NET4GAS Group Consolidated Annual Report 2016

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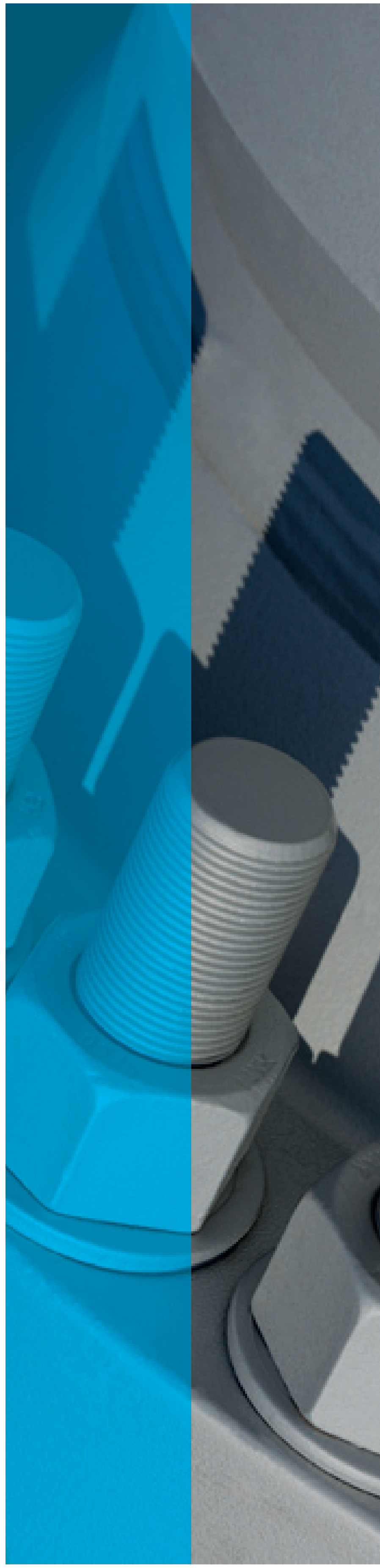


Foreword by the CEO of NET4GAS

Ladies and Gentlemen,

The results achieved in 2016, which we present to you in this annual report, allow me to state that NET4GAS and the whole consolidated group have logged another solid year's performance. The entire team of our employees, our long-term investors, customers, suppliers and other partners contributed their share to these results, for which I would like to express my thanks to them.

The safety of operations has been one of our highest priorities for more than 45 years. And so has been the safety of our employees. I am glad to report that in 2016 there were no workplace accidents resulting in any incapacity, including the staff of our contractors. At the same time, we went on providing our customers with uninterrupted gas transmission services throughout the whole year.

In 2016, total annual gas volumes transported by NET4GAS amounted to 43.9 bcm. Of this, roughly 8.3 bcm went to the Czech Republic, increasing by 0.7 bcm year-on-year, in particular as a result of rising consumption in combined cycle power generation and overall higher consumption in the Czech Republic. International transit accounted for the remaining volume.

The number of gas transmission contracts operated by NET4GAS in 2016 rose to more than 4,300. The trend of a continuous high demand for reverse flow through the Czech Republic in a west-east direction, as well as the trend of short-term gas trading activities, were again confirmed.

All the above translated into a consolidated operating profit for the 2016 fiscal year of CZK 5.8 billion, representing a positive year-on-year trend. Our BBB investment grade rating with a stable outlook was again re-affirmed by both Standard & Poor's Global Ratings and Fitch Ratings. This reflects the continuing strong financial position of NET4GAS for meeting its future operational and investment needs.

In 2016, we also continued development activities related to market integration in close cooperation with adjacent network operators and regulatory authorities, which included the Czech-Polish Gas Interconnector project and the Trading Region Upgrade Option that aims to provide transmission system users with simplified access to the Austrian and Czech markets.

NET4GAS carried out an open market survey called "Capacity4Gas" with the aim to assess market demand beyond the horizon of the Czech Ten-Year Network Development Plan. The survey showed significant long-term demand for a transit capacity of ca 40 bcm per year as of 2019/2020 from Germany through the Czech Republic to Slovakia. The new cross-border capacity between the German Gaspool market area and the Czech Republic and between the Czech and Slovak market areas was offered and successfully marketed at the annual PRISMA capacity auction on 6 March 2017.

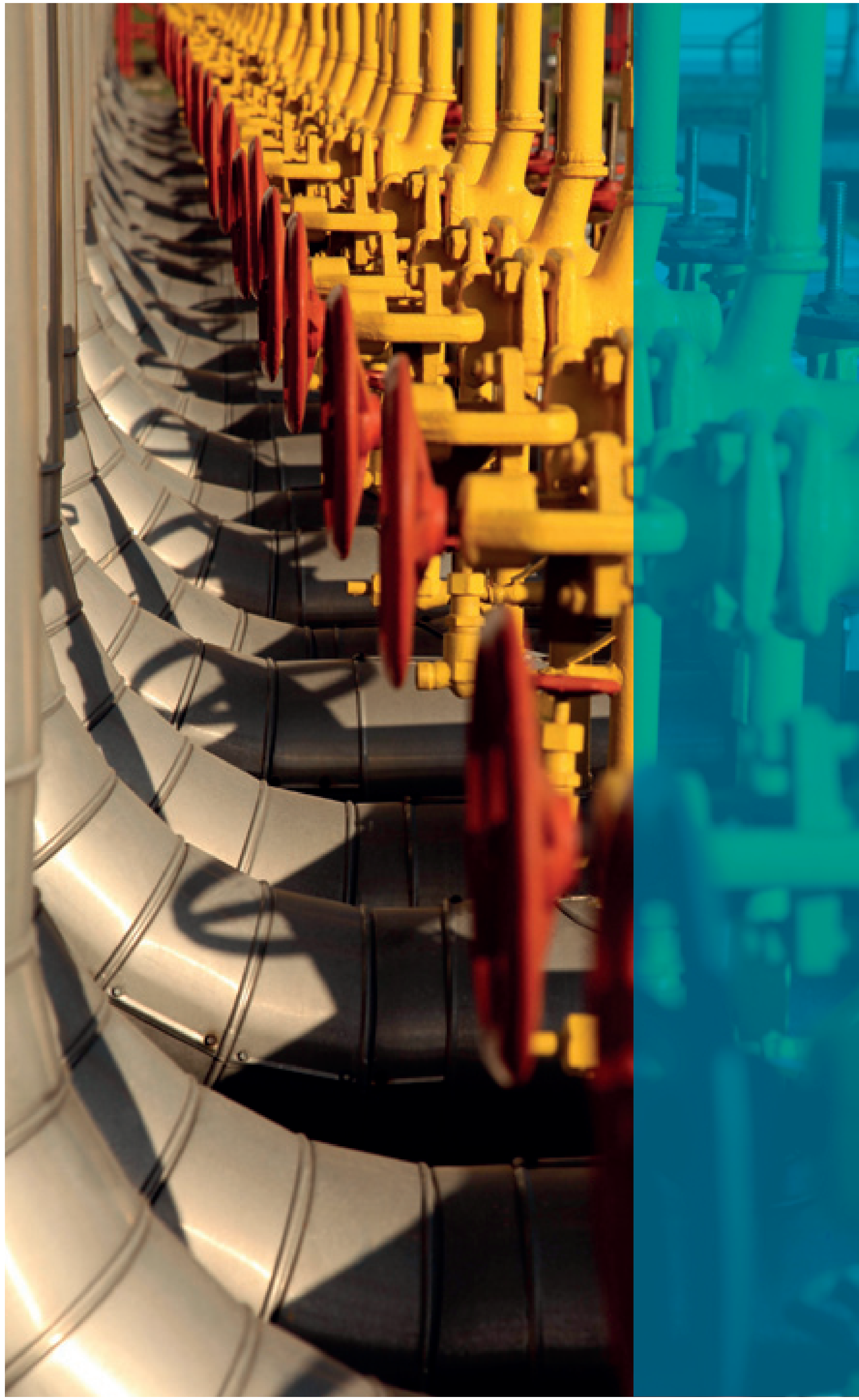
Based on the positive results of the auction, NET4GAS is ready to invest into the relevant new gas infrastructure in the Czech Republic in the upcoming years. The extension of the transmission system represents an opportunity for the Czech Republic to maintain its strong position as a European gas transit country, and thus also to enhance the security of supply in the region.

In 2017 and in the years to come, the NET4GAS Group will continue to proactively participate in shaping the future gas market design in Europe and to promote the use of natural gas as the most environmentally-friendly fossil fuel.

Andreas Rau
Chief Executive Officer,
NET4GAS, s.r.o.

Consolidated Group Data

We secure operation
of a flexible, demand-oriented
transmission system
and associated commercial
and technical services.



Consolidated Group Data

The consolidated group (hereinafter referred to as "Group" or "NET4GAS Group"), for which this Consolidated Annual Report is elaborated, consists of the consolidating company NET4GAS, s.r.o. (hereinafter referred to as "NET4GAS" or "the consolidating company") and consolidated company BRAWA, a.s. (hereinafter referred to as "BRAWA" or "consolidated company").

Consolidating company

Company name:	NET4GAS, s.r.o.
Identification number:	272 60 364
Date of registration in the Commercial Register:	29 June 2005
Address:	Na Hřebenech II 1718/8, 140 21 Prague 4 – Nusle, Czech Republic
Stake in BRAWA, a.s.:	100 %

Consolidated company

Company name:	BRAWA, a.s.
Identification number:	247 57 926
Date of registration in the Commercial Register:	10 November 2010
Address:	Na Hřebenech II 1718/8, 140 21 Prague 4 – Nusle, Czech Republic

NET4GAS Company Profile

NET4GAS holds an exclusive gas Transmission System Operator (TSO) licence in the Czech Republic. The company secures the international transit of natural gas across the Czech Republic, domestic transmission of natural gas to partners in the Czech Republic and associated commercial and technical services.

NET4GAS at a glance

- Has sufficient transmission capacities to satisfy both domestic and foreign demand
- Transmits about 45 billion m^3 of natural gas each year (of which around 15 % is for domestic consumption)
- Operates more than 3,800 km of pipelines
- Operates three border transfer stations, four compressor stations, and nearly a hundred transfer stations at the interface with domestic gas distribution
- Is a member of the Czech Gas Association, the international organisations ENTSOG, GIE, EASEE-gas, and the IGU and Marcogaz working groups
- Has more than 500 employees
- Is one of the largest private corporate donors to nature conservation in the Czech Republic
- Is committed to its corporate social responsibility

Transmission system

3 border transfer stations

4 compressor stations

3,800 km of pipelines

Annual transported volume of about 45 billion m^3

- Border transfer station
- Compressor station
- Border transfer station abroad
- Compressor station abroad
- Transit pipeline
- Intrastate pipeline

NET4GAS strategy

NET4GAS mission

Our mission is to secure economically efficient, safe and reliable gas transmission services for our customers 24 hours a day, 7 days a week and to provide sufficient capacities in all relevant supply situations based on a non-discriminatory and transparent approach.

NET4GAS vision

As a major Central European gas Transmission System Operator, NET4GAS will play an active role in connecting and integrating European gas markets to the benefit of Czech and other European gas customers.

Highly qualified employees are our company's foundation stone and most valued resource. Their team-oriented work and target-driven approach are major factors in the company's continuous development, which is clearly focused on the three strategic pillars of asset flexibility, operational excellence and new market design.

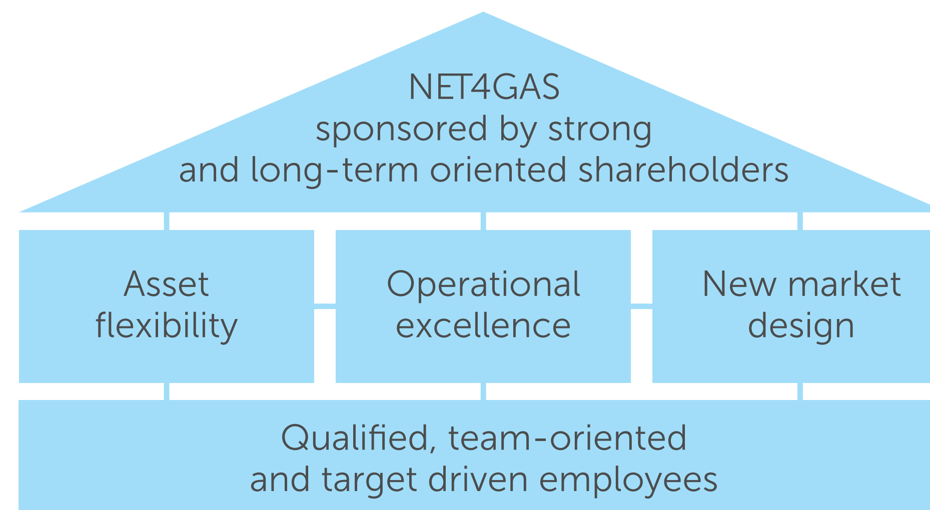
Along with the range of attractive capacity products we offer our customers, increasing our asset flexibility by building and optimising new and existing cross-border interconnectors allows us to swiftly respond to changing gas flow patterns in Europe, while strongly supporting further market integration.

We strive for operational excellence to meet our customers' expectations and to manage the financial and operational demands of increasing regulation and growing competition on energy markets.

We will continue to take a proactive role in the development of the new EU gas market structure guided by the principles of the European Gas Target Model, and by doing so will contribute to the creation of functioning gas markets, especially in Central and Eastern Europe where we operate.

In achieving our vision and attaining our strategic goals, we receive major sponsorship from our strong and long-term oriented shareholders, who thus safeguard the fulfilment of our company strategy.

We are also fully aware of our corporate social responsibility, and we strictly follow an environmental policy committed to both present and future generations.



Ownership of NET4GAS

as of 31 December 2016

For the entire year 2016, NET4GAS was wholly owned by NET4GAS Holdings, s.r.o., which in turn is owned by a consortium formed by Allianz Infrastructure Czech HoldCo II S.à r.l. (50 %) and Borealis Novus Parent B.V. (50 %).

NET4GAS Supervisory Board

as of 31 December 2016

Kenton Edward Bradbury
Chairman of the Supervisory Board
Position held since: 24 June 2016
Member since: 1 July 2015

Jaroslava Korpancová
Member of the Supervisory Board
Member since: 2 August 2013

Lenka Kovačovská
Member of the Supervisory Board
Member since: 26 March 2015

Mikhail Nahorny
Member of the Supervisory Board
Member since: 1 July 2016

Melchior Stahl
Member of the Supervisory Board
Member since: 2 August 2013

Changes in NET4GAS Supervisory Board

In the course of 2016, several changes took place in the composition of the NET4GAS Supervisory Board. Under a letter dated 16 May 2016, Ralph Adrian Berg resigned as Member of the Supervisory Board. His term of office expired on 30 June 2016. Under a decision of the sole shareholder of NET4GAS exercising the powers of the General Meeting, Mikhail Nahorny was appointed as a new Member of the Supervisory Board effective as of 1 July 2016. On 24 June 2016, Kenton Edward Bradbury was appointed as Chairman of the Supervisory Board. Furthermore, membership of Radek Hromek in the Supervisory Board expired on 23 December 2016. As of the date of the publication of the Consolidated Annual Report, the sixth member of the NET4GAS Supervisory Board has not been elected. No other changes occurred in the composition of the NET4GAS Supervisory Board in 2016.

NET4GAS Statutory Directors

as of 31 December 2016

Andreas Rau
Statutory Director and CEO
Position held since: 1 December 2013

Radek Benčík
Statutory Director and COO
Position held since: 1 October 2011

Václav Hrach
Statutory Director and CFO
Position held since: 1 March 2014

Changes in the NET4GAS Statutory Directors

On 16 September 2016, the NET4GAS Supervisory Board re-elected Radek Benčík as COO of the company for a further term. No changes occurred in the composition of the NET4GAS Statutory Directors in 2016.

NET4GAS Audit Committee

as of 31 December 2016

Following the issue of investment securities accepted for trading on the regulated European market or on a foreign market similar to the regulated market in a country that is a contracting party to the Agreement on the European Economic Area, NET4GAS has become a public interest entity within the meaning of Act No. 563/1991 Coll. on Accounting, as in effect, and is subject to the duty to establish an Audit Committee. The main responsibilities of the Audit Committee include monitoring the internal control system and the risk management system, overseeing the effectiveness of internal audit and securing its functional independence, monitoring the compilation of financial statements and consolidated financial statements, recommending the statutory auditor, assessing the independence of the statutory auditor and the audit company, evaluating the provision of supplementary services, and overseeing the conduct of mandatory audit.

The NET4GAS Audit Committee was established under a decision of the NET4GAS Statutory Directors on 31 May 2016. At the same time, the Statute of the Audit Committee was approved. On 1 June 2016, the sole shareholder exercising the powers of the General Meeting appointed five members of the Audit Committee.

Michal Petrman
Chairman of the Audit Committee
Position held since: 15 September 2016
Member since: 1 June 2016

Igor Lukin
Member of the Audit Committee
Member since: 1 June 2016

Mikhail Nahorny
Member of the Audit Committee
Member since: 1 June 2016

Stanislav Staněk
Member of the Audit Committee
Member since: 1 June 2016

Pavel Závitkovský
Member of the Audit Committee
Member since: 1 June 2016

BRAWA Company Profile

BRAWA is the sole owner of the line sections of the GAZELLE gas pipeline. This 166-kilometre pipeline, with a pipe diameter of DN 1400 and a design pressure of 84 bar, connects the transmission systems of the Czech Republic and the Federal Republic of Germany at the border points Brandov and Rozvadov. NET4GAS is the operator of the GAZELLE pipeline.

Shareholder of BRAWA

as of 31 December 2016

In 2016, BRAWA's sole shareholder was NET4GAS.

BRAWA Supervisory Board

as of 31 December 2016

Martin Kolář
Chairman of the Supervisory Board
Position held since: 20 September 2016
Member since: 1 July 2016
(in the Supervisory Board continuously since 20 March 2012)

Radek Benčík
Vice-Chairman of the Supervisory Board
Position held since: 20 September 2016
Member since: 1 July 2016
(in the Supervisory Board continuously since 20 March 2012)

Andreas Rau
Member of the Supervisory Board
Member since: 19 February 2016
(in the Supervisory Board continuously since 19 February 2014)

Changes in the Supervisory Board

No changes occurred in the composition of the Supervisory Board of BRAWA in 2016.

BRAWA Board of Directors

as of 31 December 2016

Jan Martinec
Chairman of the Board of Directors
Position held since: 11 November 2015
Member since: 7 July 2014

Miroslav Holý
Vice-Chairman of the Board of Directors
Position held since: 11 November 2015
Member since: 1 November 2015

Changes in the Board of Directors

No changes occurred in the composition of the Board of Directors of BRAWA in 2016.

Consolidated Report on Operations

For more than 40 years, our net for gas has been connecting energy markets, guaranteeing the security and reliability of natural gas transmission.

Consolidated Report on Operations

Key Economic Events & Indicators

Economic indicators of the Group 2016

Selected indicators*	2016
Revenue (CZK million)	9,280
Operating profit (CZK million)	5,756
Profit before taxation (CZK million)	4,425
Profit after taxation (CZK million)	1,417
Investments (CZK million) – capital expenditure to tangible and intangible assets	680

* according to IFRS as adopted by the European Union

Revenues, costs, profit
The Group's main business activity is natural gas transmission in accordance with the Act No. 458/2000 Coll., on conditions for undertaking the business and for the execution of state administration in the energy sector and on changes to certain decrees (the "Energy Act").

In 2016, the Group achieved a profit before taxation of CZK 4,425 million. Profit after taxation was CZK 1,417 million. Net profit was affected by the one-off effect of increase in deferred tax payable of CZK 2,125 million in connection with a change in the estimate of the tax position.

The operating profit of the Group amounted to CZK 5,756 million in 2016.

The Group generated a profit from its core business operations – transit of natural gas and domestic transmission. Its total operating income amounted to CZK 9,308 million and total operating costs were CZK 3,552 million.

Asset structure
The total assets of the Group in 2016 amounted to CZK 45,952 million, of which non-current assets accounted for CZK 44,481 million, representing 97 %. The main components of these assets were tangible fixed assets valued at CZK 44,383 million, intangible fixed assets valued at CZK 89 million and prepayments for acquisition of fixed assets.

As of 31 December 2016, current assets amounted to CZK 1,471 million, representing 3 % of total assets. Roughly 28 % of cash and roughly 44 % of borrowings to related parties consisted of current assets.

Investments
The Group invested a total of CZK 680 million in 2016. Of this, CZK 33 million was in intangible assets and CZK 647 million in tangible assets.

The most important investment that the NET4GAS Group made into tangible assets in 2016 consisted of an upgrade of the measuring technology at the four largest domestic transfer stations (Velké Němčice, Bylany, Sviňomazy, and Měcholupy), where a total of CZK 146 million was invested.

Structure of liabilities and credit rating confirmation
The Group's equity in the year ended on 31 December 2016 amounted to CZK 7,606 million and accounted for approximately 17 % of the Group's total liabilities. Current and non-current liabilities amounted to CZK 38,346 million.

Non-current borrowings and other non-current liabilities (particularly bonds and bank borrowings issued by a bank consortium, deferred taxes liabilities, and derivatives liabilities) accounted for approximately 96 % of total liabilities; current liabilities accounted for approximately 4 % of total liabilities.

In 2016, the NET4GAS Group settled its non-current liability of CZK 11,000 million, which was provided by Allianz Infrastructure Luxembourg I S.à r.l. and Borealis Novus Holdings B.V. in the form of loans in 2014. Part of the liability in the amount of CZK 2,500 million was repaid. The remaining part in the amount of CZK 8,500 million was ceased to NET4GAS Holdings, s.r.o. Subsequently, part in the amount of CZK 6,602 million was set off against a receivable relating to an increase in the capital contribution outside the registered capital and part in the amount of CZK 1,898 million was set off against the loan provided to NET4GAS Holdings, s.r.o.

The settlement of loans was consulted with the rating agencies Standard & Poor's Global Ratings and Fitch Ratings, both of which confirmed BBB investment grade credit rating of NET4GAS with a stable outlook. The transaction was therefore rating neutral, and the confirmation of the credit rating reflects the strong financial position of NET4GAS.

Investment instruments
To secure a return on its available cash during 2016, the Group made use of term deposits and bills of note offered by leading banking institutions. No significant price, credit, liquidity or cash flow risks were identified in connection with the instruments concluded, other than described in the consolidated financial statements, which are an integral part of this Consolidated Annual Report.

Research and development activities

The Group did not make any major expenditure into research and development in 2016.

Branches

Neither of the companies of the Group has branches in the Czech Republic or abroad.

BRAWA Operations

The core activity of BRAWA in 2016 was managing its property, the GAZELLE pipeline, and its lease to the transmission system operator NET4GAS.

NET4GAS Commercial Operations

We secure efficient, safe and reliable gas transmission services for our customers 24 hours a day, 7 days a week and provide sufficient capacities in all supply situations based on a non--discriminatory and transparent approach

In 2016, NET4GAS fulfilled its contractual commitments under 4,342 gas transmission contracts.

Total gas transmission in 2016 amounted to 43.9 billion m^3, of which 8.3 billion m^3 was for the Czech Republic. Compared to 2015, national transmission increased by 0.7 billion m^3, in particular as a result of rising consumption in combined cycle power generation and the overall higher consumption in the Czech Republic.

As part of the implementation of the Network Code for Gas Balancing in Transmission Systems (BAL NC), in compliance with Commission Regulation (EU) No. 312/2014 and the related provisions of Regulation No. 349/2015 Coll., the Gas Market Rules, which entered into force on July 1, 2016, a fundamental change was made in the system for balancing network users' imbalances in the transmission system. The foregoing regulations stipulate that, starting on 1 July 2016, network users may no longer balance imbalances by means of in-kind settlement, i.e. using natural gas, but only by financial payment. NET4GAS responded to the above changes by implementing a Control and Prediction System and by securing the required tasks through the dispatching centre.

Furthermore, the procedure for booking interruptible transmission capacity has been fine-tuned through over-nomination in accordance with Commission Regulation (EU) No. 984/2013, which introduced the Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems (CAM NC). At the same time, competing capacities began to be allocated at the border entry points Hora Sv. Kateřiny and Hora Sv. Kateřiny-Olbernhau in accordance with the Energy Regulatory Office's decision dated 31 March 2016. NET4GAS launched the pilot operation of the coordinated capacity conversion service, which was successfully used by a customer in December 2016.

NET4GAS Asset Operation and Maintenance Projects

In order to fulfil our role on the market and guarantee safe and reliable gas transmission, we properly maintain and modernize our transmission system using state-of-the-art technologies.

Within the framework of upgrading the transmission system in 2016, NET4GAS overhauled the commercial metering system at the four largest domestic transfer stations (Velké Němčice, Bylany, Sviňomazy, and Měcholupy), which are of key importance for the delivery of natural gas to distribution systems from which supplies are provided throughout the Czech territory. State-of-the-art gas flow measuring technology was installed at the above transfer stations. During the reported year, work was also completed on a project involving an upgrade to the measuring technology at the Lanžhot Border Transfer Station.

Aiming to further reinforce reverse flow of gas in the west-east direction, NET4GAS carried out modifications at the Břeclav and Veselí nad Lužnicí compressor stations in 2016.

