Софийска вода

**Sofiyska Voda AD**

**Annual management report and Consolidated financial statements**

**For the year ended 31 December 2016**

**With independent Auditors' Report thereon**

## Contents

**ANNUAL CONSOLIDATED REPORT ON THE ACTIVITY**

**SOFIYSKA VODA AD AND WATER INDUSTRY SUPPORT AND EDUCATION LTD. (THE GROUP)**

**31 DECEMBER 2016**

***Financial Review:***

The financial statement was prepared in compliance with the International Financial Reporting Standards (IFRS), approved by the European Union.

In 2016 the Group's revenue from main charges amounted to BGN 132.2 M, which is 4.28% higher than the revenue from main charges in the same period of previous year – BGN 126.7 M. The main reason is the update of the number of active customer accounts, as well as the increased consumption as compared to 2015. The Group's total revenue for 2016 amounted to BGN 170 M (BGN 157.5 M over the same period of 2015). The revenue from construction over 2016 amounted to BGN 37.9 M (BGN 30.8 M over the same period of 2015). The breakdown of revenues by types of services is presented in Note 5 from the financial statement.

The cogeneration installation, commissioned at Kubratovo WWTP at the end of 2009, ensured as a priority the fulfillment of the plant's power supply needs in 2016.

The Group's operating costs over 2016 amounted to BGN 136.6 M (2015 – BGN 126.1 M). This amount includes BGN 37.9 M construction costs, which result from the application of IFRIC 12 and these costs offset the construction revenue above.

The depreciation and amortization costs over 2016 amounted to BGN 32 M. The value is higher than the one reported in 2015 (BGN 28.9 M), which is mainly due to the higher number of commissioned assets and the depreciation of the asset Concession Right until the end of the concession, whose period shortens each year.

The interest charges in the year are in line with the budgeted by the Group.

The net financial costs for the first six months of 2016 are by BGN 867 k lower than the ones reported over the same period of 2015, which is mainly due to the effect of the lower interest rates under the long-term financial liabilities of the Group and the reduced addition to the subordinated loan from 5.95% to 5.20%.

As result of the above factors, the profit after tax for 2016 was BGN 25.05 M as compared to BGN 22.5 M over the same period of 2015.

The management of the financial risk and the exposition of SV regarding the price, credit and liquidity risks and the risk of the cash flow are presented in detail in Note 24. Financial instruments to the separate financial statement

***Signed significant deals:***

| № | Description | Contractor | Period of the contract | Staring date | Ending Date | Cost, w/out VAT |
|---|---|---|---|---|---|---|
| F6888 | Supply of pipes from PEHD, multi-layer plastic pipes for open laying without sand bed and multi-layer plastic pipes for trenchless laying of water mains | HTI Bulgaria EOOD | 03.02.2016 - 03.02.2018 | 3.2.2016 | 03.02.2018 | 2 195 000,00 |
| F6942 | Engineering with subject: *Design, construction and commissioning of a system for supply of air in the aeration tanks in SWWTP* | Start Engineering AD | 23.03.2016 - 02.11.2018 | 23.3.2016 | 02.11.2018 | 1 389 124,00 |
| F6956 | Execution under investment projects for the sewer network, as well as reconstruction of parts of the water supply network, in the cases when this has been envisage with an investment project - **South Zone - LOT 1** | Gelak OOD | 14.04.2016 - 14.04.2019 | 14.4.2016 | 14.04.2019 | 8 000 000,00 |
| F6983 | Electronic processing, printing, folding, putting into an envelope and delivery of invoices, notification letters, information and promo materials to the customers | DZZD Consortium Demax DPI – Star Post | 14.05.2016 - 14.05.2018 | 14.5.2016 | 14.05.2018 | 2 500 000,00 |
| F6989 | Execution under investment projects for the sewer network, as well as reconstruction of parts of the water supply network, in the cases when this has been envisage with an investment project - **North Zone LOT 2** | Partnership ViDZhi Group DZZD | 18.05.2016 - 18.05.2019 | 18.5.2016 | 18.05.2019 | 8 000 000,00 |
| F6997 | Supply of active electrical energy high, middle and low voltage under freely negotiated prices under the Energy Act and inclusion into a balancing group of the sites of Sofiyska Voda AD and coverage of their non-balances | Most Energy AD | 31.05.2016 - 31.12.2016 | 31.5.2016 | 31.12.2016 | 1 912 172,00 |
| F7017 | Planned construction of new and replacement of existing WSC and stop valves on the water supply network on the territory of MoS | Raicommerce construction EAD | 14.06.2016 - 10.08.2018 | 14.6.2016 | 10.08.2018 | 2 000 000,00 |
| F7049 | Implementation of investment projects on the water supply network on the territory of MoS - **in Zone 2** | Partnership "Zona 2-2015" DZZD - SADE - Compagnie Generale De Travaux D'hydraulique and Ancommerce OOD | 11.07.2016 - 11.07.2019 | 11.7.2016 | 11.07.2019 | 4 750 000,00 |
| F7063 | Rehabilitation of reservoir "Pod Simeonovo" for connection to the water supply network of Sofia in working regime | Partnership "Vodokanalstroy Opel-Pro" - Vodokanalstroy ODD and Opel-Neshev OOD. | 21.07.2016 - 21.07.2018 | 21.7.2016 | 21.07.2018 | 1 769 344,00 |
| F7071 | Repair works of the building of the Filter House located in Bistritsa PWTP | Galchev Engineering EOOD | 04.08.2016 - 04.08.2018 | 4.8.2016 | 04.08.2018 | 1 362 047,51 |
| F7081 | Delivery of pipes and fittings made of ductile cast iron for potable water | HTI Bulgaria EOOD | 09.08.2016 - 16.06.2018 | 9.8.2016 | 16.06.2018 | 1 650 000,00 |
| F7130 | Financing the purchase of vehicles and equipment under finance leases | Interlease EAD | 02.11.2016 - 02.11.2018 | 2.11.2016 | 02.11.2018 | 5 000 000,00 |
| F7139 | Financing the purchase of vehicles and equipment under finance leases | Raiffeisen Leasing OOD | 04.11.2016 - 04.11.2018 | 4.11.2016 | 04.11.2018 | 5 000 000,00 |
| F7141 | Financing the purchase of vehicles and equipment under finance leases | SOGELEASE Bulgaria EOOD | 02.11.2016 - 02.11.2018 | 2.11.2016 | 02.11.2018 | 5 000 000,00 |

***Signed related party transactions:***

On October 3rd, 2016 Sofiyska Voda AD signed an Annex to the Subordinated Loan Agreement with Veolia Voda Sofia B.V. on the extension of the validity of the agreement till April 28th, 2017.

A contract was signed in 2016 for servicing burners and boilers at PWTP Bistritsa, PWTP Pancharevo and WWTP Kubratovo, including preventive maintenance, adjusting and repair of gas installations, burners and boilers, as well as performance of emergency activities with contractor Veolia Energy Varna EAD.

***Information about events and indicators of nature unusual for the issuer, which have a substantial impact on its activity, the revenues generated and costs incurred by it; assessment of their impact on the results in the current year:***

There are no such events and indicators of nature unusual for the issuer with substantial impact on its activity.

***Information about off-balance sheet transactions – nature and business objective, specifying the financial impact of the transactions on the activity if the risk and benefits of these transactions are material for the issuer and if the disclosure of this information is substantial for the financial position of the issuer:***

As at the date of the preparation of this report the Group maintains the following bank guarantees:

Performance security for the obligations of Sofiyska Voda AD under the Concession Agreement with number PEBPRT593268, issued by HSBC France, to the amount of 750,000 USD, and validity till December 15th, 2017;

Performance security for the obligations of Sofiyska Voda AD under the Contract No.РД-568-68/10.08.2011 with the Municipality of Sofia for the repair of defects and damages occurred in municipal areas where Sofiyska Voda AD performs construction works, with No.GI11.231.0090, issued by Citibank N.A. – Sofia branch (to date - Citibank Europa Plc., Bulgaria Branch), to the amount of 400,000 BGN, and validity till December 31st, 2017;

Performance security for the obligations of Sofiyska Voda AD under the Contract for access to the electricity grid No.DST-081/30.12.2011 with the Electricity System Operator EAD (ESO), No.GI15.027.0019, issued by Citibank Europa Plc., Bulgaria Branch, to the amount of 6,880 BGN, and validity till January 31st, 2018;

Performance security for the obligations of Sofiyska Voda AD under the Contract for electric power transmission with the Electricity System Operator EAD (ESO), No.GI15.027.0020, issued by Citibank Europa Plc., Bulgaria Branch, to the amount of 859 BGN, and validity till January 31st, 2018.

***Information about shareholdings of the issuer, its main investments in the country and abroad (in securities, financial instruments, intangible assets and real estates), as well as for investments in equity securities beyond its business Group and the sources/ways of funding:***

The Group does not have investment in the country and abroad (in securities, financial instruments, intangible assets and real estates) as well as investments in equities outside its business Group.

***Information about the loan agreements signed by the issuer, respectively the person under § 1e of the additional provisions of the Law on Public Offering of Securities, by its subsidiary or parent company in their capacity as borrowers, as the terms under them are specified, including the deadlines for repayment, as well as information about the provided guarantees and commitments***

As at 31.12.2016 the Group has two loans: Loan "A" from the European Bank for Reconstruction and Development (EBRD) and Loan "B" (subordinated loan) from a company from the Veolia Group, Veolia Sofia B.V. – shareholder in Sofiyska Voda AD. Loans are carried at amortized cost.

***Terms and Repayment Schedule***

| *In k BGN* | Currency | Nominal Interest Rate | Year of maturity | 31 December 2016 Nominal value | 31 December 2016 Carrying amount | 31 December 2015 Nominal value | 31 December 2015 Carrying amount |
|---|---|---|---|---|---|---|---|
| Loan "A" | EUR | 1.35% + 6-month EURIBOR* | 2020 | 36,266 | 35,747 | 45,329 | 44,557 |
| Loan "B", Subordinated and unsecured loan from a related party | EUR | 5.95% + 6-month EURIBOR | 2017 | 71,117 | 71,407 | 71,118 | 71,313 |
| | | | | 107,383 | 107,154 | 116,447 | 115,870 |

On October 3rd, 2016 Sofiyska Voda AD signed an Annex to the Subordinated Loan Agreement with Veolia Voda Sofia B.V. on the extension of the validity of the agreement till April 28th, 2017.

As at 31.12.2016 Veolia Voda Sofia B.V., the majority shareholder in Sofiyska Voda AD, had a short-term loan from Veolia CEE at the amount of 36,362 k Euro or 71,117 k BGN in nominal value. The deadline for the repayment of the loan is April 28th, 2017. The nominal interest rate is 6-month EURIBOR plus add-on at the amount of 5.20%.

***Information about the loan agreements signed by the issuer, respectively the person under § 1e of the additional provisions of the Law on Public Offering of Securities, by its subsidiary or parent company in their capacity as borrowers, including provision of guarantees of any kind, including to related parties, as the terms under them are specified, including the deadlines for repayment and the objective for which they have been granted:***

As at 31.12.2016 Veolia Voda Sofia B.V., the majority shareholder in Sofiyska Voda AD, is a creditor under a short-term loan of Sofiyska Voda AD at the amount of 36,362 k Euro or 71,117 k BGN in nominal value. The deadline for the repayment of the loan is April 28th, 2017. The nominal interest rate is 6-month EURIBOR plus add-on at the amount of 5.20%.

***Terms and Repayment Schedule***

| *In k BGN* | Currency | Nominal Interest Rate | Year of maturity | 31 December 2016 Nominal value | 31 December 2016 Carrying amount | 31 December 2015 Nominal value | 31 December 2015 Carrying amount |
|---|---|---|---|---|---|---|---|
| Loan "B", Subordinated and unsecured loan from a related party | EUR | 5.95% + 6-month EURIBOR | 2017 | 71,117 | 71,407 | 71,118 | 71,313 |
| | | | | 71,117 | 71,407 | 71,118 | 71,313 |

***Analysis of the relationship between the achieved financial results reflected in the financial statements for the financial year and the forecasts for these results published earlier:***

Sofiyska Voda AD has no published forecasts for the expected financial results in the year.

***Analysis and assessment of the policy on financial resource management and specifying the capacity to service the liabilities, the possible threats and measures which the issuer, respectively the person under § 1e of the additional provisions of the Law on Public Offering of Securities, has applied or intends to apply in view of their elimination:***

The financial statements as at 31.12.2016 was prepared on the basis of the assumption that the Group is a going concern and it will continue its activity in the foreseeable future.

As at December 31st, 2016 the current liabilities of the Group exceeded the current assets by 65,762 k BGN because the intragroup loan agreement (subordinated loan) ends in April 2017 and the obligations under the loan are presented as short-term liabilities.

The management of the Group is in the process of renegotiation of the subordinated loan with bank institutions and expects a positive result. The Group has the support of the Veolia Group, confirmed through the comfort letter issued on behalf of the Veolia Voda CEE, the sole owner of Veolia Voda (Sofia) B.V., the direct parent company of Sofiyska Voda AD, which has expressed its intention not to require the repayment of the liabilities of Sofiyska Voda AD to it or its subsidiaries within at least 12 months after the maturity date.

Due to that reason, the risk of non-repayment of the intragroup subordinated loan in case it becomes payable within the next financial year, which in its turn will result in a failure to comply with Loan A granted by an international financial institution, is considered low.

Throughout the year the Group continued to generate net income after taxes, which reached 25,097 k BGN in 2016 (2015: 22,396 k BGN). The cash and cash equivalents increased by 494 k BGN as compared to 2015 and they were 17,496 k BGN. Throughout the year the Group serviced on a regular basis its liabilities to suppliers, excluding the principal under the subordinated debt. There are no arrears to third parties.

In view of the above the management has the justified expectation to believe that the available capital resources and sources of funding (cash flows from the operational activity) will be enough to enable the Group to cover its liquidity needs within 2017.

***Assessment of the capacity to implement the investment intentions and specifying the amount of the available resources and reflecting the possible changes in the funding structure for this activity:***

The investment intentions of the Company are described in detail in the paragraph below for the Business Plan of the Group for the period 2017 – 2021. The implementation of the investment program in the Business Plan is fully funded with own resources, i.e. from the revenues of the Company generated from the foreseen prices for the provision of WSS services.

***Information about changes that have occurred during the reported period in the main governance principles of the issuer and its business Group:***

No changes in the main governance principles of the business Group.

***Information about the main characteristics of the internal control system and risk management system applied by the issuer, respectively the person under § 1e of the additional provisions of the Law on Public Offering of Securities, in the process of preparing the financial statements.***

SV develops its internal control system based on best accounting practice and COSO model (COSO - Committee of Sponsoring Organizations of the Treadway Commission) The five components of internal control according to the model are:

i. Control Environment
ii. Risk Assessment (Process of Enterprise Risk Assessment)
iii. Information and Communication (Information system, included the related to it business processes referring to financial reporting and communications)
iv. Control Activities
v. Monitoring (Ongoing monitoring of the controls)

These components are also set out in the International Standard on Auditing (ISA) 315, Appendix 1 – Internal Control Components.

The control environment sets the tone of an entity, influences the control consciousness of people within an organization and is the foundation for all other components of the internal control, providing discipline and structure. The factors of the control environment comprise: integrity and ethical values; employees' commitment to competence; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its employees; as well as attention and guidelines, given by the Board of Directors.

Main policies and procedures ensuring the control environment are:

- Code of Ethics of Veolia Environnement (adopted by SV in June 2011)
- Ethics, Commitment and Responsibility of Veolia Environnement (adopted by SV in Oct 2012)
- Internal Code of Conduct
- Disclosure (Whistleblowing) Policy
- Hospitality Policy
- Conflicts of Interest Policy
- Anti-Fraud Policy, which is supported by
    - → Fraud Investigation Procedure
    - → Anti-Corruption telephone line (+359 2 8122 521, published on SV official web site www.sofiyskavoda.bg )
- Accounting Policy
- Procedure on accounting closing
- Procedure on receiving and posting invoices to suppliers
- Policy for purchasing, stocktaking and writing off of assets etc.

SV like every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with changes.

SV's risk management process in is regulated by a Risk Management Policy and supported by Business Risk Management Procedure, which describes the methodological approach at the identification, measuring, controlling and subsequent monitoring of these circumstances, event and actions that could impact the achievement of the business objectives of the company.

All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. Effective communication with external parties, e.g. customers, suppliers, regulators and shareholders should be in place.

SV's Communications Department focus on internal as well as external exchange of information with the stakeholders. In addition, SV's Regulation and Concession Compliance Department is in charge of information exchange with the Municipality of Sofia, EWRC and other institutions. The relations with the customers are managed by the teams in "Customer Service" Directorate.

The intranet and the official website of the company are also a two-way channel for exchange of information both inside and outside the company.

Control activities are the policies and procedures that help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks related to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all units. They include a range of activities as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

All effective policies, procedures and instructions on the specific work processes are published on SV's Intranet, which is accessible to all employees. The process of preparation of internal regulatory documents (policies, procedure, and instructions) is unified and described in an official internal procedure.

Monitoring – the internal control systems need to be monitored - a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures.

The management is primarily responsible for the internal control system and the chief executive officer is assumed to be "owner" of the system. Management is accountable to the board of directors, which provides corporate governance, guidance and supervision.

The audit committee of Sofiyska Voda is created and operates (including by implementing its obligations for monitoring regarding financial reporting) under the Law for the Independent Financial Audit.

Internal auditors play an important role in evaluating the effectiveness of control systems, and contribute to ongoing effectiveness. Because of organizational position and authority in an entity, the internal audit unit often plays a significant monitoring role.

The weaknesses of internal control, identified during internal audits, inspections and monitoring are reported to the managers and the most serious matters are referred to the senior management and the Board of Directors.

Internal control is, to some degree, the responsibility of everyone in an organization and therefore should be stated in the requirements of everyone's job description. Virtually all employees produce information used in the internal control system or take other actions needed to effect control.

External parties also carry out monitoring over the activity of Sofiyska Voda and these are the regulatory bodies (Energy and Water Regulatory Commission), state institutions (tax authorities, ministries etc.) and external auditors.

In 2016 there are not known arrangements (including also after the closing of the fiscal year) as result of which in a future period changes could occur regarding the owned relative share of bonds or shares from current shareholders or bondholders.

***Information about pending court, administrative or arbitration proceedings concerning liabilities or receivables of the issuer at the amount of at least 10% of its equity; if the total value of the liabilities or receivables of the issuer under all commenced proceedings exceeds 10% of its equity, information is provided for each individual procedure:***

One of the most important pending cases of the Company is the lawsuit related to the penalty imposed by the Competition Protection Commission (CPC). With the ruling No. 370/19.03.2014, on the grounds of art.74, para.1, item 3 of the Competition Protection Act (CPA), the CPC claimed that Sofiyska Voda had committed an abuse of dominant position by charging default interest on debts based on estimated readings for a service used within the meaning of art. 21, item 1 of the CPA. The imposed penalty is 4,800 k BGN and it was calculated on the basis of 0.5% of Sofiyska voda's income in 2013 as a debt ratio 8 was applied as well. The Group took actions to appeal the imposed penalty in compliance with the applicable legislation.

On 11.01.2016 the SAC approved partially the appeal of Sofiyska Voda against the decision of the CPC and decreased the amount of the imposed penalty from 4,800 k BGN to 2,400 k BGN. The decision was appealed before a 5-member jury of the SAC both by Sofiyska Voda and the CPC. Regarding the appeals filed by both parties, the lawsuit No. 3161/2016 was initiated, as the hearing was scheduled for April 7th, 2016. The court decision is expected.

***Risks and uncertainties:***

One of the main risks, which the Group is exposed to, is the possible payment of the penalty imposed by the CPC. With the ruling No. 370/19.03.2014, on the grounds of art.74, para.1, item 3 of the Competition Protection Act (CPA), the CPC claimed that Sofiyska Voda had committed an abuse of dominant position by charging default interest on debts based on estimated readings for a service used within the meaning of art. 21, item 1 of the CPA. The imposed penalty is 4,800 k BGN and it was calculated on the basis of 0.5% of Group's income in 2013 as a debt ratio 8 was applied as well. The Company took actions to appeal the imposed penalty in compliance with the applicable legislation. On 11.01.2016 the SAC approved partially the appeal of Sofiyska Voda against the decision of the CPC and decreased the amount of the imposed penalty from 4,800 k BGN to 2,400 k BGN. The decision was appealed before a 5-member jury of the SAC both by Sofiyska Voda and the CPC. Regarding the appeals filed by both parties, the lawsuit No. 3161/2016 was initiated, as the hearing was scheduled for April 7$^{th}$, 2016. The court decision is expected.

Another main risk for 2017 concerns the possible lack of approval of the price foreseen in the Business Plan 2017 – 2021. The effect of no approved prices of the WSS services from the beginning of 2017 in line with the submitted Business Plan will result in a decrease in the annual revenue from WSS services in 2017 by 18,756 k BGN and decrease in the receivables from WSS services without VAT by 17,785 k BGN (VAT excluded). This will lead to reconsideration and possible decrease in the investment program for 2017 set out in the Business Plan.

***Renegotiation of the concession agreement:***

With an order by the Mayor of Sofia dated 29.03.2016 a new working group was set up by representatives from Sofia municipality and external experts with the task to continue the renegotiations of the Concession Agreement. The first official meeting between representatives of the working group and Sofiyska Voda was held on 29.07.2016.

The meetings continued during the year with regard to the renegotiation of the Concession Agreement, which was also discussed in the context of the draft Business Plan 2017-2021 developed by the Group and its main parameters like operating costs, amount of the investment program, levels of the KPIs for the WSS services, possible refinancing of the subordinated debt, etc. As at the end of 31.12.2016 the renegotiation process was not finalized due to its complexity and the necessity for the Group to have an approved Business Plan for the period 2017-2021.

***General Assembly:***

On 19 January 2016 an extraordinary General Assembly of the shareholders of Sofiyska Voda was held. During the General Assembly the following decisions were taken:

1.1 The following members from the Board of Directors of Sofiyska Voda AD were released:
1. Mr. Bruno Daniel Paul Roche;
2. Mr. Gyorgy Palko;
3. Mr. Stefan Nikolov Peltekov;
4. Mr. Tsvetan Dobrev Gergov;

1.2. The following people were selected as members of the Board of Directors of Sofiyska Voda AD:
1. Mr. Arnaud Philippe François Valleteau de Moulliac;
2. Mr. Frederic Laurent Faroche;
3. Mrs. Milena Stajkova Tsenova;
4. Mr. Biser Nikolaev Damyanovski;

2.1 The withdrawal of Mr. Pierre Emmanuel De Cibeins from the Audit Committee of Sofiyska Voda was approved;
2.2. Mr. Fabien Ferrer was appointed as a member of the Audit Committee of Sofiyska Voda AD.
2.3. Remuneration was fixed for the Audit Committee members elected as per the proposal of the shareholder Vodosnabdyavane i Kanalizatsia EAD, as follows: for the Chair Mr. Ivan Iliev – at the amount of four minimum monthly salaries for the country, and for the AC member Mr. Petyo Ignatov - at the amount of three minimum monthly salaries for the country.

On June 10th, 2016 the annual General Shareholders Meeting of Sofiyska Voda AD was held. The following decisions were made at the General Meeting:

1. The consolidated report on the activity of Sofiyska Voda AD for 2015 and the consolidated annual financial statements of the Group for 2015 were approved;
2. The report on the activity of Sofiyska Voda AD for 2015 and the individual annual financial statements of the Sofiyska Voda for 2015 were approved;
3. The report on the activity of the Audit Committee of Sofiyska Voda for 2015 was approved;
4. The profit of Sofiyska Voda for 2015 would not be distributed and no dividends would be paid to the shareholders for 2015 in view of the provisions of the Loan Agreement between the Group and the EBRD;
5. Sofiyska Voda's Board Members were relieved of liability for their activity in 2015.

Within the statutory deadline the Group disclosed the individual and consolidated financial statements and reports on the activity under its file in the Trade Register with the Registry Agency.

On December 13th, 2016 an extraordinary General Shareholders Meeting of Sofiyska Voda was held. The following decision was made at it:

1. KPMG Bulgaria Ltd., UIC 040595851, registered under No.45 in the Institute of the Chartered accountants, was appointed as the auditor to verify and certify the individual and consolidated statements of Sofiyska Voda for the financial year 2016.

***Board of Directors***

On 19 January 2016 was held an extraordinary General Assembly of the shareholders, at which were released the following members from the Board of Directors: Mr. Bruno Daniel Paul Roche, Mr. Gyorgy Palko, Mr. Stefan Nikolov Peltekov and Mr. Tsvetan Dobrev Gergov and selected as their replacements: Mr. Arnaud Philippe François Valleteau de Moulliac, Mr. Frederic Laurent Faroche, Mrs. Milena Stajkova Tsenova and Mr. Biser Nikolaev Damyanovski. Until the end of 2016 changes were not been made in the Board of Directors of the Group. The Board of Directors of SV consists of 7 members: Mr. Arnaud Philippe François Valleteau de Moulliac, Mr. Frederic Laurent Faroche; Mrs. Mariana Georgieva Iteva, Mr. Ferenc Szucs, Mrs. Milena Stajkova Tsenova, Mr. Vladimir Georgiev Stratiev and Mr. Biser Nikolaev Damyanovski. The Group is managed and represented individually by Mr. Arnaud Philippe François Valleteau de Moulliac and Mr. Frederic Laurent Faroche.

The remunerations of the Board Members are:

| *In k BGN* | **2016** | **2015** |
|---|---|---|
| Remunerations of the Executive Director and the Board of Directors | 212 | 329 |
| From which under the balance as at 31 December | 8 | 8 |

The Board members do not hold, have not acquired and transferred shares and bonds of the Group during the year.

The Board Members have no rights to acquire shares in the Group.

In 2016 the Board Members participated in the management of other companies registered in the Trade Register with the Registry Agency or entities, or commercial proxies, managers or board members of companies registered in the Trade Register with the Registry Agency, or participated as partners with unlimited liability, or held more than 25% of the capital of another entity, as follows:

1. Frederic Laurent Faroche – participated in the management of: VEOLIA ENERGY SOLUTIONS BULGARIA, UIC: 130547859; Veolia Energy Bulgaria EAD, UIC: 121371700; VEOLIA ENERGY VARNA EAD, UIC 103195446;
2. Marian Georgieva Iteva – participated in the management of: Veolia Voda Bulgaria EOOD, UIC: 201404389; held more than 25% of the capital of MI CONSULT INTERNATIONAL EOOD, UIC: 200981719.

