



State Oil Fund of the  
Republic of Azerbaijan

# ANNUAL REPORT 2017





THE STATE OIL FUND  
OF THE REPUBLIC OF AZERBAIJAN

ANNUAL REPORT  
2017

# CONTENT

<b>1. ABOUT SOFAZ</b>	<b>4</b>
<b>2. FACTS AT GLANCE</b>	<b>10</b>
<b>3. GOVERNANCE AND TRANSPARENCY</b>	<b>14</b>
3.1. MANAGEMENT OF SOFAZ	14
3.2. TRANSPARENCY AND ACCOUNTABILITY	18
<b>4. NATIONAL ECONOMY AND SOFAZ</b>	<b>21</b>
4.1. MACROECONOMIC DEVELOPMENT	21
4.2. SOFAZ'S INCOMES	34
4.3. SOFAZ'S EXPENDITURES	39
<b>5. INVESTMENT</b>	<b>52</b>
5.1. INVESTMENT STRATEGY	52
5.2. SOFAZ'S INVESTMENT PORTFOLIO	55
5.3. RETURNS ON SOFAZ'S INVESTMENT PORTFOLIO	74
5.4. RISK MANAGEMENT	78
<b>6. EXECUTION OF THE 2017 SOFAZ BUDGET</b>	<b>83</b>
<b>7. CONSOLIDATED FINANCIAL STATEMENTS OF SOFAZ</b>	<b>88</b>
<b>APPENDIX</b>	<b>143</b>

# ABBREVIATIONS

ACG - AZERI-CHIRAG-GUNESHLI
AIOC - AZERBAIJAN INTERNATIONAL OPERATING COMPANY
BOE - THE BANK OF ENGLAND
CBAR - THE CENTRAL BANK OF THE REPUBLIC OF AZERBAIJAN
ECB - EUROPEAN CENTRAL BANK
FED - THE FEDERAL RESERVE
GDP - GROSS DOMESTIC PRODUCT
IFSWF - THE INTERNATIONAL FORUM OF SOVEREIGN WEALTH FUNDS
IMF - THE INTERNATIONAL MONETARY FUND
OPEC - ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES
PSA - PRODUCTION SHARING AGREEMENT
SGC - SOUTHERN GAS CORRIDOR
SOFAZ - THE STATE OIL FUND OF THE REPUBLIC OF AZERBAIJAN
SSC OF AZERBAIJAN - THE STATE STATISTICAL COMMITTEE OF THE REPUBLIC OF AZERBAIJAN
SWFI - THE SOVEREIGN WEALTH FUND INSTITUTE
VAR - VALUE AT RISK
WB - THE WORLD BANK

## 1. ABOUT SOFAZ

The State Oil Fund of the Republic of Azerbaijan (SOFAZ) was established in accordance with the Decree of national leader Heydar Aliyev No. 240 on December 29, 1999. SOFAZ is a mechanism whereby energy-related earnings are accumulated and efficiently managed for future generations.

SOFAZ is structured as an extra-budgetary fund and functions as the legal entity separate from the government or central bank. Statute of SOFAZ was approved in 2000.

The cornerstone of SOFAZ's philosophy is to ensure intergenerational equality with respect to the benefit from the country's oil wealth.

### MISSION

SOFAZ's mission is to transform depletable hydrocarbon reserves into financial assets generating perpetual income for current and future generations.

### OBJECTIVES

SOFAZ's activity is directed to the achievement of the following objectives:

1. Supporting macroeconomic stability, participating in ensuring fiscal-tax discipline and decreasing dependence on oil revenues while stimulating development of the non-oil sector;
2. Funding major national scale projects to support socio-economic progress;
3. Ensuring intergenerational equality with regard to the country's oil wealth, accumulating and preserving oil revenues for future generations.

### LEGAL FRAMEWORK

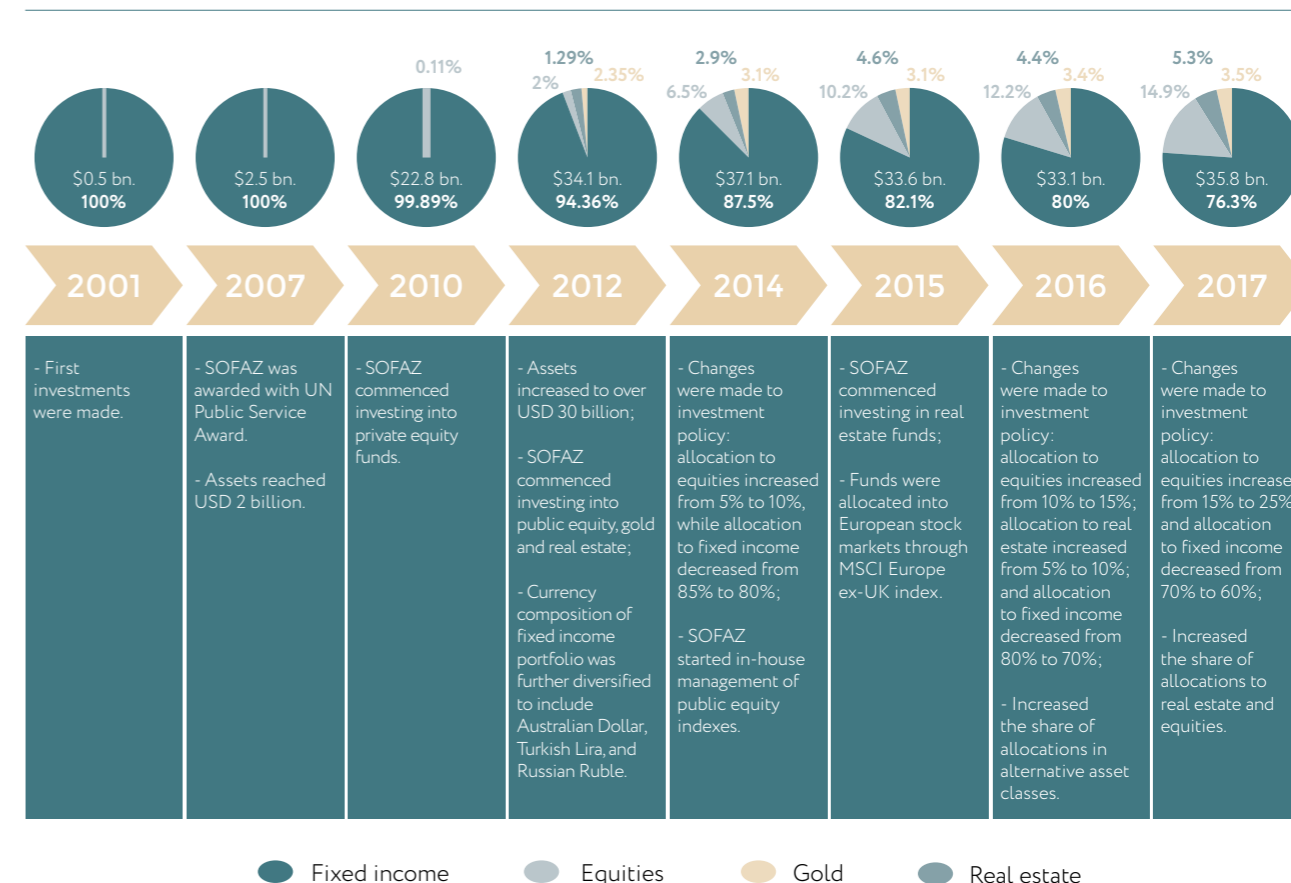
SOFAZ's operations are guided by the Constitution and laws of the Republic of Azerbaijan, Presidential decrees and resolutions, SOFAZ Statute and regulations.

SOFAZ's funding and withdrawal rules are clearly defined by the "Statute of the State Oil Fund of the Republic of Azerbaijan" and the "Rules on the preparation and execution of the annual program of revenues and expenditures (budget) of the State Oil Fund of the Republic of Azerbaijan". According to the Law "On

budget system" of the Republic of Azerbaijan, all SOFAZ expenditures, except for operating expenditures, are incorporated into an annual consolidated government budget presented to the Parliament for approval. Thus, indirectly, all citizens participate in the discussions of the budget of SOFAZ. In compliance with this law, SOFAZ can only execute the expenditures envisaged by its budget.

SOFAZ's investment and risk management policies are defined by "Investment Guidelines" and "Investment Policy" approved by the President of the Republic of Azerbaijan after the review of the Supervisory Board. According to its "Investment Policy", SOFAZ's investment decisions should aim at maximizing the risk-adjusted returns. According to the "Investment Guidelines", SOFAZ makes investment decisions independently.

In 2004, the President of the Republic of Azerbaijan Ilham Aliyev approved "Long-term Strategy on the management of oil and gas resources". This document is considered as a crucial milestone for the long-term prosperity of the country, outlining the development of the non-oil sector, human capital and competitive economy. SOFAZ is one of the central components in the implementation of the Strategy.



Note: The diagram illustrates year by year AuM and breakdowns of the investment portfolio by asset class.

### OUR VALUES: RESPECT, TEAMWORK, TRUST AND TRANSPARENCY

Since its very inception, SOFAZ has built a strong cooperation with a number of financial organizations and institutions in Azerbaijan and globally. SOFAZ's relations with its partners are based on the principles of mutual respect, trust, teamwork and transparency.

#### RESPECT

SOFAZ's relations with international organizations, financial institutions, government bodies as well as its employees are based on mutual respect. Deeply rooted into the Fund's philosophy, trust and respect are the main factors in maintaining healthy relations in workplace and cooperating fruitfully with partners.

#### TEAMWORK

It is through teamwork and joint efforts that SOFAZ succeeds in all of its endeavors and strengthens its prestige locally and

worldwide. Building strong working relationships, praising personal, achievements and encouraging teamwork contribute to the establishment as well as further development of professional work environment.

#### TRUST

Since its inception, SOFAZ adheres to the highest standards of ethical behavior and honesty to gain the trust of its partners. SOFAZ expects all of its business partners to operate on the same principles of mutual trust and cooperation.

#### TRANSPARENCY

SOFAZ's activities are based on the principles of transparency and accountability. Internationally praised as a credible and transparent institution, SOFAZ, in line with the foremost international practices, ensures the highest level of transparency towards its counterparties, employees and external managers.



*Mugham*

**MUSICAL GENRES, ROOTED IN ORAL TRADITIONS OF SOME NEAR AND MIDDLE EAST NATIONS, COME IN MANY NAMES IN DIFFERENT COUNTRIES AND HAVE PECULIARITIES THAT DIFFERENTIATE THEM FROM ONE ANOTHER. IN AZERBAIJAN, A FORM OF HIGH ART IN THE ORAL TRADITIONS OF PROFESSIONAL MUSIC IS CALLED “MUGHAM”. MUGHAMS ARE VOCAL-INSTRUMENTAL OR INSTRUMENTAL COMPOSITIONS CONVEYING DEEP EMOTIONS, PROFOUND MEANING AND LOFTY IDEAS. THE POETIC TEXT OF MUGHAM’S VOCAL SECTION IS COMPOSED OF GHAZALS WHICH ARE SAMPLES OF CLASSICAL POETRY. THE ART OF MUGHAM, WHICH ADDRESSES PHILOSOPHICAL AND PSYCHOLOGICAL THEMES, EXPRESSES A MAN’S SPIRITUAL WEALTH AND REFLECTIONS ON LIFE. MUGHAM “DASTGAH”S [ED.: DASTGAH – A SUITE-LIKE PIECE], HAVING SURVIVED TO THIS VERY DAY BY PASSING FROM PERSON TO PERSON IN THE COURSE OF THE NATION’S LONG HISTORY, REPRESENTS A PRODUCT OF GREAT EFFORTS AND INTELLIGENCE OF AZERBAIJANI PEOPLE AND REVEALS SUBTLITIES OF AZERBAIJANI MUSIC.**

Azerbaijani music is based on national modes. According to the concepts developed by Uzeyir Hajibeyli, there are seven main (rast, shur, segah, shushtar, bayaty-shiraz, chahargah and humayun) and three collateral (shahnaz, sarendj, chahargah of the second type) modes. Currently, several mugham dastgahs based on seven main modes exist. “Rast”, “Shur”, “Segah”, “Chahargah”, “Bayaty-Shiraz”, “Mahur-hindi”, “Orta Mahur”, “Dugah”, “Zabul-Segah”, “Mirza Huseyn’s Segah”, “Kharij Segah”, “Shushtar”, “Humayun” are the most famous dastgahs nowadays. Each mugham represents the development of the corresponding mode as an embodiment of its intonation components and peculiarities of performance.

There are vocal-instrumental and instrumental forms of Azerbaijani mughams. Khanandas [ed.: khananda – a mugham performer] perform mughams using samples of classical Azerbaijani poetry and lyrical-philosophical ghazals. Mugham performance usually involves an ensemble of sazandas - a trio of traditional instruments (tar, kamancha, and gaval).

The history of the Azerbaijani classical mugham is closely linked to the art of khananda performance. Notable folk artists founded a private mugham performance school (Haji Husu, Sattar, Abulhasan Khan Iqbal, Abdulbagi Zulalov, Jabbar Garyaghdioğlu, Kechachi oğlu Mohammad, Mashadi Mammad Farzaliyev, Majid Behbudov and other artists). In the second half of the 19th century - beginning of the 20th century, various mugham performance schools were established in Azerbaijan (the Garabagh, Baku and Shirvan schools). Among the musicians who made significant contributions to Azerbaijani music history were khanandas Islam Abdullayev, Alasgar Abdullayev, Seyid Shushinski, Bulbul (Murtuza Mammadov), Khan Shushinski, Zulfi Adigozalov, tar players Gurban Pirimov, Mirza Mansur Mansurov and other artists.

Prominent Azerbaijani artists, such as Mirza Sadig Asad oğlu, Gurban Pirimov, Mirza Faraj Rzayev, Mirza Mansur Mansurov, Ahmad Bakikhanov, Bahram Mansurov, Kamil Ahmadov, Hafiz Mirzaliyev and Mutallim Novruzov contributed to the development and preservation of these pearls of rich Azerbaijani art music. They are known not only as outstanding mugham masters but also as tutors who spared no effort in sharing their knowledge and skills with the upcoming generation of young musicians.

In 2008, owing to the initiative and extensive efforts of the President of the Heydar Aliyev Foundation and First Vice President of Azerbaijan Ms. Mehriban Aliyeva, the Azerbaijani mugham was included in UNESCO’s Lists of Intangible Cultural Heritage as a Masterpiece of Oral and Intangible Cultural Heritage of Humanity.

Azerbaijan regularly hosts the biennial International Mugham Contests unleashing new, young talents and nurturing mugham performers who will honourably transmit and impart the art of mugham to the future generations.

The source: The Mirza Fatali Akhundov Azerbaijan National Library

## JABBAR GARYAGHDIOĞLU

Jabbar Ismayil oğlu Garyaghdioğlu, an outstanding singer, composer, and People’s Artist, was born in Shusha in 1861. Jabbar Garyaghdioğlu had interest to music from his early ages, and grew up in a mugham and musical environment.

During his life, Jabbar Garyaghdioğlu was being called a “living history”, encyclopedia of Azerbaijani folk music, and “Prophet of Oriental music”. His mughams and folk songs are still among the greatest valuables of Azerbaijan’s music treasury. Khananda’s (i.e. Jabbar Garyaghdioğlu) name was rightfully placed alongside a number of the world’s prominent musical artists.

Garyaghdioğlu devoted 60 years of his life to the professional career of khananda and was deservedly considered as the Transcaucasia’s best singer.

Several phonograph records of mughams performed by the khananda were released.

Garyaghdioğlu played a considerable role in the formation of Azerbaijan’s opera. In fact, he was the first opera actor of Azerbaijan.

Garyaghdioğlu has nurtured a generation of renowned khanandas who made great contributions to the art of mugham. Among Garyaghdioğlu’s students were mugham masters Khan Shushinski, Seyid Shushinski, Bulbul, Davud Safiyarov, Zulfi Adigozalov, Jahan Talishinskaya, Yaver Kalanterli and Mutallim Mutallimov.

Jabbar Garyaghdioğlu passed away on April 20, 1944.

The source: “Medeniyyet” newspaper



## 2. FACTS AT GLANCE

CHART 2.1. GROWTH IN SOFAZ ASSETS (USD BILLION)

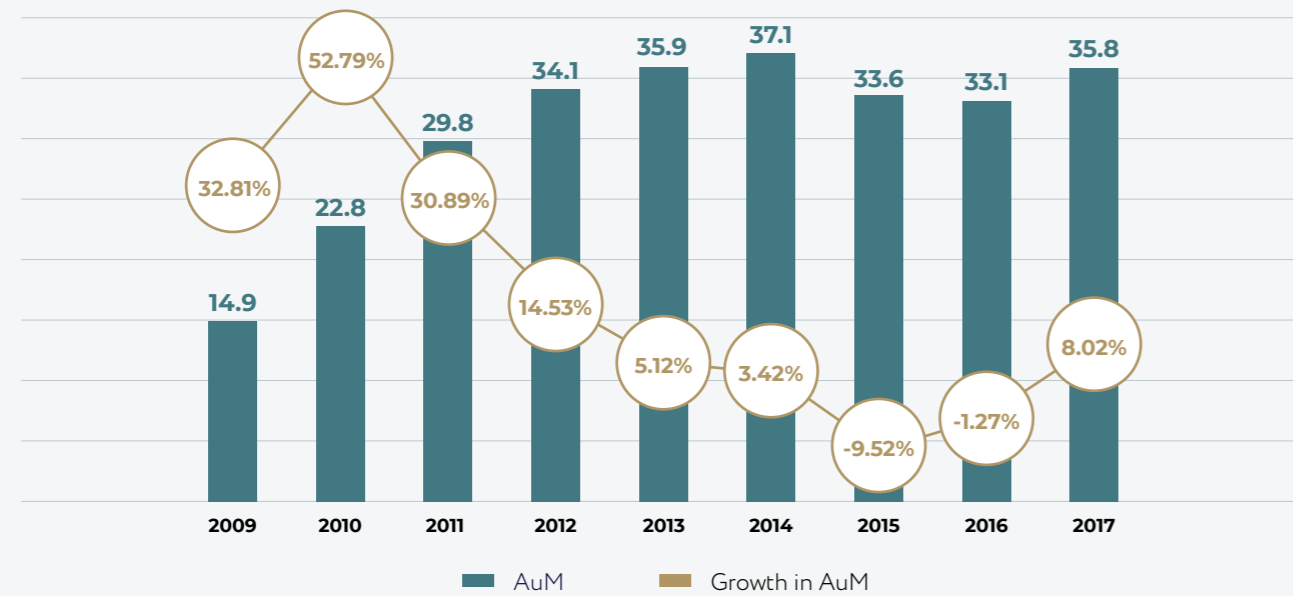


CHART 2.2. ANNUALISED RATE OF RETURN ON INVESTMENT PORTFOLIO

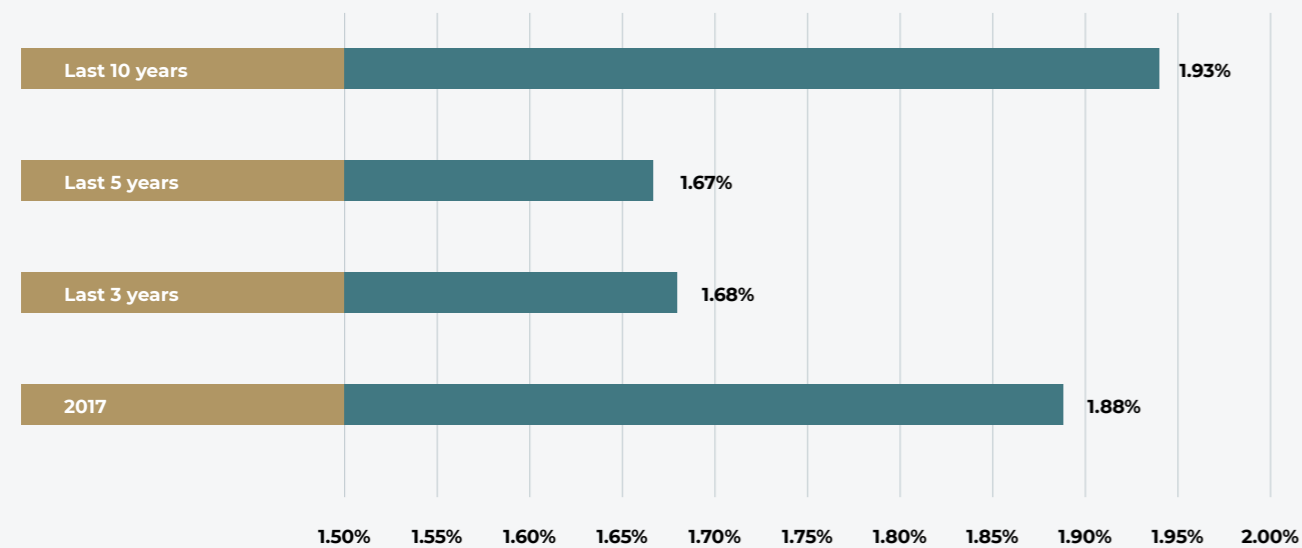


CHART 2.3. CURRENCY COMPOSITION (AS PERCENTAGE OF INVESTMENT PORTFOLIO)

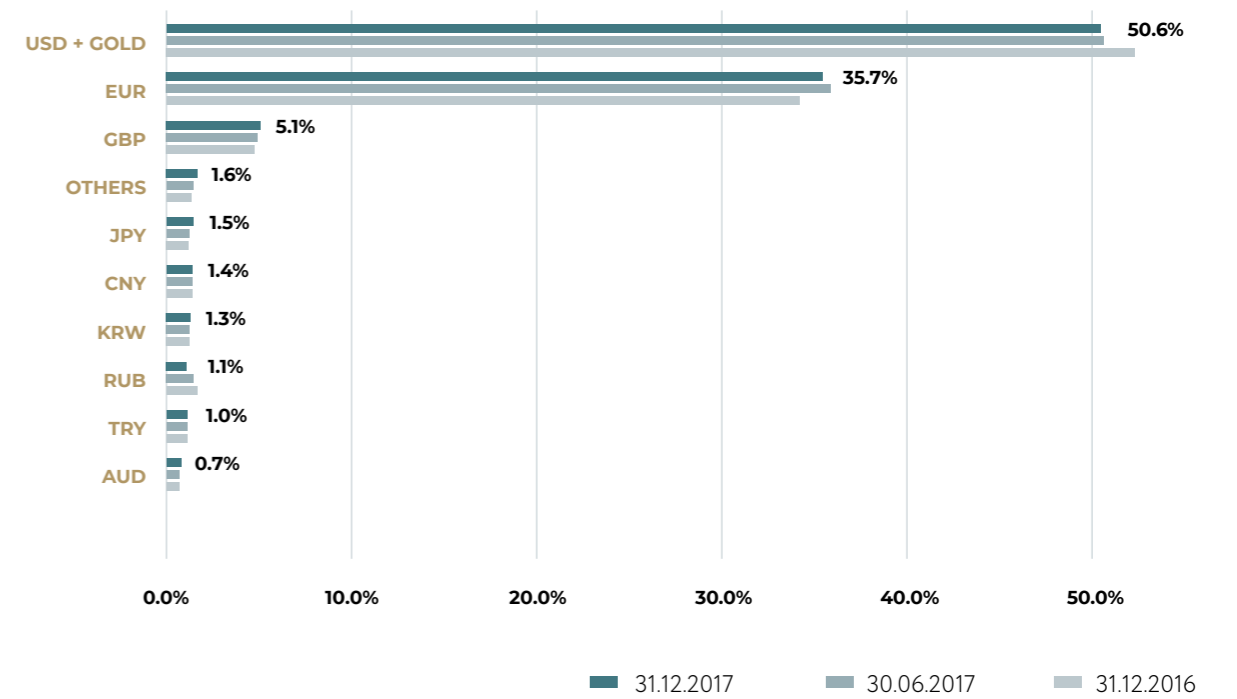


CHART 2.4. ASSET ALLOCATION (AS PERCENTAGE OF INVESTMENT PORTFOLIO), 31.12.2017



**YAGUB MAMMADOV**

Born in Agjabadi region on May 5, 1930, the People's Artist of Azerbaijan Yagub Mammad oghlu Mammadov is a well-known representative of the Azerbaijani art of mugham singing of the second half of the 20th century.

From an early age, he was interested in the art of mugham and listened to the performances of prominent khanandas who exerted a profound influence on him. In 1956, Mammadov became a laureate of the Republican Youth Festival in Baku, where his performance attracted the attention of the jury consisting of prominent artists including Hagigat Rzayeva, Khan Shushinski and Afrasiyab Badalbeyli. After the festival, the professional tar player Ahmed Bakikhanov invited Yagub to the radio show. Later, records of several songs performed by Yagub Mammadov and accompanied by Bakikhanov's ensemble were released.

Consequently, Mammadov was invited to the Azerbaijan State Philharmonic Hall. The Director of the Philharmonic Hall, the exceptional composer Soltan Hajibeyov was impressed with

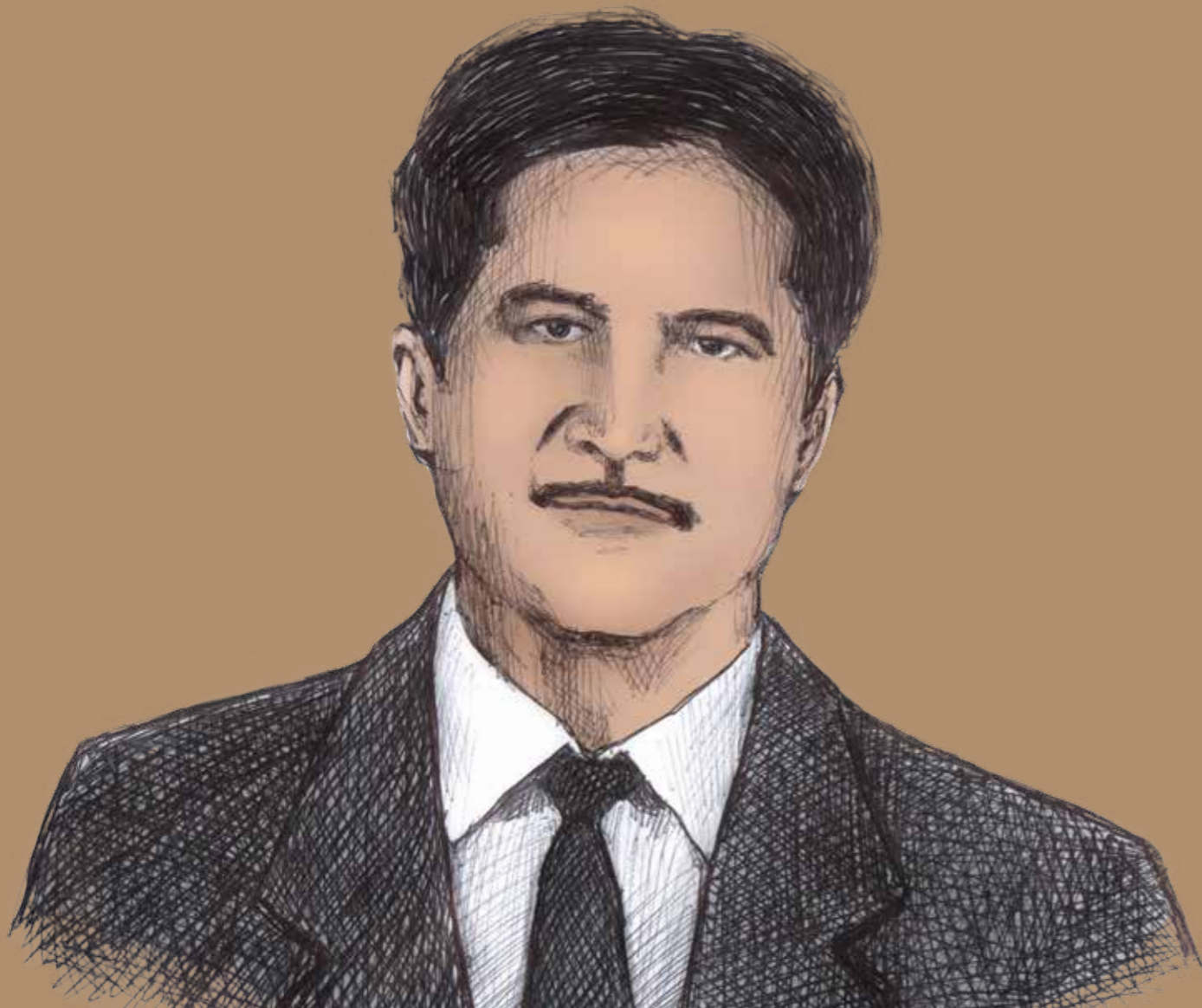
Yagub's voice. Concurrent to working at the Philharmonic Hall, Mammadov was also learning the secrets of mugham from the professional khananda Seyid Shushinski at the Baku Musical College named after Asaf Zeynally.

His tutor's favorite mugham "Chahargah" had a special place in his musical career. Being a highly cultured person with natural talent and singing ability, Mammadov was a real expert in terms of all mugham dastgahs as well as classical Azerbaijani poetry.

As a soloist of the Philharmonic Hall, he toured extensively and participated in many concerts. Several phonograph records with his voice were released. His performance of "Mansuriyya" has been etched permanently on the memory of mugham lovers.

Yagub Mammadov passed away on June 5, 2002.

**The source: "Medeniyyet" newspaper**

**ALIM GASIMOV**

The People's Artist of Azerbaijan, a world-renowned khananda and mugham master, Alim Hamza oghlu Gasimov was born in the village of Nabur of the Shamakhi region on August 14, 1957.

He studied mugham at the Baku Musical College named after Asaf Zeynally in 1978–1982 and at the Azerbaijan State Institute of Arts (now the Azerbaijan State University of Culture and Arts) during the period of 1983–1989.

He first appeared on national television in 1979, and already in 1982, he won the first Republican mugham contest. In 1983, he participated in the International Music Symposium held in Samarkand, Uzbekistan.

In 1989, he gave concerts in Moscow, Paris, Mone, Cologne, Boxum, West Berlin, Frankfurt, Basel, Geneva, Lie and Amsterdam and participated in festivals where he represented Azerbaijan's musical culture at its best. Since 1991, he has been a member of the Paris City Municipal Theatre ("Théâtre de la Ville").

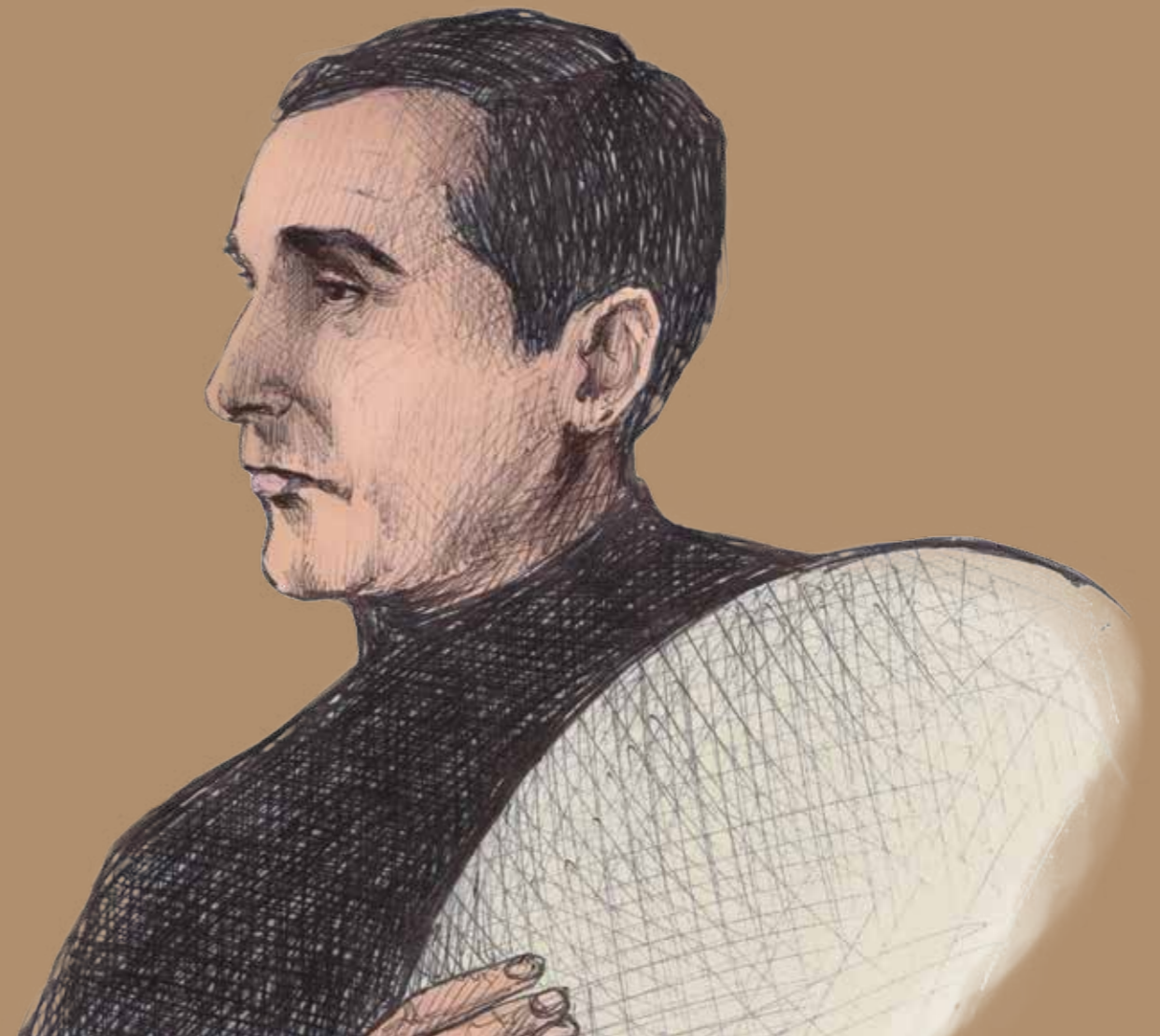
In 2000, Alim Gasimov's album titled "Love's deep ocean" was ranked 9th in the World Music Charts Europe and hit the radio airwaves in nearly fifty countries. The same year, the khananda was selected as a member of the European Rare Voices Assembly.

On May 26, 2012, the khananda shared the stage with Sabina Babayeva - the Azerbaijani entry at the Grand Finale of the 57th Eurovision Song Contest held in Baku.

As per the orders of President Ilham Aliyev, he was awarded with the "Shohrat" (Glory) Order in 2008 and "Sheref" (Honour) Order in 2017.

Currently, the khananda works at the Baku Musical College and is a soloist at the Azerbaijan State Academic Opera and Ballet Theatre.

**The source: "Medeniyyet" newspaper**





## 3. GOVERNANCE AND TRANSPARENCY

### 3.1. SOFAZ MANAGEMENT

#### SUPERVISORY BOARD

The Supervisory Board, consisting of representatives of the state authorities and public organisations, carries out general oversight of SOFAZ's operations. The Board reviews and evaluates SOFAZ's draft annual budget, annual report and financial statements, along with an audit report. Members of the Supervisory Board are approved by the President of the Republic of Azerbaijan. The board members act entirely on a voluntary basis.

Supervisory Board consists of the following members:

**Artur Rasizade\***

Prime Minister of the Republic of Azerbaijan

**Valeh Alesgerov**

Vice-Speaker of the Parliament (Milli Majlis) of the Republic of Azerbaijan

**Natig Amirov**

Assistant to the President for Economic Policy and Industrial Issues, Head of Department

**Samir Sharifov**

Minister of Finance of the Republic of Azerbaijan

**Shahin Mustafayev**

Minister of Economy of the Republic of Azerbaijan

**Elman Rustamov**

Chairman of the Central Bank of the Republic of Azerbaijan.

In 2017, the Supervisory Board of SOFAZ took a number of decisions regarding SOFAZ's activities.

The decision of the Supervisory Board of SOFAZ from May 1, 2017 approved SOFAZ's annual report for 2016 and the Independent Auditor's (PricewaterhouseCoopers) Report on SOFAZ's financial activities. The Supervisory Board recommended SOFAZ's

2016 budget execution project for the approval by the President of the Republic of Azerbaijan.

The adoption of the Law "On changes to the Law "On the state budget of the Republic of Azerbaijan for 2017" dated from June 30, 2017 made it necessary to review the budget of SOFAZ in accordance with the provisions made in the state and consolidated budgets. So, changes were introduced to the SOFAZ's 2017 budget with the decision of the SOFAZ's Supervisory Board effective from October 04, 2017. According to these changes, SOFAZ's revenues projection was increased from AZN 8 370 589.9 thousand to AZN 10 813 861.6 thousand, while the expenditures were revised from AZN 14 483 856.0 thousand to AZN 15 242 928.0 thousand. Documents pertaining to the changes to SOFAZ's budget, together with the Board's opinions, were recommended for approval by the President of the Republic of Azerbaijan.

A meeting of the Supervisory Board was held on December 25, 2017. At the meeting, the Board, having reviewed the SOFAZ's 2018 budget project as well as the data on SOFAZ's expenditures submitted by SOFAZ's Executive Director, recommended SOFAZ's 2018 draft budget, including the major directions of the use of SOFAZ's assets (including investment policy) and its draft operating expenditures plan for the approval by the President of the Republic of Azerbaijan. Upon reviewing the relevant information, the Board members also approved the proposed changes to SOFAZ's accounting policy and decided to recommend it for approval by the President of the Republic of Azerbaijan.

\* In accordance with the Order of the President of the Republic of Azerbaijan dated April 21, 2018, Novruz Mammadov was appointed as the Prime Minister of the Republic of Azerbaijan.

#### EXECUTIVE DIRECTOR

SOFAZ's day-to-day activities are managed by the Executive Director appointed by the President of the Republic of Azerbaijan. The Executive Director represents the Fund, appoints and dismisses employees of SOFAZ in a manner determined by the legislation, carries out operational management of SOFAZ's activities, ensures the management and investment of SOFAZ's assets in accordance with the Guidelines approved by the President of the Republic of Azerbaijan.

#### DEPUTY EXECUTIVE DIRECTOR

Deputy Executive Director is appointed by the President of the Republic of Azerbaijan. Israfil Mammadov was appointed as Deputy Executive Director of SOFAZ on July 23, 2013.

#### ADVISOR TO SOFAZ'S EXECUTIVE DIRECTOR

Advisor to SOFAZ's CEO is appointed by the Executive Director of SOFAZ. Nargiz Nasrullayeva-Muduroglu was appointed as Advisor to SOFAZ's CEO on July 6, 2017.

#### SOFAZ ORGANIZATIONAL STRUCTURE

Investment activity at SOFAZ is conducted by Investment Department, Risk Management Department and Settlements Department.

#### Investment Department

The Investment Department is responsible for developing investment strategy, investing across eligible asset classes, including fixed income, money market instruments, equity, real estate and gold.

The department has three divisions:

- Fixed income and money market division;
- Equity and alternative investment division;
- Real estate division.

#### Risk Management Department

The Risk Management Department is responsible for conducting relevant research for defining risk limits and providing proposals related to investment policy updates and benchmark selection. In addition, the responsibilities of this department also include, but are not limited to, assessment and management of risks related to traditional and alternative asset class investments, measuring the absolute and relative performance of investment portfolio, monitoring of compliance of SOFAZ's investment activities and its external managers to relevant regulations/mandates, and ensuring that the allocations of investment portfolio are in accordance with investment policy.

The department has two divisions:

- Quantitative solutions and performance measurement division;
- Alternative investments risk management division.

#### Settlements Department

Settlements department operates under the SOFAZ's Finance and Operations Administration.

The Settlements department is responsible for verifying trades with counterparties, settling trades with the custodian and correspondent banks, reconciling cash and transactions with statements from the banks, as well as reconciling external managers' transactions and positions.

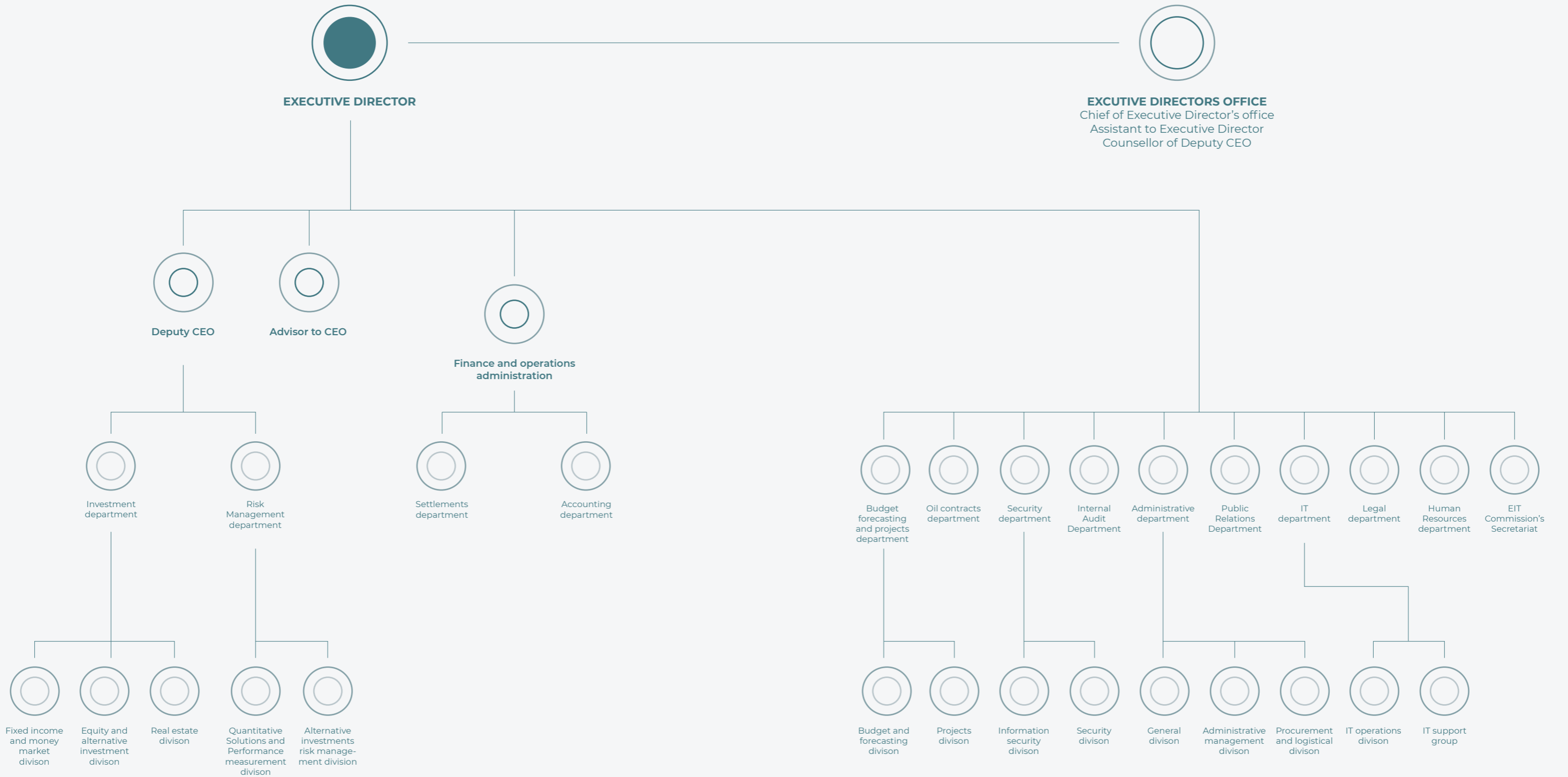
#### Budget Forecasting and Projects Department

The budget forecasting and projects department is responsible for forecasting SOFAZ's revenues and expenditures, organizing budgeting, conducting economic analysis, strategic research and macroeconomic modelling work, as well as organizing and supporting the activities of SOFAZ's Supervisory Board and the financing of fund-sponsored projects.

The department has two divisions:

- Budget and forecasting division;
- Projects division.

FIGURE 3.1. SOFAZ'S ORGANIZATIONAL STRUCTURE



## RULES OF ETHICAL CONDUCT

Rules of ethical conduct came into force in December 2013. This document outlines SOFAZ's attitude towards ethical behavior and professional conduct (confidentiality of information, anti-corruption measures, corporate values, environment etc.).

Attributes such as teamwork, enthusiasm, openness to new ideas and willingness to share experience play a crucial role in fostering ethical workplace culture at SOFAZ. These are the key factors which have contributed to the success of SOFAZ both in Azerbaijan and abroad.

## 3.2. TRANSPARENCY AND ACCOUNTABILITY

Transparency and accountability have been the key principles in SOFAZ's operations since its inception. Regular auditing of SOFAZ's financial statements by a reputable international audit firm is used as the primary safeguard to ensure the transparency of SOFAZ's operations. SOFAZ's financial performance in 2017 was audited by PricewaterhouseCoopers.

SOFAZ's public relations are managed in accordance with its Information Policy. SOFAZ's Information Policy has been developed in accordance with the Law of the Republic of Azerbaijan "On Obtaining Information" with the purpose of efficient management of SOFAZ's information exchange with stakeholders and the public and to protect and develop its transparent state entity reputation. Information Policy defines principles, purposes and objectives of the provision of information about its operations and activities to stakeholders and the public under the purposes and SOFAZ's objectives.

SOFAZ issues press releases about its assets, projects, revenues and expenditures, investment activity etc.

SOFAZ publishes quarterly revenue and expenditure statements through the press, its own website ([www.oilfund.az](http://www.oilfund.az)) and official pages in social media. It ensures the transparency of the revenues from the management of the natural reserves and their utilization.

In 2017, SOFAZ was one of the few SWF's ranked with highest points in "Linaburg-Maduell Transparency Index" that was developed by Carl Linaburg and Michael Maduell. "Linaburg-Maduell Transparency Index" consists of 10 principles and aims to increase transparency and accountability of the sovereign funds.

Press conferences with the participation of CEO are held for media representatives in order to keep them updated on SOFAZ's activities.

SOFAZ always takes an interest in answering questions of public, and replies to all verbal and written Fund-related enquiries directed to SOFAZ within the timeframe envisaged by the "Law of the Republic of Azerbaijan on Right to obtain information".

SOFAZ's Executive director is the Chair of Extractive Industries Transparency Commission (EITC). More detailed information on EITC's activity can be accessed through the following link: [http://www.oilfund.az/uploads/final\\_eit\\_report\\_2018\\_website.pdf](http://www.oilfund.az/uploads/final_eit_report_2018_website.pdf).

## INTERNATIONAL FORUM OF SOVEREIGN WEALTH FUNDS

The International Forum of Sovereign Wealth Funds (IFSWF or Forum) was established by the International Working Group of Sovereign Wealth Funds, at the meeting in Kuwait on April 5-6, 2009. IFSWF is a voluntary group of Sovereign Wealth Funds (SWFs), which meets, exchanges views on issues of common interest, and facilitates an understanding of the Santiago Principles and SWF activities.

SOFAZ is an active member of IFSWF and has systematically participated in its meetings. IFSWF held its first meeting in Baku organized by the government of Azerbaijan and SOFAZ on October 8-9, 2009.

On September 5-7, 2017, Samruk-Kazyna, one of Kazakhstan's sovereign wealth funds, hosted 9th annual meeting of IFSWF in Astana, Kazakhstan. This event gathered delegates of financial and development institutions and nearly 90 leaders representing IFSWF's 32 members. Entitled "Exploring New Frontiers", the event featured panel discussions on the key issues facing the investment landscape of 2017 and in-depth talks from leading international speakers.

In accordance with Santiago Principle No. 24, SOFAZ published its first self-assessment report on its adherence to these Principles in May 2011. This report is reviewed on an annual basis and is presented in the Appendix.



Classical  
music

CLASSICAL MUSIC REFERS TO THOSE COMPOSITIONS THAT HAVE SURVIVED THROUGH THE TIMES AND BECOME HISTORY. NEVERTHELESS, MODERN SOCIETY CONTINUES TO PRESERVE, LOVE AND LISTEN TO THEM. ANTONIO VIVALDI, JOHANN SEBASTIAN BACH, GEORGE FRIDERIC HANDEL, JOSEPH HAYDN, WOLFGANG AMADEUS MOZART, LUDWIG VAN BEETHOVEN, FRÉDÉRIC CHOPIN, RICHARD WAGNER, GIUSEPPE VERDI, PYOTR ILYICH TCHAIKOVSKY, ANTONÍN DVOŘÁK, SERGEI RACHMANINOFF, FELIX MENDELSSOHN, RICHARD STRAUSS, JOHANNES BRAHMS AND GEORGES BIZET ARE AMONG THE MOST FAMOUS AND INFLUENTIAL CLASSICAL MUSIC COMPOSERS OF ALL TIME.

Music has come a long way of development to reach our days. The major time divisions distinguished in the evolution of classical music until the 20th century include Medieval, Renaissance, Baroque, Classical and Romantic eras. Each of these eras is characterized by specific styles and genres.

The 20th century is an important milestone in the history of both Western and Azerbaijani classical music. This period is notable in Azerbaijan for a foundation of a highly-professional composer school based on traditions of European classical music but distinguished by its original style. Founded by the great composer Uzeyir Hajibeyli, professional classical music in Azerbaijan was promoted by a new generation of composers and performers. Each decade was remarkable by the expansion of the scope of composers' creative endeavours and emergence of new genres and trends. The development of the leading European music trends – neoclassicism, dodecaphony and serialism in Azerbaijan led to stunning discoveries in the world of art. Most importantly, Azerbaijani music gained popularity far beyond the borders of the country. Stage, symphonic, chorus and even small volume compositions of our composers were increasingly being performed on international scenes. This great success is primarily attributed to the creative work of three outstanding artists – Gara Garayev (1918–1982), Fikret Amirov (1922–1984) and Niyazi (1912–1984). Gara Garayev produced beautiful pieces of classical music including ballets “Yeddi gozel” (Seven Beauties) and “İldirimli yollarla” (The Path of Thunder), a symphonic poem “Leyli and Majnun”, “Albanian Rhapsody”, world-renowned symphonies and other symphonic compositions. These works brilliantly embody the synthesis of national and classical music and are considered unique examples of Azerbaijani classical music. The founder of the symphonic mugham genre in Azerbaijan, Fikrat Amirov authored symphonic mughams “Shur” and “Kurd Ovshari”, the ballet “Min bir gece” (One Thousand and One Nights), opera “Sevil”, which are genuine masterpieces of Azerbaijani classical music. A holder of Jawaharlal Nehru Award, Béla Bartók Medal and numerous international awards, Niyazi was unquestionably one of the greatest musical conductors and composers of our time. His ballet “Chitra”, symphonic mugham “Rast” and other classical music compositions played a big role in the development of our music and they are still popular around the globe.

1930s–1940s witnessed an outbreak and rise of Azerbaijani classical music composers such as Said Rustamov (1907–1983) and Tofiq Guliyev (1917–2000). S.Rustamov's songs (“Alagoz” (Green-eyed), “Gurban adina” (For your sake), “Gelmedin” (You didn't come), “Surayya”, “Oxu tar” (Sing, tar) etc.) and T.Guliyev's compositions that embrace Azerbaijani folk music traditions and European pop and jazz music elements (“Sene de galmaz” (Your beauty won't last forever), “Gizil uzuk” (Golden ring), “Bekhtever oldum” (I got lucky), “Bakı haggında mahni” (A song about Baku), “Zibeyda”) are distinct illustrations of Azerbaijan's classical music heritage. The outstanding composers including Jovdat Hajiyev (1917-2002), Jahangir Jahangirov (1921-1992), Rauf Hajiyev (1922-1995), Agshin Alizada (1937-2014), Emin Sabitoglu (1937-2000), Azer Rzayev (1930-2015), Arif Malikov (1993), Tofiq Bakikhanov (1930) and Khayyam Mirzazade (1935) have created astounding music and hence made valuable contributions to the world's treasury of classical music.

The source: The Mirza Fatali Akhundov Azerbaijan National Library

## 4. NATIONAL ECONOMY AND SOFAZ

### 4.1. MACROECONOMIC DEVELOPMENT

**Global economy.** The 70% decrease in the global oil prices observed in 2014-2016 turned out to be one of the biggest price shocks of the recent decades. However, owing to the demand rebound started in early 2016, production decrease policies pursued by the OPEC members and non-member oil producers, and a range of other factors, a certain price recovery took place (23.8% in 2017). Thus, a barrel of crude oil reached the levels above USD 60 by the end of 2017.

A pronounced fall in the oil prices, that resulted in significantly decreased incomes from oil sales, prompted oil exporter countries to pursue important reforms. Among these countries, those with fiscal buffers, flexible exchange rate policy and more diversified economies were especially successful. According to

the World Bank (WB) estimates, the average Gross Domestic Product (GDP) growth among the net exporters of natural resources constituted 1.8% in 2017.

Overall, the whole global economy experienced positive trends in 2017. On the background of the favourable state of the global financial market, development-oriented economic policies and stabilizing natural resource prices, the global GDP rose by 3%, outperforming both the GDP growth rate of 2016 (2.4%) and the annual forecast updated in June 2017 (2.7%). Thus, the GDP growth amounted to 2.3% and 4.3% in the developed countries and the Emerging Markets and Developing Economies (EMDEs) group, respectively. The widespread character of economic revival and acceleration of growth in majority of countries around the world were among hot topics of economic forums and analyst reports throughout 2017.

