assumptions used to determine the value in use to which the calculation is most sensitive include:

- Volume growth from CJSC Azerbaijan Railway – The exclusion of these volumes from the projected cash flows would have resulted in an impairment loss of about GEL 353 million;

- Discount rate – An increase of 1% point in the discount rate used would have resulted in an impairment loss of approximately GEL 187 million.
- Volume growth due to Anaklia Deep Sea Port – The exclusion of these volumes from the projected cash flows would have resulted in an impairment loss of about GEL 73 million;
- Terminal growth rate – a decrease of 1% in the terminal growth rate would not have resulted in any impairment, however such a change would have reduced the recoverable amount by GEL 43 million;

(d) Capital contributions

The Government of Georgia contributes certain property, plant and equipment in the form of an increase in share capital. In 2017 and 2016 the share capital has been increased by the fair value of these assets of GEL 267 thousand and GEL 521 thousand respectively (see note 17 (a)).

(e) Security

At 31 December 2017, property with a carrying amount of GEL 108,365 thousand (2016: GEL 52,330 thousand) is pledged in respect of the secured loan (see note 19).

(f) Capital commitment

As at 31 December 2017, the Group had entered into contracts for the construction or purchase of property, plant and equipment of GEL 488,135 thousand (2016: GEL 612,862 thousand) mainly relating to the Main Line Modernization project of GEL 267,305 thousand (2016: GEL 335,250 thousand) and Tbilisi Bypass project of GEL 216,375 thousand (2016: GEL 211,476 thousand).

Management does not expect that the cessation of the construction agreement with the counterparty, responsible for the Tbilisi Bypass project completion, will result in the payment of the above amount.

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 22.

’000 GEL	**2017**	**2016**
Non-current assets		
Entity managed by the Group*	-	18,901
Parent company	18,113	16,816
	18,113	**35,717**
Current assets		
Entity managed by the Group*	-	3,974
	-	**3,974**

(a) Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

’000 GEL	Currency	Nominal interest rate	Year of maturity	31 December 2017 Face value	31 December 2017 Carrying amount	31 December 2016 Face value	31 December 2016 Carrying amount
Entity managed by the Group	USD	10.00%	2023	-	-	22,875	22,875
Parent company	USD	9.75%	2021	18,113	18,113	16,816	16,816
Total interest-bearing assets				**18,113**	**18,113**	**39,691**	**39,691**

As at 31 December 2017, Management identified an indicator that the loan receivable from the Entity managed by the Group may be impaired. Compared to initial payment schedule principal and interest payments of GEL 4,762 thousand are past due as at 31 December 2017 and as it is not generating the sufficient cash flows as was initially expected. As a result, the Group recognized an impairment loss for the carrying value of the loan receivable as at 31 December 2017, amounting to GEL 23,502 thousand which was recognised in finance costs during 2017.

13. Other non-current assets

’000 GEL	2017	2016
Prepayments for non-current assets	79,071	100,976
Construction materials	36,108	43,457
Intangible assets	8,337	3,086
Other	46	46
	123,562	**147,565**

14. Inventories

’000 GEL	2017	2016
Materials	29,563	26,727
Fuel	2,380	2,105
Rails	1,174	1,499
Other	2,948	2,857
	36,065	**33,188**
Allowance for inventory obsolescence	(3,258)	(3,436)
	32,807	**29,752**
Reversal of previous write-down of inventories	178	540

15. Trade and other receivables

’000 GEL	2017	2016
Trade receivables *	237,464	227,117
Impairment allowance on trade receivables *	(164,058)	(151,372)
	73,406	**75,745**
Receivable from the Government **	27,149	23,690
Impairment allowance on receivable from the Government **	(27,149)	-
	-	**23,690**
Other receivables	208	214
	73,614	**99,649**

* Trade receivables as at 31 December 2017 include the receivable from Foreign Company (see note 6), amounting to GEL 21,256 thousand. As at 31 December 2017 and the date these consolidated financial statements were authorised for issue, the receivable above was fully overdue.