3. Bisser Nikolaev Damyanovski – participated in the management of and held more than 25% of the capital of INTERTRADE CONSULT EOOD, UIC: 201824172

The Board Members did not signed contracts under art.240b of the Commerce Act during the year.

***Acquired and transferred shares:***
In 2016 the Group did not acquire or transfer own shares.

***Research and development***
The Group does not carry out research and development.

***Business Plan:***
With its decision № БП-28 dated 12.02.2016 the Energy and Water Regulatory Commission (EWRC) approved Business Plan 2016.

With Decision № Ц-8 dated 28.04.2016 the EWRC approved the new prices of the WSS services provided by the Group, where the total increase of the combined price (supply, sewerage, treatment) is 5 stotinki (0.05 BGN) without VAT

With decision dated 13 January 2016 the Council of Ministers approved an Ordinance on the regulations of the quality of the WSS services and an Ordinance on the regulation of the prices of the WSS services, which were the basis for the preparation of Business Plan 2017-2021.

The preparation of the Business Plan 2017-2021 has been significantly delayed by the EWRC in terms of the submission of the necessary instructions for application of the ordinances and the provision of a final electronic model for the preparation of the document.

Sofiyska Voda started preparing the Business Plan 2017-2021, based on the current legislation and in accordance with the Ordinance on regulating the quality of water supply and sewerage services, the Ordinance on regulating the prices of the water supply and sewerage services and the instructions for their application. When preparing the business plan of the Group, the fact that Sofiyska Voda operates as the only public-private partnership in the WSS sector in Bulgaria is taken into account. For this reason, in the preparation and implementation of the business plan, the Group should be guided not only by the requirements of the legislation, but also the need to take into consideration the contractual obligations of the company set in the Concession Agreement.

Sofiyska Voda submitted its draft Business Plan 2017-2021 to MoS and the Regulator on 30.06.2016 in compliance with the legal set period. After the submission of the strategic document, the efforts of the Group were aimed at cooperation with the Regulator and the MoS regarding the analysis and the approval of the BP.

Following the submission of the Business plan, the EWRC requested on a couple of occasions further information and clarifications in connection with the BP. The Group took into account the further recommendations made by the Commission and they were reflected in the final version of the Business plan submitted to the EWRC and the MoS on 04.01.2017.

SV developed the investment program for the regulatory period 2017-2021 on the basis of:

- The maintenance of high H&S standards at work and ensuring an optimal working environment for the Company employees;
- The commitment for an indicative amount of the investments till the end of the Concession Term (in connection with the memorandum under ISPA signed between the Ministry of Environment and Water and the European Commission);
- The commitment for additional investments under the Settlement Agreement between the MoS and SV dated 2009 and for compensating considerations;
- The long-term financial estimates of the Group;
- The new legislation for regulation of the WSS services and the instructions to them;
- Corporate Accounting Policy.

The content of the investment program was planned by taking into account:

- The necessity of providing WSS services with sustainable high quality to an increasing number of residents of MoS;
- Necessity of achieving the agreed with EWRC individual and long-term KPIs for the activity of the Group;
- The requirements of the normative regulations in the area of the WSS services, construction, energy efficiency, occupational safety and environmental protection;
- Necessity for continuous modernization of the facilities and optimization of the working processes in order to improve the effectiveness and ensure occupational health and safety;
- The forecasts for the development of the WSS systems in Detailed Urban Development Plan of Sofia, Strategy for the Development of the Technical Infrastructure of MoS as well as the investment priorities of the Grantor in relation to the sewerage network.

The breakdown of the total investments of the Group for the period 2017-2021 is given in the table below:

| | 2017 (k BGN) | 2018 (k BGN) | 2019 (k BGN) | 2020 (k BGN) | 2021 (k BGN.) |
|---|---|---|---|---|---|
| **Investments in regulated services** | 44 163 | 44 435 | 38 684 | 33 779 | 32 982 |
| **Non-regulated investments** | 1 748 | 2 712 | 1 304 | 1 248 | 1 196 |
| **Additional investments** | 2 368 | 1 660 | 760 | 1 060 | 1 060 |
| **Total investments:** | **48 279** | **48 807** | **40 748** | **36 087** | **35 238** |

The total amount of the financial resources envisaged for investments in the period amount to **209.16 M BGN**, and the average annual amount of the investments is **41.83 M BGN**. In view of reaching quicker the target levels of the KPIs and enhancing the work efficiency, the Group has envisaged a higher amount of investments in the first two years of the period (46.4% of the total investments for the period).

In compliance with the new regulatory framework, the EWRC determined (following a discussion with the WSS operator) the individual levels, which should be achieved by every WSS operator till the end of the regulatory period. Such levels were determined for Sofiyska Voda as well. The Group structured and planned its future projects and activity in a way allowing the achievement of the levels of the KPIs for the WSS services determined by the EWRC.

We think that in this rapidly changing and unstable regulatory framework, Sofiyska Voda has prepared a realistic and balanced business plan for the period 2017 – 2021, envisioning an ambitious investment program (BGN 209.16 million) and the achievement of the levels of key performance indicators for water supply and sewerage services determined by the EWRC.

Sofiyska Voda AD believes that the open and expert discussion on the key assumptions in the Business Plan with the main stakeholders – the MoS, the EWRC and society lead to better clarity in terms of the long-term plans of the Group and the possibilities of ensuring a stable financial framework in the new regulatory period, which will secure the implementation of the Business Plan of the Company.

***Events following the balance sheet date:***

On 10 January 2017 an annex was signed to contract for subordinated loan between Sofiyska Voda AD and the shareholder and creditor of the Group Veolia Voda Sofia B.V. The aim of the annex is reduction of the amount of the addition from 5.95% to 5.20% backdated from 05 October 2016. The correction of the reduced addition is registered as at the date of the financial report of the Group 31 December 2016.

***Customer Service***

The main event related to the Customer Services in the first half of 2016 is the project for ISO 9001:2015 certification of the customer related processes. Sofiyska Voda has implemented a quality management system compliant to the new standard`s requirements, based on the principles of process approach, risk based thinking and continuous improvement. The project has been the follow-up of the previous implementation of the new customer information system, which already structured and simplified the processes, as well as provided the necessary tools for monitoring the performance of processes included in the scope of certification: management of customer accounts, meter management and meter reading, billing, payments and debt collection, management of customer interactions. The certification audit which took place in June 2016 was successfully passed and Sofiyska Voda became the first utility company in Bulgaria to certify its customer service processes under the new version of the standard ISO 9001:2015.

**Relations with customers**

In the reporting period of 2016, 374,402 incoming calls were registered in the Call Center, which is a drop by -26% compared to the same period in 2015 and by-18% compared with the same period in 2014. The fewer number of incoming calls is a proof of improvement in the quality of service, since the customers have fewer inquires and complaints about our services. The share of complaints from all received calls is 14.1% for the reporting period of 2016. In 2016 a new key performance indicator was introduced: % of calls answered in less than 30 seconds, which was 86% for the period January – December from the calendar 2016. The rate of the not received calls was below the targeted 4% since March 2016, and the registered values were between 2.97% in March and 1.11% in December.

**Customer Service Centers**

In 2016, Sofiyska Voda maintained its network of 8 Customer Service Centers, located in various parts of the city. The total number of visits received in this period was 169, 411 nos, which is by -7.9% fewer than the same period of the previous year. The number of payments received in the centers also decreased by -5.9% (115,148 over the reporting period of 2016 compared to 122,399 in 2015), due to several alternatives for payment.

**Internet services**

In January – December 2016, there were 1 844 667 registered visits to the Company's website. 74,895 water meter self-readings were submitted by our customers, as for the same period of 2015 they were 53, 423.

The enquiries received through the website were 8,043 and 7,337of them required an answer. All answers were sent within 24 hours from receipt of the enquiry.

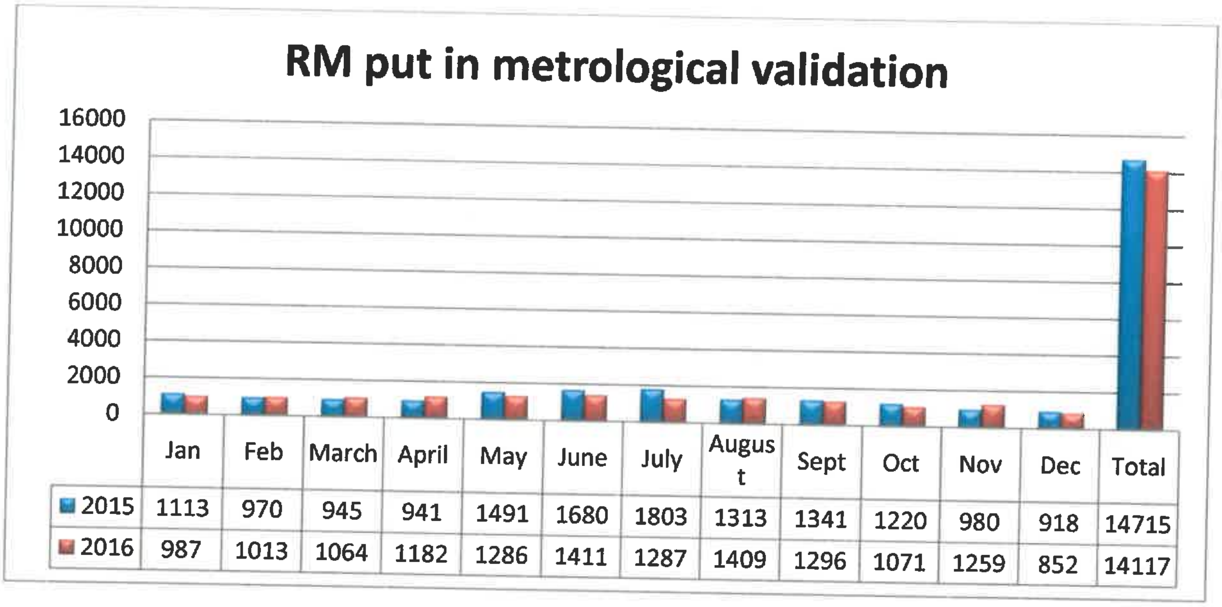
In January – December 2016, 20,515 customers cancelled their paper invoices. At the end of December 2016, a total of 70,295 customers received electronic invoices.

**Water meter services, billing and debt collection**

**Replacing water meters**

**Replacing water meters on WSCs**

- For the period January 2016 – December 2016;
- The number of water meters set into metrological validity by teams of the Group is 14,117.

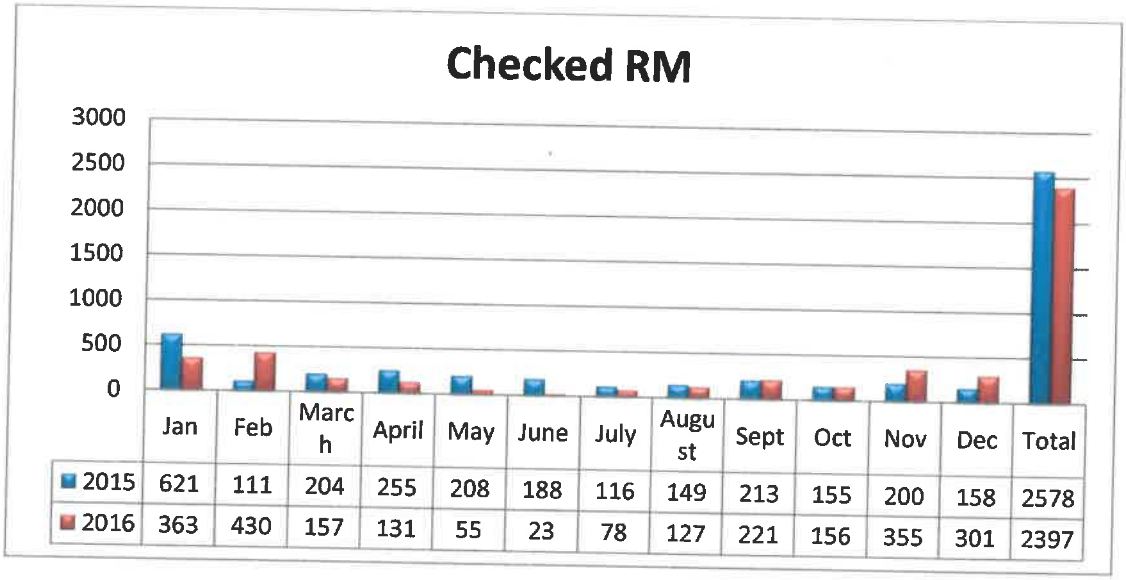



| | Jan | Feb | March | April | May | June | July | August | Sept | Oct | Nov | Dec | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2015 | 1113 | 970 | 945 | 941 | 1491 | 1680 | 1803 | 1313 | 1341 | 1220 | 980 | 918 | 14715 |
| 2016 | 987 | 1013 | 1064 | 1182 | 1286 | 1411 | 1287 | 1409 | 1296 | 1071 | 1259 | 852 | 14117 |

In addition, 752 water meters on water service connections were replaced by the customers and sealed by Illegal Connections team – these are water meters, which were frozen, broken or the customer prefers not to pay for the replacement and install directly a new device, which meets the normative, technical and metrological requirements.

Or the total number of the water meters set into metrological validity in 2016 is 14,869.

- 2, 379 water meters on WSC were checked in an authorised laboratory




| | Jan | Feb | March | April | May | June | July | August | Sept | Oct | Nov | Dec | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2015 | 621 | 111 | 204 | 255 | 208 | 188 | 116 | 149 | 213 | 155 | 200 | 158 | 2578 |
| 2016 | 363 | 430 | 157 | 131 | 55 | 23 | 78 | 127 | 221 | 156 | 355 | 301 | 2397 |

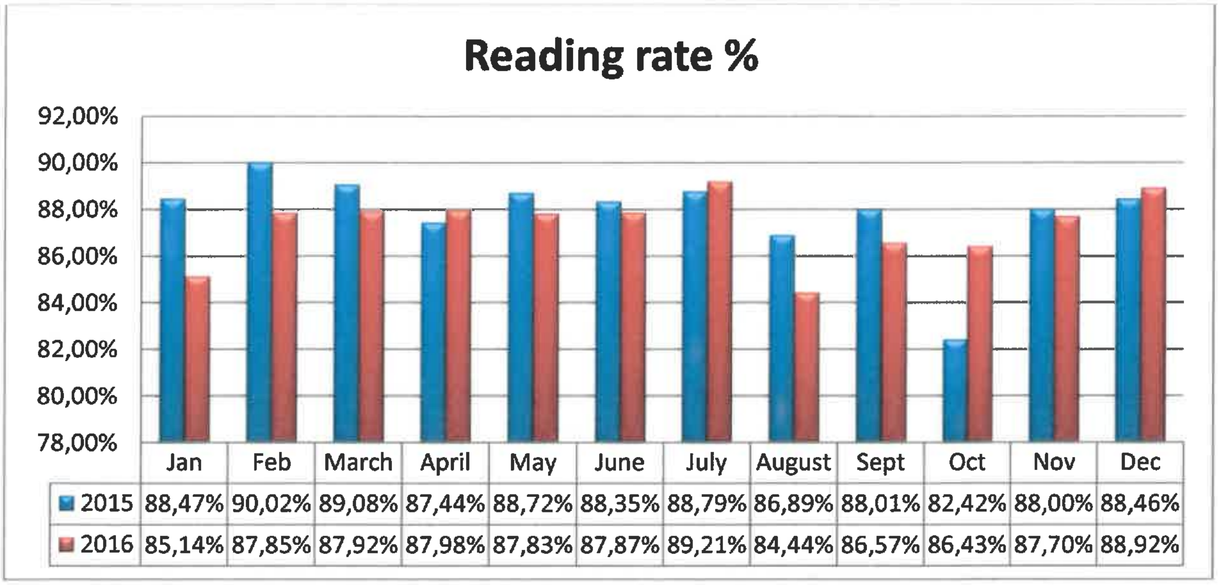
The challenges regarding the performance of the activities are related to the lack of contract or expired contracts for:

- Delivery of water meters
- Check on water meters in authorized laboratories.

This has an effect on the necessary regular deliveries and on the goals set for achievement for 2016.

**Meter reading**

Since the middle of June the meter reading process is almost entirely automated. The abandoning of the hard copies of invoices and termination of manual data entry related to water meters, customers and properties is about to be completed.




| | Jan | Feb | March | April | May | June | July | August | Sept | Oct | Nov | Dec |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2015 | 88,47% | 90,02% | 89,08% | 87,44% | 88,72% | 88,35% | 88,79% | 86,89% | 88,01% | 82,42% | 88,00% | 88,46% |
| 2016 | 85,14% | 87,85% | 87,92% | 87,98% | 87,83% | 87,87% | 89,21% | 84,44% | 86,57% | 86,43% | 87,70% | 88,92% |

The total success rate regarding the performance of the water meter reading activity for 2016 is 87.32%.

**Billing**

In 2016 the company registered an increase by 0.6% in the billed volumes of potable water on an annual base, compared to 2015.

The total sum billed of amounts for the same period were BGN 149.55 M, which is by +2.8% more compared to 2015 (BGN 145.51 M). The higher percent of increase of the total billed value compared to the billed water volumes is due to the increased combined price for the service (potable water supply, sewerage and wastewater treatment) by 3.4% valid as of 01.05.2016.

**Debt Collection**

In 2016, the Group continued the successful implementation of the strategy for increase of debt collection from its customers. As a result, the total collected amount at the end of the year is BGN 142.56 M as compared to BGN 137.46 M in 2015 or the registered increase was 3.7% on an annual basis. Also the annual coefficient of debt collection for 2016 is 95.34%, by 0.92% higher compared to 2015.

Over the reporting period is registered also considerable increase in the result and the activities of the internal teams for debt collection. The total number of performed phone calls shows an increase of 34,497 calls (11.7%) and the total collected sum as result of this activity by BGN 1.11 M more compared to 2015. (BGN 11.40 M in 2016 and BGN 10.29 M in 2015). The teams visiting and negotiating at the address of the customer realized respectively higher debt collection by 9.11% (14.98% in 2016 compared to 13.72% in 2015) and billed more than 61 k BGN more compared to the same period of the previous year (588 k BGN in 2016 and 526 k BGN in 2015).

For the purpose of continuous improving and increasing of the quality of the supplied services and customer satisfaction. The Group continued to develop its payment channel, through which the customers could pay their debts, as well as to propose flexible deferred payment agreement to the customers with temporary financial difficulties.

**Non-regulated business**

SV continues to develop its activities of providing additional services to its customers – installing, testing and sealing individual meters, as well as small plumbing services. As at December 2016 the activity is being implemented within the estimates.

## OPERATIONS AND MAINTENANCE

### Water Resource Management

The continuous monitoring of water volumes supplied to the Concession Area is the basis for the water management, implemented by SV.

Total water volume abstracted from all potable water sources over the period January – December 2016 is 161,034,786 m3

The data from the monitoring showed that the Group has achieved an actual decrease in the water volumes used for water supply to the Concession Area.

The raw water abstracted from all water sources over the period January-December 2016 compared to the same period of 2015 decreased by – 5,994,298 m3

### Consumption trends

In 2016, the billed volumes of the Group increased by 1.12% compared to 2015 or 1,024 million $m^3$

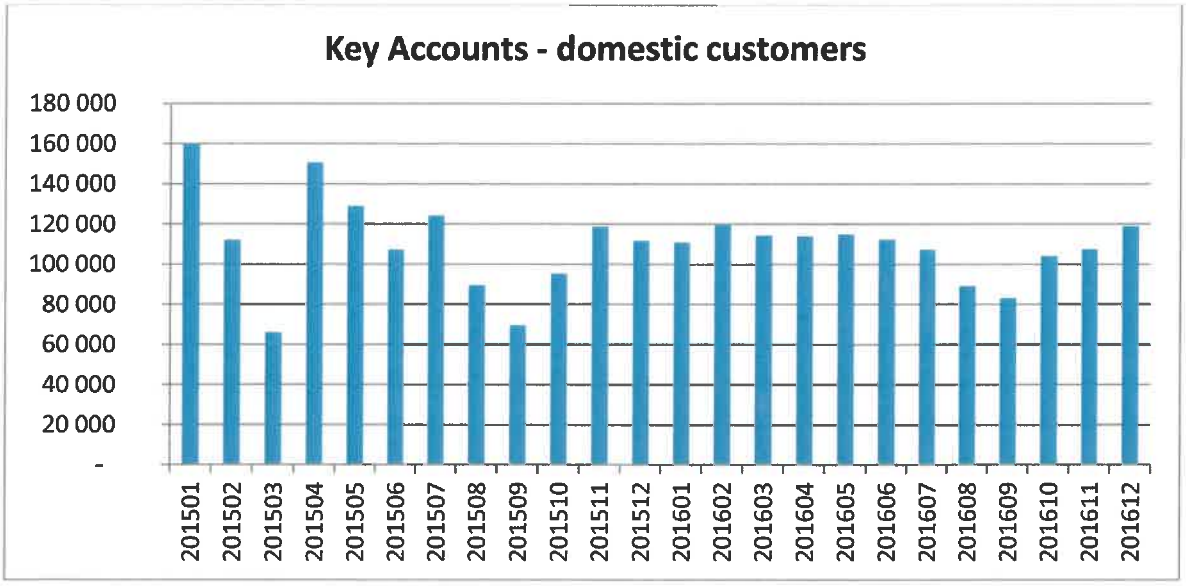
The table below presents the consumption trend evolution by types of customers and types of water supplied (potable, non-potable and supplied raw water):

| Water | 2015, $m^3$ | 2016 $m^3$ | Annual Diff ($m^3$) | Annual Diff (%) |
|---|---|---|---|---|
| Households | 61 086 283 | 61 272 664 | 186 381 | 0.31% |
| Budget customers | 4 511 538 | 4 605 925 | 94 387 | 2.09% |
| Commercial customers | 13 836 300 | 14 034 489 | 198 189 | 1.43% |
| *Non-potable water* | 4 449 349 | 4 605 372 | 156 023 | 3.51% |
| *Raw water (Samokov and Bozhurishte)* | 7 427 742 | 7 817 128 | 389 386 | 5.24% |
| **Total potable water WS Sofia** | **79 434 121** | **79 913 078** | **478 957** | **0.60%** |
| **Total billed water for all water systems** | **91 311 212** | **92 335 578** | **1 024 366** | **1.12%** |

The considerable % of increase in the raw water is due to the fact that in September 2015 a new consumer was connected – the villages of Gorni and Dolni Okol, which is billed during the entire 2016. The increase by 1.43% in the billed volumes of commercial customers is due to the increased production of these customers.

The tables below show the monthly consumption by type of key customers for the period 2015-2016.