### ECONOMIC REACTION OF THE RESOURCE EXPORTING COUNTRIES TO THE OIL PRICE FALL

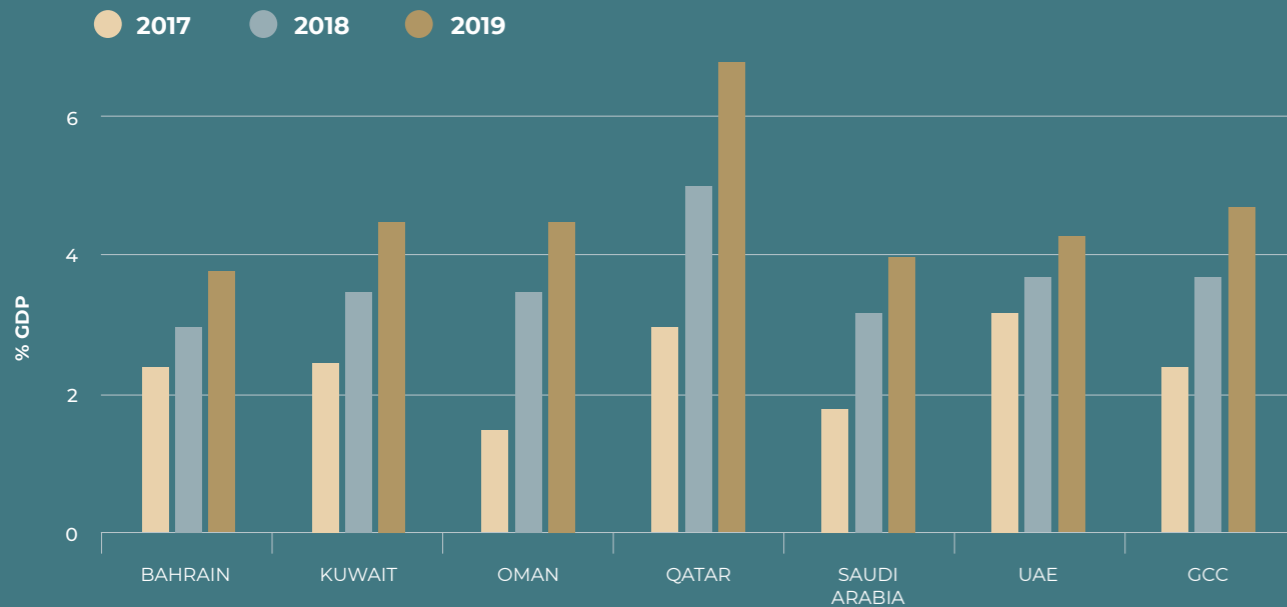
The decrease in the prices of oil and other natural resources, that had been unfolding since June 2014 up to January 2016, was accompanied by an unexpected slowdown of the global economic growth. At the same time, the deceleration of investment growth rate by half, compared to 2012, made a significant negative contribution to the economic activity. After the initial slowdown in the trade turnover, decrease in investment and efficiency growth followed suit. These processes affected not only resource exporters, but also hindered development of many other economies.

On average, countries with floating exchange rate regimes (Russia and Albania) and relatively more diversified economies (Malaysia, Qatar, Bahrain) fared better in terms of coping with the crisis than those that fix their currencies and receive larger shares of their incomes from the resource sector. Furthermore, the countries of the former group did not experience a dramatic deterioration of fiscal balances since their currencies' timely devaluation helped to assuage the effects of falling budgetary incomes and made it easier for the private sector to adapt to the new circumstances.

As the initial shock of the crisis settled down, some of the large resource-exporting countries started to prepare medium- and long-term development plans which envisaged the reforms capable of decreasing the dependence on energy sector. The program called "100 concrete steps", adopted in Kazakhstan in 2015, pursues the goals of stimulating economic diversification and improving competitiveness and transparency. The measures taken with these very purposes in different countries include giving more flexibility to labour markets, supporting foreign direct investment, increasing capital investment and improving the overall business framework. The decision to collect a 5% value-added tax made by the oil-rich states of the Gulf region was meant to boost non-oil fiscal incomes. At the same time, majority of developing oil exporter countries decreased energy subsidies during the period of 2014-2016. In many countries (such as Algeria, Angola and Saudi Arabia), social insurance mechanisms were strengthened in order to protect the vulnerable social strata from the negative effects of the crisis.

Among the numerous attempts to overcome resource dependence, Saudi Arabia's "Saudi Vision 2030" plan can be distinguished for the strategic approach it takes. Aiming to turn the Kingdom into a global investment giant, this program puts such targets as transforming Saudi Arabia's Public Investment Fund into the largest sovereign wealth fund in the world, implementing the most cutting-edge and innovative technologies, and undertaking a profound reform of public services. "Saudi Vision" pays special attention to the quality of public expenditures. Current investment policies, mechanisms of investment adoption and their real economic value are being reviewed. Special project management units have been created in order to conduct evaluation of the public agencies based on the "Performance Measurement Program".

NON-RESOURCE SECTOR GROWTH FORECAST FOR THE GULF COUNTRIES



Source: 'Oxford Economics' and 'Haver Analytics'

Finally, it should be mentioned that the crisis has revealed weaknesses in fiscal policies of resource-abundant countries. For example, fiscal rules capable of mitigating the influence of resource cycles on economic activity and state budget exist only in fourth of the oil exporting countries. Moreover, some countries did not manage to conform to the fiscal rules they adopted (for example, Nigeria) or had to change them, like Russia, in order to increase public spending. This examples show that maintaining long-term budget sustainability requires more robust and efficient fiscal frameworks.

The WB forecasts predict global growth to remain sustainable throughout several following years and even emphasize the probability of its acceleration due to economic breakthroughs in resource exporter countries. However, significant downside risks to growth posed by the possibility of falling productivity, sudden reversals of financial and asset markets, and the lack of fiscal sustainability persist. The WB recommends paying special attention to structural economic policies in order to avoid macroeconomic pitfalls, secure stable growth and further improvements in living standards.

According to the WB, the global economy is expected to grow by 3.1% in 2018 (2.2% for the developed countries and 4.5% for EMDEs). The International Monetary Fund (IMF), taking a more optimistic approach, forecasts the growth of 3.9% (2.3% in the developed world and 4.9% in EMDEs). For Azerbaijan, the WB predicts a modest annual economic growth of 0.9% in 2018 (1.3% according to the IMF) and 2.6% in 2020.

**National economy and SOFAZ.** In accordance with its purposes and responsibilities, SOFAZ maintained accumulation and management of the incomes stemming from the execution of the oil and gas contracts, and secured macroeconomic and fiscal stability of the country in 2017. Higher than forecasted average oil prices throughout the reference year, as well as execution of SOFAZ's expenditures at the lower than expected level resulted in SOFAZ's budget profit, savings and increase in SOFAZ's assets.

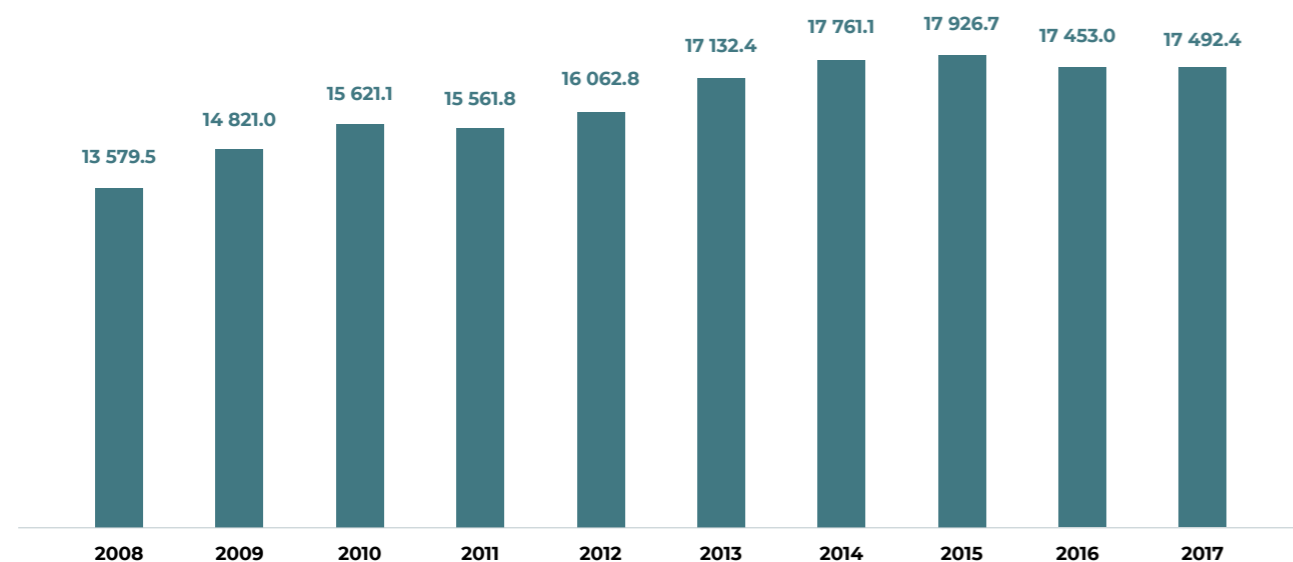
The "regulated floating regime" of the manat announced by the Central Bank of the Republic of Azerbaijan (CBAR), crude oil prices in the commodity markets, and the country's balance of payments were the major factors influenced the manat's exchange rate in 2017. In late January 2017, USD appreciated against manat from 1.77 to 1.92, but then fell again and leveled at 1.70-1.72 throughout the rest of the year. The average annual inflation in Azerbaijan is estimated at 12.9%. GDP of Azerbaijan rose to AZN 70 135.1 million in nominal figures, while its growth constituted 0.1% in real terms (-3.1% in 2016 and 1.1% in 2015).

In 2017, GDP per capita constituted AZN 7 205, having declined by 0.9% since the previous year, while GDP per capita adjusted to purchasing power parity (PPP), as estimated by the IMF, amounted to USD 17 492. The nominal income of the population rose by 8.3%, compared to 2016, reaching AZN 49 162.9 million. The income per capita increased by 7.2% and reached AZN 5 050.5, whereas the average nominal monthly salary rose by 6.2%\* up to AZN 525.0\*.

After all mandatory and voluntary disbursements, the overall disposable income of the population amounted to AZN 44 983.3 million, or 8.5% higher than in 2016 in nominal terms. 62.8% of the country's GDP fell into the share of the non-oil sector.

\* In January-November 2017

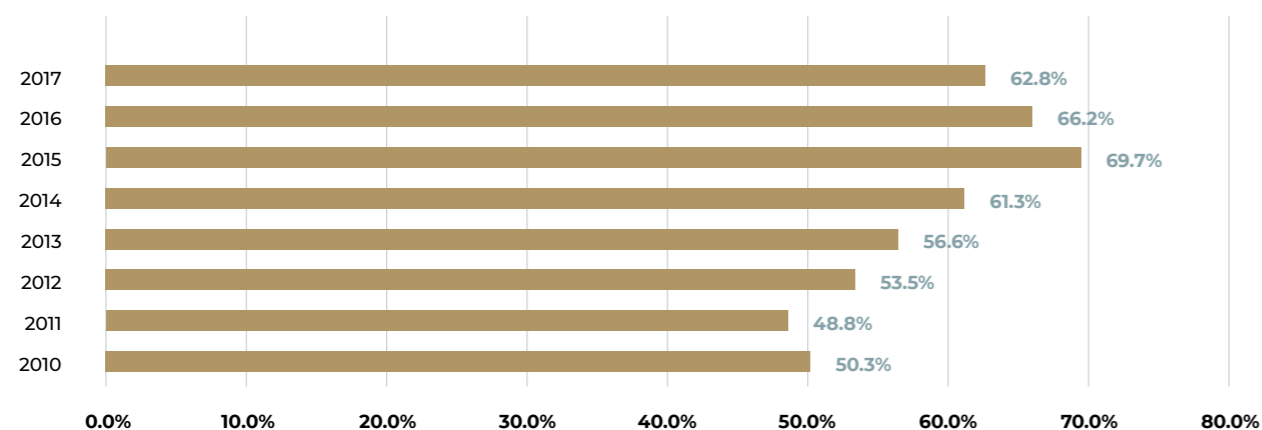
**CHART 4.1.1.** GDP PER CAPITA ADJUSTED TO PURCHASING POWER PARITY (IN CURRENT INTERNATIONAL DOLLARS)



Source: IMF

GDP of Azerbaijan in 2017 had the following structure: 55.2% was attributable to the production of goods, 37.5% - to services, while net taxes on goods and imports accounted for the remaining 7.3%. Compared to 2016, the production of value-added in the non-oil sector increased by 2.7% in real terms, while the respective indicator in the oil sector did not change.

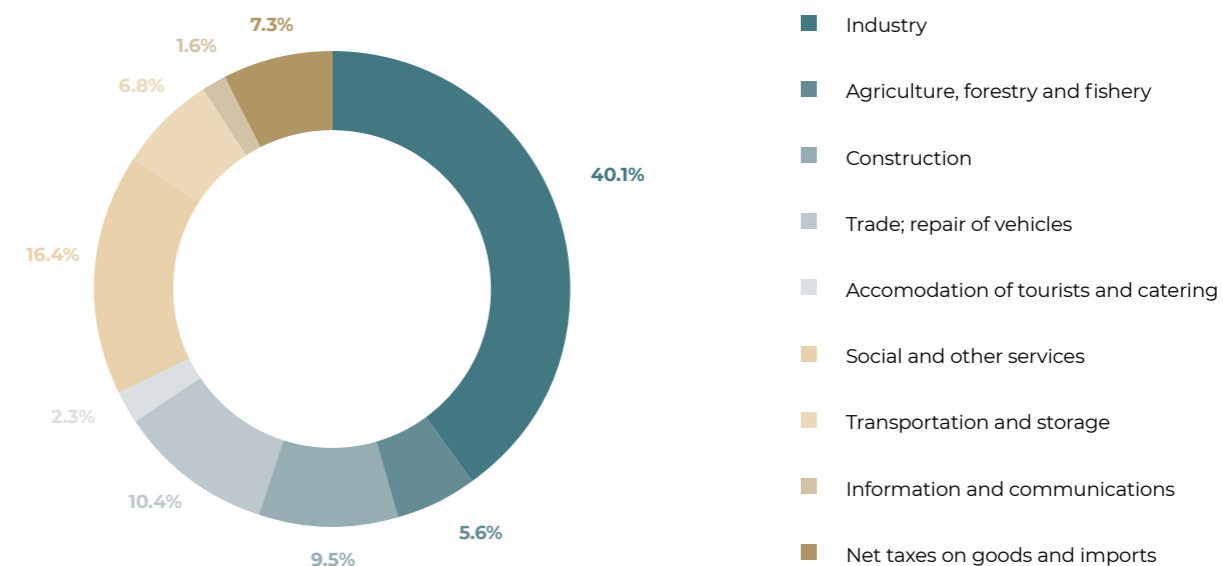
**CHART 4.1.2.** THE SHARE OF NON-OIL SECTOR IN THE COUNTRY'S GDP



Source: The State Statistical Committee of the Republic of Azerbaijan (SSC of Azerbaijan)

In the reference year, industrial sector continued playing a leading role in the Azerbaijani economy with its share in GDP amounting to 40.1%. At the same time, the services sector preserved its relative stability.

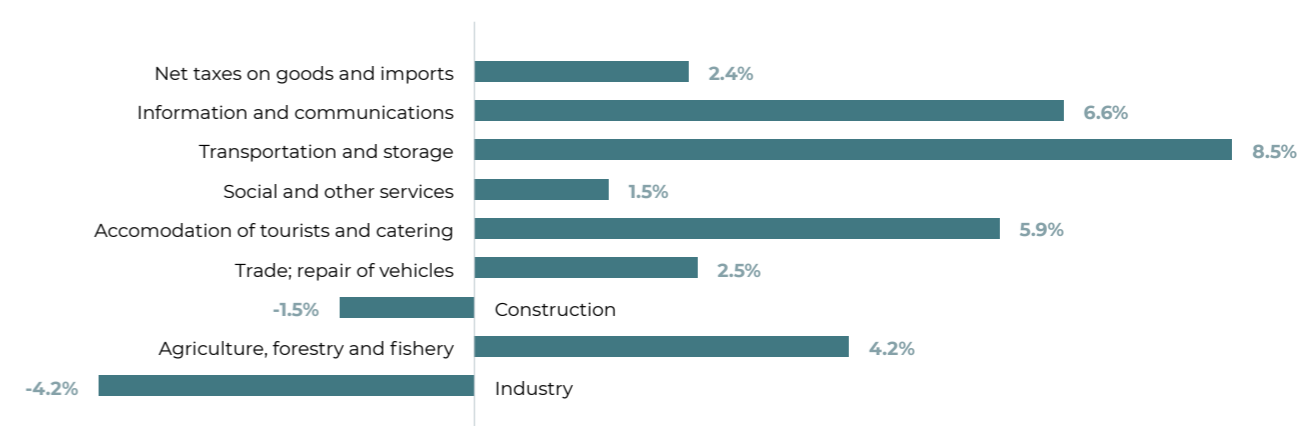
**CHART 4.1.3.** THE GDP STRUCTURE



Source: SSC of Azerbaijan

In 2017, real growth was registered in most sectors of the Azerbaijani economy. Progress in information and communications (6.6%), tourism and catering (5.9%) and agriculture (4.2%) spheres deserves special attention, since they were prioritized as main drivers of economic development. It is also worth noting that the steep decline observed in 2016 in the construction sector, important in terms of economic activity and employment, virtually stopped.

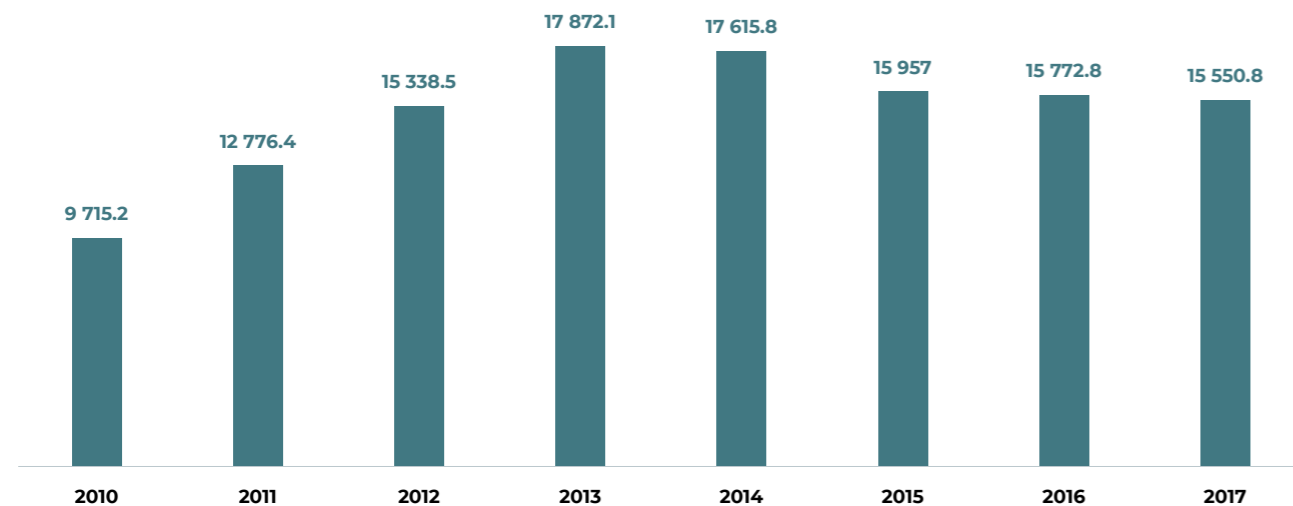
**CHART 4.1.4.** SECTORAL GROWTH RATES



Source: SSC of Azerbaijan

In the reference year, the amount of capital investment declined by 2.6% in real terms, compared to the 2016 figures, and totalled AZN 15 550.8 million. The shares of domestic and foreign investment in this total were 44.6% and 55.4% respectively, and 73.6% of this amount was spent on the execution of construction and installation works.

**CHART 4.1.5.** DYNAMICS OF CAPITAL INVESTMENT MADE IN AZERBAIJAN (MILLION AZN)



Source: The Ministry of Economy of the Republic of Azerbaijan

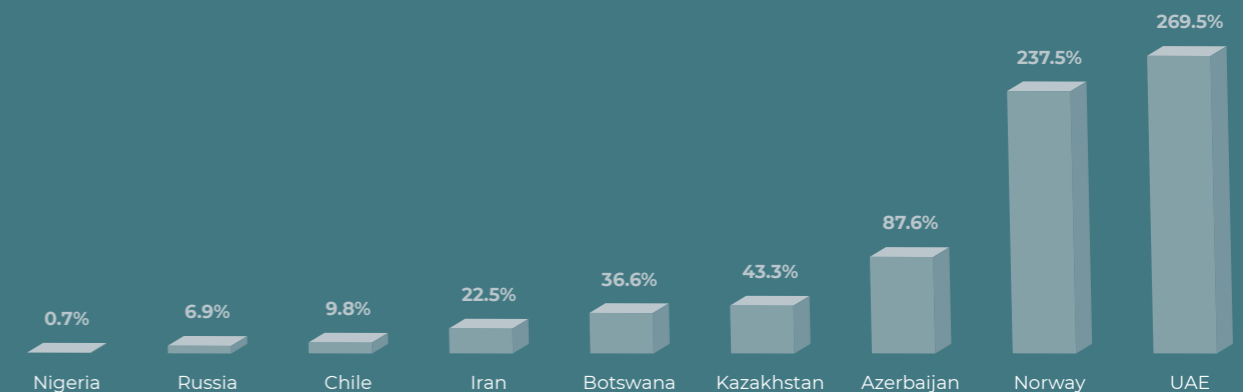
## STRATEGIC CURRENCY RESERVES

By December 31, 2017, the country's strategic currency reserves (SOFAZ and CBAR combined) reached USD 41 141.1 million, 87% thereof falling into the share of the SOFAZ's assets.

## RATIOS OF SOVEREIGN FUNDS' ASSETS TO THEIR COUNTRIES' GDP

By the end of 2016, a ratio of assets of reserve funds to GDP in Russia and Kazakhstan constituted 6.9% and 43.3%, respectively. In terms of this ratio, Azerbaijan (87.6%) is sufficiently ahead of both of them. At the same time, the SOFAZ's assets are sufficient to cover imports of goods and services for two years, which is higher than the respective indicator for Kazakhstan, Iran, Russia, Chile and some other resource-abundant countries.

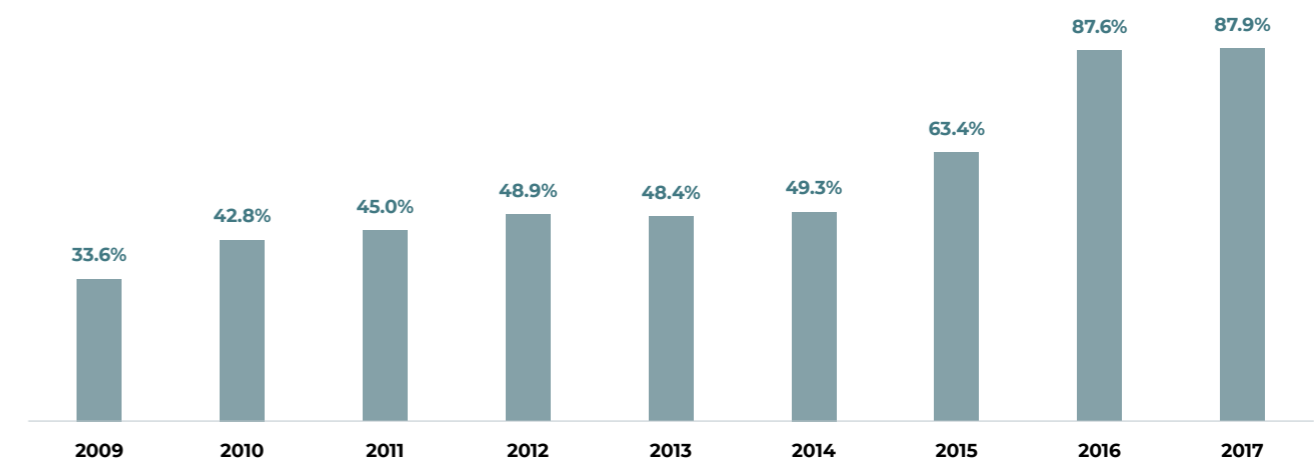
## RATIOS OF SOVEREIGN FUNDS' ASSETS TO THEIR COUNTRIES' GDP, BY THE END OF 2016



Source: IMF, SWFI

As in the preceding years, 2017 witnessed an increase in the ratio of the SOFAZ's assets to GDP. In US dollar terms, this figure reached 87.9%.

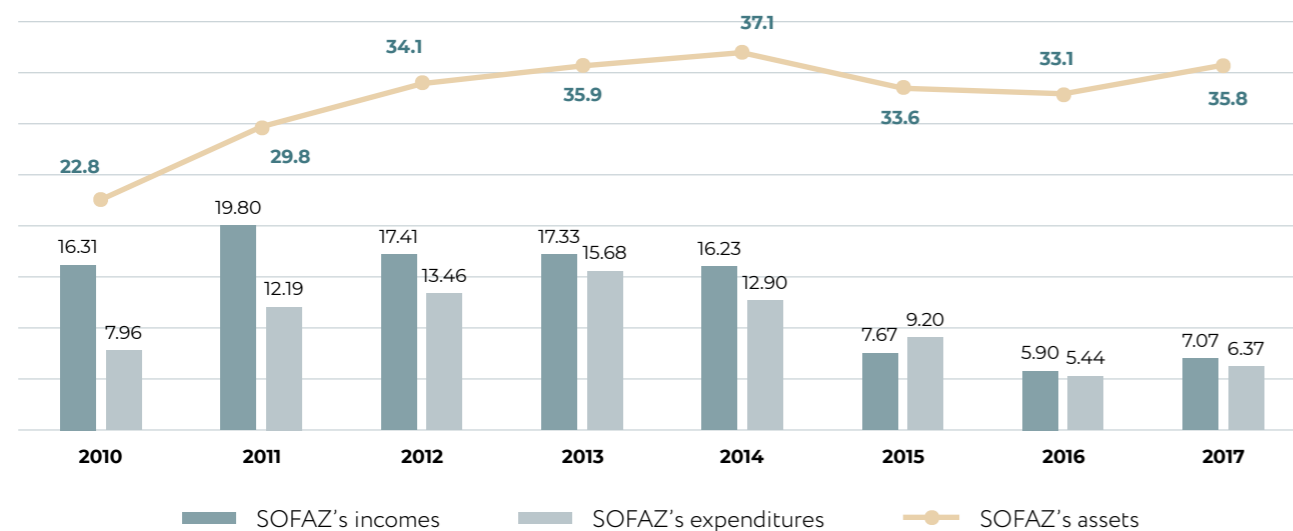
**CHART 4.1.6.** SOFAZ'S ASSETS-TO-GDP RATIO



Sources: SOFAZ, SSC of Azerbaijan

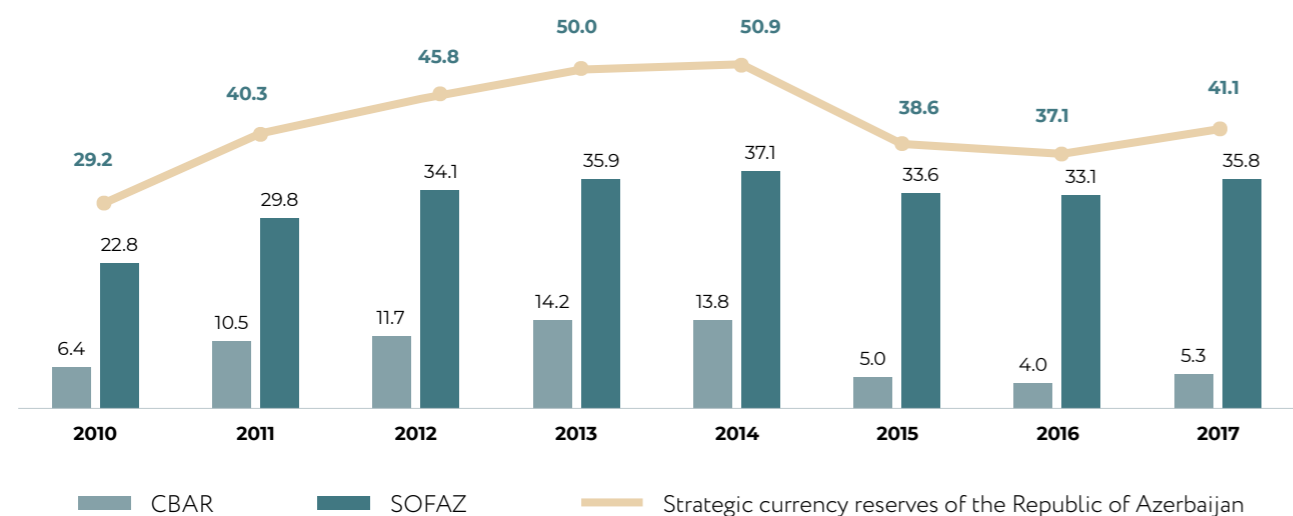
For obvious reasons, the dramatic decline of global oil prices during 2014-2016 exerted a negative influence on the SOFAZ's incomes, which equaled only USD 5.9 billion in 2016, in contrast to USD 16.2 billion in 2014. This trend resulted also in the decrease of the SOFAZ's assets, which fell from the then-peak level of USD 37.10 billion at the end of 2014 to USD 33.15 billion in 2016. However, positive dynamics in the SOFAZ's assets rebounded in 2017, when the annual income of SOFAZ equaled USD 7.1 billion and the total assets under management reached USD 35.8 billion.

CHART 4.1.7. SOFAZ'S INCOMES, EXPENDITURES AND ASSETS (USD BILLION)



Furthermore, official currency reserves of CBAR rose by USD 1.36 billion (34.2%) to reach the level of USD 5 334.6 million in 2017. Thus, the aggregate volume of the strategic currency reserves (SOFAZ and CBAR combined) amounted to USD 41.14 billion.

CHART 4.1.8. FOREIGN EXCHANGE RESERVES OF THE REPUBLIC OF AZERBAIJAN (BILLION USD)



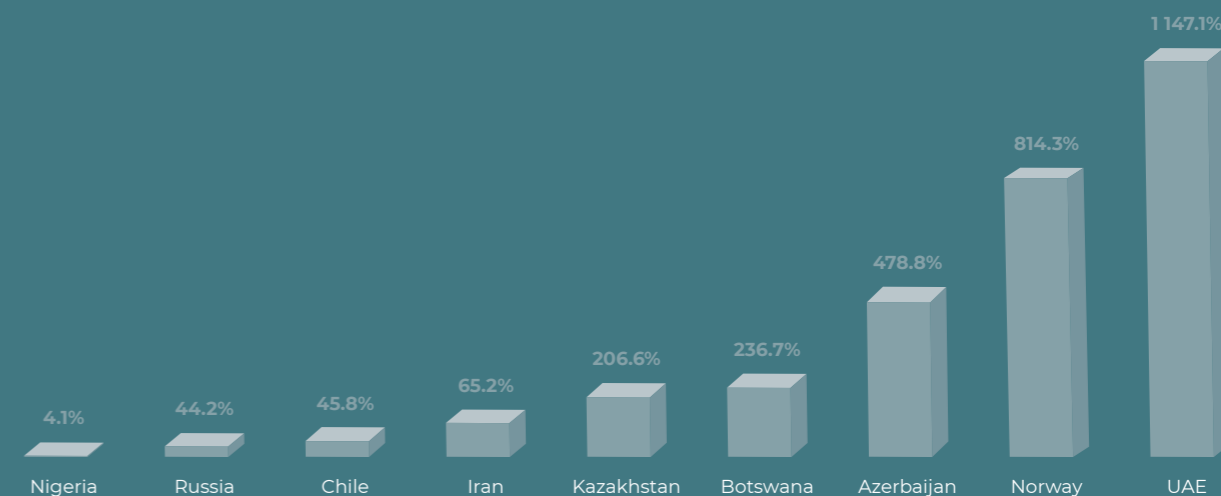
Source: SOFAZ and CBAR

## SECURING FISCAL SUSTAINABILITY

In 2017, SOFAZ played a big role in preserving fiscal balance of Azerbaijan. Thus, AZN 6.1 billion or 37.1% of the state budget incomes were formed out of the transfer from SOFAZ. By providing timely payments to the state budget regardless of prevailing oil prices and absorbing external economic shocks during the periods of low oil prices, SOFAZ has managed to secure fiscal stability in the country. At the same time, the measures financed from SOFAZ's transfers to the Central Bank with the purposes of preserving macro-economic stability helped to achieve stability in the currency market during the year.

The accumulation of reserves in SOFAZ has also contributed to financial stability and low indebtedness. Thus, according to the 2016 year-end data, the SOFAZ's assets surpassed the public debt by 4.8 times. On this indicator, Azerbaijan performed approximately 11 times better than Russia, where the respective ratio was 44.2%, and more than twice better than Kazakhstan (206.6%).

### RATIO OF THE SWF RESERVES TO GROSS PUBLIC DEPT (2016)



Source: IMF, SWFI



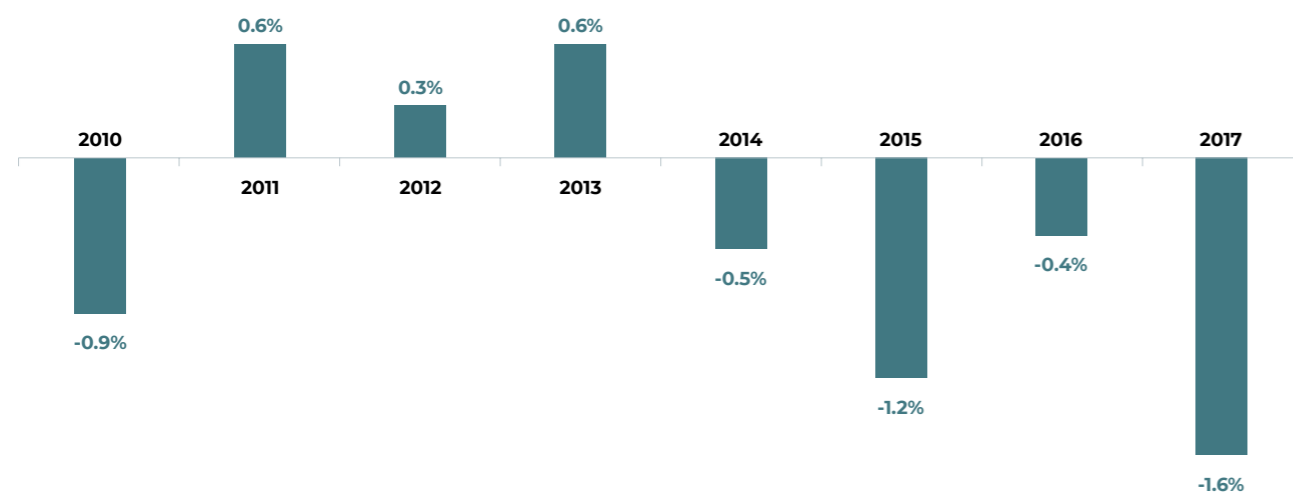
SWF RESERVES PER CAPITA (THOUSAND USD, 2016)



Source: IMF, SWFI

Revenues and expenditures of the state budget amounted to AZN 16 446.9 million and AZN 17 588.4 million, respectively, whereas 37.1% of the budgetary revenues (AZN 6 100.0 million) were attributed to the transfer from SOFAZ. The state budget deficit in 2017 totalled -1.6% of the country's GDP (AZN 70 135.1 million).

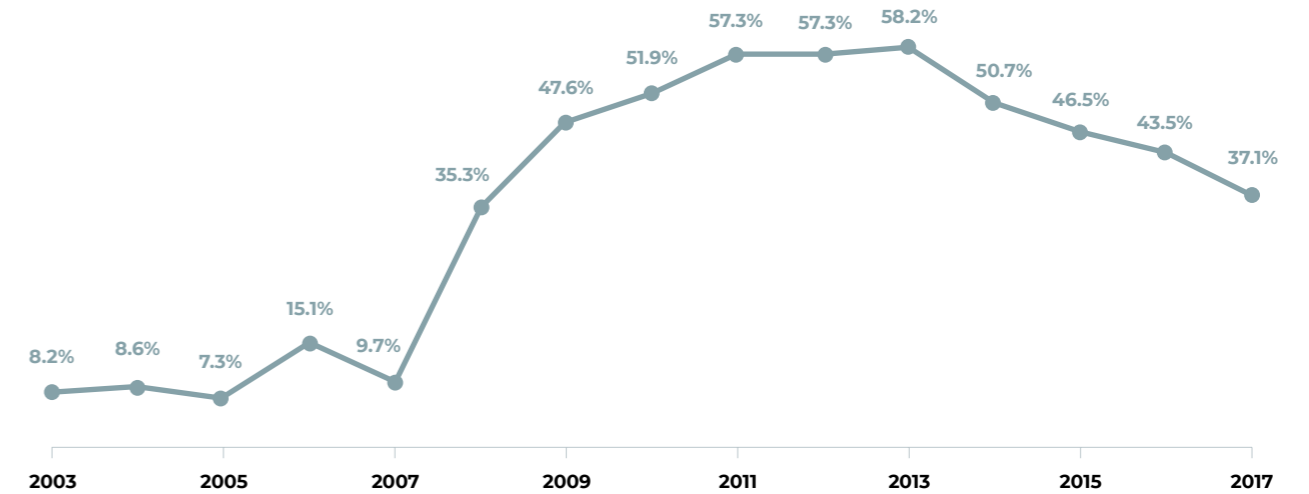
CHART 4.1.9. STATE BUDGET DEFICIT/PROFICIT IN 2010-2017 (SHARE OF GDP)



Source: CBAR and the Law of the Republic of Azerbaijan on state budget execution for 2016

During the period from 2003 to 2017, the cumulative transfer from SOFAZ to the state budget has reached AZN 77.6 billion.

CHART 4.1.10. SHARE OF THE SOFAZ'S TRANSFERS IN THE STATE BUDGET REVENUES

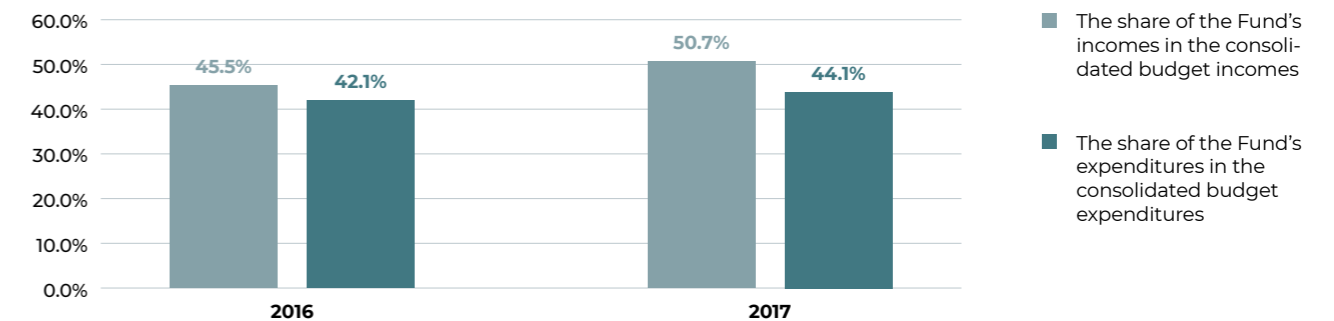


Source: SOFAZ, SSC of Azerbaijan

The average annual price of profit oil of USD 52.9, along with the higher than projected SOFAZ's revenues from the asset management, as expressed in manat, was the reason why the SOFAZ's actual incomes in 2017 exceeded the level confirmed in the budget plan by 12.2%. Furthermore, since SOFAZ's budget expenditures were executed only at 72.3% of the projected amount, the SOFAZ's budget registered a surplus by the end of the year. During the 2001-2017 period, the inflows to SOFAZ constituted USD 137.87 billion, while approximately USD 35.8 billion (26%) has been channeled into saving.

**The consolidated budget deficit when excluding SOFAZ.** Apart from the state budget, budgetary revenues and expenditures of SOFAZ comprised a considerable part of the consolidated budget revenues and expenditures in 2017. According to the Ministry of Finance of the Republic of Azerbaijan, revenues and expenditures of the consolidated budget in 2017 amounted to AZN 23 951.6 million and AZN 24 982.6 million, respectively. Out of these, 50.7% of the revenues and 44.1% of the expenditures came from the SOFAZ's budget.

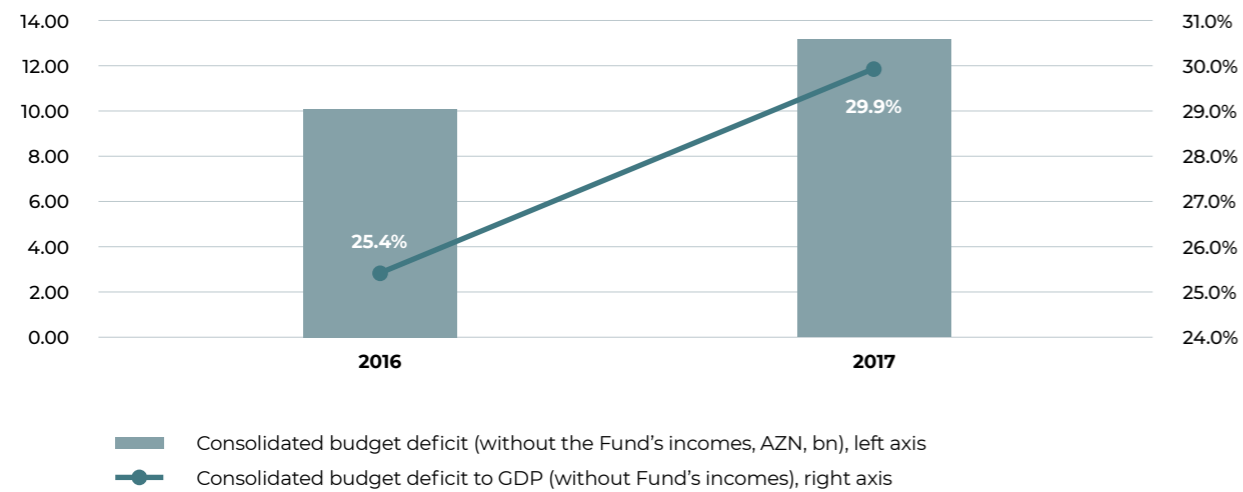
CHART 4.1.11. THE SHARE OF THE OIL FUND'S INCOMES AND EXPENDITURES IN THE CONSOLIDATED BUDGET



Sources: SOFAZ and Ministry of Finance of the Republic of Azerbaijan

At the same time, when excluding SOFAZ's incomes, the consolidated budget deficit in the reference year equaled AZN 13.17 billion, which amounted to 18.78% of GDP and 29.9% of non-oil GDP.

**CHART 4.1.12.** CONSOLIDATED BUDGET DEFICIT WITHOUT THE OIL FUND'S INCOMES

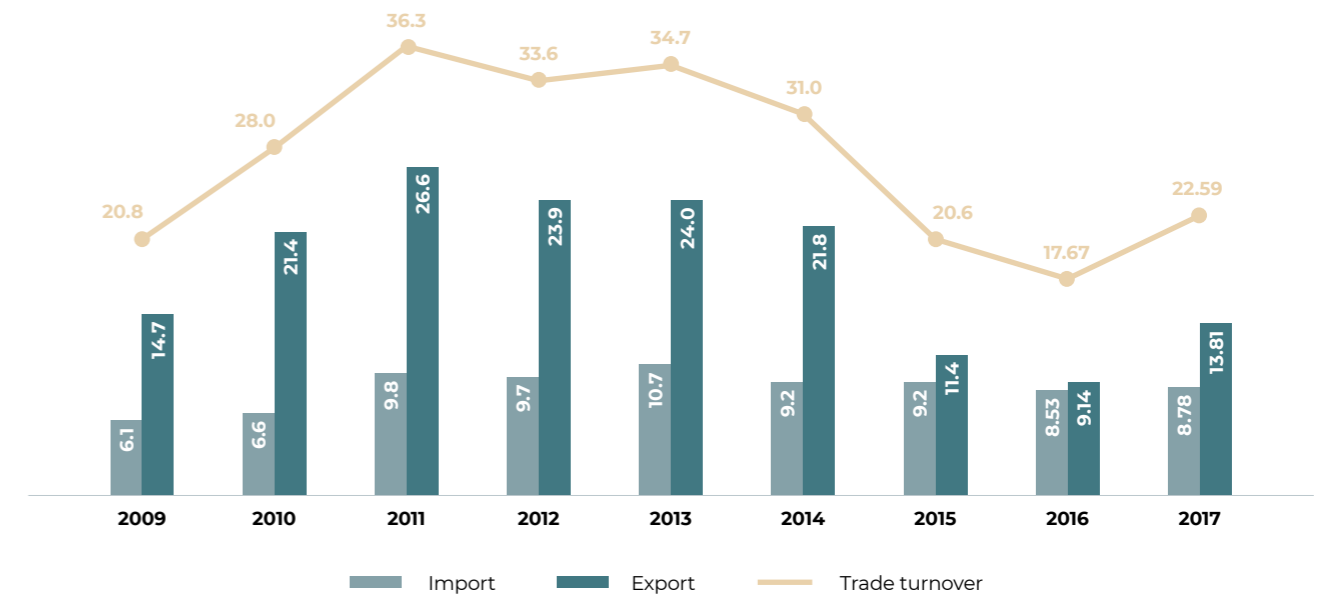


Source: SOFAZ, SSC of Azerbaijan, the Ministry of Finance of the Republic of Azerbaijan

## FOREIGN TRADE

According to the State Customs Committee of the Republic of Azerbaijan, the country's foreign trade turnover in the reference year amounted to USD 22.59 billion, with the exports and imports constituting USD 13.81 billion and USD 8.78 billion, respectively. During 2017, an increase by 27.8% in the volume of foreign trade turnover was observed, while exports rose by 51.1% and the imports increased by 2.9%.

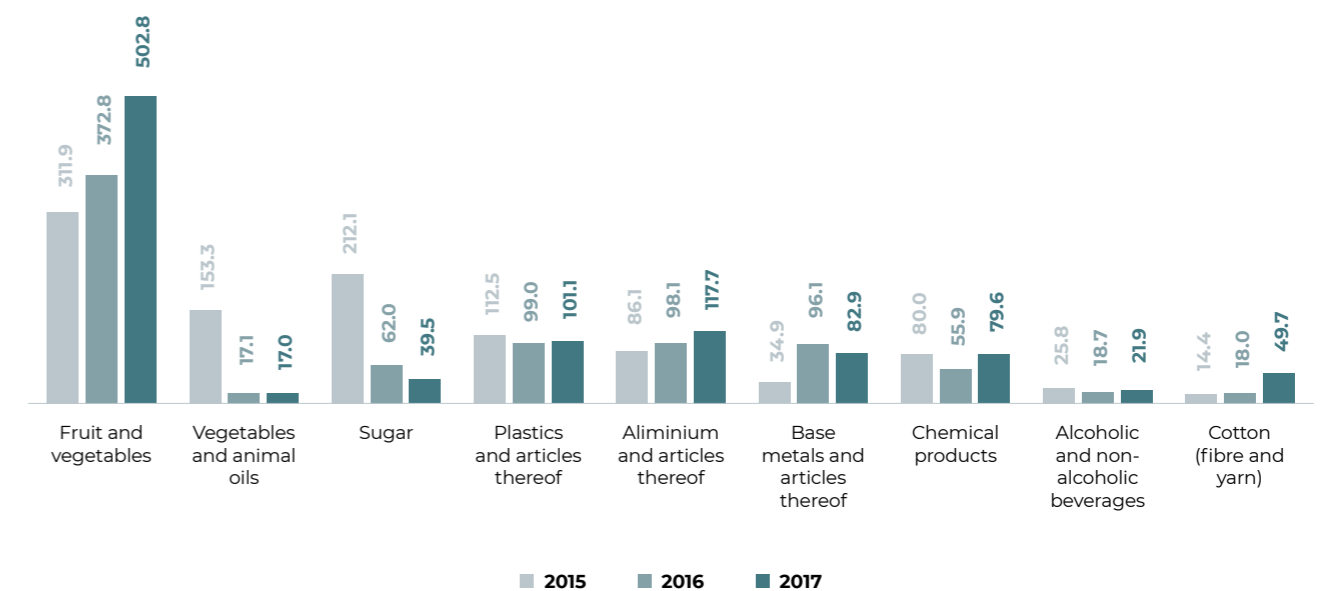
**CHART 4.1.13.** FOREIGN TRADE TURNOVER (USD BILLION)



Source: The State Customs Committee of the Republic of Azerbaijan

Non-oil sector export. In 2017, non-oil export mainly consisted of fruit and vegetables, plastics, sugar, aluminium, base metals and items made of them and chemical products. As the Chart 4.1.14. illustrates, a significant increase in the export of fruit, vegetables, and cotton was observed, while other items mainly experienced a decrease in export volumes.

**CHART 4.1.14.** MAJOR NON-OIL GOODS EXPORT (USD MILLION)

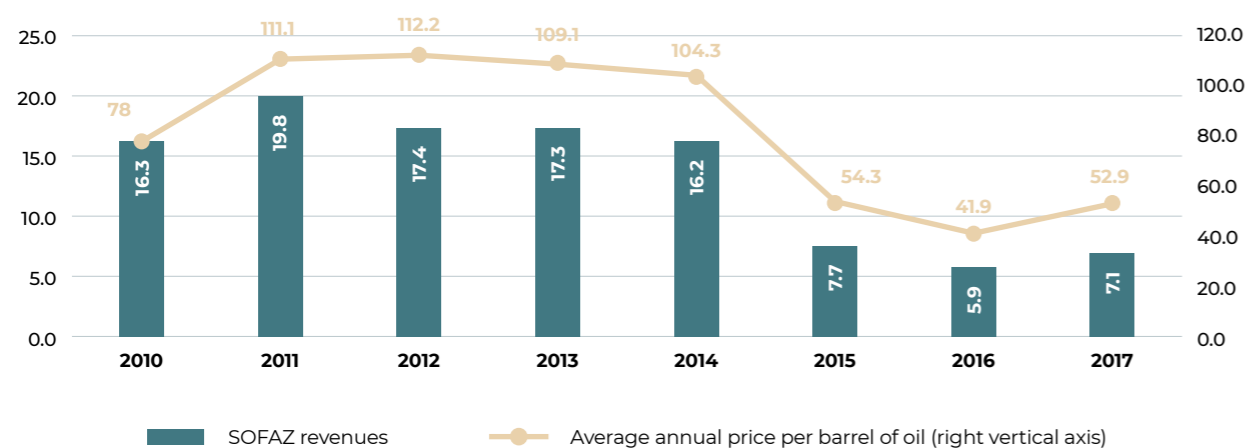


Source: The State Customs Committee of the Republic of Azerbaijan

#### 4.2. SOFAZ'S REVENUES

In 2017, SOFAZ's revenues obtained from the sales of the Republic of Azerbaijan's share of hydrocarbons rose compared to 2016 in virtue of increase in the average annual price of crude oil from USD 41.9 in 2016 to USD 52.9. In the reference year, the sources of the SOFAZ's budget revenues included proceeds from the sales of the Republic of Azerbaijan's share of hydrocarbons, bonus payments, acreage fees, the fees paid to Azerbaijan for the transit of oil and gas through its territory, and revenues from the management of SOFAZ's assets. By the end of 2017, the overall revenues from these sources recorded a total of AZN 12 137.5 million or USD 7 065.5 million. In 2017, the SOFAZ's revenues increased by 19.9% in US dollar terms, compared to the previous year's results.

CHART 4.2.1. SOFAZ REVENUES (IN USD BILLION) AND OIL PRICE (IN USD) DYNAMICS

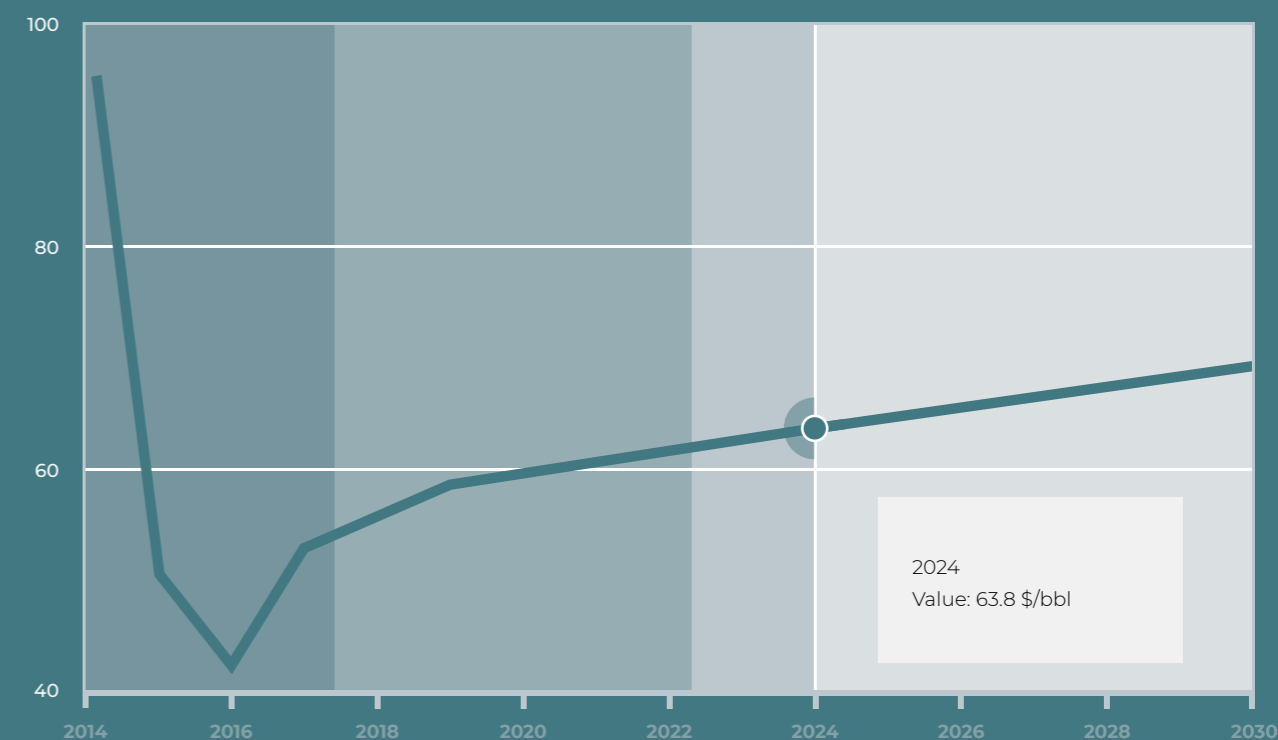


**Proceeds from the sales of profit oil and gas.** In 2017, proceeds to the SOFAZ's budget from the sale of profit oil and gas constituted AZN 11 030.0 million or USD 6 409.6 million.