During the first two month after the reporting date, the counterparty made additional payments of GEL 6,040 thousand. The Group and foreign company has agreed on updated payment terms on the outstanding amount above. The first payment was due on 31 May 2018. On 2 June 2018, the counterparty provided the first payment of USD 200 thousand. Based on all of the above, the Group expects to recover the receivable by the end of 2018 and thus, did not make any provision for the outstanding balance as at 31 December 2017.

** Receivable from the Government of Georgia (hereinafter the Government or the GoG) was recognized as a result of the transfer of the property to the GoG, as according to the Bypass Project Memorandum of Understanding (MoU), the Government will reimburse the Group for the value added tax payable incurred on such transfers (see note 17 (e)).

Based on discussions with the GoG and due to uncertainties associated with the reimbursement of the above receivable, the Group recognized an impairment loss on the receivable from the Government, which was recognised in finance cost during 2017.

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

16. Cash and cash equivalents

’000 GEL	2017	2016
Current accounts in banks	79,073	222,047
Call deposits	163,866	55,837
Petty cash	79	69
Cash and cash equivalents in the consolidated statement of financial position and the consolidated statement of cash flows	**243,018**	**277,953**

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 22.

17. Equity and liabilities to the Government

(a) Share capital

Number of shares	Ordinary shares	
	2017	**2016**
In issue at 1 January	1,053,003,675	1,052,604,503
Issued for property, plant and equipment (see note 11 (d))	267,330	399,172
In issue at 31 December, fully paid	**1,053,271,005**	**1,053,003,675**
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 Government 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 Government. These liabilities are recorded at the carrying amount of assets to be transferred to the owner.

'000 GEL	**2017**	**2016**
Liabilities to the Government	**7,592**	**8,399**

(d) Dividends

In 2017 and 2016, no dividends were declared.

(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 meters of land plots with attached constructions which would 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 agreed 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

During 2017 and 2016, the Company transferred 55,787 and 89,166 square meters of 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	**2017**	**2016**
Cost of the transferred property, as agreed between the Group and the Government	27,215	147,979
Less: fair value of the transferred property	(27,215)	(85,634)
Recognized in non-cash owner contribution reserve	**-**	**62,345**
Fair value of the transferred property	27,215	85,634
Less: carrying value of the transferred property	(3,798)	(5,340)
Recognized as income from the transferred property	**23,417**	**80,294**

18. 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.

19. Loans and borrowings

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

'000 GEL	**2017**	**2016**
Non-current liabilities		
Secured loan	80,294	42,788
Unsecured bonds	1,294,069	1,318,814
Loans and borrowings	**1,374,363**	**1,361,602**
Current liabilities		
Secured loan	11,708	6,959
Current portion of unsecured bonds	47,101	50,213
Loans and borrowings	**58,809**	**57,172**

(a) Terms and debt repayment schedule

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

				31 December 2017		**31 December 2016**	
'000 GEL	**Currency**	**Nominal interest rate**	**Year of maturity**	**Face value**	**Carrying amount**	**Face value**	**Carrying amount**
Unsecured bonds	USD	7.8%	2022	1,341,170	1,341,170	1,369,027	1,369,027
Secured loan	USD	Libor +1.25%	2026	92,002	92,002	49,747	49,747
Total interest-bearing liabilities				**1,433,172**	**1,433,172**	**1,418,774**	**1,418,774**

In July 2012, the Group carried out the issuance, placement and registration (listing) of unsecured bonds of USD 500 million on the London Stock Exchange with an interest rate of 7.75% due in 2022.

Part of the above bonds were used for an early redemption of the unsecured bonds of USD 250 million issued by the Group in 2010.

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, with the carrying amount of GEL 108,365 thousand as at 31 December 2017 (31 December 2016: GEL 52,330 thousand) (see note 11 (e)).