For the period January-December 2016 the billed volume is by 38,019 $m^3$ less for the key account of the **population** type as opposed to 2015. The monthly levels are indicated in the following graph:

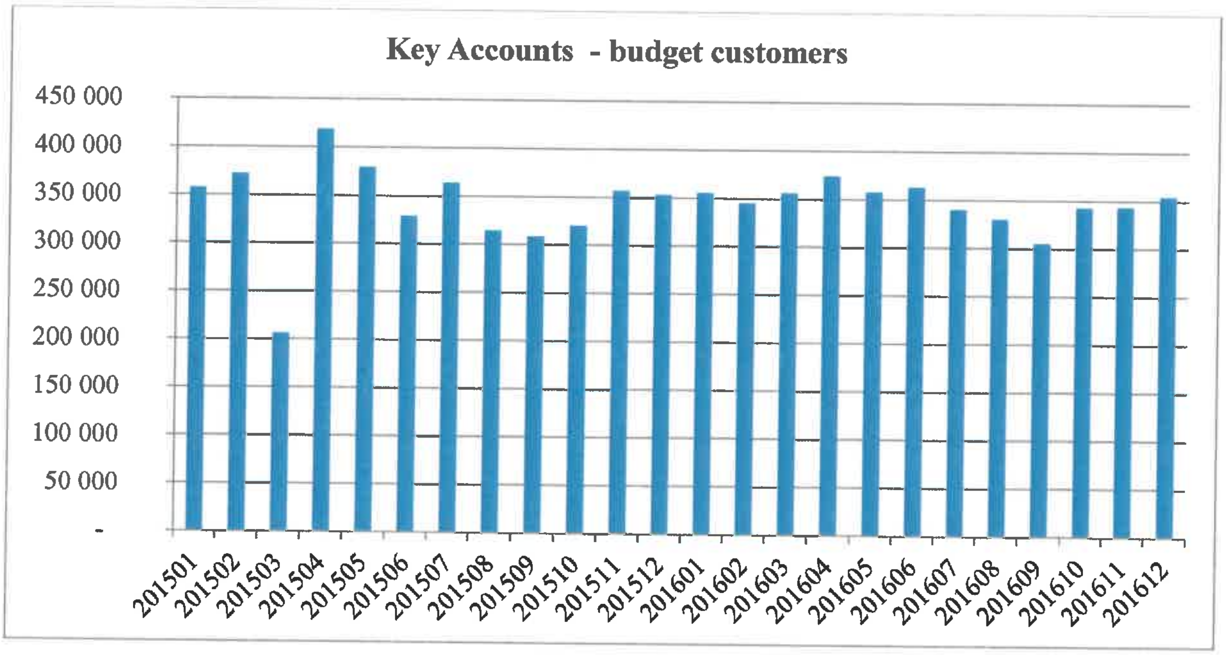



The table below shows 7 customers who form 55% of the mentioned decrease. These are the students' hostels and their consumption is determined by the different number of students. For one of the residential buildings in 2016 a rule was introduced according to which the students pay for part of the consumed water volumes which leads to a decrease of the consumed and respectively the billed water volumes.

| Customer number | Customer | Cause for the decreased consumption | Region MoS | Total 2015, $m^3$ | Total 2016, $m^3$ | Annual change, м3 | Annual change, % |
|---|---|---|---|---|---|---|---|
| 1001001960 | Block 41 | The consumption rate depends on the different number of residing students. | Studentski | 22 465 | 18 135 | -4 330 | -19.27% |
| 1001003298 | Block 50 | The consumption rate depends on the different number of residing students. | Studentski | 22 668 | 19 176 | -3 492 | -15.40% |
| 1001001931 | Block 50 | The consumption rate depends on the different number of residing students. | Studentski | 10 459 | 7 729 | -2 730 | -26.10% |
| 1001001922 | Block 34 | In 2016 the students pay part of the consumed water and they economize it. | Studentski | 8 779 | 6 080 | -2 699 | -30.74% |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 1001001912 | Block 22 | The consumption rate depends on the different number of residing students. | Studentski | 11 157 | 8 464 | -2 693 | -24.14% |
| 1005059727 | Block 12 | The consumption rate depends on the different number of residing students. | Studentski | 20 172 | 17 572 | -2 600 | -12.89% |
| 1001001943 | Block 59 | The consumption rate depends on the different number of residing students. | Studentski | 17 868 | 15 681 | -2 187 | -12.24% |
| **TOTAL** | | | | **113 568** | **92 837** | **-20 731** | **-18.25%** |

For the entire 2016 the billed volume of the key customers of the budget type has reported an increase by 87,947 $m^3$, or by 2% more as opposed to 2015. Detailed information on the monthly levels is presented in the following graph:



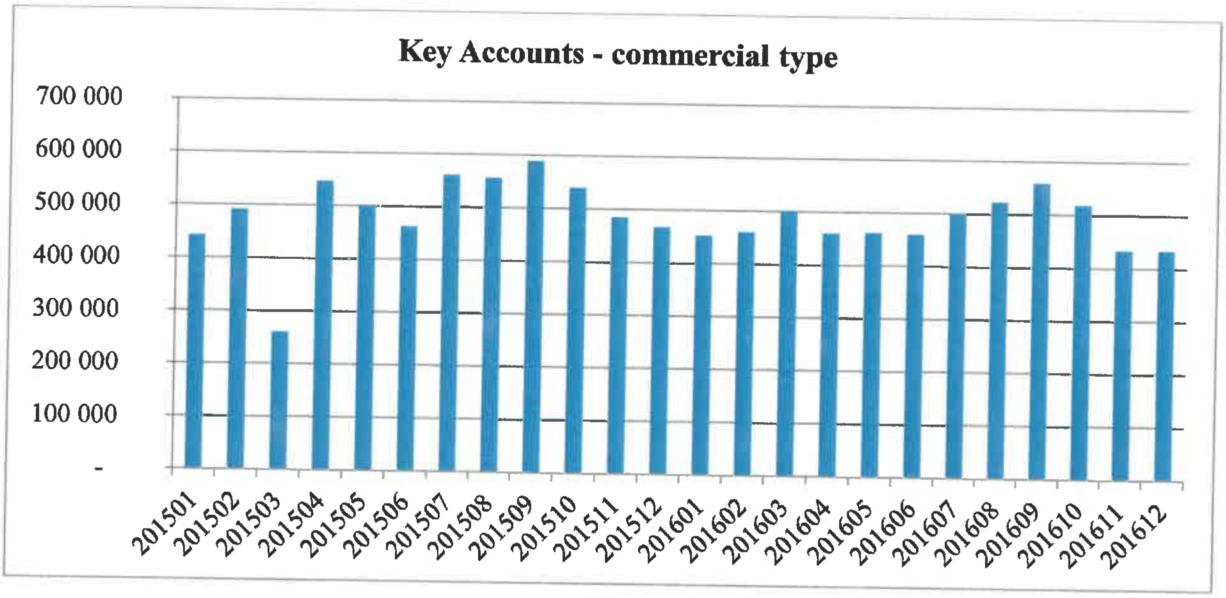

The billed volume of one customer in 2016 is by 177,777 $m^3$ more – Sofia Prison. The main reason for this is that in 2015 the customer submitted self-readings which were lower. The following graph shows the dynamics of the billed volumes for 2015 and 2016 by months for this budget customer:


The increase of 177,777 m3 of the stated budget customer compensates to a large extent the registered fluctuation (increase or decrease) in the billed consumption of the budget key customers in 2015 and 2016. The next table shows budget customers with more significant differences in the consumption rate:

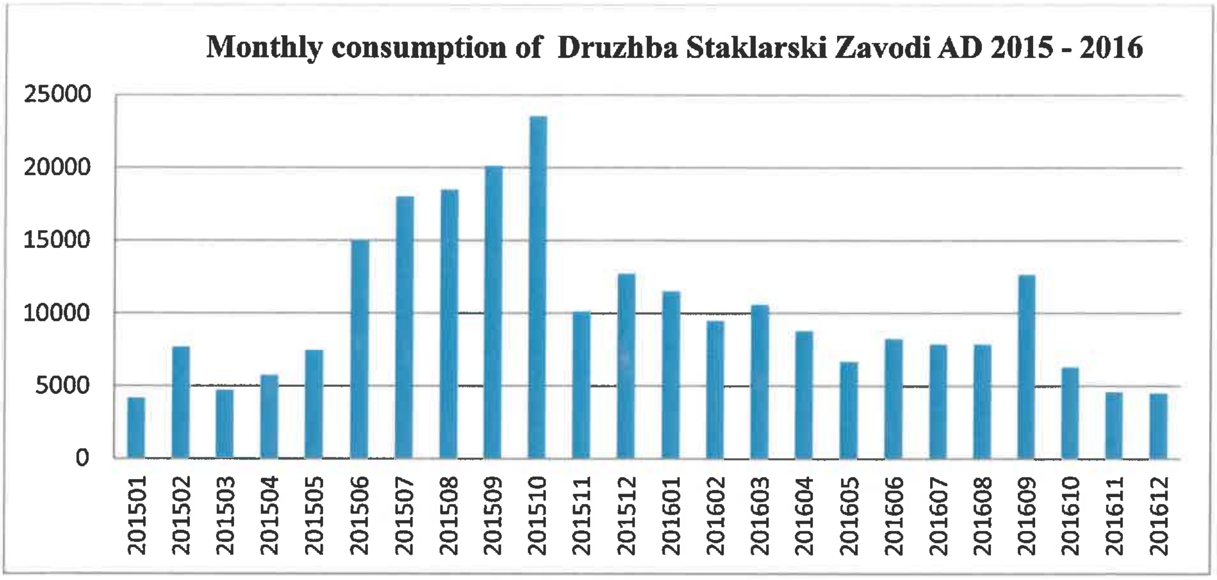
| Customer number | Customer | Region MoS | Total 2015, $m^3$ | Total 2016, м3 | Annual change $m^3$ | Annual change, % |
|---|---|---|---|---|---|---|
| 1001044093 | SOFIA JAIL | SERDIKA | 125924 | 303701 | 177 777 | 141.18% |
| 1001003316 | UNIVERSITY OF FORESTRY | STUDENTSKI | 12405 | 7580 | -4 825 | -38.90% |
| 1002053732 | MILITARY ACADEMY | TRIADITSA | 96588 | 91733 | -4 855 | -5.03% |
| 1001001882 | UNIVERSITY OF MINING AND GEOLOGY ST. IVAN RILSKI | STUDENTSKI | 13235 | 8268 | -4 967 | -37.53% |
| 1004052351 | MoI-SQUAD FOR COMBATTING TERRORISM | ISKAR | 14191 | 9035 | -5 156 | -36.33% |
| 1004051481 | KAZICHENE JAIL | KAZICHENE | 75724 | 70454 | -5 270 | -6.96% |
| 1001043885 | FIFTH MULTIPROFILE HOSPITAL FOR ACTIVE TREATMENT | SERDIKA | 53751 | 48464 | -5 287 | -9.84% |
| 1001045592 | PSYCHIATRIC HOSPITAL ST. IVAN RILSKI | ISKAR | 18032 | 12664 | -5 368 | -29.77% |
| 1005001223 | MILITARY ACADEMY G. S. RAKOVSKI | SREDETS | 14515 | 7998 | -6 517 | -44.90% |
| 1005214893 | DIRECTORATE OF MIGRATION – MINISTRY OF | ISKAR | 35036 | 27071 | -7 965 | -22.73% |

| | | | | | | |
|---|---|---|---|---|---|---|
| | INTERIOR BUSMANTSI | | | | | |
| 1002053738 | SPECIALISED HOSPITA; FOR ACTIVE TREATMENT | TRIADITSA | 26703 | 18615 | -8 088 | -30.29% |
| 1001003012 | DS EP SOFIA | IZGREV | 47222 | 38979 | -8 243 | -17.46% |
| 1003074861 | MEDICAL INSTITUTE - MoI | VAZRAZHDANE | 60013 | 51759 | -8 254 | -13.75% |
| 1001002972 | TRAFFIC POLICE – TECHNICAL INSPECTIONS | IZGREV | 24084 | 14663 | -9 421 | -39.12% |
| **TOTAL** | | | **617 423** | **710 984** | **93 561** | **15.15 %** |

For the period January – December 2016 it is by 139,091 $m^3$ less than the billed volume of potable water of the key customers of the commercial type as opposed to 2015. The evolution in the monthly billed volumes of these customers is presented in the graph below:



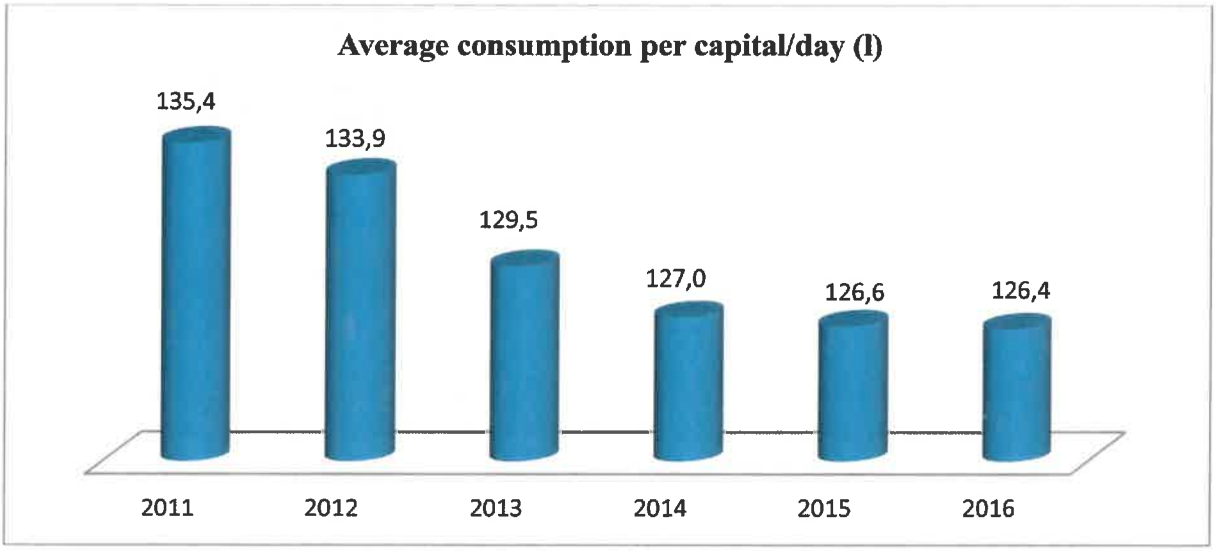

35% of the total decrease of the billed consumption of potable water for the commercial customers for 2016 is formed by 1 customer – Druzhba Staklarski Zavodi AD. In 2016 most of the machines of this customer operate with non-potable water and this is the reason why the consumption of potable water decreases by 48,803 $m^3$, or by 33% as opposed to the billed consumption in 2015. The detailed information by months for the billed consumption for 2015 and 2016 of the mentioned customer is presented in the following table:




Consumption of domestic customers – analysis of the current trends

In 2015 the consumption of domestic customers is 77% from the total billed volume. In 2016 there is no considerable increase in the percent as the consumption of the domestic customers reached 77% and the one of commercial customers is 17% from the billed volumes.

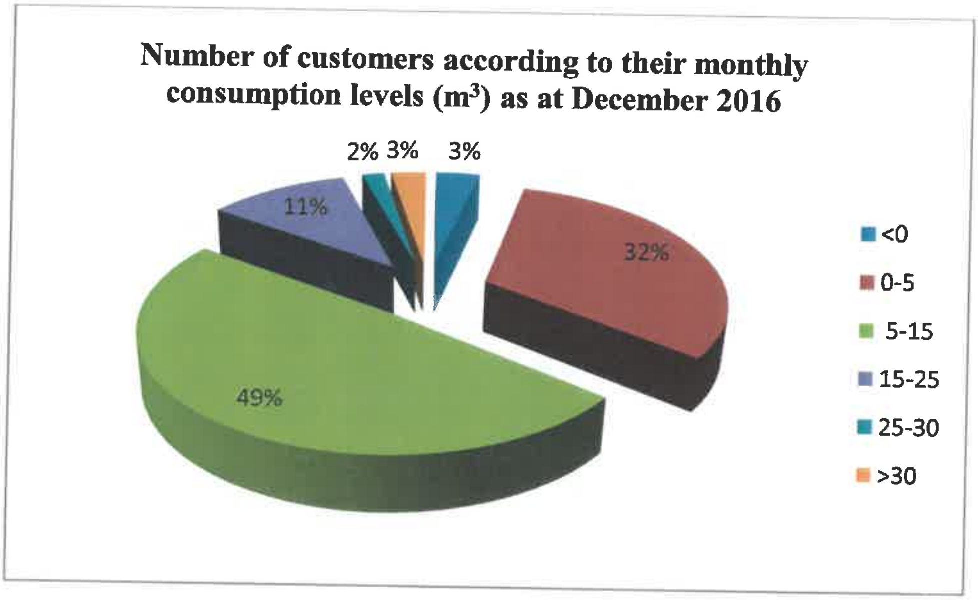
The reducing trend in the consumption of domestic customers might be seen in the daily consumption per capita in the chart below



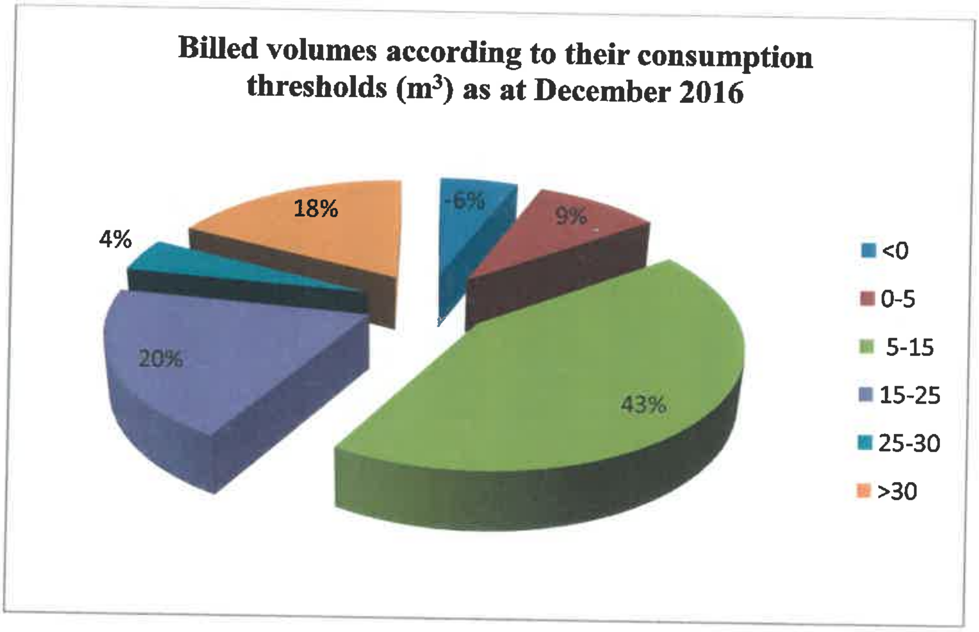

The average daily consumption is calculated as a ratio between the billed annual volume for these customers, the number of the population in Sofia city (estimate for 2016 of the National Statistical Institute) and 365 days

This trend is related also to the dynamics of the customers from groups with higher water consumption to such with lower water consumption. On a monthly basis the Group monitors the number of the domestic customers, whose water consumption is measured by the following monthly consumption: 0-5 $m^3$, 5-15 $m^3$, 15-25 $m^3$, 25-30 $m^3$, exceeding 30 $m^3$/month.

In 2016, 32% of the customers with measured consumption consumed between 0-5 $m^3$/month, 49% between 5–15 $m^3$/month and 11% between 15-25 $m^3$/month.

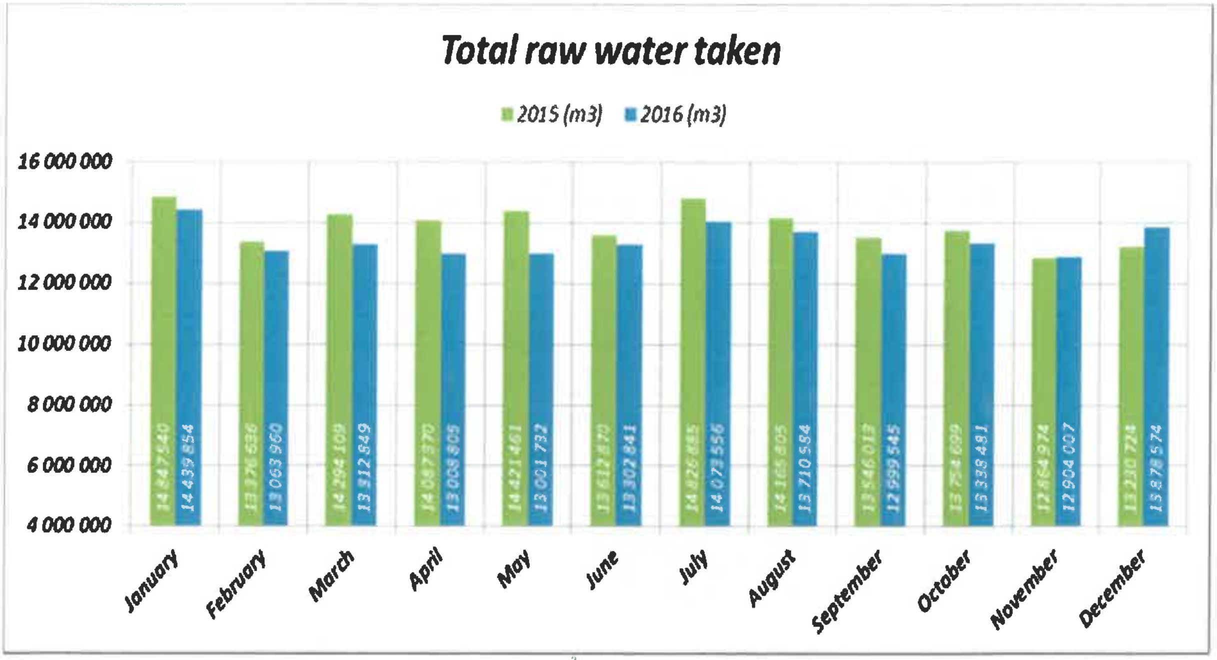



The breakdown of the billed volumes by consumption levels is presented on the following chart:

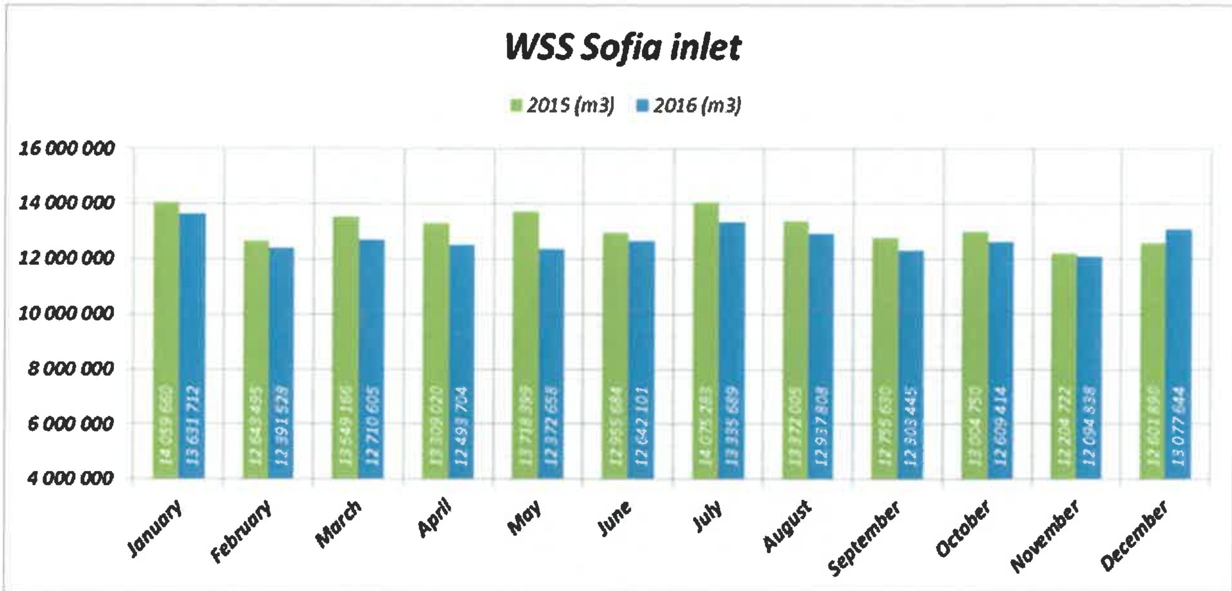



**Reducing unaccounted-for water**

Over the period January – December 2016 were achieved the following results:

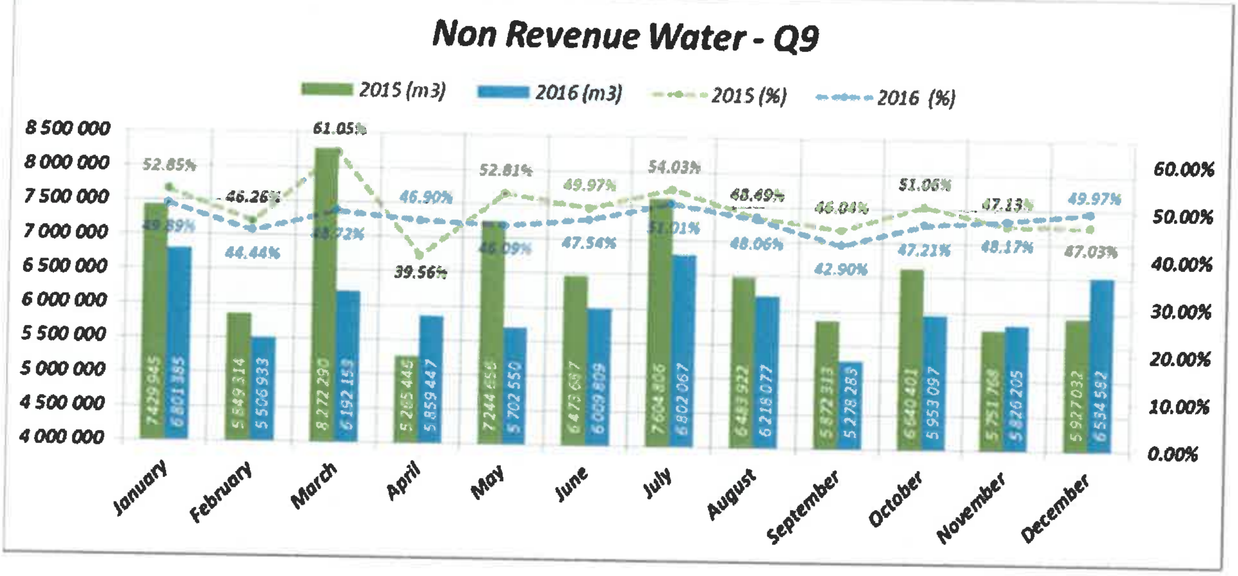



*Total abstracted water: reduction by 6.0 mln. m$^3$ (reduction by 3.59%);*

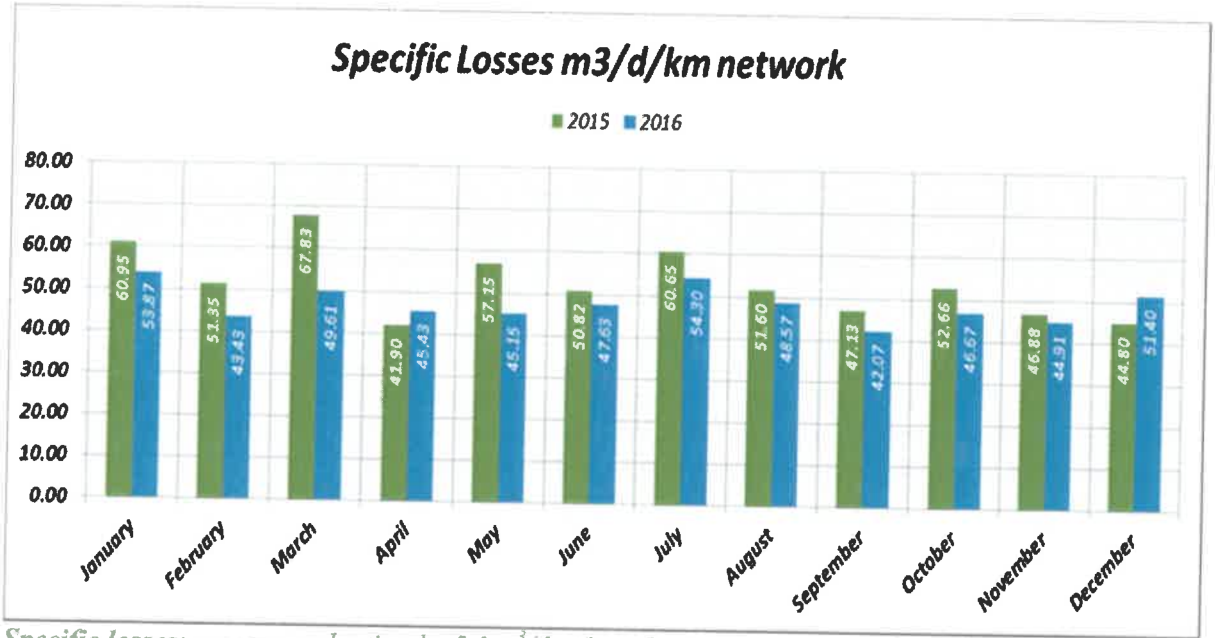



*Inlet WS Sofia: reduction by 5.7 mln m$^3$ (reduction by 3.57%);*

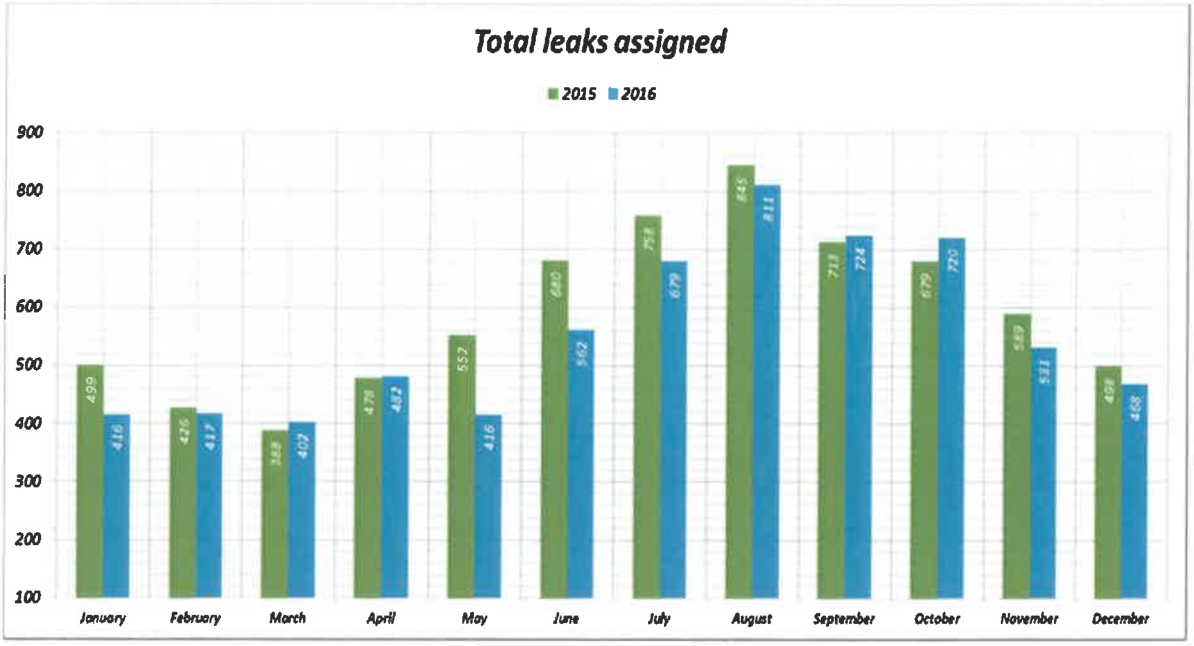
- *Billed water volumes Q3: increase by 0.48 mln. m3 (increase by 0.6%)*




*Unaccounted-for water Q9: reduction by 6.1 mln. m3 (reduction by 7.78%);*




*Specific losses: average reduction by 5.1 $m^3$/day/km of network (reduction by 7.98%)*




*Total assigned leaks: reduction by 477 nos. (reduction by 6.71%)*

**Quality of the supplied water**

With implementation of the monitoring program for potable water quality in the period January-December 2016 the percentage compliance of the samples taken from the points of the water supply system is 99.90% by physical and chemical indicators and 99.88% by microbiological indicators, thus the trends from 2015 have continued. The reported levels of compliance of potable water quality fully meet the requirements of the Ordinance on the long-term levels of the KPIs for WSS services (98% for physical and chemical indicators and 99% compliance for microbiological indicators).