In 2016, the preparation and execution of the OPTIMUS programme continued, which consists of upgrading the Kouřim and Břeclav compressor stations. The first stage of the project began at the Kouřim Compressor Station. It consisted of upgrading the facility's control system, renewing electrical installations, and implementing measures to improve the operating safety of the piping and ventilation systems in the compressor room based on a HAZOP study carried out to identify hazards and assess risks related to the operation of the facility. The preparatory stage was completed, the contractor was selected, and the supply of materials was secured. The first stage is planned to be completed in 2017. An upgrade project for the Břeclav Compressor Station was prepared for execution to an extent similar to the Kouřim Compressor Station. Subsequent steps will be coordinated with the Capacity4Gas project and the Czech-Polish Gas Interconnector project, which are to follow the first stage of the upgrade.

As part of transmission system maintenance in 2016, NET4GAS completed the last stage of the replacement of the Hrušky-Kyselovice-Libhošť-Děhylov DN 700 pipeline, which is of key importance for the supply of natural gas to Northern Moravia. In total, 8,460 meters of pipelines were replaced during 2010–2016. Throughout the duration of necessary shutdowns, the full range of natural gas supplies was provided to customers in cooperation with operators of distribution systems and gas storage systems. Other projects completed in the year under review included an upgrade of 75.4 kilometres of a DN 500 pipeline in the Šlapanov-Křečhoř section, including the modernization of line valve stations.

NET4GAS Asset Development Projects

We carefully plan our investment projects aimed at preserving high security of supply in the context of changing gas supply patterns in Europe and strengthening market integration.

Projects of Common Interest (PCI)

A list of Projects of Common Interest is included in Regulation (EU) No. 347/2013. The regulation should, in particular, facilitate and accelerate the implementation of strategically important energy-sector projects and introduces, inter alia, the status as a Project of Common Interest (PCI). PCI status can be awarded to ventures that contribute significantly to the formation of the internal energy market, guarantee the security of supply, and build strategic priority corridors with a cross-border impact. The list of PCI projects is updated on a biannual basis. The first list was approved in 2013 and updated in 2015. The next version of the PCI list is planned to be approved in 2017. The list includes two NET4GAS cross-border cooperation projects, namely the Czech-Polish Gas Interconnector and the Bidirectional Austrian-Czech Interconnection (BACI). Both projects are an important part of the effort to build the North-South Gas Corridor in Central Europe.

Czech-Polish Gas Interconnector project

Co-financed by the European Union
Connecting Europe Facility

Co-financed by the European Union
Trans-European Energy Networks Program (TEN-E)

The objective of building a new bidirectional Czech-Polish pipeline is to enable the safe and reliable transmission of gas and to increase the transmission capacity between the Czech Republic and Poland. The construction of this transmission corridor is intended not only to strengthen the flexibility of natural gas transmission in Central and Eastern Europe, but also to integrate gas markets in the region. Another important purpose of building the Czech-Polish Gas Interconnector is to reinforce the security of natural gas supply to Moravian regions by boosting the entry capacity of the domestic zone and by increasing the injectability and deliverability at underground gas storage facilities located in Central and Northern Moravia. In addition, the project will be a major contribution as regards the securing of an environmentally sound source of energy for industrial production in the South Moravian, Moravian-Silesian, Olomouc and Zlín Regions.

The project was awarded PCI status for the Libhošť-Hať section under Regulation (EU) No. 347/2013, and the European Commission placed it in its entirety on the second PCI list in 2015.

In the past, NET4GAS obtained a grant under the Trans-European Networks (TEN-E) programme in the amount of 46 % of the eligible cost of preparing part of the design documents for the Tvrdonice-Libhošť section. Furthermore, a grant in the amount of 50 % of the eligible cost of preparatory work was received for the Libhošť-Hať section of the project under the Connecting Europe Facility (CEF) programme in 2014.

The project consists of the construction of a high-pressure pipeline (DN 1000, PN 73.5) that is to interconnect the existing transmission systems of the Czech Republic and Poland. The projected length of the pipeline in the territory of the Czech Republic is approximately 207 km. The partner to the project is the Polish transmission system operator GAZ-SYSTEM, S.A.

In 2016, work continued on the preparation of design documents, and steps were taken to secure easements. A provider was selected who began preparing documents for the contractor selection process. At the end of 2016, a zoning permit application was filed with the Czech Ministry for Regional Development. In accordance with Regulation (EU) No. 347/2013, the pre-application stage of the project was completed at the end of 2016 by the approval of the draft documentation by the Czech Ministry of Industry and Trade, which acts as the process coordinator.

In 2016, the Polish government reviewed the overall energy policy of the country, partially affecting the further progress of the Czech-Polish Gas Interconnector project in terms of its timing.

Bidirectional Austrian-Czech Interconnection project (BACI)

Co-financed by the European Union
Connecting Europe Facility

Co-financed by the European Union
Trans-European Energy Networks Program (TEN-E)

In 2016, preparatory work continued on the first Czech-Austrian pipeline, the BACI project (Bidirectional Austrian-Czech Interconnection). NET4GAS updated documents for the zoning permit process and sent a Final Report on Activities Co-Financed by the EU to the European Commission for approval. The European Commission approved the report and made the final payment in December 2016.

In 2015, the project was re-awarded PCI status under Regulation (EU) No. 347/2013, and the European Commission placed it on the second PCI list. As to European Union initiatives intended to promote the development of energy networks, NET4GAS received grants in 2012 and 2014 for the preparation of the project within the framework of the TEN-E and CEF programmes.

The projected length of the new high-pressure pipeline (DN 800, PN 85) in the territory of the Czech Republic is 12 km. The partner to the project is the Austrian transmission system operator Gas Connect Austria GmbH.

Other development projects

Capacity4Gas project

In its position of transmission system operator, NET4GAS is obliged to analyse market demand for the development of the transmission system in the Czech Republic and for this purpose communicates with neighbouring transmission system operators and network users. In response to the "more capacity" market survey conducted in Germany, which indicated demand for additional capacity in the direction Germany-Czech Republic, NET4GAS launched a market survey entitled "Capacity4Gas" in the first quarter of 2016.

The survey provided valuable information on indicative demand for additional, i.e. higher than originally planned, entry capacity on the Czech-German border, additional exit capacity on the Czech-Slovak border, and additional exit capacity on the Czech-Austrian border. The last demand was retracted later in the course of the year.

Based on data obtained in the survey, NET4GAS launched technical studies and began the preparation of specific projects aimed at increasing capacity at the applicable border points in an effective and efficient manner.

Dolní Dunajovice underground gas storage connection project

The objective of the project is to connect the Dolní Dunajovice underground gas storage to the NET4GAS transmission system via a new measuring point in Horní Věstonice to enable the facility to supply gas to the network at two independent locations. The project consists of building a new interconnection pipeline and a new measuring station. In 2016, construction and assembly work was carried out. The project is planned to be completed and the assets put into service in 2017.

NET4GAS New Market Design Projects

We are taking a proactive role in the development of the new EU gas market structure guided by the principles of the European Gas Target Model, and by doing so will contribute to the creation of functioning gas markets, especially in Central and Eastern Europe where we operate.

In 2016, NET4GAS took part in the drafting of documents intended to modify the regulatory framework with a view to improving access to transmission systems, both at the European level in cooperation with the European Network of Transmission System Operators for Gas (ENTSOG), and at the national level in cooperation with the Energy Regulatory Office and the Czech market operator, OTE, a.s. The foregoing effort mainly concerned measures arising under network codes implemented in accordance with European Commission regulations, the full implementation of which is to ensure the security of natural gas supplies and the integration of regional markets, specifically measures arising under the Network Code on Gas Balancing of Transmission Networks (BAL NC) and their implementation into the Gas Market Rules and the Transmission Network Code, the finalization of the Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems (CAM NC 2.0), and the finalization of the Network Code on Harmonised Transmission Tariff Structures (TAR NC) as part of the so-called comitology procedure.

Furthermore, the reported year saw NET4GAS focus on the preparation of alternatives for the integration of the Czech and Austrian gas markets. In cooperation with Austria's transmission system operators Gas Connect Austria GmbH and TAG GmbH, NET4GAS prepared an integration concept that would provide transmission system users with simplified access to both the Austrian and Czech markets. The new service would provide users holding entry capacity into the Czech Republic with access to the Austrian market to the extent of the capacity they hold and vice versa. In March 2016, this option concept, referred to as "TRU Option" (Trading Region Upgrade Option), was introduced within the framework of a public consultation process, carried out by national regulatory authorities, to market participants, who responded with favourable feedback. Market integration can be achieved either by building the BACI pipeline, which is to interconnect the Czech and Austrian markets directly, or via existing gas infrastructure, for example, via Slovakia. The Slovak transmission system operator Eustream, a.s. has already offered prospective cooperation in this context. In the second half of 2016, the respective transmission system operators prepared an implementation concept.

Moreover, NET4GAS took part in several meetings of the Gas Forum taskforce in 2016, which operates within the framework of the Visegrad Group (V4), where the objective was to identify new ways and opportunities to strengthen the security of supply and to deepen market integration in the V4 region, thus contributing to the formulation of a joint approach to the assessment of risks throughout the Group.

Human Resources

Highly qualified employees are our company's foundation stone and most valued resource.

Number of employees

As of 31 December 2016, the number of employees working at NET4GAS was 524. 20 % of employees working at NET4GAS were women, out of which 12 % in managerial positions. As of 31 December 2016, BRAWA had no employees.

NET4GAS social policy

The standard of NET4GAS employees' working and social conditions is defined under a Collective Agreement valid 2015–2020.

NET4GAS has also been developing special programmes in the area of its social policy. For example, it is helping young families with the process of returning to work, in particular by staying in contact with mothers during their parental leave, allowing them to actively participate in company projects even during this period, and not least of all by offering a home office option. And just as in previous years, in 2016 NET4GAS employees had an opportunity to obtain financial support for a pre-school which their children attend.

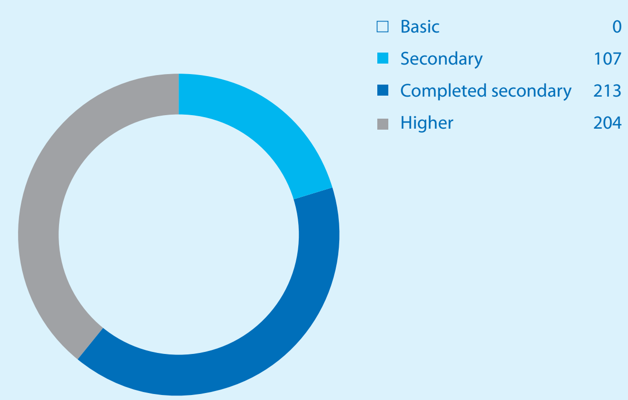
NET4GAS also provided support for the employment of handicapped persons. Every job was given an assessment to determine its suitability or unsuitability for handicapped persons, and then advertised as such.

NET4GAS professional training and career development

In 2016, NET4GAS invested 2.4 % of the company's annual personnel costs into the professional training of its employees. The average expenditure on training per employee was CZK 18,627. The education structure of NET4GAS employees has remained stable.

NET4GAS also continued its programmes for students and graduates "Internship" and "Trainee", which are aimed at retaining specialist know-how and helping senior staff who are going into retirement pass on their experience to new employees (for more about how NET4GAS works with students see the section "NET4GAS Corporate Philanthropy").

NET4GAS employee education structure
as of 31 December 2016



Health and Safety at Work

The NET4GAS Group focuses particular attention on health and safety at work (HSE). The "Health and Safety at Work and Fire Safety Policy" is one of the Group's key policies and is actively enforced by both regular employees and supervisors at all management levels. Safety programmes and measures go beyond the framework of legal requirements. Efforts to maintain a safe working environment target all parts of the workplace and apply not only to employees, but also to contractors and other persons who are exposed to HSE risks.

Actions taken to improve the quality of work safety in 2016 mainly focused on excavation work carried out during construction projects, an area where an elevated HSE risk exists on a permanent basis, as well as on the use of motor vehicles and the prevention of traffic accidents.

The basic objective is that each employee returns home in the same state of health as he or she was when they came to work. There were no workplace accidents resulting in an incapacity for work in 2016, including the staff of contractors working on the Group's worksites. The high level of safety maintained presents the Group with a challenge and commitment in the forthcoming period.

Environmental Protection

We are fully aware of our corporate social responsibility, and we strictly follow an environmental policy committed to both present and future generations.

Environmental protection is one of the highest priorities and is understood by the NET4GAS Group not only as fulfilment of legal requirements, but primarily as an issue of social responsibility. The Group is guided by the latest scientific findings in the area of environmental protection and uses environmentally-friendly technology. Environmental protection is taken into account in all decisions and process implementation.

No ecological accidents or serious events that would represent a danger to the environment occurred in 2016 in association with the business or any other activities of the Group.

Statutory compliance

The Group makes the effort to minimize the environmental burden caused by the transmission system. The "Environmental Protection Policy" is one of the key policies.

In 2016, the Group complied with all statutory obligations regarding environmental conservation and landscape protection, emergency preparedness, prevention and remediation of environmental damage, integrated pollution prevention, prevention of air pollution, reduction of greenhouse gas emissions, waste and water management, and the handling of chemical products and mixtures.

In line with the requirements of state administration and local government, designated operational facilities have developed preventive emergency plans in the event of environmental accidents and the prevention of serious accidents caused by selected hazardous materials, although the stated plans fulfilled only the role of preventative measures in 2016 and did not have to be put into action, just as no environmental accidents occurred at any Group facilities.

All compressor stations were operated in accordance with their valid integrated permits issued under Act No. 76/2002 Coll., on integrated pollution prevention and control and the integrated pollution register, as amended, and compliance with these state-issued decisions is a guarantee of the correct approach towards the environment. In 2016, the Czech Environmental Inspectorate audited compliance with the mandatory operating conditions stipulated in the valid integrated permits for the Kralice and Veselí nad Lužnicí compressor stations. The Jihlava Regional Public Health Office carried out a complex audit of compliance with the public health regulations stated for the Kralice Compressor Station.

State administration and local government authorities which carried out audits stated in their final reports that the Group has complied with its obligations in relation to the valid legislation and the integrated permits issued to it.

The Group was also in compliance with the requirements of Act No. 25/2008 Coll., on the integrated environmental pollution register and the system of performing reporting obligations in conjunction with European Parliament and Council Regulation 166/2006, concerning the establishment of a publicly accessible European Pollutant Release and Transfer Register. Legislation relating to issues of greenhouse gases was also adhered to, particularly Act No. 383/2012 Coll., on conditions of trading greenhouse gas emission allowances, and carbon dioxide allowances consumed at all compressor stations were duly reported to the Czech Ministry of Environment. No penalty measures were imposed by the competent authorities on the Group in 2016.

Activities going beyond legislation

The Group acts responsibly in regard to environmental protection, even going beyond what is required by law. For example, thanks to the operation of the mobile gas recovery compressor of NET4GAS, which is used for pumping natural gas from a section of pipeline earmarked for repair and is unique on a European scale, 4,062,678 m^3 of natural gas was re-pumped in the transmission system in 2016 which for technical reasons would otherwise have had to be released into the atmosphere.

Recycling, energy conservation and other environmentally--friendly activities were and continue to be an everyday part of the Group's operations.

In 2016, NET4GAS also continued to support projects in the area of nature and environmental protection via its NET4GAS Closer to Nature programme (see the section NET4GAS Corporate Philanthropy).

Internal Control Principles

We have internal control principles in place as a preventive measure, and as a means to achieve better results.

NET4GAS has internal control principles in place as a preventive measure, and as a means to achieve better results. They include advisory bodies to the NET4GAS Statutory Directors, whose role is to perform internal control and risk management, as well as institutions in the areas of ethics and fraud prevention.

Internal Audit

The essence of the internal audit is objective assurance and consultancy activity focused on adding value to improving processes and reducing possible risk. The Internal Audit is an integral component of the management and control system and an important tool for the continuous improvement of the NET4GAS Group. The Internal Audit is supervised by the Audit Committee.

Risk Management Committee

The NET4GAS Group manages its risk with due care and diligence. Risks are continuously identified, assessed from the point of view of their likely occurrence and the extent of potential damage and reported to the Risk Management Committee. Existing risks are continuously monitored and updated.

The Risk Management Committee's responsibilities include, in particular, discussing identified risks to the Group and approving strategies for managing them. It is also the Committee's task to regularly assess the overall risk to the Group.

Code of Conduct

The Compliance Officer monitors adherence to the Code of Conduct, which is one of the key management documents of NET4GAS.

NET4GAS is conscious of its role in society and its responsibility towards all its stakeholders and the environment, in which it operates. It has therefore committed itself to a clear set of principles which form a framework for its activities in the business and social spheres. These are defined for the company and its employees by its Code of Conduct, and are based on personal responsibility, honesty, loyalty, and respect for others and the environment.

Ombudsman and Fraud Prevention

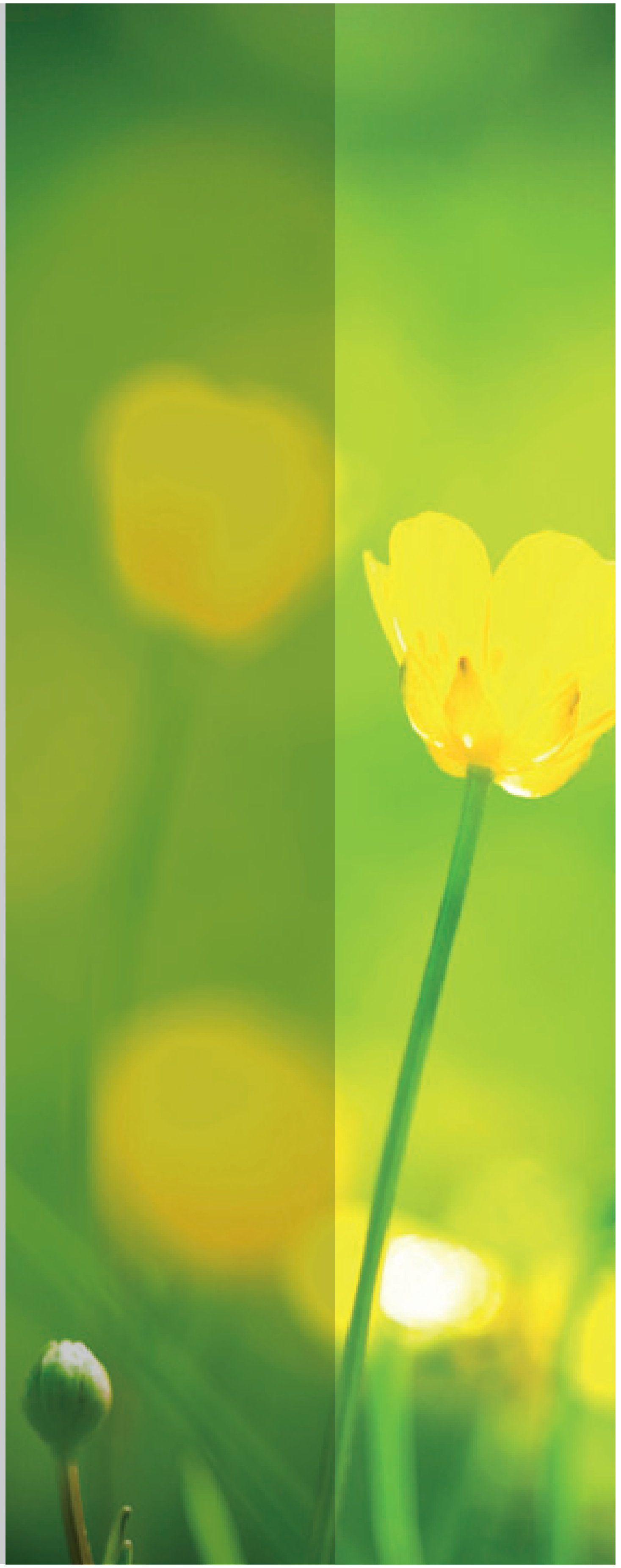
The Ombudsman is an independent position which chiefly involves collecting complaints and information relating to fraudulent activities or to activities which are in conflict with the company's internal regulations or the law. The Ombudsman evaluates these submissions before convening an investigation committee, whose role is to make an independent assessment and evaluation and then propose corrective measures. The Ombudsman may also be contacted by parties outside the company. The position of Ombudsman is performed for NET4GAS by an outside law firm.

Audit Committee

The Audit Committee is described in the section Consolidated Group Data.

NET4GAS Corporate Philanthropy

We are aware of our social responsibility and therefore devote ourselves to corporate philanthropy.



NET4GAS Corporate Philanthropy

An integral aspect of the good reputation of a modern company is its responsible conduct towards local communities, the environment, its shareholders, suppliers and partners, and not least of all its own employees. And an integral part of the concept of corporate social responsibility is corporate philanthropy.

NET4GAS is aware of its corporate social responsibility. Therefore, in 2016 it continued devoting itself to corporate philanthropy and sponsorship, aimed at improving the living conditions where it operates, which is in the Czech Republic, in the following areas:

- NET4GAS Closer to Nature: nature and the environment protection
- NET4GAS Closer to Knowledge: education, training and research
- NET4GAS Closer to Regions: community development
- Companius: a programme supporting employees' volunteer activities

NET4GAS Closer to Nature

Come to nature with us at www.closertonature.cz

NET4GAS is both a reliable and safe gas transmission system operator, and at the same time pursues a responsible policy aimed at protecting nature and the environment with respect to current and future generations. The commercial operations of the NET4GAS Group are very closely connected with the issue of nature conservation, as during both the construction and the operation of its gas infrastructure it must comply with strict environmental standards. In fact, its concern for the natural environment extends even beyond the requirements of legislation. This principle not only underlies the company's responsible entrepreneurship, but is also the basis for its long-term strategy of corporate philanthropy and sponsorship, which has been implemented under the programme NET4GAS Closer to Nature since 2007.

NET4GAS has been systematically providing long-term support to projects where a major aspect of sustainable development is expressed by precisely that motto – "Closer to Nature" – and can therefore be proud that it is one of the largest corporate donors in the field of nature conservation in the Czech Republic. In 2015, NET4GAS was awarded the prestigious VIA BONA prize for its Closer to Nature programme for which it was nominated by its long-term partner and expert guarantor, the Czech Union for Nature Conservation.

General partnership with the ČSOP

The general partnership between NET4GAS and the Czech Union for Nature Conservation (ČSOP) has pursued a clear and unchanging vision since the collaboration first began in 2007. And that is to present attractive and valuable natural sites to the public, and to use both education and fun as means to raise awareness about the reasons for their protection.

In 2016, NET4GAS and the ČSOP opened a further six sites of natural value to the public, bringing the total over their ten-year partnership to 80. The collaboration also focused on the renovation of existing sites and popularizing and promotional activities.

Sites opened to the public with ČSOP in 2016

Jinošov Quarry
Project manager: ZO ČSOP Vlašim
Opening date: 20 June 2016
Location: Vlašim, District of Benešov, Central Bohemian Region
When production ceased at this quarry for crystalline calcite (marble), which lies three kilometres to the south of Vlašim, pools formed and became home to numerous amphibians. However, with the passage of time, the quarry became overgrown with wind-propagated shrubs, turning it into an impenetrable jungle, and the pools disappeared. With the care of conservationists, the place is now returning to life.

Olešná Brook
Project manager: ZO ČSOP Radnice
Opening date: 23 July 2016
Location: Olešná, municipality of Němčovice, district of Rokycany, Plzeň Region
The Olešná Brook (Olešenský potok) is an inconspicuous right-bank tributary of the Berounka River within the Horní Berounka nature park that is found almost 30 kilometres to the northeast of Pilsen. The educational trail provides insight into a valley, in some places up to 60 metres deep, that is the manifestation of the fluvial phenomenon, its nature, and its ties to the immediate surroundings.

Trip Around the World
Project manager: ZO ČSOP Třeboň
Opening date: 30 September 2016
Location: Třeboň, District of Jindřichův Hradec, South Bohemian Region
The educational trail leads through scenery that is typical of the area around Třeboň, with fishponds, forests, fields and meadows, as well as authentic farmsteads. Along its 12-kilometre length, there are countless opportunities to watch both common and protected plants and animals. The trail is traditional in terms of its layout, but not of its concept. It contains numerous games, quizzes and suggestions for activities that one can try out right in the nature.

Path through the Reeds
Project manager: ZO ČSOP Pozemkový spolek Hády
Opening date: 16 October 2016
Location: Brno, South Moravian Region
The Rose's Quarry is one of the first limestone quarries renatured while adhering to nature friendly methods. The local reeds through which the new path leads grow up to three meters high and are one of only a few concentrated reed sites far and wide. Tracks of local animals were burnt into the walkway to guide visitors along their way.

Hruboskalsko
Project manager: ZO ČSOP Bukovina
Opening date: 31 October 2016
Location: Hruboskalsko-Sedmihorky, district Semily, Liberec Region
The Hruboskalsko educational trail is located to the southeast of Turnov in one of the most popular areas of the 'Bohemian Paradise' (Český ráj) – the "Town of Rocks" that forms part of the greater "Hrubá skála" area. It is the largest sandstone formation within the UNESCO Global Geopark of Bohemian Paradise.

