1. Corporate information

The consolidated financial statements of FLAG JSC ("the Company") and its subsidiary ("the Group") for the year ended 31 December 2016 were authorized for issue by a decision of the Board of Directors dated 19 May 2017.

FLAG JSC is a joint-stock company incorporated by virtue of Decision No 1 dated 4 July 2007 under company file 10151/2007 of the Sofia City Court, having its seat in the city of Sofia, Sofia Region, Bulgaria. The financial year of the Company ends on 31 December.

In the consolidated financial statements, the investment in subsidiary (where the Group has a direct or indirect control over the operations of the Entities) has been consolidated.

These consolidated financial statements have been prepared in accordance with the requirements of the law effective in Bulgaria.

The core activity of the Group includes financing of municipal infrastructure and other projects for consideration and co-financing the development and implementation of projects of the European Union.

As at 31 December 2016, the shareholders of the Company include:
Republic of Bulgaria, represented by the Minister of Regional Development and Public Works – 100.00%.

2.1 Basis of preparation of the consolidated financial statements

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). They have been prepared under the historical cost convention.

The preparation of the financial statements in conformity with IFRS requires the use of certain critical estimates and assumptions. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2.2o).

New and amended standards and interpretations

During the current year the Group adopted all the new and revised International Financial Reporting Standards (IFRS) that are relevant to its operations and are effective for accounting periods beginning on 1 January 2016. This adoption did not have a material effect on the accounting policies of the Group.

At the date of approval of these financial statements, standards and interpretations were issued by the International Accounting Standards Board (IASB)/International Financial Reporting Interpretations Committee (IFRIC) which were not yet effective. Some of them were adopted by the European Union and others not yet. The Board of Directors expects that the adoption of these accounting standards in future periods will not have a material effect on the financial statements of the Group.

Standards issued by IASB/IFRIC and endorsed by EU, but not yet effective and not earlier applied

Standards issued but not yet effective and not early adopted up to the date of issuance of the Group's financial statements are listed below. The Group intends to adopt these standards when they become effective.

IFRS 9 Financial Instruments
The new standard is effective for annual periods beginning on or after January 1, 2018. The Group is in process of assessing the impact of the new standard on its financial position or performance.

IFRS 15 Revenue from Contracts with Customers
The new standard is effective for annual periods beginning on or after January 1, 2018. The Group is in process of assessing the impact of the new standard on its financial position or performance.

2.1 Basis of preparation of the consolidated financial statements (continued)

Standards issued by IASB, but not yet effective and not yet endorsed by EU

IFRS 14 Regulatory Deferral Accounts
The new standard is effective for annual periods starting on or after 1 January 2016. Endorsement process is postponed by EU for indefinite period. The Group is in process of assessing the impact of the new standard on its financial statements.

IFRS 16 Leases
The new standard is effective for annual periods starting on or after 1 January 2019. The Group is in the process of assessing the impact of the new standard on its financial statements.

Amendments to IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture.
The effective date is deferred indefinitely. The adoption of these amendments by EU is postponed. The Group is in the process of assessing the impact of the amendments on its financial statements.

Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealized Losses
These amendments are effective for annual periods starting on or after 1 January 2017. The Group is in the process of assessing the impact of the amendments on its financial statements.

Amendments to IAS 7: Disclosure Initiative
These amendments are effective for annual periods starting on or after 1 January 2017. The Group is in the process of assessing the impact of the amendments on its financial statements.

Clarifications to IFRS 15: Revenue from Contracts with Customers
These clarifications are effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the clarifications on its financial statements.

Amendments to IFRS 2: Classification and Measurement of Share - based Payment Transactions
These amendments are effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the amendments on its financial statements.

Amendments to IFRS 4: Application of IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts
These amendments are effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the amendments on its financial statements.

Annual Improvements to IFRS Standards 2014-2016 cycle
These improvements are effective for annual periods starting on or after 1 January 2017. The Group is in the process of assessing the impact of the improvements on its financial statements.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration
This interpretation is effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the interpretation on its financial statements.

Amendments to IAS 40: Transfer of Investment Property
These amendments are effective for annual periods starting on or after 1 January 2018. The Group is in the process of assessing the impact of the amendments on its financial statements.

The Group expects that the adoption of these standards, amendments and interpretations will not have significant impact on the financial statements of the Group in the period of initial application.

Statement of compliance

The consolidated financial statements of FLAG JSC have been prepared in accordance with International Financial Reporting Standards, as adopted by the European Union (IFRS, adopted by EU).

2.2 Summary of significant accounting policies

a) Foreign currency conversion

The financial statements are presented in Bulgarian Levas (BGN), which is the Group's functional and presentation currency. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into the functional currency at the end of each month by applying the closing exchange rate published by the Bulgarian National Bank for the last working day of the respective month. All foreign currency differences are recognised in the statement of comprehensive income. Non-monetary assets and liabilities which are estimated in terms of historical cost in a foreign currency are translated into the functional currency using the exchange rate as at the date of the initial transaction (acquisition).

b) Revenue recognition

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured regardless of when the payment is being made.

Revenue is measured at the fair value of the consideration received or due based on the agreed payment terms, net of discounts, rebates, and other sales taxes or customs duties. The Group analyses its selling arrangements against specific criteria to determine whether it acts as a principal or as an agent. It has concluded that it acts as principal in all such arrangements. The following specific recognition criteria must also be met before revenue is recognised:

Interest income

Interest income is recognised using the effective interest rate, i.e. the interest rate that discounts exactly the estimated future cash flows over the estimated useful life of the financial instrument, or a shorter period where appropriate, to the carrying amount of the financial asset.

The calculation includes all fees and consideration paid or received to/from the parties to the contract that are an integral part of the effective interest rate, transaction costs and any other premiums or discounts.
Interest income is included in finance income in the statement of comprehensive income.

Service delivery

The income from service delivery is recognised in the period in which the services were delivered.

c) Taxes

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantially enacted by the reporting date. Management analyses the individual items of the tax return for which the applicable tax provisions are subject to interpretation and recognises provisions where appropriate.

Current income tax is recognised directly in the equity (and not in the statement of comprehensive income) where the tax relates to items that have been recognised directly in the equity.

Deferred income tax

Deferred income tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.
Deferred income tax liabilities are recognised for all taxable temporary differences, except:

- when the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled by the Group and it is probable that the temporary differences will not reverse in the foreseeable future.

2.2 Summary of significant accounting policies (continued)

c) Taxes (continued)

Deferred income tax (continued)
Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised, except:

- when the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed by the Group at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Unrecognised deferred income tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax relating to items recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised in correlation to the underlying transaction either in other comprehensive income or directly in equity.

Deferred income tax assets and deferred income tax liabilities are offset by the Group only if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

d) Financial instruments – initial recognition and subsequent measurement

- **Financial assets**

Initial recognition
Financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* are classified as either financial assets at fair value through profit or loss, or loans and receivables, or held-to-maturity investments, or available-for-sale financial assets, or derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition.

Financial assets are recognised initially at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the market place (regular purchases) are recognised on the trade (transaction) date, which is the date that the Group commits to purchase or sell the asset.

Financial assets of the Group include cash and cash equivalents, loans granted, trade and other receivables.

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

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement loans and receivables are subsequently carried at amortised cost using the effective interest method (EIR), less any allowance for impairment. Amortised cost is calculated taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The EIR amortisation is included in finance income in the statement of comprehensive income. The losses arising from impairment are recognised as other expenses in the statement of comprehensive income.