(b) Changes in liabilities arising from financing activities

’000 GEL	Loans and borrowings
Balance at 1 January 2017	**1,418,774**
Proceeds from borrowings	50,248
Repayment of borrowings	(10,996)
Interest paid	(103,126)
Total change from financing cash flows	**(63,874)**
The effect of changes in foreign exchange rates	**(24,750)**
Other changes	
Interest expense recognised in finance cost during 2017	53,267
Interest expense capitalised as borrowing costs (note 11 (a))	49,755
Total liability-related other changes	**103,022**
Balance at 31 December 2017	**1,433,172**

20. Trade and other payables

’000 GEL	2017	2016
Payables for non-current assets	77,805	73,576
Trade payables	16,771	17,676
Advances received from customers	17,645	18,386
	112,221	**109,638**

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

21. Provisions

’000 GEL	2017	2016
Balance as at 1 January	8,547	8,325
Net provisions made during the year	(594)	222
Balance at 31 December	**7,953**	**8,547**

The Group recognised a provision for the estimated cash outflow required to settle legal cases against the Group existing as at 31 December 2017 as well as to settle the legal obligations towards the employees injured during the performance of their duties.

22. 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	**2017**	**2016**
Cash and cash equivalents	242,939	277,884
Trade and other receivables	73,406	75,745
Loans receivable	18,113	39,691
Receivable from the Government (see note 15)	-	23,690
Balance at 31 December	**334,458**	**417,010**

Cash and cash equivalents

The Group usually holds funds with banks with good credit ratings. As at 31 December 2017, approximately 90% (31 December 2016: 48%) of the bank balances are held with the 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. During 2017, about 8% (2016: 13%) 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	**2017**	**2016**
CIS countries	67,929	57,152
Domestic	5,477	18,593
	73,406	**75,745**

The Group's two most significant customers account for GEL 40,681 thousand of the trade receivables carrying amount as at 31 December 2017 (31 December 2016: GEL 55,880 thousand).

Impairment losses

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

'000 GEL	**Gross 2017**	**Impairment 2017**	**Gross 2016**	**Impairment 2016**
Past due 0- 90 days	21,808	-	18,697	5,434
Past due 91-180 days	4,520	1,270	4,251	1,294
Past due 181-365 days	1,606	680	8,920	3,547
Past due more than one year	209,530	162,108	195,249	141,097
	237,464	**164,058**	**227,117**	**151,372**

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

'000 GEL	**2017**	**2016**
Balance at beginning of the year	**151,372**	**140,846**
Increase during the year	12,134	7,972
Write off during the year	-	(1,333)
Net foreign exchange loss	552	3,887
Balance at end of the year	**164,058**	**151,372**

Most of the remaining impairment loss at 31 December 2017 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 10,335 thousand (2016: 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 2017, the Group has issued loans to the parent company. The loan is not 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 2017 and there are no indications that the parent company will fail to meet its obligations, when it falls due.

As at 31 December 2016 Group had issued loan to the Entity managed by the Group amounting to GEL 22,875. As at 31 December 2017 per management assessment the loan was impaired. As a result, the Group recognized an impairment loss for the carrying value of the loan receivable as at 31 December 2017, amounting to GEL 23,502, which was recognised in finance costs during 2017.

(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 2017, the Group maintains a committed credit line of GEL 158,835 thousand (31 December 2016: GEL 161,400 thousand).

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.

2017

'000 GEL	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-2 years	2-5 years	Over 5 years
Secured loan	92,002	115,581	7,109	7,044	13,820	39,507	48,101
Unsecured bonds	1,341,170	1,798,338	50,223	50,223	100,446	1,597,446	-
Trade payables	94,576	94,576	94,576	-	-	-	-
Other current liabilities	9,857	9,857	9,857	-	-	-	-
	1,537,605	**2,018,345**	**161,729**	**57,296**	**114,592**	**1,639,885**	**44,843**

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	91,246	91,246	91,246	-	-	-	-
Other current liabilities	7,240	7,240	7,240	-	-	-	-
	1,517,260	**2,112,992**	**154,190**	**55,236**	**110,359**	**330,612**	**1,462,595**

(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 2017	CHF – denominated 2017	USD - denominated 2016	CHF - denominated 2016
Cash and cash equivalents	167,859	1,891	182,617	499
Loan receivable	18,113	-	39,691	-
Trade receivables	39,433	28,505	234	57,152
Secured loan	(92,002)	-	(49,747)	-
Unsecured bonds	(1,341,170)	-	(1,369,027)	-
Trade and other payables	(8,748)	-	(10,591)	-
Net exposure	**(1,216,515)**	**30,396**	**(1,206,823)**	**57,651**