Dry Feet through Water
Project manager: ZO ČSOP Záchranná stanice a ekocentrum "Pasíčka"
Opening date: 16 December 2016
Location: Pasíčka, Chrudim District, Pardubice Region
This short interactive trail leads through a system of small ponds that have been created in a waterlogged meadow, forming a natural extension of the visitors' area of 'Pasíčka', a wildlife rescue station and environmental centre.

1) Hruboskalsko

2) Path through the Reeds

3) Olešná Brook

4) Jinošov Quarry

5) Trip Around the World

6) Dry Feet through Water

1

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1

General partnership with the Young Environmentalists Association competitions

It is growing increasingly difficult in this day and age to encourage children and young people to develop a close relationship with nature. In 2016, NET4GAS therefore continued providing its support to the nationwide science and nature competitions Zlatý list ("Golden Leaf") and Ekologická olympiáda ("Ecological Olympiad") organised by the Young Environmentalists Association of the ČSOP as their general partner.

Golden Leaf is a nationwide science and ecology competition for primary and secondary school students. Its main aim is to bring together kids who have a profound interest in the natural world at an event where they can test out and compare their knowledge through competition. The competition emphasises more than just theoretical "school" knowledge – it also involves hands-on work in the natural environment and for its benefit. The Ecological Olympiad is a nationwide secondary school competition which focuses on comparing knowledge and skills in the areas of ecology, nature conservation and care for the environment. It particularly prioritises the practical application of knowledge and skills in solving real problems in the field, as well as the cultivation of teamwork.

Main partnership with the Naše příroda magazine

2016 was the sixth year that NET4GAS had been the main partner of the Naše příroda ("Our Nature") civic association, providing contribution to the publication of its magazine of the same name.

NET4GAS Closer to Knowledge

This second pillar of philanthropy and sponsoring has its foundation in the focus of NET4GAS on operational excellence delivered by a trained and qualified team. Sustainable development would be impossible without quality training, education, research and development. NET4GAS therefore supports these areas under its programme NET4GAS Closer to Knowledge.

Partnership with universities

In 2016, NET4GAS continued to develop its general partnership with the Department of gaseous and solid fuels and air protection of the Faculty of Environmental Technology at the University of Chemistry and Technology Prague, and its main partnership of the Czech Technical University in Prague. The cooperation included awarding motivational scholarships to exceptional students, specialist lectures and trips, consulting with students on their theses, and hiring students under the Internship and Trainee programmes (see the "Human Resources" section).

NET4GAS Closer to Regions

Long-term development and maintenance of the gas transmission system, which runs through almost every one of the regions of the Czech Republic, is a cornerstone of the NET4GAS Group's business operations. As a good neighbour, the company targets its third programme – NET4GAS Closer to Regions – on community development in the areas where it operates.

General partnership with "The Place Where We Live" programme of VIA Foundation

In 2016, NET4GAS continued its general partnership with the VIA Foundation in its programme "The Place Where We Live". The programme supports the projects, whose goal is to create or restore public spaces with the help of local inhabitants. The conditions for receiving support are that the public must be able to influence the future form of the space during the planning process, and must contribute their own voluntary work during its construction. It is also assumed that opportunities will be created for close cooperation among the non-profit sector, local government and local businesses. The aim of the programme is to stimulate the development of local community life. Each of the chosen organisations received a grant as well as access to free training in the area of community planning.

Main partnership with the "Voluntary Firemen of the Year"

In 2016, NET4GAS was the main partner of the Voluntary Firemen of the Year contest for the third year in a row. Firefighters, both professional and volunteer, are a natural partner of NET4GAS while ensuring the safety and reliability of natural gas transmission. The aim of the competition is to raise public awareness and prestige of volunteer firemen.

Companius

In 2016, NET4GAS targeted its corporate philanthropy not only at external projects, but internal ones too. Thanks to the Companius Programme, it provided assistance to projects of company employees who in their free time were engaged in organisations focusing on sports, culture and the arts, education, social issues, or the core area of its corporate philanthropy – nature conservation. NET4GAS supported a total of 36 employees and non-profit organisations under this programme in 2016.

NET4GAS Report on Relations

The Statutory Directors of NET4GAS, s.r.o. (hereinafter in this Report on Relations referred to as "Company") have drawn up, in accordance with the provision of the Section 82 of Act No. 90/2012 Coll., the Business Corporations Act (hereinafter referred to as "BCA"), the following Report on Relations covering the relations among the Company and controlling entities and among the Company and other entities controlled by the same controlling entities (hereinafter referred to as "Related Parties") during 2016 in all cases where the Company is aware of the existence of such Related Parties. This Report on Relations forms an integral part of the NET4GAS Group Consolidated Annual Report 2016, and is provided to the Company's shareholder for its review within the same period of time and under the same conditions as the Financial Statements.

1. Controlling entities

In the accounting period ended 31 December 2016, the Company was controlled:

a) directly by
NET4GAS Holdings, s.r.o., with its registered office at Na hřebenech II 1718/8, Nusle, Prague 4, 140 00, Czech Republic, ID No. 291 35 001, registered in the Commercial Register maintained by the Municipal Court in Prague, Section C, File No. 202655;

b) indirectly by
(i) Allianz Infrastructure Czech HoldCo II S.à r.l., with its registered office at L-2450 Luxembourg, boulevard F.D. Roosevelt 14, Grand Duchy of Luxembourg, registration number: B 175770, and (ii) Borealis Novus Parent B.V., with its registered office at 1011PZ Amsterdam, Muiderstraat 9, Kingdom of the Netherlands, registration number: 57412243, each of which is a shareholder of NET4GAS Holdings, s.r.o. with an ownership interest of 50 %, and which together have the status of controlling entities in relation to NET4GAS Holdings, s.r.o. by virtue of Section 75(3) of the BCA.

2.Other Related Parties

The Company requested the above controlling entities to provide a list of any other entities controlled by the same controlling entities during the last accounting period, and the Statutory Directors of the Company have drawn up the present Report on Relations based on the information provided by these controlling entities and the other information at their disposal.

The structure of the relations among the controlling entities and the controlled entity and other Related Parties is set out in Annex No. 1 to this Report on Relations.

3. Role of the controlled entity, method and means of control

In 2016, the Company carried out its activities as an independent transmission system operator in accordance with Section 58b et seq. of Act No. 458/2000 Coll., on conditions for undertaking the business and for the execution of state administration in the energy sector and on changes to certain decrees (hereinafter referred to as "Energy Act"), and as such operated independently of controlling entities and other Related Parties.

NET4GAS Holdings, s.r.o., as the controlling entity, exercised its rights and performed its obligations in respect of the Company in compliance with legislation, in particular as laid down in the BCA and the Energy Act.

4. Agreements concluded between the Company and Related Parties

The agreements concluded between the Company and controlling entities or Related Parties during the last accounting period are listed in Annex No. 2 to this Report on Relations. The agreements concluded in preceding accounting periods which were in effect during the last accounting period form Annex No. 3 to this Report on Relations. The values of performance and counter-performance in Related Party transactions during the last accounting period are shown in the Notes to the Separate Financial Statements of the Company as of 31 December 2016.

5. Acts performed in the last accounting period at the instigation or in the interest of controlling entities or Related Parties in respect of assets exceeding 10 % of the Company's equity amounting to CZK 759 million as per the last financial statements prepared as of 31 December 2016

In the last accounting period, the Company, in addition to concluding agreements as specified in Article 4 of this Report on Relations, also performed acts at the instigation or in the interest of controlling entities or Related Parties as specified in Annex No. 4 to this Report on Relations.

6. No damage

In the accounting period ended 31 December 2016, the Company incurred no damage as a result of agreements with controlling entities or Related Parties, or as a consequence of other acts or actions performed in the interest or at the instigation of the same, which were concluded or undertaken during the last accounting period or in any preceding accounting period. It has therefore not been necessary to secure compensation for damage or to conclude any agreements on such compensation.

7. Advantages and disadvantages resulting from relations with Related Parties

In the 2016 accounting period, the relations among the controlling entities and Related Parties were an advantage for the Company in terms of the increased financial stability.

8. Confidentiality

None of the information contained in this Report on Relations constitutes a trade secret of the Company.

9. Conclusion

This Report on Relations was approved by the Company's Statutory Directors on 4 April 2017, and was submitted for review to the Company's Supervisory Board.

In Prague, on 4 April 2017

Andreas Rau
Statutory Director

Radek Benčík
Statutory Director

Václav Hrach
Statutory Director

Annex No. 1
Structure of relations among controlling entities and Related Parties in the last accounting period

Allianz Infrastructure Czech HoldCo II S.à r.l. (50.00 %) and Borealis Novus Parent B.V. (50.00 %)			
	100.00 %	**NET4GAS Holdings, s.r.o.**	
		100.00 % NET4GAS, s.r.o.	
			BRAWA, a.s.

Annex No. 2
Agreements concluded between the Company and controlling entities or Related Parties in the last accounting period

Contracting party	Agreement	Date of conclusion	Details
NET4GAS Holdings, s.r.o.	Amendment No. 1 to a Credit Facility Agreement on 26 June 2015	18 March 2016	The subject matter of the amendment is a change in the maturity of a short-term loan.
NET4GAS Holdings, s.r.o.	Credit Facility Agreement as amended by the Amendment No. 1 on 7 July 2016	4 April 2016	The subject matter of the agreement is a short-term loan. The subject matter of the amendment is a change in the maturity of the short-term loan.
NET4GAS Holdings, s.r.o.	Set-off Agreement	4 April 2016	The subject matter of the agreement is a set-off of mutual liabilities and receivables under loan agreements.
NET4GAS Holdings, s.r.o.	Contribution and Set-off Agreement	7 July 2016	The subject matter of the agreement is the provision of a contribution by NET4GAS Holdings, s.r.o. to the Company and a set-off of mutual liabilities and receivables as of 8 July 2016.

Orders of BRAWA, a.s. at the Company

- Reposting insurance premiums (three orders)

Annex No. 3
Agreements concluded between the Company and controlling entities or Related Parties in previous accounting periods and effective in 2016

Contracting party	Agreement	Date of conclusion	Details
BRAWA, a.s.	Agreement on the provision of selected services as amended by Amendment No. 1 on 20 December 2013, Amendment No. 2 on 27 January 2014, Amendment No. 3 on 6 February 2015 and Amendment No. 4 on 30 November 2015	31 December 2012	The subject matter of the agreement is the Company's provision of the following services to BRAWA, a.s.: GAZELLE project supervision, construction and assembly work within the construction, accounting, controlling, tax issues, payroll administration, cash-flow, risk management, insurance, facility management, purchasing and logistics, corporate affairs and network documentation.
BRAWA, a.s.	Lease Agreement	31 December 2012	Under the agreement, BRAWA, a.s. leases gas infrastructure to the Company, consisting primarily of the interconnector "High-pressure DN 1400 gas pipeline – Brandov BTS–Rozvadov" of approximately 160 km in length.
BRAWA, a.s.	Agreement on the provision of loans as amended by Amendment No. 1 on 16 July 2015	2 July 2013	
NET4GAS Holdings, s.r.o., BRAWA, a.s. (multi-party agreement)	Agreement Ref. No. ZBA/2012/14 on the provision of Real Unidirectional Cash Pooling as amended by Amendment No. 1 on 11 November 2013	8 July 2013	
NET4GAS Holdings, s.r.o.	Agreement Ref. No. TBA/2013/16 on the provision of Real Unidirectional Cash Pooling	11 November 2013	The agreements lay down a framework for cash pooling of Czech currency (among the Company, BRAWA, a.s. and NET4GAS Holdings, s.r.o.) and US dollars and euros (between the Company and NET4GAS Holdings, s.r.o.), the purpose of which is to optimise the use of funds within the related parties and to reduce transaction costs.
NET4GAS Holdings, s.r.o.	Agreement Ref. No. TBA/2013/15 on the provision of Real Unidirectional Cash Pooling	11 November 2013	
NET4GAS Holdings, s.r.o.	Agreement on the provision of loans as amended by Amendment No. 1 on 16 January 2014, Amendment No. 2 on 21 March 2014 and Amendment No. 3 on 16 July 2015	11 November 2013	

Contracting party	Agreement	Date of conclusion	Details
NET4GAS Holdings, s.r.o.	Agreement on the provision of selected services	25 June 2015	The subject matter of the agreement is the Company's provision of the following services to NET4GAS Holdings, s.r.o.: accounting, controlling, tax issues, cash-flow, contract management and PR service.
NET4GAS Holdings, s.r.o.	Credit Facility Agreement	26 June 2015	The subject matter of the agreement is a short-term loan.

Annex No. 4
Acts performed in the last accounting period at the instigation or in the interest of controlling entities or Related Parties

Controlling entity or Related Party	Acts performed	Date	Details
Allianz Infrastructure Luxembourg I S.à r.l., Borealis Novus Holdings B.V., NET4GAS Holdings, s.r.o. (multi-party agreement)	Agreement on the assignment of parts of receivables	7 July 2016	The subject matter of the agreement is the assignment of parts of receivables resulting from the Loan Agreement concluded between Allianz Infrastructure Luxembourg I S.à r.l. and Borealis Novus Holdings B.V. towards the Company to NET4GAS Holdings, s.r.o.
Allianz Infrastructure Luxembourg I S.à r.l., Borealis Novus Holdings B.V. (multi-party declaration)	Joint declaration	8 July 2016	This declaration of the Company and Allianz Infrastructure Luxembourg I S.à r.l. and Borealis Novus Holdings B.V. confirms the repayment of the loan, provided to the Company based on the Loan Agreement concluded between the Company and Allianz Infrastructure Luxembourg I S.à r.l. and Borealis Novus Holdings B.V. on 28 July 2014.
NET4GAS Holdings, s.r.o.	Resolution of the sole shareholder of the Company	16 December 2016	The subject matter of the resolution is the approval of the advance payment of the profit distribution for 2016.

Post Balance Sheet Events

Based on the positive results of the market survey "Capacity4Gas", which showed a significant long-term market demand for additional capacity, and based on subsequent technical studies on the relevant gas infrastructure carried out by the NET4GAS Group, new cross-border capacity between the German Gaspool market area and the Czech Republic, and the Czech and Slovak market areas was offered and successfully marketed at the annual PRISMA capacity auction on 6 March 2017. Based on the results of the auction, NET4GAS is ready to invest into relevant new gas infrastructure in the Czech Republic in the upcoming years.

No other events have occurred subsequent to year-end that would have a material impact on the consolidated annual report for the year ended 31 December 2016.

Persons Responsible for the Consolidated Annual Report

We hereby declare on our honour that the information stated in this Consolidated Annual Report is true and that no material facts have been omitted or misstated.

In Prague, on 4 April 2017

Andreas Rau
Statutory Director

Radek Benčík
Statutory Director

Václav Hrach
Statutory Director

Annex no. 1: Consolidated Financial Statements

NET4GAS Group
Consolidated Financial Statements

prepared in accordance with International Financial Reporting Standards
as adopted by the European Union, 31 December 2016

Contents

NET4GAS Group
Consolidated Balance Sheet

In millions of Czech Crowns	Note	31 December 2016	31 December 2015
ASSETS			
NON-CURRENT ASSETS			
Property, plant and equipment	8	44,383	45,762
Intangible assets	9	89	110
Other non-current assets	10	9	1
Total non-current assets		**44,481**	**45,873**
CURRENT ASSETS			
Inventories	11	63	65
Trade and other receivables	13	303	119
Current income tax prepayments	26	11	94
Loans to related parties	12	652	1,886
Other non-financial assets	14	27	59
Cash and cash equivalents	15	415	1,750
Total current assets		**1,471**	**3,973**
TOTAL ASSETS		**45,952**	**49,846**
EQUITY AND LIABILITIES			
EQUITY ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT COMPANY			
Registered capital	16	2,750	2,750
Capital contributions outside registered capital	16	6,631	29
Cash flow hedges	16	(1,813)	(2,035)
Retained earnings		38	1,811
Total equity		**7,606**	**2,555**
NON-CURRENT LIABILITIES			
Other payables	21	8	2
Borrowings	17	27,761	38,670
Derivative financial instruments	28	2,478	2,534
Deferred income tax liability	26	6,330	4,246
Provisions	20	167	177
Accrued employee benefits	22	100	68
Other non-financial liabilities	22	15	15
Total non-current liabilities		**36,859**	**45,712**

The accompanying notes on pages 56 to 105 are an integral part of these consolidated financial statements.

In millions of Czech Crowns	Note	31 December 2016	31 December 2015
CURRENT LIABILITIES			
Borrowings	17	286	268
Trade and other payables	21	524	623
Derivative financial instruments	28	292	276
Current income tax payable	26	176	16
Other taxes payable	19	20	14
Provisions	20	–	40
Other non-financial liabilities	22	189	342
Total current liabilities		**1,487**	**1,579**
Total liabilities		**38,346**	**47,291**
EQUITY AND LIABILITIES		**45,952**	**49,846**

4 April 2017

Andreas Rau
Statutory Director

Radek Benčík
Statutory Director

Václav Hrach
Statutory Director

The accompanying notes on pages 56 to 105 are an integral part of these consolidated financial statements.

NET4GAS Group
Consolidated Statement of Profit or Loss and Other Comprehensive Income

In millions of Czech Crowns	Note	2016	2015
Revenue	6	9,280	9,879
Raw materials consumed	23	(450)	(790)
Services purchased and lease charges	23	(510)	(807)
Employee benefits	23	(510)	(461)
Depreciation and amortisation	8, 9	(2,080)	(2,463)
Impairment		–	(2)
Gains less losses on disposal of property, plant and equipment		3	4
Changes in fair value of derivatives, net		31	(1)
Foreign exchange differences, net		1	32
Other operating income		27	13
Other operating expenses		(36)	(97)
Operating profit		**5,756**	**5,307**
Finance income	24	8	17
Finance costs	25	(1,339)	(1,694)
Finance result (net)		(1,331)	(1,677)
Profit before income tax		**4,425**	**3,630**
Income tax expense	26	(3,008)	(868)
PROFIT FOR THE YEAR		**1,417**	**2,762**

Other comprehensive income / (loss)			
Items that may be subsequently reclassified to profit or loss			
Cash flow hedge	16	274	(1,023)
Income tax recorded directly in other comprehensive income – cash flow hedge	26	(52)	194
TOTAL OTHER COMPREHENSIVE INCOME FOR THE YEAR		**222**	**(829)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**1,639**	**1,933**

The accompanying notes on pages 56 to 105 are an integral part of these consolidated financial statements.

NET4GAS Group
Consolidated Statement of Changes in Equity

In millions of Czech Crowns	Registered capital	Capital contributions outside registered capital	Cash flow hedges	Retained earnings	Total
Balance as at 1 January 2015	**2,750**	**29**	**(1,206)**	**3,515**	**5,088**
Total comprehensive income					
Profit for the year 2015	–	–	–	2,762	2,762
Cash flow hedge – net of related tax effect	–	–	(829)	–	(829)
Total comprehensive income for the year	–	–	(829)	2,762	1,933
Transactions with owners					
Dividends paid	–	–	–	(1,566)	(1,566)
Advance dividends paid	–	–	–	(2,900)	(2,900)
Balance as at 31 December 2015	**2,750**	**29**	**(2,035)**	**1,811**	**2,555**
Total comprehensive income					
Profit for the year 2016	–	–	–	1,417	1,417
Cash flow hedge – net of related tax effect	–	–	222	–	222
Total comprehensive income for the year	–	–	222	1,417	1,639
Transactions with owners					
Non-cash contribution outside registered capital (Note 17)	–	6,602	–	–	6,602
Dividends paid	–	–	–	(1,540)	(1,540)
Advance dividends paid	–	–	–	(1,650)	(1,650)
Balance as at 31 December 2016	**2,750**	**6,631**	**(1,813)**	**38**	**7,606**

The accompanying notes on pages 56 to 105 are an integral part of these consolidated financial statements.

NET4GAS Group
Consolidated Statement of Cash Flows

In millions of Czech Crowns	Note	2016	2015
Cash flows from operating activities			
Profit before tax		**4,425**	**3,630**
Adjustments for:			
Depreciation and amortisation	8, 9	2,080	2,463
Finance income	24	(8)	(17)
Finance costs	25	1,339	1,694
Impairment		–	2
Gains less losses on disposals of property, plant and equipment		(3)	(4)
Other non-cash operating expenses / (gains)		(1)	96
thereof: – provision for penalty		*(39)*	39
– foreign exchange differences		*–*	*27*
– employee benefit provision		*47*	*–*
– other		*(9)*	*30*
Operating cash flows before working capital changes		**7,832**	**7,864**
Decrease / (Increase) in trade and other receivables	13, 14	(150)	96
Increase / (Decrease) in trade and other payables	21, 22	(240)	100
Decrease in inventories	11	2	1
Operating cash flows after changes in working capital		**7,444**	**8,061**
Interest paid	25	(1,021)	(1,568)
Interest received	24	11	11
Income tax paid	26	(733)	(799)
Net cash flows from operating activities		**5,701**	**5,705**
Cash flows from investing activities:			
Purchase of property, plant and equipment	8	(695)	(540)
Purchase of intangible assets	9	(33)	(44)
Proceeds from sale of property, plant and equipment		4	31
Repayments of loans provided to related parties*	12	4	3,328
Loans provided to related parties	12	(650)	(3,869)
Net cash flows used in investing activities		**(1,370)**	**(1,094)**

The accompanying notes on pages 56 to 105 are an integral part of these consolidated financial statements.

In millions of Czech Crowns	Note	2016	2015
Cash flows from financing activities:			
Dividends paid to the Company's shareholder	16	(1,540)	(1,566)
Advance dividends paid to the Company's shareholder	16	(1,650)	(2,900)
Repayments of borrowings*	17	(3,588)	(1,397)
Proceeds from borrowings	17	1,112	1,397
Net cash flows from financing activities		**(5,666)**	**(4,466)**
Net increase / (decrease) in cash and cash equivalents		**(1,335)**	**145**
Cash and cash equivalents at the beginning of the period	15	1,750	1,605
Cash and cash equivalents at the end of the period	15	**415**	**1,750**

* Part of loans from related parties Borealis Novus Holdings B.V. and Allianz Infrastructure Luxembourg I S.à r.l. in total amount of CZK 11,000 million was settled in cash (CZK 2,500 million). Remaining amount of CZK 8,500 million was cessed to NET4GAS Holdings, s.r.o. It was subsequently netted against receivable from capital contribution outside registered capital of CZK 6,602 million and also netted against loan provided to NET4GAS Holdings, s.r.o. of CZK 1,898 million (Note 17).

The accompanying notes on pages 56 to 105 are an integral part of these consolidated financial statements.

NET4GAS Group Notes to the Consolidated Financial Statements

for the year ended 31 December 2016

1. NET4GAS Group and Its Operations – General Information

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union for the year ended 31 December 2016 for NET4GAS, s.r.o. (the "Company" or "NET4GAS") and its subsidiary BRAWA, a.s. (the "Subsidiary" or "BRAWA") (together the "Group" or "NET4GAS Group").

The Company was incorporated and is domiciled in the Czech Republic where is also the Group's principal place of business. The Company is a limited liability company. It was incorporated on 29 June 2005 and has its registered office at Na Hřebenech II 1718/8, Prague 4 – Nusle, the Czech Republic. Identification number of the Company is 272 60 364.

The subsidiary BRAWA, a.s. (joint stock company) was incorporated on 10 November 2010 as 100% subsidiary of the Company and has its registered office at Na Hřebenech II 1718/8, Prague 4 – Nusle, the Czech Republic. The Subsidiary's primary business activity is lease of GAZELLE gas pipeline to the Company. Identification number of the Subsidiary is 247 57 926.

The Group's main business activity is natural gas transmission in accordance with the Act No. 458/2000 Coll. (the "Energy Act").

Since 2 August 2013 the Company is fully owned by NET4GAS Holdings, s.r.o. (the "NET4GAS Holdings"), incorporated in the Czech Republic, which is the Company's ultimate parent company. NET4GAS Holdings is a joint venture of two venturers: Allianz Infrastructure Czech HoldCo II S.à r.l. (50%) with its registered office in Luxembourg and Borealis Novus Parent B.V. (50%) with its registered office in the Netherlands.

The Statutory Directors of the Company:

As at 31 December 2016	As at 31 December 2015
Andreas Rau	Andreas Rau
Radek Benčík	Radek Benčík
Václav Hrach	Václav Hrach

Radek Benčík was re-elected on 16 September 2016.

The members of the Supervisory Board of the Company were as follows:

As at 31 December 2016	Function	As at 31 December 2015	Function
Melchior Stahl	Member	Radek Hromek	Member
Jaroslava Korpancová	Member	Ralph Adrian Berg	Member
Lenka Kovačovská	Member	Melchior Stahl	Member
Kenton Edward Bradbury (from 24 June 2016)	Chairman	Jaroslava Korpancová	Member
Mikhail Nahorny (from 1 July 2016)	Member	Lenka Kovačovská	Member
		Kenton Edward Bradbury	Member

Mikhail Nahorny became member of the Supervisory Board on 1 July 2016 and the change was registered in the Commercial Register on 31 August 2016.

Ralph Adrian Berg was terminated from Supervisory Board on 30 June 2016 and the change was registered in the Commercial Register on 31 August 2016.

Membership of Radek Hromek in the Supervisory Board expired on 23 December 2016. This change has not been enrolled to the Commercial Register yet.

As of the date of the preparation of the consolidated financial statement, the sixth member of the NET4GAS Supervisory Board has not been elected.