#### OIL PRICES IN 2018 AND AFTERWARDS

The WB and IMF slightly differ in their oil price forecasts for 2018. In the bulletin issued in January 2018, IMF predicted the annual average price of oil to rise by 11.7% compared to 2017, while the WB expects the growth of only 9.4%. It should be noted that the current price level better aligns with the WB's forecast of USD 53 published in the beginning of 2017, in contrast to USD 50 projected by IMF.

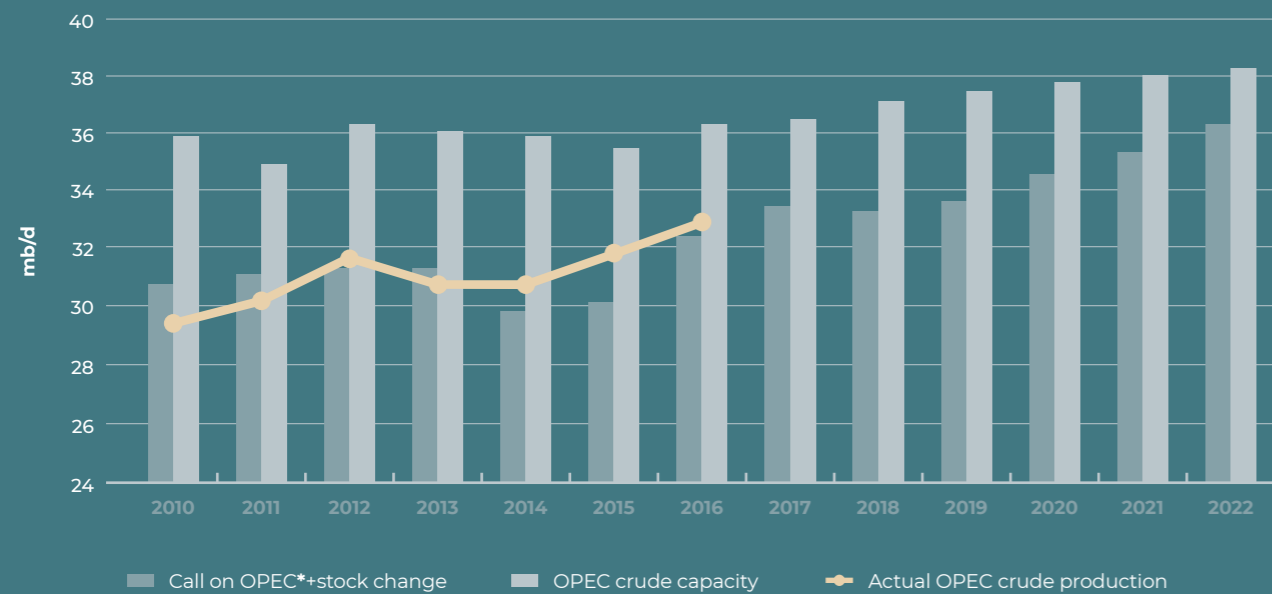
CHART 1. PRICE PER BARREL FORECAST (IN USD)



Source: World Bank

At the same time, volatility of the oil prices and the very approximate character of any forecasts given are emphasized in a range of reliable sources. Traders believe that the price per barrel may fluctuate within a vast band from USD 40 to USD 85 due to existence of both optimistic and pessimistic views on the directions of oil prices.

CHART 2. OIL MARKET DYNAMICS



\* oil production volume required to balance the global supply and demand for crude oil

Source: International Energy Agency

Improvements in technological efficiency of crude oil and gas production may cause a decline in the break-even price that renders the extraction of the shale oil in the US profitable. Yet, some analysts forecast that, despite a certain stagnation in oil demand in the OECD countries, the markets of developing countries will ensure an increase of global oil demand by 1.4 million barrels per day by 2022. Further, the important role of the OPEC agreement on production limits, recently observed underinvestment in the oil sector, as well as the stabilization of US shale oil production, are also highlighted in favor of oil price increase. Moreover, it is claimed that the failure of some producer countries to comply fully with the OPEC agreement is offset by a gradual production decline observed in Mexico and Venezuela, as well as periodic interruptions happening in Libya and Nigeria. Finally, the value of US dollar also indirectly impacts oil prices: since most oil exporters peg their currencies to the dollar, the target oil price level exporters are seeking depends on the fluctuation in the exchange rate of US dollar.

In accordance with the Production Sharing Agreements (PSA) that regulate oil production both onshore and offshore, 97.4% of the revenues generated from the sales of profit oil and gas in 2017 came from the sale of oil and gas extracted from the Azeri-Chirag-Gunashli (ACG) field. Hence, in the reference year, a profit of USD 6 241.2 million and USD 135.6 million were received from ACG and Shah Deniz (gas condensate sales)

fields, respectively, and the remaining USD 32.8 million was earned from the sales of oil extracted from other oil fields. In accordance with the gas sales agreements between SOCAR (representing the Republic of Azerbaijan) and buyers within the framework of the Shahdeniz Stage 1 project, SOCAR purchased the excess natural gas over the agreed annual level for USD 227.2 million, which was not transferred to SOFAZ.

CHART 4.2.2. STRUCTURE OF SOFAZ'S REVENUES IN 2017, USD MILLION

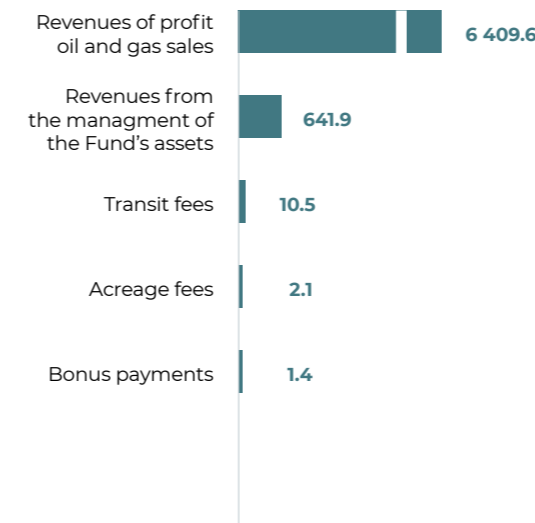
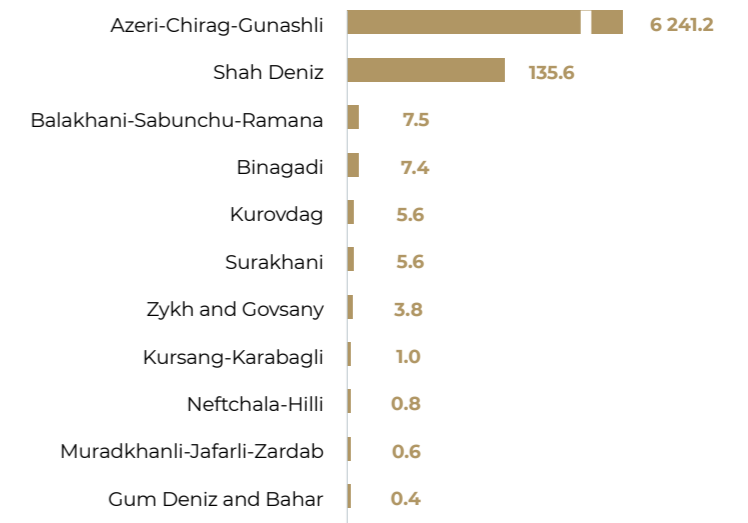


CHART 4.2.3. DISTRIBUTION STRUCTURE OF THE INFLOWS FROM THE SALES OF PROFIT OIL AND GAS, 2017 (USD MILLION)



**Revenues from the asset management.** In 2017, SOFAZ's assets were invested in fixed income (debt and money market instruments), equities, real estate and gold. SOFAZ's revenues from asset management totaled USD 641.9 million or AZN 1 083.6 million. The annual rate of return from SOFAZ's investment portfolio constituted 2.32%, while the same indicator without gold amounted to 1.88%.

**Transit fees.** In 2017, another revenue inflow was generated from the transportation of oil and gas through the territory of Azerbaijan (transit fees). The amount of transit fees transferred to the Fund's budget constituted AZN 17.9 million or USD 10.5 million. Detailed decomposition of the above mentioned income item is provided in the Table 4.2.1.

TABLE 4.2.1. SOFAZ'S PROCEEDS FROM THE TRANSIT FEES IN 2017

Transferor party	Date	Amount, million	
		USD	AZN
AIOC	11.01.2017	0.8	1.51
AIOC	13.02.2017	0.8	1.32
AIOC	13.03.2017	1.0	1.72
AIOC	13.04.2017	1.0	1.76
AIOC	12.05.2017	0.9	1.54
AIOC	13.06.2017	1.1	1.80
AIOC	12.07.2017	1.1	1.84
AIOC	14.08.2017	0.8	1.38
AIOC	12.10.2017	0.9	1.52
AIOC	13.11.2017	1.1	1.79
AIOC	13.12.2017	1.0	1.74
<b>Total</b>		<b>10.5</b>	<b>17.92</b>

**Revenues related to acreage fees.** In 2017, a sum of USD 2.1 million (AZN 3.6 million) of acreage fees was transferred to SOFAZ in accordance with the offshore exploration and production sharing agreement between SOCAR and the oil company co-owned by SOCAR and BP Exploration Limited (Azerbaijan) over the Shafag-Asiman field in the Azerbaijani sector of the Caspian Sea. Acreage fees per company are represented in the Table 4.2.2.

**TABLE 4.2.2. PROCEEDS FROM ACREAGE FEES IN 2017**

Transferor party	Oil field	Date	Amount, million	
			USD	AZN
BP Exploration (Azerbaijan)	Shafag-Asiman	19.06.2017	2.1	3.61
<b>Total</b>			<b>2.1</b>	<b>3.61</b>

**Bonus payments.** In the reference year, SOFAZ's revenues from bonuses paid by investors for signing and fulfilling oil and gas contracts amounted to AZN 2.41 million or USD 1.4 million. Bonus payment inflows are represented in the Table 4.2.3.

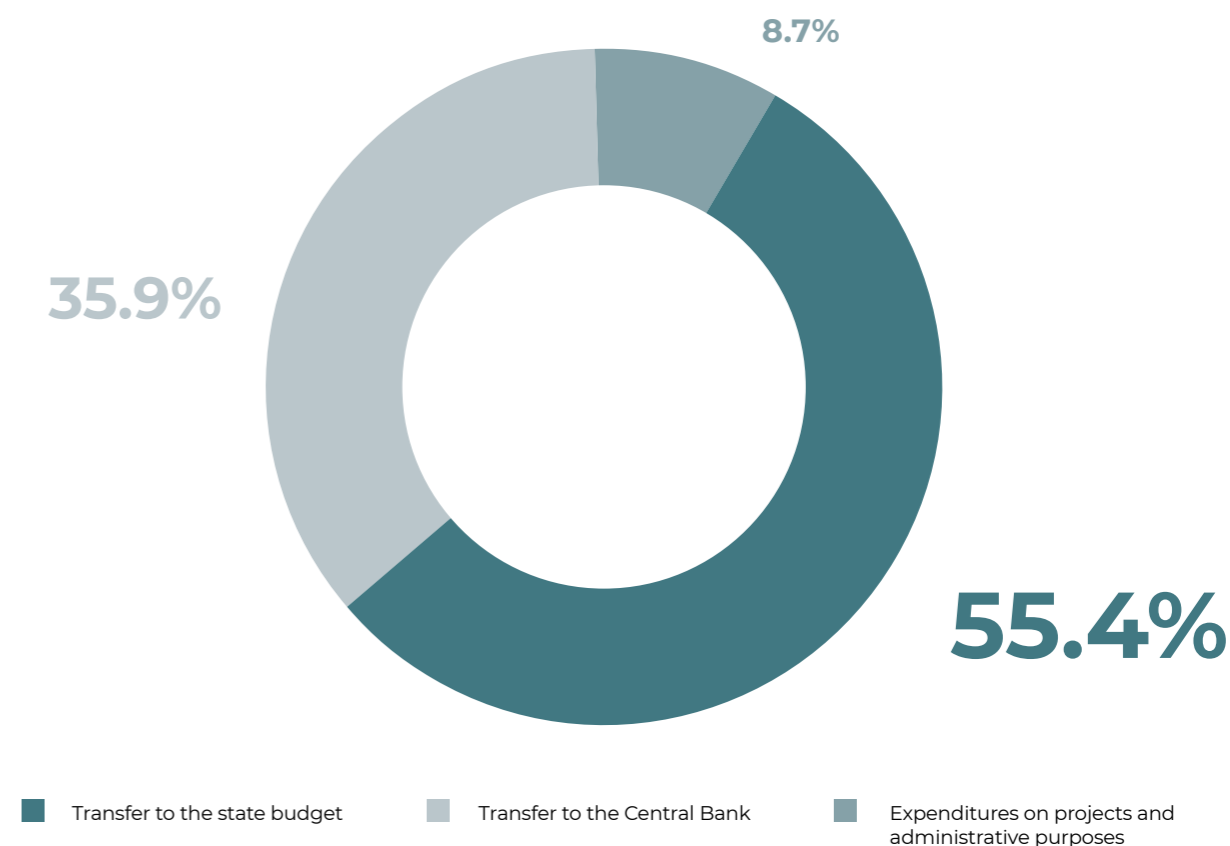
**TABLE 4.2.3. SOFAZ'S PROCEEDS FROM BONUS PAYMENTS IN 2017**

Transferor party	Oil field	Date	Sum	
			USD thousand	AZN thousand
BP Exploration (Azerbaijan) Limited	Shah Deniz	27.01.2017	25.96	49.51
Lukoil Overseas Shah Deniz Limited	Shah Deniz	30.01.2017	9.01	17.27
Turkish Petroleum Overseas Company Limited	Shah Deniz	30.01.2017	17.11	32.79
Petronas	Shah Deniz	30.01.2017	13.96	26.75
NICO	Shah Deniz	31.01.2017	9.01	17.26
<b>Total</b>	Absheron	24.04.2017	<b>886.67</b>	<b>1 509.28</b>
Engie	Absheron	12.05.2017	443.33	754.78
<b>Total</b>			<b>1 405.05</b>	<b>2 407.64</b>

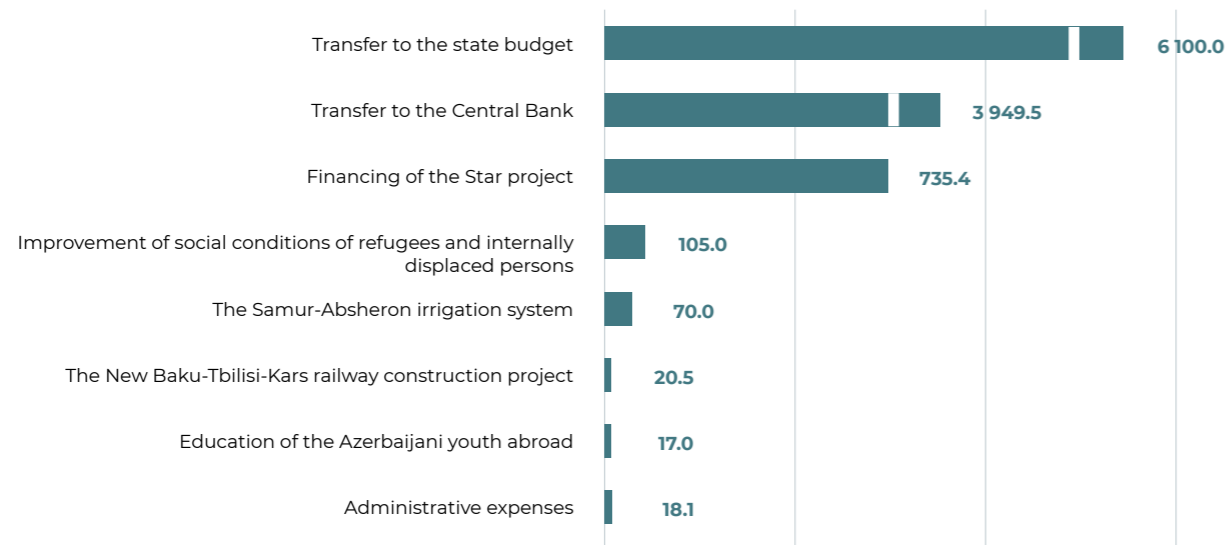
### 4.3. SOFAZ'S EXPENDITURES

In 2017, SOFAZ's expenditures were equal to AZN 11 015.5 million or USD 6 373.4 million. 55.4% of the total expenditures accrued to the annual transfer to the state budget, 35.9% fell into the share of the transfer to CBAR, 8.6% - to the projects and state programs financed from SOFAZ's budget, while SOFAZ's administrative expenses constituted the remaining 0.1%. The breakdown of the SOFAZ's expenditures is provided in the Chart 4.3.2.

**CHART 4.3.1. STRUCTURE OF THE SOFAZ EXPENDITURES**



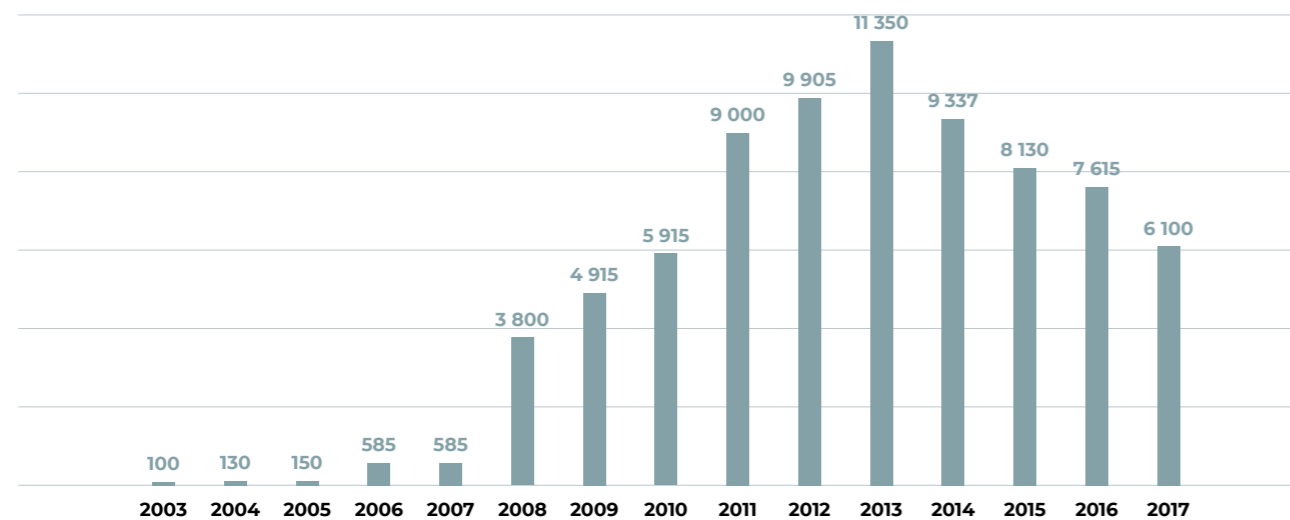
**CHART 4.3.2. STRUCTURE OF THE SOFAZ EXPENDITURES IN 2017, AZN MILLION**



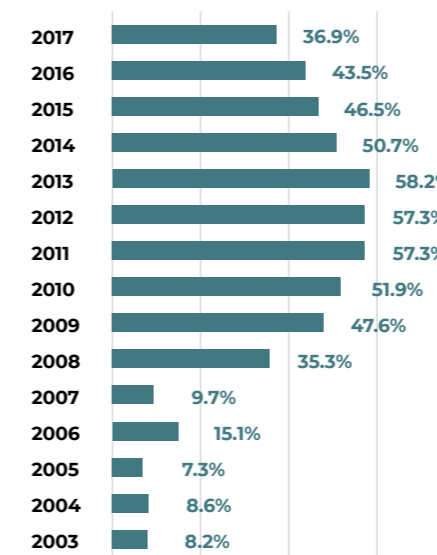
**Transfer to the state budget.** In the reference year, the amount of transfer to the state budget constituted AZN 6 100.0 million, 20.0% or AZN 1 515 million lower than in 2016. The breakdown of the budget transfer throughout the years, as well as the share of the transfer in the overall budgetary incomes and expenditures, is demonstrated in the Charts 4.3.3., 4.3.4 and 4.3.5.

Throughout 2003-2017, the overall transfer from SOFAZ to the state budget amounted to AZN 77.62 billion or 85.7% of SOFAZ's cumulative budgetary expenditures during the same period. In 2017, the transfer from SOFAZ to the state budget comprised 36.9% and 34.7% of the state budget revenues and expenditures, respectively.

**CHART 4.3.3. TRANSFER TO THE STATE BUDGET BY YEARS (AZN MILLION)**



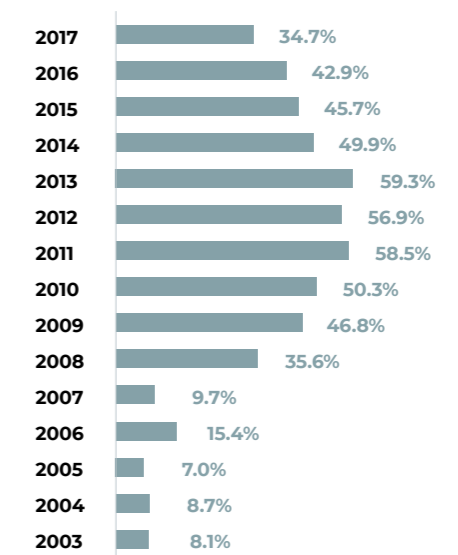
**CHART 4.3.4. TRANSFER FROM SOFAZ AS A SHARE OF THE STATE BUDGET REVENUES**



Source: CBAR, SSC of Azerbaijan

**Upper limit of the transfer to CBAR for the purposes of preserving macroeconomic stability.** Financing of this spending item has been executed in accordance with the Clause №4 of the Decree of the President of the Republic of Azerbaijan from December 27, 2016 on the implementation of the "Law of the Republic of Azerbaijan on the state budget for 2017". This clause charged the Financial Stability Council with the task of confirming "The action plan on preserving macroeconomic and financial stability in 2017 and in the medium term" and maintaining the execution of the envisioned measures. The

**CHART 4.3.5. TRANSFER FROM SOFAZ AS A SHARE OF THE STATE BUDGET EXPENDITURES**



Source: CBAR, SSC of Azerbaijan

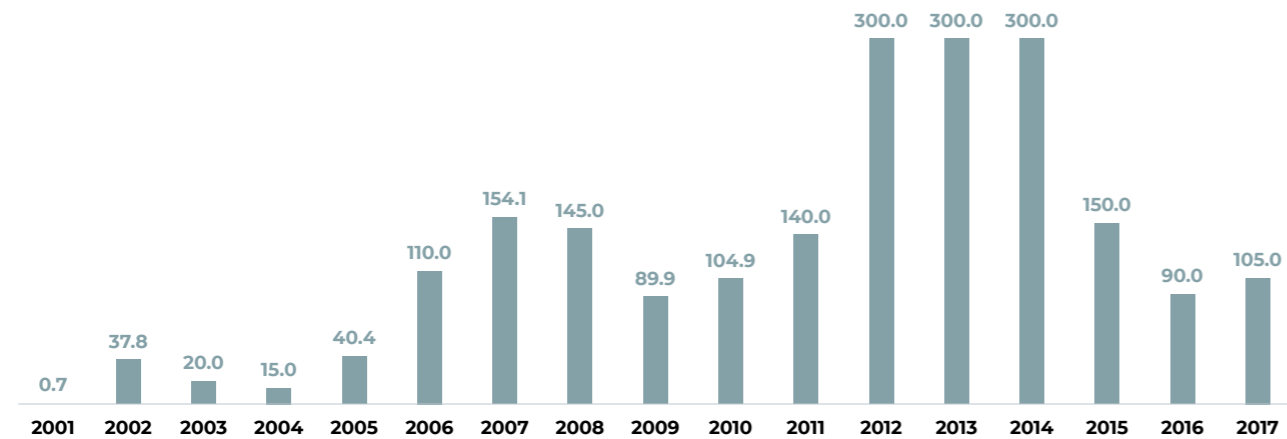
Council's decision as of December 29, 2016 stipulated an upper limit of USD 3.5 billion to the transfer from SOFAZ to the Central Bank in order to secure the resolution of certain foreign currency liabilities outside of the macroeconomic framework. A respective expenditure item was included into SOFAZ's 2017 budget as confirmed by the Presidential Decree on SOFAZ's budget for 2017, with the upper limit of AZN 7 500.0 million. In the reference year, AZN 3 949.5 million or USD 2 263.0 million was transferred from SOFAZ to CBAR within the framework of the aforementioned budgetary item.

## FINANCING SOCIAL AND INFRASTRUCTURE PROJECTS

SOFAZ plays a significant role in financing social and infrastructure projects of strategic national importance.

**The improvement of the socio-economic conditions of refugees and internally displaced persons.** The sponsoring of "The State Program on the improvement of the socio-economic conditions of refugees and internally displaced persons" by SOFAZ continued in 2017 as well. Overall, AZN 2 102.8 million has been spent on this program since 2001 (Chart 4.3.6). More specifically, the amount allocated to this program constituted AZN 105 million in the reference year.

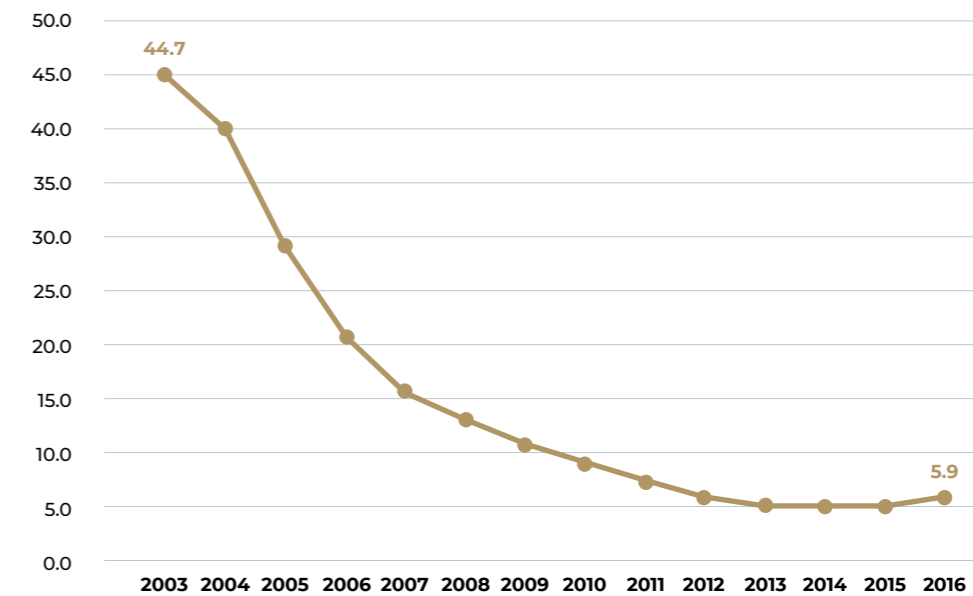
**CHART 4.3.6.** EXPENDITURES ON THE IMPROVEMENT OF THE SOCIO-ECONOMIC CONDITIONS OF REFUGEES AND INTERNALLY DISPLACED PERSONS BY YEAR (2001-2017 AZN MILLION)



Aforementioned funds were allocated for the construction of 71 residential districts of private houses, 16 residential blocks with 202 multi-storeyed buildings that in total allow for the settlement of 32 480 families, as well as a large number of socio-infrastructure objects. In addition, 76 schools, 7 music colleges, 55 community centres, 63 administrative buildings, 60 kindergartens, 17 medical centres, 5 hospitals, an Olympic complex, as well as 49 communication junctions, 773 km of highways, 870 km of water pipelines, 1 640 km of transmission lines, 436 km of gas pipelines, 84 km of sewerage lines were

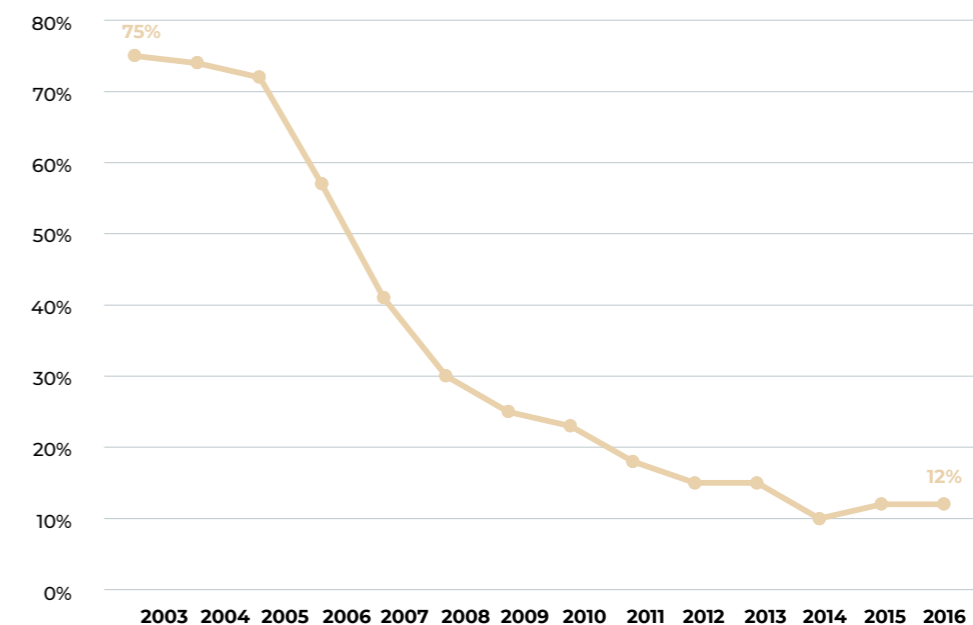
built within the framework of the program; 745 high voltage electric transformers, 30 electric sub-stations, 241 artesian wells, 212 water reservoirs and 86 pumping stations were completed and made ready for use, and an irrigation system covering 11 310 hectares was created. All these measures provided opportunities for improving socio-economic conditions of the refugees and internally displaced persons, reduction of poverty rate among them from 75% to 12% (6.2 times) during the last 14 years, while the respective rate countrywide fell from 44.7% in 2003 to 5.9% in 2017.

**CHART 4.3.7.** POVERTY REDUCTION DYNAMICS IN THE REPUBLIC OF AZERBAIJAN (PERCENTAGE)



Source: The State Committee of the Republic of Azerbaijan on Deals of Refugees and Internally displaced persons and Ministry of Economy of the Republic of Azerbaijan

**CHART 4.3.8.** POVERTY RATE AMONG THE REFUGES AND INTERNALLY DISPLACED PERSONS (PERCENTAGE)



Source: The State Committee of the Republic of Azerbaijan on Deals of Refugees and Internally displaced persons and Ministry of Economy of the Republic of Azerbaijan

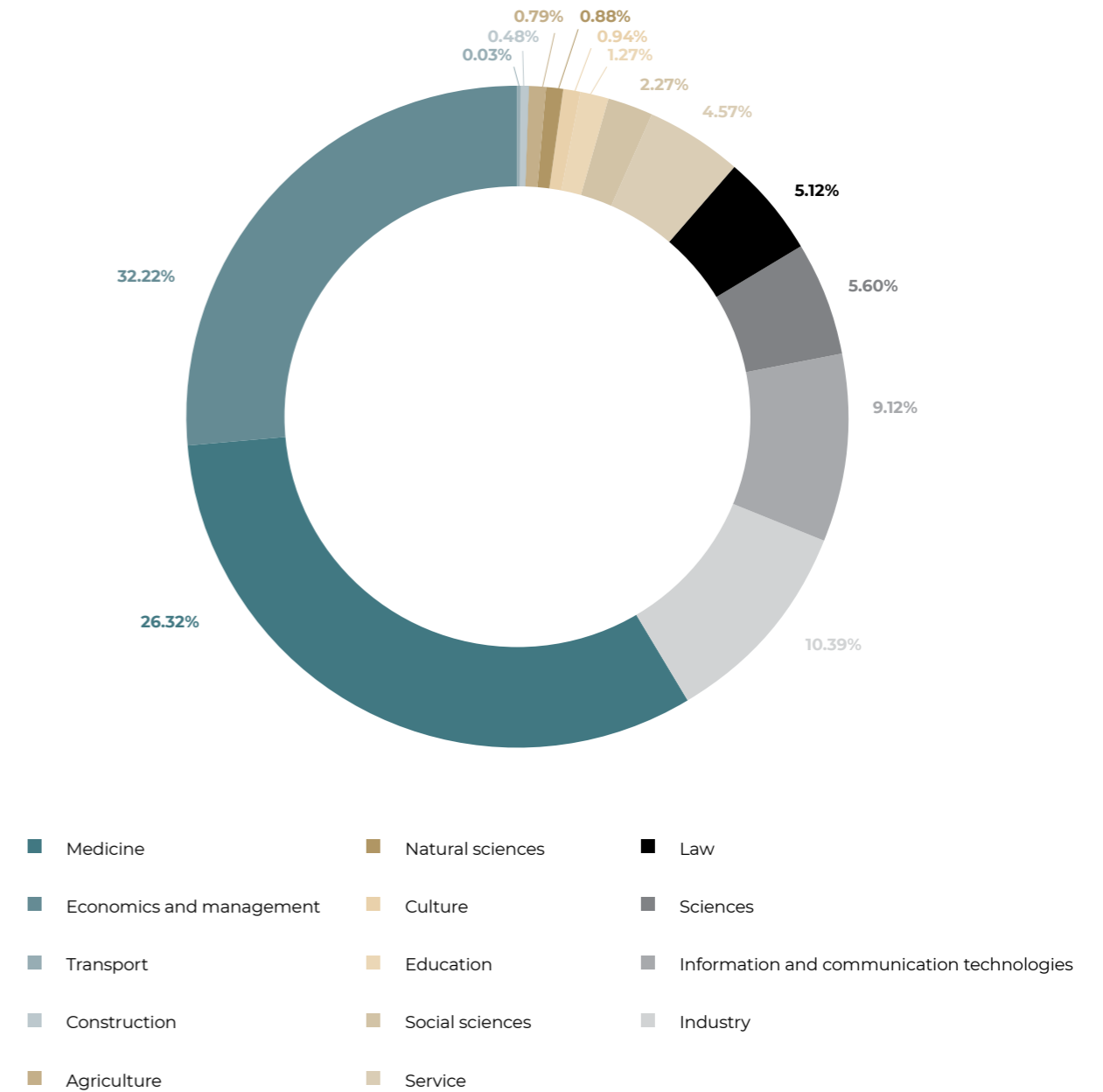
## DEVELOPMENT OF THE HUMAN CAPITAL

Financing the “State Program on Education of Azerbaijani Youth abroad in the years 2007-2015”. SOFAZ finances the “State Program on Education of Azerbaijani Youth Abroad in the years 2007-2015” that aims at fulfilling the idea of transforming black gold into human capital. Out of AZN 17.01 million allocated by SOFAZ for the education program in 2017, AZN 7.87 million was spent to cover the living expenses, AZN 8.25 million was directed to pay tuition fees, approximately AZN 0.55 million covered transport exports, AZN 0.33 million was paid on medical insurance charges, while visa and registration fees and some other expenses constituted AZN 0.01 million.

As of 31 December 2017, SOFAZ had financed the education of 3 454 students within the framework of the State Program, 1 692 of whom have already graduated. 79% of the students were funded to study at either undergraduate or graduate levels. More precisely, 1 180 studied at bachelor and 1 430 - at master's degrees, moreover, the Program also financed 692 students pursuing doctoral or higher medical studies. Most of the undergraduate level students studied economics and management (320 students), medicine (238 students), industry (191 students), information and communication technologies (174 students). At the graduate level, economics and management were mostly prioritized (722 people), followed by industry (138) and law (120). The majority of the program participants studied in Great Britain (29.1%), followed by Turkey (22.1%), Germany (12.4%), Canada (7.2%), Netherlands (5.2%) and Russia (3.8%). For the purposes of financing the State Program, SOFAZ allocated AZN 205.4 million during the period of 2008-2017.

The praiseworthy fact is that currently 95% of the graduates are employed according to the profession they acquired, which is a sign of a correct allocation of the professions. Educational work by the Program participants helps to spread further their knowledge and multiply the Program effects making them long-lasting and sustainable. Some of the former students teach at the leading universities of Azerbaijan or share their knowledge via various online course platforms, thus reaching not only to Azerbaijani but to the worldwide auditoria. The Program has not finished yet, and 1 611 participants are still to graduate. The last graduates are expected to study abroad until 2021. It means that the full positive effects will be felt only in future. The beneficiaries of the program are set to exert lasting influence on the socio-economic development of Azerbaijan.

CHART 4.3.9. DISTRIBUTION OF THE STUDENTS BY STUDY AREAS



**Funding of the new Baku-Tbilisi-Kars Railway construction project.** The main purpose of the project is to consolidate the Trans-European and Trans-Asian railway networks and ensure efficient transportation of cargo and passengers between Europe and Asia by building a railway line that would pass through Azerbaijan, Georgia, and Turkey. The project envisages building a Kars-Akhalkalaki railway line, 76 km of which will

pass through Turkey and 26 km through Georgia. This project also includes restoring and rebuilding 160 km of Georgia's Marabda-Akhalkalaki railway line. In 2017, SOFAZ allocated USD 12.1 million (AZN 20.5 million) to finance this project. Throughout 2007-2017, SOFAZ spent in total USD 642.1 million (AZN 572.4 million) on the railway construction. It should be noted that on October 30, 2017 the President of the Republic



of Azerbaijan participated in the official opening ceremony of the new Baku-Tbilisi-Kars railroad, and subsequently the first cargo train was launched.

**Reconstruction of the Samur-Absheron irrigation system.**

The project on the reconstruction of the Samur-Absheron irrigation system aims at creating a reliable source of water supply for the cities of Baku and Sumgayit, preventing energy losses incurred from water transportation and using this spare capacity to produce 25 MVT of energy, as well as boosting the irrigation and melioration capacity of Azerbaijan. The project has been funded by SOFAZ since its inception in 2006. The extension of building works on the Takhtakorpu water reservoir, Velvelichay-Takhtakorpu and Takhtakorpu-Jeyranbatan water channels, which are part of the Samur-Absheron project, has been included in the action plan for the "State Program on the reliable food supply of population in the Republic of Azerbaijan in the years 2008-2015".

The project should be fulfilled in two stages and the works envisaged for the first stage are already over. They included the construction of such facilities as the Takhtakorpu water reservoir, Velvelichay-Takhtakorpu and Takhtakorpu-Jeyranbatan channels which were officially launched on September 28, 2013 with the participation of the President of the Republic of Azerbaijan. According to the Act dated

November 12, 2014 of the State Commission, which was created on May 08, 2014 with the Order №019U of Azerbaijan Amelioration and Water Management OJSC, the Takhtakorpu water reservoir and hydroelectric power plant, the Velvelichay-Takhtakorpu and Takhtakorpu-Jeyranbatan water channels were put in commission. During the second stage of the project, the Takhtakorpu water reservoir, the Velvelichay-Takhtakorpu and Takhtakorpu-Jeyranbatan water channels, once launched, are expected to improve the irrigation of 150 thousand hectares of cultivated land and to make 30 thousand hectares land arable again. The newly irrigated land will create plentiful opportunities for agricultural development.

The second stage envisages the construction of water intake facilities and water transmission channels on the northern rivers (first of all, on the rivers Gusarchay, Gudyalchay, and Jagajug), commissioning of newly irrigated lands in the Shabran, Siyazan and Khizi districts within the framework of improvement of water supply for the lands already irrigated, and consultancy services regarding the aforementioned works.

Over the last 12 years (2006-2017), AZN 1 379.6 million (USD 1 611.7 million) has been transferred from SOFAZ with the purpose of financing the "Reconstruction of the Samur-Absheron irrigation system" project, including AZN 70 million (USD 41 million) in the reference year.

**Financing the share of the Republic of Azerbaijan in the charter capital of the "Southern Gas Corridor" Closed Joint Stock Company.** In accordance with the Decree of the President of the Republic of Azerbaijan from February 25, 2014, the "Southern Gas Corridor" CJSC was established with its charter capital of USD 100 million, 51% of which is owned by the Azerbaijani government and the remaining 49% by SOCAR. The company's purpose is to facilitate the management of such projects as the second stage of exploitation works at the "Shah Deniz" gas-condensate field, the expansion of the South Caucasus Pipeline, the construction of the Trans-Anatolian Pipeline and the Trans-Adriatic Pipeline. According to the paragraph 2.1. of the aforementioned Decree, the Fund is responsible for the financing of the company's state-owned shares, while their ownership and management are vested to the Ministry of Economy. In the reference year, SOFAZ did not receive any request from the Ministry of Economy for funding the project. In order to support the project on the exploitation of the "Shah Deniz" gas-condensate field, a direct credit worth USD 500 million was provided by the Asian Development Bank (ADB) upon the state guarantee in May 2017. Further, a syndicated loan of USD 524.5 million was provided by ADB upon the state guarantee in December 2017.

During the period of 2014-2017, the overall amount of money allocated by SOFAZ for financing the government share in the SGC project equaled AZN 1 530.3 million (USD 1 232.1 million).

**Funding of the Azerbaijan's share in the STAR project.** The funding of the project by SOFAZ is fulfilled in accordance with the Executive Order №2698 of the President of the Republic of Azerbaijan from February 04, 2013 on the additional measures

aimed at supporting the participation of the Azerbaijani side in the "SOCAR Turkey Ege" Oil Refinery Plant (STAR) project. In accordance with the aforementioned Order, a joint-stock company (hereafter-Company) with the charter capital of USD 1 900 million was established. The financing of state-owned shares (40% of the total) has been assigned to SOFAZ. Ownership and management of the Company's state-owned shares are entrusted to the Ministry of Economy of the Republic of Azerbaijan, while the dividends on these shares are transferred to SOFAZ.

The Executive Order №1804 of the President of the Republic of Azerbaijan from February 24, 2016 "On additional measures aimed at supporting the participation of the Azerbaijani side in the STAR project" introduced certain amendments to the previous Presidential Order №2698, according to which the charter capital of the Company was increased from USD 1 900 million to USD 2 412.0 million, while the value of the state-owned 40% share of the Company was increased up to USD 964.8 million.

According to the Executive Order №3136 of the President of the Republic of Azerbaijan, the charter capital of the Company was raised from USD 2 412.0 million to USD 3 482.0 million, while the value of the 40% share of its stocks held by the state was increased to USD 1 392.8 million.

Since the start of the project till the end of 2017, SOFAZ has transferred USD 1 392.8 million (AZN 1 663.3 million) via Treasury to the Ministry of Economy in order to finance the Azerbaijani share in the project. In the reference year, the respective expenditure item constituted USD 432.6 million (AZN 735.4 million).

**TABLE 4.3.1. LIST OF THE COMPLETED AND ONGOING OBJECTS ON SAMUR-ABSHERON PROJECT**

Objects put in commission by the act of the State Commission as of 12 November, 2014	Objects construction of which has already been completed during 2015-2017 but which are still within the guarantee period	Objects construction of which is still ongoing	Objects construction of which is to be started in 2018
1. Takhtakorpu water reservoir	1. Improvement of water supply for the lands already irrigated and commissioning of newly irrigated lands in the Siyazan region	1. Improvement of water supply for the lands already irrigated and commissioning of newly irrigated lands, as well as construction of a channel connecting with the SAK system, in the Khizi region	1. Construction of water intake facilities and water transmission channels on the Guruchay, Aghchay and Garachay rivers
2. Takhtakorpu hydroelectric station (capacity of 25 MVT)	2. Construction of water intake facilities and water transmission channels on the northern rivers (Gusarchay, Gudyalchay and Jagajug)	2. Improvement of water supply for the lands already irrigated and commissioning of newly irrigated lands, as well as construction of a channel connecting with the SAK system, in the Shabran region (projected to be completed in 2019)	
3. Roads built to ensure access to the Takhtakorpu water reservoir as part of its construction			
4. Velvelichay-Takhtakorpu channel			
5. Takhtakorpu-Jeyranbatan channel			

## UZEYIR HAJIBEYLI

The great Azerbaijani composer, musicologist, teacher, public figure, publicist, playwright, People's Artist of the USSR, academician Uzeyir Abdulhuseyn oghlu Hajibeyli is the founder of Azerbaijani professional music and author of the first opera in the East. Uzeyir Hajibeyli was born in the Agjabadi region on September 18, 1885 and spent his childhood in Shusha where he received his primary education in a two-year Russian-Turkish school. The rich music and performance environment of Shusha, which is considered the cradle of Azerbaijani music, had an exceptional impact on his musical education.

During 1899–1904, Uzeyir Hajibeyli studied at the Gori Pedagogical Seminary. Here, he mastered the works of European classical music composers, learned to play violin and baritone, and translated some folk songs into musical notations.

In 1911, U.Hajibeyli went to Moscow to acquire an education in music and enrolled in Ilyinsky's special music course at the Philharmonic Society. However, financial straits forced him to drop out of the course. In 1913, Uzeyir Hajibeyli was admitted to the St. Petersburg Conservatory and studied there for six months.

U.Hajibeyli is the author of ten theatre music compositions. With his opera "Leyli and Majnun" performed at Haji Zeynalabdin Taghiyev's Theater in Baku on January 12, 1908 (according to the new calendar,

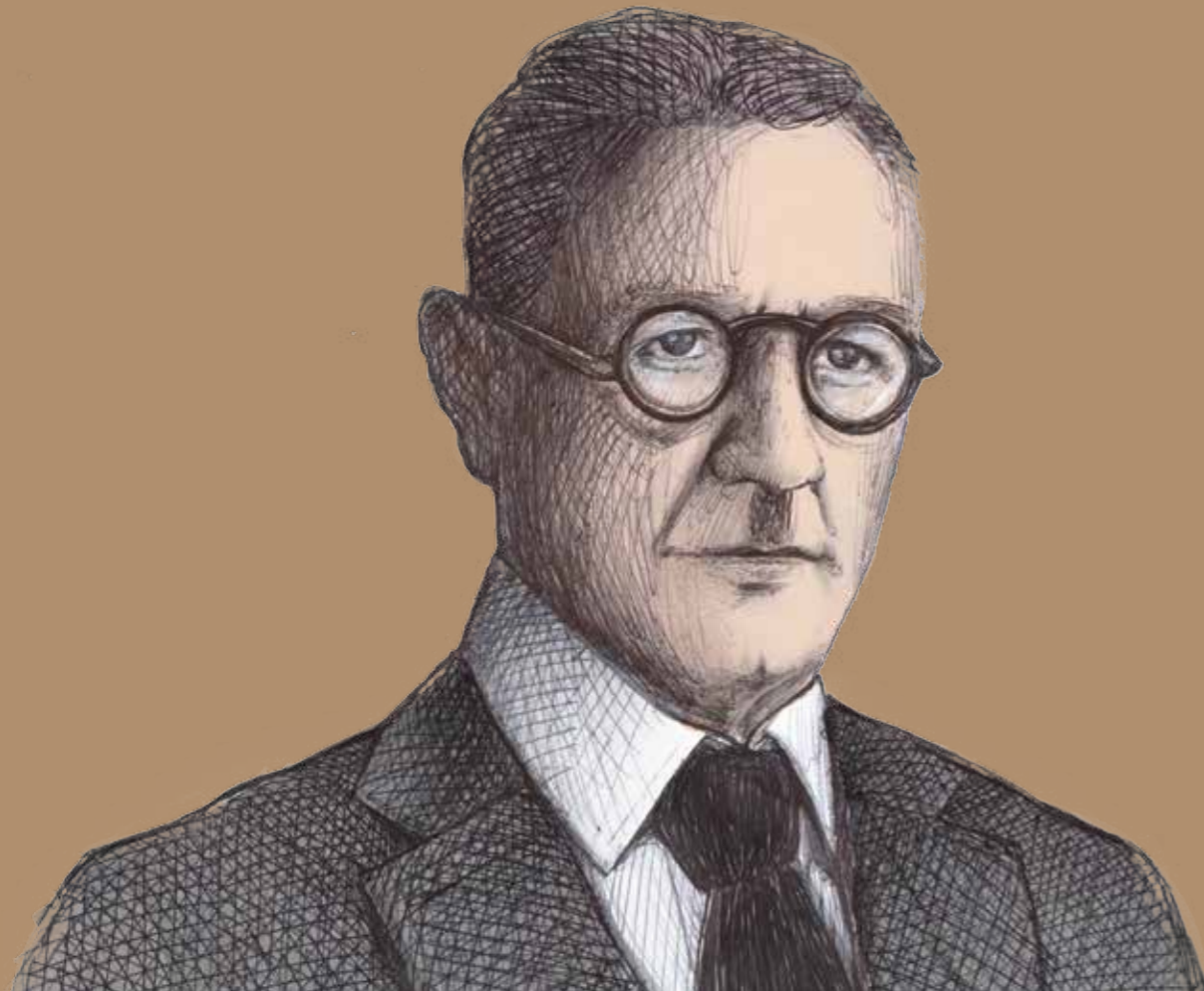
on January 25), Hajibeyli laid the foundations of the operatic art not only in Azerbaijan, but also in the entire Muslim world of the East. During 1909–1915, the composer wrote the following mugham operas: "Sheikh Sanan" (1909), "Rustam and Sohrab" (1910), "Shah Abbas and Khurshud Banu" (1912), "Asli and Kerem" (1912) and "Harun and Leyla" (1915). He is also the author of the musical comedies "Er ve arvad" (Husband and Wife, 1909), "O olmasin, bu olsun" (If Not That One, Then This One, 1910) and "Arshin Mal Alan" (1913). The opera "Koroglu" (the libretto by H.Ismayilov and M.Ordubadi) performed for the first time at the Opera and Ballet Theater on April 30, 1937 appeared as the peak of the outstanding musician's creativity.

During the period of the existence of the Azerbaijan Democratic Republic (1918–1920), Mr. Hajibeyli, who had actively participated in the socio-cultural life of the republic, composed the music for the national anthem with lyrics provided by Ahmed Javad.

Throughout his career, U.Hajibeyli engaged with various musical genres and composed a number of orchestral, chamber, instrumental music pieces, choreographic miniatures, gazals-romances and songs.

Uzeyir Hajibeyli passed away on November 23, 1948.

The source: "Medeniyyet" newspaper



## GARA GARAYEV

Born in Baku on February 5, 1918, People's Artist of the USSR, Hero of Socialist Labour and USSR State Prize laureate Gara Abulfaz oghlu Garayev was the great Azerbaijani composer, prominent tutor and public figure.

In 1926, he enrolled at the music school at the Azerbaijan State Conservatoire, and from 1930, he studied piano in the class of Professor Georgi Sharoyev at the music college at the Azerbaijan State Conservatoire. In 1935, Gara Garayev was admitted to the Azerbaijan State Conservatoire where he studied composition theory in the class of Leonid Rudolf and the basics of Azerbaijan folk music under the guidance of Uzeyir Hajibeyli. From 1938 to 1940, he studied at the Moscow State Tchaikovsky Conservatory where he received a degree in composition (the class of A. Aleksandrov). After a short return to Baku, he moved to Moscow to study at the State Conservatory for the second time, where he was a student of the prominent composer Dmitri Shostakovich until 1946.

Along with new themes, Garayev introduced a modern means of expression and new genres to the national music of Azerbaijan. As a student, in 1937, he wrote a piano piece titled "Tsarskoselskaya statuya" (The Statue in the Tsar's Village) and

cantata "Konul naghmasi" (Music of soul). In 1945, he composed the opera "Vatan" (Motherland) in collaboration with Jovdat Hajiyev.

In 1947, Gara Garayev wrote the symphonic poem "Leyli and Majnun" on the occasion of the 800th anniversary of Nizami Ganjavi. In 1952, the composer, inspired by Nizami's characters, wrote the ballet "Yeddi Gozel" (Seven Beauties) which is among the finest examples of Azerbaijan's music treasury. Garayev's other ballet "Ildirimli yollarla" (The Path of Thunder) was written in 1958 and together with the ballet "Yeddi Gozel" brought worldwide recognition to the author.

The great composer's poem "Ganjlik" (The Youth) composed for piano and orchestra (1937), "Azerbaijan suite" (1939), "The Albanian Rhapsody" (1952), symphonic engravings "Don Quixote" (1960) and other pieces from various genres of music made significant contributions to the musical culture of Azerbaijan.

Gara Garayev, the author of immortal compositions for theatre performances and films, passed away on May 13, 1982.

The source: "Medeniyyet" newspaper



## FIKRET AMIROV

The renowned Azerbaijani composer, People's Artist of the USSR, USSR State Prize laureate and Hero of Socialist Labour Fikret Mashadi Jamil oghlu Amirov was born in Ganja in 1922.

A graduate of the Azerbaijan State Conservatoire (the class of Uzeyir Hajibeyli and Boris Zeydman, 1948), Fikret Amirov was one of the notable figures of 20th-century Azerbaijani music. While Amirov's compositions embraced a wide range of genres, symphony and theatrical music were his favourites. He is a founder of a new genre called a "symphonic mugham" represented by his brilliant works such as "Shur", "Kurd Ovshari" and "Gulistan Bayati-Shiraz". Fikret Amirov's symphony "Nizami", "Azerbaijan Capriccio", "Azerbaijan Suite" and "Azerbaijan Engravings" which glorify his native land are valuable pieces of the composer's heritage.