**Laboratory Testing Complex**

The Laboratory Testing Complex (LTC) of SV implements the Group's plans for monitoring surface and potable water, wastewater and sludge in terms of taking samples from water and sludge and analyzing the microbiological, physical and chemical, and hydro biological parameters.

The activities executed by the LTC over the reporting period are connected mainly to the implementation of the plans for monitoring of potable water, surface water and groundwater, as well as of wastewater and sludge; the keeping of the accreditation; the control over the processes, ensuring traceability and transparency of the executed activities, the provision of confidentiality regarding the analytical results from the samples of the LTC customers LTC and marketing of the laboratory services.

In February 2016, the LTC passed successful evaluation, implemented by Executive Agency "Bulgarian Accreditation Service" by which was expanded the scope of the accreditation by about 80%. The expansion includes both new methods and new matrices – table, spring and mineral water and sludge from WWTP. The expanded scope of the LTC accreditation was officially confirmed by the new certificate, issued in May 2016

In 2016 in sector *Potable Waters* of LTC a total of 8,500 samples were received and 140,000 analyses were conducted on them, and in sector *Wastewater* respectively 10,000 samples for a total of 88 000 analyses.

In 2016, the LTC continued servicing successfully its contracts for provision of laboratory services to external customers, under which revenues were realized, and service level agreements with internal customers. There have not been claims made against the laboratory services on behalf of the customers.

The LTC was provided the opportunity to participate in 17 international programs for proficiency testing, including 154 methods. The result of the LTC was more than 90% success rate. The participation in these programs ensures an independent assessment of the performance of the laboratory and provides an opportunity to compare its efficiency with other equivalent laboratories frequently world-wide. This participation provides feedback for the quality of the tests and allows the laboratory to find the spheres of improvement in order to acquire more accurate control on the processes and demonstrate competence before customers, the accreditation authorities and other regulatory bodies.

The LTC was successfully audited for the second time on July 7-8$^{th}$, 2016 by the Executive Agency 'Bulgarian Accreditation Service'. The microbiological methods for the potable water were monitored and assessed. Non-compliances were not found.

Each sample received by LTC is given a unique identification number and then registered in the laboratory information management system with controlled levels of access to the information. This ensures anonymity, confidentiality and reliability in terms of the results of the samples analyzed upon requests of the internal and external customers.

**Water Network Management**

The focus of the Group in 2016, like in 2015, was on several main aspects:

- Improving operational customer service, mainly by reducing the response time in case of disruptions in the normal functioning of the water supply network and improving the information which the Company provides to its customers regarding the occurred or future operational events through the Information Centre, in which the zones affected by the emergency and planned water supply interruptions are visualized, and through the SMS-notification service for the upcoming planned water supply interruptions.
- Enhanced control and speeding up the reinstatement works after the completion of the civil works.
- Increasing the number of planned water supply interruptions for network reconstructions, which allows for preliminary information and reduction of the inconvenience for the customers.
- Improving the interaction among the departments involved in the operational activity and optimizing the information flows within the Company concerning current or planned operational events.

As result of the taken measures there was a significant drop in the number of failures of the water supply network compared to the same period in 2015

The first mobile software in Sofiyska Voda was launched in December with regard to the improvement of the operational customer service. The software is a mobile version of Pegasus application, which is used for management of the signals, related to the operations and maintenance of the water supply and sewer network. The mobile software is used by 60 users from different teams of the Company and allows the receiving of signals, as well as the processing and reading of a sequence of stages of the work processes by the employees on field. The software provides options to work with maps and files, as well as to control the entered information and the assignment of repairs by the validation at key stages of the processes. It is expected to achieve promptness and accuracy of the servicing of the signals, related to the management of the WSS network and enhancement of customer satisfaction. Last, but not least the mobile software will help with the implementation of one of the objectives of the company for environmental protection – reduction of the consumption of paper and printing of documents.

**Sewerage**

In 2016, we continued the implementation of the program for proactive maintenance of the sewerage network, as result of which over the period proactively cleaned more than 56 km of the network within the Concession Area.

At the beginning of 2016 to Sewerage Service Dept. was created a team for survey of big sewers on the territory of the concession area. The setting up of the team became possible thanks to the achievement of operational efficiency in other activities and the provision of the necessary human resources. At present, the team consists of four field specialist and a team lead that launched a new activity of the company. Since the setting up of the team until the end of 2016 more than 60 kilometers of trunk sewers were surveyed. The activity is related to the detection of a number of 'invisible' current problems along the sewage facilities, whose repair is crucial for the future operation of the facilities.

## Wastewater treatment

Over the period January – December 2016, Kubratovo Wastewater Treatment Plant (WWTP) treated a total of 133.7 M $m^3$ of wastewater from the sewerage network of the MoS.

The Wastewater Unit of the Laboratory Testing Complex at Kubratovo WWTP conducts continuous monitoring of the quality indicators of treated wastewater and sludge generated in the treatment process.

**Quality of treated wastewater**

Under a permit for discharge of wastewater the main indicators are analyzed - biological oxygen demand (BOD5), chemical oxygen demand (COD) and suspended solids (SS), total nitrogen, total phosphorus and all other indicators specified in the discharge permit for treated wastewater at the outlet of WWTP

In 2016 was taken the statutory number of samples regarding the listed above quality indicators of the treated wastewater.

The values of the quality indicators of the samples are below the levels, determined in the permit for discharge of wastewater

### Sludge stabilization and utilization

The sludge generated through wastewater treatment is stabilized in four anaerobic digesters. The sludge treated in the digesters is mechanically dewatered to produce a 'sludge cake' with dry matter content of about 25%.

Over the period were stabilized more than 154,875 tons of sludge by the treatment processes and at present in agriculture were utilized more than 77 432 tons.

The control on waste produced in WWTP Kubratovo, including the dewatered sludge, is exercised in accordance with the requirements of the Waste Management Act. SV draws up and submits the reports required to the Ministry of Environment and Water

## INVESTMENTS JANUARY-DECEMBER 2016

With Decision БП-28 dated 12.02.2016 the EWRC approved Business Plan 2016 with a total annual financial amount of the investment program BGN 60.5 M. It should be pointed out that the investment opportunities of the Group regarding the amount of the investments depend directly on the level of the tariff of the supplied WSS services. The cited financial estimates for 2016 were forecasted upon the assumption that the price of the provided combined WSS services will be 1.76 BGN/ m3 (without VAT), valid as of 01.02.2016 – something which in fact did not happen.

With decision No Ц-8 dared 28.04.2016 EWRC approved combined price of the WSS services from 1.52 BGN/ m3 (without VAT) valid as of 01.05.2016 i.e. by 0.24 BGN m3 lower than the initially set. It impacted the estimates for the amount of the investments program and the analyses of the Group showed that the financial opportunities of the company require the total investment program to be updated to the amount of about BGN 48.7 M

In 2016, the Group implemented investments amounting to BGN 42.5 M, which is 87% of the updated annual plan.

**ENVIRONMETAL PROTECTION AND SUSTAINABLE DEVELOPMENT**

SV has a certified Environmental Management System in compliance with the requirements of the international standard ISO 14001:2004 dated 2008.In 2016 the maintenance of the system continued by improving the EMS documentation and conducting internal regular inspections in line with the approved annual schedule.

In connection with the introduction of a Quality Management System (QMS) in compliance with the requirements of international standard ISO 9001 regarding customer service process and the integration of the Occupational Health and Safety Management System (OHSMS) and the Environmental Management System (EMS), a new integrated policy was created. Consequently 5 main procedures were updated for the purpose of the proper functioning of the integrated management systems.

In July and November 2016 two combined internal audits were conducted of the EMS and OHSAS. 10 audit teams were set up, and within 3 days they held audits on a process principle covering key processes in the Company. Reports were issued and submitted to the management of the Company.

At the beginning of December 2016 the Group was audited under the EMS by a third independent party – a certifying authority. The audit was concluded with 3 recommendations made for improvement, concerning the EMS, as effective functioning of the system was reported.

**Environmental incidents**

In 2016, 7 cases of sudden pollution at the inlet of Kubratovo WWTP were registered as well as 4 incidents with leakage of fuel and lubricants. The respective procedural measures were taken in due time in order to eliminate the incidents.

**Program for achieving the environmental protection goals**

The environmental protection goals of the Group are related to introducing best practices of energy efficiency upon operation and maintenance of the water supply and sewerage network, decrease in the water losses along the network, ensuring more and more efficient and high-quality treatment of wastewater by reducing at the same time the use of chemicals and reagents and transferring waste into raw material for production of energy.

**Training and initiatives**

Under the annual program for training under the Environmental Protection 7 modules were held, related to the activities of the Group. In 2016 more than 10 different internal and external initiatives were implemented, related to environmental protection, including the traditional participation of the Group in the *European week for waste reduction* 2016.

**Waste management**

The Group strictly complies with the Bulgarian waste management legislation. In 2016, the following was submitted for disposal, recovery or recycling:

- 36.22 tons of hazardous waste, including 30 tons of asbestos containing materials
- 44,233 tons of non-hazardous waste, which do not include sludge from Sofia WWTP to be utilized on agricultural areas
- 19,358 tons (dry substance) - sludge from the Sofia WWTP to be utilized on agricultural areas

**Green energy production**

Over the period January – December 2016, 21,008,977 MWh of green energy were produced in Kubratovo WWTP. The production is based on a CHP installation for utilization of the biogas, released in the process of sludge treatment in the plant. In 2016 the green energy produced in the treatment plant meets 111.29 % of the energy needs of the treatment plant.

**HEALTH AND SAFETY AT WORK**

Health and safety at work is a fundamental value and priority for SV.

**Occupational Health and Safety Management System (OHSAS)**

SV has a certified occupational H&S management system in line with the requirements of the OHSAS 18001 from 2008.

The applicable normative requirements are met and exceeded. The annual program for the audit on occupational health and safety is implemented. The health and safety risks are assessed and managed systemically.

**Trainings and exchange of information**

The annual schedule for H&S trainings for 2016 was implemented. 579 employees took part in at least one H&S training in 2016.

Two information campaigns on Health and Safety at Work were implemented: Safe Driving of Company Motor Vehicles (January 2016) and Corporate Safety Week (September 2016), which was focused on five significant risk and standards for their management: excavation works, confined spaces, chemicals, fireworks, traffic management.

The potential subcontractors are assessed by their competence and performance in terms of Health and Safety at Work. The subcontractors are inspected by “Health and Safety” Dept. Information is being exchanged as well as good practices in the field of occupational health and safety.

**Accidents, incidents and near-miss incidents**

In 2016 there were nine occupational accidents (seven as per art.55 para.1– during work and two as per art. 55, para 2 –on way to work). There were also 2 incidents (without loss of work capacity), 21 near –miss incidents (adverse events, without personal injury), and 161 traffic accidents with company vehicles without injuries. All accidents, incidents and near miss incidents were reported and analyzed immediately so that preventive actions are taken.

**HUMAN RESOURCES MANAGEMENT**

In its policy and practice SV develops and applies modern forms of human resource management with the awareness that these factors are of vital importance for business development and achievement of high results. The achievement and maintenance of a balance between the interests of the employer and the workforce are based on compliance with the legislation, maintaining high budget discipline and social partnership with the trade unions.

Human resources management is developed by applying a complex of policies and procedures planned in advance so that the entire management team can be involved in the process.

**Remuneration and benefits**

Valid as of January 1 the salaries of the employees were increased by 0.61%.

In March 2016 the annual bonuses were paid to the employees for the previous year in line with the approved bonus scheme of the Group, taking into account the fulfillment of the Company's business objectives agreed in the previous year.

As of 1 July the salaries of the employees with the lowest remunerations were increased on average by 6.8% after consultations held with the trade union organizations, presented in the company.

After completing a PPA procedure, a new one-year contract on Supplementary Voluntary Health Insurance was signed in April. This benefit package aims at providing employees choice and access to a wide range of health services.

Sofiyska Voda signed agreements with two companies - "Benefit Systems Bulgaria" and "Sodexo Pass Bulgaria" for sport passes. The employees have access to a variety of sport activities and clubs at a preferential price.

**Training, motivation and development**

In 2016 were implemented 84 training topics with more than 2100 participations.

Two Bulgarian students participated in the Summer Campus of Veolia for 2016. This year for the first time Bulgarian students were given the opportunity to take part in it. Within a week in Paris, the students were taught theory and were provided with hands-on experience by visiting different sites of the company and participating in discussions with experts in the field of natural resources management. In the campus the students solved also difference cases.

For second year in a row SV selected representatives and took part in Company Sport Games. At the World Company Sport games SV employees won two gold medals in the chess and volleyball competitions.

The internship program of Sofiyska Voda "Challenge the Future 2016" commenced on 4th of July. A total of 20 enthusiastic trainees determined to develop their knowledge and to gain professional skills in our company joined the following departments: Illegal connections, Control Center, Customer Service, H&S, Laboratory Testing Center, GIS, Asset Management, Construction Control, WWTP, Leak Detection, Environmental Services, Customer Technical Support and Non-regulated Business. Positions were proposed to six of the trainees in the departments LTC, Debt Collection, Sewer Modelling, H&S and Control Room.

A process of Counselling and Career orientation for employees was held in October. The HR team held individual meetings with 19 employees who had expressed his/her wishes for Career Development at the Annual Appraisal Form. The aim of the meetings was to let the employees share their professional plans and receive information about the opportunities and ways to have professional realization within the company.

Anelia Ilieva
/Finance Director/

СОФИЙСКА ВОДА

Arnaud Philippe Valleteau De Moulliac
/Executive Director/

**CORPORATE GOVERNENCE DECLARATION**

**SOFIYSAK VODA JSC**

**31 DECEMBER 2016**

**CORPORATE MANAGEMENT CODE**

Sofiyska Voda JSC follows, where appropriate, the National Code for Corporate Management, created in 2007 and approved by the National Commission for Corporate management, and amended in February 2012 and April 2016

***MAIN CHARACTERITICS OF THE SYSTEMS FOR INTERNAL CONTROL AND RISK MANAGEMENT OF THE COMPANY IN CONNECTION WITH THE PROCESS OF FINANCIAL REPORTING***

SV develops its internal control system based on best accounting practice and COSO model (COSO - Committee of Sponsoring Organizations of the Treadway Commission) The five components of internal control according to the model are:

i. Control Environment
ii. Risk Assessment (Process of Enterprise Risk Assessment)
iii. Information and Communication (Information system, included the related to it business processes referring to financial reporting and communications)
iv. Control Activities
v. Monitoring (Ongoing monitoring of the controls)

These components are also set out in the International Standard on Auditing (ISA) 315, Appendix 1 – Internal Control Components.

The control environment sets the tone of an entity, influences the control consciousness of people within an organization and is the foundation for all other components of the internal control, providing discipline and structure. The factors of the control environment comprise: integrity and ethical values; employees' commitment to competence; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its employees; as well as attention and guidelines, given by the Board of Directors.

Main policies and procedures ensuring the control environment are:

- Code of Ethics of Veolia Environnement (adopted by SV in June 2011)
- Ethics, Commitment and Responsibility of Veolia Environnement (adopted by SV in Oct 2012)
- Internal Code of Conduct
- Disclosure (Whistleblowing) Policy
- Hospitality Policy
- Conflicts of Interest Policy
- Anti-Fraud Policy, which is supported by
  - → Fraud Investigation Procedure
  - → Anti-Corruption telephone line (+359 2 8122 521, published on SV official web site www.sofiyskavoda.bg )
- Accounting Policy
- Procedure on accounting closing
- Procedure on receiving and posting invoices to suppliers
- Policy for purchasing, stocktaking and writing off of assets etc.

SV like every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with changes.

SV's risk management process in is regulated by a Risk Management Policy and supported by Business Risk Management Procedure, which describes the methodological approach at the identification, measuring, controlling and subsequent monitoring of these circumstances, event and actions that could impact the achievement of the business objectives of the company.

All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. Effective communication with external parties, e.g. customers, suppliers, regulators and shareholders should be in place.

SV's Communications Department focus on internal as well as external exchange of information with the stakeholders. In addition, SV's Regulation and Concession Compliance Department is in charge of information exchange with the Municipality of Sofia, EWRC and other institutions. The relations with the customers are managed by the teams in "Customer Service" Directorate.

The intranet and the official website of the company are also a two-way channel for exchange of information both inside and outside the company.

Control activities are the policies and procedures that help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks related to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all units. They include a range of activities as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

All effective policies, procedures and instructions on the specific work processes are published on SV's Intranet, which is accessible to all employees. The process of preparation of internal regulatory documents (policies, procedure, and instructions) is unified and described in an official internal procedure.

Monitoring – the internal control systems need to be monitored - a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures.

The management is primarily responsible for the internal control system and the chief executive officer is assumed to be "owner" of the system. Management is accountable to the board of directors, which provides corporate governance, guidance and supervision.

The audit committee of Sofiyska Voda is created and operates (including by implementing its obligations for monitoring regarding financial reporting) under the Law for the Independent Financial Audit.

Internal auditors play an important role in evaluating the effectiveness of control systems, and contribute to ongoing effectiveness. Because of organizational position and authority in an entity, the internal audit unit often plays a significant monitoring role.

The weaknesses of internal control, identified during internal audits, inspections and monitoring are reported to the managers and the most serious matters are referred to the senior management and the Board of Directors.

Internal control is, to some degree, the responsibility of everyone in an organization and therefore should be stated in the requirements of everyone's job description. Virtually all employees produce information used in the internal control system or take other actions needed to effect control.

External parties also carry out monitoring over the activity of Sofiyska Voda and these are the regulatory bodies (Energy and Water Regulatory Commission), state institutions (tax authorities, ministries etc.) and external auditors.

***Significant direct and indirect shareholdings (including indirect shareholdings through pyramid structures and cross shareholdings) within the meaning of Article 85 of Directive 2001/34/EC***

In 2016 the company did not acquire significant direct or indirect shareholdings by the virtue of art. 85 of Directive 2001/34/EC

***The holders of any securities with special control rights and a description of these rights;***

The company does not have securities with special control rights.

***Any restrictions on voting rights, such as limitations of the voting rights of holders of a given percentage or number of votes, deadlines for exercising voting rights, or systems whereby, with the company's cooperation, the financial rights attaching to securities are separated from the holding of securities;***

There are not any limitations of the voting right

***The rules governing the appointment or replacement of board members and the filing of amendments of the articles of association;***

The rules regulating the appointment or change of the Board members and filing of amendments to the articles of association are defined in the Statutes of the Company, which is made public under the account of Sofiyska Voda JSC in the Trade Register. As per art.10, para.1 of the Statutes, the General Shareholders' Meeting appoints and removes the Board members and determines their remuneration. As per art.18, para.1 of the Statutes, the Board of Directors shall consist at any time of at least 7 and not less than three Board members, and as per art.18, para.2 of the Statutes, while ViK EAD is a shareholder in the Company, it may appoint three directors.
The amendments to the articles of association are regulated by the Statutes of the Company, and the consent of the senior lender, the EBRD, is also needed for an amendment to the articles of association as per art.6.11. of the Loan Agreement.

***The powers of board members, and in particular the power to issue or buy back shares;***

The members of the Board of Directors do not have powers to issue or buy back shares

***MEMBERS AND FUNCTIONING OF THE ADMINISTRATIVE, MANAGEMENT AND SUPERVISORY BODIES AND THEIR COMMITTEES***

Sofiyska Voda JSC has one-tier board system

***Members of the Board of Directors:***

The Board of Directors consists of 7 members

***Functioning of the Board of Directors***

The functioning of the management body of the company – the Board of Directors is regulated in the Statutes of the Company. In art 19 thereof the main duties are stated and in art. 20 and 21 detailed rules are presented for the procedure for conduct of meeting of the Board of Directors, its convening and the requirements for quorum for a valid taking of decisions and the preparing of meeting minutes. In article 22 the rights of the BoD Members are laid down and in art. 23 is commented the matter with the remunerations of the members of the Board of Directors.

***Administrative bodies:***

The organizational structure of Sofiyska Voda AD consist of an Executive Director and 11 main directorates, namely: *Finance* Directorate, *Human Resources and Administration* Directorate, *Logistics and Supply Chain* Directorate, *Security* Directorate, *Internal Audit, Quality Assurance and Risk Management* Directorate, *Commercial* Directorate, *Network Management* Directorate, *Operation and Maintenance* Directorate, *Engineering and Construction Works* Directorate, *Strategic Partnerships and Projects* Directorate and *Information Technologies* Directorate. The *PR and Communications* Department also reports directly to the Executive Director.

Within the scope of each directorate there are a certain number of departments and units related to the main functions of the directorate. These are as follows:

- *Financial* Directorate – *Financial Accounting* Unit, *OPEX Control* Unit and *CAPEX Control* Unit
- *Human Resources and Administration* Directorate – *Human Resources* Department and *Secretariat* Department
- *Logistics and Supply Chain* Directorate – Warehouse, *Procurement* Department, *Transport* Department and *Facility* Department
- *Internal Audit, Quality Assurance and Risk Management* Directorate – *Health and Safety at Work* Department, *Internal Audit* Department, *Environmental Protection* Department and *Laboratory Testing Complex* Department
- *Commercial* Directorate – *Billing and Debt Collection* Department, *Customer Service* Department and *Quality Management* Unit
- *Network Management* Directorate – *Geographic Information Systems* Department, *Strategic Network Management and Planning* Department and *Technical Customer Support* Department
- *Operations and Maintenance* Directorate – Chief Engineer "*Operation and Maintenance*", *Potable Water Treatment and Disinfection* Department, *Sewerage and Wastewater Treatment* Department, *Electrical and Mechanical Maintenance* Dept., *Non-regulated Business* Department, *External Water Supply* Department, *Control Center* Dept., *Quality Management* Unit and *Contract Management* Unit
- *Engineering and Construction Works* Directorate – *In-House Failures and Maintenance* Department, *Asset Management* Department, *Capital Works Delivery* Department, *Relations with Institutions* Unit, *Management of Failure Contracts with Contractors* Unit and *Capital Project Contract Management* Unit
- *Strategic Partnerships and Projects* Directorate – Legal Department, RCCU Department
- *Information Technologies* Directorate – *IT Operations* Department, *Strategic Services* Department and *IT Program Office and Control* Unit.

***Audit Committee:***

***Members of the audit committee:***

The Audit Committee of Sofiyska Voda consists of 5 members.

***Functioning of the audit committee:***

The Audit Committee is created and functions in compliance with the requirements of the Law for the Independent Financial Audit. The Audit Committee has established Statutes, which regulates in more detail how the functions and task of the committee are implemented, how work is organized, what the necessary quorum for the conduct of meetings and taking of decisions is. The committee conducts meetings at least 4 times a year and ta least once every quarter. It is allowed to summon additional meetings as well initiated by each member of the committee. Company management is invited and on a regular basis takes part in the meetings of the Audit Committee. The meetings are documented. The audit committee prepares an annual report for its activity to the General Assembly of the Shareholders.