About the Group. NET4GAS, s.r.o. is the exclusive gas transmission system operator in the Czech Republic, operating more than 3,800 km of gas pipelines. The Group is currently operating four compressor stations. The flow rate of the gas transmitted is measured at five border transfer stations (the Lanžhot, Brandov and Hora Svaté Kateřiny stations in the Czech Republic, and the Waidhaus and Olbernhau stations in the Federal Republic of Germany) and at almost a hundred national transfer stations. The NET4GAS transmission system has been specifically targeted in last few years for a number of new projects delivering additional transmission capacity and the greater diversification of transmission routes. These projects have included the construction of the GAZELLE high-pressure gas pipeline (DN 1400, put in operation in 2013), connecting the transmission systems of the Czech Republic and the Federal Republic of Germany at the border points Brandov and Rozvadov, and a project of a connection between the Czech and Polish transmission systems in Český Těšín. The entire NET4GAS transmission system can also be used for reverse flow, which means that it now has the capacity and technology to cope with natural gas transmission in any direction.

NET4GAS, s.r.o. is the successor to Tranzitní plynovod, n. p., Transgas, a.s. and RWE Transgas Net, s.r.o.

NET4GAS, s.r.o. founded BRAWA, a.s. as its subsidiary on 10 October 2010. Till 1 January 2013 BRAWA, a.s. was a dormant company. On 1 January 2013, under the legal reorganisation of NET4GAS's business, the GAZELLE pipeline was transferred to BRAWA and BRAWA became the sole owner of the GAZELLE pipeline. The GAZELLE pipeline is operated by NET4GAS.

Structure of the Group as at 31 December 2016 and 2015:

Name	Activity	Percentage of voting rights	Percentage of ownership	Country of registration
Subsidiary:				
BRAWA, a.s.	Owner of the GAZELLE natural gas pipeline which is rented to the Company	100%	100%	Czech Republic

With the effect from 2015, a new accounting period of BRAWA ends 30 November. Accounting period for year 2016 begins on 1 December 2015 and ends on 30 November 2016. For the preparation of the Group's consolidated financial statements as at 31 December 2016 the actual BRAWA's transactions for January – December 2016 and balances as at 31 December 2016 were used.

Note

The consolidated financial statements have been prepared in Czech and in English. In all matters of interpretation of information, views or opinions, the Czech version of these consolidated financial statements takes precedence over the English version.

2. Operating Environment of the Group

The regulatory environment in the Czech Republic:

(a) Legal framework pertaining to the transmission system operator

The transmission system operator holds an exclusive gas transmission licence under the Energy Act, and its operations are regulated by the Energy Regulatory Authority (the "ERO").

The transmission system operator's rights and obligations are primarily derived from Section 58 of the Energy Act and are clarified in more detail in the related implementing legislation. The transmission system operator is also required to comply with obligations under the European legislation, in particular Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and the related implementing legislation.

(b) Regulatory framework pertaining to the transmission system operator
Gas transmission prices are set annually by the ERO based on regulation methodology applicable in the regulatory period. Gas transmission prices for the next calendar year are usually published in an ERO's Pricing Decision by 30 November of the current year.

The 2016 gas transmission prices were established by ERO's Price Decision No 6/2015 from 25 November 2015 on Regulated Prices related to the gas supply.

(c) Current regulatory period
The transmission system operator is currently subject to the regulatory period, which has begun on 1 January 2016 and ends on 31 December 2018 (so called fourth regulatory period).

(d) Domestic transmission regulation methodology applicable in the fourth regulatory period
The transmission system operator regulation methodology for domestic gas transmission is based on a ceiling established for permissible revenues over a predetermined period (the revenue cap method). Domestic gas transmission prices are then derived from such defined permissible revenues. These prices consist of a fixed component for booked transmission capacity and a variable component depending on the amount of gas transmitted.

(e) Transit transmission regulation methodology applicable in the fourth regulatory period
The transmission system operator regulation methodology for transit transmission relies on a price ceiling (of permissible prices) for a predetermined period (the price cap method). Permissible prices are set annually by the ERO based on a comparison of gas transmission prices in other relevant Member States of the European Union (benchmarking). The underlying documentation for this benchmarking is prepared and supplied by the transmission system operator.

(f) Unregulated part
Further to a decision of the Energy Regulatory Authority of 28 July 2011, the GAZELLE interconnecting pipeline was exempted from the obligation to grant third-party access at a regulated price under the conditions set out in the Energy Act.

3. Summary of Significant Accounting Policies

a) Basis of preparation
These consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS") under the historical cost convention, as modified by the revaluation of relevant financial assets and financial liabilities (including derivative instruments) carried at fair value. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented.

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

Presentation currency. These consolidated financial statements are presented in Czech Crowns ("CZK") which is also the functional currency of both companies of the Group.

b) Consolidation
Subsidiaries are those investees, including structured entities, that the Group controls because the Group (i) has power to direct relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of investor's returns.

Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date on which control ceases.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

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

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

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

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

A portfolio of financial derivatives that are not traded in an active market is measured at the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (i.e. an asset) for a particular risk exposure or paid to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date. This is applicable for assets carried at fair value on a recurring basis if the Group:

(a) manages the group of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy; (b) it provides information on that basis about the group of assets and liabilities to the entity's key management personnel; and (c) the market risks, including duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities is substantially the same.

Fair value measurements are analysed by level in the fair value hierarchy as follows (Note 31):

(i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based solely on observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

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

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

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

d) Classification of financial assets

Financial assets are classified in the following categories: (a) loans and receivables; and (b) financial assets at fair value through profit or loss.

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments and are carried at amortized costs.

Financial assets at fair value through profit or loss, including financial derivatives are carried at their fair value. All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The group designates certain derivatives as hedges of a particular risk associated with a fixed commitment or highly probable forecast transaction (cash flow hedge).

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 31. Movements on the hedging reserve in other comprehensive income are shown in Note 16. The full fair value of a hedging derivative is classified as a non-current asset or liability when the remaining hedged item is more than 12 months, and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months. Trading derivatives are classified as a current asset or liability.

Cash flow hedge: The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the profit or loss within 'Finance costs' (in case of hedging of cash flows from revenues denominated in foreign currencies) or 'Changes in fair value of derivatives, net' (in case of hedging of cash flows from bonds issued denominated in foreign currency). Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss (for example, when the forecast sale that is hedged takes place). The gain or loss relating to the effective portion of cross currency interest rate swaps hedging foreign exchange risk is recognised in the profit or loss within 'Revenue' (in case of hedging of revenues denominated in foreign currencies) or 'Finance costs' (in case of hedging of cash flows from bonds issued denominated in foreign currency).

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in profit or loss when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recorded in other comprehensive income is immediately transferred to profit or loss within 'Foreign exchange differences, net'.

e) Classification of financial liabilities

Financial liabilities have the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. Liabilities held for trading are carried at fair value with changes in value recognised in profit or loss for the year (as finance income or finance costs) in the period in which they arise. Other financial liabilities are carried at amortised cost.

The Group designates certain financial liabilities as hedges of a particular risk associated with highly probable forecast transactions (cash flow hedge – Note 3d).

f) Initial recognition of financial instruments

Financial instruments not carried at fair value through profit or loss are initially recognized at fair value plus transaction costs. Financial instruments carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in profit or loss. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

The Group uses discounted cash flow valuation techniques to determine the fair value of cross-currency interest rate swaps and loans to related parties that are not traded in an active market. Differences may arise between the fair value at initial recognition, which is considered to be the transaction price, and the amount determined at initial recognition using the valuation technique. Any such differences are amortised on a straight line basis over the term of the cross-currency interest rate swaps and loans to related parties.

g) Derecognition of financial assets and financial liabilities

The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control.

Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

The Group derecognises financial liabilities only when the contractual liabilities of the Group are discharged, cancelled or expire. The difference between the carrying amount of a derecognised financial liability and the consideration paid is recognised in profit or loss.

h) Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation and provision for impairment, where required.

Significant spare parts are recognised and treated as property, plant and equipment.

Repairs and maintenance expenditures of tangible fixed assets are expensed as incurred. Cost of replacing major parts or components of property, plant and equipment items are capitalised and the replaced part is retired. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

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

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised in profit or loss for the year.

When the Group recognises the cost of a replacement for part of the carrying amount of property, plant and equipment, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it was not practicable to determine the carrying amount of the replaced part, the Group used the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

i) Depreciation

Land is not depreciated. Construction in progress is not depreciated. Depreciation on other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	Useful lives
Buildings and constructions	30 – 70 years
Plant, machinery and equipment	4 – 40 years
Furniture and fittings	4 – 8 years
Motor vehicles	5 – 8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

j) Capitalisation of borrowing costs

General and specific borrowing costs directly attributable to the acquisition, construction or production of assets that are not carried at fair value and that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets
The commencement date for capitalisation is when (a) the Group incurs expenditures for the qualifying asset; (b) it incurs borrowing costs; and (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

The Group capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Group's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred on the specific borrowings less any investment income on the temporary investment of these borrowings are capitalised.

k) Leasing

Operating leases. Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss for the year on a straight-line basis over the lease term. The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

l) Intangible assets

The Group's intangible assets have definite useful lives and primarily include capitalised computer software, patents, trademarks and licences.

Acquired computer software licences, patents and trademarks and other intangibles are capitalised on the basis of the costs incurred to acquire and bring them to use.

Development costs that are directly associated with identifiable and unique software controlled by the Group are recorded as intangible assets if an inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred.

m) Amortisation

Intangible assets are amortised using the straight-line method over their useful lives (unless the agreement or licence conditions state shorter or longer period):

	Useful lives
Software	3 years
Patents, and other licences	1.5 – 6 years
Development costs	6 years
Other intangible assets	6 years

n) Emission Rights

The Group receives free emission rights as a result of the European Emission Trading Schemes. The rights are received on an annual basis and in return the Group is required to return rights equal to its actual emissions. Therefore, a provision is only recognised when actual emissions exceed the emission rights received free of charge. The emission rights which were granted free of charge are carried at cost, i.e. at zero. When emission rights are purchased from third parties, they are measured at cost and treated as a reimbursement right. When emission rights are acquired by exchange and such an exchange is deemed to have the economic substance, they are measured at fair value as at the date when they become available for use and the difference between the fair value of rights received and cost of assets given up is recognised through profit or loss. The Group did not recognise any provision resulting from the gas emissions as at 31 December 2016 and 31 December 2015.

The amounts of emissions rights held in zero value by the Group were as follows:

In tons	31 December 2016	31 December 2015
Emission rights	403,619	366,825

o) Impairment of non-financial assets

Intangible assets not ready to use are not subject to amortisation and are tested annually for impairment. Assets that are subject to depreciation and amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash--generating units). Prior impairments of non-financial assets are reviewed for possible reversal at each reporting date.

p) Assets held for sale

Assets (or disposal groups) are classified as assets held for sale and stated at the lower of their residual amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than through continuing use. Assets held for sale are not depreciated.

q) Taxes

Income tax

Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge /credit comprises current tax and deferred tax and is recognised in profit or loss for the year, except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity (for example the effective portion of changes in the fair value of financial derivatives that are designated and qualify as cash flow hedges).

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

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

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

Value added tax

Output value added tax (VAT) related to sales is payable to tax authorities on the earlier of (a) collection of receivables from customers or (b) delivery of goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the balance sheet on a net basis. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

r) Uncertain tax positions

The Group's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period, and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognized based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period.

s) Inventories

Raw materials are mainly spare parts for the gas pipeline system. Purchased inventories are stated at the lower of cost and net realizable amount. Cost includes all costs related with its acquisition (mainly transport costs, customs duty, etc.). The weighted average cost method is applied for all disposals. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and selling expenses. Significant spare parts are recognised and treated as property, plant and equipment.

t) Trade receivables

Trade receivables are carried at amortised cost using the effective interest method less relevant impairment.

u) Impairment of financial assets carried at amortised cost

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

– Any portion or instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;

– The counterparty experiences a significant financial difficulty as evidenced by its financial information that the Group obtains;

– The counterparty considers bankruptcy or a financial reorganisation;

– There is adverse change in the payment status of the counterparty as a result of changes in the national or local economic conditions that impact the counterparty.

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

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

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

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

v) Prepayments
Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss for the year.

w) Cash and cash equivalents
Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method.

x) Dividends
Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved. Any dividends declared after the reporting period and before the financial statements are authorised for issue are disclosed in the subsequent events note.

y) Advance dividends paid
The Group's decision to pay an advance dividend is reflected in the consolidated financial statements as a decrease in equity as of the date of the payment and is deducted from the balance sheet line – Retained earnings.

z) Borrowings
Borrowings are carried at amortised cost using the effective interest method.

At their initial recognition, all bank credits, loans and issued bonds are recorded at their purchase price corresponding to the fair value of the received cash funds, less the costs of obtaining the credit or loan or issue of bonds.

Amortised cost is determined by taking into account the costs of obtaining the credit or loan, as well as the discounts or bonuses received at the settlement of the liability.

The Group designates certain borrowings as hedges of a particular risk associated with a highly probable forecast transaction (cash flow hedge – Note 3d).

aa) Government and other grants
Grants from the government and European Commission are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Grants relating to the purchase of property, plant and equipment decrease directly the costs of the relevant asset.

bb) Trade and other payables
Trade payables are accrued when the counterparty performs its obligations under the contract and are carried at amortised cost using the effective interest method.

cc) Provisions for liabilities and charges
Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Where there are a number of similar obligations, the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

dd) Financial guarantees
Financial guarantees are irrevocable contracts that require the Group to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. When the Group expects to receive recurring future premiums from an issued financial guarantee contract, the guarantee is recorded at the premium receivable at the inception of the contract and no receivable is recognised in respect of the future premium payments receivable. The premium receivable in one instalment is amortised on a straight line basis over the period covered by that instalment. At the end of each reporting period, the premium receivable in respect of the respective period is measured at its present value and the financial liability is measured at the higher of the remaining unamortised balance and the best estimate of expenditure required to settle the obligation at the end of the reporting period.

ee) Assets retirement obligations
The Group's transmission system is mainly constructed on the land owned by third parties. The current legislation requires the Company to incur the costs related to transmission system's operation and maintenance. The current Czech environmental and energy legislation does not set the obligation to liquidate the assets at the end of their useful life. Given the currently valid legislation management believes that there is no asset retirement obligation (dismantling and removing an item of property, plant and equipment) to be recognised in the financial statements.

ff) Foreign currency translation
The functional currency of each of the Group's consolidated entities is the currency of the primary economic environment in which the entity operates. The functional currency of the Company and its subsidiary is Czech Crown ("CZK"), and the Group's presentation currency is also CZK.

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

gg) Revenue recognition
The Group recognises as revenue mainly income from fees collected for the gas transmission within and across the Czech Republic.

Revenue from gas transmission services is recognised on time proportional basis based on the reserved capacity, at the maximum on a monthly basis. Revenues are invoiced on a monthly basis (or shorter where applicable) and sales are shown net of VAT and discounts. Revenues are measured at the fair value of the consideration received or receivable.

Interest income is recognised on a time-proportion basis using the effective interest method.

hh) Employee benefits
Wages, salaries, contributions to the Czech state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and other services) are accrued in the year in which the associated services are rendered by the employees of the Group.

a) Pension obligations
A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to

pay all employees the benefits relating to employee service in the current and prior periods. A defined benefit plan is a pension plan that is not a defined contribution plan.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

b) Termination benefits
Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits at the earlier of the following dates: (a) when the Group can no longer withdraw the offer of those benefits; and (b) when the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to their present value.

c) Other long term benefits
Long-term employee benefits, such as long-term bonuses, and long service awards are accounted for measured using the projected unit credit method in the same way as defined benefit pension plan, with the exception that re-measurements (actuarial gains/losses) and related charges are recognised immediately through in profit or loss.

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

jj) Segment reporting
Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or group of persons who allocates resources and assesses the performance for the Group. Segments are reported in a manner consistent with the internal reporting provided to the Group's chief operating decision maker. Segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

4. Critical Accounting Estimates and Judgements in Applying Accounting Policies

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

Functional currency
Management assessed the relevant primary and secondary factors during the consideration about the Company's functional currency. The functional currency is the currency of the primary economic environment, in which the entity operates. The regulated sales prices of the Group are determined by ERO – the Czech regulatory authority and are defined in CZK. Majority of the entity's revenue stems from regulated sales. Majority of the operating expenses of the Group are influenced by CZK. Capital expenditures are twofold: regular capital expenditure safeguarding the existing system and its safeness; and large one off projects. The regular capital expenditure is almost entirely influenced by CZK, while the pricing of large one off projects is influenced by a mix of currencies (including CZK, EUR and other). The funds from financing activities are generated by a mix of currencies (including CZK, EUR and US Dollars). Although the entity's operations are influenced by a mix of currencies, management concluded that majority of the indicators support CZK as the functional currency of the Company. Functional currency of the company BRAWA is affected by the functional currency of NET4GAS, because BRAWA does not operate totally autonomously. It is actually more an extension of the Company's operation.

Classification of pipeline capacity contract
The Group entered into a long-term contracts expiring on 1 January 2021 and 1 January 2035 whereby it provided majority of its GAZELLE pipeline capacity under 'ship or pay' basis. Management considered whether the contract for the provision of pipeline capacity to its major customer is, in substance, a finance lease. Management's conclusion that the contract is not a lease of the pipeline is based on the fact that there is significant (although minority) capacity of the pipeline, which is available to other customers and this capacity can be used by the other customers. The pipeline is under the Group's full control and the major customer has no ability or right to control physical access to the pipeline. Therefore the arrangement is not, in substance, a lease contract. The Group treats the pipeline as its property, plant and equipment and recognises revenue from the contract with the major customer in accordance with IAS 18.

Transmission System Operator licence and gas pipelines
Considering the applicability of IFRIC 12 for the Group, management believes that the control requirements have not been met as the title will never be transferred to the government nor can the government control the operator's practical ability to sell or pledge the infrastructure and government is not controlling the construction process. Therefore the Group's system is classified as property, plant and equipment and is not treated as infrastructure used in public-to-private service concession arrangements.

Risk related to tax position
NET4GAS was established by way of legal reorganisation of part of the business of RWE Transgas, a.s. ("RWE Transgas") due to the unbundling requirement under the so called Second Energy Package of the European Union, while part of the business of RWE Transgas was contributed to registered capital of NET4GAS. As a result of the unbundling process and related revaluation, the accounting carrying amounts of the gas transmission system under the Czech accounting legislation ("local GAAP") were significantly increased (based on an appointed appraiser's valuation) compared to their tax values (i.e. the historical cost based measurement rolled over from the tax books of RWE Transgas, which was the basis for tax depreciation). Due to the temporary differences between the new carrying amounts and the tax values of the transmission system, the deferred tax liability was recorded in 2006 against equity of NET4GAS under local GAAP. ERO has approved the inclusion of accounting depreciation (based on the revalued amounts) of the gas pipeline system in the final price for the inland gas transmission services for regulatory periods between 2005–2009 and 2010–2015. It means that the regulated prices (taxable income) charged by NET4GAS to its customers have been increased by the effect of local GAAP accounting depreciation, while the original tax base has been based on the historical costs of the gas pipeline system only.

NET4GAS considered the relation between eligible depreciation and eligible revenues, given by a regulatory formula, as costs directly tied to revenues according to Section 24(2)(zc) of the Income Tax Act, and in the 2008 through 2014 taxable periods, referring to the said provisions of the Income Tax Act, it considered the entire amount of local-GAAP-based accounting eligible depreciation to be a tax deductible expense. This method was reflected also in the calculation of the deferred tax.

Tax deductibility of part of the accounting depreciation of the gas pipeline system was reassessed by management supported by tax experts during 2010. Therefore, tax deduction for the difference between the accounting depreciation and historical cost based tax depreciation was claimed by NET4GAS in its remedial corporate income tax returns for the prior years from 2008 (the right to submit remedial tax returns for earlier years had expired).

Management believed that it was probable that the Group would receive the income tax benefits resulting from applying the accounting depreciation of the gas pipeline system over the period of its useful life. This position was supported by the fact that the tax authorities returned tax overpayments for the years 2008–2011.

However, during 2015 the Supreme Court decided on the same issue in a case of another company with similar business activities that the entity was not entitled to tax benefits resulting from applying the accounting depreciation of the gas pipeline system. The Group submitted the supplementary corporate income tax returns and paid up additional income tax charge of CZK 162 million in respect of 2012–2014 years (Note 26).

In 2015 the tax legislation has changed, in management's view, in favour of the Group. Therefore in 2015 NET4GAS applied the amended Income Tax Act, in which the provision of Section 23(4) (e) governs direct relation between tax non-deductible expenses and revenues. As a result of the change, part of the taxable income generated by the gas pipeline network was, in management's view, not taxable. Although the amended favourable rule was new and its application in the Company's specific case could be challenged, management was of the view that it was more likely than not, that the Company was able to sustain its position based on the amended law. The calculation of income tax charge for 2015 and deferred tax liability as at 31 December 2015 were based on this view.

Views of expert audience and professional advisors developed during 2016. As a result of the development, management no longer keeps the view that it is more likely than not, that the Company sustains its position. Management decided to recognise deferred tax liability related to the temporary differences of pipeline network in full amount without taking into account the (potential) benefit of the provision of Section 23(4) (e). As a result of this change in management estimate the deferred tax liability was increased by CZK 2,125 million and the change was recognised as an expense (loss) of the current period. This adjustment as a change in management view is a change in estimate in respect of deferred tax liability that was according to IAS 8 guidance recognised prospectively. It is neither a change in an accounting policy nor a correction of prior period error. Submitted income tax return for 2015 (filed on 24 October 2016, in extended deadline) reflected the revised management view.

Segments
Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or a group of persons who allocates resources and assesses the performance of the Group. Recurring revenues are from the contracts with foreign and domestic customers. Information for CODM (the Company's Statutory Directors) who are responsible for allocating resources and assessing performance of the Group is prepared for the whole Group without any particular structuring. Management regularly obtain information with assessment of the split of revenue between the transit revenue and domestic transmission revenue. There is no profit measure, which would be based on similar basis. All profit measures used by the CODM are based on the results of the Group considered as one business unit. As a result, management consider the whole Group as one segment for the purpose of segment reporting.

5. Adoption of New or Revised Standards and Interpretations and New Accounting Pronouncements

a) Adoption of new or revised standards and interpretations that are effective on or after 1 January 2016
Disclosure Initiative Amendments to IAS 1 (issued on 18 December 2014 and effective for annual periods on or after 1 January 2016). The Standard was amended to clarify the concept of materiality and explains that an entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material, even if the IFRS contains a list of specific requirements or describes them as minimum requirements. The Standard also provides new guidance on subtotals in financial statements, in particular, such subtotals (a) should be comprised of line items made up of amounts recognised and measured in accordance with IFRS; (b) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable; (c) be consistent from period to period; and (d) not be displayed with more prominence than the subtotals and totals required by IFRS standards.

No other new or revised standards and interpretations have material impact on the Group.

b) New standards and interpretations that have been issued and are mandatory for the annual periods beginning on or after 1 January 2017 or later
Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2017 or later, and which the Group has not early adopted.

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

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

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

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

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

- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in

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

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

Management of the Group is currently assessing the impact of the standard on the consolidated financial statements of the Group.

IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The Group is currently assessing the impact of the new standard on its consolidated financial statements, however does not expect material impact of the new standard on its financial position.

Amendments to IFRS 15, Revenue from Contracts with Customers (issued on 12 April 2016 and effective for annual periods beginning on or after 1 January 2018). The amendments do not change the underlying principles of the Standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new Standard. Management is currently assessing the impact of the amendment on its financial statements.

IFRS 16 "Leases" (issued in January 2016 and effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Group is currently assessing the impact of the amendment on its consolidated financial statements, however does not expect material impact of the new standard on its financial position (see Note 27 for operating lease commitments).

Disclosure Initiative – Amendments to IAS 7 (issued on 29 January 2016 and effective for annual periods beginning on or after 1 January 2017). The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities. Management is currently assessing the impact of the amendment on its consolidated financial statements.

IFRIC 22 – Foreign Currency Transactions and Advance Consideration (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018). The interpretation addresses how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part thereof) on the derecognition of a non-monetary asset or non-monetary liability arising from an advance consideration in a foreign currency. Under IAS 21, the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part thereof) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the date of the transaction for each payment or receipt of advance consideration. IFRIC 22 only applies in circumstances in which an entity recognises a non-monetary asset or non-monetary liability arising from an advance consideration. IFRIC 22 does not provide application guidance on the definition of monetary and non-monetary items. An advance payment or receipt of consideration generally gives rise to the recognition of a non-monetary asset or non-monetary liability, however, it may also give rise to a monetary asset or liability. An entity may need to apply judgment in determining whether an item is monetary or non-monetary. Management is currently assessing the impact of the amendments on its financial statements.

No other new or revised standards and interpretations have material impact on the Group.

6. Segment Information

(a) Description of products and services from which each reportable segment derives its revenue

The Group is organised on the basis of one main business segment – Natural gas transmission (representing natural gas transmission services).

(b) Factors that management used to identify the reportable segments

Refer to the information in Note 4.