The following significant exchange rates applied during the year:

in GEL	Average rate		Reporting date spot rate	
	2017	**2016**	**2017**	**2016**
USD 1	2.51	2.37	2.59	2.65
CHF 1	2.55	2.40	2.66	2.60

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**
2017	
USD (10% weakening)	(121,652)
CHF (10% weakening)	3,040
2016	
USD (10% weakening)	(120,682)
CHF (10% weakening)	5,765

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:

'000 GEL	**Carrying amount**	
Fixed rate instruments	**2017**	**2016**
Financial assets	181,980	95,527
Financial liabilities	(1,341,170)	(1,369,027)
	(1,159,190)	**(1,273,500)**
Variable rate instruments		
Financial liabilities	(92,002)	(49,747)
	(92,002)	**(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 as at 31 December 2017 would have affected profit or loss by GEL 920 thousand (31 December 2016: GEL 497 thousand). This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

23. Subsidiaries

Subsidiary	Country of incorporation	Principal activities	2017 Ownership/ voting	2016 Ownership/ voting
GR Property Management LLC	Georgia	Property management and development	100%	100%
GR Logistics and Terminals LLC	Georgia	Container transportation and terminal services	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	Georgia	Transportation services	100%	100%

24. Operating leases

Non-cancellable operating lease rentals are receivable as follows:

’000 GEL	**2017**	**2016**
Less than one year	4,378	4,499
Between one and five years	5,660	6,663
More than five years	18,250	19,288
	28,288	**30,450**

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.

25. 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 not already provided for, 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.

26. Related parties

(a) 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	**2017**	**2016**
Salaries and bonuses	**1,086**	**1,093**

(b) 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 662 thousand for 2017 (2016: GEL 1,376 thousand). The Group also purchases security services from a state agency which amounted to GEL 8,956 thousand for 2017 (2016: GEL 8,968 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	
	2017	2016	2017	2016
Loans issued:				
Parent company	-	12,884	18,113	16,816

During 2017, interest income of GEL 1,598 thousand (2016: GEL 851 thousand) was recognised in profit and loss in respect of related party loans.

(iv) Income from the transferred property

During 2017, the Group recogised income from the sale of transferred property of GEL 23,417 thousand (2016: GEL 80,294) within the framework of Bypass Project Memorandum. The movement in the advance received from the Government is summarized in note 17 (e) (i).

The receivable from the Government within the scope of the Bypass Project memorandum as at 31 December 2017 amounted to GEL 27,149 thousand (31 December 2016: GEL 23,690 thousand). The receivable as at 31 December 2017 was fully provisioned (see note 15).

(v) Credit line

As at 31 December 2017, the Group has unused credit line of USD 7 million from the parent company (2016: USD 7 million). The credit line bears interest rate of 10% per annum and matures in June, 2018.

27. Basis of measurement

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

28. 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;
- impairment loss on loans receivable;
- 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 moves the moment of taxation from when taxable profits are earned to when they are distributed. The law entered into force in 2016 and is effective for tax periods starting after 1 January 2017 for all entities except for financial institutions (such as banks, insurance companies, microfinance organizations, pawnshops), for which the law will become effective at a later date.

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

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

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

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

(g) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the 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.

29. New standards and interpretations not yet adopted

(a) Estimated impact of the adoption of IFRS 9 and IFRS 15

The Group is required to adopt IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* from 1 January 2018. The Group has assessed and determined the initial application of IFRS 9 and IFRS 15 will not have an impact in excess of GEL 15,000 thousand on its consolidated financial statements. The estimated impact of the adoption of these standards on the Group's equity as at 1 January 2018 is based on preliminary assessments undertaken to date.

(b) IFRS 9 Financial Instruments

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.

(c) IFRS 15 Revenue from Contracts with Customers

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

(d) IFRS 16 *Leases*

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

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

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

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