***DESCRIPTION OF THE DIVERSITY POLICY, APPLIED REGARDING THE ADMINISTRATIVE, MANAGEMENT AND SUPERVISORY BODIES OF SOFIYSKA VODA JSC in connection with aspects such as age, sex or education and professional experience, the objectives of the diversity policy, the way of its application and the results over the reporting period, when such policy is not applied, the declaration contains clarification regarding the reasons for it.***

Under the Ethics Guide, approved by the company at the beginning of 2014, Sofiyska Voda JSC as part of Veolia Group commits to conducting business in compliance with national laws and the relevant recommendations of international organizations, in particular with respect to observance of fundamental principles, taking account of cultural diversities and promoting environmental protection

This document provides guidelines regarding the everyday conduct of all employees, at all levels of the company and determines the commitment of all in the company to conduct our business as professionals, treating our customers with respect and meeting our responsibilities in the best possible way.

The company is aware of its responsibilities and places great importance on upholding the values and rules of behavior described below in the Ethics Guide both with regard to its employees, and on fostering such values and rules with regard to its other stakeholders; particularly its customers and suppliers and citizens. The practices described in this ethics guide are aimed at ensuring compliance with:

- The values and rules of behavior specific to Veolia;
- International initiatives that the group has joined, in particular the United Nations Global Compact, as well as international human rights law and the OECD (Organization for Economic Co-operation and Development ) Guidelines for Multinational Enterprises; and
- Local laws in all countries in which the group is present.

In a complex and multicultural world that is constantly changing, this guide serves as a reference for all employees. It should enable employees to act as guarantors of these values and to perform their duties with full knowledge of their rights and obligations vis-à-vis the company and its stakeholders.

Veolia's core values are responsibility, solidarity, respect, innovation and customer focus, and they form the base on which its economic, social and environmental performance is built.

The company strives therefore to enable them to grow professionally and personally by developing an effective and ambitious corporate model. Accordingly, the company places great importance on basing its social initiatives on four key principles: equity, solidarity, developing the employability of employees and preventing occupational health and safety risks.

**The company committed to guaranteeing equity in the workplace**
This means creating the conditions for properly recognizing what each employee contributes to the company's success, thereby enabling each individual to improve his/her performance. Since the company is convinced that the diversity of its employees is a significant asset for the success of the company, it strives to recognize the efforts and merits of each of them and to ensure that employees fully share its projects and values, so that they feel that they have a stake in the company's performance. Feeling that they are integrated, respected and treated equitably is essential for employees 'everyday commitment, which also implies the promotion of diversity, non-discrimination and refusal of all forms of harassment.

The next significant commitment of the company regarding employees is **fostering the employability of employees.** This means supporting employees' skills development, and encouraging employees to exchange ideas, innovate and meet professional challenges. In a service business, employees' know-how is the primary resource. The aim of the company for continuous improvement of the management of its human resources is bolstered by an active professional training and career support policy. The company strives to continually improve its response to the constant changes in its business.

Veolia is fully aware that its employees' expertise is a key asset and encourages experience-sharing and offers its employees motivating prospects throughout their careers.

СОФИЯ
СОФИЙСКА ВОДА
АКЦИОНЕРНО ДРУЖЕСТВО

Arnaud Philippe Francois Valleteau De Moulliac

/Executive Director/

## Consolidated statement of financial position

| *In thousands of BGN* | *Note* | 31 December 2016 | 31 December 2015 |
|---|---|---|---|
| **Assets** | | | |
| Property, plant and equipment | *13* | 17,066 | 16,274 |
| Intangible assets | *14* | 288,677 | 279,016 |
| Deferred tax assets | *20* | 6,638 | 6,186 |
| Other receivables and prepayments | *16* | 290 | 983 |
| **Non-current assets** | | 312,671 | 302,459 |
| Inventories | *15* | 1,064 | 1,346 |
| Trade and other receivables | *16* | 35,266 | 32,906 |
| Income tax receivables | | 81 | - |
| Related party receivables | *24,30* | 14 | 2 |
| Cash and cash equivalents | *17,24* | 17,496 | 17,002 |
| **Current assets** | | 53,921 | 51,256 |
| **Total assets** | | 366,592 | 353,715 |
| **Equity** | | | |
| Share capital | *18* | 8,884 | 8,884 |
| Reserves | *18* | 10,774 | 10,774 |
| Retained earnings | | 185,816 | 160,810 |
| **Total equity** | | 205,474 | 180,468 |

## Consolidated statement of financial position (continued)

| *In thousands of BGN* | *Note* | 31 December 2016 | 31 December 2015 |
|---|---|---|---|
| **Liabilities** | | | |
| Loans and borrowings | *19,24* | 26,931 | 35,793 |
| Finance lease liabilities | *19,24* | 1,880 | 1,469 |
| Employee benefits | *26* | 1,084 | 906 |
| Deferred income | *29* | 2,771 | 1,816 |
| Trade and other payables | *21,28* | 8,737 | 10,469 |
| **Non-current liabilities** | | 41,403 | 50,453 |
| | | | |
| Loans and borrowings | *19,24* | 80,224 | 80,077 |
| Finance lease liabilities | *19,24* | 1,283 | 1,178 |
| Deferred income | *28* | 200 | 200 |
| Income tax liabilities | *23* | 442 | 649 |
| Payables to related parties | *24,30* | 4,697 | 4,688 |
| Trade and other payables | *21* | 29,285 | 29,560 |
| Provisions | *22* | 3,157 | 5,973 |
| Employee benefits | *26* | 427 | 469 |
| **Current liabilities** | | 119,715 | 122,794 |
| **Total liabilities** | | 161,118 | 173,247 |
| | | | |
| **Total equity and liabilities** | | 366,592 | 353,715 |

*The notes on pages 11 to 59 are an integral part of these consolidated financial statements.*

Arnaud Philippe Francois Valleteau De Moulliac
*Executive Director*

Anelia Ilieva
*Finance Director*

In accordance with an Independent Auditors' Report:
KPMG Bulgaria OOD

Ivan Andonov
*Authorised Representative*

Tzvetelinka Koleva
*Registered Auditor*

*Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.*

## Consolidated statement of profit or loss and other comprehensive income

**For the year ended 31 December**

| *In thousands of BGN* | *Note* | **2016** | **2015** |
|---|---|---|---|
| Revenue | *4* | 129,804 | 125,006 |
| Other income | *5* | 2,366 | 1,739 |
| Construction revenue | *6* | 37,907 | 30,797 |
| | | 170,077 | 157,542 |
| Expenses for materials | *7* | (8,767) | (8,743) |
| Expenses for hired services | *8* | (25,444) | (25,009) |
| Depreciation and amortization | *13,14* | (32,043) | (28,913) |
| Employee benefit expenses | *9* | (18,280) | (17,131) |
| Social security contributions and other social expenses | *9* | (4,618) | (4,459) |
| Expenses for impairment of trade receivables | *24* | (8,208) | (8,180) |
| Other expenses | *10* | (1,311) | (2,991) |
| Construction expenses | *6* | (37,907) | (30,797) |
| **Operating profit** | | 33,499 | 31,319 |
| Finance income | *11* | 75 | 56 |
| Finance costs | *11* | (5,551) | (6,399) |
| **Net finance costs** | | (5,476) | (6,343) |
| **Profit before income tax** | | 28,023 | 24,976 |
| Income tax expense | *12* | (2,926) | (2,580) |
| **Profit for the year** | | 25,097 | 22,396 |

## Consolidated statement of profit or loss and other comprehensive income (continued)

**For the year ended 31 December**

| *In thousands of BGN* | *Note* | 2016 | 2015 |
|---|---|---|---|
| **Other comprehensive income** | | | |
| ***Items that will never be reclassified to profit or loss:*** | | | |
| Remeasurements of defined benefit liability | 26 | (91) | (62) |
| | | (91) | (62) |
| **Other comprehensive income for the year, net of tax** | | (91) | (62) |
| **Total comprehensive income for the year** | | 25,006 | 22,334 |

*The notes on pages 11 to 59 are an integral part of these consolidated financial statements.*

Arnaud Philippe Francois Valleteau De Moulliac
*Executive Director*

Anelia Ilieva
*Finance Director*

In accordance with an Independent Auditors' Report:
KPMG Bulgaria OOD

Ivan Andonov
*Authorised Representative*

Tzvetelinka Koleva
*Registered Auditor*

ОДИТОРСКО ДРУЖЕСТВО
София
Рег. № 045
КПМГ БЪЛГАРИЯ ООД

*Translation from the original Bulgarian version, in case of divergence the Bulgarian original shall prevail.*

## Consolidated statement of changes in equity

| *In thousands of BGN* | *Note* | Share capital | Legal reserve | Retained earnings | Total equity |
|---|---|---|---|---|---|
| Balance at 1 January 2015 | | 8,884 | 10,774 | 138,476 | 158,134 |
| **Total comprehensive income for the period** | | | | | |
| Profit | | - | - | 22,396 | 22,396 |
| Other comprehensive income, net of taxes | | - | - | (62) | (62) |
| **Total comprehensive income for the period** | | - | - | 22,334 | 22,334 |
| **Balance at 31 December 2015** | *18* | 8,884 | 10,774 | 160,810 | 180,468 |
| Balance at 1 January 2016 | | 8,884 | 10,774 | 160,810 | 180,468 |
| **Total comprehensive income for the period** | | | | | |
| Profit | | - | - | 25,097 | 25,097 |
| Other comprehensive income, net of taxes | | - | - | (91) | (91) |
| **Total comprehensive income for the period** | | - | - | 25,006 | 25,006 |
| **Balance at 31 December 2016** | *18* | 8,884 | 10,774 | 185,816 | 205,474 |

*The notes on pages 11 to 59 are an integral part of these consolidated financial statements.*

Arnaud Philippe Francois Valleteau De Moulliac
*Executive Director*

Anelia Ilieva
*Finance Director*

In accordance with an Independent Auditors' Report:
KPMG Bulgaria OOD

Ivan Andonov
*Authorised Representative*

Tzvetelinka Koleva
*Registered Auditor*

ОДИТОРСКО ДРУЖЕСТВО
София
Рег. № 045
КПМГ БЪЛГАРИЯ ООД

## Consolidated statement of cash flows

**For the year ended 31 December**

| *In thousands of BGN* | *Note* | **2016** | **2015** |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Profit for the year | | 25,097 | 22,396 |
| *Adjustments for:* | | | |
| Depreciation of property, plant and equipment | *13* | 3,336 | 3,434 |
| Amortisation of intangible assets | *14* | 28,707 | 25,479 |
| Impairment losses on trade receivables | *24* | 8,208 | 8,180 |
| Write-downs of inventory to net realisable value | *10* | 55 | (37) |
| Expenses for scrapping of materials | *10* | 50 | 2 |
| Expenses for scrapping of non-current assets | *10* | 17 | 30 |
| Net finance costs | *11* | 5,476 | 6,343 |
| Gain on sale of property, plant and equipment | | (4) | (15) |
| Tax expense | *12* | 2,926 | 2,580 |
| | | 73,868 | 68,392 |
| Changes in: | | | |
| - employee benefits | | 28 | (79) |
| - other provisions | | (2,816) | 22 |
| - inventories | | 177 | 390 |
| - trade and other receivables | | (9,951) | (9,375) |
| - trade and other payables | | (2,538) | (5,860) |
| - deferred income, including financing | | 955 | (133) |
| **Cash generated from operating activities** | | 59,723 | 53,357 |
| Income tax paid | | (3,589) | (1,840) |
| **Net cash from operating activities** | | 56,134 | 51,517 |
| **Cash flows from investing activities** | | | |
| Proceeds from sale of property, plant and equipment | | 28 | 16 |
| Acquisition of property, plant and equipment | | (4,171) | (2,622) |
| Acquisition of intangible assets | | (36,370) | (29,133) |
| **Net cash used in investing activities** | | (40,513) | (31,739) |

## Consolidated statement of cash flows (continued)

**For the year ended 31 December**

| *In thousands of BGN* | *Note* | **2016** | **2015** |
|---|---|---|---|
| **Cash flow from financing activities** | | | |
| Repayment of borrowings | | (9,063) | (9,063) |
| Payment of finance lease liabilities | | (1,255) | (1,108) |
| Interest paid | | (4,789) | (5,190) |
| Other financial payments | | (20) | (21) |
| **Net cash used in financing activities** | | (15,127) | (15,382) |
| **Net increase in cash and cash equivalents** | | 494 | 4,396 |
| Cash and cash equivalents at 1 January | | 17,002 | 12,606 |
| **Cash and cash equivalents at 31 December** | *17,24* | 17,496 | 17,002 |

*The notes on pages 11 to 59 are an integral part of these consolidated financial statements.*

Arnaud Philippe Francois Valleteau De Moulliac
*Executive Director*

Anelia Ilieva
*Finance Director*

In accordance with an Independent Auditors' Report:
KPMG Bulgaria OOD

Ivan Andonov
*Authorised Representative*

ОДИТОРСКО ДРУЖЕСТВО
София
Рег. № 045
КПМГ БЪЛГАРИЯ ООД

Tzvetelinka Koleva
*Registered Auditor*

## Notes to the consolidated financial statements

## 1. Reporting entity

Sofiyska Voda AD (the Group) is registered in Sofia City Court on 28 December 1999 under company case № 16172/1999 / №54111, p.557, registration. 1, page 20 and registered as per the Public Register Act in the Public Register to the Registry Agency under uniform identification code 130175000.

The address of the registered office of the Group is Bulgaria, Sofia , bl. Mladost 4, 1 Business Park Sofia Str, building 2A. The Group is 77.1% owned by Veolia Voda (Sofia) BV and 22.9% owned by Vodosnabdiavane and Kanalizatsia EAD.

The consolidated financial statements of the Group for the year ended 31 December 2016 comprise the financial statements of Sofiyska Voda AD and its subsidiary Water Industry Support and Education EOOD (together referred to as the "Group" and individually as "Group entities").

The Group's business is the provision of water-supply and wastewater treatment services in the Municipality of Sofia, including management and maintenance of the public assets which represent part of the main water and wastewater-treatment system in Sofia as well as design, construction, financing and managing of new assets.

On 23 December 1999, Sofiyska Voda AD signed a Concession Contract through which the Municipality of Sofia granted to the Concessionaire (Sofiyska Voda AD) a specific right for use of the public assets and exclusive right to provide the Services within the Concession Area for a period of 25 years. The Services include the provision of water, sewerage and wastewater treatment services.

## 2. Basis of accounting

### (a) Statement of compliance

These financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union.

These are the Group's consolidated financial statements prepared by law by Sofiyska Voda AD as a parent company where the investments in subsidiaries are presented at acquisition cost less impairment.

The consolidated financial statements as of and for the year ended 31 December 2016 were approved for issuance by the Board of Directors on 27 March 2017.

### (b) Basis of measurement

The Consolidated financial statements have been prepared on historical cost basis except for the following positions in the statement of financial position:

- the defined benefit liability is recognized at the present value of the defined benefit obligation
- liability under additional Settlement agreement with Municipality of Sofia is recognized at the present value of the expected future cash outflows

### (c) Functional and presentation currency

The Consolidated financial statements have been prepared in Bulgarian leva (BGN), which is the Company's functional currency. All financial information presented in BGN has been rounded to the nearest thousand unless otherwise indicated.

### (d) Going concern

These Consolidated financial statements have been prepared on the assumption that the Group will continue to operate as a going concern in the foreseeable future.

As at 31 December 2016, its current liabilities exceed its current assets by BGN 65,794 thousand due to the fact the intercompany loan (subordinated loan) contract expires at the end of April 2017 and is presented as short term.

## 2. Basis of accounting (continued)

### (d) Going concern (continued)

The management of the Group is in process of negotiation of further extension of the subordinated loan with Veolia Group and expects a positive outcome. The Group has the support from the Veolia Group, evidenced with a letter of support issued by the Group on behalf Veolia CEE, the sole owner of Veolia Voda (Sofia) BV – the direct parent company of Sofiyska voda, which has expressed intention not to request repayment of the liabilities of Sofiyska voda to it or its subsidiaries for the next at least 12 months from the reporting date.

Therefore the risk of not repaying the intragroup subordinated loan, if it becomes due in the following year, which would also incur an event of default for the loan A obtained from an international financial institution, is considered remote.

During the year, the Group continued to generate a net profit after tax, which reached BGN 25,097 thousand in 2016 (2015: BGN 22,396 thousand). Cash and cash equivalents increased with BGN 494 thousand, compared to 2015, thus amounting to BGN 17,496 thousand. During the year, the Group regularly serviced its liabilities to suppliers, excluding subordinated debt principals. There are no overdue liabilities to external parties.

Considering the above, the management has a reasonable expectation to believe that the available capital resources and sources of financing (cash flows from operating activities) will be adequate to meet all other Group's obligations in the course of 2017.

### (e) Use of estimates and judgments

In preparing these Consolidated financial statements, management has made judgments, estimates and assumptions that affect the application of the Group's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

***(i) Judgments***

Information about critical judgments made in applying accounting policies that have the most significant effect on the amounts recognized in these Consolidated financial statements is included in the following notes:

- Note 3 (d) and Note 3 (k) (ii) – Accounting for intangible assets approach under IFRIC 12, Service Concession Arrangements and related revenue from construction services
- Note 3 (d) (iii) – Intangible assets: Subsequent costs and capitalization

***(ii) Assumptions and estimation uncertainties***

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

- Note 16 – Estimation of the recoverable amount of trade receivables from clients
- Note 26 – Measurement of defined benefit obligations and personnel liabilities
- Note 21 – Estimation of the liability to Municipality of Sofia as per Settlement Agreement
- Note 22 and Note 27 – Provisions and Contingencies – key assumptions about the likelihood and magnitude of an outflow of resources

## 2. Basis of accounting (continued)

### (e) Use of estimates and judgments (continued)

***Fair values***

A number of the Group's accounting policies and disclosures require the measurement of fair value, for both financial and non-financial assets and liabilities.

The Group has an established control framework with respect to the measurement of fair values.

The financial department regularly reviews significant unobservable inputs and valuation adjustments. If third party information, such as broker quotes or pricing services is used to measure fair values, then the financial department assesses the evidence obtained from third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

Significant valuation issues are reported to the Group's Executive Director.

When measuring the fair value of an asset or liability, the Group uses market observable data as far as possible. Fair values are categorized into different level in a fair value hierarchy based on the inputs in the valuation techniques as follows:

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

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

The Group recognizes transfers between levels of the fair value hierarchy at end of the reporting period during which the change has occurred.

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

- Note 24 – Financial instruments

## 3. Significant accounting polices

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

### (a) Foreign currency

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

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the exchange rate at the reporting date. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into the functional currency at the exchange rate when the fair value was determined. Non-monetary items that are measured based on historical cost in a foreign currency are translated at the exchange rate at the date of the transaction. Foreign currency differences are generally recognized in profit or loss.

However, foreign currency differences arising from the translation of the following items are recognized in OCI:

- available-for-sale equity investments (except on impairment in which case foreign currency differences that have been recognized in other comprehensive income are reclassified to profit or loss); or
- qualifying cash flow hedges to the extent the hedges are effective.

From 1 January1999 the exchange rate of the Bulgarian lev (BGN) has been fixed against the Euro (EUR). The exchange rate is BGN 1.95583 / EUR 1.0.

### (b) Financial Instruments

The Group classifies non-derivative financial assets into the category loans and receivables.

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

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

The Group initially recognizes loans and receivables on the date they originated. All other financial assets and financial liabilities are initially recognized on the trade date.

The Group derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred, or it neither transfers nor retains substantially all of the risks and rewards of ownership and does not retain control over the transferred asset. Any interest in such derecognized financial assets that is created or retained by the Group is recognized as a Consolidated asset or liability.

The Group derecognizes a financial liability when its contractual obligations are discharged or cancelled, or expire.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

**3. Significant accounting polices (continued)**

**(b) Financial instruments (continued)**

***(ii) Non-derivative financial assets – measurement***

***Loans and receivables***

These assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition they are measured at amortized cost using the effective interest method.

***Cash and cash equivalents***

Cash and cash equivalents comprise cash balances and call deposits with initial maturity of three months or less of the acquisition date, which are associated with insignificant risk of changes in fair value and are used by the Group to manage short-term commitments.

***(iii) Non-derivative financial liabilities – measurement***

Non-derivative financial liabilities are initially recognized at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these liabilities are measured at amortized cost using the effective interest method.

***(iv) Share capital***

***Ordinary shares***

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects. The equity of the Group is presented at historical cost as at the date of registration.

**(c) Property, plant and equipment**

***(i) Recognition and measurement***

Items of property, plant and equipment are initially measured at cost which includes purchase price, including import duties and non-reimbursable taxes on purchase, as well as all other expenses directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the following:

- cost of materials and direct labor;
- any other costs directly attributable to bringing the assets to a working condition for their intended use;
- when the Group has an obligation to dismantle the asset or restore the site, estimate of the costs of dismantling and restoring the site on which they are located;
- capitalized borrowing costs.

Purchased software, that is essential for the functioning of the purchased equipment, is capitalized as part of the equipment.

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

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognized net in profit or loss.

*Subsequent measurement*

After recognition as an asset, an item of property, plant and equipment is measured at its cost less accumulated depreciation and accumulated impairment losses (see Significant accounting policy 3 (h)).

**3. Significant accounting polices (continued)**

**(c) Property, plant and equipment (continued)**

***(ii) Subsequent costs***

Any subsequent expenditures are being capitalized only if it is probable that the future economic benefits embodied within the part will flow to the Group. The costs of the day-to-day servicing of property, plant and equipment are recognized as loss as incurred.

***(ii) Depreciation***

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives of property, plant and equipment are as follows:

| | |
|---|---|
| • buildings | 25 years |
| • plant and equipment | 5-25 years |
| • vehicles – automobiles | 5-10 years |
| • vehicles – trucks | 10-12,5 years |
| • improvements of leased assets | 10 years |

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

**(d) Intangible assets**

***IFRIC 12, Concession service arrangements***

As stated in Note 1, Sofiyska Voda AD is a party in a concession contract with Municipality of Sofia (Grantor), and as a result a specific right emerges for the Group - granting it the use of public assets as well as an exclusive right to render water supply and sewerage services within the concession area – the territory of the Municipality of Sofia.

Taking into account the concession contract with the Municipality of Sofia, the requirements of IFRIC 12 have been applied, and consequently an intangible asset "concession right" has been recognized in the financial statements of the Group. As the concession agreement includes a requirement for the Group to deliver construction services to the grantor in order to enhance the infrastructure, the Group delivers construction services in consideration for an enhancement to its right to collect tariffs from users of the network and records revenue as it performs the services for water supply, sewerage and waste water treatment to the customers on the territory of the concession.

***(i) Intangible asset "concession right"***

The intangible asset "concession right" is recognized at acquisition cost less accumulated amortization and impairment losses (see accounting policy 3 (h)). The intangible asset "concession right" arises in relation to the Concession Agreement, which sets Sofiyska Voda's right of use of public assets in order to deliver water supply, sewerage and waste water treatment services within the concession area.

The Grantor has the ownership rights on all the existing public assets for the concession period, but the Concessionaire has exclusive and specific right to use the existing public assets. The ownership rights of any new assets are transferred to the Grantor at the time of their acquisition by the Concessionaire or at the beginning of their operation. The Group does not have the right to receive any payments from Grantor related to the acquisition or construction of new public assets. The improvements in the public assets are capitalized and represented as improvements in the intangible asset "concession right".

**3. Significant accounting polices (continued)**

**(d) Intangible assets (continued)**

***(ii) Other intangible assets***

Other intangible assets, acquired by the Group, that have limited useful life, are stated at acquisition cost less accumulated amortization and impairment losses.

***(iii) Subsequent expenditure***

Subsequent expenditures are capitalized only whenever it is probable that they lead to future economic benefits from the specific asset they are related to. All other expenditures are expensed as incurred.

Based on assessment and expertise of internal experts of the Group, it is considered that when a pipe less than 10 meters long is replaced, it does not increase the life of the conduit and is accounted for as an expense immediately. In contrast, replacement of a pipe with length equal to or more than 10 meters extends the life of the pipeline with more than one year and is capitalized.

***(iv) Amortization***

Amortization is charged to the profit or loss on a straight-line basis over the estimated useful lives of the intangible assets, apart from the concession asset, which is depreciated for the term of the concession.

*Other intangible assets:*

| | |
|---|---|
| • capitalized development costs | 6.67 years |
| • other intangibles | 6.67 years |
| • software | 10 years |

Amortization methods, useful lives and residual values are reviewed at each reporting date.

**(e) Leased assets**

Leases in terms of which the Group assumes substantially all the risks and benefits of ownership are classified as finance leases. Upon initial recognition the leased assets are measured at cost equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to it.

Other leases are operating leases. The leased under operating lease assets are not recognized in the Group's statement of financial position.

**(f) Investments**

*Investments in subsidiaries*

Subsidiaries are the enterprises controlled by the Group.

The investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Therefore, an investor must possess all of the following elements to be deemed to control an investee:

- power over the investee
- exposure, or rights, to variable returns from its involvement with the investee; and ability to exert power over the investee to affect the amount of the investor's return;

Investments are accounted for in the Consolidated financial statements under the cost method. On initial recognition the investment is recognized at cost, including the amounts paid and the attributable expenses: fees, commissions, royalties, non-refundable taxes, etc.

## 3. Significant accounting polices (continued)

### (g) Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the weighted average cost principle.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated selling expenses.

### (h) Impairment

#### *(i) Non-derivative financial assets*

Financial assets not classified as at fair value through profit or loss, are assessed at each reporting date to determine whether there is objective evidence of impairment.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Group on terms that the Group would not consider otherwise, indications that a debtor or issuer will enter bankruptcy etc.

*Financial assets measured at amortized cost*

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

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

The impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The impairment loss is recognized in profit and loss and results in decrease of the receivables. When the Group considers that there are no realistic prospects of recovery of the asset, the relevant amounts are written off. If the amount of impairment loss subsequently decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, then the previously recognized impairment loss is reversed through profit or loss.