(c) Information about reportable segment profit or loss, assets and liabilities

The whole Group is considered as one reportable segment. Segment information for the reportable segment for the years ended 31 December 2016 and 31 December 2015 is set out below:

In millions of Czech crowns	Natural gas transmission	Natural gas transmission
	2016	**2015**
Revenues	9,280	9,879
Foreign exchange differences, net	1	32
Other operating income	27	13
Finance income	8	17
Total segment income	**9,316**	**9,941**
Raw materials consumed	450	790
Employee benefits	510	461
Depreciation and amortization	2,080	2,463
Impairment	–	2
Services purchased and lease charges	510	807
Gains less losses on disposals of property, plant and equipment	(3)	(4)
Derivatives	(31)	1
Other operating expenses	36	97
Income tax expense	3,008	868
Finance costs	1,339	1,694
Segment profit for the year	**1,417**	**2,762**
Segment other comprehensive income for the year	**222**	**(829)**
Segment total comprehensive income for the year	**1,639**	**1,933**
Capital expenditure	**680**	**689**

In millions of Czech crowns	Natural gas transmission	Natural gas transmission
	31 December 2016	**31 December 2015**
Total reportable segment Assets	**45,952**	**49,846**
Total reportable segment Liabilities	**38,346**	**47,291**

Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

(d) Geographical information

Total revenues for geographical areas for which the revenues are material are reported separately and disclosed below.

The analysis is based on domicile of shippers (users of the transmission system that is operated by the Group in the Czech Republic).

In millions of Czech Crowns	2016	2015
Czech Republic	1,850	1,726
Other EU countries	2,129	2,382
Non-EU countries	5,301	5,771
Total consolidated revenues from core activities	**9,280**	**9,879**

Capital expenditure for each individual country for which it is material is reported separately as follows:

In millions of Czech Crowns	2016	2015
Czech Republic	680	689
Total consolidated capital expenditure	**680**	**689**

The analysis is based on location of assets. Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

(e) Major customers

Revenues from customers which represent 10% or more of the total revenues are as follows:

In millions of Czech Crowns	2016	2015
Customer 1	5,659	5,547
Customer 2	1,390	1,345
Customer 3	1,274	1,310
Total revenues from major customers	**8,323**	**8,202**

Revenues comprise only revenues from core activities.

Entities known to the Group as being under common control are considered as a single customer.

7. Balances and Transactions with Related Parties

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

The Company is fully owned by NET4GAS Holdings and NET4GAS Holdings is the ultimate parent company of the group.

The Group's balances and transactions with subsidiaries of ultimate parent of Allianz Infrastructure Czech HoldCo II S.à r.l. and subsidiaries of ultimate parent of Borealis Novus Parent B.V. are disclosed below within the category Subsidiaries of joint ventures' ultimate parents.

At 31 December 2016, the outstanding balances with related parties were as follows:

In millions of Czech crowns	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Loans to related parties (Note 12)		
NET4GAS Holdings, s.r.o.	–	652
Borrowings (Note 17)		
NET4GAS Holdings, s.r.o.	–	25

The subordinated borrowings from related parties amounting to CZK 11,000 million were settled in June 2016 (Note 17).

The income and expense items with related parties for the year ended 31 December 2016 were as follows:

In millions of Czech crowns	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Purchases / expenses		
NET4GAS Holdings, s.r.o. – interest expense	–	1
Borealis Novus Holdings B.V. – interest expense	182	–
Allianz Infrastructure Luxembourg I S.à r.l. – interest expense	182	–
Other revenues		
NET4GAS Holdings, s.r.o. – interest income	–	6
NET4GAS Holdings, s.r.o. – services	–	1

At 31 December 2015, the outstanding balances with related parties were as follows:

In millions of Czech crowns	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Gross amount of trade and other receivables		
NET4GAS Holdings, s.r.o.	–	1
Loans to related parties (Note 12)		
NET4GAS Holdings, s.r.o.	–	1,886
Borrowings (Note 17)		
Subordinated borrowings (contractual interest rate 6.3%, originally repayable on 28 July 2044)		
Allianz Infrastructure Luxembourg I S.à r.l.	5,500	–
Borealis Novus Holdings B.V.	5,500	–

The income and expense items with related parties for the year ended 31 December 2015 were as follows:

In millions of Czech crowns	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Purchases / expenses		
Borealis Novus Holdings B.V. – interest expense	352	–
Allianz Infrastructure Luxembourg I S.à r.l. – interest expense	352	–
Other revenues		
NET4GAS Holdings, s.r.o. – interest income	–	12
NET4GAS Holdings, s.r.o. – services	–	1

At 31 December 2016 and 2015 the Group did not have any other rights and obligations connected to related parties.

Key management compensation is presented below:

	2016		2015	
In millions of Czech Crowns	Expense	Accrued liability	Expense	Accrued liability
Short-term benefits:				
– Salaries	47	4	40	4
– Short-term bonuses	14	14	15	15
– Current portion of long-term bonuses	–	8	–	8
Other long-term employee benefits:				
– Long-term bonus scheme	13	32	10	29
– Defined contribution benefits	5	3	4	3
Total	**79**	**61**	**69**	**59**

Short-term bonuses fall due wholly within twelve months after the end of the period in which management rendered the related services.

Key management represents Statutory Directors and managers directly reporting to them.

8. Property, Plant and Equipment

Movements in the carrying amount of property, plant and equipment were as follows:

In millions of Czech Crowns	Freehold Land	Buildings and constructions	Plant and equipment	Construction in progress	Total
Cost at 1 January 2015	182	61,369	5,320	206	67,077
Accumulated depreciation	–	(15,533)	(4,021)	–	(19,554)
Carrying amount at 1 January 2015	**182**	**45,836**	**1,299**	**206**	**47,523**
Additions	–	–	–	645	645
Transfers	–	182	343	(525)	–
Disposals	–	(2)	(1)	–	(3)
Depreciation charge	–	(1,896)	(507)	–	(2,403)
Carrying amount at 31 December 2015	**182**	**44,120**	**1,134**	**326**	**45,762**
Cost at 31 December 2015	182	61,516	5,624	326	67,648
Accumulated depreciation	–	(17,396)	(4,490)	–	(21,886)
Carrying amount at 1 January 2016	**182**	**44,120**	**1,134**	**326**	**45,762**
Additions	–	–	–	634	634
Capitalised borrowing costs	–	–	–	13	13
Transfers	3	310	184	(497)	–
Disposals	–	(20)	–	–	(20)
Depreciation charge	–	(1,784)	(222)	–	(2,006)
Carrying amount at 31 December 2016	**185**	**42,626**	**1,096**	**476**	**44,383**
Cost at 31 December 2016	185	61,684	5,774	476	68,119
Accumulated depreciation	–	(19,058)	(4,678)	–	(23,736)
Carrying amount at 31 December 2016	**185**	**42,626**	**1,096**	**476**	**44,383**

As at 31 December 2016, construction in progress consists mainly of construction of Czech-Polish interconnector gas pipeline in the amount of CZK 252 million (31 December 2015: CZK 110 million). Upon completion, assets are expected to be transferred to buildings and constructions. Other items represent smaller projects.

9. Intangible Assets

In millions of Czech Crowns	Acquired software licences	Development costs	Other	Assets under construction	Total
Cost at 1 January 2015	397	60	24	31	512
Accumulated amortisation	(327)	(51)	(8)	–	(386)
Carrying amount at 1 January 2015	**70**	**9**	**16**	**31**	**126**
Additions	–	–	–	44	44
Transfers	43	–	–	(43)	–
Amortisation charge	(53)	(4)	(3)	–	(60)
Carrying amount at 31 December 2015	**60**	**5**	**13**	**32**	**110**
Cost at 31 December 2015	416	57	24	32	529
Accumulated amortisation	(356)	(52)	(11)	–	(419)
Carrying amount at 1 January 2016	**60**	**5**	**13**	**32**	**110**
Additions	–	–	–	33	33
Transfers	43	–	2	(45)	–
Amortisation charge	(48)	(3)	(3)	–	(54)
Carrying amount at 31 December 2016	**55**	**2**	**12**	**20**	**89**
Cost at 31 December 2016	458	54	26	20	558
Accumulated amortisation	(403)	(52)	(14)	–	(469)
Carrying amount at 31 December 2016	**55**	**2**	**12**	**20**	**89**

10. Other Non-Current Assets

In millions of Czech crowns	31 December 2016	31 December 2015
Advances for acquisition of fixed assets	9	1
Total other non-current assets	**9**	**1**

11. Inventories

In millions of Czech crowns	31 December 2016	31 December 2015
Raw materials	63	65
Total inventories	**63**	**65**

Raw materials are mainly spare parts for the gas transmission system.

There are no inventories valued at net realisable value as at 31 December 2016 and 2015.

12. Loans to Related Parties

In millions of Czech crowns	31 December 2016	31 December 2015
Corporate loans		
– denominated in Czech Crowns	164	–
– denominated in Euros	488	1,886
Total loans provided	**652**	**1,886**

Loans to related parties as at 31 December 2016 mature on 30 June 2017 at the latest (31 December 2015: 31 March 2016).

Interest rates related to loan to related parties are disclosed in Note 29, section interest rate risk.

Analysis by credit quality of loans outstanding is as follows:

In millions of Czech crowns	31 December 2016 Corporate loans	31 December 2015 Corporate loans
Neither past due nor impaired		
– NET4GAS Holdings, s.r.o. – parent company (without external rating)	652	1,886
Total neither past due nor impaired	**652**	**1,886**
Total loans provided	**652**	**1,886**

There are no collaterals related to the above mentioned loans.

Refer to Note 31 for the estimated fair value of each class of loans. Interest rate analysis of loans is disclosed in Note 29. Information on related party transactions is disclosed in Note 7.

13. Trade and Other Receivables

In millions of Czech crowns	31 December 2016	31 December 2015
Trade and estimated receivables	304	122
Less impairment loss provision	(1)	(3)
Total current trade and other receivables	**303**	**119**

Analysis by credit quality of trade and other receivables is as follows:

In millions of Czech crowns	31 December 2016 Trade and estimated receivables	31 December 2015 Trade and estimated receivables
Neither past due nor impaired – exposure to		
– Between A- and BBB-*	238	86
– Not rated	47	33
Total neither past due nor impaired	285	119
Past due but not impaired		
– less than 30 days overdue	9	–
– between 30–60 days overdue	9	–
Total past due but not impaired	18	–
Individually determined to be impaired (gross)		
– 360 days or more overdue	1	3
Total individually impaired	1	3
Less impairment provision	(1)	(3)
Total trade and other receivables	**303**	**119**

* Rating disclosed is equivalent credit rating from the third party rating agencies defined in the Network Code approved by ERO which is applicable for the Company.

14. Other Non-Financial Assets

In millions of Czech crowns	31 December 2016	31 December 2015
Value-added tax	3	16
Prepayments for services	24	36
Other receivables	–	7
Total current non-financial assets	**27**	**59**

15. Cash and Cash Equivalents

In millions of Czech crowns	31 December 2016	31 December 2015
Bank balances available on demand	415	1,213
Deposit bills of exchange with original maturity of less than three months	–	537
Total cash and cash equivalents	**415**	**1,750**

The credit quality of cash and cash equivalents balances may be summarised as follows:

	31 December 2016		31 December 2015	
	Bank balances payable on demand	Deposit bills of exchange	Bank balances payable on demand	Deposit bills of exchange
Neither past due nor impaired				
– A+ to A- rated	376	–	422	537
– BBB+ to BBB- rated	39	–	791	–
Total	**415**	**–**	**1,213**	**537**

16. Equity

The Company is a limited liability company. It has no issued share securities. The rights attributed to share in the equity correspond to the proportion in the ownership interest.

Dividends declared and paid during the year were as follows:

In millions of Czech crowns	2016	2015
Dividends payable at 1 January	–	–
Dividends declared and paid during the year	1,540	1,566
Dividends payable at 31 December	–	–

Advance dividends paid during the year were as follows:

In millions of Czech crowns	2016	2015
Advance dividends paid	1,650	2,900
Total advance dividends paid	**1,650**	**2,900**

All dividends were declared in Czech Crowns and paid in a different currency mix (CZK, EUR and USD).

On 15 December 2016 (on 10 December 2015), the Statutory Directors of the Company decided about the advance dividend payment of CZK 1,650 million (2015: 2,900 CZK million). The payment of the advance dividend is subsequently subject to approval of the general meeting of the sole shareholder of the Company. The advance dividend payments are recognised as a decrease in equity as at the date of the payment.

A description of the nature and purpose of each reserve is provided below the table.

In millions of Czech Crowns	Capital contributions outside registered capital	Cash flow hedges	Total other reserves
Balance as at 1 January 2015	**29**	**(1,206)**	**(1,177)**
Revaluation – gross	–	(1,342)	(1,342)
Reclassification to profit or loss (Revenues) – gross	–	275	275
Reclassification to profit or loss (Finance costs) – gross	–	44	44
Deferred tax effect	–	194	194
Balance as at 31 December 2015	**29**	**(2,035)**	**(2,006)**
Revaluation – gross	–	(2)	(2)
Reclassification to profit or loss (Revenues) – gross	–	275	275
Reclassification to profit or loss (Finance costs) – gross	–	1	1
Deferred tax effect	–	(52)	(52)
Non-cash contribution to equity (Note 17)	6,602	–	6,602
Balance as at 31 December 2016	**6,631**	**(1,813)**	**4,818**

Capital contributions outside registered capital
Capital contributions outside registered capital comprises of cash and non-cash capital contributions that does not give rise to the registered capital.

Cash flow hedges
Cash flow hedges are used to record gains or losses on hedging instruments that are designated and qualify as cash flow hedges and that are recognised in other comprehensive income, as described in Note 3(d). Amounts are reclassified to profit or loss when the associated hedged transaction affects profit or loss.

17. Borrowings

In millions of Czech crowns	31 December 2016	31 December 2015
Subordinated borrowings from related parties (originally repayable on 28 July 2044)	–	11,000
Short-term borrowings from related parties (cash pooling NET4GAS Holdings)	25	–
Current portion of bonds and bank borrowings		
– CZK denominated bank borrowings (repayable on 28 July 2018)	–	–
– USD denominated bank borrowings (repayable on 28 July 2018)	–	–
– CZK denominated bond (repayable on 28 January 2021)	117	119
– EUR denominated bond (repayable on 28 July 2021)	70	72
– EUR denominated bond (repayable on 28 July 2026)	59	61
– EUR denominated bond (repayable on 28 July 2026) – issued in 2015	15	16
Non-current bonds and bank borrowings		
– CZK denominated bank borrowings (repayable on 28 July 2018)	5,736	5,724
– USD denominated bank borrowings (repayable on 28 July 2018)	1,381	1,334
– CZK denominated bond (repayable on 28 January 2021)	6,952	6,936
– EUR denominated bond (repayable on 28 July 2021)	8,055	8,042
– EUR denominated bond (repayable on 28 July 2026)	4,291	4,289
– EUR denominated bond (repayable on 28 July 2026) – issued in 2015	1,346	1,345
Total borrowings – current	**286**	**286**
Total borrowings – non-current	**27,761**	**38,670**
Total borrowings	**28,047**	**38,938**

Borrowings from related parties
Part of loans from related parties Borealis Novus Holdings B.V. and Allianz Infrastructure Luxembourg I S.à r.l. in total amount of CZK 11,000 million was settled in cash (CZK 2,500 million). Remaining amount of CZK 8,500 million was cessed to NET4GAS Holdings. It was subsequently netted against receivable from contribution to Company's other reserves of CZK 6,602 million and also netted against loan provided to NET4GAS Holdings of CZK 1,898 million.

Bank borrowings and bonds
The Group borrowings are constituted by bank borrowings acquired in 2014 and bond borrowings issued in 2014 and 2015. The bank borrowings were acquired pari-passu as well as bonds were issued pari-passu and have the senior position to the subordinated borrowings from related parties. The bank borrowings were denominated in CZK and USD.

Further, the Group acquired the committed revolving facility agreement in equivalent of EUR 100 million (CZK 2,702 million per Czech National Bank foreign exchange rate as at 31 December 2016). The revolving facility agreement might be utilized in CZK or EUR. In 2015 the revolving facility agreement was undrawn. During 2016 the revolving facility agreement was drawn and repaid, as at 31 December 2016 was undrawn.

Nine banks with different share participated on the total bank borrowings as at 31 December 2016 (seven banks as at 31 December 2015).

There is no collateral related to the above mentioned bank borrowings or bonds.

The bank borrowings and bonds have no quantitative financial covenants. There are several qualitative covenants applied, i.e. negative pledge, change of control put and loss of licence put. Violation of these covenants can lead to immediate maturity of the debt.

The Group's right to lien its property in favour of another creditor is restricted due to conditions stated in bank and bond financing contracts.

Bank borrowings and bonds denominated in foreign currency represent a constituent of hedge accounting, which represents the hedging instrument for securing of foreign exchange risk associated with a highly probable forecasted future cash flows resulting from natural gas transmission revenues (cash flow hedge) – Note 29, Note 3d).

Bonds issued:

In millions of Czech Crowns	Issue nominal value	Due date	Annual coupon repayment due date	31 December 2016	31 December 2015
Bond EUR, serial no. 1, ISIN XS1090450047	300,000,000 EUR	28 Jul 2021	Each 28.7. in arrears	8,125	8,114
Bond EUR, serial no. 2, ISIN XS1090449627	160,000,000 EUR	28 Jul 2026	Each 28.7. in arrears	4,350	4,350
Bond CZK, serial no. 3, ISIN XS1090620730	7,000,000,000 CZK	28 Jan 2021	Each 28.1. in arrears	7,069	7,055
Bond EUR, serial no. 4, ISIN XS1172113638	50,000,000 EUR	28 Jul 2026	Each 28.7. in arrears	1,361	1,361
Total bonds				**20,905**	**20,880**

Coupon rates to the above mentioned bonds are in range of 2.25% – 3.5% p.a. On 28 July 2014 bonds, serial no. 1–3, were accepted for trading on a regulated market of the Irish Stock Exchange PLC. The terms of issue of all above stated bonds have been approved by the decision of the Central Bank of Ireland. The 2015 bond, serial no. 4, was issued via private placement.

The fair value of borrowings is disclosed in Note 31.

18. Government and Other Grants

The Company obtained grants from European Commission for construction projects specified below and deducted the grant value from the carrying amount of the related property, plant and equipment when all conditions attached to the grant were fulfilled. In 2013, the Company received a grant of CZK 7 million and in 2015 a grant of CZK 10 million and a part of this amount of CZK 3 million was deducted from the carrying amount of property, plant and equipment in 2015 for Action no. 2011-G190/11-ENER/11/TEN-E-SI2.636400 based on the European Commission decision concerning the granting of Union financial aid in the field of Regulation Trans-European energetic networks. The Company has not complied with all attached conditions as at 31 December 2016 and 2015 yet and therefore the amount received was presented as part of other non-financial liabilities (Note 22). During 2015 and 2016, the Company also received grants from the European Commission of approximately CZK 1 million for the above mentioned construction project and this amount was deducted from the carrying amount of property, plant and equipment in 2016.

19. Other Taxes Payable

In millions of Czech crowns	31 December 2016	31 December 2015
Other taxes payable within one year comprise:		
Property and other taxes	8	5
Social and health insurance	12	9
Other taxes payable – current	**20**	**14**

20. Provisions for Liabilities and Charges

Movements in provisions are as follows:

	2016		2015	
In millions of Czech Crowns	Current	Non-current	Current	Non-current
Carrying amount at January 1	**40**	**177**	**–**	**175**
Additions charged to profit or loss	–	2	40	5
Unused amounts reversed	–	(12)	–	(3)
Amounts used during the year	(40)	–	–	–
Carrying amount at December 31	**–**	**167**	**40**	**177**

The non-current provisions as at 31 December 2016 and 2015 were primarily set aside for restructuring on selected compressor stations. The non-current restructuring provisions as at 31 December 2016 are expected to be utilised in 2021 (as at 31 December 2015: in 2021).

21. Trade and Other Payables

In millions of Czech crowns	31 December 2016	31 December 2015
Trade payables for purchased property, plant and equipment	145	156
Trade payables – other	106	178
Accrued liabilities for purchased property, plant and equipment	20	54
Accrued liabilities – other	111	102
Received deposits from customers	139	126
Other financial liabilities	3	7
Total financial payables within trade and other payables – current	**524**	**623**
Other payables	8	2
Total financial payables within other payables – non-current	**8**	**2**

22. Accrued Employees Benefits and Other Non-Financial Liabilities

In millions of Czech crowns	31 December 2016	31 December 2015
Accrued employee benefits		
– Salaries and bonuses	31	21
– Defined contribution costs	15	20
– Untaken holiday costs	7	–
Advance payments received	130	299
Other non-financial liabilities	6	2
Total accrued employee benefits and other non-financial liabilities – current	**189**	**342**

In millions of Czech crowns	31 December 2016	31 December 2015
Accrued employee benefits – other long-term benefits	100	68
Grant pre-payments received (Note 18)	15	15
Total accrued employee benefits and other non-financial liabilities – non-current	**115**	**83**

23. Expenses

In millions of Czech crowns	2016	2015
Raw materials consumed*	450	790
Salaries	*338*	*293*
Statutory and private pension contribution	*172*	*168*
Employee benefits	510	461
Depreciation and amortisation	2,080	2,463
Impairment	–	2
Repairs and maintenance services	*137*	*145*
Flexibility service costs	*25*	*330*
IT & Telecommunications expenses	*98*	*104*
Consultancy and advisory services	*74*	*52*
Lease charges	*52*	*58*
Marketing	*21*	*23*
Other services	*103*	*95*
Services purchased and lease charges	510	807
(Gains) on disposal of fixed assets	(3)	(4)
Losses / (gains) on derivative financial instruments	(31)	1
Other expenses	36	97
Total operating expenses	**3,552**	**4,617**

* Represents mainly consumption of natural gas.

24. Finance Income

In millions of Czech crowns	2016	2015
Interest income on other financial assets	7	15
Other finance income	1	2
Total finance income recognised in profit or loss	**8**	**17**

25. Finance Costs

In millions of Czech crowns	2016	2015
Net foreign exchange differences on financing activities	262	259
Interest expense	1,016	1,369
Other finance costs	61	66
Total finance costs recognised in profit or loss	**1,339**	**1,694**

26. Income Taxes

For details about the risks related to tax position refer to Note 4.

(a) Components of income tax expense

Income tax expense / (credit) recorded in profit or loss comprises the following:

In millions of Czech crowns	2016	2015
Supplementary income tax return for prior years filed (Note 4)	–	162
Adjustment in respect of current income tax from prior year	48	–
Current income tax expense	928	860
Deferred income tax expense / (credit)	2,032	(154)
Income tax expense for the year in statement of profit or loss	**3,008**	**868**

(b) Reconciliation between the tax expense and profit or loss multiplied by applicable tax rate

The income tax rate applicable to the majority of the Group's 2016 and 2015 income is 19%. The reconciliation between the expected and the actual tax charge is provided below.

In millions of Czech crowns	2016	2015
Profit before tax	**4,425**	**3,630**
Theoretical tax charge at statutory rate of 19%:	841	690
Tax effect of items which are not deductible or assessable for income tax purposes:		
– Non-deductible expenses	6	14
Difference between current income tax provision and final current income tax return	48	4
Supplementary income tax returns for prior years (2012–2014) (Note 4)	–	162
Other effects	(12)	(2)
Increase in deferred tax liability – change in estimate (Note 4)	2,125	–
Income tax expense for the year	**3,008**	**868**

(c) Deferred taxes analysed by type of temporary difference

Differences between IFRS and tax regulation in the Czech Republic give rise to temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below.

In millions of Czech Crowns	1 January 2016	(Charged) / credited to profit or loss	(Charged) / credited to other comprehensive income	31 December 2016
Tax effect of deductible/(taxable) temporary differences				
Difference between tax and accounting carrying amounts of property, plant and equipment (different tax depreciation)	(4,781)	(2,029)	–	(6,810)
Impairment provision for receivables	1	(1)	–	–
Other liabilities; tax deductible in different period	24	–	–	24
Provisions for liabilities and charges	33	(2)	–	31
Cash flow hedges	477	–	(52)	425
Net deferred tax asset/(liability)	**(4,246)**	**(2,032)**	**(52)**	**(6,330)**

Management estimates that net deferred tax liabilities of CZK 6,330 million (2015: CZK 4,246 million) are recoverable in more than twelve months after the end of the reporting period.

The tax effects of the movements in the temporary differences for the year ended 31 December 2015 were:

In millions of Czech Crowns	1 January 2015	(Charged) / credited to profit or loss	(Charged) / credited to other comprehensive income	31 December 2015
Tax effect of deductible/(taxable) temporary differences				
Difference between tax and accounting carrying amounts of property, plant and equipment (different tax depreciation)	(4,922)	141	–	(4,781)
Impairment provision for receivables	–	1	–	1
Other liabilities; tax deductible in different period	11	13	–	24
Provisions for liabilities and charges	33	–	–	33
Cash flow hedges	283	–	194	477
Net deferred tax asset/(liability)	**(4,595)**	**155**	**194**	**(4,246)**

(d) Tax effects in the other comprehensive income

Disclosure of tax effects relating to cash flow hedge reserve (see also Note 16):

	31 December 2016			31 December 2015		
In millions of Czech Crowns	Before tax	Tax effects	After tax	Before tax	Tax effects	After tax
Cash flow hedge	(2,238)	425	(1,813)	(2,512)	477	(2,035)
Other comprehensive income for the period	**(2,238)**	**425**	**(1,813)**	**(2,512)**	**477**	**(2,035)**

27. Contingencies and Commitments

Operating lease commitments in respect of lease agreements for offices Kavčí hory Office Park and car fleet are as follows:

In millions of Czech crowns	2016	2015
Not later than 1 year	44	51
Total operating lease commitments	**44**	**51**

Capital expenditure commitments. As at 31 December 2016 the Group has contractual capital expenditure commitments in respect of property, plant and equipment of CZK 274 million (31 December 2015: CZK 198) mainly related to Czech-Polish Interconnector gas pipeline of CZK 125 million (31 December 2015: CZK 14 million) and Optimus project – optimisation project on compressor stations of CZK 70 million (31 December 2015: CZK 98 million).