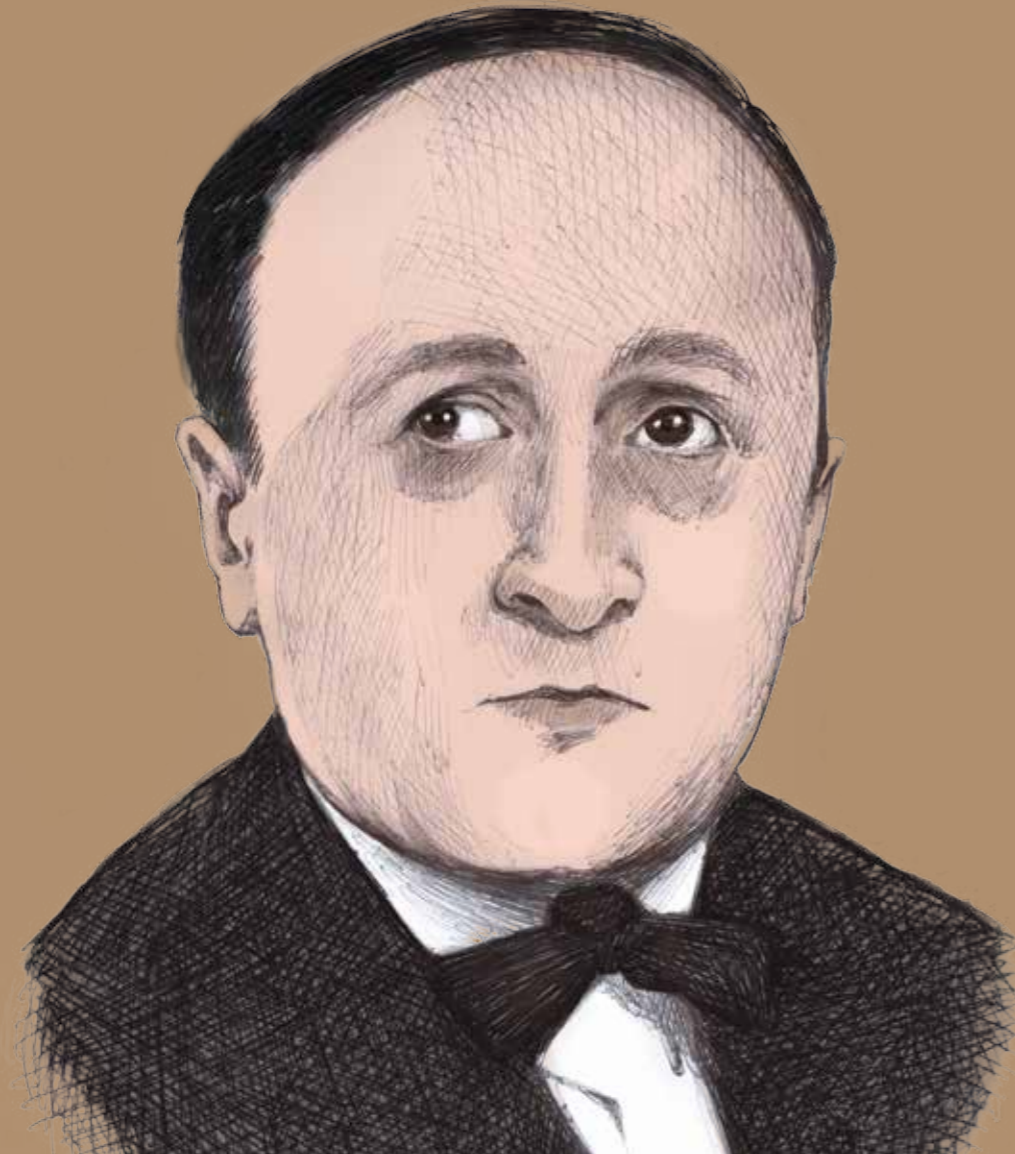
Fikret Amirov showed his mastery in the theatre music genre as well. With the opera "Sevil" (1953), the composer founded the lyrical-psychological opera in Azerbaijan. His ballet "Min bir gece" (Arabian nights or One Thousand and One Nights, 1979) is one of

the best examples of this genre. Further, Amirov's musical comedies "Urekachanlar" (Positive people, 1943) and "Cozun aydin" (Good news, 1946), vocal-choreographic poem "Nasimi" (1973) are precious compositions that exemplify Azerbaijani classical music.

Amirov's unique style was also reflected in his instrumental and chamber vocal pieces. "12 Miniatures for Piano", a variety of music pieces including "Ulduz" (Star), "Azerbaijan Elleri" (Azerbaijan's lands), "Gulum" (My flower), "Gulerem Gulsen" (I'll smile if you smile) and other romances and songs from his repertoire remain invaluable even nowadays. "Azerbaijan Capriccio" (1961) is also among the composer's most loved compositions. Moreover, Fikret Amirov composed extraordinary music for a number of plays and movies including "Boyuk dayag" (Great support), "Men ki gozel deyildim" (But I was not beautiful) and so on.

The composer passed away on February 20, 1984.

The source: "Medeniyyet" newspaper



## ARIF MALIKOV

Arif Jahangir oghlu Malikov, a renowned member of the Azerbaijani composer school, tutor, People's Artist of the USSR, USSR State Prize laureate and full-time member of Azerbaijan National Academy of Sciences, was born in Baku on September 13, 1933.

In 1960, Arif Malikov graduated from the Azerbaijan State Conservatoire (presently known as the Baku Academy of Music named after U.Hajibeyli) with a major in composition (Gara Garayev's class). That same year, he began teaching at the institution. Currently, he heads the Composition Department at the Baku Academy of Music.

Arif Malikov is notable for his creativity, giftedness and uniqueness. Being a contemporary virtuoso, he combines national musical traditions with the achievements of the 20th-century music in his compositions.

His compositions are characterized by high morals, meaningfulness, deep emotional and psychological expressions of characters. A.Malikov's ballet "Mehebbet efsanesi" (The Legend of Love, 1961)

earned a worldwide recognition for the composer. In his oeuvre, Malikov demonstrated interest to many music genres. His symphonies, symphonic poems, ballets "Iki nefer" (Two People, 1969), "Alibaba ve qirx quldur" (Ali Baba and the Forty Thieves, 1973), "Iki gelbin dastani" (The Epic of Two Souls, 1981), musical comedy "Lepeler" (Waves), cantata "Torpaghin sesi" (The sound of the land), music to movies and plays have greatly enriched the musical culture of Azerbaijan.

By the nature of his creative work, Malikov is a symphonist. His compositions have been performed and his ballets have been staged in nearly thirty countries. 2016 was marked by the publication of the composer's "The Complete Collection of Compositions" in twenty-eight volumes.

Malikov was awarded with the "Istiglal" (Independence) Order (1998) and "Heydar Aliyev" Order (2013).

The source: "Medeniyyet" newspaper



## 5. INVESTMENT REPORT

### 5.1. INVESTMENT STRATEGY

SOFAZ's investment strategy is aimed at maximizing long-term risk-adjusted returns. Broad diversification among the asset classes and across the countries along with monitoring and analysis of macroeconomic environment serves this strategic goal and assures the persistence of stable investment performance.

The government has laid down general principles and guidelines for the efficient management of the SOFAZ's assets in order to set up the legal framework for SOFAZ's investment mandate and ensure the transparency in the Fund's investment decisions. SOFAZ's investment portfolio is managed in accordance with the "Rules on managing the foreign currency assets of SOFAZ" ("Investment Guidelines"), approved by Presidential Decree No. 511 of 19 June 2001 and the Investment Policy approved by Presidential Decrees on an annual basis.

"Investment Guidelines" sets the general principles of SOFAZ's asset management framework. Along with other purposes, it

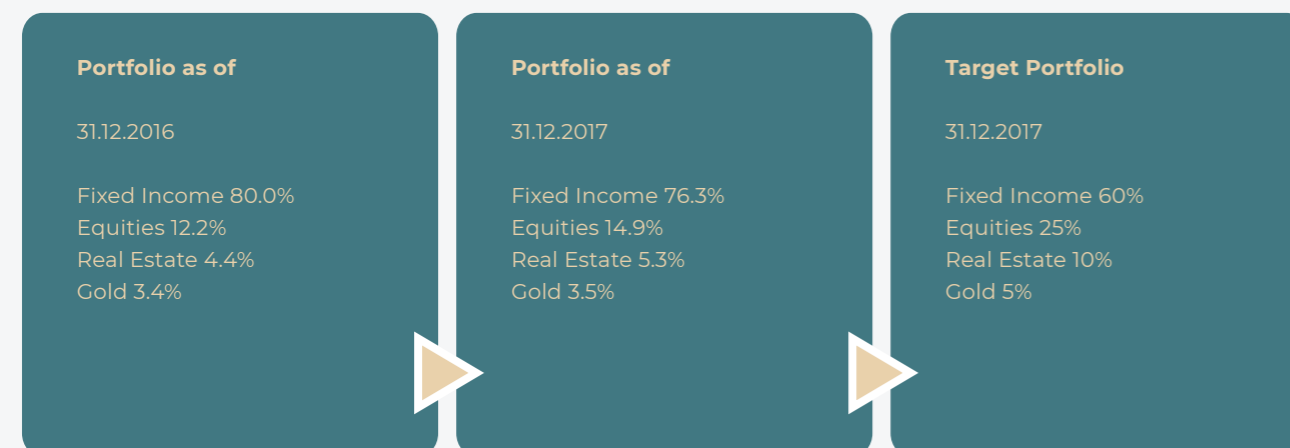
outlines permissible asset classes, currencies, minimum requirements for SOFAZ's external managers, and defines the credit quality limits for SOFAZ's counterparties (custodian banks, correspondent banks etc.). Investment Policy defines the objectives, forecasted size, currency composition, strategic asset allocation, benchmarks and risk limits for the SOFAZ's investment portfolio.

In line with the long-term objectives, asset class composition of the Fund's investment portfolio is reviewed and approved annually. According to the 2017 Investment Policy, the asset allocation of the investment portfolio is defined as below:

- 60% - Debt obligations and money market instruments;
- 25% - Equities;
- 10% - Real estate;
- 5% - Gold.

As of December 2017, 76.3% of the investment portfolio comprised of fixed income and money market securities while 14.9%, 3.5% and 5.3% were invested in equities, gold and real estate, respectively.

TABLE 5.1.1. TARGET ASSET ALLOCATION



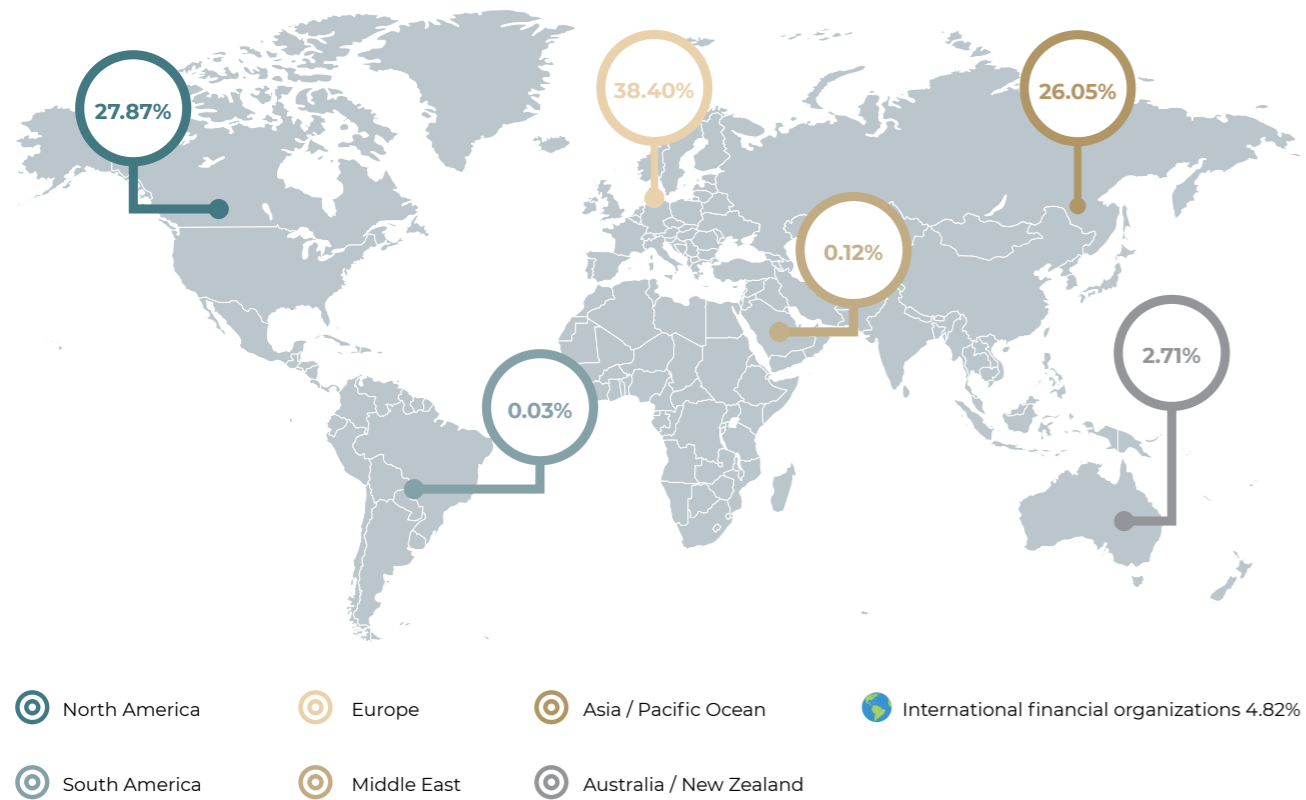
6-month LIBOR for corresponding currencies (6-month EURIBOR for assets denominated in EUR) is selected as the benchmark for the fixed income and money market instruments portfolio while the MSCI World Index is the benchmark for the equity portfolio.

Table 5.1.2. provides a summary snapshot of SOFAZ's current investment approach and its implementation to the portfolio:

TABLE 5.1.2. INVESTMENT DIRECTIONS

	Asset classes	Strategy employed	Implementation methods
Traditional	Public Equity	Exposure to global equities	MSCI World Index, MSCI Europe ex UK, S&P 100, strategic stake in VTB Bank.
	Fixed Income	Exposure through bonds and money market instruments	Sovereign, supranational, agency and corporate investment grade bonds, and money market instruments.
Alternative	Private Equity	Exposure through private equity funds	Commitments to IFC AMC managed funds, EBRD EPF Fund, Carlyle Partners VII, Blackstone Core Equity Partners, BC European Partners X, Apollo Fund IX and FSI Mid-market Growth Fund;  Private Equity Separately Managed Mandate with Neuberger Berman;  Investment in the charter capital of the Azerbaijan Rigs LLC formed with the participation of SOFAZ (90%) and SOCAR (10%).
	Real Estate	Exposure through direct property acquisitions, co-investments and real estate funds	Prime office space in Moscow, London, Paris, Seoul, Tokyo and Milan;  Co-investments in office and retail properties located in CBD areas in Germany, Japan, China, the USA and Singapore;  Commitments to real estate funds making commercial investments in Asia Pacific, Europe and the United States, as well as logistics investments in Japan.
	Gold	Exposure through physical purchase	Investments through gold bars.

CHART 5.1.1. SOFAZ'S INVESTMENT PORTFOLIO BREAKDOWN BY GEOGRAPHIC REGIONS



EXTERNAL MANAGERS

As of December 2017, 11.4% of SOFAZ's investment portfolio was managed by external managers. Benefits brought by external managers include market expertise, specific industry experience and regional presence thereby adding value to the investment portfolio.

The following external managers were responsible for managing the portion of SOFAZ assets:

For fixed income portfolio:

- World Bank – the World Bank Treasury manages USD 228 mln. (0.6% of assets);
- Deutsche Bank Advisors – manages USD 104 mln. (0.3% of assets).

For equity portfolio:

- UBS Asset Management – manages USD 1 598 mln. (4.5% of assets);
- State Street Global Advisors (SSGA) – manages USD 1 493 mln. (4.2% of assets);

- Mellon Capital Management - manages USD 332 mln. (0.9% of assets);
- BlackRock Investment Management - manages USD 315 mln. (0.9% of assets).

GOLD INVESTMENTS

According to the "Investment Guidelines", up to 5% of the SOFAZ's assets can be invested into gold.

As of 2017 year-end, the outstanding amount of gold in SOFAZ's investment portfolio was 30 175 kg (970 146 troy ounces). Starting from January 11, 2013, SOFAZ began to transfer the purchased gold to Azerbaijan and by the end of 2016, 30 169 kg of gold has been transferred and stored in the vault of the Central Bank of the Republic of Azerbaijan. During 2017, the gold was transferred to the vault for storage of the valuables built in the administrative building of SOFAZ.

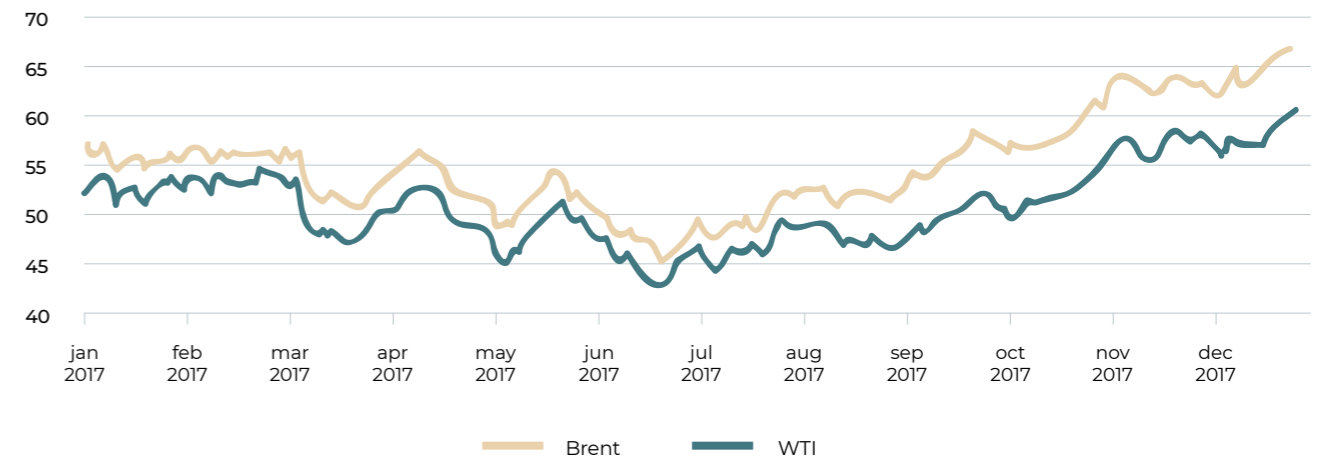
5.2. SOFAZ'S INVESTMENT PORTFOLIO

GLOBAL ECONOMY REVIEW

GLOBAL ECONOMY KEPT GROWING FOR ANOTHER YEAR

Underpinned by the growth in the developed economies as well as the stronger performance in the emerging countries, the global economic activity continued to accelerate in 2017 following the pickup that began in 2016. The growth in advanced economies was supported by increasing wage levels, strong consumption and exports, while the activity in the emerging market economies benefited from higher domestic demand and recovering commodity prices. Oil prices continued to exhibit a rally despite a stumble in the middle of 2017, rebounding about 20% over the year and peaking at above USD 67/bbl (Brent) in December. Along with the success of OPEC deal brokered in 2016 contributing to the rebound in oil prices, demand also grew stronger on the back of improving fundamentals.

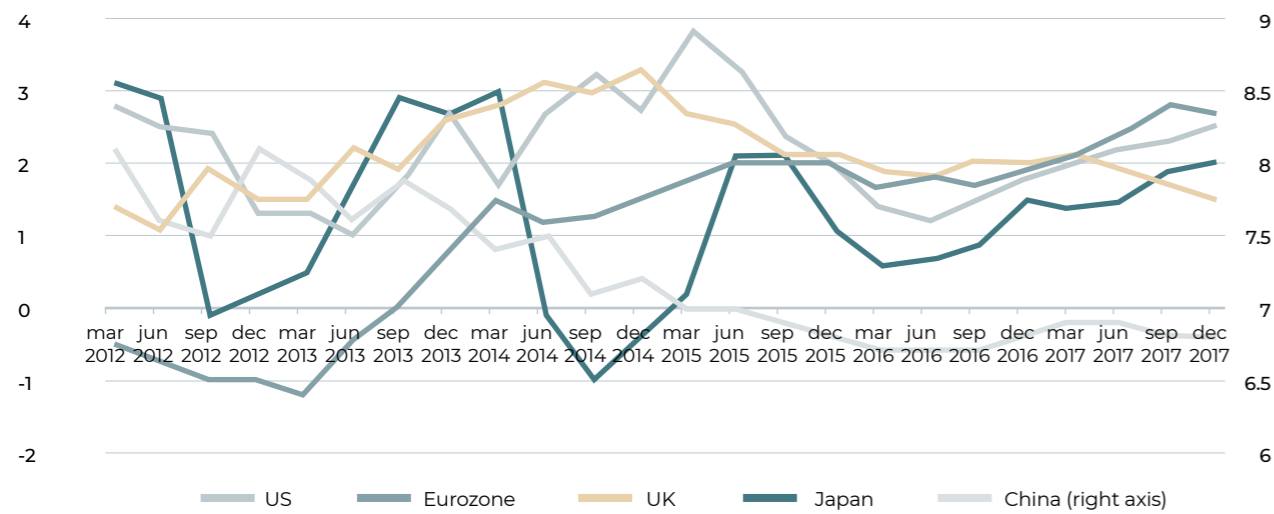
CHART 5.2.1. OIL PRICES IN 2017 (USD)



Source: Bloomberg

With an annual GDP growth rate of 3.7%, 2017 recorded the eighth consecutive year of expansion in the world economy. Growth in the United States reached 2.3% with the economy approaching full employment. The new tax reform was approved at the end of the year, which is set to take effect in 2018. Strong activity in the euro area with GDP growth of 2.4% was driven not only by exports but also the accommodative monetary policy and good job market momentum. The fiscal stimulus helped speed up the GDP growth in Japan to 1.7%, while the British economy posted a lower growth rate (1.7%) affected by the slowdown in employment and weaker consumer spending. Chinese output growth was recorded at 6.9%, where the share of household consumption in GDP is no longer falling while remaining below the share of investment. The growth in Russia rebounded to 1.5% resulting from the rise in oil prices and monetary easing.

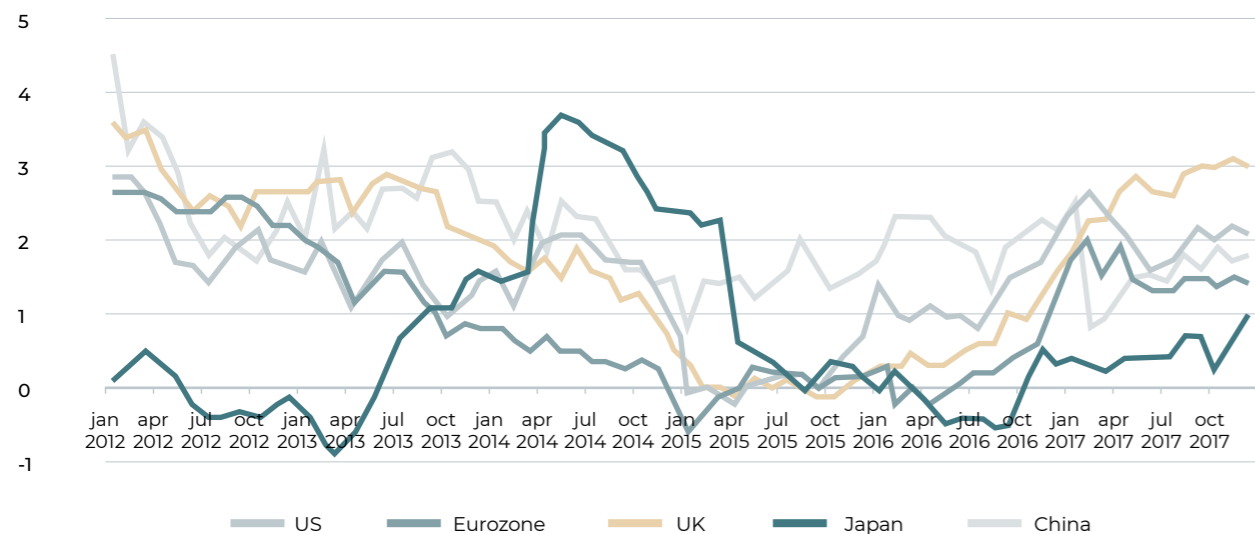
**CHART 5.2.2. GDP GROWTH RATE IN MAJOR ECONOMIES (2012-2017, PERCENTAGES)**



Source: Bloomberg

Headline inflation increased across the advanced economies, however, this was mainly the result of the recovery in oil prices. The increase in core inflation was quite modest, especially given the pressures in the labor market. Although inflation remained limited in the US (2.1%), strong economic indicators increased the confidence of the Federal Reserve (Fed) in the path of continuing to hike rates further in 2017. In the euro area, the inflation figure picked up (CPI 1.5%) after hovering below 1% for the previous three years. Inflation in Japan breached into the positive area (0.5%) following the negative inflation observed in 2016.

**CHART 5.2.3. INFLATION RATES IN MAJOR ECONOMIES (2012-2017, PERCENTAGES)**



Source: Bloomberg

## MONETARY POLICY – MAJOR DEVELOPMENTS

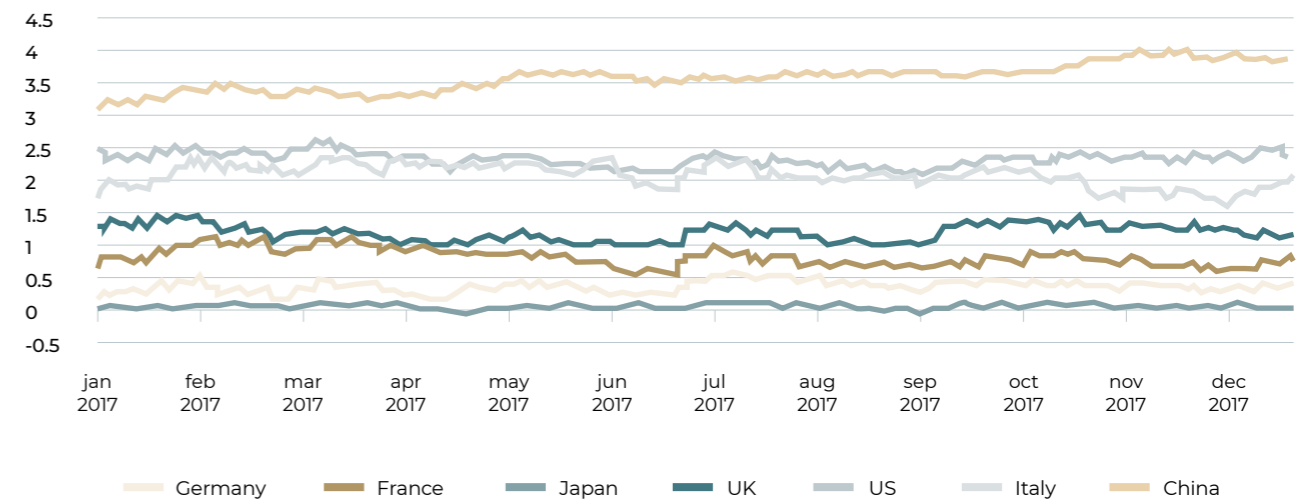
The rise in inflationary pressures did not result in significant policy reactions among major central banks in 2017, except for the Fed and the Bank of England (BoE). Responsive moves came from both in the form of interest rate hikes to offset rapid rise in prices. Several other central banks, however, have continued their asset purchase programmes. While the Fed and the European Central Bank (ECB) have started to employ exit strategies causing a slowdown in liquidity creation, emerging central banks have been picking up speed in supplying due liquidity.

The Fed has led the central banks during the year with three 25 bp hikes, raising the key interest rate range to 1.25%-1.5%. The Fed also announced intentions to reduce its balance sheet, after keeping it close to USD 4.5 trillion for the last three years. Despite below target inflation levels, the Fed remained hawkish on its policy stance.

The BoE raised its policy rate by 25 bps to 0.5% in November 2017 and halted its asset purchases while keeping the asset portfolio accumulated during the QE programme unchanged.

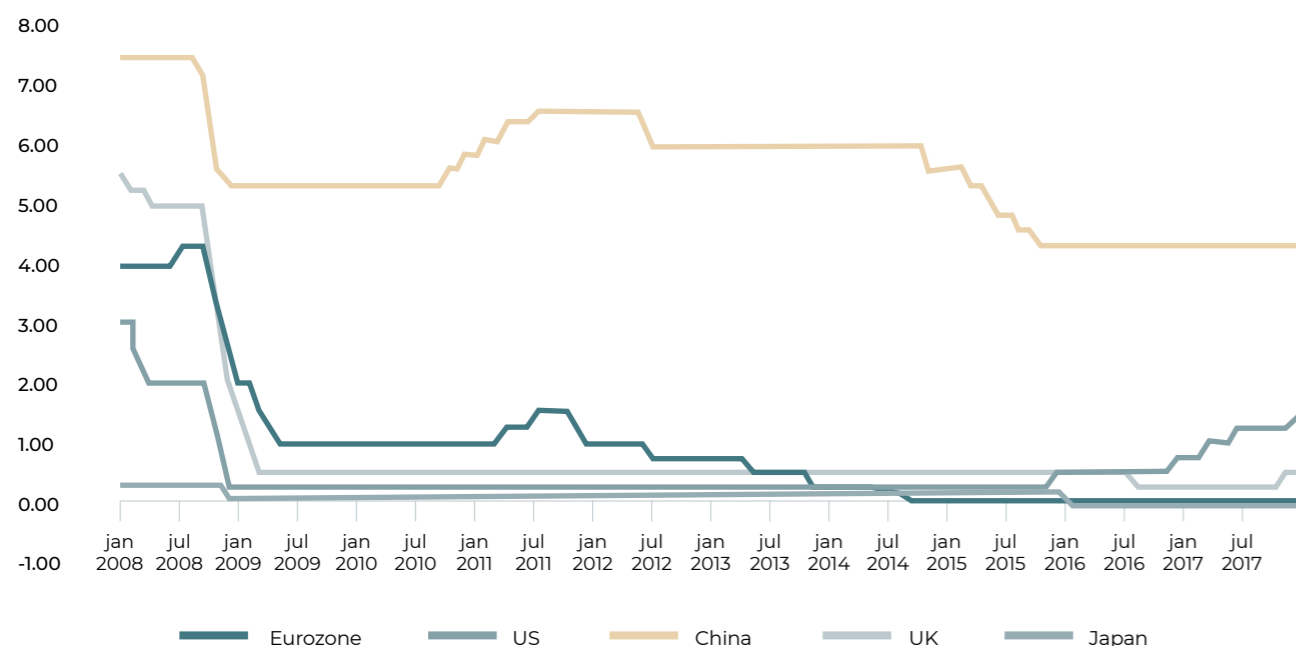
Influenced by strong growth and sudden increase in inflation, ECB made changes to its policy stance by removing dovish bias and becoming more hawkish as the year progressed. While signaling a reduction in monthly purchases from EUR 60 billion to EUR 30 billion starting from January 2018, ECB kept its policy rates unchanged: 0% for the repo, 0.25% for the marginal facility and -0.40% for the deposit facility.

**CHART 5.2.4. 10 YEAR GENERIC YIELD (PERCENTAGES)**



Source: Bloomberg

**CHART 5.2.5. CENTRAL BANKS' BENCHMARK INTEREST RATES (2008-2017, PERCENTAGES)**



Source: Bloomberg

## FIXED INCOME MARKETS

In 2017, bonds in the euro area, the US and the UK ended the year virtually flat. In the US, the short-end and intermediary segments of the Treasury curve were most affected by the Fed's tightening cycle, while the longer end stayed rather indifferent to the changes in the Fed policy in 2017 despite the plans regarding the Fed's balance sheet, upward-revised growth forecasts, promises of implementation of pro-growth fiscal measures and an infrastructure spending program, as well as the decline in the unemployment rate to 4.1%.

The outcome of the snap elections in June 2017 and the announcement of a rate hike by the BoE in September 2017 sent shock waves through the gilt yields in the UK. The gilt market remained unaffected by the downgrade of the UK's long-term issuer rating from Aa1 to Aa2 by Moody's stemming from the uncertainties surrounding Brexit.

German sovereign bond yields showed a tendency to increase during the year. As a whole, fluctuations in the yield curve were quite limited relative to the previous year with the biggest change of 53 bps in the 1-month rates and 30 bps observed in the 2Y-5Y rates.

In China, credit growth has supported the overall economy over the last few years, as the source of growth has shifted somewhat from China's export market to domestic markets. Therefore, Chinese leaders were more vocal in 2017 about reducing local government and corporate debt, with the Bank of China tightening in some of its short-term markets in Q1 2017.

Total negative-yielding bonds stood at around USD 9.7 trillion by 2017 year-end compared to USD 9.3 trillion at the end of 2016. USD 3.92 trillion of these negative-yielding bonds were accounted for by the Eurozone debt as of the end of 2017.

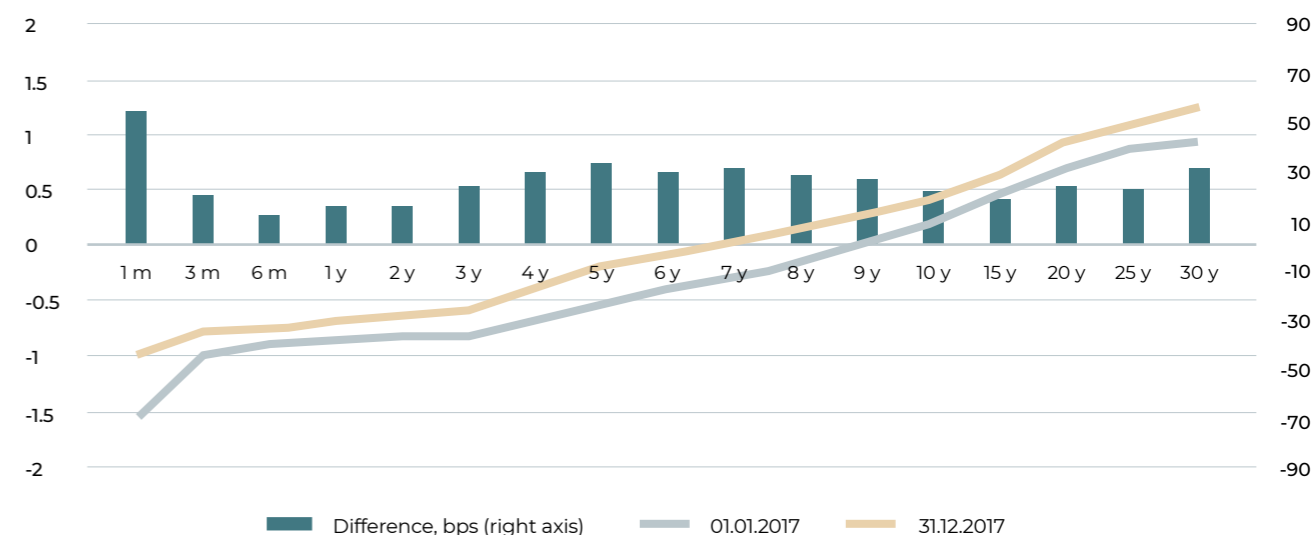
Meanwhile, volatility subsided significantly despite the political risks (elections in France, the UK, Germany etc.) and geopolitical risks, mainly owing to the recovery of global growth together with still abundant liquidity.

Sovereign spreads in the eurozone did not exhibit any major changes in the beginning of the year but later narrowed in the wake of French elections. The spread between 10-year Portuguese and German government bonds narrowed by more than

200 bps, registering the biggest change among European spreads, while Spanish, French and Italian spreads to German bunds changed only marginally. Overall, political events did not

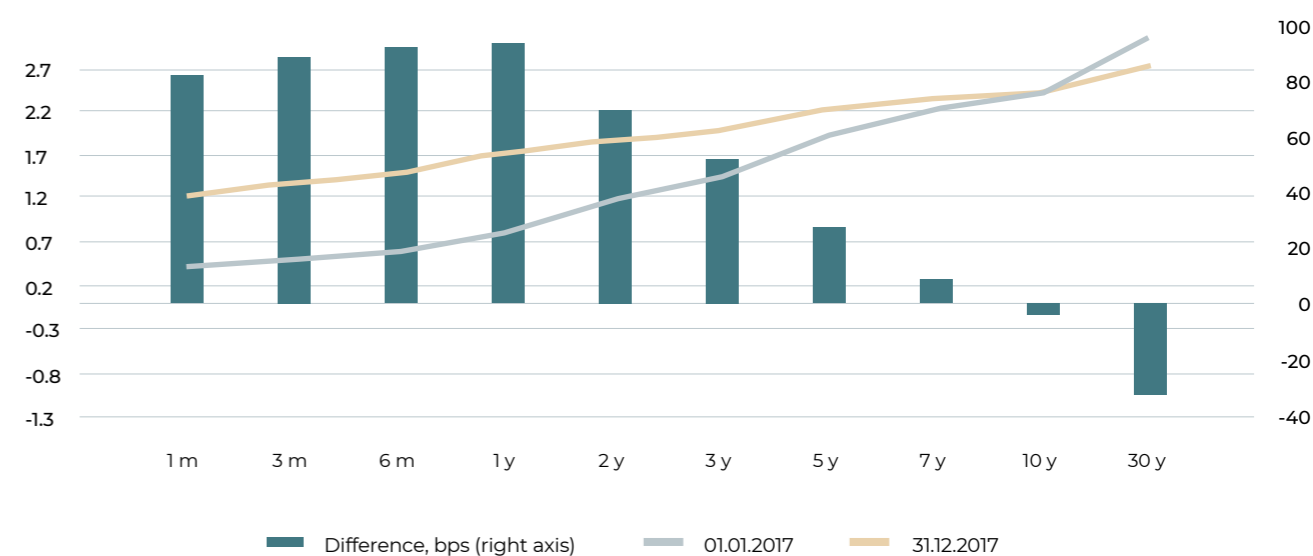
seem to affect the sovereign spreads in the euro area too much. Similarly, no major impact on bunds was observed following the failure of Germany to form a coalition.

**CHART 5.2.6. GERMANY SOVEREIGN YIELD CURVE (PERCENTAGES)**



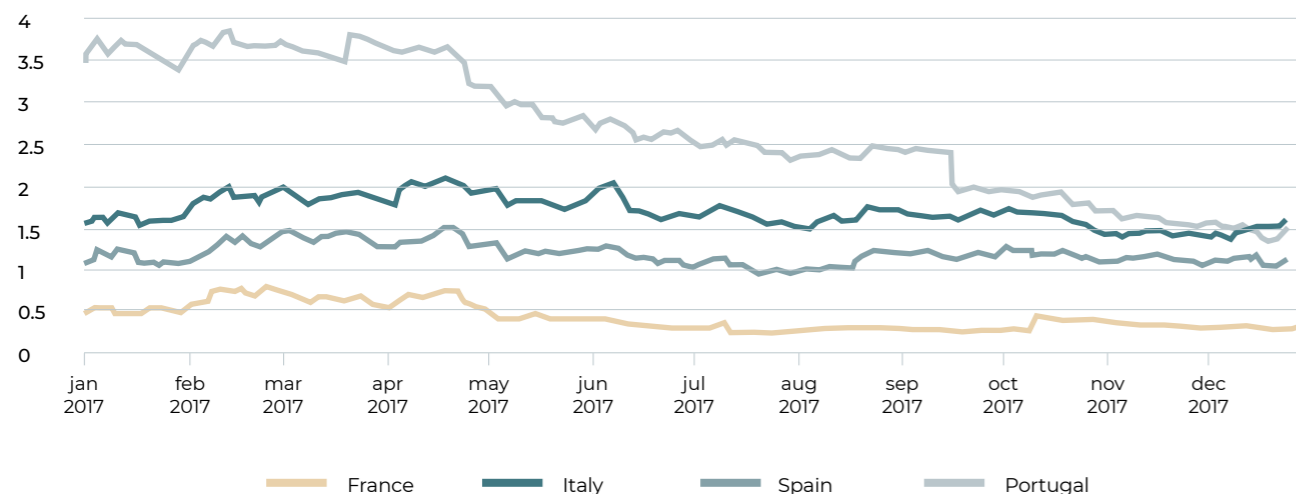
Source: Bloomberg

**CHART 5.2.7. US SOVEREIGN YIELD CURVE (PERCENTAGES)**



Source: Bloomberg

**CHART 5.2.8.** 10-YEAR YIELD SPREADS AGAINST GERMANY GOVERNMENT BONDS (PERCENTAGES)



Source: Bloomberg

## FOREIGN EXCHANGE MARKETS

In the foreign exchange market, the year was not without surprises. While the consensus amid the prospect of a tax reform and the expectations of the Fed interest rate hikes was a stronger dollar in 2017, DXY Index was down 10% for the year, having been weakened during the Trump presidency. Aiming to make the US economy more competitive by weakening the dollar, the government concentrated on protectionist measures which raised uncertainties around existing major trade agreements. Toward the end of the year, underpinned by strong economic indicators, USD started stabilizing, and the approval of the new tax plan solidified this trend.

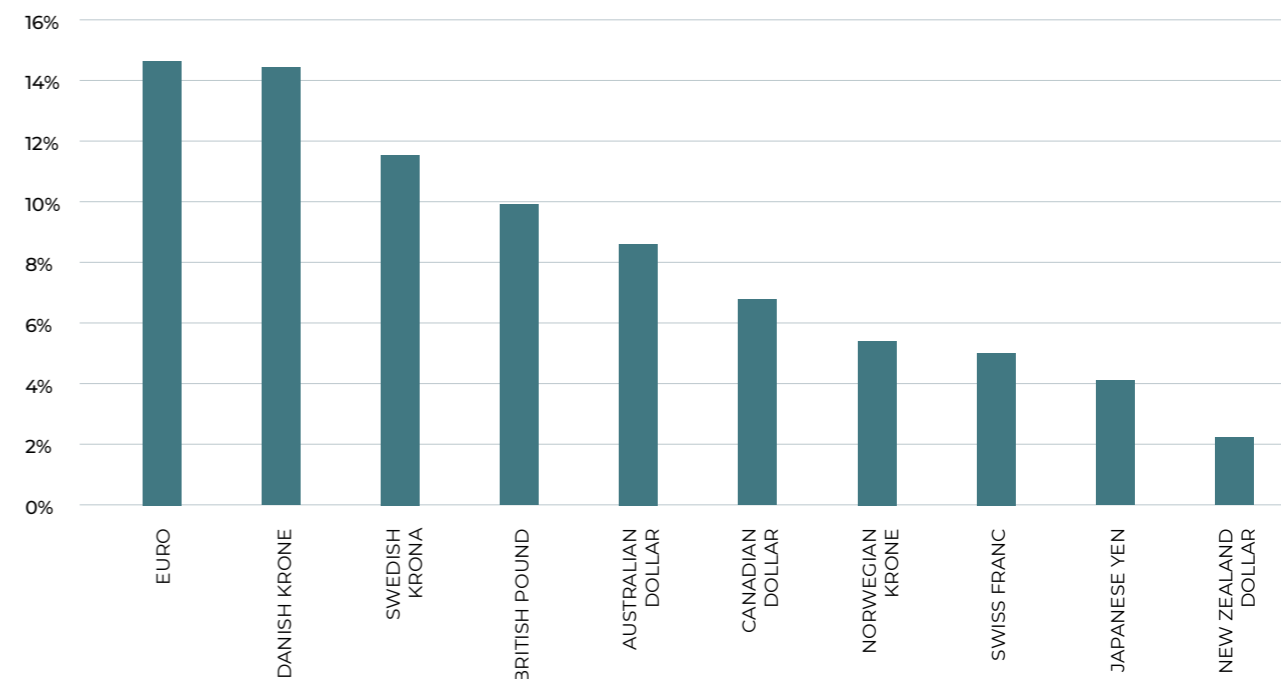
Euro ended up posting the strongest appreciation of all the G10 currencies since the start of 2017. Having started the year with a rather stable performance, the EUR/USD exchange rate corrected sharply after the French elections, appreciating in light of the prospects of a better European integration.

Despite the problems surrounding Brexit and Theresa May emerging weakened after the June 2017 snap elections, GBP, also bolstered by the hike announced by the Bank of England, managed to recover on the back of a weaker US dollar.

In the face of pressure from the Trump administration on countries with a significant trade surplus with the US, China held back the interventions as much as possible in the FX market. Closely correlated with the DXY index, the Chinese yuan appreciated by more than 5%.

By contrast, a sharp downward correction was observed in TRY, mainly due to geopolitical and economic risks.

**CHART 5.2.9.** G10 CURRENCY PERFORMANCE IN 2017 AGAINST USD (PERCENTAGES)



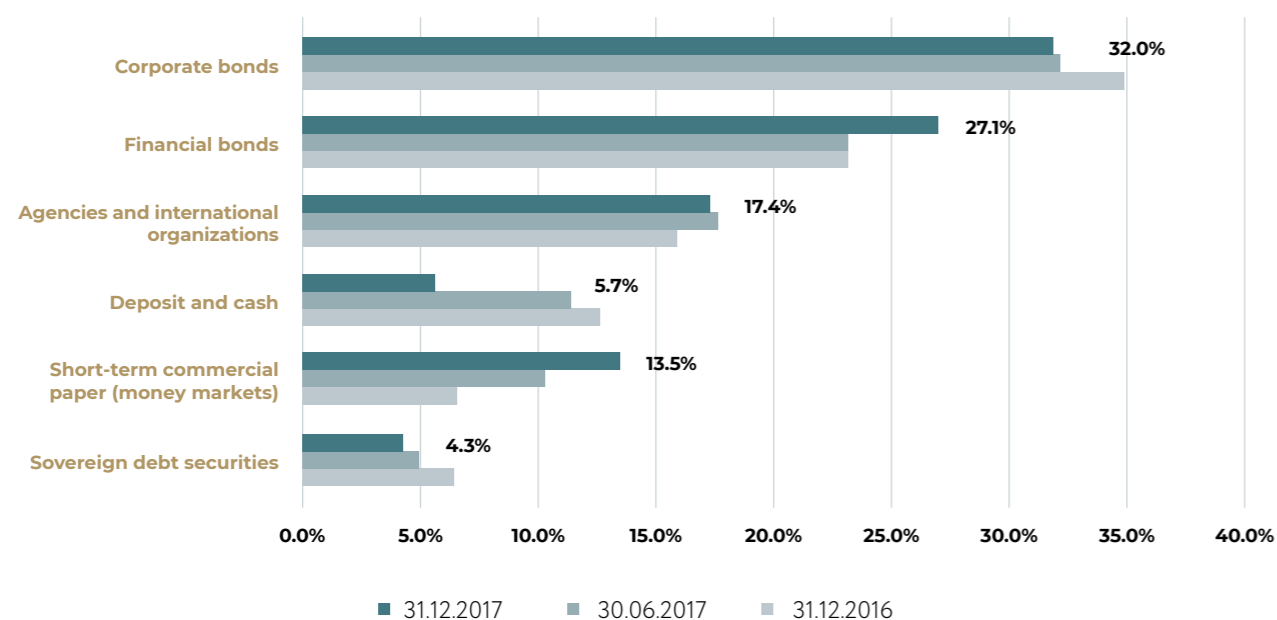
Source: Bloomberg

## SOFAZ'S FIXED INCOME INVESTMENTS

In 2017, SOFAZ's exposure to Sovereign-Supra-Agencies (SSAs) was largely kept equal to its level in the previous year and the strategy of relocating funds to securities offering lower duration such as short-term commercial papers and some financial bonds was implemented. Holdings of financial bonds were also increased to gain additional pickup, particularly in euro-denominated bonds. Exposure to sovereign debt securities was reduced by 2.2% due to lower yield environment and lack of opportunities. Coming to the corporate bonds, 3% decrease was marked due to falling credit spreads and very high demand for corporate securities.

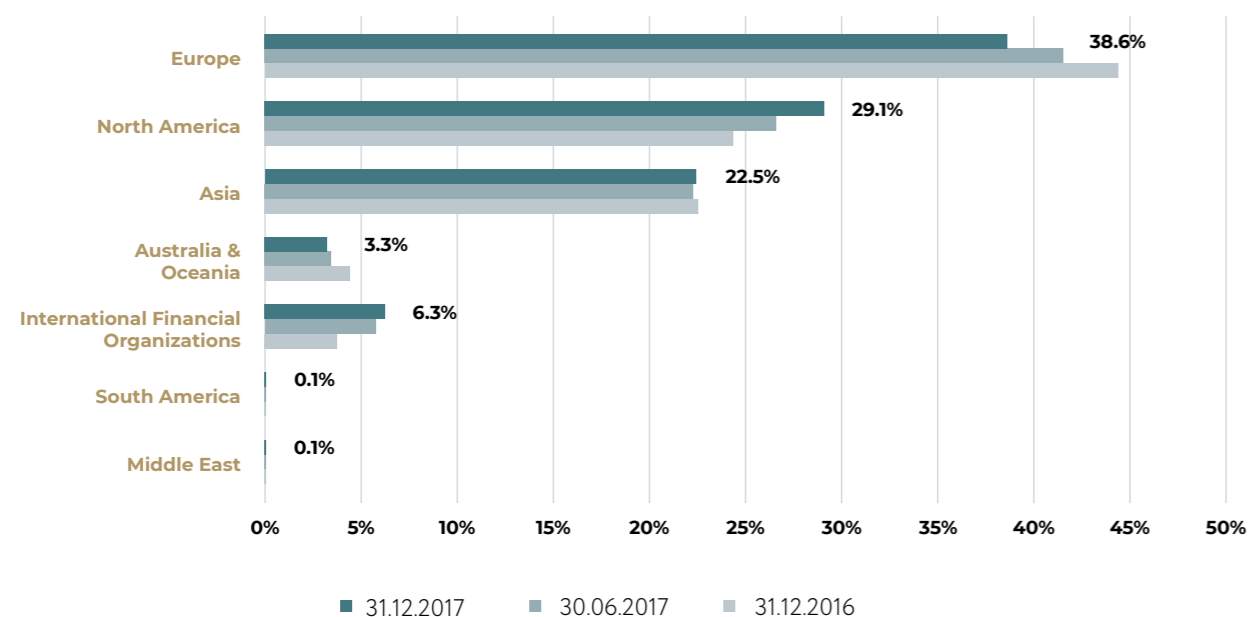


**CHART 5.2.10.** BREAKDOWN OF FIXED INCOME PORTFOLIO BY PRODUCT TYPES (PERCENTAGES)



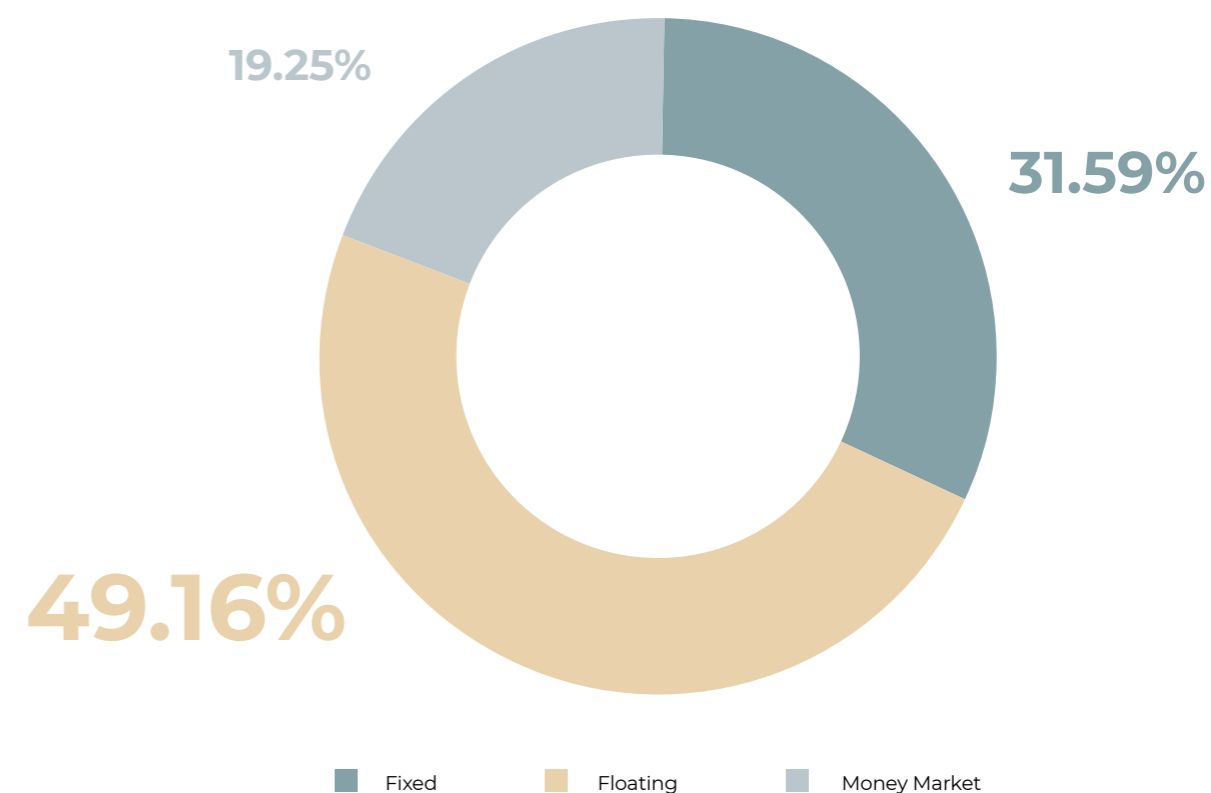
During the year under review, SOFAZ continued the strategy of geographical diversification of fixed income portfolio. SOFAZ slightly decreased its exposure to Europe (38.6%), while the exposure to International Financial Organizations and North America was increased from approximately 3.8% to 6.3% and from 24.4% to 29.1%, respectively. There was no significant percentage change in holdings in other regions.