**3. Significant accounting polices (continued)**

**(h) Impairment (continued)**

***(ii) Non-financial assets***

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

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

Impairment losses are recognized in profit and loss. Impairment losses recognized in respect of cash-generating units are allocated in such way as to reduce the carrying amount of the assets in the CGU (group of CGUs) on a *pro rata* basis.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

**(i) Employee benefits**

***(i) Defined contribution plan***

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a Consolidated entity and will have no legal or constructive obligation to pay further amounts. The Government of Bulgaria is responsible for providing pensions in Bulgaria under a defined contribution pension plan. The Group's obligation for contributions to the defined contribution pension plan are recognized as an employee benefit expense in profit or loss in the periods during which services are rendered by employees. The contributions on a defined contribution plan, that are payable more than 12 months after the end of the period of service rendering by employees, are discounted to their present value.

***(ii) Defined benefit plans***

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value.

The Group has obligation to pay certain amounts to each employee who retires with the Group in accordance with Art. 222, § 3 of the Labour Code. According to the regulations of the Collective Labour agreement, when a labour contract of a Group's employee, who has acquired a pension right, is ended, the Group is obliged to pay him compensations amounted to two gross monthly salaries. If the employee's length of service in the Group equals to or is greater than 10 years, as at retirement date, then the compensation amounts to seven gross monthly salaries. As at the reporting date the management estimates the amount of such expenses based on a report prepared by a qualified actuary using the projected unit credit method. The estimated amount of the obligation and the main assumptions, on the base of which the estimation of the obligation has been made, are disclosed to the financial statements in Note 26.

Re-measurements arising from defined benefit plans comprise actuarial gains and losses and are recognised in OCI. Net interest expense and other expenses related to defined benefit plans are recognised in profit or loss.

## 3. Significant accounting polices (continued)

### (i) Employee benefits (continued)

#### *(iii) Short-term personnel benefits*

Short-term employee benefit obligations are expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

### (j) Provisions

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

*Legal liabilities provision*

Legal liabilities provisions are included in the Group's financial statements as a result of existing legal liabilities on court actions concerning past events. Estimation of the provision is carried out by the legal advisors of the Group based on all the facts and circumstances related to the expected cash outflows resulting from a hypothetical court decision in other party's favor.

### (k) Revenue

#### *(i) Rendering of services*

Revenue from services rendered is recognized in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed by analysis of the work performed.

The revenue from water supply, sewerage and waste water treatment services are realized by the Group as per the Concession Contract and the effective legislation, in particular the Law of Regulation of the water supply and sewerage services (LRWSSS) and the relevant subordinate legislation. As per Art.5 of LRWSSS, the prices of the water supply and sewerage services rendered are subject to regulation by the Energy and Water Regulatory Commission (EWRC).

Revenue from water supply, sewage and waste water treatment is recognized on basis of quantities of water measured through the water measuring devices (WMD).

Key clients (large consumers) are measured and billed monthly of actual consumptions.

For the rest of the clients, as a general rule, actual measurement of clients' devices is performed once every three months. During the other two months, client's consumption is calculated and billed on basis of the average daily consumption from the last actual consumption. When the actual quarterly reading is made, the difference between already invoiced in the previous 2 months and actual reading on the third month is automatically calculated and invoiced in the third month. If it happens that the quantity of actual quarterly reading is lower than the sum of the previous two invoiced quantities, the consumption is adjusted up to the level of the actual reading by issuing of a credit note.

The interest income for overdue receivables is calculated as per the regulations on the legal interest rate (base rate + 10%).

## 3. Significant accounting polices (continued)

### (k) Revenue (continued)

#### *(ii) Construction contracts revenues*

Contract revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably.

If the outcome of a construction contract can be estimated reliably, contract revenue is recognized in profit or loss in proportion to the stage of completion of the contract. The stage of completion is assessed with reference to surveys of work performed. Otherwise, contract revenue is recognized only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognized immediately in profit or loss.

Construction contracts bring revenue related to the investments in public assets – improvement and construction of new components of the water supply and sewerage system against the right to invoice and charge the customers for the service at the prices approved by EWRC. In this respect the Group recognizes an intangible asset "concession right" against crediting revenue from construction contracts upon termination of the works.

### (l) Government grants

The Group recognizes government grants initially as deferred income at fair value when there is reasonable assurance that they will be received and the Group will comply with the conditions associated with the grant; they are then recognized in profit or loss as other income on a systematic basis over the useful life of the asset.

Grants that compensate the Group for expenses incurred are recognized in profit or loss as other income on a systematic basis in the same periods in which the expenses are recognized.

### (m) Leases

Payments on operating leases are recognized in profit and loss on a straight-line basis over the term of the lease. Any additional payments made are recognized in profit and loss as an integral part of the total lease expenses over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the outstanding principal of the liability.

### (n) Finance income and finance costs

Finance income comprises interest income and profit from transactions in foreign currencies, recognized in profit or loss. Interest income is recognized as it is accrued using the effective interest method.

Finance expenses comprise interest expense on borrowings, expenses resulting from increase in liabilities due to being one period closer to the date for realizing the provisions. Borrowing costs that are not directly attributable to the acquisition, construction or production of an asset, meeting the requirements for capitalization of interest, are recognized in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis.

## 3. Significant accounting polices (continued)

### (o) Income tax

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

***Current tax***

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

***Deferred tax***

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future; and
- taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

In determining the amount of current and deferred tax the Group takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Group to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

**3. Significant accounting polices (continued)**

**(p) New standards and interpretations not yet adopted**

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2016 and earlier application is permitted, although they are not yet mandatory until a later period; however, the Group has not early adopted the following new or amended standards in preparing these financial statements.

***Standards, Interpretations and amendments to published Standards that have not been early adopted – endorsed by the EC:***

**(a) IFRS 15 *Revenue from Contracts with Customers***

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognized. It replaces existing revenue recognition guidance, including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes*. IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted.

Although it has not yet fully completed its initial assessment of the potential impact of IFRS 15 on the Group's financial statements, management does not expect that the new Standard, when initially applied, will have material impact on the Group's financial statements. The timing and measurement of the Group's revenues are not expected to change under IFRS 15 because of the nature of the Group's operations and the types of revenues it earns.

**(b) IFRS 9 *Financial Instruments***

This Standard replaces IAS 39, Financial Instruments: Recognition and Measurement. Although the permissible measurement bases for financial assets – amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit and loss (FVTPL) – are similar to IAS 39, the criteria for classification into the appropriate measurement category are significantly different. The impairment model in IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model, which means that a loss event will no longer need to occur before an impairment allowance is recognised. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Group currently plans to apply IFRS 9 initially on 1 January 2018.

The Group does not expect IFRS 9 to have material impact on the financial statements. The classification and measurement of the Group's financial instruments are not expected to change under IFRS 9 because of the nature of the Group's operations and the types of financial instruments that it holds. However the Group believes that impairment losses are likely to increase and become more volatile for assets in the scope of expected credit loss impairment model. The Group has not yet finalised the impairment methodologies that it will apply under IFRS 9.

**(c) Amendments to IFRS 10 and IAS 28 *Sale or contribution of assets between an investor and its associate or joint venture***

The Group does not expect that the amendments, when initially applied, will have material impact on the financial statements.

**3. Significant accounting polices (continued)**

**(p) New standards and interpretations not yet adopted (continued)**

***IASB/IFRIC documents not yet endorsed by EC:***

Management believes that it is appropriate to disclose that the following new or revised standards, new interpretations and amendments to current standards, which are already issued by the International Accounting Standards Board (IASB), are not yet endorsed for adoption by the EC, and therefore are not taken into account in preparing these financial statements. The actual effective dates for them will depend on the endorsement decision by the EC.

**(a) Disclosure Initiative (Amendments to IAS 7)**

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

**(b) IFRS 16 *Leases***

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

These changes are not expected to have a significant impact on the financial statements of the Group. The Group has started an initial assessment of the potential impact on its financial statements. The Group has not yet quantified the impact on its reported assets and liabilities of adoption of IFRS 16. The quantitative effect will depend on, inter alia, the transition method chosen, the extent to which the Group uses the practical expedients and recognition exemptions, and any additional leases that the Group enters into. The Group expects to disclose its transition approach and quantitative information before adoption.

**(c) Other amendments**

The following changes are not expected to have a significant impact on the Group's financial statements.

- *Recognition of Deferred Tax Assets far Unrealized Losses (Amendments to IAS 12)*
- *Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)*
- *Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*
- *Amendments to IAS 40 Transfers of Investment Property*
- *IFRIC 22 Foreign Currency Transactions and Advance Consideration*
- *Annual improvements to IFRSs 2014-2016 cycle were issued on 8 December 2016*

## 4. Revenue

| *In thousands of BGN* | Note | 2016 | 2015 |
|---|---|---|---|
| Income from water supply | | 86,286 | 83,643 |
| Income from sewerage | | 17,428 | 15,299 |
| Income from waste water treatment | | 20,713 | 20,800 |
| Interest income from overdue receivables | | 4,366 | 4,596 |
| Income from service sales | | 2,151 | 2,024 |
| Revenue invoiced to customers, which is to be transferred to meet the obligations regarding the financial memorandum ISPA* | | (1,081) | (1,300) |
| Revenue invoiced to customers, which offsets the consideration for the new water and sewerage infrastructure financed by the Municipality of Sofia's budget | *27(b)* | (59) | (56) |
| | | 129,804 | 125,006 |

*According to an agreement dated 22 June 2007 between Sofiyska Voda AD and Sofia Municipality (MoS), and in relation to Financial Memorandum ISPA 2000 BG 16 P PE 001, signed between European Commission and Republic of Bulgaria, the Group is obliged to include in its price for water supply, sewerage and treatment of waste waters an adjustment, allowing it to accumulate the necessary annual funds for repayment of the Financial Memorandum loan that was received from the European Investment Bank (EIB). The total expected amount to be serviced by Sofiyska voda was approximately EUR 8,775 thousand representing 15% of the project value. The end beneficiary of the loan from the European Investment Bank is the Municipality of Sofia.

On basis of received attachments to MoEW letters from 7 November 2011 and 30 January 2012, it became known that respectively on 3 October 2011 and 13 January 2012, EIB disbursed two tranches of the agreed loan amounting to EUR 7,086 thousand. At the end, it became the final amount, because of expiry of the period of availability of the funds and no new utilizations could be made.

The payment started from the beginning of 2012 and will last in year 2030. Interest and principle are due to EIB on each 10th March and 10th September.

The Energy and Water Regulatory Commission, on basis of an indicative repayment schedule, approved a tariff adjustment, though the inclusion in the tariff of a certain amount for servicing and repayment of the EIB financing.

The Agreement stated above, specifies that upon the receipt of the relevant notices, the collected amounts from the clients of the Group as a result of the approved by the EWRC price component, should be transferred to the Ministry of Environment and Waters (MoEW) in a specially opened to service the loan bank account.

Having received a notice from the Municipality of Sofia in 2016, the Group transferred two installments for a total amount of BGN 900 thousand to the bank account indicated by the Municipality of Sofia, to service the loan from EIB.

The portion of billed revenue in 2016, set aside for servicing and repayment of the EIB loan, based on the price component in the tariff, amounts to BGN 1,081 thousand (2015: 1,300 thousand), presented above as a reduction of the Group's yearly revenue.

## 5. Other income

| *In thousands of BGN* | 2016 | 2015 |
|---|---|---|
| Penalties of contractors | 235 | 123 |
| Penalties for industrial discharges of water with excessive concentration of pollutants | 613 | 545 |
| Gain on sale of inventories to subcontractors for construction works | 133 | 192 |
| Green energy income | 365 | 272 |
| Income from rent | 41 | 8 |
| Gain on sale of Property, plant and equipment | 4 | 15 |
| Income from financing | 228 | 216 |
| Other income | 747 | 368 |
| | 2,366 | 1,739 |

The gain on sale of non-current assets is realized from the sale of a vehicle as follows:

| | 2016 | 2015 |
|---|---|---|
| Revenue from sale of vehicles | 28 | 16 |
| NBV of sold vehicles | (24) | (1) |
| | 4 | 15 |

## 6. Construction revenue and expenses

| *In thousands of BGN* | | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|---|
| **Project** | **Note** | **Revenue** | **Expenses** | **Profits** | **Revenue** | **Expenses** | **Profits** |
| Water supply | | 15,890 | 15,890 | - | 14,710 | 14,710 | - |
| Potable water treatment | | 2,215 | 2,215 | - | 1,390 | 1,390 | - |
| Sewerage | | 9,715 | 9,715 | - | 6,373 | 6,373 | - |
| Waste water treatment | | 4,296 | 4,296 | - | 2,444 | 2,444 | - |
| House connections and meters | | 5,791 | 5,791 | - | 5,880 | 5,880 | - |
| Total | *14* | 37,907 | 37,907 | - | 30,797 | 30,797 | - |

## 7. Expenses for materials

| *In thousands of BGN* | 2016 | 2015 |
|---|---|---|
| Electricity, water, heating | 1,303 | 1,421 |
| Fuels and lubricants | 1,123 | 1,242 |
| Water for technological needs | 1,500 | 1,343 |
| Chemicals | 2,735 | 2,728 |
| Plumbing materials | 694 | 472 |
| Other | 1,412 | 1,537 |
| | 8,767 | 8,743 |

## 8. Expenses for hired services

| *In thousands of BGN* | 2016 | 2015 |
|---|---|---|
| Annual water tax | 3,992 | 4,082 |
| Repairs and maintenance of concession infrastructure | 4,920 | 4,364 |
| Insurance | 1,215 | 1,399 |
| Rent | 1,082 | 1,075 |
| Security | 5,631 | 5,617 |
| Other services | 8,604 | 8,472 |
| | 25,444 | 25,009 |

## 8. Expenses for hired services (continued)

Other expenses for hired services include:

| *In thousands of BGN* | 2016 | 2015 |
|---|---|---|
| Water – meters reading | 1,878 | 1,739 |
| Courier services | 364 | 412 |
| Printing services | 476 | 468 |
| Technical services | 1,496 | 1,496 |
| Consultancy | 519 | 422 |
| Asphalt covering | 350 | 271 |
| SEWRC fee | 399 | 395 |
| Sterilization | 20 | 24 |
| Communication | 156 | 141 |
| Annual software licenses | 742 | 780 |
| Collection of receivables | 133 | 303 |
| Hired transportation | 212 | 142 |
| Water carriers | 170 | 172 |
| Software maintenance and internet | 539 | 431 |
| Training | 100 | 110 |
| Announcements and communications | 102 | 83 |
| Local taxes and fees | 95 | 76 |
| Cleaning of offices and water tanks | 64 | 47 |
| Fees | 30 | 35 |
| Other | 759 | 925 |
| | 8,604 | 8,472 |

## 9. Employee benefit expenses

| *In thousands of BGN* | *Note* | 2016 | 2015 |
|---|---|---|---|
| Wages and salaries | | 18,058 | 17,015 |
| Compulsory social security contribution | | 2,686 | 2,552 |
| Social expenses | | 116 | 98 |
| Expenses for additional pension contribution | | 467 | 429 |
| Current and past service costs in relation to employee benefits | *26* | 184 | 116 |
| Voucher expenses | | 1,387 | 1,380 |
| | | 22,898 | 21,590 |

The salary expenses include an accrual for unused annual paid leave amounting to BGN 541 thousand (2015: 356 thousand).

The compulsory social security contribution includes an accrual for social and health security on unused annual paid leave for the amount of BGN 95 thousand (2015: 64 thousand).

The average number of Group's personnel is 1,155 employees (2015: 1,151 employees).

## 10. Other operating expenses

| *In thousands of BGN* | Note | 2016 | 2015 |
|---|---|---|---|
| Reduction of inventories to net realizable value | *15* | 55 | (37) |
| One-off taxes | | 146 | 133 |
| Commission for collection of trade receivables | | 1,275 | 1,139 |
| Provisions for fines and penalties, net | | (2,359) | 252 |
| Scrapping of materials | | 50 | 2 |
| Scrapping of non-current assets | | 19 | 30 |
| Others | | 2,125 | 1,472 |
| | | 1,311 | 2,991 |

## 11. Finance income and finance costs, recognized in profit and loss

| *In thousands of BGN* | 2016 | 2015 |
|---|---|---|
| Interest income | 24 | 20 |
| Effect from guarantee discounts | 51 | 36 |
| Financial income | 75 | 56 |
| | | |
| Interest expenses for Loan "A" | (844) | (1,119) |
| Interest expenses for Loan "B" | (4,239) | (4,405) |
| Finance charges on finance leases | (74) | (88) |
| Interest expenses on employee benefits | (17) | (31) |
| Effect from guarantee discounts | (31) | (38) |
| Interest expenses from discounting trade payables as per agreement between Sofiyska Voda and Municipality of Sofia | (262) | (594) |
| Other finance costs | (41) | (42) |
| Loss from foreign currency exchange differences | (43) | (82) |
| Finance costs | (5,551) | (6,399) |
| | | |
| Finance costs (net) | (5,476) | (6,343) |

The financial income and expenses listed above include interest income and expenses on assets (liabilities) that are not recognised at fair value in profit and loss:

| | 2016 | 2015 |
|---|---|---|
| Total interest income on financial assets | 75 | 56 |
| Total interest expense on financial liabilities | (5,157) | (5,612) |

## 12. Tax expenses

| *In thousands of BGN* | Note | 2016 | 2015 |
|---|---|---|---|
| **Current tax expense** | | | |
| Income tax for current year | | (3,378) | (2,921) |
| **Deferred tax expense** | | | |
| Origination and reversal of temporary differences | *20* | 452 | 341 |
| Total tax expense | | (2,926) | (2,580) |

The relevant tax period of the Group may be subject to examination by the tax authorities until the expiration of five years from the end of the year in which the declaration is or should have been filed, and also additional tax liabilities or penalties may be imposed accordingly to the interpretation of the tax legislation. The management of the Group is not aware of any circumstances that may bring additional significant liabilities in this area.

A tax audit on the Group in respect of the Corporate Income Tax covers the periods up to 31 December 2012. The last tax review on the Group with respect to Value Added Tax covers the periods up to 31 August 2013.

| **Reconciliation of effective tax rate**<br>*In thousands of BGN* | | 2016 | | 2015 |
|---|---|---|---|---|
| Profit for the year | | 25,097 | | 22,396 |
| Total tax expenses | | 2,926 | | 2,580 |
| Profit before tax | | 28,023 | | 24,976 |
| Income tax using the Group's domestic tax rate | 10% | (2,802) | 10% | (2,498) |
| Non-deductible expenses | 0.40% | (112) | 0.26% | (66) |
| Effects of write off of deferred tax | 0.04% | (12) | 0.06% | (16) |
| Net current income tax (expense)/income | 10.42% | (2,926) | 10.33% | (2,580) |

## 13. Property, plant and equipment

| *In thousands of BGN* | Land and buildings | Plant and equipment | Vehicles | Leasehold improvements | Assets under construct ion | Total |
|---|---|---|---|---|---|---|
| ***Cost*** | | | | | | |
| Balance at 1 January 2015 | 710 | 26,258 | 12,940 | 1,099 | 538 | 41,545 |
| Additions | - | - | - | - | 2,622 | 2,622 |
| Disposals | - | (285) | (178) | - | - | (463) |
| Transfers | - | 1,782 | 1,081 | 74 | (2,937) | - |
| Transfers to intangible assets | - | - | - | - | (223) | (223) |
| Balance at 31 December 2015 | 710 | 27,755 | 13,843 | 1,173 | - | 43,481 |
| Balance at 1 January 2016 | 710 | 27,755 | 13,843 | 1,173 | - | 43,481 |
| Additions | - | - | - | - | 4,171 | 4,171 |
| Disposals | - | (273) | (835) | (2) | - | (1,110) |
| Transfers | - | 2,208 | 1,948 | 15 | (4,171) | - |
| Transfers to intangible assets | - | - | - | - | - | - |
| Balance at 31 December 2016 | 710 | 29,690 | 14,956 | 1,186 | - | 46,542 |
| ***Depreciation*** | | | | | | |
| Depreciation as at 1 January 2015 | (155) | (15,168) | (7,849) | (1,001) | - | (24,173) |
| Depreciation charge for the year | (20) | (2,362) | (1,017) | (35) | - | (3,434) |
| Depreciation on disposals | - | 228 | 172 | - | - | 400 |
| Balance at 31 December 2015 | (175) | (17,302) | (8,694) | (1,036) | - | (27,207) |
| Depreciation as at 1 January 2016 | (175) | (17,302) | (8,694) | (1,036) | - | (27,207) |
| Depreciation charge for the year | (20) | (2,232) | (1,057) | (27) | - | (3,336) |
| Depreciation on disposals | - | 259 | 808 | - | - | 1,067 |
| Balance at 31 December 2016 | (195) | (19,275) | (8,943) | (1,063) | - | (29,476) |
| ***Carrying amounts*** | | | | | | |
| At 1 January 2015 | 555 | 11,090 | 5,091 | 98 | 538 | 17,372 |
| At 31 December 2015 | 535 | 10,453 | 5,149 | 137 | - | 16,274 |
| At 1 January 2016 | 535 | 10,453 | 5,149 | 137 | - | 16,274 |
| At 31 December 2016 | 515 | 10,415 | 6,013 | 123 | - | 17,066 |

## 13. Property, plant and equipment (continued)

### Acquisitions

The most significant tangible assets, acquired in 2016 amount to BGN 4,156 thousand (2015: 2,863 thousand) and are listed below:

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| CHP generator | 170 | 48 |
| Transportation vehicles and mechanization | 2,199 | 1,363 |
| Laboratory equipment | 77 | 55 |
| Computer equipment | 1,184 | 677 |
| Other equipment | 526 | 720 |
| | 4,156 | 2,863 |

***Assets pledged as collateral***

The Group has pledged all its present and future non-current assets in respect of secured bank loan "A".

***Assets pledged as collateral on finance lease contracts***

In relation to the finance lease contracts, the value of pledged non-current assets (motor vehicles and construction machinery) according to the Central Pledge Registry records is BGN 3,532 thousand.

## 14. Intangible assets

| *In thousands of BGN* | Development costs | Software | Concession right | Assets under construction – Concession right | Assets under construction – other | Total |
|---|---|---|---|---|---|---|
| ***Cost*** | | | | | | |
| Balance as at 1 January 2015 | 21,041 | 15,797 | 387,016 | 14,165 | 3,019 | 441,038 |
| Acquisitions | - | - | - | 30,797 | 980 | 31,777 |
| Disposals | - | - | (18) | - | - | (18) |
| Transfers | - | 3,827 | 32,840 | (32,839) | (3,828) | - |
| Transfers to intangible assets | - | - | - | 394 | (171) | 223 |
| Balance as at 31 December 2015 | 21,041 | 19,624 | 419,838 | 12,517 | - | 473,020 |
| Balance as at 1 January 2016 | 21,041 | 19,624 | 419,838 | 12,517 | - | 473,020 |
| Acquisitions | - | - | - | 37,907 | 461 | 38,368 |
| Disposals | - | - | - | - | - | - |
| Transfers | | 461 | 37,222 | (37,222) | (461) | - |
| Transfers from tangible assets | - | - | - | - | - | - |
| Balance as at 31 December 2016 | 21,041 | 20,085 | 457,060 | 13,202 | - | 511,388 |
| ***Amortization*** | | | | | | |
| Balance as at 1 January 2015 | (20,852) | (14,207) | (133,469) | - | - | (168,528) |
| Amortization for the year | (154) | (429) | (24,896) | - | - | (25,479) |
| Amortization on disposals | - | - | 3 | - | - | 3 |
| Balance as at 31 December 2015 | (21,006) | (14,636) | (158,362) | - | - | (194,004) |
| Balance as at 1 January 2016 | (21,006) | (14,636) | (158,362) | - | - | (194,004) |
| Amortization for the year | (31) | (667) | (28,009) | - | - | (28,707) |
| Amortization on disposals | | | | | | |
| Balance as at 31 December 2016 | (21,037) | (15,303) | (186,371) | - | - | (222,711) |
| ***Carrying amounts*** | | | | | | |
| At 1 January 2015 | 189 | 1,590 | 253,547 | 14,165 | 3,019 | 272,510 |
| At 31 December 2015 | 35 | 4,988 | 261,476 | 12,517 | - | 279,016 |
| At 1 January 2016 | 35 | 4,988 | 261,476 | 12,517 | - | 279,016 |
| At 31 December 2016 | 4 | 4,782 | 270,689 | 13,202 | - | 288,677 |

## 14. Intangible assets (continued)

### Acquired assets

The major acquisitions of intangible assets in 2016, which are transferred from Assets under construction, relate to the increase of the value of the Concession right and amount to BGN 37,222 thousand (2015: 32,839 thousand). The main components are listed below:

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| Water supply network and house connections | 16,506 | 16,796 |
| Water Waste Treatment Plant Koubratovo | 3,343 | 1,208 |
| Sewerage and house connections | 10,185 | 9,181 |
| Hydrants and cranes | 1,800 | 2,029 |
| Water meters | 2,053 | 2,142 |
| Leasehold improvements | 1,765 | 1,475 |
| Pumping Stations | 1,570 | 8 |
| | 37,222 | 32,839 |

### *Assets under construction*

The major intangible assets under construction which relates to concession right amount to BGN 13,201 thousand (2015: 12,517 thousand). The most significant of them are listed below:

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| Second stage of strengthening of Beli Iskar Dam | 1,015 | 936 |
| Waste Water Treatment Plant | 1,006 | 1,629 |
| Construction of water main system, water-main net model and DMA zones for reduction of unaccounted for water | 3,730 | 4,819 |
| Chlorinating stations | - | 1 |
| Construction of sewerage mains and sewerage model | 2,717 | 3,197 |
| Potable Water Treatment Plants | 920 | 902 |
| Impounding Structures | 2,451 | 573 |
| Rehabilitation of reservoirs, pumping stations, sanitary protection zones | 1,274 | 457 |
| Proactive replacement of stop valves, fire hydrants, water connections | 89 | 3 |
| | 13,202 | 12,517 |

### *Assets pledged as collateral*

The Group has pledged all its present and future non-current assets in respect of secured bank loan "A", besides for assets that are state owned.