Guarantees. The Group did not record any obligations from financial guarantees as at 31 December 2016 and 2015.

Assets pledged and restricted. In connection with the Group's bank borrowings, the Group's right to lien its property in favour of another creditor is restricted.

Compliance with covenants. The Group is subject to certain qualitative covenants related to its borrowings. Non-compliance with such covenants may result in immediate maturity of the debt. The Group was in compliance with covenants at 31 December 2016 and 31 December 2015.

28. Derivative Financial Instruments

The table below sets out fair values, at the end of the reporting period, of currencies receivable or payable under cross currency interest rate swaps and foreign exchange swap contracts entered into by the Group. The table reflects gross positions before the offsetting of any counterparty positions (and payments) and covers the contracts with settlement dates after the respective end of the reporting period.

Cross currency interest rate swap contracts are long-term while foreign exchange swap contracts are short-term in nature. The respective part of fair value of a hedging derivative is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months.

The Group did not have any other derivative financial instruments besides cross currency interest rate swaps and foreign exchange swaps.

The disclosure below provides aggregated overview of the fair value of receivable and payable legs of individual contracts per currency mix.

	31 December 2016			
	Current		Non-Current	
In millions of Czech Crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Cross currency interest rate swaps: fair values, as at the reporting period, of				
EUR/USD currency mix				
– USD payable on settlement (-)	–	(578)	–	(13,884)
– EUR receivable on settlement (+)	–	287	–	11,527
EUR/CZK currency mix				
– CZK payable on settlement (-)	–	(39)	–	(1,764)
– EUR receivable on settlement (+)	–	38	–	1,643
Net fair value of cross currency interest rate swaps	**–**	**(292)**	**–**	**(2,478)**

Inputs used: Market data provided by commercial bank holding the related instruments, Czech National Bank foreign exchange rates.

	31 December 2015			
	Current		Non-Current	
In millions of Czech Crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Cross currency interest rate swaps: fair values, as at the reporting period, of				
EUR/USD currency mix				
– USD payable on settlement (-)	–	(562)	–	(13,910)
– EUR receivable on settlement (+)	–	287	–	11,495
EUR/CZK currency mix				
– CZK payable on settlement (-)	–	(39)	–	(1,730)
– EUR receivable on settlement (+)	–	38	–	1,611
Net fair value of cross currency interest rate swaps	**–**	**(276)**	**–**	**(2,534)**

Inputs used: Market data provided by commercial bank holding the related instruments, Czech National Bank foreign exchange rates.

The Group had one outstanding obligation from foreign exchange swaps as at 31 December 2016. The Group had no outstanding obligations from foreign exchange swaps as at 31 December 2015 since all these derivatives were settled during 2015.

	31 December 2016		31 December 2015	
	Current		Non-Current	
In thousands of Czech Crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Foreign exchange swaps: fair values, as at the reporting period, of				
– CZK receivable on settlement (+)	(108)	–	–	–
– EUR payable on settlement (-)	108	–	–	–
Net fair value of foreign exchange swaps – current	**–**	**–**	**–**	**–**

Cross currency interest rate swaps and foreign exchange swaps entered into by the Group are generally traded in an over-the--counter market with professional market counterparties on standardized contractual terms and conditions. Aforementioned financial instruments have potentially favourable (assets) or unfavourable (liabilities) conditions as a result of fluctuations in foreign exchange rates, market interest rates or other variables relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly during the life time of derivatives.

Cross currency interest rate swaps
The nominal principal amounts of the outstanding cross currency interest rate swap contracts at 31 December 2016 were EUR 410 million / USD 484 million / CZK 1,397 million (2015: EUR 410 million / USD 484 million / CZK 1,397 million). All cross currency interest rate swaps have fixed interest rates on both legs. At 31 December 2016, the fixed interest rates vary from 2.50% to 5.23% p.a. (as at 31 December 2015: 2.50% to 5.23% p.a.).

The Group designates certain cross currency interest rate swaps, in combination with bonds denominated in EUR, as hedging instrument of a foreign exchange risk associated with a highly probable forecasted cash flows from natural gas transmission revenues (cash flow hedge) – Note 29, Note 3d).

The Group designates certain cross currency interest rate swaps as hedging instrument of a foreign exchange risk associated with a highly probable forecasted cash flows from bond issued (cash flow hedge) – Note 29, Note 3d).

29. Financial Risk Management

The risk management function within the Group is carried out in respect of financial risks, operational risks, market risks and environment risks. Financial risk comprises market risk (including currency risk and interest rate risk), credit risk and liquidity risk. Management sets a strategy for each of the risk, including a limit on open position that may be accepted. The primary objectives of the financial risk management function are then ensure that exposure to risks stays within these limits. Monitoring is performed continuously but minimum on a monthly basis.

Credit risk. Exposure to credit risk arises as a result of cash and cash equivalents held with banks, loans provided to related parties, the Group's sales of services on credit terms and other transactions with counterparties giving rise to financial assets.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to counterparties. Limits on the level of credit risk are approved by management. The risks are monitored on a revolving basis and are subject to a monthly review. The Group is exposed to credit concentration risk considering the receivables from financial institutions.

The credit risk is mitigated by advance payments and a system of creditworthiness conditions which are applied to the Group's customers, suppliers of services with potential significant credit position and financial counterparties such as banks or insurance companies. The conditions are incorporated in the Network Code, relevant tender documentations and internal guidelines.

The Group's management reviews ageing analysis of outstanding trade and other receivables and follows up on past due balances. Management therefore considers it appropriate to provide ageing and other information about credit risk as disclosed in Note 13 and in Note 15.

Market risks. The Group takes on exposure to market risks. Market risks arise from open positions in (a) foreign currencies and (b) interest bearing assets and liabilities, all of which are exposed to general and specific market movements.

Sensitivities to market risks included below are based on a change in a factor while holding all other factors constant. In practice this is unlikely to occur and changes in some of the factors may be correlated – for example, changes in interest rate and changes in foreign currency rates.

Currency risk. The Group treasury's risk management policy is to hedge the long-term contracted cash flows (mainly revenues from the gas transmission) in each major foreign currency up until 2034. Management approves the strategy of the currency risk management. The positions are monitored continuously but at minimum on a monthly basis. The amount of risk is evaluated in terms of open positions.

The offsetting of currency positions is applied where possible. When needed the outstanding positions are managed by means of buying or selling the relevant currency in the short term derivative forward or swap contract. The Group reports one outstanding obligation from foreign exchange swaps as at 31 December 2016. In 2015 there were no obligations.

The table below summarises the Group's exposure to foreign currency exchange rate risk at the end of the reporting period:

	At 31 December 2016					At 31 December 2015			
In millions of Czech Crowns	Monetary financial assets	Monetary financial liabilities	Derivatives (assets)	Derivatives (liabilities)	Net position	Monetary financial assets	Monetary financial (liabilities)	Derivatives (liabilities)	Net position
US Dollars	2	1,383	–	12,404	(13,785)	49	1,334	12,009	(13,294)
Euros	691	13,868	108	(11,078)	(1,991)	2,261	13,844	(11,080)	(503)
Total exposed to currency risk	**693**	**15,251**	**108**	**1,326**	**(15,776)**	**2,310**	**15,178**	**929**	**(13,797)**
Czech Crowns	413	13,054	(108)	1,397	(14,146)	1,340	24,122	1,397	(24,179)
Total	**1,106**	**28,305**	**–**	**2,723**	**(29,922)**	**3,650**	**39,300**	**2,326**	**(37,976)**

As at 31 December 2016 and 2015 the outstanding derivatives, cross currency interest rate swaps and foreign exchange swaps, were disclosed in their notional amounts translated to Czech Crowns using foreign exchange rate as at 31 December 2016 and 2015. The fair values are disclosed in Note 31.

The above analysis includes only monetary assets and liabilities. Investments in non-monetary assets are not considered to give rise to any material currency risk.

Hedging of currency risk. In 2014, the Group decided to introduce two cash-flow hedges to manage the foreign exchange currency risk in revenues in line with the Group treasury's policy. The financial instruments designated as hedging instruments are represented by (a) bank borrowing denominated in USD, (b) 33 % of bonds maturing in 2021 denominated in EUR and (c) joint hedging instrument of 66 % of bonds maturing in 2021 denominated in EUR and bonds maturing in 2026 denominated in EUR and cross currency interest rate swaps EUR/USD (Note 17, Note 28). The hedged item is represented by contracted or highly probable forecasted natural gas transmission revenues denominated in foreign currencies (in USD and in EUR) that are expected to occur on a monthly basis up until 2034. The dynamic hedging strategy is applied to hedged item. This strategy allows identification of hedged item in any period of the hedge accounting and is based on the continuous designation and re-designation of hedged item on a monthly basis from 28 July 2014 to 31 December 2034. Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until the repayment of the hedging instruments and within revenue up until 2034 which is beyond the repayment date of the hedging instruments (Note 17, Note 28). Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until the repayment of the hedging instruments and within revenue up until 2034, which is beyond the repayment date of the hedging instruments (Note 17, Note 28). There was no ineffectiveness to be recorded from cash flow hedges in 2016 and 2015.

In 2015, the Group introduced additional, third, cash-flow hedge. The financial instruments designated as hedging instruments are represented by cross currency interest rate swap EUR/CZK (Note 17, Note 28). The hedged item is represented by cash flow related to private placement EUR bond maturing in 2026. Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until 2026 (Note 17, Note 28). In 2016, there were no additional hedges. The hedged item is represented by cash flow related to private placement EUR bond maturing in 2026. Gains and losses recognised in other reserves in equity will be continuously released to profit or loss within finance costs up until 2026 (Note 17, Note 28). There was no ineffectiveness to be recorded from cash flow hedges in 2016 and 2015. The table below analyses the volume of hedged cash flows that were designated as hedged item:

In millions of Czech Crowns	Within 1 year	1–3 years	3–5 years	5–10 years	Over 10 years	Total
31 December 2016						
Currency risk exposure:						
Hedging of future cash flows – future receivables USD	1,711	2,497	1,958	5,441	1,345	12,952
Hedging of future cash flows – future receivables EUR	–	1,337	1,189	–	–	2,526
Hedging of future cash flows – future payables EUR	(38)	(76)	(76)	(1,540)	–	(1,730)
TOTAL	**1,673**	**3,758**	**3,071**	**3,901**	**1,345**	**13,748**

In millions of Czech Crowns	Within 1 year	1–3 years	3–5 years	5–10 years	Over 10 years	Total
31 December 2015						
Currency risk exposure:						
Hedging of future cash flows – future receivables USD	1,657	3,154	1,832	4,086	996	11,725
Hedging of future cash flows – future receivables EUR	–	599	1,485	442	–	2,526
Hedging of future cash flows – future payables EUR	(37)	(76)	(76)	(189)	(1,389)	(1,767)
TOTAL	**1,620**	**3,677**	**3,241**	**4,339**	**(393)**	**12,484**

The amount of reclassified other comprehensive income to revenues during 2016 decreased revenues by CZK 275 million (2015: decreased revenues by CZK 275 million). The amount of reclassified other comprehensive income to financial costs during 2016 increased financial costs by CZK 1 million (2015: increased financial costs by CZK 44 million).

The following table presents sensitivities of profit or loss or equity (cash flow hedge) to reasonably possible changes in exchange rates applied at the end of the reporting period relative to the functional currency, with all other variables held constant:

	At 31 December 2016		At 31 December 2015	
In millions of Czech Crowns	Impact on profit or loss	Impact on equity	Impact on profit or loss	Impact on equity
US Dollar strengthening by 10%	10	(1,284)	5	(1,282)
US Dollar weakening by 10%	(10)	1,284	(5)	1,282
Euro strengthening by 10%	77	(31)	224	(35)
Euro weakening by 10%	(77)	31	(224)	35

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the respective entity of the Group and for currency sensitive derivatives.

The Group's exposure to currency risk with impact to profit or loss as at 31 December 2016 is influenced by (i) cash balances held in foreign currency and (ii) by existing loans to related parties provided in EUR (Note 12, Note 24 and Note 25).

Interest rate risk. The Group's bank borrowings are contracted at floating interest rates. Some instruments, like bonds and fix-to-fix cross currency interest rate swaps, are priced at fixed rates and are exposed to re-pricing risk at maturity. The fair value is among other factors also sensitive to interest rates through the discounted cash flow model which is used for the valuation (see Note 31a).

The table below summarises the Group's exposure to interest rate risks (e.g. term deposits; bonds and borrowings from related parties on fixed rate, both with re-pricing risk). The table presents the aggregated amounts of the Group's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest re-pricing or maturity dates.

In millions of Czech Crowns	On demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
31 December 2016					
Financial assets – floating rate	417	–	–	–	417
Financial assets – fixed rate with re-pricing risk	650	–	–	–	650
Financial liabilities– floating rate	(7,142)	–	–	–	(7,142)
Financial liabilities– fixed rate with re-pricing risk	–	–	(15,194)	(5,711)	(20,905)
Net interest sensitivity gap at 31 December 2016	**(6,075)**	**–**	**(15,194)**	**(5,711)**	**(26,980)**
31 December 2015					
Financial assets – floating rate	1,213	–	–	–	1,213
Financial assets – fixed rate with re-pricing risk	2,423	–	–	–	2,423
Financial liabilities– floating rate	(7,046)	–	–	–	(7,046)
Financial liabilities– fixed rate with re-pricing risk	–	–	–	(31,892)	(31,892)
Net interest sensitivity gap at 31 December 2015	**(3,410)**	**–**	**–**	**(31,892)**	**(35,302)**

As the Group's bank assets and liabilities (borrowings) are directly exposed to the floating interest rate, the change in interest rates has an impact on the Group's profit or loss for the current year.

The following table presents sensitivities of profit or loss to reasonably possible changes in short term interest rates applied at the end of the reporting period, with all other variables held constant:

	At 31 December 2016
In millions of Czech crowns	Impact on profit or loss
1M CZK PRIBOR increase by 25 bps	(14)
1M CZK PRIBOR decrease by 25 bps	14
1M USD LIBOR increase by 25 bps	(3)
1M USD LIBOR decrease by 25 bps	3
Overnight PRIBOR/EURIBOR increase by 25 bps	1
Overnight PRIBOR/EURIBOR decrease by 25 bps	(1)

	At 31 December 2015
In millions of Czech crowns	Impact on profit or loss
1M CZK PRIBOR increase by 25 bps	(14)
1M CZK PRIBOR decrease by 25 bps	14
1M USD LIBOR increase by 25 bps	(3)
1M USD LIBOR decrease by 25 bps	3
Overnight PRIBOR increase by 25 bps	3
Overnight PRIBOR decrease by 25 bps	(3)

The Group interest rate risk management policy requires that at least 70% of the interest rate exposure arising from bonds and term loans is at fixed rate. The existing financing structure achieves this requirement.

The Group's exposure to interest rate risk at the end of the reporting period is representative of the typical exposure during the year, starting from July 2014.

The Group monitors interest rates for its financial instruments. The table below summarises effective interest rates at the respective end of the reporting period based on reports reviewed by key management personnel:

	31 December 2016			31 December 2015		
In % p.a.	CZK	USD	EUR	CZK	USD	EUR
Assets						
Cash and cash equivalents	0.10	0.01	0.01	0.10	0.01	0.01
Loans to related parties	0.96	n/a	0.39	n/a	n/a	0.70
Liabilities						
Borrowings	2.18	2.28	3.00	4.20	1.95	3.00

Liquidity risk. Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Group is exposed to daily calls on its available cash resources. Liquidity risk is managed by Treasury department of the Group and monitored in terms of monthly (one month forward), short-term (one year forward) and mid-term (five years forward) forecasts. Management monitors short-term forecasts of the Company's cash flows provided on the monthly basis.

The Group has strong liquidity position and is able to secure its operating funding needs through the cash collected from the business operations continuously throughout the year. The Group's liquidity portfolio comprises cash and cash equivalents (Note 15) and bank term deposits and deposit bills. Management estimates that the liquidity portfolio can be realised in cash within few days in order to meet unforeseen liquidity requirements.

The tables below show liabilities as at 31 December 2016 and 2015 by their remaining contractual maturity. The amounts disclosed in the table below are the contractual undiscounted cash flows and gross loan commitments. Such undiscounted cash flows differ from the amount included in the balance sheet because the balance sheet amount is based on discounted cash flows Financial derivatives are included at the contractual amounts to be paid or received, unless the Group expects to close the derivative position before its maturity date in which case the derivatives are included based on the expected cash flows.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. Foreign currency payments are translated using the spot exchange rate at the end of the reporting period.

The maturity analysis of financial liabilities at 31 December 2016 is as follows:

In millions of Czech Crowns	Demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities					
Bank borrowings, bonds and borrowings from related parties (Note 17)	212	485	24,503	6,620	31,820
Trade and other payables (Note 21)	524	–	8	–	532
Gross settled cross currency interest rate swaps (Note 28)					
– inflows	–	(324)	(6,701)	(6,620)	(13,645)
– outflows	–	620	9,374	8,567	18,561
Total future payments, including future principal and interest payments	**736**	**781**	**27,184**	**8,567**	**37,268**

The maturity analysis of financial liabilities at 31 December 2015 is as follows:

In millions of Czech Crowns	Demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities					
Bank borrowings, bonds and borrowings from related parties (Note 19)	361	1,010	12,281	49,839	63,491
Trade and other payables (Note 23)	623	–	1	–	624
Gross settled cross currency interest rate swaps (Note 30)					
– inflows	–	(324)	(1,297)	(12,350)	(13,971)
– outflows	–	603	2,409	15,619	18,631
Total future payments, including future principal and interest payments	**984**	**1,289**	**13,394**	**53,108**	**68,775**

The net current liquidity position calculated as difference between current assets and current liabilities at 31 December 2016 is net current liability of CZK 16 million (31 December 2015: net current asset of CZK 2,394 million). The decrease in net liquidity position in 2016 does not result in liquidity issue of the Group.

Payments in respect of cross currency interest rate swaps will be accompanied by related cash inflows which are disclosed at their present values in Note 28.

30. Management of Capital

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders. The Group is managing its capital ratios to ensure a strong credit rating (e.g. the Company may adjust the amount of dividends paid to shareholders in order to maintain or adjust the capital structure).

According to the Group's policy, capital structure consists mainly of equity, subordinated borrowings from related parties, non-subordinated borrowings from banks and bonds.

In millions of Czech crowns	At 31 December 2016	At 31 December 2015
Equity	7,606	2,555
Subordinated borrowings from related parties that received the equity-like treatment from the rating agencies Fitch and S&P	–	11,000
Non-subordinated borrowings from banks and bonds	28,022	27,938
Non-subordinated short-term borrowings from related parties	25	–
Total	**35,653**	**41,493**

Subordinated borrowings from related parties were settled during 2016 (Note 17).

The Group has complied with all requirements arising from the borrowings as at 31 December 2016 and 2015.

31. Fair Value of Financial Instruments

Fair value measurements are analysed by level in the fair value hierarchy. Management applies judgement in categorising financial instruments using the fair value hierarchy. If a fair value measurement uses observable inputs that require significant adjustment, that measurement is a Level 3 measurement. The significance of a valuation input is assessed against the fair value measurement in its entirety.

(a) Recurring fair value measurements

Recurring fair value measurements are those that the accounting standards require or permit in the balance sheet at the end of each reporting period:

(b) Financial instruments carried at fair value

Only derivatives are measured at fair value.

All recurring fair value measurements are categorised in the fair value hierarchy into level 2 as at 31 December 2016 and 2015.

There were no changes in valuation technique for level 2 recurring fair value measurements since 31 December 2015.

The description of valuation technique and description of inputs used in the fair value measurement for level 2 measurements at 31 December 2016:

In millions of Czech crowns	Fair value	Valuation technique	Inputs used
Derivative financial instruments			
Cross currency interest rate swap contracts	(2,770)	Discounted cash flow method	Czech National Bank foreign exchange rates, inter-bank swap rates
TOTAL RECURRING FAIR VALUE MEASUREMENTS AT LEVEL 2	**(2,770)**	**–**	**–**

The description of valuation technique and description of inputs used in the fair value measurement for level 2 measurements at 31 December 2015:

In millions of Czech crowns	Fair value	Valuation technique	Inputs used
Derivative financial instruments			
Cross currency interest rate swap contracts	(2,810)	Discounted cash flow method	Czech National Bank foreign exchange rates, inter-bank swap rates
TOTAL RECURRING FAIR VALUE MEASUREMENTS AT LEVEL 2	**(2,810)**	**–**	**–**

The following table presents movements in fair values of derivative financial instruments:

In millions of Czech crowns	2016	2015
Opening balance	**(2,810)**	**(1,256)**
Change in fair value of contracts held at the beginning of the period settled during the period	–	–
Settlement of contracts held at the beginning of the period	–	–
Change in fair value of contracts concluded and realised during the period	31	(1)
Settlement of contracts concluded and realised during the period	(31)	1
Change in unrealised gains or losses for the period included in profit or loss for contracts held at the end of the reporting period	–	–
Change in unrealised gains or losses for the period included in other comprehensive income for contracts held at the end of the reporting period	40	(1,554)
Closing balance	**(2,770)**	**(2,810)**

(c) Non-recurring fair value measurements

There are no assets held for sale or other items with non-recurring fair value measurements as of 31 December 2016 and 31 December 2015.

(d) Financial assets and liabilities not measured at fair value but for which fair value is disclosed

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

	31 December 2016				31 December 2015			
In millions of Czech Crowns	Level 1	Level 2	Level 3	Carrying value	Level 1	Level 2	Level 3	Carrying value
ASSETS								
Other financial assets								
– Loans to related parties	–	–	653	652	–	–	1,899	1,892
Total ASSETS	**–**	**–**	**653**	**652**	**–**	**–**	**1,899**	**1,892**
LIABILITIES								
Borrowings								
– Borrowings from related parties	–	–	25	25	–	–	11,939	11,000
– Bank borrowings	–	–	7,127	7,117	–	–	7,085	7,046
– Bonds	20,941	–	1,394	20,905	20,024	–	1,314	20,880
Total LIABILITIES	**20,941**	**–**	**8,546**	**28,047**	**20,024**	**–**	**20,338**	**38,926**

Trade and other receivables' carrying values approximate to their fair values.

The fair values in level 1 of fair value hierarchy reflects the price of fixed interest rate bonds listed in active markets in public stock exchanges.

The fair values in level 3 of fair value hierarchy were estimated using the discounted cash flows valuation technique. Inputs used for loans to related parties are market observable (PRIBOR, LIBOR, EURIBOR) adjusted by unobservable estimated credit spreads. Inputs used for bank borrowings, borrowings from related parties and financial leasing are market observable (PRIBOR, LIBOR and IRS) adjusted by unobservable estimated credit spreads.

The fair value of unquoted bonds was determined based on estimated future cash flows expected to be received discounted by market observable yield curve adjusted by unobservable estimated credit spread.

Financial assets carried at amortised cost. The estimated fair value of asset instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

Financial liabilities carried at amortised cost. The estimated fair value of liability instruments is based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

NET4GAS Group
Notes to the Consolidated Financial Statements
for the year ended 31 December 2016

32. Events After the Reporting Period

New cross-border capacity was offered and successfully marketed at the annual capacity auction on March 6, 2017 – a result of the joint efforts between the transmission operators in the Federal Republic of Germany, the Czech Republic and the Slovak republic. Based on the results of this auction, NET4GAS is ready to invest into relevant new gas infrastructure in the Czech Republic in the upcoming years. The extension of the transmission system represents an opportunity for the Czech Republic to maintain its strong position as a European transit country, and thus enhance the security of supply in the region. In connection with this construction, the Company must reassess changes with regards to continued operation of some compressor stations, reassess their useful lifes and reconsider the provision for liquidation, construction work on selected compressor stations and the provision for restructuring – termination payments to employees (provisions in total amount of CZK 160 million as at 31 December 2016).

No other events have occurred subsequent to year-end that would have a material impact on the consolidated financial statements for the year ended 31 December 2016.

Signature of the members of the statutory body of the Company:

4 April 2017

Andreas Rau	**Radek Benčík**	**Václav Hrach**
Statutory Director	Statutory Director	Statutory Director

The General Meeting approved the consolidated financial statements for publication on 25 April 2017.