**CHART 5.2.11.** BREAKDOWN OF FIXED INCOME PORTFOLIO BY GEOGRAPHICAL DISTRIBUTION (PERCENTAGES)



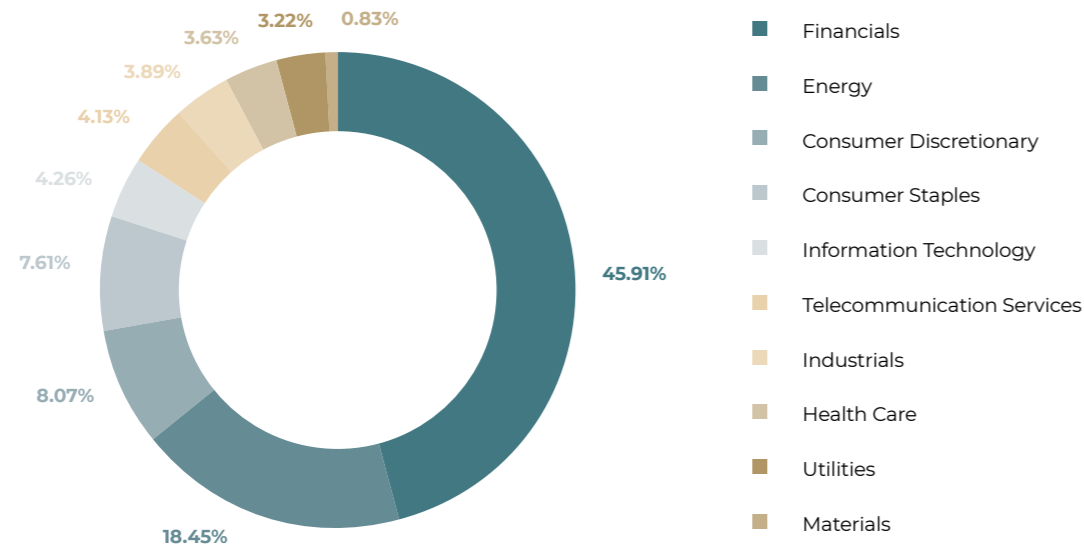
A significant change was observed in the breakdown of fixed income portfolio by security type in 2017. So, the portion of fixed coupon securities was decreased further to 31.59% from 41.40%, while the holdings of floating rate notes were significantly increased from 39.72% to 49.16%, due to rising yield environment. The proportion of money market instruments (including deposit and cash) remained relatively stable. The aim of the described strategy was to gain from potential rate hikes, increases in yields, and decreasing spreads in the fixed income markets. For the purpose of protecting the fixed income portfolio from adverse effects of movements in the interest rates, its duration was kept short throughout the reporting year.

**CHART 5.2.12.** BREAKDOWN OF FIXED INCOME PORTFOLIO BY SECURITY TYPE

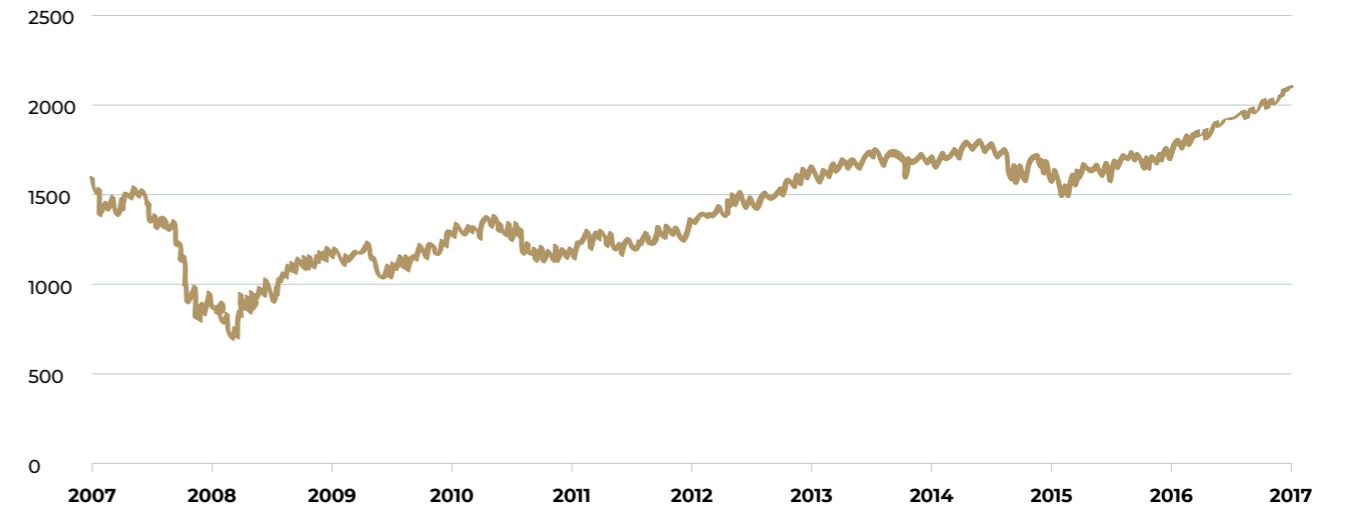


Fixed income portfolio is well diversified across different industry sectors. The sectors receiving highest allocations during the reporting year were financials, energy, consumer discretionary and consumer staples.

**CHART 5.2.13.** BREAKDOWN OF FIXED INCOME PORTFOLIO BY SECTORS (PERCENTAGES)



**CHART 5.2.14.** MSCI WORLD INDEX (2007-2017, INDEX POINTS)



Source: Bloomberg

## EQUITY INVESTMENTS

### PUBLIC EQUITY MARKET REVIEW

2017 was a positive year for the equity markets. As of 2017 year-end, the STOXX Europe 600 gained 8% annual return while the S&P 500 index performed even more remarkably, with a 20% return for the year. Gains for European indices were mainly observed during two distinct periods: from the start of the year until the election of Emmanuel Macron and since the start of September till the end of 2017. The gains for the US indices were firmer and steadier throughout the year.

In terms of sector performance, the energy and commodities sectors were the biggest beneficiaries (gaining +9% and +11%, respectively) due to the recovery in oil prices throughout the year. European banks could not derive the gains enjoyed by their US counterparts, partly driven by the prospect of Donald Trump's tax reform.

In terms of investment style, Growth stocks outperformed Value stocks over the full year.

### SOFAZ'S PUBLIC EQUITY PORTFOLIO

By the end of 2017, SOFAZ had increased its public equity portfolio to 11.70% of total AUM, compared to 9.20% in 2016. Throughout the year, public equity investments generated a local return of 10.57% (16.61% in USD terms). The Fund mitigates portfolio volatility by investing the largest proportion of the equity portfolio into the well-diversified MSCI World index. The return of the portfolio tracking MSCI World accounted for 18.83% local return (22.72% in USD terms) in 2017. SOFAZ's internally managed portfolio which is benchmarked to the S&P 100 index generated the return of 22% throughout the year. SOFAZ continues to hold an equity stake in VTB bank, a state-controlled Russian bank. In 2017, its local currency denominated return equaled -34.29% (-31.09% in USD terms). The return of the portfolio tracking MSCI Europe ex-UK index was 11.93% in EUR and 26.98% in USD terms in 2017.

## PRIVATE EQUITY

### PRIVATE EQUITY MARKET REVIEW 2017

Private Capital markets had another healthy year with USD 453 billion of aggregate capital raised by 921 Private Equity funds throughout the year. Combined with an increase in the unrealized value, total Private Equity AUM currently stands at USD 2.83 trillion. Dry powder continued its surge and stood at USD 1.7 trillion, increasing the competition over deals in the market among funds. Accumulated dry powder, rich valuations and high leverage continued to be major investor concerns. Accordingly, SOFAZ has tried to steer clear of the funds that have generated poor returns during economic downturns and that have been relying too much on leverage to deliver returns.

### PRIVATE EQUITY PORTFOLIO

During 2017, SOFAZ has committed to four buy-out funds and one growth fund. Below are short descriptions of the mentioned investments:

- "Carlyle Partners VII" is a USD 15 billion fund managed by Carlyle Group. The fund aims to realize buy-out investments, predominantly in the US. SOFAZ has committed USD 50 million to the fund.
- "Blackstone Core Equity Partners" (BCEP) is a USD 5 billion fund managed by Blackstone Group. The fund aims to invest in mature companies globally, predominantly in the developed markets. SOFAZ has committed USD 50 million to the fund.
- "BC European Partners X" (BCEC X) is a EUR 7.5 billion fund managed by BC Partners. The fund aims to make buy-out investments, predominantly in Europe. SOFAZ has committed EUR 56 million to the fund.
- "Apollo Fund IX" is a USD 24 billion mega-fund managed by Apollo Global Management. The fund is aimed at realizing buy-out and distressed investments globally, predominantly in the US. SOFAZ has committed USD 85 million to the fund.
- "FSI Mid-market Growth Fund" is a EUR 1 billion fund managed by Fondo Strategico Italiano (FSI). The fund is aimed at making growth investments in Italy. SOFAZ has committed EUR 20 million to the fund.

Below are SOFAZ's previous PE investments

TABLE 5.2.1. SOFAZ'S PREVIOUS PE INVESTMENTS

Funds	Vintage year	Base currency	Committed amount, mln
ALAC Fund	2010	USD	100
Global Infrastructure Fund	2013	USD	200
The Catalyst Fund	2013	USD	50
NB Caspian Fund	2016	USD	200
EBRD EPF	2016	EUR	100

CHART 5.2.15. BREAKDOWN OF PRIVATE EQUITY FUNDS BY REGIONS

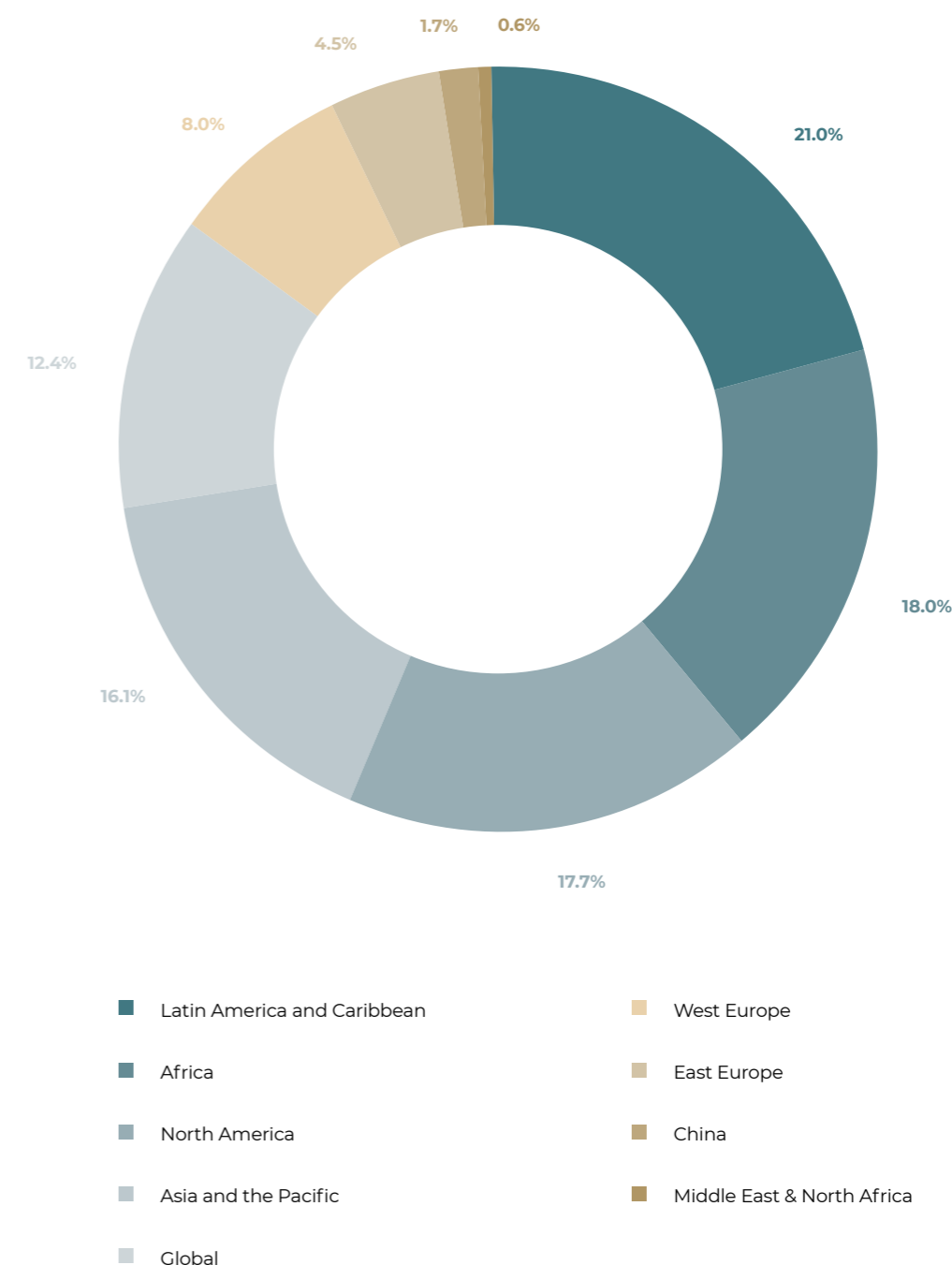
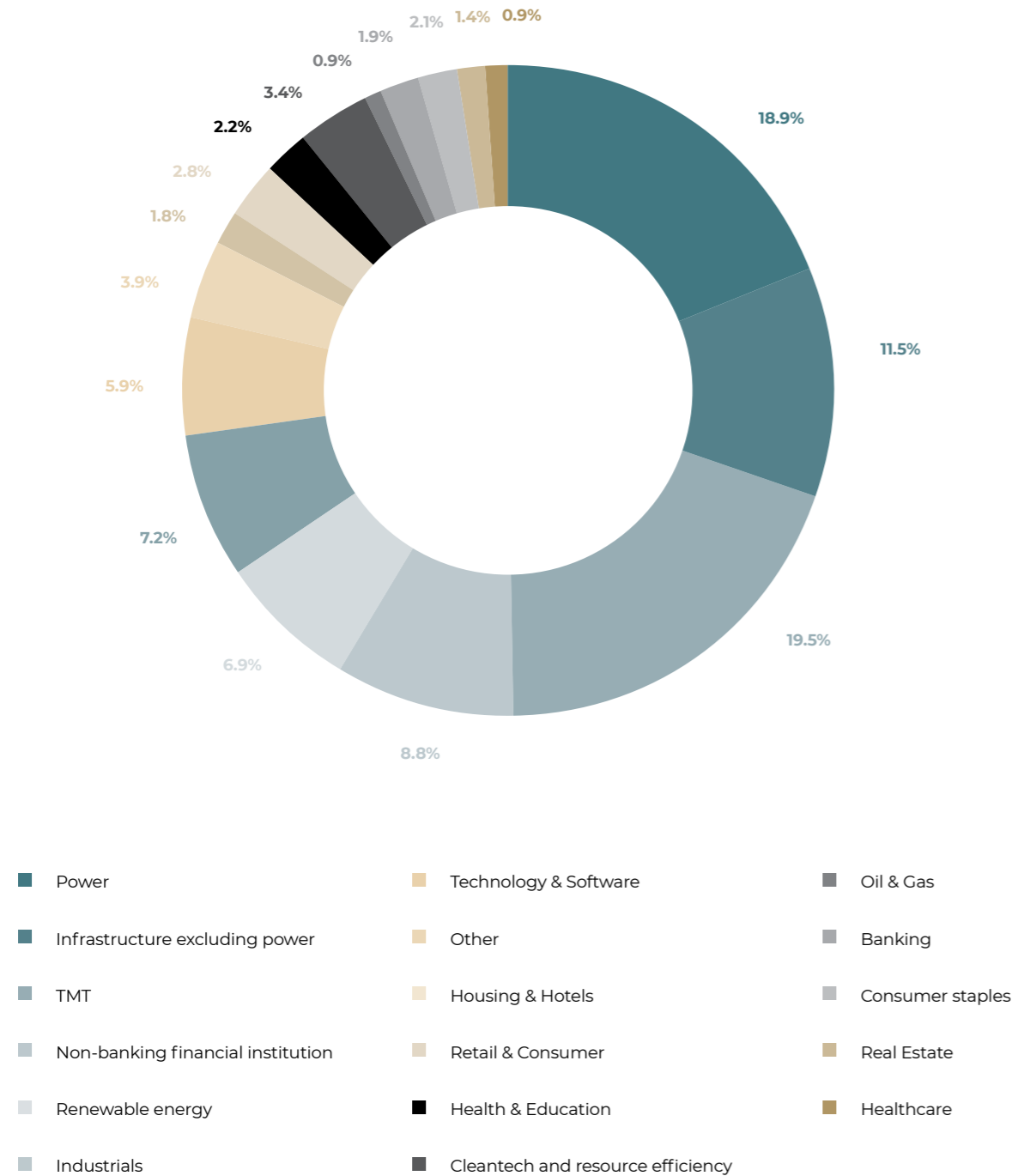


CHART 5.2.16. BREAKDOWN OF PRIVATE EQUITY FUNDS BY SECTORS



### INVESTMENT TO THE NEW, SEMI-SUBMERSIBLE DRILLING RIG

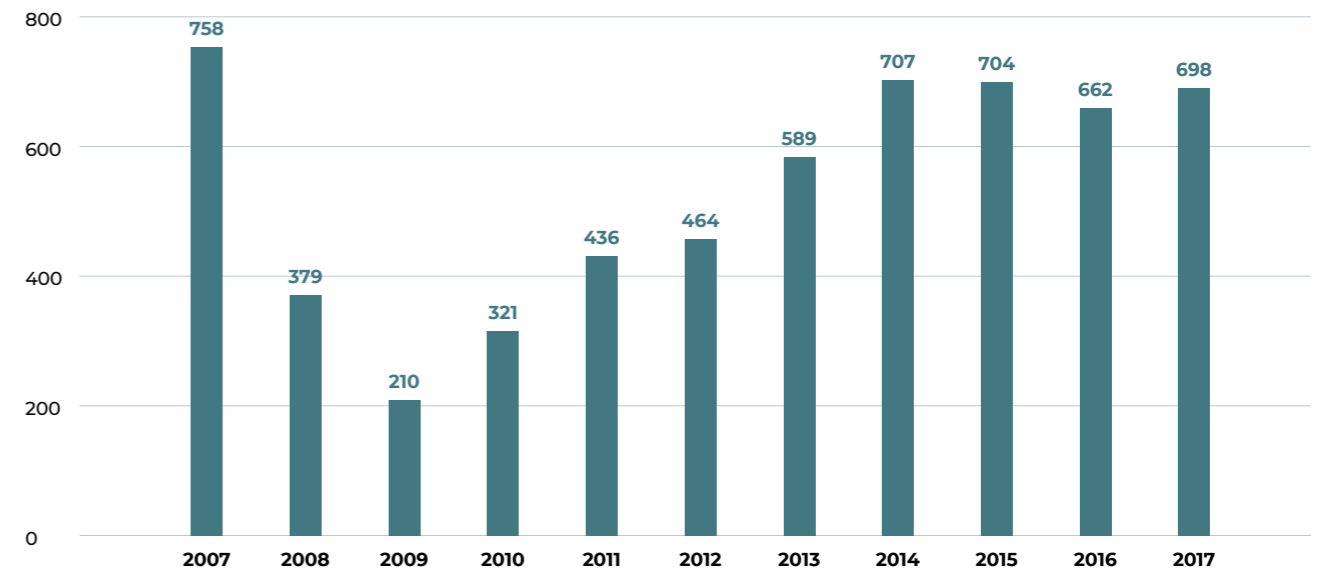
In 2017, SOFAZ invested USD 110.9 million (AZN 193.5 million) in the charter capital of the Azerbaijan Rigs LLC, formed with the participation of SOFAZ (90%) and SOCAR (10%). The maximum budget limit of the project is USD 1 116.7 million. Payments to the contractors are fulfilled by periodic capital contributions from SOFAZ and SOCAR. According to the Engineering Procurement Construction and Management Contract dated 24 June 2013, Caspian Drilling Company LLC is a project contractor, which was founded by SOCAR and is the owner of existing drilling rigs in the Caspian Sea. The project completion date is February 2018.

### GLOBAL REAL ESTATE MARKET

#### INVESTMENT VOLUMES

Global commercial real estate transaction volumes for 2017 came in at USD 698 billion, 6% above last year's total. Continuing the trend seen throughout 2017, full-year investment volumes in the Americas was down 12%, with investment levels dipping to USD 249 billion. Sustained investor appetite for European real estate led to 2017 surge as volumes jumped by 22% to USD 300 billion. Robust investor demand in Asia Pacific brings annual activity to USD 149 billion, 13% higher than in 2016.

CHART 5.2.17. GLOBAL DIRECT COMMERCIAL REAL ESTATE INVESTMENT

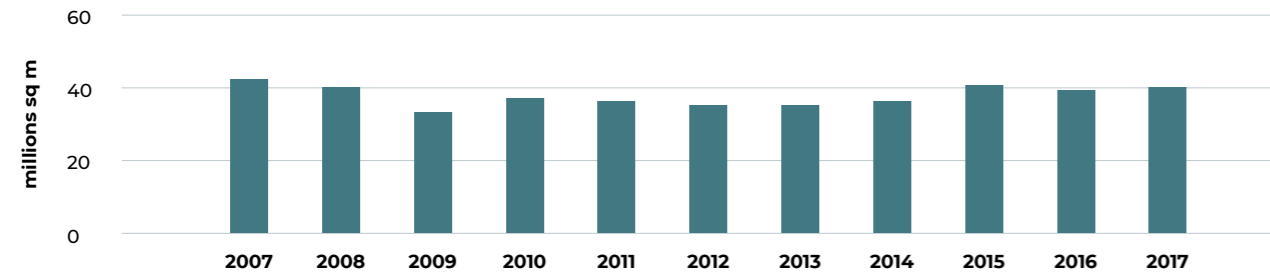


Source: JLL

**OFFICE MARKET**

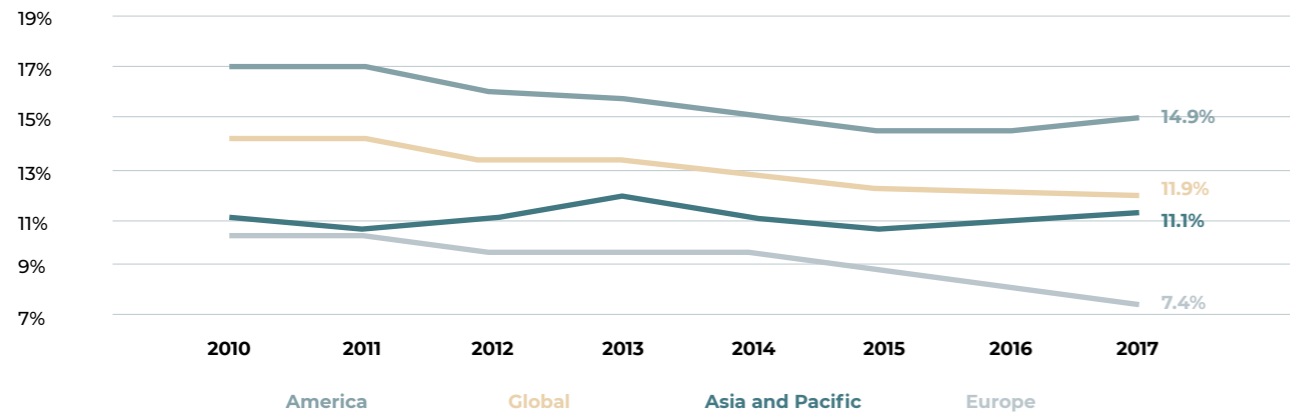
The global office leasing markets finished the year on a high note, with 40.7 million square meters leased in 2017 across 96 markets, 4% higher than in 2016. Global office vacancy rate defied expectations by falling marginally to 11.9% in Q4 2017, testimony to the capacity of the market to absorb additional space. Rents for prime offices across 26 major markets grew by 4.1% for the full-year 2017, the highest rate since 2011.

**CHART 5.2.18. GLOBAL OFFICE DEMAND - ANNUAL GROSS LEASING VOLUMES**



Source: JLL

**CHART 5.2.19. GLOBAL AND REGIONAL OFFICE VACANCY RATES**



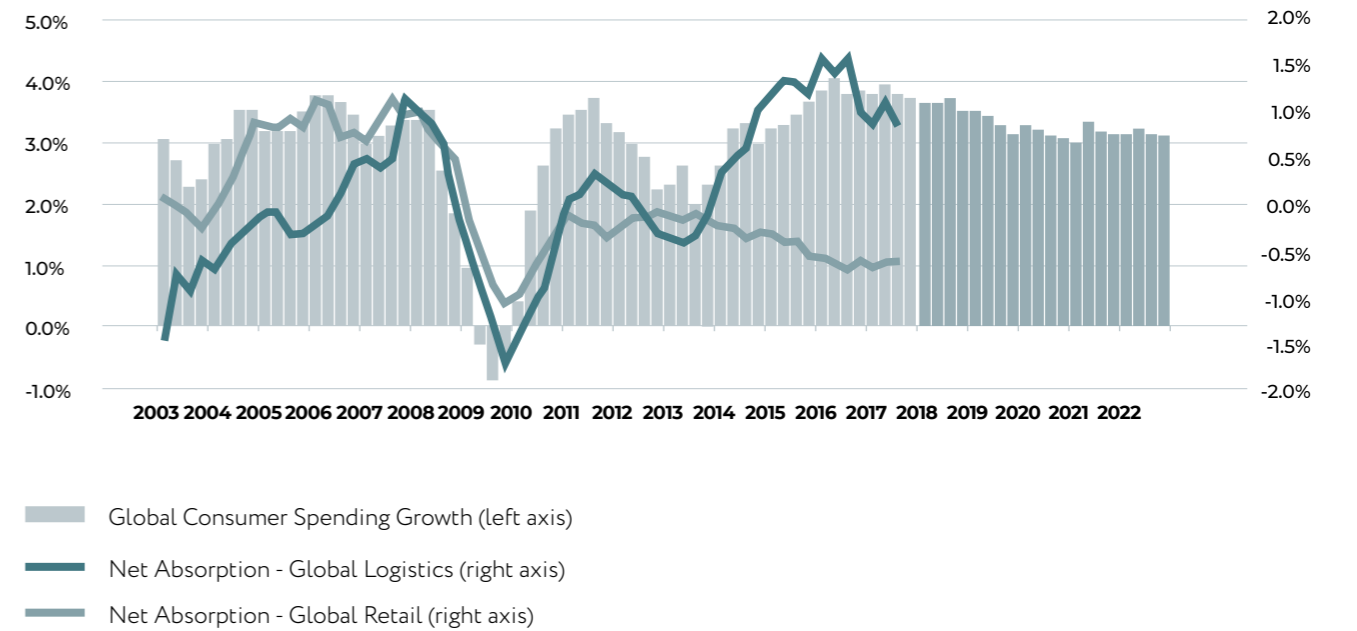
Source: JLL

**RETAIL AND LOGISTICS MARKET**

Before the 2008 financial crisis, retail take-up and consumer spending growth were highly correlated. In the past few years, with the rise of internet shopping, the relationship between consumer and retailer demand has broken down. Facing stiff competition from online competitors, physical retailers are opening fewer stores and quickly closing underperforming units. Since 2014, the latest upswing in global consumer spending growth has more clearly benefited logistics operators owing to supply chain expansion among both pure-play online retailers and physical retailers that are building multi-channel capacity. Unlike the retail sector, space absorption across logistics markets has been elevated compared to history.

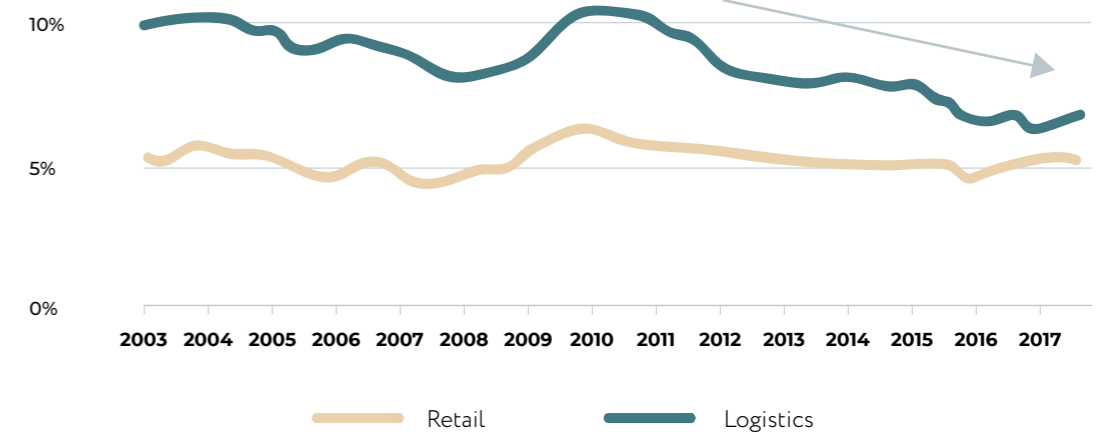
In major markets, retail development is decreasing with the exception of a handful of emerging markets, such as Shanghai and Warsaw. On the demand side, vacancy is creeping upwards, even on previously desirable in-town prime pitches in Europe and in class "A" malls in the United States. Real rental growth remains very weak, especially compared to logistics where building rates have not kept pace with demand expansion and vacancy has decreased resulting in strong rental growth.

**CHART 5.2.20. GLOBAL CONSUMER SPENDING AND NORMALIZED RETAIL AND LOGISTICS ABSORPTION**



Source: PGIM Real Estate

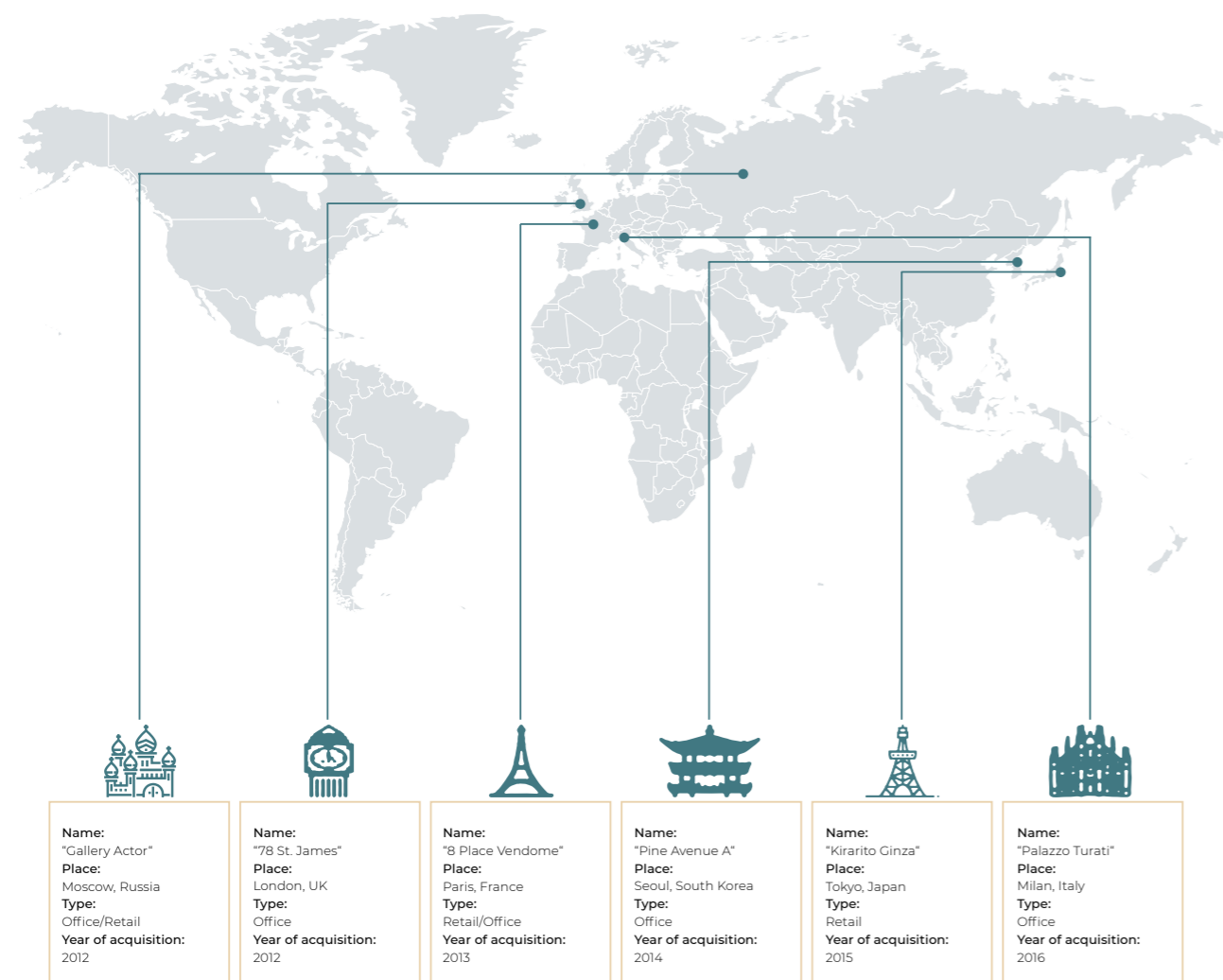
**CHART 5.2.21. GLOBAL VACANCY RATE (%)**



Source: PGIM Real Estate

## CURRENT REAL ESTATE PORTFOLIO

### DIRECT INVESTMENTS



### INDIRECT INVESTMENTS

Consistent with its real estate strategy of building a diversified risk-adjusted portfolio across geographies, real estate types and investment strategies, SOFAZ made investments to the following private real estate funds:

- AXA's "Pan European Value Added Venture" (PEVAV) fund. The Fund was established in 2014 with the size of EUR 445 million and makes real estate investments mostly in the UK, Germany, France, Italy. SOFAZ's commitment to PEVAV is EUR 100 million as a Limited Partner.

- PGIM's "European Value Partners" (EVP) fund. The Fund was established in 2015 with the size of EUR 457 million and makes real estate investments mostly in Germany and France. SOFAZ's commitment to EVP is EUR 100 million as a Limited Partner.

- Blackstone's "Blackstone Real Estate Partners Europe V" (BREP EUROPE V) fund. The Fund was established in 2016 with the target size of EUR 7.5 billion and makes commercial real estate investments across all asset classes in Europe. The fund will be investing mostly in the UK, Germany, Spain and Italy starting from 2016. SOFAZ's commitment to BREP EUROPE V is EUR 100 million as a Limited Partner.

- PAC's "PAC Real Estate Partners" (PREP) fund. The Fund was established in 2014 with the size of USD 1.3 billion and makes commercial real estate investments across all asset classes in Asia-Pacific. The fund makes investments mostly in Australia, China, Hong Kong and Japan. SOFAZ's commitment to PREP is USD 100 million as a Limited Partner.

- PGIM's "Asia Property Fund III" (ASPF III). The Fund was established in 2015 with the size of EUR 580 million and makes commercial real estate investments across all asset classes in Asia-Pacific. The fund makes investments mostly in Australia, China, Japan, South Korea, Singapore and Malaysia. SOFAZ's commitment to ASPF III is EUR 100 million as a Limited Partner.

- E-Shang Redwood's "Redwood Japan Logistics Fund II" (RJLF II). The Fund was established in 2016 with the target size of USD 1 billion and makes logistics real estate investments in Japan. SOFAZ's commitment to RJLF II is USD 100 million as a Limited Partner.

- Starwood Group's "Starwood Global Opportunity Fund XI" (SOF XI). The Fund was established in 2016 with the target size of USD 7.5 billion and makes commercial real estate investments across all asset classes in the United States and Western Europe. The fund will be investing mostly in the US starting from 2017. SOFAZ's commitment to SOF XI is USD 200 million as a Limited Partner.

### New Indirect Investments in 2017

- Walton Street Capital's "Walton Street Real Estate Fund VIII" (WSREF VIII). The Fund was established in 2016 with the size of USD 1.3 billion and makes real estate investment in the US. SOFAZ's commitment to WSREF VIII is USD 100 million as a Limited Partner.

- Ares's "ARES US Real Estate Fund IX". The Fund was established in 2017 with the target size of USD 1 billion and makes real estate investment in the US. SOFAZ's commitment to "ARES US Real Estate Fund IX" is USD 100 million as a Limited Partner.

- BlackRock's "Europe Property Fund IV" (EF IV). The Fund was established in 2015 with the size of EUR 700 million and makes real estate investment in Europe. SOFAZ's commitment to EF IV is EUR 100 million as a Limited Partner.

- Gaw Capital Partners's "Gateway Real Estate Fund V" (GREF V). The Fund was established in 2016 with the size of USD 1.3 billion and makes real estate investment in Asia Pacific. SOFAZ's commitment to "GREF V" is USD 34.1 million as a Limited Partner.

- Angelo, Gordon & Co's "Commercial Real Estate Debt Opportunities Fund" (CREDO). The Fund was established in 2016 with the size of USD 452 million and makes real estate debt investment in the US. SOFAZ's commitment to "CREDO" is USD 50 million as a Limited Partner.

### Co-investments

- In 2016 SOFAZ has reached an agreement with PGIM's "European Value Partners" fund to make co-investment to the property located at Junghof Strasse 14/16 in the Frankfurt city

centre. SOFAZ's equity portion in the co-investment is EUR 41 million.

### New Co-investments in 2017

- SOFAZ has reached an agreement with Gaw Capital Partners's "Gateway Real Estate Fund V" to make co-investment to office property located in the CBD area of Yokohama, Japan. SOFAZ's equity portion in the co-investment is USD 20 million.

- SOFAZ has reached an agreement with BlackRock's "Europe Property Fund IV" to make co-investment to office property located in the CBD area of Munich, Germany. SOFAZ's equity portion in the co-investment is EUR 6.3 million.

- SOFAZ has reached an agreement with Gaw Capital Partners's "Gateway Real Estate Fund V" to make co-investment to a portfolio consisting of industrial properties located across China. SOFAZ's equity portion in the co-investment is USD 60 million.

- SOFAZ has reached an agreement with PGIM's "Asia Property Fund III" to make co-investment to hotel development project located in Kyoto, Japan. SOFAZ's equity portion in the co-investment is JPY 2 134 million.

- SOFAZ has reached an agreement with Walton Street Capital's "Walton Street Real Estate Fund VIII" to make co-investment to office/retail property located in the CBD area of Chicago, United States. SOFAZ's equity portion in the co-investment is USD 25 million.

- SOFAZ has reached an agreement with Gaw Capital Partners's "Gateway Real Estate Fund V" to make co-investment to office/retail property located in the CBD area of Singapore. SOFAZ's equity portion in the co-investment is USD 20 million.

### Annual earnings

As of the year-end, the real estate portfolio consisted of six assets located in London, Paris, Moscow, Seoul, Tokyo and Milan. During 2017, gross rents mentioned below were collected from the six respective investments:

- London, 78 St James Street, GBP 9 650 000;
- Paris, 8 Place Vendome, EUR 5 782 297;
- Moscow, 16 Tverskaya, RUB 264 272 000;
- Seoul, Pine Avenue Tower A, KRW 11 975 228 650;
- Tokyo, Kirarito Ginza, JPY 1 555 424 174;
- Milan, Palazzo Turati, EUR 4 870 218.

All six assets were independently valued at the end of 2017. The valuation results and valuation companies are as below:

- 78 St James Street, JLL, GBP 190 000 000;
- 8, Place Vendome, BNP Paribas Real Estate, EUR 180 500 000;
- Tverskaya 16, Cushman & Wakefield, RUB 3 396 000 000;
- Pine Avenue Tower A, Kyungil Appraisal, KRW 499 350 000 000;
- Kirarito Ginza, Daiwa Real Estate Appraisal, JPY 57 400 000 000;
- Palazzo Turati, CBRE, EUR 99 600 000.

### 5.3. SOFAZ INVESTMENT PORTFOLIO PERFORMANCE

#### PERFORMANCE MEASUREMENT METHODOLOGY

Returns on SOFAZ's assets are calculated in accordance with the "Performance measurement methodology for the investment portfolio and sub-portfolios of the State Oil Fund", approved by the Internal Resolution No.5 dated April 21, 2009. In accordance with this methodology, AZN, USD and EUR are selected as the base currencies for calculating performance of the investment portfolio with and without taking into account currency exchange fluctuations.

The following figures are based on the performance of investment portfolio measured in local currencies.

#### SOFAZ RATE OF RETURN IN 2017

The total rate of return on SOFAZ's investment portfolio was 1.88%. Historical returns for the period of 10 years starting from 2008 and monthly cumulative returns for the year of 2017 are illustrated in Charts 5.3.1 and 5.3.2, respectively:

In 2017, annual returns for fixed income, equity (public and private) and real estate investments were 0.82%, 7.82%, and 4.72%, respectively, while their corresponding contributions to the total performance of the investment portfolio (1.88%) accounted for 0.65%, 1.01% and 0.22% (Charts 5.3.3. and 5.3.4).

CHART 5.3.1. SOFAZ INVESTMENT PORTFOLIO RATE OF RETURN (LOCAL)

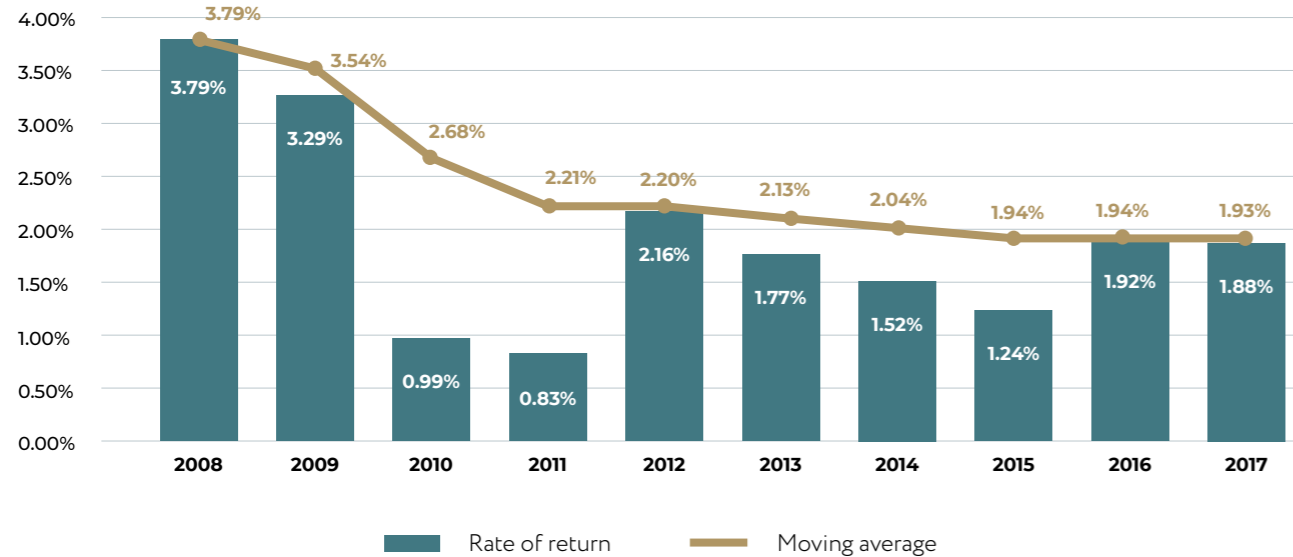


CHART 5.3.2. CUMULATIVE MONTHLY LOCAL PERFORMANCE

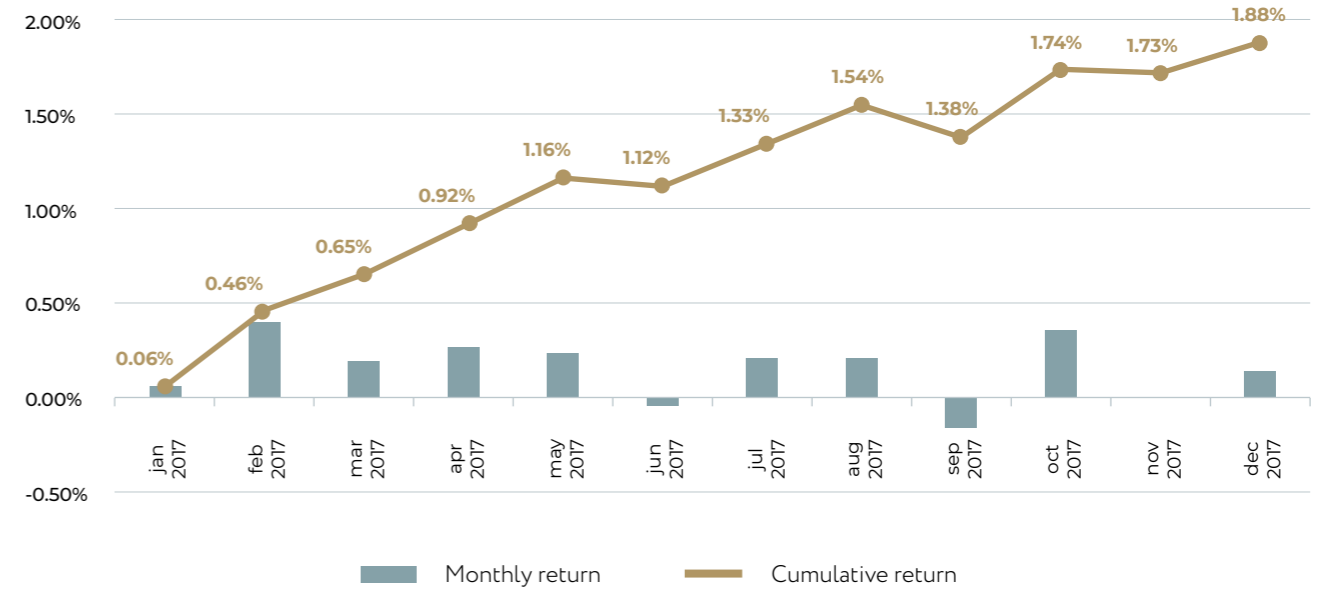
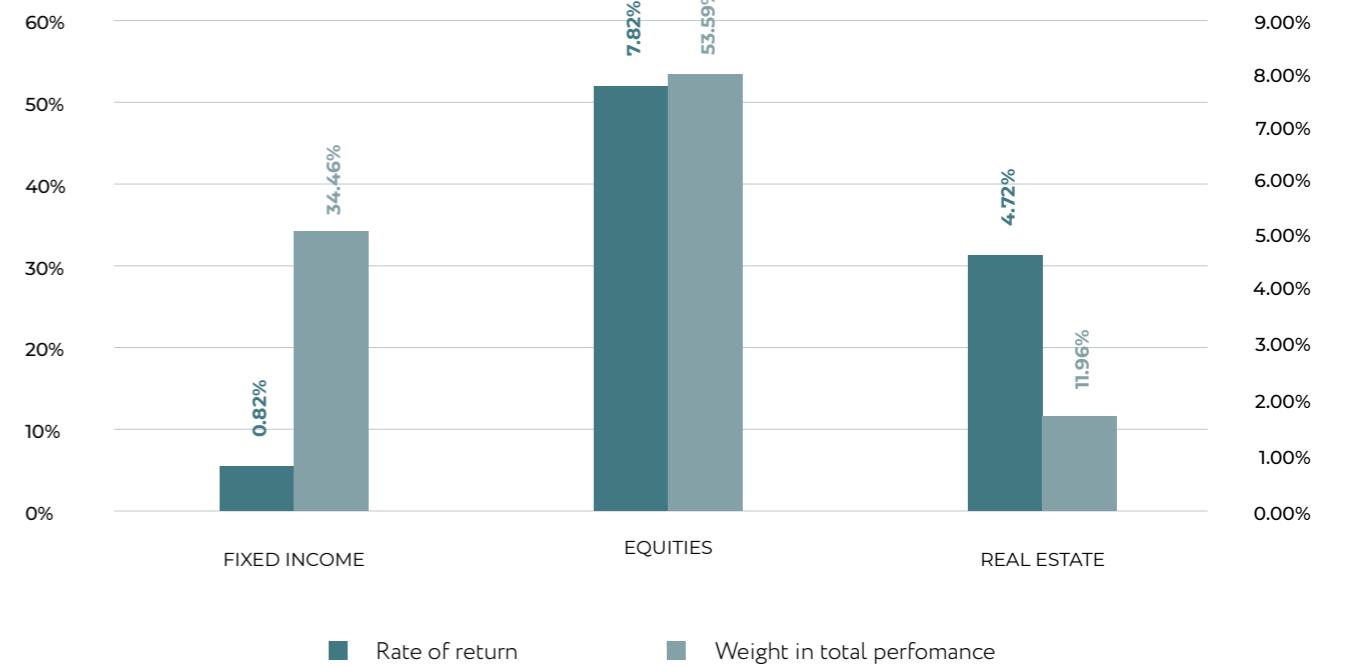
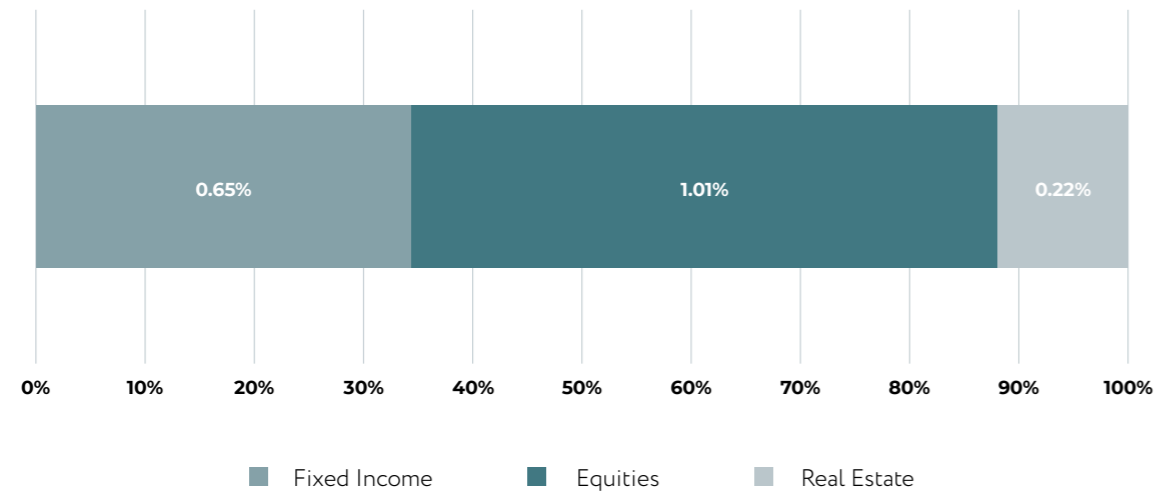


CHART 5.3.3. PERFORMANCE OF ASSET CLASSES AND WEIGHTS OF THEIR CONTRIBUTIONS IN TOTAL PERFORMANCE (1.88%)\*



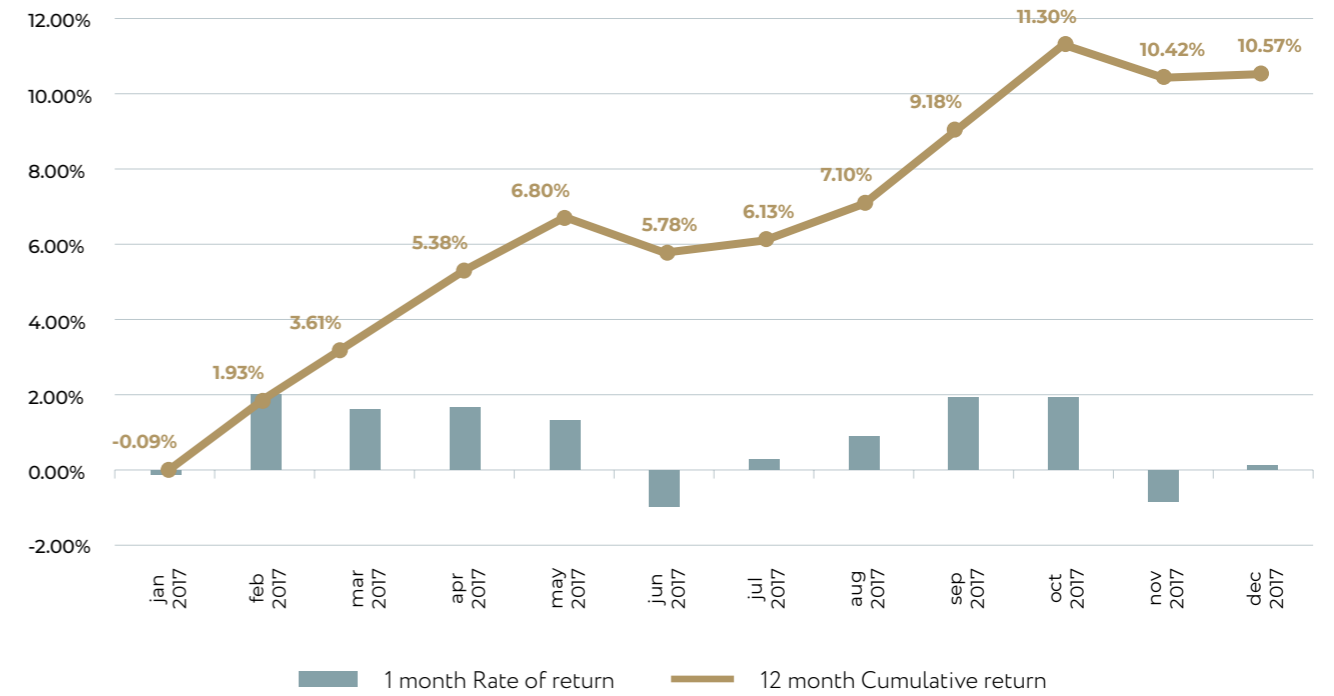
\* Performance of the Gold investments is not included into the total performance results because it is treated as FX effect.