### Impairment test

In 2016 the Group performed impairment test of the cash generating unit due to changes in the regulatory environment, incl. price levels determined by the regulator. The CGU recoverable amount is based on its value-in-use for the period of concession (therefore there is no terminal value). The estimated value-in-use was determined based on discount factor of 8.7% after tax and average revenue increase until the end of the concession of 2.16%.

As a result of the impairment test no impairment losses of the CGU are identified.

## 15. Inventories

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| Spare parts and consumables | 1,064 | 1,346 |
| | 1,064 | 1,346 |

The balance of stock write down as at 31 December 2016 amounts to BGN 1,463 thousand (2015: BGN 1,408 thousand).

***Inventories pledged as collateral***

The Group has pledged all its present and future movables in respect of secured bank loan "A", which include raw materials and inventories.

## 16. Trade and other receivables

| *In thousands of BGN* | **Note** | **2016** | **2015** |
|---|---|---|---|
| Trade and other receivables | | 79,706 | 79,472 |
| Impairment losses on trade receivables | | (47,734) | (47,366) |
| Court receivables | | 28,590 | 21,211 |
| Impairment losses on court receivables | | (28,590) | (21,211) |
| Total trade receivables | *24* | 31,972 | 32,106 |
| | | | |
| Other receivables and prepayments | | 3,628 | 1,827 |
| Impairment of receivables and prepayments | | (44) | (44) |
| | | 3,584 | 1,783 |
| | | | |
| Total trade and other receivables | | 35,556 | 33,889 |
| *Non-current* | | 290 | 983 |
| *Current* | | 35,266 | 32,906 |

In 2016 receivables amounting to BGN 561 thousand have been written off (2015: BGN 1,136 thousand).

*Accounts receivable pledged as collateral:*

The Group has pledged all its accounts receivable, to be collected in the future in any local currency bank account, general receivables accounts from any party and insurance receivables related to any account receivable under the requirements of bank loan "A".

The Group's exposure to interest rate risk and the sensitivity analysis of all financial assets and liabilities are reported in Note 24 – *Financial Instruments*.

***Other receivables and prepayments:***

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| Insurance | 870 | 847 |
| Licenses | 82 | 78 |
| Subscriptions | 364 | 132 |
| Advances for PPE | 2,161 | 697 |
| Other | 107 | 29 |
| | 3,584 | 1,783 |

## 17. Cash and cash equivalents

| *In thousands of BGN* | Note | 2016 | 2015 |
|---|---|---|---|
| Cash on hand | | 52 | 96 |
| Local currency | | 38 | 82 |
| Foreign currency | | 14 | 14 |
| Cash at banks | 24 | 17,444 | 16,906 |
| Local currency | | 17,243 | 16,499 |
| Foreign currency | | 201 | 407 |
| Cash and cash equivalents in the statement of cash flows | 24 | 17,496 | 17,002 |

***Cash at banks pledged as collateral:***

The Group has pledged all its bank accounts under the requirements of a bank loan "A".

The Group's exposure to Interest rate risk and the sensitivity analysis of all financial assets and liabilities are stated in Note 24.

## 18. Capital and reserves

| *In thousands of shares* | Ordinary shares 2016 | 2015 |
|---|---|---|
| On issue at 1 January | 8,884 | 8,884 |
| On issue as at 31 December – fully paid | 8,884 | 8,884 |

As at 31 December 2016 the share capital includes 8,884,435 ordinary shares (2015: 8,884,435). All shares have a nominal value of BGN 1. Shareholders in the Group as at 31 December 2016 are:

- Veolia Voda (Sofia) BV – 6,850,000 ordinary shares (77.1%);
- Vodosnabdyavane i kanalizatsia AD - 2,034,435 ordinary shares (22.9%).

The ultimate parent company is Veolia Environnement S.A., France.

With a pledged endorsement dated 19 December 2000 in favor of the bank which provided secured bank loan "A", 6,850,000 ordinary shares have been pledged and this fact is inscribed in the shareholders' book based on a contract for pledge of shares.

The holders of ordinary shares possess dividend rights and voting rights at the Group's General Shareholders Meeting of one vote for each share in their possession. All shares rank equally with regard to the Group's residual assets.

***Legal reserves***

Legal reserves are formed based on the requirement of the Bulgarian Commercial Law for transfer of 1/10 of the net profit to Reserves at least until the amount of 1/10 or more of the registered Group capital is reached.

## 19. Loans and borrowings

This note provides information on the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortized cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 24, *Financial instruments.*

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| **Non-current liabilities** | | |
| Loans at nominal value | 27,203 | 36,266 |
| Amortization | (272) | (473) |
| Loans at amortized cost | 26,931 | 35,793 |
| Finance lease liabilities | 1,880 | 1,469 |
| | 28,811 | 37,262 |
| **Current liabilities** | | |
| Loans at nominal value | 80,181 | 80,181 |
| Amortization | 43 | (104) |
| Loans at amortized cost | 80,224 | 80,077 |
| Finance lease liabilities | 1,283 | 1,178 |
| | 81,507 | 81,255 |
| Total loans and borrowings | 110,318 | 118,517 |

In accordance with the loan agreement 'A' the Group has the obligation to maintain an Annual Debt Service Coverage Ratio (ADSCR) of 1.3:1. The ADSCR should show that at any Calculation Date (ending on 31 December) the ratio of Free Cash Flow for the preceding twelve month period to the aggregate amount of principal and interest payments falling due and payable during such period should be 1.3:1.

In accordance with the Amended and Restated Loan Agreement (ARLA) the calculation of the annual debt service coverage ratio is calculated by the bank by the means of a model based on the actual and estimated values as at the date of preparation. As per the internal calculations based on the actual cash flow for 2016 result in an actual ADSCR of 2.14:1 at the reporting date. The Group has the obligation of submitting the verified annual financial statements within 120 calendar days of the beginning of the year to the Bank. The Bank updates the calculations of the ratio for the past year in a new version of their model.

***Terms and debt repayment schedule***

| | | | | **31 December 2016** | | **31 December 2015** | |
|---|---|---|---|---|---|---|---|
| *In thousands of BGN* | Currency | Nominal interest rate | Year of Maturity | Face Value | Carrying Amount | Face Value | Carrying Amount |
| Loan „A" | EUR | 1.35 % plus 6 month EURIBOR* | 2020 | 36,266 | 35,748 | 45,329 | 44,557 |
| Loan „B", subordinated and unsecured, from related party | EUR | 5.95% plus 6 month EURIBOR | 2017 | 71,117 | 71,407 | 71,118 | 71,313 |
| Finance lease liabilities | | | | 3,163 | 3,163 | 2,647 | 2,647 |
| | | | | 110,546 | 110,318 | 119,094 | 118,517 |

## 19. Loans and borrowings (continued)

*As of April 2011 the margin on Loan A has been reduced in accordance with the EBRD loan contract from 1.75% to 1.35% due to fact the Group has achieved debt service coverage ratio of above 1.41:1 for the previous year.

***Finance lease liabilities***

The finance lease liabilities are payable as follows:

| *In thousands of BGN* | Future minimum lease payments **2016** | Interest **2016** | Present value of minimum lease payments **2016** | Future minimum lease payments **2015** | Interest **2015** | Present value of minimum lease payments **2015** |
|---|---|---|---|---|---|---|
| Less than 1 year | 1,346 | 63 | 1,283 | 1,252 | 74 | 1,178 |
| Between 1 and 2 years | 1,485 | 55 | 1,430 | 920 | 32 | 887 |
| 2 to 5 years | 455 | 5 | 450 | 601 | 20 | 582 |
| | 3,286 | 123 | 3,163 | 2,773 | 126 | 2,647 |

## 20. Deferred tax assets and liabilities

The deferred tax assets and liabilities are attributable to the following:

| *In thousands of BGN* | **Assets 2016** | **Liabilities 2016** | **Net 2016** | **Assets 2015** | **Liabilities 2015** | **Net 2015** |
|---|---|---|---|---|---|---|
| Property, plant and equipment | - | (995) | (995) | - | (926) | (926) |
| Inventories | 146 | - | 146 | 141 | - | 141 |
| Trade receivables | 6,549 | - | 6,549 | 5,573 | - | 5,573 |
| Provisions | 455 | - | 455 | 945 | - | 945 |
| Accrual for unused paid leave and bonus | 271 | - | 271 | 245 | - | 245 |
| Payables as per defined benefit plan | 119 | - | 119 | 115 | - | 115 |
| Financing from EBRD | 26 | - | 26 | 26 | - | 26 |
| Trade payables | 67 | - | 67 | 67 | - | 67 |
| Deferred tax assets/ (liabilities) | 7,633 | (995) | 6,638 | 7,112 | (926) | 6,186 |

In determining the current and deferred taxes the Group has adopted as an accounting basis the one stated in Significant accounting policies (Note 3). The deferred tax for 2016 is calculated by using the tax rate applicable to the Group which is the effective income tax rate for 2017 – 10%.

## 20. Deferred tax assets and liabilities (continued)

Changes in temporary differences during the year:

| *In thousands of BGN* | **Balance as at 1 January 2015** | **Recognized in profit or loss** | **Recognized in OCI** | **Balance as at 31 December 2015** | **Recognized in profit or loss** | **Recognized in OCI** | **Balance as at 31 December 2016** |
|---|---|---|---|---|---|---|---|
| Property, plant and equipment | (944) | 18 | - | (926) | (69) | - | (995) |
| Inventories | 144 | (3) | - | 141 | 5 | - | 146 |
| Trade receivables | 5,233 | 340 | - | 5,573 | 976 | - | 6,549 |
| Provisions | 941 | 4 | - | 945 | (490) | - | 455 |
| Accrual for unused annual paid leave and bonus | 257 | (12) | - | 245 | 26 | - | 271 |
| Liabilities under a defined benefit plan | 121 | (6) | - | 115 | 4 | - | 119 |
| Financing from EBRD | 26 | - | - | 26 | - | - | 26 |
| Trade payables | 67 | - | - | 67 | - | - | 67 |
| Deferred tax assets/ (liabilities) | 5,845 | 341 | - | 6,186 | 452 | - | 6,638 |

## 21. Trade and other payables

| *In thousands of BGN* | Note | 2016 | 2015 |
|---|---|---|---|
| Trade payables | | 12,075 | 11,886 |
| Guarantees | | 2,427 | 2,273 |
| Payables to employees | | 3,873 | 3,573 |
| Insurance | | 852 | 856 |
| Pollution | | 1,061 | 3,108 |
| ISPA payable | | 4,085 | 3,904 |
| Total trade payables | 24 | 24,373 | 25,600 |
| Social security payables | | 651 | 596 |
| Payable as per Contract with Municipality of Sofia | | 7,947 | 8,842 |
| Payables for water usage tax | | 3,992 | 4,082 |
| VAT payable | | 7 | 263 |
| Other taxes payable | | 283 | 232 |
| Other payables and accruals | | 769 | 414 |
| | | 13,649 | 14,429 |
| Total trade and other payables | | 38,022 | 40,029 |
| *Non-current* | | 8,737 | 10,469 |
| *Current* | | 29,285 | 29,560 |

## 22. Provisions

| *In thousands of BGN* | 2016 | 2015 |
|---|---|---|
| Provision for court liabilities | 3,157 | 5,973 |
| | 3,157 | 5,973 |

*Provision for court liabilities*

The provision is calculated on basis of estimation of the most likely outcome and historical evidence by the Group's internal lawyers.

Provisions are made for legal claims of contractual nature – indemnification of claimed damage due to emergencies related to assets operated by the Group, claims for refunds of amounts paid for assets construction, as well as claims for refund of asserted unduly paid bills.

Another group of legal cases for which a provision is made, are of labor legislative character and most often relate to potential payments of unemployment indemnifications to ex-employees in case the court pronounces the termination of the employment illegal.

In a Consolidated group are the provisions in relation to the imposing of administrative sanctions, mostly due to findings for possible abuse of a dominant position. The most significant amount in the closing balance in the current financial period is due to provisions from this group. In accordance with order №370/19.03.2015 on the basis of art. 74, p.3 from Act for Protection of Competition (APC), the Commission for Protection of Competition initiated proceedings that Sofiyska Voda used its dominant position on the market in relation to charging interest for delayed payments on estimated bills for provided services under art. 21, p.1 from APC. The sanction amounts to BGN 4,800 thousand and is calculated based on 0.5% of Sofiyska Voda 2013 revenue, applying leverage ratio 8. The Group has undertaken measures to appeal the penalty imposed in compliance with the applicable legislation.

On 11 January 2016, the 3 panel body of Supreme Administrative Court (SAC) issued a decision regarding CPC case. In the decision, the penalty was decreased up to BGN 2,400 thousand from BGN 4,800 thousand. Sofiyska voda objected the decision at the next instance as well as the CPC. Court case 3161/2016 is open and the hearing was on 7 April 2016. The case is announced for resolution (still pending).

## 22. Provisions (continued)

The change in provisions throughout the year is presented below:

| *In thousands of BGN* | Balance at 1 January 2016 | Provisions made during the year | Provisions used during the year | Reversed provisions during the year | Discount effect | Balance at 31 December 2016 |
|---|---|---|---|---|---|---|
| Provision for court liabilities | 5,973 | 245 | (100) | (2,961) | - | 3,157 |
| | 5,973 | 245 | (100) | (2,961) | - | 3,157 |

## 23. Income tax liabilities

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| Income tax | 442 | 649 |
| | 442 | 649 |

## 24. Financial instruments

***Financial Risk Management***

***Overview***

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

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

This note presents information about the Group's exposure to each of the risks listed above, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital.

***Risk Management Framework***

The Board of Directors has the responsibility for the establishment and supervision of the Group's risk management. The Board has established a Risk Management Committee which is responsible for the development and supervision on the Group's policies for risk management and the Committee is obliged to report regularly its actions to the Board of Directors.

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

The Risk Management Committee of the Group monitors how the management ensures compliance with the risk management policies and reviews the adequacy of the risk management framework related to the risks the Group faces. The Committee is being assisted by the internal audit department. Internal audit undertakes both planned and unplanned inspections of the risk management controls and procedures and the results are reported directly to the management.

**Credit Risk**

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises from the Group's receivables from customers and investments in financial instruments.

## 24. Financial instruments (continued)

***Exposure to Credit Risk***

The carrying amount of the financial instruments represents the maximum credit exposure. The maximum credit exposure at the reporting date is:

| *In thousands of BGN* | Note | Carrying amount 2016 | Carrying amount 2015 |
|---|---|---|---|
| Trade and other receivables | *16* | 31,972 | 32,106 |
| Receivables from related parties | *30* | 14 | 2 |
| Cash and cash equivalents (at banks) | *17* | 17,444 | 16,906 |
| | | 49,430 | 49,014 |

**Trade and other receivables**

The credit risk exposure of the Group results from the individual characteristics of the clients. The exposure also depends on the risk of non-payment common to the utilities sector. The Group is a monopolist in rendering its services on the territory of Sofia Municipality and as at 31 December 2016 the active clients of the Group are 632,550 (2015 – 617,245). Based on the analyses of the Group, the services rendered have low price elasticity. The prices are regulated by the State Energy and Water Regulation Commission. The Group does not require guarantees from its customers in relation to the services rendered, but is currently developing and implementing a policy to increase the debt collection. In addition, the Group uses external collection agencies in order to take advantage of the expertise and best practices, as well as up-to-date software support. The Group's efforts are orientated towards demanding active contact with customers, tracing results and using a customers' contacts history database and other operational statistics.

In view of the credit risk it can be said that the Group's ability to influence directly its customers' behavior is limited due to the legal framework and the complications at interruption of the consumption, as well as to the fact that the majority of uncollected trade receivables are owed by individual customers (households) and not institutional customers.

The carrying amount of trade receivables by type of customers represents the credit exposure at the reporting date of the Group's statement of financial position and it is as follows:

| *In thousands of BGN* | Cost 31 December 2016 | Impairment 2016 | Carrying amount 31 December 2016 | Cost 31 December 2015 | Impairment 2015 | Carrying amount 31 December 2015 |
|---|---|---|---|---|---|---|
| State budget organizations | 1,677 | (472) | 1,205 | 1,602 | (376) | 1,226 |
| Commercial customers | **11,282** | **(5,764)** | **5,505** | **10,875** | **(5,161)** | **5,714** |
| Domestic population | **94,503** | **(70,088)** | **24,415** | **86,974** | **(63,040)** | **23,934** |
| Other customers | 834 | - | 834 | 1,232 | - | 1,232 |
| Related parties | 14 | - | 14 | 2 | - | 2 |
| | 108,310 | (76,324) | 31,986 | 100,685 | (68,577) | 32,108 |

## 24. Financial instruments (continued)

***Exposure to credit risk (continued)***

The aging of trade receivables of the Group at the reporting date was:

| *In thousands of BGN* | **2016 Cost** | **2016 Impairment** | **2015 Cost** | **2015 Impairment** |
|---|---|---|---|---|
| Not past due | 19,735 | (60) | 19,844 | (80) |
| Past due 30 days | 2,859 | (216) | 3,072 | (210) |
| Past due from 31-120 days | 6,084 | (875) | 6,224 | (965) |
| Past due from 121-210 days | 5,011 | (1,933) | 4,562 | (1,812) |
| Past due from 211-270 days | 2,870 | (2,372) | 3,010 | (2,485) |
| Past due from 271-360 days | 3,832 | (3,773) | 3,670 | (3,612) |
| Past due more than 1 year | 67,905 | (67,095) | 60,301 | (59,413) |
| | 108,296 | (76,324) | 100,683 | (68,577) |

Impairment of not past due receivables is related to the Group's assessment of the risk of uncollectibility for certain population groups based on historical information.

Group's receivables impairment at reporting date, including court receivables impairment is:

| *In thousands of BGN* | ***Note*** | **2016** | **2015** |
|---|---|---|---|
| Balance in the beginning of the period | | (68,577) | (61,577) |
| Accruals during the period | *24* | (8,208) | (8,136) |
| Reintegrated impairment | *10* | - | - |
| Written-off | | 461 | 1,136 |
| Balance in the end of the period | | (76,324) | (68,577) |

The quality of the trade and other receivables is assessed based on credit policy prepared by the Risk Management Committee and applied by the Group. The Group's management monitors the customers' credit risk by grouping trade and other receivables by characteristics as in 2016 it continues to carry out analysis of specific customers on the basis of precise proactive actions, working with them and the history of past communication. As of 2011 the Group has also introduced impairment of undue trade receivables for certain groups of customers, while as of 2016 the balances of customers with deferred payment agreements, which are not violated are excluded from the calculation of the impairment.

**Liquidity risk**

Liquidity risk is the risk that the Group will not be able to meet its obligations relating to financial liabilities, ment to be met by cash or other financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or damaging the Group's reputation.

The Group management's efforts are focused on upholding in accordance with the regulatory framework in Bulgaria the necessary revenue using the tariff, which will make it possible to reach the goals, levels of services and investments set in the current Business Plan, in the same time taking into account the cost of capital, the level of expenditure, the consumption, the annual inflation and the achieved efficiency of operating and capital costs and also meeting the requirements of the main creditor (EBRD) regarding the service coverage ratio of the loan. In relation to that, Sofiyska Voda AD submits and justifies annual tariff applications as per the terms and procedures in the regulatory legislation.

**24. Financial instruments (continued)**

**Liquidity risk (continued)**

As to the cash outflow and the payments to contractors, the Group is seeking the balance between the optimization of the working capital cycle and the provision of adequate working conditions for maintaining viable partnerships.

Usually the Group ensures that it has sufficient cash on demand to meet the expected operational expenses for a 60-day period, including the servicing of financial obligations except for the potential impact of extreme circumstances which cannot be envisaged, i.e. natural disasters. As at 2016 the Group does not maintain credit lines or overdrafts.

As disclosed in Note 2 (d), as at 31 December 2016, the Group's current liabilities exceed its current assets by BGN 65,986 thousand due to the fact the intercompany loan (subordinated loan) contract expires at the end of 28 April 2016 and is presented as short term.

The management of the Group is in process of negotiation of further extension of the subordinated loan with the related company from Veolia Group and expects a positive outcome. The Group has the support from the Group.

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements:

**31 December 2016**
*In thousands of BGN*

| | Carrying Amount | Contracted cash flows | Up to 1 year | Between 1 - 2 years | Between 2 – 5 years | More than 5 years |
|---|---|---|---|---|---|---|
| **Non-derivative financial liabilities** | | | | | | |
| Loan „A" | 35,747 | (37,293) | (9,478) | (9,373) | (18,442) | - |
| Loan „B" | 71,407 | (72,822) | (72,822) | - | - | - |
| Liabilities to related parties | 4,697 | (4,697) | (4,697) | - | - | - |
| Finance lease liabilities | 3,163 | (3,286) | (1,346) | (1,485) | (455) | - |
| Trade and other payables | 24,373 | (24,373) | (24,373) | - | - | - |
| | 139,387 | (142,471) | (112,716) | (10,858) | (18,897) | - |

The gross amounts in the preceding table are the contractual undiscounted cash flows on non-derivative financial liabilities.

As disclosed in Note 19, the Group has secured bank loan "A" with a requirement to comply with certain conditions, as upon breach of any obligation, e.g. failing to maintain debt service coverage ratio over 1.3:1 (see note 19) – the Group may fall into default and the outstanding amount of the loan may become due to the creditor. The interest payments on loans with floating interest rate in the preceding table reflect the market interest rates as at the end of the period based on EURIBOR and these amounts may vary upon change in the market rate.

Except for these financial liabilities, it is not expected that cash flows included in the table may occur much earlier or be significantly different amounts.

**24. Financial instruments (continued)**

**Liquidity risk (continued)**

**31 December 2015**

| *In thousands of BGN* | Carrying Amount | Contracted cash flows | Up to 1 year | Between 1 - 2 years | Between 2 – 5 years | More than 5 years |
|---|---|---|---|---|---|---|
| **Non-derivative financial liabilities** | | | | | | |
| Loan „A" | 44,557 | (47,169) | (9,686) | (9,557) | (27,926) | - |
| Loan „B" | 71,313 | (74,989) | (74,989) | - | - | - |
| Payables to related parties | 4,688 | (4,688) | (4,688) | - | - | - |
| Finance lease liabilities | 2,647 | (2,773) | (1,252) | (920) | (601) | - |
| Trade and other payables | 25,600 | (25,600) | (25,600) | - | - | - |
| | 148,805 | (155,219) | (116,215) | (10,477) | (28,527) | - |

**Market Risk**

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

***Currency risk***

The Group is exposed to currency risk on purchases and / or sales and / or being a party in loan contracts in currencies other than the functional currency - BGN. Such transactions are denominated primarily in (EUR), (USD), (GBP) and (CZK). Since 1999 the exchange rate of the Bulgarian lev (BGN) is fixed to the euro (EUR). The exchange rate is BGN 1.95583 / EUR 1.0. Significant part of the transactions made in currency other than the local are in EUR and therefore the Group's exposure to currency risk is minimal.

- ***Exposure to currency risk***

The Group's exposure to foreign currency risk was as follows based on notional amounts:

| | **31 December 2016** | | | | **31 December 2015** | | | |
|---|---|---|---|---|---|---|---|---|
| *In thousands of* | EUR | GBP | USD | CZK | EUR | GBP | USD | CZK |
| Trade payables | (2,103) | (1) | (326) | - | (2,087) | (1) | (326) | (87) |
| Interest-bearing loans and borrowings | (54,787) | - | - | - | (59,244) | - | - | - |
| Gross Balance Exposure | (56,890) | (1) | (326) | - | (61,331) | (1) | (326) | (87) |

The following significant exchange rates are applied during the period:

| | **Average period FX rate** | | **FX rate at reporting date** | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| USD 1 | 1.7683 | 1.6992 | 1.8555 | 1.7900 |
| GBP 1 | 2.3925 | 2.5751 | 2.2844 | 2.6502 |
| CZK 100 | 7.2346 | 7.1696 | 7.2382 | 7.2360 |

## 24. Financial instruments (continued)

**Market risk (continued)**

***Currency risk (continued)***

- ***Sensitivity Analysis***

A 10% increase of the exchange rate at 31 December in relation to the currencies shown below would increase (decrease) the capital and profit or losses with amounts written below. The analysis makes the assumptions that all other variables, especially the interest rates are fixed. The analysis for 2015 is done on the same basis.

| *In thousands of BGN* | **Statement of comprehensive income** | **Statement of comprehensive income** |
|---|---|---|
| | **31 December 2016** | **31 December 2015** |
| USD | (59) | (58) |
| CZK | (1) | (1) |

A 10 % decrease of BGN against the above stated currencies as at 31 December would have the same, as amounts, but opposite effect, making the same assumption that all other variables are fixed.

***Interest rate risk***

- ***Profile***

As at the date of reporting the interest rate profile of financial instruments is:

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| **Fixed rate instruments** | | |
| Financial assets | 17,444 | 16,906 |
| Financial liabilities | - | - |
| | 17,444 | 16,906 |
| **Variable rate instruments** | | |
| Financial assets | - | - |
| Financial liabilities | (110,318) | (118,517) |
| | (110,318) | (118,517) |

## 24. Financial instruments (continued)

### Market risk (continued)

***Interest rate risk (continued)***

- ***Sensitivity analysis against the fair value of instruments with fixed interest rate***

The Group has not accrued financial assets and liabilities with fixed interest rate at fair value, accounted through profits and loss in the Statement of comprehensive income.

A change of the interest rates by 25 basis points as at the date of financial statements would increase / (decrease) the equity and profit or loss with the amounts shown below. An assumption is made during the analysis that all other variables, especially the currency exchange rates are relatively constant. The analysis for 2015 is made on the same basis.

| *Effects in thousands of BGN* | **Profit or loss** | | **Equity** | |
|---|---|---|---|---|
| | **25 basis points increase** | **25 basis points decrease** | **25 basis points increase** | **25 basis points decrease** |
| **31 December 2016** | | | | |
| Financial assets with floating interest rate | - | - | - | - |
| Financial liabilities with floating interest rate | (276) | 276 | - | - |
| Cash flow sensitivity (net) | (276) | 276 | - | - |
| **31 December 2015** | | | | |
| Financial assets with floating interest rate | - | - | - | - |
| Financial liabilities with floating interest rate | (296) | 296 | - | - |
| Cash flow sensitivity (net) | (296) | 296 | - | - |

***Capital Management***

The Board of Directors' policy is to maintain a strong capital base so as to maintain customers', creditors' and market's confidence and to sustain future development of the business. The Board of Directors monitors the return on capital and the level of dividends to ordinary shareholders.