Annex no. 2: Separate Financial Statements

NET4GAS, s.r.o.
Separate Financial Statements

prepared in accordance with International Financial Reporting Standards
as adopted by the European Union, 31 December 2016

Contents

NET4GAS, s.r.o.
Separate Balance Sheet

In millions of Czech Crowns	Note	31 December 2016	31 December 2015
ASSETS			
NON-CURRENT ASSETS			
Property, plant and equipment	8	44,041	45,410
Intangible assets	9	89	110
Investment in subsidiary	10	7,476	7,476
Other non-current assets	11	9	1
Total non-current assets		**51,615**	**52,997**
CURRENT ASSETS			
Inventories	12	63	65
Trade and other receivables	14	303	125
Current income tax prepayments	29	–	94
Loans to related parties	13	652	1,886
Other non-financial assets	15	27	59
Cash and cash equivalents	16	410	1,411
Total current assets		**1,455**	**3,640**
TOTAL ASSETS		**53,070**	**56,637**

EQUITY AND LIABILITIES			
EQUITY			
Registered capital	17	2,750	2,750
Capital contributions outside registered capital	17	6,631	29
Cash flow hedges	17	(1,813)	(2,035)
Retained earnings		21	1,789
Total equity		**7,589**	**2,533**
NON-CURRENT LIABILITIES			
Other payables	23	8	2
Borrowings	18	27,761	38,670
Finance lease liability	19	6,778	6,888
Derivative financial instruments	31	2,478	2,534
Deferred income tax liability	29	5,951	3,966
Provisions	22	167	177
Accrued employee benefits	24	100	68
Other non-financial liabilities	24	15	15
Total non-current liabilities		**43,258**	**52,320**

The accompanying notes on pages 116 to 168 are an integral part of these financial statements.

In millions of Czech Crowns	Note	31 December 2016	31 December 2015
CURRENT LIABILITIES			
Borrowings	18	810	268
Finance lease liability	19	196	197
Trade and other payables	23	540	640
Derivative financial instruments	31	292	276
Current income tax payable	29	176	–
Other taxes payable	21	20	16
Provisions	22	–	40
Other non-financial liabilities	24	189	347
Total current liabilities		**2,223**	**1,784**
Total liabilities		**45,481**	**54,104**
EQUITY AND LIABILITIES		**53,070**	**56,637**

4 April 2017

Andreas Rau
Statutory Director

Radek Benčík
Statutory Director

Václav Hrach
Statutory Director

The accompanying notes on pages 116 to 168 are an integral part of these financial statements.

NET4GAS, s.r.o.
Separate Statement of Profit or Loss and Other Comprehensive Income

In millions of Czech Crowns	Note	2016	2015
Revenue	6	9,286	9,891
Raw materials consumed	25	(450)	(790)
Services purchased and lease charges	25	(545)	(842)
Employee benefits	25	(509)	(466)
Depreciation and amortisation	8, 9	(2,068)	(2,451)
Impairment		–	(2)
Gains less losses on disposal of property, plant and equipment		3	4
Changes in fair value of derivatives, net		31	(1)
Foreign exchange differences, net		1	30
Other operating income	26	458	970
Other operating expenses		(37)	(96)
Operating profit		**6,170**	**6,247**
Finance income	27	8	17
Finance costs	28	(1,852)	(2,216)
Finance result (net)		**(1,844)**	**(2,199)**
Profit before income tax		**4,326**	**4,048**
Income tax expense	29	(2,904)	(769)
PROFIT FOR THE YEAR		**1,422**	**3,279**

Other comprehensive income / (loss)			
Items that may be subsequently reclassified to profit or loss			
Cash flow hedge	17	274	(1,023)
Income tax recorded directly in other comprehensive income – cash flow hedge	29	(52)	194
TOTAL OTHER COMPREHENSIVE INCOME FOR THE YEAR		**222**	**(829)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**1,644**	**2,450**

The accompanying notes on pages 116 to 168 are an integral part of these financial statements.

NET4GAS, s.r.o.
Separate Statement of Changes in Equity

In millions of Czech Crowns	Registered capital	Capital contributions outside registered capital	Cash flow hedges	Retained earnings	Total
Balance as at 1 January 2015	**2,750**	**29**	**(1,206)**	**2,976**	**4,549**
Total comprehensive income					
Profit for the year 2015	–	–	–	3,279	3,279
Cash flow hedge – net of related tax effect	–	–	(829)	–	(829)
Total comprehensive income for the year	–	–	(829)	3,279	2,450
Transactions with owners					
Dividends paid	–	–	–	(1,566)	(1,566)
Advance dividends paid	–	–	–	(2,900)	(2,900)
Balance as at 31 December 2015	**2,750**	**29**	**(2,035)**	**1,789**	**2,533**
Total comprehensive income					
Profit for the year 2016	–	–	–	1,422	1,422
Cash flow hedge – net of related tax effect	–	–	222	–	222
Total comprehensive income for the year	–	–	222	1,422	1,644
Transactions with owners					
Non-cash contribution outside registered capital (Note 18)	–	6,602	–	–	6,602
Dividends paid	–	–	–	(1,540)	(1,540)
Advance dividends paid	–	–	–	(1,650)	(1,650)
Balance as at 31 December 2016	**2,750**	**6,631**	**(1,813)**	**21**	**7,589**

The accompanying notes on pages 116 to 168 are an integral part of these financial statements.

NET4GAS, s.r.o.
Separate Statement of Cash Flows

In millions of Czech Crowns	Note	2016	2015
Cash flows from operating activities			
Profit before tax		**4,326**	**4,048**
Adjustments for:			
Depreciation and amortisation	8, 9	2,068	2,451
Finance income	27	(8)	(17)
Finance costs	28	1,852	2,216
Impairment		–	2
Gains less losses on disposals of property, plant and equipment		(3)	(4)
Dividend income from subsidiary		(432)	(957)
Other non-cash operating expenses / (gains)		(2)	97
thereof: – provision for penalty for additional CIT return		*(39)*	*40*
– foreign exchange differences		–	*30*
– employee benefit provisions		*47*	–
– other		*(9)*	*27*
Operating cash flows before working capital changes		**7,801**	**7,836**
Decrease / (Increase) in trade and other receivables	14, 15	(146)	93
Increase / (Decrease) in trade and other payables	23, 24	(244)	95
Decrease in inventories	12	2	–
Operating cash flows after changes in working capital		**7,413**	**8,024**
Interest paid	28	(1,534)	(2,088)
Interest received	27	11	11
Income tax paid	29	(701)	(754)
Net cash flows from operating activities		**5,189**	**5,193**

The accompanying notes on pages 116 to 168 are an integral part of these financial statements.

In millions of Czech Crowns	Note	2016	2015
Cash flows from investing activities			
Purchase of property, plant and equipment	8	(694)	(539)
Purchase of intangible assets	9	(33)	(44)
Proceeds from sale of property, plant and equipment		4	31
Repayments of loans provided to related parties*	13	4	3,327
Loans provided to related parties	13	(650)	(3,869)
Dividends received from subsidiary	26	432	957
Net cash flows used in investing activities		**(937)**	**(137)**
Cash flows from financing activities			
Dividends paid to the Company's shareholder	17	(1,540)	(1,566)
Advance dividends paid to the Company's shareholder	17	(1,650)	(2,900)
Repayment of borrowings*	18	(4,203)	(3,890)
Proceeds from borrowings	18	2,140	3,118
Net cash flows from financing activities		**(5,253)**	**(5,238)**
Net (decrease) in cash and cash equivalents		**(1,001)**	**(182)**
Cash and cash equivalents at the beginning of the period	16	1,411	1,593
Cash and cash equivalents at the end of the period	16	**410**	**1,411**

* Part of loans from related parties Borealis Novus Holdings B.V. and Allianz Infrastructure Luxembourg I S.à r.l. in total amount of CZK 11,000 million was settled in cash (CZK 2,500 million). Remaining amount of CZK 8,500 million was cessed to NET4GAS Holdings, s.r.o. It was subsequently netted against receivable from capital contribution outside registered capital of CZK 6,602 million and also netted against loan provided to NET4GAS Holdings, s.r.o. of CZK 1,898 million (Note 18).

The accompanying notes on pages 116 to 168 are an integral part of these financial statements.

NET4GAS, s.r.o. Notes to the Separate Financial Statements

for the year ended 31 December 2016

1. NET4GAS, s.r.o. and Its Operations – General Information

These separate financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union for the year ended 31 December 2016 for NET4GAS, s.r.o. (the "Company" or the „NET4GAS").

The Company was incorporated and is domiciled in the Czech Republic where is also the Company's principal place of business. The Company is a limited liability company. It was incorporated on 29 June 2005 and has its registered office at Na Hřebenech II 1718/8, Prague 4 – Nusle, the Czech Republic. Identification number of the Company is 272 60 364.

The Company's main business activity is natural gas transmission in accordance with the Act No. 458/2000 Coll. (the "Energy Act").

Since 2 August 2013 the Company is fully owned by NET4GAS Holdings, s.r.o. (the "NET4GAS Holdings"), incorporated in the Czech Republic, which is the Company's ultimate parent company. NET4GAS Holdings is a joint venture of two venturers: Allianz Infrastructure Czech HoldCo II S.à r.l. (50%) with its registered office in Luxembourg and Borealis Novus Parent B.V. (50%) with its registered office in the Netherlands.

The Statutory Directors of the Company:

As at 31 December 2016	As at 31 December 2015
Andreas Rau	Andreas Rau
Radek Benčík	Radek Benčík
Václav Hrach	Václav Hrach

The members of the Supervisory Board of the Company:

As at 31 December 2016	Function	As at 31 December 2015	Function
Melchior Stahl	Member	Radek Hromek	Member
Jaroslava Korpancová	Member	Ralph Adrian Berg	Member
Lenka Kovačovská	Member	Melchior Stahl	Member
Kenton Edward Bradbury (from 24 June 2016)	Chairman	Jaroslava Korpancová	Member
Mikhail Nahorny (from 1 July 2016)	Member	Lenka Kovačovská	Member
		Kenton Edward Bradbury	Member

Mikhail Nahorny became member of the Supervisory Board on 1 July 2016 and the change was registered in the Commercial Register on 31 August 2016.

Ralph Adrian Berg was terminated from Supervisory Board on 30 June 2016 and the change was registered in the Commercial Register on 31 August 2016.

Membership of Radek Hromek in the Supervisory Board expired on 23 December 2016. This change has not been enrolled to the Commercial Register yet.

As of the date of the preparation of the separate financial statement, the sixth member of the NET4GAS Supervisory Board has not been elected.

About the Company. The Company is the exclusive gas transmission system operator in the Czech Republic, operating more than 3,800 km of gas pipelines. NET4GAS is currently operating four compressor stations. The flow rate of the gas transmitted is measured at five border transfer stations (the Lanžhot, Brandov and Hora Svaté Kateřiny stations in the Czech Republic, and the Waidhaus and Olbernhau stations in the Federal Republic of Germany) and at almost a hundred national transfer stations. NET4GAS transmission system has been specifically targeted in last few years for a number of new projects delivering additional transmission capacity and the greater diversification of transmission routes. These projects have included the construction of the GAZELLE high-pressure gas pipeline (DN 1400, put in operation in 2013), connecting the transmission systems of the Czech Republic and the Federal Republic of Germany at the border points Brandov and Rozvadov, and a project of a connection between the Czech and Polish transmission systems in Český Těšín. The entire NET4GAS transmission system can also be used for reverse flow, which means that it now has the capacity and technology to cope with natural gas transmission in any direction.

The Company is the successor to Tranzitní plynovod, n. p., Transgas, a.s. and RWE Transgas Net, s.r.o.

The Company founded BRAWA, a.s. ("BRAWA") as its subsidiary on 10 October 2010. Till 1 January 2013 BRAWA, a.s. was a dormant company. On 1 January 2013, under the legal reorganisation of NET4GAS's business, the GAZELLE pipeline was transferred to BRAWA and BRAWA became the sole owner of the GAZELLE pipeline. The GAZELLE pipeline is operated by NET4GAS.

Note

The separate financial statements have been prepared in Czech and in English. In all matters of interpretation of information, views or opinions, the Czech version of these financial statements takes precedence over the English version.

2. Operating Environment of the Company

The regulatory environment in the Czech Republic:

(a) Legal framework pertaining to the transmission system operator

The transmission system operator holds an exclusive gas transmission licence under the Energy Act, and its operations are regulated by the Energy Regulatory Authority (the "ERO").

The transmission system operator's rights and obligations are primarily derived from Section 58 of the Energy Act and are clarified in more detail in the related implementing legislation. The transmission system operator is also required to comply with obligations under the European legislation, in particular Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and the related implementing legislation.

(b) Regulatory framework pertaining to the transmission system operator

Gas transmission prices are set annually by the ERO based on regulation methodology applicable in the regulatory period. Gas transmission prices for the next calendar year are usually published in an ERO's Pricing Decision by 30 November of the current year.

The 2016 gas transmission prices were established by ERO´s Price Decision No 6/2015 from 25 November 2015 on Regulated Prices related to the gas supply.

(c) Current regulatory period

The transmission system operator is currently subject to the regulatory period, which began on 1 January 2016 and ends on 31 December 2018 (so called fourth regulatory period).

(d) Domestic transmission regulation methodology applicable in the fourth regulatory period

The transmission system operator regulation methodology for domestic gas transmission is based on a ceiling established for permissible revenues over a predetermined period (the revenue cap method). Domestic gas transmission prices are then derived from such defined permissible revenues. These prices consist of a fixed component for booked transmission capacity and a variable component depending on the amount of gas transmitted.

(e) Transit transmission regulation methodology applicable in the fourth regulatory period

The transmission system operator regulation methodology for transit transmission relies on a price ceiling (of permissible prices) for a predetermined period (the price cap method). Permissible prices are set annually by the ERO based on a comparison of gas transmission prices in other relevant Member States of the European Union (benchmarking). The underlying documentation for this benchmarking is prepared and supplied by the transmission system operator.

(f) Unregulated part

Further to a decision of the Energy Regulatory Authority of 28 July 2011, the GAZELLE interconnecting pipeline was exempted from the obligation to grant third-party access at a regulated price under the conditions set out in the Energy Act.

3. Summary of Significant Accounting Policies

a) Basis of preparation

These separate financial statements of the Company have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS") under the historical cost convention, as modified by the revaluation of relevant financial assets and financial liabilities (including derivative instruments) carried at fair value. The principal accounting policies applied in the preparation of these separate financial statements are set out below. These policies have been consistently applied to all the periods presented.

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

These separate financial statements relate to the consolidated financial statements prepared for the Company and its subsidiary BRAWA. They should be read together.

Presentation currency. These separate financial statements ("financial statements") are presented in Czech Crowns ("CZK") which is also the functional currency of the Company.

b) Financial instruments – key measurement terms

Depending on their classification financial instruments are carried at fair value or amortised cost as described below.

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

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

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

A portfolio of financial derivatives that are not traded in an active market is measured at the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (i.e. an asset) for a particular risk exposure or paid to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date. This is applicable for assets carried at fair value on a recurring basis if the Company:

(a) manages the Company of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy; (b) it provides information on that basis about the Company of assets and liabilities to the entity's key management personnel; and (c) the market risks, including duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities is substantially the same.

Fair value measurements are analysed by level in the fair value hierarchy as follows (Note 34):

(i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based solely on observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

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

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

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

c) Classification of financial assets

Financial assets are classified in the following categories: (a) loans and receivables; and (b) financial assets at fair value through profit or loss.

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments and are carried at amortized costs.

Financial assets at fair value through profit or loss, including financial derivatives are carried at their fair value. All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Company designates certain derivatives as hedges of a particular risk associated with a fixed commitment or highly probable forecast transaction (cash flow hedge).

The Company documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 31. Movements on the hedging reserve in other comprehensive income are shown in Note 17. The full fair value of a hedging derivative is classified as a non-current asset or liability when the remaining hedged item is more than 12 months, and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months. Trading derivatives are classified as a current asset or liability.

Cash flow hedge: The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the profit or loss within 'Finance costs' (in case of hedging of cash flows from revenues denominated in foreign currencies) or 'Changes in fair value of derivatives, net' (in case of hedging of cash flows from bonds issued denominated in foreign currency). Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss (for example, when the forecast sale that is hedged takes place). The gain or loss relating to the effective portion of cross currency interest rate swaps hedging foreign exchange risk is recognised in the profit or loss within 'Revenue' (in case of hedging of revenues denominated in foreign currencies) or 'Finance costs' (in case of hedging of cash flows from bonds issued denominated in foreign currency).

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in profit or loss when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recorded in other comprehensive income is immediately transferred to profit or loss within 'Foreign exchange differences, net'.

d) Classification of financial liabilities

Financial liabilities have the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. Liabilities held for trading are carried at fair value with changes in value recognised in profit or loss for the year (as finance income or finance costs) in the period in which they arise. Other financial liabilities are carried at amortised cost.

The Company designates certain financial liabilities as hedges of a particular risk associated with highly probable forecast transactions (cash flow hedge – Note 3c).

e) Initial recognition of financial instruments

Financial instruments not carried at fair value through profit or loss are initially recognized at fair value plus transaction costs. Financial instruments carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in profit or loss. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

The Company uses discounted cash flow valuation techniques to determine the fair value of cross-currency interest rate swaps and loans to related parties that are not traded in an active market. Differences may arise between the fair value at initial recognition, which is considered to be the transaction price, and the amount determined at initial recognition using the valuation technique. Any such differences are amortised on a straight line basis over the term of the cross-currency interest rate swaps and loans to related parties.

f) Derecognition of financial assets and financial liabilities

The Company derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire or (b) the Company has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control.

Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

The Company derecognises financial liabilities only when the contractual liabilities of the Company are discharged, cancelled or expire. The difference between the carrying amount of a derecognised financial liability and the consideration paid is recognised in profit or loss.

g) Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation and provision for impairment, where required.

Significant spare parts are recognised and treated as property, plant and equipment.

Repairs and maintenance expenditures of tangible fixed assets are expensed as incurred. Cost of replacing major parts or components of property, plant and equipment items are capitalised and the replaced part is retired. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

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

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised in profit or loss for the year.

When the Company recognises the cost of a replacement for part of the carrying amount of property, plant and equipment, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it was not practicable to determine the carrying amount of the replaced part, the Company used the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

h) Depreciation

Land is not depreciated. Construction in progress is not depreciated. Depreciation on other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	Useful lives
Buildings and constructions	30 – 70 years
Plant, machinery and equipment	4 – 40 years
Furniture and fittings	4 – 8 years
Motor vehicles	5 – 8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

i) Capitalisation of borrowing costs.

General and specific borrowing costs directly attributable to the acquisition, construction or production of assets that are not carried at fair value and that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets.

The commencement date for capitalisation is when (a) the Company incurs expenditures for the qualifying asset; (b) it incurs borrowing costs; and (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

The Company capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Company's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred on the specific borrowings less any investment income on the temporary investment of these borrowings are capitalised.

j) Leasing

Operating leases. Where the Company is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Company, the total lease payments are charged to profit or loss for the year on a straight-line basis over the lease term. The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Finance lease liabilities. Where the Company is a lessee in a lease which transfers substantially all the risks and rewards incidental to ownership to the Company, the assets leased are capitalised in property, plant and equipment at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of future finance charges, are included in borrowings. The interest cost is charged to profit or loss over the lease period using the effective interest method. The assets acquired under finance leases are depreciated over their useful life or the shorter lease term, if the Company is not reasonably certain that it will obtain ownership by the end of the lease term.

k) Intangible assets

The Company's intangible assets have definite useful lives and primarily include capitalised computer software, patents, trademarks and licences.

Acquired computer software licences, patents and trademarks and other intangibles are capitalised on the basis of the costs incurred to acquire and bring them to use.

Development costs that are directly associated with identifiable and unique software controlled by the Company are recorded as intangible assets if an inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred.

l) Amortisation

Intangible assets are amortised using the straight-line method over their useful lives (unless the agreement or licence conditions state shorter or longer period):

	Useful lives
Software	3 years
Patents, and other licences	1.5 – 6 years
Development costs	6 years
Other intangible assets	6 years

m) Investment in subsidiary

Investment in subsidiary is measured at cost less any impairment loss. The transaction costs are capitalised as part of the cost of the investment. The transaction costs are the costs directly attributable to the acquisition of the investment such a profession fees for legal services, transfer taxes and other acquisition related costs.

The investment is tested for impairment whenever there are indicators that the carrying amount of an investment may not be recoverable. If the recoverable amount of an investment (the higher of its fair value less cost to sell and its value in use) is less than its carrying amount, the carrying amount is reduced to its recoverable amount.

The carrying amount of an investment is derecognised on disposal. The difference between the fair value of the sale proceeds and the disposed share of the carrying amount of the investment is recognised in profit or loss as gain or loss on disposal. The same applies if the disposal results in a step down from subsidiary to joint venture or an associate measured at cost.

n) Emission Rights

The Company receives free emission rights as a result of the European Emission Trading Schemes. The rights are received on an annual basis and in return the Company is required to return rights equal to its actual emissions. Therefore, a provision is only recognised when actual emissions exceed the emission rights received free of charge. The emission rights which were granted free of charge are carried at cost, i.e. at zero. When emission rights are purchased from third parties, they are measured at cost and treated as a reimbursement right. When emission rights are acquired by exchange and such an exchange is deemed to have the economic substance, they are measured at fair value as at the date when they become available for use and the difference between the fair value of rights received and cost of assets given up is recognised through profit or loss. The Company did not recognise any provision resulting from the gas emissions as at 31 December 2016 and 31 December 2015.

The amounts of emission rights held in zero value by the Company were as follows:

In tons	31 December 2016	31 December 2015
Emission rights	403,619	366,825

o) Impairment of non-financial assets
Intangible assets not ready to use are not subject to amortisation and are tested annually for impairment. Assets that are subject to depreciation and amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). Prior impairments of non-financial assets are reviewed for possible reversal at each reporting date.

p) Assets held for sale
Assets (or disposal groups) are classified as assets held for sale and stated at the lower of their residual amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than through continuing use. Assets held for sale are not depreciated.

q) Taxes
Income tax
Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge/credit comprises current tax and deferred tax and is recognised in profit or loss for the year, except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity (for example the effective portion of changes in the fair value of financial derivatives that are designated and qualify as cash flow hedges).

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

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

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

Value added tax
Output value added tax (VAT) related to sales is payable to tax authorities on the earlier of (a) collection of receivables from customers or (b) delivery of goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the balance sheet on a net basis. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

r) Uncertain tax positions
The Company's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period, and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognized based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period.

s) Inventories
Raw materials are mainly spare parts for the gas pipeline system. Purchased inventories are stated at the lower of cost and net realizable amount. Cost includes all costs related with its acquisition (mainly transport costs, customs duty, etc.). The weighted average cost method is applied for all disposals. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and selling expenses. Significant spare parts are recognised and treated as property, plant and equipment.

t) Trade receivables
Trade receivables are carried at amortised cost using the effective interest method less relevant impairment.

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

– Any portion or instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;

– The counterparty experiences a significant financial difficulty as evidenced by its financial information that the Company obtains;

– The counterparty considers bankruptcy or a financial reorganisation;

– There is adverse change in the payment status of the counterparty as a result of changes in the national or local economic conditions that impact the counterparty.

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

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

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

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

v) Prepayments
Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Company has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Company. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss for the year.

w) Cash and cash equivalents
Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method.

x) Dividends
Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved. Any dividends declared after the reporting period and before the financial statements are authorised for issue are disclosed in the subsequent events note.

y) Advance dividends paid
The Company's decision to pay an advance dividend is reflected in the financial statements as a decrease in equity as of the date of the payment and is deducted from the balance sheet line – Retained earnings.

z) Borrowings
Borrowings are carried at amortised cost using the effective interest method.

At their initial recognition, all bank credits, loans and issued bonds are recorded at their purchase price corresponding to the fair value of the received cash funds, less the costs of obtaining the credit or loan or issue of bonds.

Amortised cost is determined by taking into account the costs of obtaining the credit or loan, as well as the discounts or bonuses received at the settlement of the liability.

The Company designates certain borrowings as hedges of a particular risk associated with a highly probable forecast transaction (cash flow hedge – Note 3c).

aa) Government and other grants
Grants from the government and European Commission are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions. Grants relating to the purchase of property, plant and equipment decrease directly the costs of the relevant asset.

bb) Trade and other payables
Trade payables are accrued when the counterparty performs its obligations under the contract and are carried at amortised cost using the effective interest method.

cc) Provisions for liabilities and charges
Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Where there are a number of similar obligations, the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

dd) Financial guarantees
Financial guarantees are irrevocable contracts that require the Company to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. When the Company expects to receive recurring future premiums from an issued financial guarantee contract, the guarantee is recorded at the premium receivable at the inception of the contract and no receivable is recognised in respect of the future premium payments receivable. The premium receivable in one instalment is amortised on a straight line basis over the period covered by that instalment. At the end of each reporting period, the premium receivable in respect of the respective period is measured at its present value and the financial liability is measured at the higher of the remaining unamortised balance and the best estimate of expenditure required to settle the obligation at the end of the reporting period.

ee) Asset retirement obligations
The Company's transmission system is mainly constructed on the land owned by third parties. The current legislation requires the Company to incur the costs related to transmission system's operation and maintenance. The current Czech environmental and energy legislation does not set the obligation to liquidate the assets at the end of their useful life. Given the currently valid legislation management believes that there is no asset retirement obligation (dismantling and removing an item of property, plant and equipment) to be recognised in the financial statements.

ff) Foreign currency translation
The functional currency of the Company is the currency of the primary economic environment in which the entity operates. The functional currency of the Company is Czech Crown ("CZK") and the Company's presentation currency is also CZK.

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

gg) Revenue recognition
The Company recognises as revenue mainly income from fees collected for the gas transmission within and across the Czech Republic.