**CHART 5.3.4. CONTRIBUTION TO TOTAL PERFORMANCE BY ASSET CLASS \***

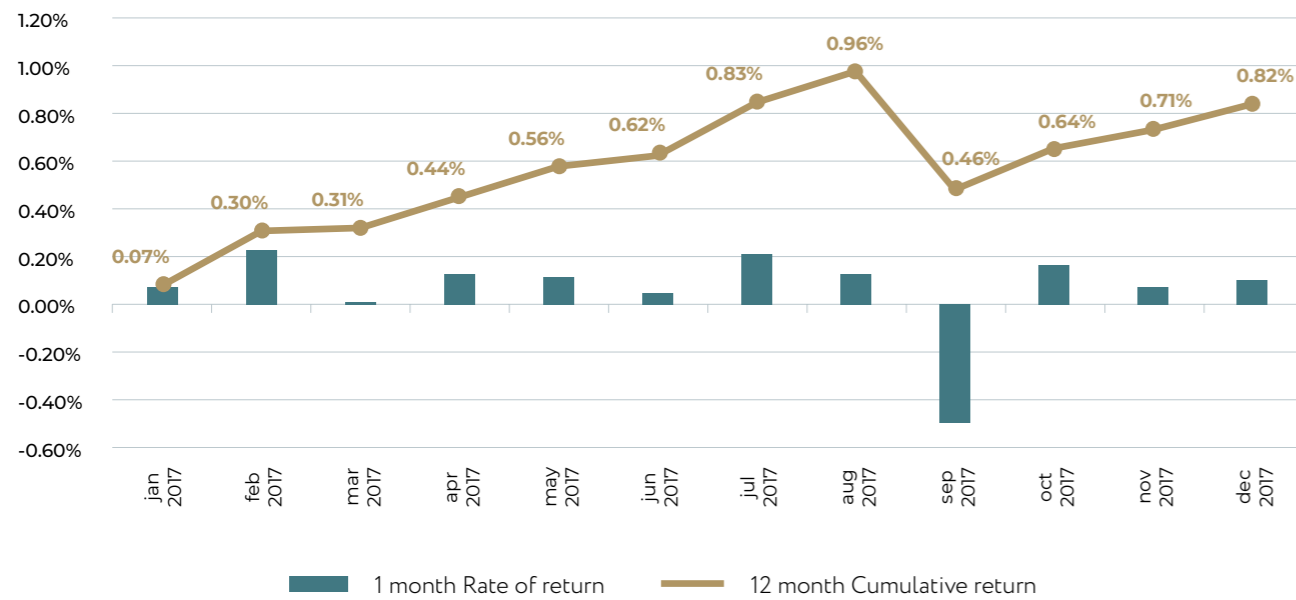


\* Performance of the Gold investments is not included into the total performance results because it is treated as FX effect.

**CHART 5.3.6. CUMULATIVE MONTHLY PUBLIC EQUITY PERFORMANCE**



**CHART 5.3.5. CUMULATIVE MONTHLY FIXED INCOME PERFORMANCE**





#### 5.4. RISK MANAGEMENT

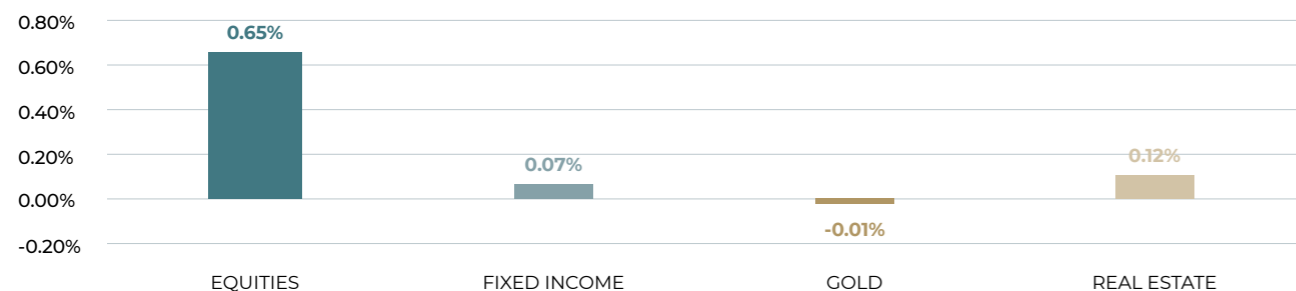
Risk management and risk monitoring procedures of SOFAZ encompass analysis across risk classes. Market risk and credit risk indicators, as well as other relevant measures, are reported both internally and externally. The measures of assessing market risk include Value at Risk, tracking error, scenario analysis, stress tests etc.

To monitor the risk of divergence of SOFAZ's sub-portfolio returns from their passively tracked benchmarks, tracking errors are continually observed. Ex-ante tracking error limits for the equity sub-portfolios managed by UBS Global Asset Management (UBS), State Street Global Advisors (SSgA), Mellon Capital Management (MelCap) and BlackRock Investment Management (BlackRock) are established at the level of 30 bps on an annual basis. As of 31.12.2017, the tracking errors on an annual basis were 11 bps, 5 bps, 3 bps, and 4 bps for the MSCI World index mandate portfolios managed by UBS, SSgA, MelCap and BlackRock respectively, and 9 bps for the MSCI Europe ex UK index mandate portfolio managed by UBS.

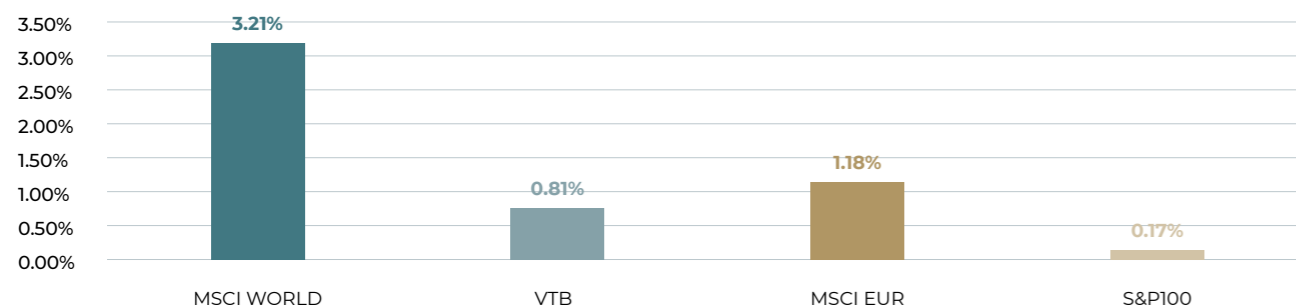
For the purpose of internal risk management, Value at Risk (VaR) is a common, well-recognized and valuable measure of total risk. We obtain VaR of the portfolio using Monte Carlo and historical simulations. As of 31.12.2017, SOFAZ's 20 day horizon 95% VaR accounted for USD 258 million compared to USD 342 million at the end of the previous year.

The calculation of VaR and contributions to VaR of different sub-portfolios is based on local returns, since the impact of FX fluctuations might considerably skew the results, especially those of the fixed income instruments. However, due to the minor impact of FX fluctuations on the VaR of equities, FX effect is not excluded from the results of the latter.

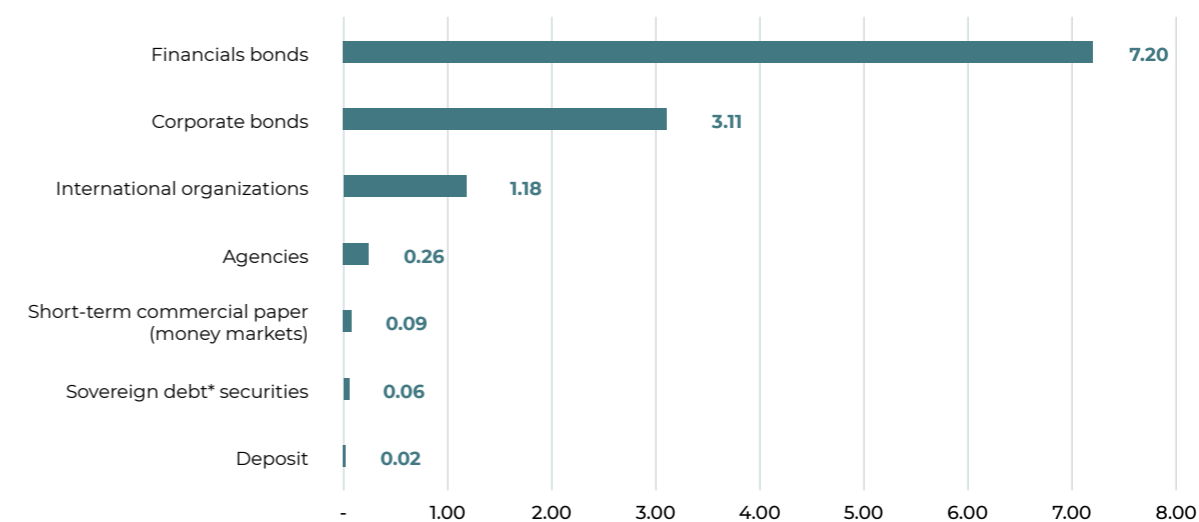
**CHART 5.4.1. CONTRIBUTION TO TOTAL VAR BY ASSET CLASSES (EX FX)**



**CHART 5.4.2. CONTRIBUTION TO EQUITY VAR**

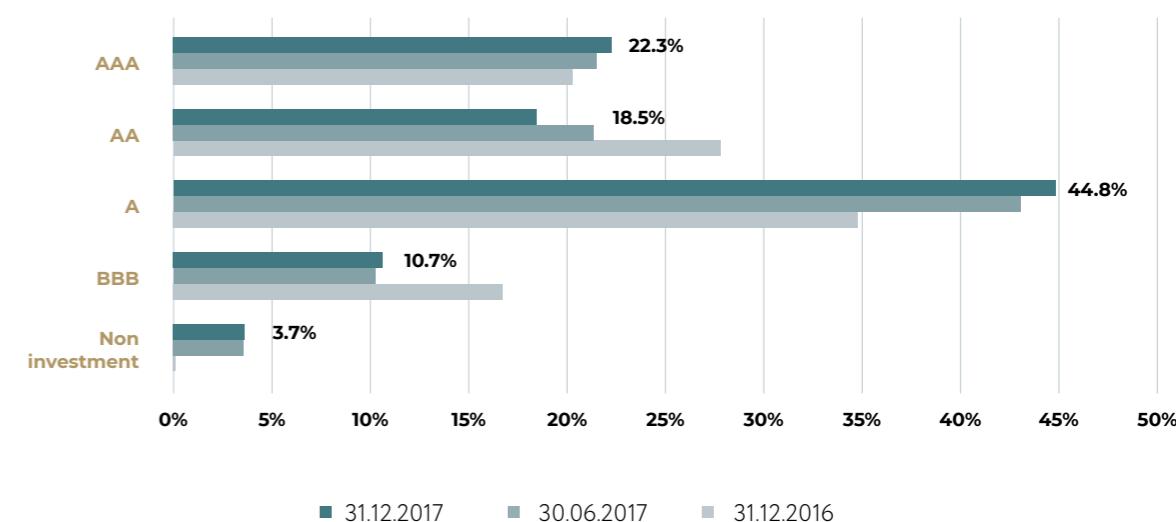


**CHART 5.4.3. CONTRIBUTION TO FIXED INCOME VAR BY PRODUCT TYPES (EX FX, BPS)**



Credit risk management is another crucial part of SOFAZ's risk procedures. SOFAZ's "Investment Guidelines" sets restrictions on the credit ratings of issuers and securities. The Chart 5.4.4 represents the change in the composition of the fixed income portfolio by credit rating from 2016 to 2017.

**CHART 5.4.4. COMPOSITION OF THE FIXED INCOME PORTFOLIO BY CREDIT RATINGS**



# Azerbaijani jazz

---

**AZERBAIJANI JAZZ IS A BRANCH OF JAZZ MUSIC. THE BASIS OF AZERBAIJANI JAZZ WAS LAID BY THE STATE ESTRADA ORCHESTRA, ALSO KNOWN AS THE STATE JAZZ, FORMED BY NIYAZI AND TOFIG GULIYEV IN THE LATE 1930S. THE FIRST LINE-UP OF THE ENSEMBLE CONSISTED OF THREE TROMBONES, THREE TRUMPETS, FIVE SAXOPHONES, A GRAND PIANO, A GUITAR AND DRUMS. ALONG WITH CLASSICAL JAZZ COMPOSITIONS, THE FIRST CONCERT PROGRAM OF THE ORCHESTRA INCLUDED COMPOSITIONS BY NIYAZI AND TOFIG GULIYEV.**

---

In the 1960s, the second era of pop and jazz music began in Azerbaijan with the support and guidance of Gara Garayev, Niyazi, Tofig Guliyev and Rauf Hajiyev. Moreover, Rafiq Babayev formed "Gaya" quartet and finally, Vagif Mustafazadeh's time began.

However, there were still serious gaps in the field of jazz in the 1960s in Azerbaijan, as it was not entirely accepted in certain social circles. Therefore, Tofig Ahmadov began to write jazz compositions using national rhythms and modes. He elaborated folk songs with jazz arrangements and created fantasies for the orchestra.

The revival of jazz music in Azerbaijan is associated with the great pianist and composer Vagif Mustafazadeh, who laid the foundations of jazz mugham (ethno jazz) traditions. In the early 1960s, Vagif Mustafazadeh founded a new genre of music called jazz mugham. He presented oriental mugham in the language familiar to the Western audience, i.e. the language of jazz, and simultaneously, introduced jazz to listeners in his country using the native mugham language.

The pianist has led the musical ensemble "Orero", jazz trio "Gafgaz", female vocal-instrumental ensembles "Leyli" and "Sevil", and the instrumental ensemble "Mugham" until his death. Mustafazadeh was a laureate of several international jazz contests and festivals (Tallinn-66, Tbilisi-78 and Monte-Carlo).

It is also worth to mention an important role of Rafiq Babayev in the formation of jazz in Azerbaijan. He made valuable contributions to jazz music with his amazing compositions.

Azerbaijan still have worthy contemporary jazz musicians. Salman Gambarov, Rain Sultanov, Emil Afrasiyab, Isfar Sarabski and others decently represent national jazz in festivals and contests held in different countries around the world.

## VAGIF MUSTAFAZADEH

The celebrated composer, magnificent pianist, founder of the jazz mugham style and Honoured Artist of Azerbaijan Vagif Aziz oghlu Mustafazadeh was born in Old City, the historic core of Baku on March 16, 1940.

In 1963, he graduated from the Baku Musical College named after Asaf Zeynally and, a year later, enrolled at the Azerbaijan State Conservatoire (presently known as the Baku Academy of Music named after U.Hajibeyli). From his young ages, V.Mustafazadeh impressed everyone with his unusual talent and virtuoso performance.

In 1979, a new festival with unusual conditions set for performance appraisals was held in Monaco. According to the conditions of this festival, a composition's author, performer and a country had to be kept a secret. Vagif Mustafazadeh was de-

servedly chosen the winner of the festival and returned home with a "White Piano" award.

The composer is the author of "Concerto in Jazz Style for Piano and String Orchestra", the (incomplete) symphony "Mugham" as well as numerous jazz compositions and musical pieces. He is the founder of Azerbaijani jazz and new jazz ideas.

Mustafazadeh fused traditional Azerbaijani music and mugham with classical American jazz. He is an architect of Azerbaijan's jazz mugham movement.

He died of a heart attack on December 16, 1979, in Tashkent, Uzbekistan and was buried in Baku.

The source: "Medeniyyet" newspaper



## 6. 2017 SOFAZ BUDGET EXECUTION

SOFAZ's budget for 2017 was approved by the Presidential Decree №1186 on January 10, 2017. In 2017, SOFAZ's budget revenues and expenditures were projected to constitute AZN 8 370 589.9 thousand and AZN 14 483 856.0 thousand, respectively. Moreover, the Presidential Order as of October 04, 2017 introduced certain amendments to the SOFAZ's 2017 budget. Based on these amendments introduced within the framework of the policy of specifying the consolidated budget, the projected SOFAZ's budget revenues were raised from AZN 8 370 589.9 thousand to AZN 10 813 861.6 thousand, while the expenditures increased from AZN 14 483 856.0 thousand up to AZN 15 242 928.0 thousand.

As of January 1, 2017, SOFAZ's assets amounted to AZN 56 979.0 million, or USD 33 147.0 million.

Throughout the reference year, SOFAZ's assets have risen by USD 2 659.5 million, or 8.02%, eventually reaching USD 35 806.5 million. At the same time, SOFAZ's assets as expressed in the national currency, have grown by AZN 1 998.2 million (3.51%) and reached to AZN 58 977.2 million by the end of the year.

In 2017, SOFAZ's budget revenues constituted AZN 12 137.5 million, or USD 7 065.5 million, meaning that the sum envisaged in the budget plan (AZN 10 813.9 million) was executed at the level of 112.24%. The overall SOFAZ revenues as expressed in US dollars were 19.94% above the respective figure in 2016 (USD 5 891.1 million).

The actual budget expenditures in 2017 equaled AZN 11 015.5 million (USD 6 373.4 million), or 72.27% of the estimated amount (AZN 15 242.9 million). Despite the fact that the SOFAZ's 2017 budget was initially expected to incur a deficit of AZN 4 429.1 million, the budget was executed with a profit of AZN 1 122.0 million.

**Revenues.** In 2017, revenues accrued to SOFAZ were formed from sales of the Republic of Azerbaijan's share of hydrocarbons, fees paid to Azerbaijan for the transit of oil and gas through its territory, bonus payments, acreage fees and revenues from the management of SOFAZ's assets.

In 2017, **revenues from the sale of profit oil and gas** constituted AZN 11 030.0 million, or USD 6 409.6 million. The volume of production at ACG field constituted 214.75 million barrels, which was 1.4% above the forecasted amount (211.7 million barrels). Since oil prices were higher than estimated throughout the reference year, the respective revenue item was executed at 12.3% higher level than projected in the budget (AZN 9 826.2 million). That is, the average sale price of oil constituted USD 52.9 per barrel in 2017 in contrast to USD 40 that was forecasted in the budget plan.

**Acreage fees** paid by the foreign investors working in the hydrocarbons production sector made up another source of the SOFAZ's income in 2017. In accordance with the terms of the agreement between SOCAR and a company jointly owned by SOCAR and BP Exploration Limited on oil prospecting, exploitation and production sharing at the Shafag-Asiman offshore field situated in the Azerbaijani sector of the Caspian Sea, USD 2.1 million, or AZN 3.6 million of acreage fees was transferred to SOFAZ. This revenue item was executed at 100%, compared to the budget plan (AZN 3.6 million).

The revenues obtained from the **transit of oil and gas through the territory of Azerbaijan** in the reference year amounted to USD 10.5 million, or AZN 17.9 million. Compared to the budgetary target of AZN 17 688.5 thousand, the aforementioned item was executed at 101.3%.

In the reference year, the **bonus payments received** by SOFAZ constituted AZN 2.4 million (USD 1.4 million), with the execution rate of 100%, compared to the budget plan (AZN 2.4 million).

The revenues accrued to SOFAZ from the **management of its investment portfolio** equaled USD 641.9 million USD in 2017.

TABLE 6.1. SOFAZ'S REVENUES IN 2017

№	Sources of revenue	Total revenue (AZN million)		Execution rate
		envisioned	actual	
1.	Net income obtained from the sales of hydrocarbons falling into the share of Azerbaijan (excluding expenditures on transportation, customs clearance and banking services, independent surveyor services, marketing and insurance, as well as the shareholder incomes received by SOCAR in the capacity of investor, shareholder or partner in different projects it is a party to)	9 826.2	11 030.0	112.25
2.	Acreage fees paid by investors for land they use for the exploitation of hydrocarbon reserves	3.6	3.6	100.0
3.	Fees from the transit of oil and gas through the territory of the Republic of Azerbaijan	17.7	17.9	101.13
4.	Bonus payments made by investors within the framework of signing or executing oil and gas contracts	2.4	2.4	100.0
5.	Revenues obtained from the management of SOFAZ's assets	963.9	1 083.6	112.42
6.	<b>Total revenues</b>	<b>10 813.8</b>	<b>12 137.5</b>	<b>112.24</b>
7.	<b>Extrabudgetary revenues</b>		<b>876.2</b>	

**Extrabudgetary revenues.** In 2017, SOFAZ's extrabudgetary incomes resulted from the appreciation of the foreign currencies in SOFAZ's portfolio against manat amounted to AZN 707.5 million, while extrabudgetary revenues from the changing price of gold equaled AZN 168.7 million. Apart from that, SOFAZ's extrabudgetary revenues as expressed in its base currency (US dollar) constituted USD 1 967.4 million.

**Expenditures.** SOFAZ's budget expenditures in 2017 were executed at the level of 72.3% from the projected amount and constituted AZN 11 015.5 million. In the reference year, the structure of SOFAZ's expenditure was as follows:

**Financing measures aimed at ameliorating social and living conditions of the refugees and internally displaced persons.** In 2017, a total sum of AZN 105.0 million was spent on funding the aforementioned measures, with the execution rate of 100% (AZN 105.0 million).

**Upper limit of the transfer from SOFAZ to the state budget.** In 2017 a transfer of AZN 6 100.0 million from SOFAZ to the state budget was executed, 100% of the sum envisioned in the budget projections (AZN 6 100.0 million).

**Upper limit to the transfer to the Central Bank of the Republic of Azerbaijan with the purpose of preserving macroeconomic stability.** In the reference year, AZN 3 949.5 million, or USD 2 263.0 million was transferred from SOFAZ to CBAR, hence the execution rate of this expenditure item constituted 52.7%.

The budget for financing the **project on the reconstruction of the Samur-Absheron irrigation system** was executed at the 100% level (AZN 70.0 million) in the reference year.

USD 12.1 million, or AZN 20.5 million was channelled by SOFAZ to the **financing of the New Baku-Tbilisi-Gars Railway project** in 2017, amounting to 12.4% of the initially projected sum of AZN 165.8 million.

The **"State Program on education of Azerbaijani youth abroad in the years 2007-2015"** was financed by SOFAZ at AZN 17.0 million, 58.0% of the sum initially allocated for the respective budget item (AZN 29.3 million).

**Financing the share of the Republic of Azerbaijan in the STAR project.** In accordance with the orders of the Ministry of

Economy, AZN 735.4 million (USD 432.6 million) was allocated by SOFAZ to the Ministry's account, and the execution rate of this budget item constituted 98.8%. The process of financing the share of the Republic of Azerbaijan in the STAR project came to an end in 2017.

**Financing the share of the Republic of Azerbaijan in the Southern Gas Corridor project.** Since the financing of the project has been done by raising debt capital in 2017, no payment was made by SOFAZ.

**SOFAZ's administrative expenses** in 2017 equaled AZN 18.1 million, or 55.5% of the respective item as envisioned in the budget plan (AZN 32.6 million).

TABLE 6.2. SOFAZ'S EXPENDITURES IN 2017

№	Expenditure items	Expenditure amount (AZN million)		Execution rate
		Confirmed	Actual	
1.	Financing measures aimed at ameliorating social and living conditions of the refugees and internally displaced persons	105.0	105.0	100
2.	Transfer from SOFAZ to the state budget in 2017	6 100	6 100	100
3.	Financing the project on the reconstruction of the Samur-Absheron irrigation system	70	70	100
4.	Financing the new Baku-Tbilisi-Kars railway project	165.8	20.5	12.4
5.	State Program on education of Azerbaijani youth abroad in the years 2007-2015	29.3	17	58
6.	Upper limit to the transfer to the Central Bank of the Republic of Azerbaijan with the purpose of preserving macroeconomic stability	7 500	3 949.5	52.7
7.	Financing the share of the Republic of Azerbaijan in the Southern Gas Corridor	496.2	0.0	0.0
8.	Financing the share of the Republic of Azerbaijan in the project on construction of the "STAR" oil refinery complex in the Republic of Turkey	744.1	735.4	98.8
9.	SOFAZ's administrative expenses	32.6	18.1	55.5
10.	<b>Total expenses</b>	<b>15 243</b>	<b>11 015.5</b>	<b>72.3</b>

**RAFIG BABAYEV**

Rafiq Babayev was born in Baku on March 31, 1936.

In 1954, Rafiq Babayev entered the Azerbaijan State Conservatoire named after Uzeyir Hajibeyli (presently known as Baku Academy of Music) where he was a student in Professor Rauf Atakishiyev's piano class.

In 1955, Rafiq Babayev formed his first jazz quartet and started performing at clubs in Baku.

In 1957, Rafiq successfully represented Baku at the "World Festival of Youth and Students" held in Moscow. In 1960, Babayev formed a jazz band with Baku-based musicians and embarked on a three-year tour across the Soviet Union.

He performed in various jazz festivals along with his jazz band, recorded jazz albums, and organized the first jazz festivals in Baku.

Rafiq Babayev travelled the world with a variety of bands in the course of this career.

Babayev worked as a music director of the band "Gaya" during 1965–1966 and 1970–1971. In 1983, Babayev headed the Symphonic Estrada Orchestra of the State Television and Radio Broadcasting Committee.

In 1986, Rafiq Babayev founded a jazz-oriented Estrada music department in Baku Musical School. A year later, he authored the project named "Concert studio of Estrada and jazz music". In 1991, R.Babayev opened his own recording studio and formed the jazz band "Jangi".

On March 19, 1994, he was killed in an explosion at a metro station.

The source: "Medeniyyet" newspaper

**ISFAR SARABSKI**

An Azerbaijani pianist, composer and honoured artist Isfar Aydin oghlu Rzayev-Sarabski was born in Baku on November 2, 1989. He is the great-grandson of Huseyngulu Sarabski, the renowned Azerbaijani opera singer, actor and one of the founders of the Eastern opera.

He graduated from the Bulbul Specialized Secondary Music School and thereafter from the Baku Academy of Music. Sarabski performed at the world's best concert halls where he promoted Azerbaijan's musical culture. In 2011, the participant of numerous festivals in Switzerland, Norway, France, Russia and Georgia, Isfar Sarabski formed "Isfar Sarabski Trio" with Alexander Mashin (drums) and Makar Novikov (contrabass), Moscow-based musicians. On July 18, 2009, he won the Solo Piano Competition of the 43rd Montreux Jazz Festival in Switzerland.

Sarabski shared a stage with the Royal Philharmonic Concert Orchestra, the Oleg Lundstrem Orchestra, and celebrated musicians including Igor Butman, Ben Williams, Mark Guiliana, Alan Hampton, Pat Senatore, Greg Swiller, Eric Klass, Christian Veber, Samuel Rohrer, Malcolm Creese and James Maddren.

He is the author of the following compositions: "Novruz", "G-Man", "Generation", "Edge", "Deja Vu", "Melancholy Evening", "Last Chance", "Preludiya", "Agent", "Revival", "Eastern Market", "Now I'm Here", "In Transit to New York", "Buta", "Lullaby", "Limping Stranger", "Cobra Dance" and "In Memory of V. Mustafazadeh".

The source: "Medeniyyet" newspaper



## 7. CONSOLIDATED FINANCIAL STATEMENTS OF SOFAZ

**31 DECEMBER 2017**

**INTERNATIONAL FINANCIAL REPORTING STANDARDS  
CONSOLIDATED FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITOR'S REPORT**

### **INDEPENDENT AUDITOR'S REPORT 90** **CONSOLIDATED FINANCIAL STATEMENTS 90**

Consolidated Statement of Financial Position	92
Consolidated Statement of Profit or Loss and Other Comprehensive Income	93
Consolidated Statement of Changes in Equity	94
Consolidated Statement of Cash Flows	96

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 97**

1. The State Oil Fund of the Republic of Azerbaijan and its Operations	97
2. Operating Environment of the Fund	99
3. Summary of Significant Accounting Policies	100
4. Critical Accounting Estimates, and Judgements in Applying Accounting Policies	110
5. Adoption of New or Revised Standards and Interpretations	110
6. New Accounting Pronouncements	110
7. Cash and Cash Equivalents	114
8. Trading Securities	116
9. Other Financial Assets at Fair Value through Profit or Loss	119
10. Financial Assets at Amortised Cost	120
11. Gold Bullion	122
12. Investment Properties	122
13. Investments in Joint Ventures	124
14. Capital Contributions	126
15. Non-Current Liabilities	126
16. Interest Income and Other Investment Income	127
17. Foreign Currency Translation Differences	127
18. Net Fair Value Gain on Financial Assets at Fair Value Through Profit or Loss	127
19. Operating expenses	127
20. Transfers by the Fund	128
21. Income Taxes	128
22. Fair Value of Financial Instruments	128
23. Financial Risk Management	131
24. Commitments and Contingencies	140
25. Transactions with Related Parties	140
26. Interests in Structured Entities	142
27. Events after the Reporting Period	142

## INDEPENDENT AUDITOR'S REPORT

TO THE SUPERVISORY BOARD OF THE STATE OIL FUND OF THE REPUBLIC OF AZERBAIJAN:

### OUR OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the State Oil Fund of the Republic of Azerbaijan (the "SOFAZ") and its subsidiaries (together – the "Fund") as at 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

### WHAT WE HAVE AUDITED

The Fund's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2017;
- the consolidated statement of profit and loss and other comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

### BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report.

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

### INDEPENDENCE

We are independent of the Fund in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code).

### 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 Fund'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 Fund or to cease operations, or has no realistic alternative but to do so.

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

### AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional 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 Fund'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 Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund 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 Fund 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.

*PricewaterhouseCoopers Audit Azerbaijan LLC*

29 March 2018  
Baku, the Republic of Azerbaijan

PricewaterhouseCoopers Audit Azerbaijan LLC  
The Landmark Office Plaza III, 12th floor, 90A, Nizami Street  
AZ1010, Baku, Azerbaijan  
T: +994 (12) 497 25 15, F: +994 (12) 497 64 11, www.pwc.com/az

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

In thousands of Azerbaijani Manats	Notes	31 December 2017	31 December 2016
<b>Assets</b>			
<b>Non-current assets</b>			
Financial assets at amortised cost	10	5,199,931	5,378,473
Investment properties	12	2,763,757	2,619,625
Property and equipments		132,992	141,180
Other non-current and intangible assets		8,204	11,316
Investments in joint venture	13	979,598	787,589
<b>Total non-current assets</b>		<b>9,084,482</b>	<b>8,938,183</b>
<b>Current assets</b>			
Cash and cash equivalents	7	2,747,381	6,218,035
Trading Securities	8	45,492,913	40,726,478
Other financial assets at fair value through profit or loss	9	1,440,247	737,966
Financial assets at amortised cost	10	137,285	142,206
Gold bullion	11	2,137,212	1,968,469
Other current assets		32,888	41,393
<b>Total current assets</b>		<b>51,987,926</b>	<b>49,834,547</b>
<b>TOTAL ASSETS</b>		<b>61,072,408</b>	<b>58,772,730</b>
<b>Equity</b>			
Contributed capital	14	27,688,603	27,632,157
Foreign currency translation reserve		1,173,876	952,240
Retained earnings		31,656,494	29,658,449
<b>Equity attributable to the Fund</b>		<b>60,518,973</b>	<b>58,242,846</b>
<b>Non-controlling interest</b>	26	<b>8,020</b>	<b>7,208</b>
<b>Total equity</b>		<b>60,526,993</b>	<b>58,250,054</b>
<b>Liabilities</b>			
<b>Non-current liabilities</b>			
Borrowings of subsidiaries		469,979	472,007
Tenancy deposits		40,087	37,776
Other non-current liabilities		19,783	243
<b>Total non-current liabilities</b>	15	<b>529,849</b>	<b>510,026</b>
<b>Current liabilities</b>		<b>15,566</b>	<b>12,650</b>
<b>TOTAL LIABILITIES</b>		<b>545,415</b>	<b>522,676</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>61,072,408</b>	<b>58,772,730</b>

**CONSOLIDATED STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME**

In thousands of Azerbaijani Manats	Notes	2017	2016
Interest income and other investment income	16	977,101	1,005,830
Net gain on foreign currency translation differences	17	744,033	5,320,847
Net gain on financial assets at fair value through profit or loss	18	73,663	71,666
Net gain on gold bullions	11	168,743	349,574
Net fair value (loss)/gain on revaluation of investment properties	12	15,466	(26,827)
Rental income		92,063	100,956
Other operating income		16,426	17,535
<b>Total operating income</b>		<b>2,087,495</b>	<b>6,839,581</b>
Operating expenses	19	(68,744)	(56,250)
Share of after tax results of joint venture	13	(1,491)	2,694
<b>Profit before income tax</b>		<b>2,017,260</b>	<b>6,786,025</b>
Income tax	21	(17,937)	(902)
<b>Net profit for the year</b>		<b>1,999,323</b>	<b>6,785,123</b>
<b>Other comprehensive income:</b>			
<i>Items that may be reclassified subsequently to profit or loss</i>			
<i>Translation of financial information of foreign operations to presentation currency</i>			
		224,386	68,872
<b>Other comprehensive income for the year</b>		<b>224,386</b>	<b>68,872</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<b>2,223,709</b>	<b>6,853,995</b>
<b>Profit is attributable to:</b>			
- The Fund		1,998,045	6,784,315
- Non-controlling interest	26	1,278	808
<b>Profit for the year</b>		<b>1,999,323</b>	<b>6,785,123</b>
<b>Total comprehensive income is attributable to:</b>			
- The Fund		2,219,681	6,850,380
- Non-controlling interest	26	4,028	3,615
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<b>2,223,709</b>	<b>6,853,995</b>



CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Note	Attributable to the Fund				Total	Noncontrol- ling interest	Total Equity
		Contributed capital	Currency translation reserve	Retained earnings/ (Accumulated deficit)	Total			
<b>In thousands of Azerbaijani Manats</b>								
<b>At 1 January 2016</b>		<b>28,292,786</b>	<b>886,175</b>	<b>22,874,134</b>	<b>52,053,095</b>	<b>13,809</b>	<b>52,066,904</b>	
Profit for the year		-	-	6,784,315	6,784,315	808	6,785,123	
Other comprehensive income		-	66,065	-	66,065	2,807	68,872	
<b>Total comprehensive income for 2016</b>		<b>-</b>	<b>66,065</b>	<b>6,784,315</b>	<b>6,850,380</b>	<b>3,615</b>	<b>6,853,995</b>	
Contributions received	14	8,341,348	-	-	8,341,348	-	8,341,348	
Disposal of non-controlling interest in subsidiaries		-	-	-	-	(10,216)	(10,216)	
Transfers to the State Budget	20	(7,615,000)	-	-	(7,615,000)	-	(7,615,000)	
Transfers for construction of "Star" oil refinery complex	20	(331,776)	-	-	(331,776)	-	(331,776)	
Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund	20	(89,995)	-	-	(89,995)	-	(89,995)	
Transfers for the reconstruction of Samur Absheron Irrigation system	20	(69,998)	-	-	(69,998)	-	(69,998)	
Transfers for the construction of new Baku-Tbilisi-Kars railway line	20	(66,174)	-	-	(66,174)	-	(66,174)	
Transfers for the State Program on "Education of Azerbaijani youth abroad"	20	(31,607)	-	-	(31,607)	-	(31,607)	
Transfer for the "Southern Gas Corridor"	20	(797,427)	-	-	(797,427)	-	(797,427)	
<b>Balance at 31 December 2016</b>		<b>27,632,157</b>	<b>952,240</b>	<b>29,658,449</b>	<b>58,242,846</b>	<b>7,208</b>	<b>58,250,054</b>	
Profit for the year		-	-	1,998,045	1,998,045	1,278	1,999,323	
Other comprehensive income		-	221,636	-	221,636	2,750	224,386	

The notes set out on pages 97 to 142 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (CONTINUED)

	Note	Attributable to the Fund				Total	Noncontrol- ling interest	Total Equity
		Contributed capital	Currency translation reserve	Retained earnings/ (Accumulated deficit)	Total			
<b>In thousands of Azerbaijani Manats</b>								
<b>Total comprehensive income for 2017</b>		<b>-</b>	<b>221,636</b>	<b>1,998,045</b>	<b>2,219,681</b>	<b>4,028</b>	<b>2,223,709</b>	
Contributions received	14	11,053,917	-	-	11,053,917	-	11,053,917	
Exchange translation differences		-	-	-	-	(3,216)	(3,216)	
Transfers to the State Budget	20	(6,100,000)	-	-	(6,100,000)	-	(6,100,000)	
Transfers for construction of "Star" oil refinery complex	20	(735,422)	-	-	(735,422)	-	(735,422)	
Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund	20	(105,000)	-	-	(105,000)	-	(105,000)	
Transfers for the reconstruction of Samur Absheron Irrigation system	20	(69,997)	-	-	(69,997)	-	(69,997)	
Transfers for the construction of new Baku-Tbilisi-Kars railway line	20	(20,557)	-	-	(20,557)	-	(20,557)	
Transfers for the State Program on "Education of Azerbaijani youth abroad"	20	(17,010)	-	-	(17,010)	-	(17,010)	
Transfers to the Central Bank of the Republic of Azerbaijan	20	(3,949,485)	-	-	(3,949,485)	-	(3,949,485)	
<b>Balance at 31 December 2017</b>		<b>27,688,603</b>	<b>1,173,876</b>	<b>31,656,494</b>	<b>60,518,973</b>	<b>8,020</b>	<b>60,526,993</b>	

The notes set out on pages 97 to 142 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

In thousands of Azerbaijani Manats	Notes	2017	2016
<b>Cash flows from operating activities:</b>			
Profit before income tax expense		2,017,260	6,786,025
Adjustments to reconcile result to net cash used in operating activities			
Depreciation of property and equipment		5,757	5,679
Amortization of intangible assets		3,263	3,400
Unrealized (gain)/loss on change in fair value of financial assets at fair value through profit or loss	18	(75,740)	(82,537)
Net unrealized gain on foreign currency translation differences		(874,299)	(4,980,520)
Net gain on revaluation of gold bullion	11	(168,743)	(349,574)
Fair value loss/(gain) on revaluation of investment properties	12	(15,466)	26,827
Share of after tax results of joint venture	13	1,491	(2,694)
Change in interest accruals		(79,870)	(62,272)
Changes in operating assets and liabilities:			
Decrease/(increase) in financial assets at fair value through profit or loss	8, 9	(4,279,839)	1,640,113
Decrease in financial assets at amortised cost	10	74,943	14,166
Increase in investment properties	12	(4,412)	(412,763)
Increase in investment in joint venture	13	(193,500)	(153,000)
(Decrease)/increase in other assets		8,900	(8,792)
(Decrease)/increase in current liabilities		2,917	(3,229)
<b>Net cash (used in)/from operating activities</b>		<b>(3,577,338)</b>	<b>2,420,829</b>
Income tax paid		(1,529)	(902)
<b>Net cash (used in)/from operating activities before income tax</b>		<b>(3,578,867)</b>	<b>2,419,927</b>
<b>Cash flows from investing activities:</b>			
Purchase of property and equipment		-	(11,409)
Decrease in other non-current assets		2,280	-
<b>Net cash (used in)/from investing activities</b>		<b>2,280</b>	<b>(11,409)</b>
<b>Cash flows from financing activities:</b>			
Contributions received	14	11,053,917	8,341,348
Transfers to the State Budget	20	(6,100,000)	(7,615,000)
Transfers to the Central Bank of the Republic of Azerbaijan	20	(3,949,485)	-
Transfers for construction of "Star" oil refinery complex	20	(735,422)	(331,776)
Transfers for the reconstruction of Samur Absheron Irrigation system	20	(69,997)	(69,998)
Transfers to the State Refugees Committee and Internally Displaced Peoples' Social Development Fund	20	(105,000)	(89,995)
Transfers for the construction of new Baku-Tbilisi-Kars railway line	20	(20,557)	(66,174)
Transfers for the State Program on "Education of Azerbaijani youth abroad"	20	(17,010)	(31,607)
Transfer for the "Southern Gas Corridor"	20	-	(797,427)
Proceeds from non-current liabilities		1,388	477,560

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

In thousands of Azerbaijani Manats	Notes	2017	2016
<b>Net cash (used in)/from financing activities</b>		<b>57,834</b>	<b>(183,069)</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>		<b>48,099</b>	<b>631,180</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(3,470,654)</b>	<b>2,856,629</b>
<b>Cash and cash equivalents, beginning of the year</b>	7	<b>6,218,035</b>	<b>3,361,406</b>
<b>Cash and cash equivalents, end of the year</b>	7	<b>2,747,381</b>	<b>6,218,035</b>
Operating cash flows from interest and dividend received		980,831	716,304

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS – 31 DECEMBER 2017

1. THE STATE OIL FUND OF THE REPUBLIC OF AZERBAIJAN AND ITS OPERATIONS

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2017 for the State Oil Fund of the Republic of Azerbaijan (the "SOFAZ") and its subsidiaries (the "Fund").

SOFAZ was incorporated and is domiciled in the Azerbaijan Republic.

**Principal Activity.** The State Oil Fund of the Republic of Azerbaijan ("SOFAZ") was established by Decree #240 of the President of the Republic of Azerbaijan on the "Establishment of The State Oil Fund of the Republic of Azerbaijan" dated 29 Decem-

ber 1999 (the "Decree"). The purpose of SOFAZ is to ensure the accumulation, effective management, and use of income and other inflows generated from agreements related to oil and gas exploration and development, as well as, from SOFAZ's own activities, for the benefit of citizens and future generations of the Republic of Azerbaijan.

In accordance with the Decree and the Regulations (discussed below), SOFAZ is an extra-budget state organization, formed as a separate legal entity, which is accountable and responsible to the President of the Republic of Azerbaijan.

The consolidated financial statements include the financial statements of SOFAZ and its direct and indirect subsidiaries listed in the following table and the after tax results of its joint venture(together the "Fund"):

Subsidiary	% interest		Country	Date of establishment	Date of acquisition	Industry
	2017	2016				
SOFAZ Re Ltd.	100	100	Island of Jersey	22-may-12	-	Property management
SOFAZ Re UK L.P.	100	100	Island of Jersey	6-aug-12	-	Property management
SOFAZ Re Min Ltd.	100	100	Island of Jersey	13-aug-12	-	Property management
78, St James `s Street Unit Trust	100	100	Island of Jersey	2-oct-12	-	Property management
JSC Tverskaya 16	100	100	Russian Federation	29-jun-93	21-dec-12	Property management

CONTINUED

Subsidiary	% interest		Country	Date of establishment	Date of acquisition	Industry
	2017	2016				
SOFAZ RE Europe Holding S.a.r.l	100	100	Luxembourg	31-oct-12	-	Property management
SOFAZ RE Europe S.a.r.l.	100	100	Luxembourg	31-oct-12	-	Property management
SCI 8 Place Vendome	100	100	France	14-nov-12	-	Property management
Pine Avenue Tower A	100	100	South Korea	30-oct-11	31-mar-14	Property management
GK001	98	98	Japan	21-aug-15	26-aug-15	Property management
SOFAZ RE Fund	100	100	Luxembourg	27-may-15	-	Investment management
SOFAZ PE Fund	100	100	Luxembourg	28-sep-15	-	Investment management
SOFAZ Italy Fund	100	100	Italy	19-oct-15	-	Property management
SOFAZ Europe Securitization S.a.r.l	100	-	Luxembourg	6-dec-17	-	Investment management

Contributions into the Fund are made in accordance with the Regulation of the Fund ("Regulation") approved by Presidential Decree #434 dated 29 December 2000 as amended by Presidential Decrees #849 and #202 on "Amending Certain Legislative Acts Regulating the Operations of The State Oil Fund of the Republic of Azerbaijan" dated 7 February 2003 and 1 March 2005, respectively, and Article 2.3 of the "Regulations on Development and Implementation of the Annual Program of Income and Expenses ("Budget") of the Fund" approved by Presidential Decree #579 dated 12 September 2001 as amended by Presidential Decrees #849 and #202 mentioned earlier. Pursuant to the Regulations of the Fund, contributions are received from the following sources:

**a)** Agreements on exploration, development and production sharing for oil and gas fields in the territory of the Republic of Azerbaijan including the Azerbaijan Sector of the Caspian Sea, as well as other agreements on oil and gas exploration, development and transportation entered into between the State Oil Company of the Republic of Azerbaijan ("SOCAR") or other authorized state bodies and investors, including:

**i.** Contributions from the sale of hydrocarbons related to the share of the Republic of Azerbaijan in oil and gas agreements (net of expenditures incurred for hydrocarbons transportation, customs clearance and bank costs, marketing, insurance, and independent surveyor fees) excluding portion related to the

participating interest or investment of SOCAR in a project in which SOCAR is an investor, participant or a contracting party;

**ii.** Bonus payments - the fees payable by foreign oil companies to SOCAR or other relevant authorities of the Republic of Azerbaijan due to signing of an oil contract and its implementation;

**iii.** Acreage payments due to SOCAR and/or an authorized state body of the Republic of Azerbaijan from investors for the use of the contract area in connection with oil and gas exploration and development;

**iv.** Contributions generated from oil and gas transported over the territory of the Republic of Azerbaijan with the use of the Baku-Supsa export pipeline;

**b)** Revenues generated from investment, management, sale and other disposal of the Fund's assets (including financial assets and assets contributed by investors within oil and gas agreements), other non-sale income or revaluation surplus of the Fund's assets in its reporting currency (Azerbaijani manats), etc.;

**c)** Grants and other free aids;

**d)** Other revenues and receipts in accordance with the legislation of the Republic of Azerbaijan.

Under the provisions of the Fund's Regulations approved by the President of the Republic of Azerbaijan, SOCAR or an authorized state body implements the collection of the fees listed above and transfers them to SOFAZ.

The Regulations exclude the following from the list of sources of the Fund's contribution and assets:

- The rental fees from the use of state property under contracts with foreign companies;
- Contributions from the sale of hydrocarbons related to the participating interest or investment of SOCAR in any project in which SOCAR is an investor, participant or a contracting party; and
- Other proceeds generated from joint activities with foreign companies.

In 2017 and 2016, the Fund was a party to a custody agreement with the Bank of New York Mellon. Management of some portion of the financial assets of the Fund is granted to financial institutions, which were four in 2016, namely Deutsche Asset Management International GmbH (Deutsche Bank AG), the International Bank for Reconstruction and Development (IBRD – World Bank Group), State Street Global Advisors (SSGA), Union Bank of Switzerland (UBS). Three more investment management agreements were signed with Sumitomo Mitsui Trust International LTD, Blackrock Investment Management (UK) LTD and Mellon Capital Management Corporation in 2017. Under the custody agreement the financial institutions hold securities purchased by the Fund, whereas in accordance with the investment management agreements the financial institutions manage the Fund's investments based on general investment policies established by the Fund.

SOFAZ's registered and actual office address is 165, Heydar Aliyev Avenue, Baku, Azerbaijan, AZ1029.

These consolidated financial statements as of and for the year ended 31 December 2017 are authorized for issue by the Fund's Management on 29 March 2018.

**Presentation currency.** These consolidated financial statements are presented in thousands of Azerbaijani Manats ("AZN"), unless otherwise stated.

2. OPERATING ENVIRONMENT OF THE FUND

During 2017, the Republic of Azerbaijan displayed macro-economic processes of an emerging market. Its economy was resilient to changes in oil and gas prices as a result of effective inter-institutional communication in the field of monetary policy and accumulated foreign currency reserves in support of the fiscal sector. Furthermore, economic reforms undertaken by government, restructuring of banks, reforms in financial and monetary policy have made a significant contribution to the economic sustainability of Azerbaijan.

Following the devaluation of national currency against major international currencies, which took place in 2015, the domestic currency market continued to be strained, which was significantly reflected in the financial and budgeting activities of the Fund. At the same time, the measures financed by the Fund's transfers to the Central Bank with the purpose of preserving macroeconomic stability within the approved budget of the Fund for 2017, played a significant role in achieving stability in the currency market.

During the reporting period, tight monetary policy decisions were taken towards the reduction inflation and strengthening of confidence in the national currency. In this respect, the government of the Republic of Azerbaijan implemented macroeconomic stability-oriented policy and the size of money supply was regulated in light of economic growth and inflation forecasts, developments in financial markets and the Fund's liquidity position.

Significant measures have been taken in taxation as well. To ensure more operative and transparent regulations many amendments were made to Tax Code in 2017. As a result of presidential decree signed in 2016 on improvement of existing tax system, the coverage of electronic audits has been extended in order to limit in person contact between taxpayers and tax authorities. Also, the implementation of electronic invoices plays an important role in prevention of tax evasion and will impact positively on tax system optimization.

In July 2017, Standard & Poor's, international credit agency, kept Azerbaijan's long-term and short-term sovereign loan rating at its previous level. The agency linked keeping the rating unchanged with the sound fiscal position of the country, in particular due to the foreign currency reserves of SOFAZ.

The Fund's management observes these developments related to the economic environment and takes precautionary measures as it considers necessary in order to support the sustainable development of the Fund's strategy. However, the future effects of the current economic situation are difficult to predict and management's current expectations and estimates could differ from actual results.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of preparation.** These consolidated financial statements have been prepared in accordance with IFRS under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, and by the revaluation of premises and equipment, investment properties, gold bullions, and financial instruments categorised at fair value through profit or loss. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated. (refer to Note 5 for new and amended standards adopted by the Fund).

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Fund's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

The Fund presents its consolidated statement of financial position separating current and non-current assets and liabilities. An analysis regarding recovery or settlement within 12 months after the statement of financial position date (current) and more than 12 months after the statement of financial position date (non-current) is presented.

**Consolidated financial statements.** Subsidiaries are those investees, including structured entities, that the Fund controls because the Fund (i) has power to direct the relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of the investor's returns. The existence and effect of substantive rights, including substantive potential voting rights, are considered when assessing whether the Fund has power over another entity. For a right to be substantive, the holder must have a practical ability to exercise that right when decisions about the direction of the relevant activities of the investee need to be made. The Fund may have power over an investee even when it holds less than the majority of the voting power in an investee. In such a case, the Fund assesses the size of its voting rights relative to the size and dispersion of holdings of the other vote holders to determine if it has de-facto power over the investee. Protective rights of other investors, such as those that relate to fundamental changes of the investee's activities or apply only in exceptional circumstances, do not prevent the Fund from controlling an investee. Subsidiaries are consolidated from the date on which control is transferred to the Fund (acquisition date) and are deconsolidated from the date on which control ceases.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

The Fund measures non-controlling interest that represents present ownership interest and entitles the holder to a proportionate share of net assets in the event of liquidation on a transaction by transaction basis, either at: (a) fair value, or (b) the non-controlling interest's proportionate share of net assets of the acquiree. Noncontrolling interests that are not present ownership interests are measured at fair value.

Goodwill is measured by deducting the net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and the fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount ("negative goodwill" or a "bargain purchase") is recognised in profit or loss, after management reassesses whether it identified all the assets acquired and all the liabilities and contingent liabilities assumed and reviews the appropriateness of their measurement.

The consideration transferred for the acquiree is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed, including the fair value of assets or liabilities from contingent consideration arrangements, but excludes acquisition related costs such as advisory, legal, valuation and similar professional services. Transaction costs related to the acquisition of and incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt as part of the business combination are deducted from the carrying amount of the debt and all other transaction costs associated with the acquisition are expensed.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. SOFAZ and all of its subsidiaries use uniform accounting policies consistent with the Fund's policies. When necessary, amounts reported by subsidiaries have been adjusted to conform with the Fund's accounting policies.

Non-controlling interest is that part of the net results and of the equity of a subsidiary attributable to interests which are not owned, directly or indirectly, by SOFAZ. Non-controlling interest forms a separate component of the Fund's equity.

**Purchases and sales of non-controlling interests.** The Fund applies the economic entity model to account for transactions with owners of non-controlling interest in transactions that

do not result in a loss of control. Any difference between the purchase consideration and the carrying amount of non-controlling interest acquired is recorded as a capital transaction directly in equity. The Fund recognises the difference between sales consideration and the carrying amount of non-controlling interest sold as a capital transaction in the statement of changes in equity.

**Joint arrangements.** Under IFRS 11 investments in joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations of each investor. SOFAZ has assessed the nature of its joint arrangements and determined them to be joint ventures. Joint ventures are accounted for using the equity method.

Under the equity method of accounting, interests in joint ventures are initially recognised at cost and adjusted thereafter to recognise the Fund's share of the post-acquisition profits or losses and movements in other comprehensive income. When the Fund's share of losses in a joint venture equals or exceeds its interests in the joint ventures (which includes any long-term interests that, in substance, form part of the Fund's net investment in the joint ventures), the Fund does not recognise further losses, unless it has incurred obligations or made payments on behalf of the joint ventures.

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

**Disposals of subsidiaries, associates or joint ventures.** When the Fund ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity, are accounted for as if the Fund had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

**Foreign currency translation.** The functional currency of each of the Fund's consolidated entities is the currency of the primary economic environment in which the entity operates. The functional currency of SOFAZ and the Fund's presentation currency, is the national currency of the Republic of Azerbaijan, Azerbaijani Manat ("AZN"). The consolidated financial statements are presented in Azerbaijani Manat ("AZN"), which is the Fund's presentation currency.

**Transactions and balances.** Monetary assets and liabilities are translated into each entity's functional currency at the official exchange rate of the Central Bank of the Republic of Azerbaijan ("CBAR") at the respective end of the reporting period. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into each entity's functional currency at year-end official exchange rates of the CBAR are recognised in profit or loss. Translation at year-end rates does not apply to non-monetary items that are measured at historical cost. Non-monetary items measured at fair value in a foreign currency, including equity investments, are translated using the exchange rates at the date when the fair value was determined. Effects of exchange rate changes on non-monetary items measured at fair value in a foreign currency are recorded as part of the fair value gain or loss.

**Group companies.** Loans between group entities and related foreign exchange gains or losses are eliminated upon consolidation. However, where the loan is between group entities that have different functional currencies, the foreign exchange gain or loss cannot be eliminated in full and is recognized in the consolidated profit or loss, unless the loan is not expected to be settled in the foreseeable future and thus forms part of the net investment in foreign operation. In such a case, the foreign exchange gain or loss is recognized in other comprehensive income.

The results and financial position of each group entity (the functional currency of none of which is a currency of a hyperinflationary economy) are translated into the presentation currency as follows:

- (i) assets and liabilities for each statement of financial position are translated at the closing rate at the end of the respective reporting period;
- (ii) income and expenses are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions);
- (iii) components of equity are translated at the historic rate; and
- (iv) all resulting exchange differences are recognised in other comprehensive income.