There were no changes in the Group's approach to capital management during the year. The Group was not in a breach of any of the equity requirements enforced by external authorities.

According to the second additional amendment to the Concession contract, signed on 19 March, 2008, the actual return on shareholders' capital must be at least 17%.

In accordance with the Bulgarian Commercial Act, the Group as a joint stock company should maintain net assets exceeding the registered capital. At the reporting date this capital adequacy rule is met.

## 24. Financial instruments (continued)

### *Accounting classifications and fair values*

The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair value hierarchy. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

| 31 December 2016 | | Carrying amount | | | | | | | | Fair value | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *In thousands of BGN* | *Note* | Held for sale | Defined at fair value | Fair value – hedging instruments | Held to maturity | Loans and receivables | Available for sale | Other financial liabilities | Total | Level 1 | Level 2 | Level 3 | Total |
| **Financial assets, not measured at fair value** | | | | | | | | | | | | | |
| Trade and other receivables | *16* | - | - | - | - | 31,972 | - | - | 31,9972 | | | | |
| Cash and cash equivalents | *17* | - | - | - | - | 17,444 | - | - | 17,444 | | | | |
| | | - | - | - | - | 49,416 | - | - | 49,416 | | | | |
| **Financial liabilities, not measured at fair value** | | | | | | | | | | | | | |
| Loans from related parties – Loan “B” | *19* | - | - | - | - | - | - | (71,407) | (71,407) | | | | |
| Loan „A” | *19* | - | - | - | - | - | - | (35,747) | (35,747) | | | (36,117) | (36,117) |
| Trade and other payables | *21* | - | - | - | - | - | - | (24,373) | (24, 373) | | | | |
| Payables to related parties | *30* | - | - | - | - | - | - | (4,697) | (4,697) | | | | |
| Payables on financial lease | *19* | - | - | - | - | - | - | (3,163) | (3,163) | | | | |
| | | - | - | - | - | - | - | (139,387) | (139,387) | | | | |

**24. Financial instruments (continued)**

***Accounting classifications and fair values (continued)***

| 31 December 2015 | | Carrying amount | | | | | | | | Fair value | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *In thousands of BGN* | *Note* | Held for sale | Defined at fair value | Fair value – hedging instruments | Held to maturity | Loans and receivables | Available for sale | Other financial liabilities | Total | Level 1 | Level 2 | Level 3 | Total |
| **Financial assets, not measured at fair value** | | | | | | | | | | | | | |
| Trade and other receivables | *16* | - | - | - | - | 32,106 | - | - | 32,106 | | | | |
| Cash and cash equivalents | *17* | - | - | - | - | 16,906 | - | - | 16,906 | | | | |
| | | - | - | - | - | 49,012 | - | - | 49,012 | | | | |
| **Financial liabilities, not measured at fair value** | | | | | | | | | | | | | |
| Loans from related parties – Loan "B" | *19* | - | - | - | - | - | - | (71,313) | (71,313) | | | | |
| Loan „A" | *19* | - | - | - | - | - | - | (44,557) | (44,557) | | | (45,187) | (45,187) |
| Trade and other payables | *21* | - | - | - | - | - | - | (25,600) | (25,600) | | | | |
| Payables to related parties | *30* | - | - | - | - | - | - | (4,688) | (4,688) | | | | |
| Payables on financial lease | *19* | - | - | - | - | - | - | (2,647) | (2,647) | | | | |
| | | - | - | - | - | - | - | (148,805) | (148,805) | | | | |

## 24. Financial instruments (continued)

### Measurement of fair value

*(i) Valuation technique and significant unobservable inputs*

Below are the valuation techniques used in the measuring the fair value of Level 2 and Level 3, as well as the significant unobservable inputs used.

**Financial instruments not measured at fair value**

Other financial liabilities*, are valued on basis of discounted cash flows. As significant unobservable inputs have been used the discount rate, adjusted by the Group, taking into account the specifics of the Group and the sector in which it operates. The amount of the reduction is 3% below the annual average rates for commercial loans of similar size and maturity granted in Bulgaria, according to interest rate statistics of the Central Bank for 2016.

*Other financial liabilities include secured and unsecured bank loans and finance lease liabilities.

## 25. Operating leases

***Leases as lessee***

Rental payments under operating leases are payable as follows:

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| Less than 1 year | 1,030 | 1,070 |
| Between 1 and 5 years | 2,172 | 2,969 |
| More than 5 years | - | - |
| | 3,202 | 4,039 |

## 26. Employee benefits

Postemployment liabilities represent the present value of defined benefits payable at retirement with respect to age and length of service.

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| Present value of the liability on 1 January | 1,375 | 1,361 |
| Interest expense | 18 | 31 |
| Current service cost | 263 | 238 |
| Past service cost | (79) | (122) |
| Actuarial loss | 91 | 62 |
| Paid compensations to retired employees | (157) | (195) |
| Present value of the liability on 31 December | 1,511 | 1,375 |

| | | |
|---|---|---|
| Liability recognized in the Statement of financial position as at 31 December, including: | 1,511 | 1,375 |
| *Short – term liabilities for retirement compensation* | 427 | 469 |
| *Long – term liabilities for retirement compensation* | 1,084 | 906 |

***Expenses recognized in Statement of comprehensive income***

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| Current service cost | 263 | 238 |
| Past service cost | (79) | (122) |
| Interest expense | 18 | 31 |

**Actuarial assumptions**

| | **2016** | **2015** |
|---|---|---|
| Discount rate at 31 December | 1.2% | 2.3% |
| Salary increase (annual for 10 years) | 2.50% | 1.75% |
| Employee turnover | 7% | 7.5% |

The actuarial assumptions for death rates are based on the National Statistics Institute's population mortality tables. For the purposes of the discounting effective annual interest rate i = 1.2% is used. This rate is based on analysis of the offered long-term investment instruments on the Bulgarian stock market (securities, municipality bonds, etc.).

## 26. Employee benefits (continued)

### Actuarial assumptions

| *In thousands of BGN* | **25 basis points increase of salaries growth** | **25 basis points decrease of salaries growth** |
|---|---|---|
| Effect on the liability for retirement compensation | 18 | (8) |

| *In thousands of BGN* | **25 basis points increase of interest growth** | **25 basis points decrease of interest growth** |
|---|---|---|
| Effect on the liability for retirement compensation | (18) | 18 |

| *In thousands of BGN* | **10 basis points increase of employee turnover** | **10 basis points decrease of employee turnover** |
|---|---|---|
| Effect on the liability for retirement compensation | (78) | 78 |

| *In thousands of BGN* | **25 basis points increase of mortality rate** | **25 basis points decrease of mortality rate** |
|---|---|---|
| Effect on the liability for retirement compensation | (12) | 12 |

## 27. Contingencies

*(a) Bank guarantees*

Currently, the Group has the following guarantees:

Bank guarantee for good performance under the concession agreement, number PEBPRT593268, issued by HSBC France, amounting to USD 750,000, with validity until 15 December 2017.

Bank guarantee GI11.231.0090 for good performance, amounting to BGN 400,000 issued by Citibank N.A. – Sofia Branch (currently Citibank Europe AD – Bulgaria Branch) - in relation to Contract No. РД-568-68/10.08.2011 with the Municipality of Sofia for repair of municipal property, where Sofiyska Voda AD performs construction, with validity until 31 December 2017.

Performance bank guarantee GI15.027.0019, issued by Citibank Europe AD – Bulgaria Branch for the obligations of Sofiyska Voda AD in relation to a Contract № DST-081/30.12.2011 for access to the electricity grid with Electricity System Operator EAD, amounting to BGN 6,880 and validity until 31 January 2018.

Performance bank guarantee GI15.027.0020, issued by Citibank Europe AD – Bulgaria Branch for the obligations of Sofiyska Voda AD in relation to a Contract for transmission through the electricity grid with Electricity System Operator EAD, amounting to BGN 859 thousand and validity until 31 January 2018.

*(b) Infrastructure*

In accordance with a contract dated 8 July 2005 between the Republic of Bulgaria, presented by the Minister of the Economy and Energy (the State) on the one side and Business Park Sofia EOOD and Lindner AG, Germany (the Investor) on the other side, the State has financed the construction and rehabilitation of elements of the technical infrastructure within the boundaries of "Sofia Park" project – buildings, roads and technical infrastructure. In compliance with a decision of the Supreme Administrative Court dated 07.06.2007 and the preceding decision of the Commission on Protection of Competition from October 2005, Sofiyska Voda AD and Sofia Municipality have signed an annex to Second Additional Agreement to the Concession Contract, stated in Annex 1 to Decision No.620 of Sofia Municipal Council under Protocol No.22/09.10.2008.

Article 2 of the Annex states a procedure and a formula for the calculation of the annual amount of the consideration that will provide equivalence and reimbursement of the value of the W&S facilities in such a pattern that the granted State capitals will not be considered State aid. As per Art.2.1. of the Annex "the amount of the consideration is different in the different years and depends on the annual expenditure of the Concessionaire, realized through or in relation to commissioning of the new assets." As per protocol by the Municipality of Sofia (MoS) and Sofiyska Voda AD dated 12 July 2016 the initial calculated amount in 2015 was increased from BGN 46,5 thousand to BGN 49,6 thousand. Consequently, the total accrued amount in 2016 is split as follows:

| *In thousands of BGN* | **Total in 2016** | **Accrual for 2016** | **Additional amount as per MoS protocol** | **2015** |
|---|---|---|---|---|
| Water Supply | 46,7 | 44,6 | 2,1 | 36,8 |
| Sewerage | 5,6 | 5,2 | 0,4 | 4,1 |
| Waste Water Treatment | 6,9 | 6,3 | 0,6 | 5,6 |
| Total: | 59,2 | 56,1 | 3,1 | 46,5 |

Based on those calculations, the revenue stated in Note 4 has been respectively decreased regarding the three types of services – water supply, sewerage and waste water treatment – by the total amounts stated above and a liability to Municipality of Sofia has been presented.

## 28. Commitments

*Concession agreement*

On 23 December 1999 Sofiyska Voda AD signed a Concession Contract with the Municipality of Sofia, which is effective as of 6 October 2000, after all the preliminary conditions have been satisfied.

As per the Concession Contract the Municipality of Sofia grants and Sofiyska Voda AD receives:

- a specific right to use public assets;
- an exclusive right to render water supply, sewerage and waste water treatment services within the concession area.

Sofiyska Voda AD has the right to invoice the customers and to collect the amounts for its benefit and at its expense. The risk of non-collected receivables is completely at its risk.

The term of the concession contract is 25 years. The contract does not define any concession fees to be paid.

As per Annex 5 to the Initial Concession Agreement during the first 15 years Sofiyska Voda AD is obliged to reach the amount of USD 153 million of investments. After that period no further investments are specified in the Agreement.

After the Law for Regulating the Water and Sewerage Services became effective in 2006, Sofiyska Voda's operations are directly regulated by the Energy and Water Regulatory Commission (EWRC, the Commission).

Key powers of the Commission in regulating the activities in the water supply and sewerage (W&S) services sector are as follows:

- Regulates the quality of W&S services;
- Carries out price regulation of the W&S services;
- Handles complaints of customers against W&S operators;
- Approves the common terms and conditions of contracts for the provision of W&S services to consumers;
- Exercises control and imposes sanctions;
- Keeps a register of W&S services assignment contracts;
- Approves proposed by the W&S operators business plans;
- Carries out preliminary control, delivers an opinion on the compliance of concession and other types of W&S system managing contracts in the process of their preparing and the regulations for its implementation.

More precisely, what is under regulation are the prices of the services and their quality, assessed by the so-called "key- performance indicators" (KPI). In order to reach the level of services, 5-year business plans are prepared (after the 3-year business plan for the period 2006-2008), and they bind the price of the services, the investment program and the KPIs as issued by EWRC Ordinances and Instructions.

In that relation, in January 2009 the renegotiations for amendments in the concession contract aiming to harmonize it with the requirements of the new regulations, have been finalized. According to the agreed, the levels of investments were to be set in the business plans, which had to be preliminarily coordinated with the Municipality of Sofia.

## 28. Commitments (continued)

*Concession agreement (continued)*

Business plan 2006-2008 was approved in 2007. In the end of October 2008 Business plan 2009-2013 was approved, which envisaged achieving of the compulsory levels of services and an investment program of BGN 240 million for the 5-year period. Failure to achieve at least 75% of the total of investments set in the Business plan for two consecutive years with approved prices of services or double failure to meet the levels of services, acknowledged by a penalty decree issued by EWRC and accompanied by a proposal to Municipality of Sofia (MoS) would be legal grounds for the initiation of a concession termination procedure by MoS.

Although the fact that the regulatory period 2009-2013 has been extended twice in the following years as per decision of the Commission, initially until 2015 and subsequently until 2016 (see note Commitments, below), for the original regulatory period 2009-2013, the Group has performed BGN 241.6 million of investments, which fulfills the Group's obligation to perform investments for BGN 240 million.

According to the concession agreement, a special Concession Monitoring Unit (the "CMU") was established by the Grantor (MoS) for the purposes of monitoring and ensuring compliance by the Concessionaire with the provisions of this Concession Agreement.

The Group has obligations to cooperate with the CMU to facilitate the monitoring of the performance and the delivery of services, prepare and submit to CMU various reports and accounts etc.

Between the 54$^{th}$ and 48$^{th}$ months before the expected expiration date of the Concession Sofiyska Voda AD and the Municipality of Sofia are due to commit to a mutual verification of the public assets. No later than 24 months before that date the parties agree on the way of handing in the assets and the operations.

As of the 15$^{th}$ Contractual year until the end of the period of the concession contract, Sofiyska Voda AD is due to transfer 1% of its annual distributable profit to a special "handback account". The financial result for the year ending on 31 December 2015 was the first annual profit from which was distributed 1% to the special account in 2016. The money from the Handback Account may be used before the Expiry Date during the last Regulatory Period to pay for construction works only. Such works shall be identified in the Handback Schedule established in accordance with the concession contract, but may not be part of the last Business plan. The Handback Account shall be transferred to "Vodosnabdiyavane I Kanalizaciq" EAD on the Expiry Date by the Concessionaire on receipt of a handback certificate issued by the Grantor to the Concessionaire. The accumulated in the special account amount covers completely Sofiyska Voda AD's liabilities with regards to Handback obligations.

Regarding the special right to use public assets and to render services of water supply, sewerage and waste water treatment to the consumers within the concession territory (service commitment), an intangible asset named "concession right" has been recognized. The carrying amount of the concession right as at 31 December 2016 is BGN 270,689 thousand (2015: BGN 261,476 thousand).

For 2016 the investments under the extended business plan amounted to BGN 42,539 thousand (2015: 34,399 thousand), of which BGN 37,907 thousand (2015: BGN 30,797 thousand) represented investments in improvements of old public assets or acquiring new ones, which led to recognizing revenue from construction (see Note 7).

For the period since the beginning of the Concession until the end of 2016 the amount of investments made is BGN 572,205 thousand.

## 28. Commitments (continued)

*Investment commitments*

Complying with Art. 14, para 3 and 4 of the transitional and final provisions of the Water Act, on 4 March 2014 Sofiyska Voda AD submitted an extension of the Business Plan 2009-2013 until 2015. Concurrently, an application for approval of prices for 2014 was submitted. Subsequently, following the written instructions of the Commission for amendments of the submitted business plan for the extended period, on 31 July 2014 the Group submitted a revised Business Plan 2009-2015. The investments planned for the period 2014-2015 for regulatory purposes exceed BGN 87.6 million. The 2009-2015 Business Plan was approved by the Regulator with a decision № БП – 57 dated 6 August 2015.

In compliance with the amendments of the Water Act, paragraph 60 published in the Stated Gazette issue 58/2015 on 2 November 2015 Sofiyska Voda AD submitted and extended the aforementioned Business Plan until 2016. After the revisions made in compliance with regulatory decision № БП-76/22.12.2015, the revised Business Plan 2014-2016 was submitted on 8 Jan 2016 which was consequently approved on 12 February 2016.

The approved investments for regulatory purposes for the 2014-2016 period are as follows: BGN 68,447 thousand for 2014-2015 and BGN 57,469 thousand for 2016. The prices for regulated services remain unchanged until Decision of Energy and Water Regulatory Commission № C-8 of 28.04.2016, which approved the first increase of the complex price of water and sewerage services (3.4% for household and equivalent users) from their latest update in effect from 1 July 2012.

## 29. Deferred income

On 16 January 2009, the Group signed a Settlement agreement with the Municipality of Sofia (MoS). With this agreement, both sides agreed fully and finally on all existing mutual claims against each other with relation to the Concession agreement. Both sides mutually relief each other from pretended payment of interest on amounts claimed, as Sofiyska voda accepted the obligation for investments in the period 2009-2023 in addition to already existing and approved the Regulator investment obligations in the Business plan as follows: BGN 2.5 million for the period 2009-2013, according to Art.5.1.(iii) from the Settlement agreement, BGN 5 million in the period 2014-2018 according to Art 6.1.(i) from the Settlement agreement and BGN 4.7 million in the period 2019-2023 according to Art. 6.1.(ii) from the Settlement agreement.

The first obligation for BGN 2.5 million in the period 2009-2013 was fulfilled in February 2014. The second and third obligations are to be fulfilled in the period 2016-2023. In 2016 were made investments in the amount of BGN 1,16 mil and for the following five-year period 2017-2021 amount to BGN 6.5 mil. The final BGN 2 mil will be fulfilled in the period 2022-2023.

As the above amounts from the Settlement Agreement are outside the investments set in the Business plan and are on the account of Sofiyska voda, they have been accounted initially as expense and liability. After which the liability is decreased with the amount invested for all assets constructed and put into use, which amount is presented as deferred income. Thereafter, deferred income is decreased proportionately to the depreciation expense of the constructed assets.

## 30. Related parties

The Group has a related party relationship with its parent company – "Veolia Voda (Sofia) B.V." (77.10% of the Group's shares), as well as with the companies within Veolia Group and with its minority shareholder-Vodosnabdyavane i kanalizatsiya EAD (ViK) (22.9%). The ultimate parent company is Veolia Environnement S.A., France.

The related parties of the Group are the ultimate parent company and all companies under common control and key management personnel. As the minority shareholder ViK is solely owned by Sofia Municipality (MoS), thus being government related entity, related parties are also companies which are under the control of the same Government.

The Group has performed analysis over the individually and collectively significant transactions with companies under the control of the Government, which are as follows:

- Construction revenue and expenses with MoS (disclosed in Note 6);
- Green energy income with National Electricity Company EAD-state owned (disclosed in Note 5);
- Under a contract signed with NEK EAD, the latter has invoiced to Sofiyska Voda BGN 1,215 thousand (without VAT) for water that Sofiyska Voda has purchased and has run through NEK's plants in order for the water to reach the suburban area of Sofia. The expense is recognized in Expenses for materials – Electricity, water, heating. On the other hand, Sofiyska Voda has invoiced to NEK BGN 1,215 thousand (without VAT) due to the fact that NEK has generated electricity from the water running through their plants. The revenue has been recognized in Revenue from water supply.

The subsidiary in the financial statements of Sofiyska Voda AD is Water Industry Support and Education EOOD, where Sofiyska Voda AD owns 100% of the capital (2015: 100%).

**30. Related parties (continued)**

The following transactions have taken place during 2016:

| **Related party** *In thousands of BGN* | **Relation** | **Transactions during the year** | **Balance as at 31 December 2016** Receivables | Payables |
|---|---|---|---|---|
| Veolia Voda (Sofia) BV | Controls 77.10% of the shares of Sofiyska Voda AD | Loan provided - | - | 71,407 Liability for loan received at amortized cost |
| | | Accrued interest 4,239 | - | 44 Other trade payables |
| | | Other - | - | |
| Veolia Voda CEE | Veolia Voda (Sofia) BV | Technical services provided 1,496 | - | 1,496 |
| Veolia Voda UK | | - | - | 3,146 |
| Veolia Campus | | Trainings 8 | - | 8 |
| Vodosnabdyavane i Kanalizatsia EAD | 22.90% of the shares of Sofiyska Voda AD | Revenue from rent 7 | - | - |
| | | Expenses for rent | | |
| Veolia Energy Solutions Bulgaria EAD | | Acquisition and maintenance of air-conditions 22 | - | - |
| | | Expert opinions 2 | - | - |
| | | Access control system maintenance 2 | - | - |
| | | Gas burner maintenance - | 13 | |
| Veolia Energy Varna EAD | | 3 | - | - |
| | | Technological upgrade of co-generator 1 | - | - |
| | | Gas installations maintenance 17 | - | - |
| | | Guarantees received 3 | - | 3 |
| | | Reinvoiced income 1 | 1 | - |
| Veolia Energy Bulgaria EAD | | Reinvoiced income 113 | - | - |
| | | Other income 2 | - | - |
| | | Total: | 14 | 76,104 |

**30. Related parties (continued)**

The following transactions have taken place during 2015:

| **Related party** *In thousands of BGN* | **Relation** | **Transactions during the year** | **Balance as at 31 December 2013** **Receivables** | **Payables** |
|---|---|---|---|---|
| Veolia Voda (Sofia) BV | Controls 77.10% of the shares of Sofiyska Voda AD | Loan provided | - | 71,313 Liability for loan received at amortized cost |
| | | Accrued interest 4,405 | - | |
| | | Other | - | 44 Other trade payables |
| Veolia Voda | Veolia Voda (Sofia) BV | Technical services provided 1,496 | - | 1,496 |
| Veolia Voda UK | | - | - | 3,124 |
| Vodosnabdyavane i Kanalizatsia EAD | 22.90% of the shares of Sofiyska Voda AD | Rent 10 | - | 1 |
| Veolia Energy Solutions Bulgaria EAD | | Water treatment services 1 | - | - |
| | | Reinvoiced expenses 3 | 2 | - |
| | | Chemical analysis income 2 | - | - |
| | | Acquisition of assets 15 | - | 20 |
| | | Air-condition maintenance 2 | - | - |
| Veolia Energy Varna EAD | | Guarantees received 3 | - | 3 |
| | | Reinvoiced income 2 | - | - |
| | | Water treatment services 2 | - | - |
| | | Total: | 2 | 76,001 |

## 30. Related parties (continued)

*Transactions with directors and officers on key positions*

The Group has relationship of a related party with directors and officers on key positions. The total amount of the accounted remunerations included in personnel expenses and in hired services are as follows:

| *In thousands of BGN* | **2016** | **2015** |
|---|---|---|
| Remuneration of the Executive Director and Board of Directors | 212 | 329 |
| As at 31 December | 8 | 8 |

## 31. Subsequent events

On 10 January 2017 was signed an Annex to the Subordinated loan agreement between Sofiyska Voda AD and the shareholder and creditor of the Group Veolia Water Sofia BV. The purpose of the Annex is a reduction the size of the allowance from 5.95% to 5.20%, retrospectively with effect from 5 October 2016.

KPMG Bulgaria OOD
45/A Bulgaria Boulevard
Sofia 1404, Bulgaria
+359 (2) 9697 300
bg-office@kpmg.com
kpmg.com/bg

# INDEPENDENT AUDITORS' REPORT

To the shareholders of
Sofiyska voda AD

## Opinion

We have audited the consolidated financial statements of Sofiyska voda AD ('the Company") and its subsidiary (together "the Group") as set out on pages 3 to 59, which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the financial statements, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

## Basis for Opinion

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

## Information Other than the Consolidated Financial Statements and Auditors' Report Thereon

Management is responsible for the other information. The other information comprises the management report, including the corporate governance statement prepared by management in accordance with Chapter Seven of the Accountancy Act, but does not include the consolidated financial statements and our auditors' report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, unless and to the extent explicitly specified in our report.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

## *Additional Matters to be Reported under the Accountancy Act and the Public Offering of Securities Act*

In addition to our responsibilities and reporting in accordance with ISAs, in relation to the management report and the corporate governance statement, we have also performed the procedures added to those required under ISAs in accordance with the Guidelines of the professional organisation of certified public accountants and registered auditors in Bulgaria, i.e. the Institute of Certified Public Accountants (ICPA), approved by its Management Board on 29 November 2016. These procedures refer to testing the existence, form and content of this other information to assist us in forming opinions about whether the other information includes the disclosures and reporting provided for in Chapter Seven of the Accountancy Act and in the Public Offering of Securities Act (Art. 100m, paragraph 10 of the POSA in conjunction with Art. 100m, paragraph 8 (3) and (4) of the POSA) applicable in Bulgaria.

*Opinion in connection with Art. 37, paragraph 6 of the Accountancy Act*

Based on the procedures performed, our opinion is that:

a) The information included in the management report for the financial year for which the consolidated financial statements have been prepared is consistent with those consolidated financial statements.

b) The management report has been prepared in accordance with the requirements of Chapter Seven of the Accountancy Act and of Art. 100(m), paragraph 7 of the Public Offering of Securities Act.

c) The corporate governance statement for the financial year for which the consolidated financial statements have been prepared presents the information required under Chapter Seven of the Accountancy Act and Art. 100 (m), paragraph 8 of the Public Offering of Securities Act.

*Opinion in connection with Art. 100(m), paragraph 10 in conjunction with Art. 100 m, paragraph 8(3) and (4) of the Public Offering of Securities Act*

Based on the procedures performed and the knowledge and understanding obtained about Group's activities and the environment in which it operates, in our opinion, the description of the main characteristics of entity's internal control and risk management systems relevant to the financial reporting process, which is part of the management report (as a component of the content of the corporate governance statement) and the information under Art. 10 paragraph 1(c), (d), (f), (h) and (i) of Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, do not contain any material misrepresentations.

## 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 as adopted by the EU and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

## Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

— Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

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

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

KPMG Bulgaria OOD

Ivan Andonov
*Authorised representative*

Tzvetelinka Koleva
*Registered auditor*

45/A Bulgaria Boulevard
Sofia 1404, Bulgaria

30 March 2017

ОДИТОРСКО ДРУЖЕСТВО
София
Рег. № 045
КПМГ БЪЛГАРИЯ ООД