When control over a foreign operation or a subsidiary with a functional currency other than the functional or presentation currency of the Fund is lost, the exchange differences recognised previously in other comprehensive income are reclassified to profit or loss for the year as part of the gain or loss on disposal. On partial disposal of a subsidiary without loss of control, the related portion of accumulated currency translation differences is reclassified to non-controlling interest within equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. Exchange differences arising are recognised in other comprehensive income.

At 31 December 2017, the principal rates of exchange used for translating foreign currency balances was USD 1 = AZN 1.7001; EUR 1 = AZN 2.0307; KRW 100 = AZN 0.1591; GBP 1 = AZN 2.2881; JPY 100 = AZN 1.5079; RUB 1 = AZN 0.0295 (2016: USD 1 = AZN 1.7707; EUR 1 = AZN 1.8644; KRW 100 = AZN 0.1468; GBP 1 = AZN 2.1745; JPY 100 = AZN 1.5168; RUB 1 = AZN 0.0293). The principal average rate of exchange used for translating income and expenses was USD 1 = AZN 1.7205; EUR 1 = AZN 1.9464; KRW 100 = AZN 0.1523; GBP 1 = AZN 2.2196; JPY 100 = AZN 1.5347; RUB 1 = AZN 0.0295 (2016: USD 1 = AZN 1.5973; EUR 1 = AZN 1.7659; KRW 100 = AZN 0.1378; GBP 1 = AZN 2.1565; JPY 100 = AZN 1.4728; RUB 1 = AZN 0.0240).

**Investment property.** Investment property is property held by the Fund to earn rental income or for capital appreciation, or both and which is not occupied by the Fund. Investment property includes assets under construction for future use as investment property.

Investment property is initially recognised at cost, including transaction costs, and subsequently remeasured at fair value updated to reflect market conditions at the end of the reporting

period. Fair value of investment property is the price that would be received from sale of the asset in an orderly transaction, without deduction of any transaction costs. The best evidence of fair value is given by current prices in an active market for similar property in the same location and condition.

In the absence of current prices in an active market, the Fund considers information from a variety of sources, including:

- (a) current prices in an active market for properties of a different nature, condition or location, adjusted to reflect those differences;
- (b) recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and
- (c) discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and (when possible) by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.

Market value of the Fund's investment property is determined based on reports of independent appraisers, who hold recognised and relevant professional qualifications and who have recent experience in the valuation of property in the same location and category.

Earned rental income is recorded in profit or loss for the year within rental income. Gains and losses resulting from changes in the fair value of investment property are recorded in profit or loss for the year and presented separately.

Subsequent expenditure is capitalised to the asset's carrying amount only when it is probable that future economic benefits associated with the expenditure will flow to the Fund and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred.

**Classification of financial assets.** Financial assets have the following categories: (a) loans and receivables; (b) available-for-sale financial assets; (c) financial assets held to maturity and (d) financial assets at fair value through profit or loss. Financial assets at fair value through profit or loss have two sub-categories: (i) assets designated as such upon initial recognition, and (ii) those classified as held for trading.

*Loans and receivables* are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Fund intends to sell in the near term. The Fund's loans and receivables comprise of 'cash and cash equivalents' in the statement of financial position.

*Held-to-maturity* assets include quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Fund has both the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at the end of each reporting period.

*Held-for-trading investments* are financial assets which are either acquired for generating a profit from short-term fluctuations in price or trader's margin, or are securities included in a portfolio in which a pattern of short-term trading exists. The Fund classifies securities into trading investments if it has an intention to sell them within a short period after purchase, i.e. within 3-6 months. The Fund's held-for-trading assets comprise of 'trading securities'.

The Fund may choose to reclassify a non-derivative trading financial asset out of the fair value through profit or loss category if the asset is no longer held for the purpose of selling it in the near term. Financial assets other than loans and receivables are permitted to be reclassified out of the fair value through profit or loss category only in rare circumstances arising from a single event that is unusual and highly unlikely to reoccur in the near term. Financial assets that would meet the definition of loans and receivables may be reclassified if the Fund has the intention and ability to hold these financial assets for the foreseeable future or until maturity.

Certain derivative instruments embedded in other financial instruments are treated as separate derivative instruments when their risks and characteristics are not closely related to those of the host contract.

*Other financial assets at fair value through profit or loss* are financial assets designated irrevocably, at initial recognition, into this category. Management designates financial assets into this category only if (a) such classification eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or (b) a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information on that basis is regularly provided to and reviewed by the Fund's key management personnel. Recognition and measurement of this category of financial assets is consistent with the accounting policy for trading investments.

**Trading investments.** Trading investments are carried at fair value. Interest earned on trading investments calculated using the effective interest method is presented as finance income in profit or loss for the year. Dividends are included in finance

income when the Fund's right to receive the dividend payment is established and it is probable that the dividends will be collected. All other elements of the changes in the fair value and gains or losses on derecognition are recorded in profit or loss for the year as gains less losses from trading investments in the period in which they arise.

**Trade and other receivables.** Trade and other receivables are recognised initially at fair value and are subsequently carried at amortised cost using the effective interest method.

**Impairment of financial assets carried at amortised cost.** Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Fund determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics, and collectively assesses them for impairment. The primary factors that the Fund considers in determining whether a financial asset is impaired are its overdue status and realisability of related collateral, if any. The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

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

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the counterparty, impairment is measured using the original effective interest rate before the modification of terms. The renegotiated asset is then derecognized and a new asset is recognized at its fair value only if the risks and rewards of the asset substantially changed. This is normally evidenced by a substantial difference between the present values of the original cash flows and the new expected cash flows.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateral-

sed financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to the impairment loss account within the profit or loss for the year.

**Borrowings.** Borrowings are recognised initially at fair value, net of transaction costs incurred and are subsequently carried at amortised cost using the effective interest method.

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

Current tax is the amount expected to be paid to, or recovered from, the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period, which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised.

Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that the temporary difference will reverse in the future and there is sufficient future taxable profit available against which the deductions can be utilised.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred tax assets and liabilities are netted only within the individual companies of the Fund.

The Fund controls the reversal of temporary differences relating to taxes chargeable on dividends from subsidiaries or on gains upon their disposal. The Fund does not recognise deferred tax liabilities on such temporary differences except to the extent that Management expects the temporary differences to reverse in the foreseeable future.

**Dividends.** Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved.

**Business combinations.** Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Fund, liabilities incurred by the Fund to the former owners of the acquiree and the equity interests issued by the Fund in exchange for control of the acquiree. Acquisition-related costs are generally recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value, except that:

- Deferred tax assets or liabilities are recognised and measured in accordance with IAS 12 Income Taxes
- Liabilities or equity instruments related to share-based payment arrangements of the acquiree or sharebased payment arrangements of the Fund entered into to replace share-based payment arrangements of the acquiree are measured in accordance with IFRS 2 Share-based Payment at the acquisition date; and
- Assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations are measured in accordance with that Standard.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any noncontrolling interest

in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any noncontrolling interest in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Non-controlling interest that are present ownership interests and entitle their holders to a proportionate share of the entity's equity in the event of liquidation may be initially measured either at fair value or at the noncontrolling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interest are measured at fair value or, when applicable, on the basis specified in another IFRS.

When the consideration transferred by the Fund in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the 'measurement period' (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with IAS 39 Financial Instruments: Recognition and Measurement, or IAS 37 Provisions, Contingent Liabilities and Contingent Assets, as appropriate, with the corresponding gain or loss being recognised in profit or loss.

When a business combination is achieved in stages, the Fund's previously held equity interest in the acquiree is remeasured to its acquisition date fair value and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income

are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Fund reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognised at that date.

Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business (see above) less accumulated impairment losses, if any.

For the purposes of impairment testing, goodwill is allocated to each of the Fund's cash-generating units (or groups of cash-generating units) that is expected to benefit from the synergies of the combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata based on the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in profit or loss in the consolidated statement of profit or loss and other comprehensive income. An impairment loss recognised for goodwill is not reversed in subsequent periods.

On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

The Fund's policy for goodwill arising on the acquisition of an associate or joint ventures is described below.

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

*Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the quantity held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees, are used to measure fair value of certain financial instruments for which external market pricing information is not available. Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period. Refer to Note 22.

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

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

*The effective interest method* is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount.

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

**Initial recognition of financial instruments.** Trading securities and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date on which the Fund commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

The Fund uses discounted cash flow valuation techniques to determine the fair value of investments that are not traded in an active market. Differences may arise between the fair value at initial recognition, which is considered to be the transaction price, and the amount determined at initial recognition using a valuation technique with level 3 inputs. Any such differences are initially recognised within assets or liabilities and are subsequently amortised on a straight line basis over the term of the investments. The differences are immediately recognised in profit or loss if the valuation uses only level 1 or level 2 inputs.

**Derecognition of financial assets.** The Fund derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Fund has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining

substantially all risks and rewards of ownership, but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

**Derecognition of financial liabilities.** A financial liability is derecognized when the obligation is discharged, cancelled, or expires.

**Cash and cash equivalents.** Cash and cash equivalents include cash on hand, deposits with original maturity of three months, and short-term, highly liquid investments i.e. money market funds, readily convertible to known amounts of cash and subject to low risk of changes in value, with an original maturity of three months or less. Cash on hand, cash in banks and deposits are carried at amortised cost plus interest, if any.

**Gold bullion.** The Fund is involved in purchase of gold bullion for investment purposes with the intention of diversification of the investment portfolio with the ability to sell the gold in the future. The gold bullion is initially recognized and subsequently measured at fair value with gains or losses recognised in profit or loss.

**Premises and equipment.** The Fund's premises and equipment are tangible assets held for administrative purposes with an expected useful life of more than one accounting period. Premises and equipment are stated at cost less accumulated depreciation and provision for impairment, where required.

Premises are subject to revaluation with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Increases in the carrying amount arising on revaluation are credited to other comprehensive income and increase the revaluation surplus in equity. Decreases that offset previous increases of the same asset are recognised in other comprehensive income and decrease the previously recognised revaluation surplus in equity; all other decreases are charged to profit or loss for the year. The revaluation reserve for premises included in equity is transferred directly to retained earnings when the revaluation surplus is realised on the retirement or disposal of the asset. If there is no market based evidence of fair value, fair value is estimated using an income approach.

Costs of minor repairs and day-to-day maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalised, and the replaced part is retired.

At the end of each reporting period management assesses whether there is any indication of impairment of premises and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year to the extent it exceeds the previous revaluation surplus in equity. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss for the year (within other operating income or expenses).

**Depreciation.** Land is not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives:

	Years
Building	50
Vehicles	7
Office equipment	4
Furniture	5
Other property and equipment	3

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

**Intangible assets.** Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over their useful economic lives (5 years) and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization periods and methods for intangible assets with definite useful lives are reviewed at least at each financial year-end.

**Derecognition of intangible assets.** An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is derecognised.

**Provisions.** Provisions are recognised when the Fund has a present obligation (legal or constructive) as a result of a past event, it is probable that the Fund will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle

the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

**Trade and other payables.** Trade payables are accrued when the counterparty has performed its obligations under the contract and are carried at amortised cost.

**Contingencies.** Contingent liabilities are not recognized in the statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognized in the statement of financial position but disclosed when an inflow of economic benefits is probable.

**Equity reserves.** The reserves recorded in equity (other comprehensive income) on the Fund's consolidated statement of financial position include:

- 'Foreign currency translation reserve' which is used to record exchange differences arising from the translation of the net investment in foreign operations;
- 'Property revaluation reserve' which comprises revaluation reserve of land and building;
- 'Other capital reserve'

As discussed in Note 14 and 20, in accordance with the Decrees and the Regulations, the Fund is an extrabudget state organization. All decisions regarding contributions to and transfers from the Fund are made and approved by the Decrees of the President of the Republic of Azerbaijan.

Contributions/transfers received/made by the Fund represent contributions/withdrawals and, accordingly, are recognized through net equity at the fair value of the consideration received/paid.

Transfers to the State Budget, as well as state institutions, state-owned entities and companies are recognized on the date of payment. All transfers are made within the approved budget of the Fund and transferred to the State Treasury of the Republic of Azerbaijan for payments to eligible budgetary beneficiaries (state institutions, state-owned entities and companies) based on their requests for payments.

**Recognition of income and expense.** Interest income is recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset.

Dividend income from financial assets at fair value through profit or loss is recognized in the statement of profit or loss when the Fund's right to receive payment is established.

Other operating income including rental income is recognized on accruals basis, i.e. when these are earned.

Once a financial asset or a group of similar financial assets has been written down (or partly written down) as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest earned on assets at fair value is classified within interest income.

Expenses are recognized on accrual basis, i.e. when they are incurred.

**Offsetting.** Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) the event of default and (iii) the event of insolvency or bankruptcy.

The preparation of the Fund's consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the reporting date and the reported amount of income and expenses during the year ended. Management evaluates its estimates and judgments on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances.

**Accounting for Cash Inflows and Outflows.** As described in Note 1, the Fund receives cash inflows from revenues generated from various oil and gas activities carried out in the Republic of Azerbaijan. These cash inflows are made according to certain decrees of the President of the Republic of Azerbaijan. Cash outflows for major projects and contributions to the State budget are also made according to decrees of the President of the Republic of Azerbaijan. SOFAZ believes these inflows and outflows of funds represent contributed capital and withdrawals of capital, respectively. Accordingly, SOFAZ recognises them as movements in equity in the consolidated statement of changes in equity.

**Valuation of financial instruments.** Financial instruments

that are classified at fair value through profit or loss are stated at fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an instrument, the fair value is calculated based on the market price. When valuation parameters are not observable in the market or cannot be derived from observable market prices, the fair value is derived through analysis of other observable market data appropriate for each product and pricing models which use a mathematical methodology based on accepted financial theories. Pricing models take into account the contract terms of the securities as well as market-based valuation parameters, such as interest rates, volatility, exchange rates and the credit rating of the counterparty.

Where market-based valuation parameters are absent, management will make a judgment as to its best estimate of that parameter in order to determine a reasonable reflection of how the market would be expected to price the instrument. In exercising this judgment, a variety of tools are used including proxy observable data, historical data, and extrapolation techniques. The best evidence of fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with data from observable markets. Any difference between the transaction price and the value based on a valuation technique is not recognized in the statement of profit or loss and other comprehensive income on initial recognition. Subsequent gains or losses are only recognized to the extent that it arises from a change in a factor that market participants would consider in setting a price.

The Fund considers that the accounting estimates related to valuation of financial instruments where quoted markets prices are not available are a key source of estimating uncertainty because: (i) they are highly susceptible to change from period to period because it requires management to make assumptions about interest rates, volatility, exchange rates, the credit rating of the counterparty, valuation adjustments and specific feature of the transactions and (ii) the impact that recognizing a change in the valuations would have on the assets reported in the statement of financial position as well as its profit/(loss) could be material.

Management uses different assumptions regarding the interest rates, volatility, exchange rates, the credit rating of the counterparty and valuation adjustments where quoted market prices are not available using their own knowledge and capabilities, as well as, data obtained from its custodians (mainly Bank of New York Mellon) and Bloomberg.

**Measurement of fair value of investment properties and property and equipment (building).** Fair value of investment



properties as well as at the property and equipment (building) is determined by independent professionally qualified appraisers. Fair value is determined using the combination of internal capitalization method (also known as discounted future cash flow method), sales comparison method and also based on the highest and best use method.

**Staff costs and related contributions.** Wages, salaries, contributions to the Azerbaijan State Social Insurance Fund, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Fund. The Fund has no legal or constructive obligation to make pension or similar benefit payments beyond the payments to the statutory defined contribution scheme.

#### 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

The Fund does not consolidate structured entities that it does not control. As it can sometimes be difficult to determine whether the Fund does control a structured entity, management makes judgements about its exposure to the risks and rewards, as well as about its ability to make operational decisions for the structured entity in question. In many instances, elements are present that, considered in isolation, indicate control or lack of control over a structured entity, but when considered together make it difficult to reach a clear conclusion. In cases where more arguments are in place towards existence of control, the structured entity is consolidated. Refer to Note 26 for further information about the structured entity.

#### 5. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

The following new standards and interpretations became effective for the Fund from 1 January 2017:

##### **Disclosure Initiative – Amendments to IAS 7, Statement of Cash Flows (issued on 29 January 2016 and effective for annual periods beginning on or after 1 January 2017).**

The amended IAS 7 require disclosure of a reconciliation of movements in liabilities arising from financing activities, that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both cash and non-cash changes

##### **Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS 12, Income Taxes (issued on 19 January 2016 and effective for annual periods beginning on or after 1 January 2017).**

The amendment has clarified the requirements on recognition of deferred tax assets for unrealised losses on debt instruments. The entity should recognise deferred tax asset for unrealised losses that arise as a result of discounting cash flows of debt instruments at market interest rates, even if it expects to hold the instrument to maturity and no tax will be payable upon collecting the principal amount. The economic benefit embodied in the deferred tax asset arises from the ability of the holder of the debt instrument to achieve future gains (unwinding of the effects of discounting) without paying taxes on those gains.

##### **Amendments to IFRS 12, included in Annual Improvements to IFRSs 2014-2016 Cycle (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2017).**

IFRS 12, Disclosure of Interests in Other Entities states that the entity need not provide summarised financial information for interests in subsidiaries, associates or joint ventures that are classified (or included in a disposal group that is classified) as held for sale. The amendments clarify that this is the only concession from the disclosure requirements of IFRS 12 for such entities.

#### 6. NEW ACCOUNTING PRONOUNCEMENTS

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2018 or later, and which the Fund has not early adopted.

##### **IFRS 9 “Financial Instruments: Classification and Measurement” (amended in July 2014 and effective for annual periods beginning on or after 1 January 2018).** Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).

- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.

- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.

- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.

- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

The following table reconciles the carrying amounts of financial assets, from their previous measurement categories in accordance with IAS 39 into their new measurement categories upon transition to IFRS 9 on 1 January 2018:

In thousands of Azerbaijani Manats	Measurement category		Carrying value per IAS 39 (closing balance at 31 December 2017)	Remeasurement		Effect	Carrying value per IFRS 9 (opening balance at 1 January 2018)
	IAS 39	IFRS 9		ECL	Other		
<b>Cash and cash equivalents</b>	L&R	AC	2,747,381	-	-	-	2,747,381
Investments in debt securities	FVTPL	FVTPL (mandatory)	45,492,913	-	-	-	45,492,913
Investments in debt securities	HTM	FVTPL	5,337,216	-	-	(294,903)	5,042,313
<b>Total investments in debt securities</b>			<b>50,830,129</b>				<b>50,535,226</b>
Loans and accounts receivable	L&R	AC	2,397	-	-	-	2,397
<b>Total loans and accounts receivable</b>			<b>2,397</b>				<b>2,397</b>
Other financial assets	FVTPL	FVTPL (mandatory)	1,440,247	-	-	-	1,440,247
<b>Total other financial assets</b>			<b>1,440,247</b>				<b>1,440,247</b>
<b>Total financial assets</b>			<b>55,020,154</b>				<b>54,725,251</b>

No significant changes are expected for financial liabilities, other than changes in the fair value of financial liabilities designated at FVTPL that are attributable to changes in the instrument's credit risk, which will be presented in other comprehensive income.

The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Fund's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

**IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or**

**after 1 January 2018).** The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed.

Based on the preliminary analysis of the Fund's revenue streams for the year ended 31 December 2017, individual

contracts' terms and the facts and circumstances that exist at that date, in view of simplified transition method application, the management of the Fund is not expecting a significant impact on its financial statements from the adoption of the new standard on 1 January 2018. Although assessment has not been fully completed as of financial statements issuance date.

**IFRS 16, Leases (issued on 13 January 2016 and effective for annual periods beginning on or after 1 January 2019).**

The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the statement of profit or loss and other comprehensive income. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Fund is currently assessing the impact of the new standard on its consolidated financial statements.

**IFRS 17 "Insurance Contracts" (issued on 18 May 2017 and effective for annual periods beginning on or after 1 January 2021).**

IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare and contrast the financial performance of otherwise similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately. The Fund is currently assessing the impact of the new standard on its consolidated financial statements.

**IFRIC 22 "Foreign currency transactions and advance consideration" (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).**

This interpretation considers how to determine the date of the transaction when applying the standard on foreign currency transactions, IAS 21. The interpretation applies where an entity either pays or received consideration in advance for foreign currency-denominated contracts. The interpretation specifies that the date of transaction is the date on which the entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the Interpretation requires an entity to determine the date of transaction for each payment or receipt of advance consideration. The Fund is currently assessing the impact of the new standard on its financial statements.

The following other new pronouncements are not expected to have any material impact on the Fund when adopted:

- Amendments to IFRS 2, Share-based Payment (issued on 20 June 2016 and effective for annual periods beginning on or after 1 January 2018).
- Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – Amendments to IFRS 4 (issued on 12 September 2016 and effective, depending on the approach, for annual periods beginning on or after 1 January 2018 for entities that choose to apply temporary exemption option, or when the entity first applies IFRS 9 for entities that choose to apply the overlay approach).
- Annual Improvements to IFRSs 2014-2016 cycle – Amendments to IFRS 1 an IAS 28 (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).
- Prepayment Features with Negative Compensation – Amendments to IFRS 9 (issued on 12 October 2017 and effective for annual periods beginning on or after 1 January 2019).
- IFRIC 23 "Uncertainty over Income Tax Treatments" (issued on 7 June 2017 and effective for annual periods beginning on or after 1 January 2019).
- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – Amendments to IFRS 10 and IAS 28 (issued on 11 September 2014 and effective for annual periods beginning on or after a date to be determined by the IASB).
- Transfers of Investment Property – Amendments to IAS 40 (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018).
- Long-term Interests in Associates and Joint Ventures – Amendments to IAS 28 (issued on 12 October 2017 and effective for annual periods beginning on or after 1 January 2019).
- Annual Improvements to IFRSs 2015-2017 cycle - Amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23 (issued on 12 December 2017 and effective for annual periods beginning on or after 1 January 2019).
- Amendments to IFRS 15, Revenue from Contracts with Customers (issued on 12 April 2016 and effective for annual periods beginning on or after 1 January 2018).

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Fund's consolidated financial statements.

## 7. CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise:

In thousands of Azerbaijani Manats	2017	2016
Short-term deposits	2,134,556	3,758,908
Money market funds	198,518	1,970,718
Bank accounts	414,307	488,409
<b>Total cash and cash equivalents</b>	<b>2,747,381</b>	<b>6,218,035</b>

### Money market funds

Investments in money market funds represent share ownership in funds, payable on demand. Investments in money market funds are highly liquid. Money market funds invest their assets in short-term debt and debt related instruments, such as commercial paper, certificates of deposit, bonds bearing floating interests, US treasury bonds, Eurobonds and asset-backed securities. Interest and dividends payable to the Fund are reinvested.

The Fund had the following investments in the money market funds with AAA credit ratings:

In thousands of Azerbaijani Manats	2017	2016
BlackRock ICS-Institution Liquidity Funds plc	173,933	1,961,888
The Goldman Sachs Group, Inc	24,585	8,830
<b>Total money market funds</b>	<b>198,518</b>	<b>1,970,718</b>

### Bank accounts

Bank accounts were denominated in the following currencies:

In thousands of Azerbaijani Manats	2017	2016
AZN	11,332	207,234
USD	278,035	214,597
GBP	7,171	976
CNY	1,687	2,235
CHF	1,617	1,582
AUD	1,626	1,482
EUR	69,875	15,573
RUB	3,352	4,492
KRW	1,437	2,565
CAD	967	476
HKD	226	248
NOK	273	150
DKK	159	109
NZD	76	102
JPY	35,754	36,184
SGD	303	229
SEK	326	97
ILS	57	37
TRY	34	41
<b>Total bank accounts</b>	<b>414,307</b>	<b>488,409</b>

As at 31 December 2017 the Fund had AZN 11,288 thousand and AZN 51 thousand (2016: AZN 207,177 thousand and AZN 95 thousand) held at bank accounts in the Central Bank of the Republic of Azerbaijan and the International Bank of Azerbaijan, respectively.

Other accounts originated in foreign currencies were opened with non-resident banks with long-term ratings BB/Ba3 (Standard & Poor's/ Fitch/Moody's) and above.

### Deposits

The Fund's investments in deposits comprise:

In thousands of Azerbaijani Manats	2017	2016
T.C. Ziraat Bankasi A.S.	472,222	429,025
Akbank T.A.S, Istanbul	292,613	280,168
Turkiye Is Bankasi A.S. Istanbul	687,892	637,977
Turkiye Garanti Bankasi AS	681,829	637,988
The International Bank of Azerbaijan	-	1,773,750
<b>Total deposits</b>	<b>2,134,556</b>	<b>3,758,908</b>

As at 31 December 2017, the Fund placed AZN 2,134,556 thousand (31 December 2016: AZN 1,985,158 thousand) in deposits with non-resident banks maturing in January and February 2018 with credit ratings of BB/Ba3 (Standard & Poor's/ Fitch/Moody's) and above.

The credit quality of cash and cash equivalents balances may be summarised (based on Standard and Poor's/Fitch/Moody's ratings) as follows at 31 December 2017:

In thousands of Azerbaijani Manats	Bank Account	Short term Deposit	Money Market Funds	Total
<i>Neither past due nor impaired (at fair value)</i>				
AAA	-	-	198,518	198,518
AA	-	-	-	-
A	62,606	-	-	62,606
BBB	335,669	-	-	335,669
BB*	4,693	2,134,556	-	2,139,249
CCC**	51	-	-	51
Securities without rating***	11,288	-	-	11,288
<b>Total cash and cash equivalents</b>	<b>414,307</b>	<b>2,134,556</b>	<b>198,518</b>	<b>2,747,381</b>

The credit quality of cash and cash equivalents balances may be summarised (based on Standard and Poor's/Fitch/Moody's ratings) as follows at 31 December 2016:

In thousands of Azerbaijani Manats	Bank Account	Short term Deposit	Money Market Funds	Total
<i>Neither past due nor impaired (at fair value)</i>				
AAA	-	-	1,970,718	1,970,718
AA	962	-	-	962
A	61,746	-	-	61,746
BBB	213,176	-	-	213,176
BB*	5,348	3,758,908	-	3,764,256
Securities without rating***	207,177	-	-	207,177
<b>Total cash and cash equivalents</b>	<b>488,409</b>	<b>3,758,908</b>	<b>1,970,718</b>	<b>6,218,035</b>

\* - AZN 4,654 thousand (2016: AZN 5,209 thousand) of this amount denotes the cash balances held by the Fund's subsidiaries, where the Fund is not directly involved in cash allocations.

\*\* - It indicates the AZN cash balances held by the Fund in the International Bank of Azerbaijan. The credit rating was upgraded to "BB" in January 2018.

\*\*\* - It indicates the AZN cash balances held by the Fund in the Central Bank of the Azerbaijan Republic, an institution which is not subject to the credit risk.

Interest rate analysis of cash and cash equivalents is disclosed in Note 23. Information on related party balances is disclosed in Note 25.

## 8. TRADING SECURITIES

Trading securities comprise:

In thousands of Azerbaijani Manats	2017	2016
Agency/Supranational bonds	8,056,922	7,469,002
Corporate bonds	22,056,430	21,691,572
Sovereign bonds	2,008,809	3,050,224
Equity securities	7,090,424	5,404,665
Money Market	6,280,328	3,111,015
<b>Total trading securities</b>	<b>45,492,913</b>	<b>40,726,478</b>

As at 31 December 2017 the Fund held AZN 6,918,143 thousand, (2016: AZN 4,988,283 thousand) under asset management agreements with financial institutions ("external managers")

including cash and cash equivalents. The management fees in 2017 to the external managers were AZN 2,450 thousand (2016: AZN 2,464 thousand).

**Agency/Supranational bonds.** These bonds are represented by investments in debt securities issued by international organizations of Europe, Asia and America. These securities bear fixed interest ranging from 0.125% p.a. to 5.75% p.a. and USD LIBOR, EURIBOR, GBP LIBOR, CNY average 5-day SHIBOR with the spread ranging from +0.01% p.a. to +0.875% p.a. (2016: from 0.25% p.a. to 8.75% p.a. and USD LIBOR, EURIBOR, GBP LIBOR with the spread ranging from +0.03% p.a. to +0.75% p.a.) and mature during the period from January 2018 to December 2022 (2016: January 2017 to January 2022). As at 31 December 2017 total accrued interest on these securities amounted AZN 27,470 thousand (2016: AZN 32,097 thousand). These securities were held in the portfolio managed both directly by the Fund as well as the Fund's external managers, Deutsche Bank AG and IBRD – World Bank Group.

**Corporate bonds.** Corporate bonds are represented by investments in debt securities issued by corporations of Europe, Asia, Australia and America. As at 31 December 2017 these securities bear fixed interest ranging from 0.0% p.a. to 7.5% p.a. and USD LIBOR, GBP Libor, EURIBOR and Australian Bank Bill Short Term Rate with the spread ranging from +0.17% p.a. to +1.75% p.a. (2016: from 0.0% p.a. to 8.875% p.a. and USD LIBOR, GBP Libor, EURIBOR and Australian Bank Bill Short Term Rate with the spread ranging from +0.17% p.a. to +1.75% p.a.) and mature during the period from January 2018 to January 2031 (2016: January 2017 to January 2022). As at 31 December 2017 total accrued interest on these securities amounted AZN 131,962 thousand (2016: AZN 330,200 thousand). These securities were held in the portfolio managed both directly by the Fund and the Fund's external managers Deutsche Bank AG and IBRD – World Bank Group.

**Sovereign bonds.** Sovereign bonds are represented by investments in debt securities issued by various European, Asian, Australian and American institutions. As at 31 December 2017 these securities bear fixed interest ranging from 0.75% p.a. to 11.625% p.a. and EURIBOR with the spread +1.20% p.a. (2016: from 0.5% p.a. to 9.88% p.a.) and mature during the period from January 2018 to September 2029 (2016: January 2017 to July 2021). As at 31 December 2017 total accrued interest on these securities amounted AZN 19,452 thousand (2016: AZN 30,657 thousand). These securities were held in the portfolio managed both directly by the Fund as well as the Fund's external managers, Deutsche Bank AG and IBRD – World Bank Group.

**Equity securities.** The carrying value of equity investments consists of investments in the following sectors at 31 December 2017 and 2016:

In thousands of Azerbaijani Manats	2017	2016
Finance	1,988,584	1,815,876
Consumer	1,397,982	1,001,540
Telecommunication and information technologies	1,230,558	811,522
Industrial	671,072	449,210
Healthcare	797,918	584,625
Energy	376,354	297,783
Materials	416,195	298,347
Utilities	211,761	145,762
<b>Total equity securities</b>	<b>7,090,424</b>	<b>5,404,665</b>

These securities were held in the portfolio managed both directly by the Fund as well as the Fund's external managers, SSGA, UBS, Blackrock Investment Management and Mellon Capital Management Corporation.

Trading securities are carried at fair value which also reflects any credit risk related write-downs. As trading securities are carried at their fair values based on observable market data using bid prices from Bloomberg and BONYM, the Fund does not analyse or monitor impairment indicators.

Analysis by credit quality of debt trading securities is as follows at 31 December 2017:

In thousands of Azerbaijani Manats	Agency/ Supranational Bonds	Corporate Bonds	Sovereign Bonds	Money Market	Total
<i>Neither past due nor impaired (at fair value)</i>					
AAA	4,935,999	353,303	611,850	542,369	6,443,521
AA	1,398,383	2,205,080	64,420	1,044,726	4,712,609
A	1,524,027	12,138,717	445,794	3,582,828	17,691,366
BBB	198,513	5,980,012	807,987	1,110,405	8,096,917
BB/CCC	-	1,372,418	78,758	-	1,451,176
Securities without rating	-	6,900	-	-	6,900
<b>Total neither past due nor impaired</b>	<b>8,056,922</b>	<b>22,056,430</b>	<b>2,008,809</b>	<b>6,280,328</b>	<b>38,402,489</b>
<b>Total debt trading securities</b>	<b>8,056,922</b>	<b>22,056,430</b>	<b>2,008,809</b>	<b>6,280,328</b>	<b>38,402,489</b>

Analysis by credit quality of debt trading securities is as follows at 31 December 2016:

In thousands of Azerbaijani Manats	Agency/ Supranational Bonds	Corporate Bonds	Sovereign Bonds	Money Market	Total
<i>Neither past due nor impaired (at fair value)</i>					
AAA	3,393,208	178,273	683,505	529,195	4,784,181
AA	3,197,301	3,218,575	226,873	835,086	7,477,835
A	505,831	11,937,370	574,995	926,361	13,944,557
BBB	372,662	6,337,835	1,532,081	820,373	9,062,951
BB	-	10,212	32,770	-	42,982
Securities without rating	-	9,307	-	-	9,307
<b>Total neither past due nor impaired</b>	<b>7,469,002</b>	<b>21,691,572</b>	<b>3,050,224</b>	<b>3,111,015</b>	<b>35,321,813</b>
<b>Total debt trading securities</b>	<b>7,469,002</b>	<b>21,691,572</b>	<b>3,050,224</b>	<b>3,111,015</b>	<b>35,321,813</b>

The credit ratings are based on Standard & Poor's ratings where available, or Moody's or Fitch rating converted to the nearest equivalent on the Standard & Poor's rating scale. The debt securities are not collateralised.

## 9. OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

In thousands of Azerbaijani Manats	2017	2016
Private Equity Funds	441,542	344,171
Real Estate Funds	998,705	393,795
<b>Total other financial assets at fair value through profit or loss</b>	<b>1,440,247</b>	<b>737,966</b>

The Fund irrevocably designated the above financial assets, which are not part of its trading book, as at fair value through profit or loss. The financial assets meet the criteria for classification at fair value through profit or loss because key management personnel assess performance of the investments based on their fair values in accordance with a strategy documented in the investment strategy.

### Private Equity Funds

The IFC Funds are comprised of three independent investment funds: IFC Global Infrastructure Fund (IFC GIF), IFC Catalyst Fund (IFC CF) and IFC African, Latin American and Caribbean Fund (IFC ALAC).

IFC GIF is formed with the purpose of identifying, acquiring, holding and disposing of a portfolio of equity or equity related infrastructure investments in emerging markets. As of 31 December 2017 the fair value of Fund's investment in IFC GIF was AZN 152,690 thousand (2016: AZN 164,061 thousand).

IFC CF was formed with the purpose of investing in a portfolio of limited partnerships or equivalent interests of investment funds or other pooled investment vehicles ("Investee Funds"), and direct co-investments primarily focused on resource efficiency and developing low-emission products and services in emerging markets. As of 31 December 2017 the fair value of Fund's investment in IFC CF was AZN 35,486 thousand (2016: AZN 30,180 thousand).

IFC ALAC is formed with the purpose of identifying, acquiring, holding and disposing a portfolio of equity or equity related investments in the African, Latin American and Caribbean regions. As of 31 December 2017 the fair value of Fund's investment in IFC ALAC was AZN 67,953 thousand (2016: AZN 106,340 thousand).

All declared dividends are reinvested in above mentioned funds by SOFAZ.

NB Caspian Partners is a separately managed Private Equity mandate formed with the purpose of investing predominantly in buy-out funds in the developed markets. As of 31 December 2017 the fair value of Fund's investment in NB Caspian Partners was AZN 112,950 thousand (2016: AZN 41,884 thousand).

EBRD EPF has been formed with the purpose of providing investors with the exposure to EBRD'S equity investments in Central and Eastern Europe, Mediterranean, Central Asia etc. through Equity Return Swaps. As of 31 December 2017 the fair value of Fund's investment in EBRD EPF was AZN 22,633 thousand (2016: AZN 1,705 thousand).

BCEC Management X Limited acts as Manager and General Partner to the BC European Capital X Fund and is focused on buy-outs of larger businesses exhibiting defensive growth characteristics both in Europe and selectively elsewhere. As of 31 December 2017 the fair value of Fund's investment in BCEC Management X Limited was AZN 25,745 thousand (2016: nil).

FSI is an independent management company based in Milan. FSI manages the FSI Mid-Market Growth Equity Fund, a private equity closed-end fund. The Fund offers to investors the possibility to combine strong investment returns and a unique access to Italian mid-market companies presenting significant growth opportunities in industrial and service sectors. As of 31 December 2017 the fair value of Fund's investment in FSI Fund was AZN 147 thousand (2016: Nil).

Blackstone Core Equity Partners L.P. specializes in acquisitions and buyout investments. As of 31 December 2017 the fair value of Fund's investment in Blackstone Core Equity Partners was AZN 23,938 thousand (2016: Nil).

### Real Estate Funds

Real estate's indirect portfolio is comprised of twelve real estate funds and seven co-investments.

PEVAV fund was established to implement value-added real estate strategies within targeted European countries including the UK, Germany, France, Spain, Italy, Netherlands, Poland and the Nordic/Scandinavian region. As of 31 December 2017 the fair value of Fund's investment in PEVAV was AZN 129,394 thousand (2016: AZN 103,422 thousand).

EVP is a real estate fund formed to acquire real estate assets in the Eurozone, targeting mainly France, Germany, Italy and Spain, with a value-add investment profile. As of 31 December 2017 the fair value of Fund's investment in EVP was AZN 65,565 thousand (2016: AZN 33,738 thousand).

BREP EUROPE V is an opportunistic real estate fund and makes investments mostly in United Kingdom, Germany, Spain and Italy. As of 31 December 2017 the fair value of Fund's investment in BREP EUROPE V was AZN 57,946 thousand (2016: nil).

PREP is a value driven investment strategy fund with primary focus on Japan, China and Australia. As of 31 December 2017 the fair value of Fund's investment in PREP was AZN 162,271 thousand (2016: AZN 104,260 thousand).

ASPF III is primarily focused on investing in the key markets of Australia, China, Japan, Malaysia and Singapore with value added strategy. As of 31 December 2016 the fair value of Fund's investment in ASPF III was AZN 154,357 thousand (2016: AZN 70,259 thousand).

RJLF II is an opportunistic fund with a focus on logistics real estate investments in Japan. As of 31 December 2017 the fair value of Fund's investment in RJLF II was AZN 82,941 thousand (2016: AZN 63,473 thousand).

EFIV is a private real estate fund with value-add strategy focused on European region. As of 31 December 2017 the fair value of Fund's investment in Europe Property Fund was AZN 67,068 thousand (2016: nil).

GRES V is a private real estate fund with value-add strategy focused on APAC region. As of 31 December 2017 the fair value of Fund's investment in Gateway Real Estate Fund V was AZN 13,450 thousand (2016: nil).

WSREF VIII is a private real estate fund with core-plus/value-add strategy focused on US. As of 31 December 2017 the fair value of Fund's investment in Walton Street R.E Fund VIII was AZN 60,917 thousand (2016: nil).

CREDO invests in commercial mortgage-backed securities and other real estate debt originally rated investment grade. As of 31 December 2017 the fair value of Fund's investment in CREDO was AZN 45,532 thousand (2016: nil).

Ares US Real Estate Fund IX and SOF XI are private real estate funds with value-add and opportunistic strategies focused on US respectively. As of 31 December 2017 the funds have not drawn capital from the Fund yet.

The Fund has made a co-investment into a value-add mixed-use property with PGIM's EVP fund located in Frankfurt, Germany. As of 31 December 2017 the fair value of the Fund's share in this co-investment was AZN 60,761 thousand (2016: AZN 18,644 thousand).

The Fund has made a co-investment into a core-plus office property with Gaw Capital's GREF V fund in Yokohama, Japan. As of 31 December 2017 the fair value of Fund's share in this co-investment was AZN 30,727 thousand (2016: nil).

The Fund has made a co-investment into an opportunistic hotel development with PGIM's ASPF III fund in Kyoto, Japan. As of 31 December 2017 the fair value of Fund's share in this co-investment was AZN 18,984 thousand (2016: nil).

The Fund has made a co-investment in office property with Blackrock's EFIV fund in Munich, Germany. As of 31 December 2017 the fair value of Fund's share in this co-investment was AZN 12,110 thousand (2016: nil).

The Fund has made a core-plus office co-investment with Walton Street's WSREF VIII fund in Chicago, USA. As of 31 December 2017 the fair value of Fund's share in this co-investment was AZN 35,204 thousand (2016: nil).

The Fund has made a logistics portfolio co-investment with Gaw Capital's GREF V in China. As of 31 December 2017 the fair value of Fund's share in this co-investment was AZN 1,478 thousand (2016: nil).

The Fund has commitment agreement with Gaw Capital's GREF V for a value-add mixed-use investment in Singapore. As of 31 December 2017 the fund has not drawn capital from the Fund yet.

#### 10. FINANCIAL ASSETS AT AMORTISED COST

Financial assets at amortised cost comprise:

In thousands of Azerbaijani Manats	2017	2016
Current portion of financial assets at amortised cost	137,285	142,206
Non-current portion of financial assets at amortised cost	5,199,931	5,378,473
<b>Total financial assets at amortised cost</b>	<b>5,337,216</b>	<b>5,520,679</b>

These are comprised of corporate bonds of:

In thousands of Azerbaijani Manats	2017	2016
JSC Cenub Qaz Dehlizi (Southern Gas Corridor)	4,560,936	4,637,435
Azerbaijan (ACG) Ltd (AzACG Ltd)	477,062	557,435
Mercury Investments and Holdings Ltd.	299,218	325,809
<b>Total financial assets at amortised cost</b>	<b>5,337,216</b>	<b>5,520,679</b>

On 1 May 2014, 23 July 2014, 25 September 2014 and 28 November 2014 the Fund purchased bonds of Southern Gas Corridor at face values of USD 917,321 thousand, USD 1,246,355 thousand, USD 101,120 thousand and USD 252,200 thousand, respectively. As of 31 December 2017 the carrying amount of these bonds equaled AZN 1,665,887 thousand, AZN 2,257,656 thousand, AZN 182,810 thousand, AZN 454,583 thousand, respectively (2016: AZN 1,693,652 thousand, AZN 2,295,732 thousand, AZN 185,845 thousand, AZN 462,206, respectively). The maturity dates of these bonds are 1 May 2024, 23 July 2024, 25 September 2024 and 28 November 2024 and coupons are 6-month USD LIBOR +1%.

On 26 September 2012 the Fund purchased bonds of Mercury Investments and Holdings Ltd. at face value of USD 200,000 thousand. As of 31 December 2017 and 2016 the carrying amount of these bonds equaled to AZN 299,218 thousand and AZN 325,809 thousand, respectively. The maturity date of the bonds is 31 December 2027 and the coupon rate is 6-month USD LIBOR + 1.335%. The purchase was made in accordance with the decree #519 of the President of Azerbaijan Republic dated 27 October 2011 on "Rules on management of foreign currency assets of the State Oil Fund of the Republic of Azerbaijan". Main aim of the bond issuance is to improve and reconstruct the Ship Construction Plant of the Republic of Azerbaijan.

On 5 July 2011 the Fund purchased bonds of AzACG Ltd. (which is a 100% owned subsidiary of SOCAR) at face value of USD 485,000 thousand. The purchase of the bonds was made under the framework of the "The framework (program) of the main directions of utilization of Oil Fund's assets for 2011" approved by the Decree of the President of the Republic of Azerbaijan dated 28 December 2010. According to the program SOFAZ may invest in the securities of oil and gas companies operating in the Caspian Sea basin. As of 31 December 2017 the carrying amount of these bonds equaled to AZN 477,062 thousand (2016: AZN 557,435 thousand). The maturity date of the bonds is 31 December 2024 and the coupon rate is 6-month USD LIBOR + 1%.

The custodian service for holding securities is provided by the National Depository Center of the Republic of Azerbaijan. The management of the Fund has the intention and ability to hold the bonds until the scheduled maturity date for the purpose of earning of interest income over the holding period.

Analysis by credit quality of financial assets at amortised cost at 31 December 2017 is as follows:

In thousands of Azerbaijani Manats	Corporate bonds
<i>Neither past due nor impaired</i>	
BB	5,337,216
<b>Total neither past due nor impaired</b>	<b>5,337,216</b>
<b>Total financial assets at amortised cost</b>	<b>5,337,216</b>

Analysis by credit quality of financial assets at amortised cost at 31 December 2016 is as follows:

In thousands of Azerbaijani Manats	Corporate bonds
<i>Neither past due nor impaired</i>	
BB	5,520,679
<b>Total neither past due nor impaired</b>	<b>5,520,679</b>
<b>Total financial assets at amortised cost</b>	<b>5,520,679</b>

The credit ratings are based on Standard & Poor's ratings where available, or Moody's or Fitch rating converted to the nearest equivalent on the Standard & Poor's rating scale.

Refer to Note 22 for the disclosure of the fair value of each class of investment securities at amortised cost. Information on related party investments at amortised cost is disclosed in Note 25.

## 11. GOLD BULLION

In accordance with the "Rules on Holding, Placement and Management of Foreign Assets of The State Oil Fund of the Republic of Azerbaijan" approved by Decree #511 of the President of the Republic of Azerbaijan dated 19 June 2001 as amended by Decrees #607 dated 21 December 2001, #202 dated 1 March 2005, #216 dated 10 February 2010 and #519 dated 27 October 2011, gold bars conforming to the requirements of the London Bullion Market Association may be included in the Investment Portfolio of the Fund.

Movements of gold bullion:

In thousands of Azerbaijani Manats	2017	2016
<b>Opening balance at 1 January</b>	<b>1,968,469</b>	<b>1,618,895</b>
Net fair value gain/(loss) on gold bullions	168,743	349,574
<b>Closing balance at 31 December</b>	<b>2,137,212</b>	<b>1,968,469</b>

## 12. INVESTMENT PROPERTIES

Movement of investment properties:

In thousands of Azerbaijani Manats	2017	2016
<b>Investment properties at fair value at 1 January</b>	<b>2,619,625</b>	<b>2,233,689</b>
Additions	4,412	177,514
Disposals	-	(166)
Fair value gains/(losses)	15,466	(26,827)
Effect of translation to presentation currency	124,254	235,415
<b>Investment properties at fair value at 31 December</b>	<b>2,763,757</b>	<b>2,619,625</b>

Investment properties consist of "Gallery Actor", mixed-use office and retail complex located in Moscow central business district at 16 Tverskaya Street, "78 St James's Street" an office complex in London, "8 Place Vendome" office, retail and residential building located in Paris, "Pine Avenue Tower A" office complex located in Seoul, South Korea, "Kirarito Ginza" retail complex located in Tokyo, Japan and "Palazzo Turati" office complex in Milan, Italy. All properties are leased out on a commercial basis.

As at 31 December 2017 investment properties are stated at fair value, which has been determined based on valuations performed by professional valuation companies, the accredited independent appraisers. The appraisers are recognized industry specialists in valuing these types of investment properties. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction at the date of valuation. The fair values of the properties have been primarily derived using prices for comparable properties, market information, discounted cash flow method (income approach) and the expert opinion of independent accredited valuers who have advised on current market levels.

At 31 December 2017, investment property carried at AZN 865,535 thousand have been pledged to third parties as collateral with respect to borrowings. Refer to Note 15.

Detailed disclosure on fair value increase of investment properties:

Investment property	Fair value 2017	Change in fair value	Effect of translation to presentation currency	Additions	Fair value 2016
"78 St James Street", London	434,739	(699)	21,598	-	413,840
"Gallery Actor", Tverskaya 16, Moscow	100,182	(49,409)	1,018	2,864	145,709
"SCI 8 Place Vendome", Paris	366,541	9,236	29,568	1,468	326,269
"Pine Avenue Tower A", Seoul	794,502	4,569	61,256	35	728,642
"Kirarito Ginza", Tokyo	865,535	50,601	(5,700)	45	820,589
"Palazzo Turati", Milan	202,258	1,168	16,514	-	184,576
	<b>2,763,757</b>	<b>15,466</b>	<b>124,254</b>	<b>4,412</b>	<b>2,619,625</b>

Investment property	Fair value 2016	Change in fair value	Effect of translation to presentation currency	Additions	Disposals	Fair value 2015
"78 St James Street", London	413,840	(57,545)	(30,601)	-	-	501,986
"Gallery Actor", Tverskaya 16, Moscow	145,709	(12,902)	39,316	2,655	-	116,640
"SCI 8 Place Vendome", Paris	326,269	16,295	27,328	2,052	-	280,594
"Pine Avenue Tower A", Seoul	728,642	6,022	69,277	-	(166)	653,509
"Kirarito Ginza", Tokyo	820,589	22,091	117,538	-	-	680,960
"Palazzo Turati", Milan	184,576	(788)	12,557	172,807	-	-
	<b>2,619,625</b>	<b>(26,827)</b>	<b>235,415</b>	<b>177,514</b>	<b>(166)</b>	<b>2,233,689</b>

### **Establishment of 78 St James's Street Unit Trust (the "Unit Trust")**

The Unit Trust was established by the Fund on 22 November 2012 under the provision of the Trust Instrument. SOFAZ Re Limited in its capacity as general partner of the SOFAZ RE UK L.P. has a 99% holding of the Unit Trust. SOFAZ Re Min Limited has a 1% holding of the Unit Trust. SOFAZ Re Limited, SOFAZ RE UK L.P. and SOFAZ RE Min Limited are ultimately owned by the State Oil Fund of Azerbaijan. The Unit Trust invests in real estate located in the United Kingdom and owns the office complex "78 St James's Street". The Unit Trust is established, resident and domiciled in Jersey, Channel Islands. During 2017, the Unit Trust has contributed AZN 21,419 thousand (2016: AZN 20,810 thousand) of rental income and AZN 17,316 thousand profit

(2016: AZN 39,515 thousand loss) to the net profit/(loss) before tax of the Fund (Net profit figure includes fair value decrease of AZN 699 thousand (2016: AZN 57,545 thousand decrease)).

### **Acquisition of JSC Tverskaya 16**

On 21 December 2012, the Fund acquired 100% of voting shares of JSC Tverskaya 16. Its main activity is management of business and retail centre called "Gallery Actor" located in the Central Administrative District of Moscow, Russia. During 2017, JSC Tverskaya 16 contributed AZN 7,800 thousand (2016: AZN 5,127 thousand) of rental income and AZN 70,582 thousand loss (2016: AZN 11,767 thousand loss) to the net profit/(loss) before tax of the Fund (Net loss figure includes fair value decrease of AZN 49,409 thousand (2016: decrease AZN 12,902 thousand)).

#### Establishment of SCI 8 Place Vendome

On 19 March 2013, the Fund acquired via a special purpose vehicle, a mixed use office, retail and residential complex SCI 8 Place Vendome located on Place Vendome 8, Paris, France from AXA Real Estate for EUR 135,000 thousand. SCI 8 Place Vendome is an indirect subsidiary of the Fund incorporated in France as a civil partnership with share capital of EUR 1,000 having its registered office in Paris, 6 place de Madeleine. SCI 8 Place Vendome is held by the Fund via two Luxembourg holding companies (the Luxcos): SOFAZ RE Fund S.a.r.l. - a private limited company with a share capital of EUR 12,500 having its registered office in Luxembourg which is 100% held by the Fund and holds 0.1% of SCI 8 Place Vendome and SOFAZ RE Europe S.a.r.l. - a private limited company with a share capital of EUR 12,500 having its registered office in Luxembourg which is 100% held by SOFAZ RE Europe Holding S.a.r.l. and holding 99.9% of SCI 8 Place Vendome. During 2017, SCI 8 Place Vendome has contributed AZN 11,254 thousand (2016: AZN 10,349 thousand) of rental income and AZN 13,932 thousand profit (2016: AZN 20,729 thousand profit) to the net profit/(loss) before tax of the Fund (Net profit figure includes fair value increase of AZN 9,236 thousand (2016: AZN 16,295 thousand increase)).

#### Acquisition of "Pine Avenue Tower A" office complex

On 31 March 2014 SOFAZ finalised the acquisition of prime office complex, Pine Avenue Tower A in Seoul, South Korea via acquisition of 100% interest in Beneficiary Certificates ("BCs") in Real Estate Fund from Mirae Asset Management for KRW 469,007 million (AZN 346,250 thousand). During the year ended 2017, "Pine Avenue Tower A" has contributed AZN 18,239 thousand (2016: AZN 27,687 thousand) of rental income and AZN 24,716 thousand profit (2016: AZN 41,358 thousand profit) to the net profit/(loss) before tax of the Fund (Net profit figure includes fair value increase of AZN 4,569 thousand (2016: AZN 6,022 thousand increase)).

#### Establishment of Kirarito Ginza

SOFAZ made an investment in the amount of 51,989 million JPY (AZN 455,736 thousand) to an operator entity ("OE") under a Tokumei Kumiai ("TK") agreement on 21 August 2015. This investment formed 98% of the capital of the OE. 2% is held by the Asset Managers ("AM"), PGIM Real Estate (Japan). SOFAZ is free to sell this investment(right to cashflows) in the OE at any time. The OE invested proceeds from investors in an investment property, a retail complex in Ginza, Tokyo, for 52,434 million JPY (AZN 459,633 thousand), including investment-related acquisition costs. For detailed information, refer to the Note 26.

During the year ended 2017, "Kirarito Ginza" has contributed AZN 23,872 thousand (2016: AZN 27,430 thousand) of rental income and AZN 63,917 thousand profit (2016: AZN 40,445 thousand profit) to the net profit/(loss) before tax of the Fund (Net profit figure includes fair value increase of AZN 50,601 thousand (2016: AZN 22,091 thousand increase)).

#### Establishment of Palazzo Turati

In May 2016, SOFAZ has reached an agreement to acquire Palazzo Turati, an office property in Milan for EUR 97 million. For this investment the Fund established the 100% controlled Real Estate Investment Fund (REIF) that acquired the property. The Fund invested into the REIF through its Luxembourg subsidiary - Sofaz RE Europe S.A.R.L. During 2017, Palazzo Turati contributed AZN 9,479 thousand (2016: AZN 5,426 thousand) of rental income and AZN 9,330 thousand profit (2016: AZN 3,786 thousand) to the net profit/(loss) before tax of the Fund (Net profit figure includes fair value increase of AZN 1,168 thousand (2016: AZN 788 thousand decrease)).

### 13. INVESTMENTS IN JOINT VENTURES

The table below summarises the movements in the carrying amount of the Fund's investments in joint ventures.

In thousands of Azerbaijani Manats	2017	2016
<b>Carrying amount at 1 January</b>	<b>787,589</b>	<b>631,895</b>
Additions to investments in joint venture	193,500	153,000
Share of after tax results of joint venture	(1,491)	2,694
<b>Carrying amount at 31 December</b>	<b>979,598</b>	<b>787,589</b>

On 21 June 2013, Caspian Drilling Company (90% share) and SOCAR (10% share) jointly established "SOCAR Rig Assets" LLC with the share capital of AZN 1000 (100 shares, nominal value of AZN 10 for each share). The main activity of the entity is financing the construction of a new sixth generation semi-submersible drilling rig for operations in the Caspian Sea through funding from the shareholders' proportion of their respective shares. On 5 July 2013, SOFAZ acquired all of the shares of "SOCAR Rig Assets" LLC from Caspian Drilling Company for their nominal value. "SOCAR Rig Assets" LLC did not have any operations prior to acquisition by the Fund. After acquisition "SOCAR Rig Assets" LLC was renamed "Azerbaijan Rigs" LLC. The Fund has contributed additional paid-in capital of AZN 193,500 thousand in 2017 (2016: AZN 153,000 thousand) directly to the entity. All strategic financial and operating decisions relating to the activity of the acquiree require the unanimous consent of both shareholding parties. The results of this joint venture are incorporated in these consolidated financial statements using the equity method of accounting.

At 31 December 2017, the Fund's interests in its joint venture and its summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Current assets	Non-current assets	Current liabilities	Non-current liabilities	Revenue	Other income	Expenses	Profit/(loss)	% interest held	Country of incorporation
"Azerbaijan Rigs" LLC	160,935	935,255	(7,324)	-	-	524	(2,181)	(1,657)	90%	Azerbaijan

At 31 December 2016, the Fund's interests in its joint venture and its summarised aggregate financial information, including total assets, liabilities, revenues and profit or loss, were as follows:

Name	Current assets	Non-current assets	Current liabilities	Non-current liabilities	Revenue	Other income	Expenses	Profit/(loss)	% interest held	Country of incorporation
"Azerbaijan Rigs" LLC	127,414	747,708	(1)	-	-	4,099	(1,106)	2,993	90%	Azerbaijan



#### 14. CAPITAL CONTRIBUTIONS

The movements in capital contributions to the Fund were as follows:

In thousands of Azerbaijani Manats	2017	2016
Contributions received from sales of oil and gas	11,029,989	8,320,046
Bonuses	2,408	82
Pipeline transit tariffs	17,915	17,954
Acreage fees	3,605	3,266
<b>Total capital contributions</b>	<b>11,053,917</b>	<b>8,341,348</b>

#### 15. NON-CURRENT LIABILITIES

In thousands of Azerbaijani Manats	2017	2016
Term loan (GK001 - Tokio, Japan)	469,979	472,007
Tenancy deposits	40,087	37,776
Other	19,783	243
<b>Total non-current liabilities</b>	<b>529,849</b>	<b>510,026</b>

Tenancy deposits comprise of prepayments made by tenants for Kirarito Ginza, the investment property in Tokyo with the amount of AZN 15,627 thousand (2016: AZN 19,797 thousand), Pine Avenue Tower A, the investment property in Seoul with the amount of AZN 22,790 thousand (2016: AZN 16,237 thousand) and SCI 8 Place Vendome, the investment property in Paris with the amount of AZN 1,670 thousand (2016: AZN 1,652 thousand).

The term loan is denominated in Japanese Yen. Bank borrowings mature by 09 September 2024 and bear coupon of 0.81% annually (2016: 0.81%). An investment property is pledged as collateral for the borrowing. Refer to Note 12.

The Fund does not apply hedge accounting and has not entered into any hedging arrangements in respect of its foreign currency obligations or interest rate exposures. The carrying amounts and fair values of borrowings are as follows:

In thousands of Azerbaijani Manats	Carrying amounts		Fair values	
	2017	2016	2017	2016
Term loan (GK001 - Tokio, Japan)	469,979	472,007	469,979	472,007
<b>Total borrowings</b>	<b>469,979</b>	<b>472,007</b>	<b>469,979</b>	<b>472,007</b>

The fair value of current borrowings equals their carrying amount, as the impact of discounting is not significant. The fair values are based on cash flows discounted using a rate based on the borrowing rate of 0.81% (2016: 0.81%) and are within level 2 of the fair value hierarchy.

#### 16. INTEREST INCOME AND OTHER INVESTMENT INCOME

In thousands of Azerbaijani Manats	2017	2016
Interest income on financial assets at fair value through profit or loss	502,314	519,939
<i>Interest income on assets carried at amortized cost:</i>		
Interest on term deposits	152,375	146,017
Income from financial assets at amortised cost	127,815	95,503
Income from money market funds	12,948	3,309
Interest on demand deposits	2,682	85,976
<i>Other investment income</i>		
Dividend income	146,039	122,262
Income on real estate and private equity funds	32,928	32,824
<b>Total interest and other investment income</b>	<b>977,101</b>	<b>1,005,830</b>

#### 17. FOREIGN CURRENCY TRANSLATION DIFFERENCES

Net foreign currency translation differences comprise of:

In thousands of Azerbaijani Manats	2017	2016
Net unrealized gain on foreign currency translation differences	747,147	5,113,878
Net realized gain/(loss) on foreign currency translation differences	(3,114)	206,969
<b>Total net gain on foreign currency translation differences</b>	<b>744,033</b>	<b>5,320,847</b>

#### 18. NET FAIR VALUE GAIN ON FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Net gain on financial assets at fair value through profit or loss comprises:

In thousands of Azerbaijani Manats	2017	2016
Unrealized gain on change in fair value adjustment	75,740	82,537
Realized loss on trading operations	(2,077)	(10,871)
<b>Net gain on financial assets at fair value through profit or loss</b>	<b>73,663</b>	<b>71,666</b>

#### 19. OPERATING EXPENSES

Operating expenses are comprised of:

In thousands of Azerbaijani Manats	2017	2016
Asset management fee	2,450	2,464
Operating expenses of subsidiaries	41,512	30,301
Wages, salaries and employee benefits	5,932	5,073
Bank services	2,088	1,525
Depreciation and amortization	9,020	9,079
Short-term license fee	4,122	3,977
Communication expenses	48	363
Other operating expenses	3,572	3,468
<b>Total operating expenses</b>	<b>68,744</b>	<b>56,250</b>

## 20. TRANSFERS BY THE FUND

During 2017 transfers to the State Budget, as well as to the state institutions, state-owned entities and companies were made in accordance with:

- The Decree #1186 of the President of the Republic of Azerbaijan dated 10 January 2017 on the Approval of the Budget of the State Oil Fund of the Republic of Azerbaijan for 2017.
- Decree #1612 of the President of the Republic of Azerbaijan dated 04 October 2017 on making amendments to the Decree #1186 of the President of the Republic of Azerbaijan dated January 10, 2017 on "The Budget of the State Oil Fund of the Republic of Azerbaijan for 2017".

During 2016 transfers to the State Budget, as well as to the state institutions, state-owned entities and companies were made in accordance with:

- The Decree #719 of the President of the Republic of Azerbaijan dated 29 December 2015 on the Approval of the Budget of the State Oil Fund of the Republic of Azerbaijan for 2016.
- Decree #852 of the President of the Republic of Azerbaijan dated 18 March 2016 on making amendments to the Decree No. 719 of the President of the Republic of Azerbaijan dated December 29, 2015 on "The Budget of the State Oil Fund of the Republic of Azerbaijan for 2016".

## 21. INCOME TAXES

The Fund provides for income taxes based on the tax accounts maintained and prepared in accordance with the tax regulations of Russian Federation, Luxembourg and France.

According to the Presidential decree №- 509-IVQD dated 21 December 2012, and law of State Parliament regarding changes to the Tax Code of Azerbaijan Republic dated 29 December 2012 starting from 1 January 2013 SOFAZ is exempted from corporate income tax. All the Jersey companies are zero corporate income tax rated by virtue of being International Service Entities. As a result there are no temporary differences in respect of SOFAZ's Azerbaijani and UK operations. According to double taxation treaty with Japan, gains from Tokumei Kumiai investments is exempt from taxation in this country.

Standard corporate income tax rates for companies operating in the Russian Federation comprised 20% for 2017 and 2016. Whereas Luxembourg and French subsidiaries are subject to income tax at a rate of 33% (2016: 33.3%).

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences relate mostly to

different methods of income and expense recognition as well as to recorded values of certain assets.

## 22. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based on observable market data (that is, unobservable inputs). Management applies judgement in categorising financial instruments using the fair value hierarchy. If a fair value measurement uses observable inputs that require significant adjustment, that measurement is a Level 3 measurement. The significance of a valuation input is assessed against the fair value measurement in its entirety.

### (a) Recurring fair value measurements

Recurring fair value measurements are those that the accounting standards require or permit in the statement of financial position at the end of each reporting period. The level in the fair value hierarchy into which the recurring fair value measurements are categorised are as follows:

In thousands of Azerbaijani Manats	31 December 2017				31 December 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets at fair value</b>								
<b>Financial Assets</b>								
<b>Trading securities</b>	<b>45,486,013</b>	<b>6,900</b>	-	<b>45,492,913</b>	<b>40,726,478</b>	-	-	<b>40,726,478</b>
- Agency/Supra-national bonds	8,056,922	-	-	8,056,922	7,469,002	-	-	7,469,002
- Corporate bonds	22,049,530	6,900	-	22,056,430	21,691,572	-	-	21,691,572
- Sovereign	2,008,809	-	-	2,008,809	3,050,224	-	-	3,050,224
- Equity securities	7,090,424	-	-	7,090,424	5,404,665	-	-	5,404,665
- Money Market	6,280,328	-	-	6,280,328	3,111,015	-	-	3,111,015
<b>Other financial assets at fair value through profit or loss</b>	-	-	<b>1,440,247</b>	<b>1,440,247</b>	-	-	<b>737,966</b>	<b>737,966</b>
- Private Equity Funds	-	-	441,542	441,542	-	-	344,171	344,171
- Real Estate Funds	-	-	998,705	998,705	-	-	393,795	393,795
<b>Non-financial Assets</b>	<b>2,137,212</b>	-	<b>2,896,749</b>	<b>5,033,961</b>	<b>1,968,469</b>	-	<b>2,756,566</b>	<b>4,725,035</b>
- Investment properties	-	-	2,763,757	2,763,757	-	-	2,619,625	2,619,625
- Gold bullions	2,137,212	-	-	2,137,212	1,968,469	-	-	1,968,469
- Property and equipment, net	-	-	132,992	132,992	-	-	136,941	136,941
<b>Total assets recurring fair value measurements</b>	<b>47,623,225</b>	<b>6,900</b>	<b>4,336,996</b>	<b>51,967,121</b>	<b>42,694,947</b>	-	<b>3,494,532</b>	<b>46,189,479</b>

The valuation technique, inputs used in the fair value measurement for level 3 measurements are as follows:

Income and sales comparison approaches were used during the valuation of the office and retail complex "Actor Gallery". The significant inputs were a discount rate used in a range between 12%-14.8% and the comparable prices from less active markets. For sales comparison approach, sale prices for comparable office premises are in the range of 160,000– 304,000 RUR/ sqm (4,720 – 8,968 AZN/sqm) for the whole office part.

78 St James's Street real estate has been valued using residual appraisal approach. The discount rate of 4.75% and price per square feet GBP 1,845 (AZN 4,222) was used as significant inputs for valuation.

For the valuation of Place Vendome property, estimation has been calculated using the income capitalisation, direct comparison and discounted cash-flows methods. Net initial yield of 3.01% is included in the calculations.

Income method using discounted cash flow projections (DCF) was used for the valuation of Palazzo Turati. The discounted rates at "nominal money" used, were equal to 5.30% relative to the actualization of the rents coming from the in force lease until its expiry and equal to 4.40% per annum for the final phase of development, considering also the risk connected to the actualization of the cash flows generated after the in force lease expiry.

Market and income approach with the weight of 50% was used for the valuation of Pine Avenue. The maximum and minimum value for both valuation was calculated. The significant input in the market approach was the estimated unit price per square meter in the range between KRW 7,090,000 - KRW 7,840,000 (AZN 11,280 – 12,473 AZN). For the income approach, the significant input was the discount rate in a range between 5.2%- 5.4%.

The income capitalization approach was also used in the valuation of Kirarito Ginza property. The estimated discount rate of 2.5% derived through analysis of comparable data and adding risk premiums associated with the property to the yield on financial assets. The capitalisation rate of the property was estimated as 2.7%.

Private equities are valued using discounted cash flow method or market approach method. Discounting cashflow method is used for revaluation, where discount rate is considered as a significant input for valuation.

For investments in equity and real estate funds, increases in the EBITDA multiple would each lead to an increase in estimated value. However, an increase in the discount for lack of marketability

would lead to a decrease in value. No interrelationships between unobservable inputs used in the Fund's valuation of its Level 3 equity investments have been identified.

A reconciliation of movements in Level 3 of the fair value hierarchy by class of instruments for the year ended 31 December 2017 is as follows:

In thousands of Azerbaijani Manats	Other securities at fair value through profit or loss	
	Corporate shares	
<b>Fair value at 1 January 2017</b>	<b>737,966</b>	
Gains recognised in profit or loss for the year	50,686	
Gains recognised in other comprehensive income	35,517	
Purchases	616,078	
<b>Fair value at 31 December 2017</b>	<b>1,440,247</b>	

A reconciliation of movements in Level 3 of the fair value hierarchy by class of instruments for the year ended 31 December 2016 is as follows:

In thousands of Azerbaijani Manats	Other securities at fair value through profit or loss	
	Corporate shares	
<b>Fair value at 1 January 2016</b>	<b>396,969</b>	
Gains recognised in profit or loss for the year	65,313	
Gains recognised in other comprehensive income	28,115	
Purchases	247,569	
<b>Fair value at 31 December 2016</b>	<b>737,966</b>	

#### b) Assets and liabilities not measured at fair value but for which fair value is disclosed

Fair values analysed by level in the fair value hierarchy and carrying value of assets not measured at fair value are as follows:

In thousands of Azerbaijani Manats	31 December 2017				31 December 2016			
	Level 1	Level 2	Level 3	Carrying value	Level 1	Level 2	Level 3	Carrying value
<b>ASSETS</b>								
<b>Financial assets at amortised cost</b>								
- Corporate bonds	-	5,337,216	-	5,337,216	-	5,520,679	-	5,520,679
<b>Other financial assets</b>								
- Trade receivables	-	2,397	-	2,397	-	20,417	-	20,417
<b>Total Assets</b>	<b>-</b>	<b>5,339,613</b>	<b>-</b>	<b>5,339,613</b>	<b>-</b>	<b>5,541,096</b>	<b>-</b>	<b>5,541,096</b>
<b>LIABILITIES</b>								
<b>Other borrowed funds</b>								
- Term loan	-	469,979	-	469,979	-	472,007	-	472,007
<b>Other financial liabilities</b>								
- Trade payables	-	15,566	-	15,566	-	12,650	-	12,650
<b>Total LIABILITIES</b>	<b>-</b>	<b>485,545</b>	<b>-</b>	<b>485,545</b>	<b>-</b>	<b>484,657</b>	<b>-</b>	<b>484,657</b>

The fair values in level 2 of fair value hierarchy were estimated using the discounted cash flows valuation technique. The fair value of floating rate instruments that are not quoted in an active market was estimated to be equal to their carrying amount. The fair value of unquoted fixed interest rate instruments was estimated based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

#### 23. FINANCIAL RISK MANAGEMENT

Management of risk is an essential element of the Fund's operations. Risks inherent to the Fund's operations are those related to credit exposures, liquidity, market and operational risks. A summary description of the Fund's risk management policies in relation to those risks is discussed below.

**Credit risk.** The Fund is exposed to credit risk which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Fund is subject to credit risk from its portfolio of cash and cash equivalents and its investments. The Fund manages its credit risk in accordance with the "Rules on Holding, Placement and Management of Foreign Currency Assets of The State Oil Fund of the Republic of Azerbaijan" approved by Decree #511 of the President of the Republic of Azerbaijan dated 19 June 2001 as amended by Decree #607 dated 21 December 2001, Decree #202 dated 1 March 2005, Decree #216 dated 10 February 2010, Decree #519 dated 27 October 2011 (hereinafter collectively referred to as the "Rules").

Credit risk is managed and controlled through proper selection of investment assets, credit quality of investment assets and setting limits on the amount of investment per investment asset.

The following table details the credit ratings of financial instruments held by the Fund. The credit rating is issued by internationally regarded agencies Standard & Poor's, Fitch and Moody's. If the agencies have assigned different credit ratings to an asset, the lowest one was used.

2017	AAA	AA	A	BBB	Non-investment rating	Securities without rating	Total
Cash and cash equivalents	198,518	-	62,606	335,669	2,139,300	11,288	<b>2,747,381</b>
Trading securities	6,443,521	4,712,609	17,691,366	8,096,917	1,451,176	7,097,324	<b>45,492,913</b>
Financial assets at amortised cost	-	-	-	-	5,337,216	-	<b>5,337,216</b>
Other financial assets at fair value through profit or loss	-	-	-	-	-	1,440,247	<b>1,440,247</b>

2016	AAA	AA	A	BBB	Non-investment rating	Securities without rating	Total
Cash and cash equivalents	1,970,718	962	61,746	213,176	3,764,256	207,177	<b>6,218,035</b>
Trading securities	4,784,181	7,477,835	13,944,557	9,062,951	42,982	5,413,972	<b>40,726,478</b>
Financial assets at amortised cost	-	-	-	-	5,520,679	-	<b>5,520,679</b>
Other financial assets at fair value through profit or loss	-	-	-	-	-	737,966	<b>737,966</b>

**External managers.** In accordance with the "Rules", when an external manager is engaged in management of the Fund's currency assets, the external manager or its principal founder should have investment credit ratings (not lower than Baa3 (Moody's) or BBB- (Standard & Poor's, Fitch)) or have at least five years of positive history of management of assets, or be experienced in managing assets with a value not less than one billion USD.

**Currency risk.** Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Fund is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The table below summarizes the Fund's exposure to foreign currency exchange rate risk for the year ended 31 December 2017:

2017	AZN	USD	EUR	GBP	TRY	AUD	RUB	Other	Total
<b>Financial assets</b>									
Cash and cash equivalents	11,332	358,900	1,592,489	100,240	636,561	1,626	3,352	42,881	2,747,381
Trading Securities	-	20,747,882	18,969,976	2,589,744	-	423,790	532,002	2,229,519	45,492,913
Other Securities at Fair Value Through Profit or Loss	-	703,742	603,853	-	-	-	-	132,652	1,440,247
Financial assets at amortised cost	-	5,337,216	-	-	-	-	-	-	5,337,216
Other financial assets	-	-	921	50	-	-	681	745	2,397
<b>Total financial assets</b>	<b>11,332</b>	<b>27,147,740</b>	<b>21,167,239</b>	<b>2,690,034</b>	<b>636,561</b>	<b>425,416</b>	<b>536,035</b>	<b>2,405,797</b>	<b>55,020,154</b>
<b>Financial liabilities</b>									
Other financial liabilities	(1,132)	-	(1,879)	(5,458)	-	-	-	(7,097)	(15,566)
<b>Total financial liabilities</b>	<b>(1,132)</b>	<b>-</b>	<b>(1,879)</b>	<b>(5,458)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(7,097)</b>	<b>(15,566)</b>
<b>Open position</b>	<b>10,200</b>	<b>27,147,740</b>	<b>21,165,360</b>	<b>2,684,576</b>	<b>636,561</b>	<b>425,416</b>	<b>536,035</b>	<b>2,398,700</b>	<b>55,004,588</b>

The table below summarizes the Fund's exposure to foreign currency exchange rate risk for the year ended 31 December 2016:

2016	AZN	USD	EUR	GBP	TRY	AUD	RUB	Other	Total
<b>Financial assets</b>									
Cash and cash equivalents	207,236	3,897,627	1,382,417	53,583	627,186	1,482	4,492	44,012	6,218,035
Trading Securities	-	17,506,461	17,901,559	2,323,544	-	367,997	816,875	1,810,042	40,726,478
Other Securities at Fair Value Through Profit or Loss	-	429,827	243,084	-	-	-	-	65,055	737,966
Financial assets at amortised cost	-	5,520,679	-	-	-	-	-	-	5,520,679
Other financial assets	-	-	18,146	455	-	-	-	1,816	20,417
<b>Total financial assets</b>	<b>207,236</b>	<b>27,354,594</b>	<b>19,545,206</b>	<b>2,377,582</b>	<b>627,186</b>	<b>369,479</b>	<b>821,367</b>	<b>1,920,925</b>	<b>53,223,575</b>
<b>Financial liabilities</b>									
Other financial liabilities	(646)	-	(2,369)	(75)	-	-	(1,018)	(8,542)	(12,650)
<b>Total financial liabilities</b>	<b>(646)</b>	<b>-</b>	<b>(2,369)</b>	<b>(75)</b>	<b>-</b>	<b>-</b>	<b>(1,018)</b>	<b>(8,542)</b>	<b>(12,650)</b>
<b>Open position</b>	<b>206,590</b>	<b>27,354,594</b>	<b>19,542,837</b>	<b>2,377,507</b>	<b>627,186</b>	<b>369,479</b>	<b>820,349</b>	<b>1,912,383</b>	<b>53,210,925</b>

**Currency risk sensitivity.** The tables below indicate the currencies to which the Fund had significant exposure at 31 December 2017 and 2016 on its monetary assets and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the AZN, with all other variables held constant on the statement of profit or loss and other comprehensive income. The effect on equity does not differ from the effect on the statement of profit or loss and other comprehensive income.

	Impact on profit/ (loss) for the year		Impact on profit/(loss) for the year	
	31 December 2017		31 December 2016	
<b>AZN/USD</b>	<b>10.00%</b>	2,714,774	<b>10.00%</b>	2,735,459
	<b>10.00%</b>	(2,714,774)	<b>10.00%</b>	(2,735,459)
<b>AZN/EUR</b>	<b>10.00%</b>	2,116,536	<b>10.00%</b>	1,954,284
	<b>10.00%</b>	(2,116,536)	<b>10.00%</b>	(1,954,284)
<b>AZN/GBP</b>	<b>10.00%</b>	268,458	<b>10.00%</b>	237,751
	<b>10.00%</b>	(268,458)	<b>10.00%</b>	(237,751)
<b>AZN/TRY</b>	<b>10.00%</b>	63,656	<b>10.00%</b>	62,719
	<b>10.00%</b>	(63,656)	<b>10.00%</b>	(62,719)
<b>AZN/AUD</b>	<b>10.00%</b>	42,542	<b>10.00%</b>	36,948
	<b>10.00%</b>	(42,542)	<b>10.00%</b>	(36,948)
<b>AZN/RUB</b>	<b>10.00%</b>	53,605	<b>10.00%</b>	82,035
	<b>10.00%</b>	(53,605)	<b>10.00%</b>	(82,035)

**Commodity price risk.** The Fund is affected by the volatility of gold prices. The following table shows the effect of price changes in gold:

	31 December 2017		31 December 2016	
<b>AZN/XAU</b>	<b>10%</b>	<b>-10%</b>	<b>10%</b>	<b>-10%</b>
<b>Impact on profit/(loss) for the year</b>	<b>213,721</b>	<b>(213,721)</b>	<b>196,847</b>	<b>(196,847)</b>

**Geographical concentration.** The geographical concentration of the Fund's financial assets and liabilities at 31 December 2017 is set out below:

2017	Azerbaijan	Europe	America	Asia	Africa	Australia and Oceania	International organizations	Total
<b>Financial assets</b>								
Cash and cash equivalents	11,339	2,459,785	273,133	3,124	-	-	-	2,747,381
Trading Securities	1,451,176	18,910,257	16,357,645	4,189,107	-	1,650,949	2,933,779	45,492,913
Other Securities at Fair Value Through Profit or Loss	-	955,345	352,251	132,651	-	-	-	1,440,247
Financial assets at amortised cost	5,337,216	-	-	-	-	-	-	5,337,216
Other financial assets	-	971	1,426	-	-	-	-	2,397
<b>Total financial assets</b>	<b>6,799,731</b>	<b>22,326,358</b>	<b>16,984,455</b>	<b>4,324,882</b>	<b>-</b>	<b>1,650,949</b>	<b>2,933,779</b>	<b>55,020,154</b>
<b>Financial liabilities</b>								
Other financial liabilities	(1,132)	(7,337)	-	(7,097)	-	-	-	(15,566)
<b>Total financial liabilities</b>	<b>(1,132)</b>	<b>(7,337)</b>	<b>-</b>	<b>(7,097)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(15,566)</b>
<b>Net position</b>	<b>6,798,599</b>	<b>22,319,021</b>	<b>16,984,455</b>	<b>4,317,785</b>	<b>-</b>	<b>1,650,949</b>	<b>2,933,779</b>	<b>55,004,588</b>

The geographical concentration of the Fund's financial assets and liabilities at 31 December 2016 is set out below:

2016	Azerbaijan	Europe	America	Asia	Africa	Australia and Oceania	International organizations	Total
<b>Financial assets</b>								
Cash and cash equivalents	1,981,022	3,983,955	212,739	40,319	-	-	-	6,218,035
Trading Securities	-	19,769,069	13,324,563	3,638,411	-	2,199,876	1,794,559	40,726,478
Other Securities at Fair Value Through Profit or Loss	-	368,359	304,552	65,055	-	-	-	737,966
Financial assets at amortised cost	5,520,679	-	-	-	-	-	-	5,520,679
Other financial assets	-	18,601	-	1,816	-	-	-	20,417
<b>Total financial assets</b>	<b>7,501,701</b>	<b>24,139,984</b>	<b>13,841,854</b>	<b>3,745,601</b>	<b>-</b>	<b>2,199,876</b>	<b>1,794,559</b>	<b>53,223,575</b>
<b>Financial liabilities</b>								
Other financial liabilities	(646)	(3,462)	-	(8,542)	-	-	-	(12,650)
<b>Total financial liabilities</b>	<b>(646)</b>	<b>(3,462)</b>	<b>-</b>	<b>(8,542)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(12,650)</b>
<b>Net position</b>	<b>7,501,055</b>	<b>24,136,522</b>	<b>13,841,854</b>	<b>3,737,059</b>	<b>-</b>	<b>2,199,876</b>	<b>1,794,559</b>	<b>53,210,925</b>

**Other risk concentrations.** Management monitors and discloses concentrations of credit risk by comparing reports from portfolios with investment policy of the Fund approved by the President of the Azerbaijan Republic. The Fund did not have any such significant risk concentrations at 31 December 2017 and 2016.

**Interest rate sensitivity.** At 31 December 2017 and 2016 deposits and debt securities were interest-bearing and, therefore, were exposed to the interest rate risk. Depending on the market conditions the Fund is managing this risk by gradually increasing or decreasing the duration of assets in the investment portfolio. Daily risk management and monitoring is performed within above set limits by the Risk Management Department.

The following table presents a net impact of change of the fair value of securities, when market interest rate changed by 1%. Sensitivity analysis of interest rate risk has been determined based on "reasonably possible changes in the risk variable". The level of these changes is determined by management and is contained within the risk reports provided to key management personnel.

Impact on profit/(loss) before tax:

In thousands of Azerbaijani Manats	31 December 2017		31 December 2016	
	Interest rate 1%	Interest rate - 1%	Interest rate 1%	Interest rate - 1%
<b>ASSETS:</b>				
Cash and cash equivalents	64	(64)	157	(157)
Financial assets at fair value through profit or loss	(352,622)	352,622	(360,875)	360,875
<b>Net impact on profit/(loss) before tax</b>	<b>(352,558)</b>	<b>352,558</b>	<b>(360,718)</b>	<b>360,718</b>

#### Liquidity Risk

Management's guiding policies are to maintain conservative levels of liquidity to ensure that the Fund has the ability to meet its obligations under all conceivable circumstances.

An analysis of the liquidity risk of financial position items is presented in the following tables:

2017	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	over 5 years	Maturity undefined	Total
<b>Financial assets</b>							
Cash and cash equivalents	1,879,422	255,134	-	-	-	612,825	2,747,381
Trading Securities	2,972,772	3,278,077	5,915,252	24,512,958	1,723,430	7,090,424	45,492,913
Other Securities at Fair Value Through Profit or Loss	-	-	-	-	-	1,440,247	1,440,247
Financial assets at amortised cost	64,788	-	72,497	-	5,199,931	-	5,337,216
Other financial assets	2,397	-	-	-	-	-	2,397
<b>Total financial assets</b>	<b>4,919,379</b>	<b>3,533,211</b>	<b>5,987,749</b>	<b>24,512,958</b>	<b>6,923,361</b>	<b>9,143,496</b>	<b>55,020,154</b>
<b>Financial liabilities</b>							
Other financial liabilities	(15,566)	-	-	-	-	-	(15,566)
<b>Total financial liabilities</b>	<b>(15,566)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(15,566)</b>
<b>Liquidity gap</b>	<b>4,903,813</b>	<b>3,533,211</b>	<b>5,987,749</b>	<b>24,512,958</b>	<b>6,923,361</b>	<b>9,143,496</b>	<b>55,004,588</b>

2016	Up to 1 month	1 month to 3 months	3 months to 1 year	1 year to 5 years	over 5 years	Maturity undefined	Total
<b>Financial assets</b>							
Cash and cash equivalents	4,444,286	886,530	887,219	-	-	-	6,218,035
Trading Securities	2,538,362	3,413,128	8,676,287	20,290,320	403,716	5,404,665	40,726,478
Other Securities at Fair Value Through Profit or Loss	-	-	-	-	-	737,966	737,966
Financial assets at amortised cost	66,698	-	75,508	-	5,378,473	-	5,520,679
Other financial assets	20,417	-	-	-	-	-	20,417
<b>Total financial assets</b>	<b>7,069,763</b>	<b>4,299,658</b>	<b>9,639,014</b>	<b>20,290,320</b>	<b>5,782,189</b>	<b>6,142,631</b>	<b>53,223,575</b>
<b>Financial liabilities</b>							
Other financial liabilities	(12,650)	-	-	-	-	-	(12,650)
<b>Total financial liabilities</b>	<b>(12,650)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(12,650)</b>
<b>Liquidity gap</b>	<b>7,057,113</b>	<b>4,299,658</b>	<b>9,639,014</b>	<b>20,290,320</b>	<b>5,782,189</b>	<b>6,142,631</b>	<b>53,210,925</b>

**Price risk.** Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market. The Fund is exposed to price risks of its products which are subject to general market and specific fluctuations.

	31 December 2017		31 December 2016	
	1% increase in securities price	1% decrease in securities price	1% increase in securities price	1% decrease in securities price
Impact on profit/(loss) before tax	454,929	(454,929)	405,145	(405,145)
Impact on net assets/equity	454,929	(454,929)	405,145	(405,145)

**Operational risk.** Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Fund cannot expect to eliminate all operational risks, but a control framework and monitoring and responding to potential risks could be effective tools to manage the risks. Controls should include effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

## 24. COMMITMENTS AND CONTINGENCIES

**Off-balance sheet transactions.** On 11 August 2006 the Fund signed an Asset Management Agreement on "Granting free budget (balance) Funds to trust management" with the Ministry of Finance of the Republic of Azerbaijan. According to this agreement free budget Funds of the Ministry of Finance of the Republic of Azerbaijan are to be transferred to and managed by the Fund within the asset management rules set in the agreement with the Ministry of Finance of the Republic of Azerbaijan. The Fund manages these assets free of charge, on behalf of the Ministry of Finance and in favor, at the expense and at the risks of the Ministry of Finance of the Republic of Azerbaijan. At 31 December 2017 assets received under the above agreement were AZN 755,380 thousand (31 December 2016: AZN 218,856 thousand) including accrued interest.

## 25. TRANSACTIONS WITH RELATED PARTIES

Parties are generally considered to be related if the parties are under common control, or one party has the ability to control the other party or can exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Transactions with related parties are described in Notes 7, 10, 13, 14, 15 and 20.

Transactions between the Fund and its subsidiaries, which are related parties of the Fund, have been eliminated on consolidation and are not disclosed in this note. All government entities and their subsidiaries are considered to be entities under common control with the Fund. Transactions with such entities are disclosed below as related party transactions:

	Year	Contributions received from related parties	Transfers to related parties	Carrying value of bonds acquired from related parties	Interest income on bonds acquired from related parties	Bank accounts with related parties	Precious metals	Off-balance sheet transactions
SOCAR	2017 2016	10,973,191 8,181,450						
Azerbaijan Gas Supply Company	2017 2016	- 98,905						
Operating Companies	2017 2016	80,726 60,993						
The State Budget	2017 2016		6,100,000 7,615,000					
Ministry of Finance of the Republic of Azerbaijan	2017 2016			78,758 -	1,262 -			755,380 218,856
Azerbaijan melioration and water-sludge system OSC	2017 2016		69,997 69,998					
The Ministry of Transportation of the Republic of Azerbaijan	2017 2016		20,557 66,174					

## CONTINUED

	Year	Contributions received from related parties	Transfers to related parties	Carrying value of bonds acquired from related parties	Interest income on bonds acquired from related parties	Bank accounts with related parties	Precious metals	Off-balance sheet transactions
The State Refugees Committee and Internally Displaced People' Social Development Fund	2017 2016		105,000 89,995					
Central Bank of the Republic of Azerbaijan	2017 2016		3,949,485 -			11,288 207,177	- 1,305,590	
Star oil refinery complex (SOCAR)	2017 2016		735,422 331,776					
Ministry of Education of the Republic of Azerbaijan	2017 2016		17,010 31,607					
International Bank of Azerbaijan	2017 2016			1,372,418 -	18,591 -	43 1,773,845		
JSC Cenub Qaz Dehlizi (Southern Gas Corridor)	2017 2016			4,560,936 4,637,435	107,923 9,447			
Mercury Investments and Holdings Ltd.	2017 2016			299,218 325,809	8,569 6,862			
Azerbaijan (ACG) Ltd (AzACG Ltd)	2017 2016			477,062 557,435	11,323 79,194			
Ministry of Economy of the Republic of Azerbaijan	2017 2016		- 797,428					

### Key management personnel

The senior management group consists of the Fund's Executive Director and heads of administrations. The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category are:

In thousands of Azerbaijani Manats	2017	2016
Aggregate remuneration	126	97
Number of persons	3	3



## 26. INTERESTS IN STRUCTURED ENTITIES

**Consolidated structured entities.** A Tokumei Kumiai (“TK”) agreement is a contractual arrangement under which one or more silent investors (the “TK investor”) makes a contribution to a Japanese operating company (the “TK operator”) in return for a share in the profit/loss of a specified business conducted by the TK operator (the “TK business”). To support the tax status of the TK, a Japanese resident company should have independent stake in the TK business. To comply with TK-GK rules, SOFAZ and Mitsubishi UFJ Trust and Banking (“MUTB”) entered into TK arrangement to acquire Kirarito Ginza where MUTB is a Japanese resident and contributed 2% of the investment amount JPY 1,100 mln ( AZN 9,643 thousand) required for TK Business, i.e. for TK Operator to acquire the property. TK-GK tax structure was chosen to obtain 0% withholding tax on distribution of TK profits to SOFAZ under Japan-former Soviet Union tax treaty. According to the agreement the total amount of SOFAZ’s investment constituted JPY 51,989 mln (AZN 455,736 thousand). In return both SOFAZ and MUTB were entitled to a proportional share of profit or loss of TK Business. In 2016 MUTB was replaced by PGIM Foreign Investment Inc, who acquired MUTB’s interests in the structure and took over the asset management role. The Asset Managers of PGIM Foreign Investment Inc is PGIM Real Estate (Japan).

The TK operator invested proceeds from investors in a retail complex in Ginza, Tokyo, for 52,300 mln JPY (AZN 458,462 thousand). The building met the definition of an investment property under IAS 40. SOFAZ signed an Agreement with the TK operator that contains the Strategic Plan on the development and management of the investment property. The TK operator operates the business of the company according to the Agreement and the Strategic Plan.

TK agreement provides SOFAZ with limited rights with respect to the management and development of the investment property. This makes the TK operator similar to unconsolidated structured entities under IFRS 12, where a structured entity is an entity that has been designed so that voting or similar rights are not dominant factors in its management and control. Under this arrangement, voting rights relate to the administrative tasks only and relevant activities of the company are directed by means of contractual arrangements.

Based on the specific characteristics of the TK Agreement, the management concluded that a principal/agent relationship exists between SOFAZ and the TK operator. According to IFRS 10, the investor should treat decision making powers delegated to the agent as held by the investor/principal himself. The management performed analysis based on paragraph B60 of IFRS 10 and given the limited 2% investment by the Asset Managers, concluded that the TK operator is an agent of SOFAZ and hence, SOFAZ should consolidate the investee.

## 27. EVENTS AFTER THE REPORTING PERIOD

In accordance with the Decree of the President of the Republic of Azerbaijan on the Approval of the Budget of the State Oil Fund of the Republic of Azerbaijan for 2018” dated 28 December 2017, the Fund’s budgeted contributions and distributions for the year of 2018 are estimated at AZN 11,559,956 thousand and AZN 9,730,221 thousand, respectively.

The following main types of distributions for 2018 are budgeted:

- Upper bound of transfer to the State Budget of the Republic of Azerbaijan – AZN 9,216,000 thousand;
- Financing of the measures for improvement of social conditions of refugees and internally displaced people – AZN 200,000 thousand;
- Financing “Baku-Tbilisi-Kars railway” project – AZN 176,128 thousand;
- Financing the reconstruction of the Samur-Absheron irrigation system – AZN 90,000 thousand;
- Financing the “State Program on Education of Azerbaijan youth in foreign countries during 2007-2015” – AZN 16,218 thousand;
- Expenses related to managing the Fund – AZN 31,876 thousand

# APPENDIX

## SOVEREIGN WEALTH FUNDS GENERALLY ACCEPTED PRINCIPLES AND PRACTICES “SANTIAGO PRINCIPLES” SELF-ASSESSMENT

APRIL, 2018

Narration of Principles / Sub-Principles	Responses
<p><b>A. Legal Framework, Objectives, and Coordination with Macroeconomic Policies.</b></p> <p><b>GAPP 1. PRINCIPLE</b></p> <p>The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).</p> <p><b>GAPP 1.1. Subprinciple</b> The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.</p> <p><b>GAPP 1.2. Subprinciple</b> The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.</p>	<p>Legal framework of SOFAZ is clearly defined in the "Statute of the State Oil Fund of the Republic of Azerbaijan" (hereinafter "Statute of SOFAZ") approved by the decree of the President of the Republic of Azerbaijan.</p> <p>SOFAZ is a legal entity separate from the government or central bank. SOFAZ's operation is guided by the Constitution and laws of the Republic of Azerbaijan, Presidential Decrees and resolutions and SOFAZ's Regulations.</p> <p>All relevant documents related to the legal basis and structure and the legal relationships between SOFAZ and the other government agencies are publicly disclosed and they are available on the SOFAZ's website.</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25">http://www.oilfund.az/en/content/25</a></p>
<p><b>GAPP 2. PRINCIPLE</b></p> <p>The policy purpose of the SWF should be clearly defined and publicly disclosed.</p>	<p>SOFAZ was established for the purpose of accumulation and management of the revenues generated from implementation of oil and gas agreements.</p> <p>SOFAZ's primary objectives are to help maintain macro-economic stability in the country (neutralize negative impact of the currency inflows) and to generate wealth for present and future generations.</p> <p>Above discussed purpose of establishment, as well as the primary objectives are publicly disclosed on SOFAZ's website.</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/9">http://www.oilfund.az/en/content/25/9</a> <a href="http://www.oilfund.az/en/content/3">http://www.oilfund.az/en/content/3</a></p>
<p><b>GAPP 3. PRINCIPLE</b></p> <p>Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.</p>	<p>According to its bylaws, SOFAZ is not permitted to invest domestically. Expenditures of SOFAZ constitute part of the consolidated state budget approved by the Parliament. According to Budget System Law the consolidated state budget is being prepared in close consultation with all relevant government entities (Ministry of Finance, Ministry of Economy etc.) and involvement of SOFAZ.</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a> <a href="http://www.oilfund.az/en/content/25/156">http://www.oilfund.az/en/content/25/156</a> <a href="http://www.oilfund.az/uploads/budget%20system-1_eng.pdf">http://www.oilfund.az/uploads/budget%20system-1_eng.pdf</a></p>

Narration of Principles / Sub-Principles	Responses
<p><b>GAPP 4. PRINCIPLE</b></p> <p>There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal and spending operations.</p> <p><b>GAPP 4.1. Subprinciple</b> The source of SWF funding should be publicly disclosed.</p> <p><b>GAPP 4.2. Subprinciple</b> The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.</p>	<p>SOFAZ's Funding and Withdrawal rules are clearly defined by the "Statute of SOFAZ" and "Rules on the preparation and execution of the annual program of revenues and expenditures (budget) of the State Oil Fund of the Republic of Azerbaijan" (hereinafter "Rules on the budget of SOFAZ") which are publicly disclosed on SOFAZ's website.</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a> <a href="http://www.oilfund.az/en/content/25/156">http://www.oilfund.az/en/content/25/156</a> <a href="http://www.oilfund.az/uploads/budget%20system-1_eng.pdf">http://www.oilfund.az/uploads/budget%20system-1_eng.pdf</a></p>
<p><b>GAPP 5. PRINCIPLE</b></p> <p>The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.</p>	<p>SOFAZ submits monthly statistical reports to the President and Ministry of Finance, as well as quarterly and yearly reports to the State Statistical Committee. SOFAZ also reports on its revenues and expenditures to the Parliamentary Chamber of Accounts and on other relevant information to the Ministry of Taxes, State Social Protection Fund and other relevant government agencies. Additionally, SOFAZ regularly provides the relevant information on its activities to the World Bank and International Monetary Fund.</p> <p>All the relevant statistical data pertaining to the fund, is publicly disclosed on SOFAZ's website (audited annual reports, quarterly statements etc.).</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a> <a href="http://www.oilfund.az/en/content/25/156">http://www.oilfund.az/en/content/25/156</a> <a href="http://www.oilfund.az/uploads/budget%20system-1_eng.pdf">http://www.oilfund.az/uploads/budget%20system-1_eng.pdf</a></p>
<p><b>B. Institutional Framework and Governance Structure</b></p> <p><b>GAPP 6. PRINCIPLE</b></p> <p>The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.</p>	<p>SOFAZ has a three-tier governance structure, with the President of the country being a supreme governing and reporting authority for the Fund.</p> <p>SOFAZ's activities are overseen by a Supervisory Board which is headed by the Prime Minister and consists of the Vice-Speaker of Parliament, Minister of Finance, Minister of Economy, Governor of the Central Bank and the Economic Advisor to the President.</p> <p>The operational management of SOFAZ is vested in the Executive Director. The relevant duties and responsibilities of the President of the country, Supervisory Board and Executive Director are clearly defined in the "Statute of SOFAZ".</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a></p>

Narration of Principles / Sub-Principles	Responses
<p><b>GAPP 7. PRINCIPLE</b></p> <p>The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.</p>	<p>The objectives of SOFAZ are clearly defined in "Statute of SOFAZ" approved by the President of the Republic of Azerbaijan.</p> <p>Please see also the response on GAPP 5 and 6.</p> <p>For further information: <a href="http://www.oilfund.az/az/content/25/154">http://www.oilfund.az/az/content/25/154</a></p>
<p><b>GAPP 8. PRINCIPLE</b></p> <p>The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.</p>	<p>SOFAZ's Supervisory Board, which is headed by the Prime Minister and consists of the Minister of Finance, Governor of the Central Bank, Minister of Economy, Vice-Speaker of Parliament and the Economic Advisor to the President, have a clear mandate and adequate authority and competency to fulfil its functions. All roles and responsibilities of the Supervisory Board are clearly defined in the relevant legislation.</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a></p>
<p><b>GAPP 9. PRINCIPLE</b></p> <p>The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.</p>	<p>Statute of SOFAZ", "Rules on management of foreign currency assets of the State Oil Fund of the Republic of Azerbaijan" (hereinafter "Investment guidelines") and "Rules on the budget of SOFAZ" clearly define the role and responsibilities of the Executive Director. In accordance with these role and responsibilities Executive Director has independence in operational management.</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a> <a href="http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf">http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf</a> <a href="http://www.oilfund.az/en/content/25/156">http://www.oilfund.az/en/content/25/156</a></p>

Narration of Principles / Sub-Principles	Responses
<p><b>GAPP 10. PRINCIPLE</b></p> <p>The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.</p>	<p>Accountability framework of SOFAZ is clearly defined in the "Statute of SOFAZ", "Investment guidelines", "Rules on the budget of SOFAZ" and Budget System Law, all of which are available on SOFAZ's website. SOFAZ produces and publicly discloses audited annual reports and quarterly reports. Information about Fund's activities is also disseminated through regular press conferences and published on SOFAZ's website.</p> <p>See also response on GAPP 5.</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a> <a href="http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf">http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf</a> <a href="http://www.oilfund.az/en/content/25/156">http://www.oilfund.az/en/content/25/156</a> <a href="http://www.oilfund.az/uploads/budget%20system-1_eng.pdf">http://www.oilfund.az/uploads/budget%20system-1_eng.pdf</a></p>
<p><b>GAPP 11. PRINCIPLE</b></p> <p>An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.</p>	<p>Since the start of its operations, SOFAZ has prepared annual reports and accompanying financial statements.</p> <p>All financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS").</p> <p>All annual reports and accompanying financial statements are published on the Fund's website.</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a> <a href="http://www.oilfund.az/en/account">http://www.oilfund.az/en/account</a></p>
<p><b>GAPP 12. PRINCIPLE</b></p> <p>The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.</p>	<p>Since the start of its operations SOFAZ has been audited by reputable international audit firms. In line with the Public Procurement Law, SOFAZ conducts open market tender processes to select its auditor. Price Waterhouse Coopers has been appointed to audit SOFAZ financial statements for years 2016-2018.</p> <p>All annual reports and accompanying financial statements are available on SOFAZ's website.</p> <p>SOFAZ also has an internal Audit department that prepares periodic internal audit reports.</p> <p>For further information: <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a> <a href="http://tender.gov.az/new/docs/tlotroa.doc">http://tender.gov.az/new/docs/tlotroa.doc</a></p>

Narration of Principles / Sub-Principles	Responses
<p><b>GAPP 13. PRINCIPLE</b></p> <p>Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body, management and staff.</p>	<p>Professional and ethical standards are clearly defined in the "Investment Guidelines".</p> <p>Management and staff of SOFAZ have to comply with ethical norms and rules of the International Financial Markets Association (ACI, Paris) and "Rules of Ethical Conduct for the Employees of SOFAZ".</p> <p>For further information:  <a href="http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf">http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf</a>  <a href="http://www.oilfund.az/en_US/about_found/etik-davranis-qaydalari.asp">http://www.oilfund.az/en_US/about_found/etik-davranis-qaydalari.asp</a></p>
<p><b>GAPP 14. PRINCIPLE</b></p> <p>Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.</p>	<p>SOFAZ's activities related to third parties are based on economic and financial grounds. Fund's "Investment Guidelines" and "Investment Policy" regulate SOFAZ's dealing with third parties.</p> <p>All aspects of dealing with external managers are clearly defined in relevant documentation about SOFAZ's activity. Appointment of external managers is carried out in compliance with the current legislation of Azerbaijan Republic on "State Procurement". External managers are selected on the basis of the criteria, such as credit rating of manager, assets under management, experience in the asset management industry, proposed rate of return and risk, proposed fees schedule etc. Compliance of the external managers' investments to their mandate is monitored daily. Performance of external managers' portfolios is monitored monthly.</p> <p>For further information:  <a href="http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf">http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf</a>  <a href="http://www.oilfund.az/uploads/Inv_policy1.pdf">http://www.oilfund.az/uploads/Inv_policy1.pdf</a></p>
<p><b>GAPP 15. PRINCIPLE</b></p> <p>SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.</p>	<p>SOFAZ conducts its operations and activities in host countries in compliance with all applicable regulatory and disclosure requirements of those host countries.</p>
<p><b>GAPP 16. PRINCIPLE</b></p> <p>The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.</p>	<p>SOFAZ's governance framework, objectives and its operational independence are clearly defined in the relevant legislation.</p> <p>For further information:  <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a></p>

Narration of Principles / Sub-Principles	Responses
<p><b>GAPP 17. PRINCIPLE</b></p> <p>Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.</p>	<p>Audited financial statements are published in SOFAZ's annual report, which is publicly available. Quarterly reports and all other relevant financial information about SOFAZ's activities are published on its website. Disclosed financial information includes AUM, asset allocation, benchmark, annual rates of return etc.</p> <p>For further information:  <a href="http://www.oilfund.az/en/account">http://www.oilfund.az/en/account</a>  <a href="http://www.oilfund.az/en/content/20/249">http://www.oilfund.az/en/content/20/249</a></p>
<p><b>C. Investment and Risk Management Framework</b></p>	
<p><b>GAPP 18. PRINCIPLE</b></p> <p>The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.</p> <p><b>GAPP 18.1. Subprinciple</b>  The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.</p> <p><b>GAPP 18.2. Subprinciple</b>  The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.</p> <p><b>GAPP 18.3. Subprinciple</b>  A description of the investment policy of the SWF should be publicly disclosed.</p>	<p>"Investment Guidelines" and "Investment Policy" set up SOFAZ's asset management framework and ensure the transparency in its investment decisions. Among the others, they define strategic asset allocation, currency composition, benchmarks, risk limits, minimum requirements for SOFAZ's external managers and limitations on the investment directions, as well as the credit quality limits for SOFAZ's counterparties (custodian banks, correspondent banks etc.).</p> <p>Derivatives (i.e. swaps, forwards, futures etc.) may only be used for hedging or optimizing the currency composition and asset allocation of the Investment Portfolio.</p> <p>For policies and procedures related to SOFAZ's external managers please see our response on GAPP 14.</p> <p>SOFAZ's "Investment guidelines" and "Investment Policy" are available on its website.</p> <p>For further information:  <a href="http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf">http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf</a>  <a href="http://www.oilfund.az/uploads/Inv_policy1.pdf">http://www.oilfund.az/uploads/Inv_policy1.pdf</a></p>

Narration of Principles / Sub-Principles	Responses
<p><b>GAPP 19. PRINCIPLE</b></p> <p>The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.</p> <p><b>GAPP 19.1. Subprinciple</b> If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.</p> <p><b>GAPP 19.2. Subprinciple</b> The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.</p>	<p>According to its "Investment Policy", SOFAZ's investment decisions should aim at maximizing the risk adjusted returns. SOFAZ's all investment decisions are made purely on an economic and financial basis according to the sound asset management principles.</p> <p>See also response on GAPP 18.</p> <p>For further information: <a href="http://www.oilfund.az/uploads/Inv_policy1.pdf">http://www.oilfund.az/uploads/Inv_policy1.pdf</a></p>
<p><b>GAPP 20. PRINCIPLE</b></p> <p>The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.</p>	<p>According to its bylaws, SOFAZ is not permitted to invest domestically. In line with the "Investment guidelines", SOFAZ makes investment decisions independently of the government. Institutional and legal framework of SOFAZ has been designed in a way that SOFAZ cannot seek or take advantage of any privileged information.</p> <p>For further information: <a href="http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf">http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf</a> <a href="http://www.oilfund.az/en/content/25/154">http://www.oilfund.az/en/content/25/154</a></p>
<p><b>GAPP 21. PRINCIPLE</b></p> <p>SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.</p>	<p>SOFAZ started to invest in equities in 2012 and has chosen not to exercise its ownership rights at this stage.</p>

Narration of Principles / Sub-Principles	Responses
<p><b>GAPP 22. PRINCIPLE</b></p> <p>The SWF should have a framework that identifies, assesses and manages the risks of its operations.</p> <p><b>GAPP 22.1. Subprinciple</b> The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning and an independent audit function.</p> <p><b>GAPP 22.2. Subprinciple</b> The general approach to the SWF's risk management framework should be publicly disclosed.</p>	<p>Identification, assessment and management of the risks of SOFAZ's operations play crucial role in SOFAZ's overall management framework. SOFAZ's risk management system is supported with appropriate legal framework ("Investment Guidelines", "Investment Policy" etc), a specialized risk unit (Risk Management Department), internal and external audit functions and tools like RiskManager 4 by RiskMetrics and proprietary models.</p> <p>"Investment Guidelines" and "Investment Policy" set the main principles of risk management framework and clearly define limits on major factors for market, credit, concentration and liquidity risks. Certain pre-trade limits are set based on these factors. Furthermore, these risk factors are monitored on a daily basis via regular risk and performance reports. In addition to the factors set in the "Investment Guidelines" and "Investment Policy", a more in-depth analysis and monitoring of the market risk is performed on a regular basis through: interest rate sensitivity analysis (key rate durations, PV01 etc.), risk concentration analysis (duration by groups, VaR by groups, marginal VaR etc.), tail events (conditional VaR, stress tests) and scenario analyses.</p> <p>Operational risk is managed in accordance with SOFAZ's Operational Manual and business continuity planning.</p> <p>For further information: <a href="http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf">http://www.oilfund.az/pub/tiny_upload/Inv_guide.pdf</a> <a href="http://www.oilfund.az/uploads/Inv_policy1.pdf">http://www.oilfund.az/uploads/Inv_policy1.pdf</a></p>
<p><b>GAPP 23. PRINCIPLE</b></p> <p>The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.</p>	<p>Comprehensive reports on assets of SOFAZ (including information on breakdown of investment portfolio by foreign currencies, asset class, credit ratings, maturities and geographic regions) are disseminated through the quarterly press releases. The performance of the SOFAZ's investments is measured according to best industry standards and reported on an annual basis. Annual reports and quarterly statements are posted on SOFAZ's website.</p> <p>For further information: <a href="http://www.oilfund.az/en/account">http://www.oilfund.az/en/account</a></p>
<p><b>GAPP 24. PRINCIPLE</b></p> <p>A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.</p>	<p>This report was first published on SOFAZ's official website in April, 2011 and it is reviewed on an annual basis.</p>





© State Oil Fund of the  
Republic of Azerbaijan

2 0 1 8