Revenue from gas transmission services is recognised on time proportional basis based on the reserved capacity, at the maximum on a monthly basis. Revenues are invoiced on a monthly basis (or shorter where applicable) and sales are shown net of VAT and discounts. Revenues are measured at the fair value of the consideration received or receivable.

Interest income is recognised on a time-proportion basis using the effective interest method.

hh) Employee benefits
Wages, salaries, contributions to the Czech state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and other services) are accrued in the year in which the associated services are rendered by the employees of the Company.

a) Pension obligations
A defined contribution plan is a pension plan under which the Company pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. A defined benefit plan is a pension plan that is not a defined contribution plan.

For defined contribution plans, the Company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Company has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

b) Termination benefits
Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognises termination benefits at the earlier of the following dates: (a) when the Company can no longer withdraw the offer of those benefits; and (b) when the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to their present value.

c) Other long term benefits
Long-term employee benefits, such as long-term bonuses, and long service awards are accounted for measured using the projected unit credit method in the same way as defined benefit pension plan, with the exception that re-measurements (actuarial gains/losses) and related charges are recognised immediately through in profit or loss.

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

jj) Segment reporting
Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or group of persons who allocates resources and assesses the performance for the Company. Segments are reported in a manner consistent with the internal reporting provided to the Company's chief operating decision maker. Segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

4. Critical Accounting Estimates and Judgements in Applying Accounting Policies

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

Functional currency
Management assessed the relevant primary and secondary factors during the consideration about the Company's functional currency. The functional currency is the currency of the primary economic environment, in which the entity operates. The regulated sales prices of the Company are determined by ERO – the Czech regulatory authority and are defined in CZK. Majority of the entity's revenue stems from regulated sales. Majority of the operating expenses of the Company are influenced by CZK. Capital expenditures are twofold: regular capital expenditure safeguarding the existing system and its safeness; and large one off projects. The regular capital expenditure is almost entirely influenced by CZK, while the pricing of large one off projects is influenced by a mix of currencies (including CZK, EUR and other). The funds from financing activities are generated by a mix of currencies (including CZK, EUR and US Dollars). Although the entity's operations are influenced by a mix of currencies, management concluded that majority of the indicators support CZK as the functional currency of the Company.

Classification of pipeline capacity contract
The Company entered into a long-term contracts expiring on 1 January 2021 and 1 January 2035 whereby it provided majority of its GAZELLE pipeline capacity under 'ship or pay' basis. Management considered whether the contract for the provision of pipeline capacity to its major customer is, in substance, a finance lease. Management's conclusion that the contract is not a lease of the pipeline is based on the fact that there is significant (although minority) capacity of the pipeline, which is available to other customers and this capacity can be used by the other customers. The pipeline is under the Company's full control and the major customer has no ability or right to control physical access to the pipeline. Therefore the arrangement is not, in substance, a lease contract. The Company treats the pipeline as its property, plant and equipment and recognises revenue from the contract with the major customer in accordance with IAS 18.

Transmission System Operator licence and gas pipelines
Considering the applicability of IFRIC 12 for the Company, management believes that the control requirements have not been met as the title will never be transferred to the government nor can the government control the operator's practical ability to sell or pledge the infrastructure and government is not controlling the construction process. Therefore the Company's system is classified as property, plant and equipment and is not treated as infrastructure used in public-to-private service concession arrangements.

Risk related to tax position
NET4GAS was established by way of legal reorganisation of part of the business of RWE Transgas, a.s. ("RWE Transgas") due to the unbundling requirement under the so called Second Energy Package of the European Union, while part of the business of RWE Transgas was contributed to registered capital of NET4GAS. As a result of the unbundling process and related revaluation, the accounting carrying amounts of the gas transmission system under the Czech accounting legislation ("local GAAP") were significantly increased (based on an appointed appraiser's valuation) compared to their tax values (i.e. the historical cost based measurement rolled over from

the tax books of RWE Transgas, which was the basis for tax depreciation). Due to the temporary differences between the new carrying amounts and the tax values of the transmission system, the deferred tax liability was recorded in 2006 against equity of NET4GAS under local GAAP. ERO has approved the inclusion of accounting depreciation (based on the revalued amounts) of the gas pipeline system in the final price for the inland gas transmission services for regulatory periods between 2005–2009 and 2010–2015. It means that the regulated prices (taxable income) charged by NET4GAS to its customers have been increased by the effect of local GAAP accounting depreciation, while the original tax base has been based on the historical costs of the gas pipeline system only.

NET4GAS considered the relation between eligible depreciation and eligible revenues, given by a regulatory formula, as costs directly tied to revenues according to Section 24(2) (zc) of the Income Tax Act, and in the 2008 through 2014 taxable periods, referring to the said provisions of the Income Tax Act, it considered the entire amount of local-GAAP-based accounting eligible depreciation to be a tax deductible expense. This method was reflected also in the calculation of the deferred tax.

Tax deductibility of part of the accounting depreciation of the gas pipeline system was reassessed by management supported by tax experts during 2010. Therefore, tax deduction for the difference between the accounting depreciation and historical cost based tax depreciation was claimed by NET4GAS in its remedial corporate income tax returns for the prior years from 2008 (the right to submit remedial tax returns for earlier years had expired).

Management believed that it was probable that the Company would receive the income tax benefits resulting from applying the accounting depreciation of the gas pipeline system over the period of its useful life. This position was supported by the fact that the tax authorities returned tax overpayments for the years 2008–2011.

However, during 2015 the Supreme Court decided on the same issue in a case of another company with similar business activities that the entity was not entitled to tax benefits resulting from applying the accounting depreciation of the gas pipeline system. The Company submitted the supplementary corporate income tax returns and paid up additional income tax charge of CZK 162 million in respect of 2012–2014 years (Note 29).

In 2015 the tax legislation has changed, in management's view, in favour of the Company. Therefore in 2015 NET4GAS applied the amended Income Tax Act, in which the provision of Section 23(4) (e) governs direct relation between tax non-deductible expenses and revenues. As a result of the change, part of the taxable income generated by the gas pipeline network was, in management's view, not taxable. Although the amended favourable rule was new and its application in the Company's specific case could be challenged, management was of the view that it was more likely than not, that the Company was able to sustain its position based on the amended law. The calculation of income tax charge for 2015 and deferred tax liability as at 31 December 2015 were based on this view.

Views of the expert audience and professional advisors developed during 2016. As a result of the development, management no longer keeps the view that it is more likely than not, that the Company sustains its position. Management decided to recognise deferred tax liability related to the temporary differences of pipeline network in full amount without taking into account the (potential) benefit of the provision of Section 23(4) (e). As a result of this change in management estimate the deferred tax liability was increased by CZK 2,125 million and the change was recognised as an expense (loss) of the current period. This adjustment as a change in management view is a change in estimate in respect of deferred tax liability that was according to IAS 8 guidance recognised prospectively. It is neither a change in an accounting policy nor a correction of prior period error. Submitted income tax return for 2015 (filed on 24 October 2016, in extended deadline) reflected the revised management view.

Segments
Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or group of persons who allocates resources and assesses the performance of the Company. Recurring revenues are from the contracts with foreign and domestic customers. Information for CODM (the Company's Statutory Directors) who are responsible for allocating resources and assessing performance of the Company is prepared for the whole Company without any particular structuring. Management regularly obtain information with assessment of the split of revenue between the transit revenue and domestic transmission revenue. There is no profit measure, which would be based on similar basis. All profit measures used by the CODM are based on the results of the Company considered as one business unit. As a result, management consider the whole Company as one segment for the purpose of segment reporting.

Finance lease contract with BRAWA
The Company entered into a long-term finance lease contract in January 2013 whereby it leases the GAZELLE pipeline from its subsidiary BRAWA. The contract is expiring on 1 January 2035.

In January 2013 the Company recognised finance lease as the leased asset and finance lease liability at amount of CZK 7,312 million which is equal to the fair value of the leased GAZELLE pipeline as the fair value of leased GAZELLE pipeline was lower than the present value of the minimum lease payments (each determined at the inception of the lease) using discount rate equal to the market rate.

Minimum lease payments used in the calculation represent the payments over the lease term that the Company is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to BRAWA, together with any amounts guaranteed by the Company or by a party related to the Company.

Fair value of the leased GAZELLE pipeline used in the calculation represents the carrying value of leased GAZELLE pipeline recognised in BRAWA's financial statements and it reflects the amount for which the leased GAZELLE pipeline was exchanged during its construction between knowledgeable, willing parties in an arm's length transactions (representing mostly tendered price for the construction of the leased GAZELLE pipeline with unrelated parties).

Management of the Company estimated the total useful life of the leased GAZELLE pipeline being 70 years and represents the estimated period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits embodied in the leased GAZELLE pipeline are expected to be consumed by the Company.

5. Adoption of New or Revised Standards and Interpretations and New Accounting Pronouncements

a) Adoption of new or revised standards and interpretations that are effective on or after 1 January 2016

Disclosure Initiative Amendments to IAS 1 (issued on 18 December 2014 and effective for annual periods on or after 1 January 2016). The Standard was amended to clarify the concept of materiality and explains that an entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material, even if the IFRS contains a list of specific requirements or describes them as minimum requirements. The Standard also provides new guidance on subtotals in financial statements, in particular, such subtotals (a) should be comprised of line items made up of amounts recognised and measured in accordance with IFRS; (b) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable; (c) be consistent from period to period; and (d) not be displayed with more prominence than the subtotals and totals required by IFRS standards.

No other new or revised standards and interpretations have material impact on the Company.

b) New standards and interpretations that have been issued and are mandatory for the annual periods beginning on or after 1 January 2017 or later

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2017 or later, and which the Company has not early adopted.

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

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging. The Company does not intend to early adopt the existing version of IFRS 9.

Management is currently assessing the impact of the standard on the financial statements of the Company.

IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The Company is currently assessing the impact of the new standard on its financial statements, however does not expect material impact of the new standard on its financial position.

Amendments to IFRS 15, Revenue from Contracts with Customers (issued on 12 April 2016 and effective for annual periods beginning on or after 1 January 2018). The amendments do not change the underlying principles of the Standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new Standard. Management is currently assessing the impact of the amendment on its financial statements.

IFRS 16 "Leases" (issued in January 2016 and effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. Management is currently assessing the impact of the standard on the financial statements of the Company, however does not expect material impact of the new standard on its financial position (see Note 30 for operating lease commitments).

Disclosure Initiative – Amendments to IAS 7 (issued on 29 January 2016 and effective for annual periods beginning on or after 1 January 2017). The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities. The Company is currently assessing the impact of the amendment on its financial statements.

IFRIC 22 – Foreign Currency Transactions and Advance Consideration (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018). The interpretation addresses how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part thereof) on the derecognition of a non-monetary asset or non-monetary liability arising from an advance consideration in a foreign currency. Under IAS 21, the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part thereof) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the date of the transaction for each payment or receipt of advance consideration. IFRIC 22 only applies in circumstances in which an entity recognises a non-monetary asset or non-monetary liability arising from an advance consideration. IFRIC 22 does not provide application guidance on the definition of monetary and non-monetary items. An advance payment or receipt of consideration generally gives rise to the recognition of a non-monetary asset or non-monetary liability, however, it may also give rise to a monetary asset or liability. An entity may need to apply judgment in determining whether an item is monetary or non-monetary. Management is currently assessing the impact of the amendments on its financial statements.

No other new or revised standards and interpretations have material impact on the Company.

6. Segment Information

(a) Description of products and services from which each reportable segment derives its revenue

The Company is organised on the basis of one main business segment – Natural gas transmission (representing natural gas transmission services).

(b) Factors that management used to identify the reportable segments

Refer to the information in Note 4.

(c) Information about reportable segment profit or loss, assets and liabilities

The Company is considered as one reportable segment. Segment information for the reportable segment for the years ended 31 December 2016 and 31 December 2015 is set out below:

In millions of Czech crowns	Natural gas transmission	Natural gas transmission
	2016	**2015**
Revenues from core activities	9,286	9,891
Foreign exchange differences, net	1	30
Other operating income	458	970
Finance income	8	17
Total segment income	**9,753**	**10,908**
Raw materials consumed	450	790
Employee benefits	509	466
Depreciation and amortization	2,068	2,451
Impairment	–	2
Services purchased and lease charges	545	842
Gains less losses on disposals of property, plant and equipment	(3)	(4)
Derivatives	(31)	1
Other operating expenses	37	96
Income tax expense	2,904	769
Finance costs	1,852	2,216
Segment profit for the year	**1,422**	**3,279**
Segment other comprehensive income for the year	**222**	**(829)**
Segment total comprehensive income for the year	**1,644**	**2,450**
Capital expenditures	**678**	**673**

In millions of Czech crowns	Natural gas transmission	Natural gas transmission
	31 December 2016	**31 December 2015**
Total reportable segment Assets	**53,070**	**56,637**
Total reportable segment Liabilities	**45,481**	**54,104**

Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

(d) Geographical information

Total revenues for geographical areas for which the revenues are material are reported separately and disclosed below.

The analysis is based on domicile of shippers (users of transmission system that is operated by the Company in the Czech Republic).

In millions of Czech Crowns	2016	2015
Czech Republic	1,856	1,738
Other EU countries	2,129	2,382
Non-EU countries	5,301	5,771
Total revenues from core activities	**9,286**	**9,891**

Capital expenditure for each individual country for which it is material is reported separately as follows:

In millions of Czech Crowns	2016	2015
Czech Republic	678	673
Total capital expenditure	**678**	**673**

The analysis is based on location of assets. Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

(e) Major customers

Revenues from customers that represent 10% of more of the total revenues are as follows:

In millions of Czech Crowns	2016	2015
Customer 1	5,659	5,547
Customer 2	1,390	1,345
Customer 3	1,274	1,310
Total revenues from major customers	**8,323**	**8,202**

Revenues comprise only revenues from core activities.

Entities known to the Company as being under common control are considered as a single customer.

7. Balances and Transactions with Related Parties

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

The Company is fully owned by NET4GAS Holdings and NET4GAS Holdings is the ultimate parent company of the Company.

The Company's balances and transactions with subsidiaries of ultimate parent of Allianz Infrastructure Czech HoldCo II S.à r.l. and subsidiaries of ultimate parent of Borealis Novus Parent B.V. are disclosed below within the category Subsidiaries of joint ventures' ultimate parents.

At 31 December 2016, the outstanding balances with related parties are as follows:

In millions of Czech crowns	Subsidiary	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Gross amount of trade and other receivables			
BRAWA, a.s.	1	–	–
Trade and other payables			
BRAWA, a.s.	17	–	–
Loans to related parties (Note 13)			
NET4GAS Holdings, s.r.o.	–	–	652
Finance lease liability (Note 19)			
BRAWA, a.s – non-current	6,778	–	–
– current	196	–	–
Borrowings (Note 18)			
NET4GAS Holdings, s.r.o.	–	–	25
BRAWA, a.s. – cash-pooling	524	–	–

The subordinated borrowings from related parties amounting to CZK 11,000 million were settled in June 2016 (Note 18).

The income and expense items with related parties for the year ended 31 December 2016 are as follows:

In millions of Czech crowns	Subsidiary	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Purchases / expenses			
BRAWA, a.s. – interest expense from finance lease	513	–	–
BRAWA, a.s. – interest expense from cash-pooling	1	–	–
BRAWA, a.s. – services	36	–	–
Borealis Novus Holdings B.V. – interest expense	–	182	–
Allianz Infrastructure Luxembourg I S.à r.l. – interest expense	–	182	–
NET4GAS Holdings, s.r.o. – interest expense	–	–	1
Other revenues			
NET4GAS Holdings, s.r.o. – interest income	–	–	6
NET4GAS Holdings, s.r.o. – services	–	–	1
BRAWA, a.s. – dividends	432	–	–

At 31 December 2015, the outstanding balances with related parties were as follows:

In millions of Czech crowns	Subsidiary	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Gross amount of trade and other receivables			
BRAWA, a.s.	1	–	–
Trade and other payables			
BRAWA, a.s.	18	–	–
Loans to related parties (Note 13)			
NET4GAS Holdings, s.r.o.	–	–	1,886
Finance lease liability (Note 19)			
BRAWA, a.s. – non-current	6,888	–	–
– current	197	–	–
Borrowings (Note 18)			
Subordinated borrowings (contractual interest rate 6.3%, originally repayable on 28 July 2044)			
Allianz Infrastructure Luxembourg I S.à r.l.	–	5,500	–
Borealis Novus Holdings B.V.	–	5,500	–

The income and expense items with related parties for the year ended 31 December 2015 were as follows:

In millions of Czech crowns	Subsidiary	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Purchases / expenses			
BRAWA, a.s. – interest expense from finance lease	512	–	–
BRAWA, a.s. – services	36	–	–
Borealis Novus Holdings B.V. – interest expense	–	352	–
Allianz Infrastructure Luxembourg I S.à r.l. – interest expense	–	352	–
Other revenues			
NET4GAS Holdings, s.r.o. – interest income	–	–	12
NET4GAS Holdings, s.r.o. – services	–	–	1
BRAWA, a.s. – dividends	957	–	–
BRAWA, a.s. – services	12	–	–

At 31 December 2016 and 2015 the Company did not have any other rights and obligations connected to related parties.

Key management compensation is presented below:

	2016		2015	
In millions of Czech Crowns	Expense	Accrued liability	Expense	Accrued liability
Short-term benefits:				
– Salaries	47	4	40	4
– Short-term bonuses	14	14	15	15
– Current portion of long-term bonuses	–	8	–	8
Other long-term employee benefits:				
– Long-term bonus scheme	13	32	10	29
– Defined contribution benefits	5	3	4	3
Total	**79**	**61**	**69**	**59**

Short-term bonuses fall due wholly within twelve months after the end of the period in which management rendered the related services.

Key management represents Statutory Directors and managers directly reporting to them.

8. Property, Plant and Equipment

Movements in the carrying amount of property, plant and equipment were as follows:

In millions of Czech Crowns	Freehold Land	Buildings and constructions	Buildings and constructions under finance lease	Plant and equipment	Construction in progress	Total
Cost at 1 January 2015	184	53,736	7,312	5,321	206	66,759
Accumulated depreciation	–	(15,355)	(208)	(4,021)	–	(19,584)
Carrying amount at 1 January 2015	**184**	**38,381**	**7,104**	**1,300**	**206**	**47,175**
Additions	–	–	–	–	629	629
Transfers	(5)	171	–	343	(509)	–
Disposals	–	(2)	–	(1)	–	(3)
Depreciation charge	–	(1,780)	(104)	(507)	–	(2,391)
Carrying amount at 31 December 2015	**179**	**36,770**	**7,000**	**1,135**	**326**	**45,410**
Cost at 31 December 2015	179	53,680	7,312	5,624	326	67,121
Accumulated depreciation	–	(16,910)	(312)	(4,489)	–	(21,711)
Carrying amount at 1 January 2016	**179**	**36,770**	**7,000**	**1,135**	**326**	**45,410**
Additions	–	–	–	–	632	632
Capitalised borrowing costs	–	–	–	–	13	13
Transfers	4	308	–	183	(495)	–
Disposals	–	(20)	–	–	–	(20)
Depreciation charge	–	(1,666)	(106)	(222)	–	(1,994)
Carrying amount at 31 December 2016	**183**	**35,392**	**6,894**	**1,096**	**476**	**44,041**
Cost at 31 December 2016	183	53,917	7,312	5,774	476	67,662
Accumulated depreciation	–	(18,525)	(418)	(4,678)	–	(23,621)
Carrying amount at 31 December 2016	**183**	**35,392**	**6,894**	**1,096**	**476**	**44,041**

As at 31 December 2016, construction in progress consists mainly of construction of Czech-Polish interconnector gas pipeline in the amount of CZK 252 million (31 December 2015: CZK 110 million). Upon completion, assets are expected to be transferred to buildings and constructions. Other items represent smaller projects.

The Company leases GAZELLE pipeline under non-cancellable finance lease agreement. The lease period is 22 years and ownership of the assets lies within the lessor.

9. Intangible Assets

In millions of Czech Crowns	Acquired software licences	Development costs	Other	Assets under construction	Total
Cost at 1 January 2015	397	60	23	32	512
Accumulated amortisation	(327)	(51)	(8)	–	(386)
Carrying amount at 1 January 2015	**70**	**9**	**15**	**32**	**126**
Additions	–	–	–	44	44
Transfers	43	–	–	(43)	–
Amortisation charge	(53)	(4)	(3)	–	(60)
Carrying amount at 31 December 2015	**60**	**5**	**12**	**33**	**110**
Cost at 31 December 2015	416	57	23	33	529
Accumulated amortisation	(356)	(52)	(11)	–	(419)
Carrying amount at 1 January 2016	**60**	**5**	**12**	**33**	**110**
Additions	–	–	–	33	33
Transfers	43	–	2	(45)	–
Amortisation charge	(48)	(3)	(3)	–	(54)
Carrying amount at 31 December 2016	**55**	**2**	**11**	**21**	**89**
Cost at 31 December 2016	458	54	25	21	558
Accumulated amortisation	(403)	(52)	(14)	–	(469)
Carrying amount at 31 December 2016	**55**	**2**	**11**	**21**	**89**

10. Investment in Subsidiary

The Company's interest in its subsidiary as at 31 December 2016 and 31 December 2015 was as follows:

Name	Activity	Carrying amount of the investment (CZK million)	% ownership interest held (% of voting rights if different)	Principal place of business	% ownership interest held	% of voting rights (if different than % ownership interest held)
Subsidiary:						
BRAWA, a.s.	Owner of the GAZELLE natural gas pipeline which is rented to the Company	7,476	100 %	Czech Republic	100 %	100 %
Total		**7,476**				

BRAWA, a.s. with its registered office at Na Hřebenech II 1718/18, Prague – Nusle was incorporated on 27 October 2010. The company was registered in the Commercial Register maintained by the Municipal Court in Prague, section B, insert 16622, on 10 November 2010.

11. Other Non-Current Assets

In millions of Czech crowns	31 December 2016	31 December 2015
Advances for acquisition of fixed assets	9	1
Total other non-current assets	**9**	**1**

12. Inventories

In millions of Czech crowns	31 December 2016	31 December 2015
Raw materials	63	65
Total inventories	**63**	**65**

Raw materials are mainly spare parts for the gas transmission system.

There are no inventories valued at net realisable value as at 31 December 2016 and 2015.

13. Loans to Related Parties

In millions of Czech crowns	31 December 2016	31 December 2015
Corporate loans		
– denominated in Czech Crowns	164	–
– denominated in Euros	488	1,886
Total loans provided	**652**	**1,886**

Loans to related parties as at 31 December 2016 mature on 30 June 2017 at the latest (31 December 2015: 31 March 2016).

Interest rates related to loan to related parties are disclosed in Note 32, section interest rate risk.

Analysis by credit quality of loans outstanding is as follows:

In millions of Czech crowns	31 December 2016 Corporate loans	31 December 2015 Corporate loans
Neither past due nor impaired		
– NET4GAS Holdings, s.r.o. – parent company (without external rating)	652	1,886
Total neither past due nor impaired	**652**	**1,886**
Total loans provided	**652**	**1,886**

There are no collaterals related to the above mentioned loans.

Refer to Note 34 for the estimated fair value of each class of loans. Interest rate analysis of loans is disclosed in Note 32. Information on related party transactions is disclosed in Note 7.

14. Trade and Other Receivables

In millions of Czech crowns	31 December 2016	31 December 2015
Trade and estimated receivables	304	128
Less impairment loss provision	(1)	(3)
Total current trade and other receivables	**303**	**125**

Analysis by credit quality of trade and other receivables is as follows:

In millions of Czech crowns	31 December 2016 Trade and estimated receivables	31 December 2015 Trade and estimated receivables
Neither past due nor impaired – exposure to		
– Between A- and BBB-*	238	86
– Not rated	47	39
Total neither past due nor impaired	285	125
Past due but not impaired		
– less than 30 days overdue	9	–
– between 30–60 days overdue	9	–
Total past due but not impaired	18	–
Individually determined to be impaired (gross)		
– 360 days or more overdue	1	3
Total individually impaired	1	3
Less impairment provision	(1)	(3)
Total trade and other receivables	**303**	**125**

* Rating disclosed is equivalent credit rating from the third party rating agencies defined in the Network Code approved by ERO which is applicable for the Company.

15. Other Non-Financial Assets

In millions of Czech crowns	31 December 2016	31 December 2015
Value-added tax	3	16
Prepayments for services	24	36
Other receivables	–	7
Total current non-financial assets	**27**	**59**

16. Cash and Cash Equivalents

In millions of Czech crowns	31 December 2016	31 December 2015
Bank balances available on demand	410	874
Deposit bills of exchange with original maturity of less than three months	–	537
Total cash and cash equivalents	**410**	**1,411**

The credit quality of cash and cash equivalents balances may be summarised as follows:

	31 December 2016		31 December 2015	
In millions of Czech Crowns	Bank balances payable on demand	Deposit bills of exchange	Bank balances payable on demand	Deposit bills of exchange
Neither past due nor impaired				
– A+ to A- rated	371	–	83	537
– BBB+ to BBB- rated	39	–	791	–
Total	**410**	**–**	**874**	**537**

17. Equity

The Company is a limited liability company. It has no issued share securities. The rights attributed to share in the equity correspond to the proportion in the ownership interest.

Dividends declared and paid during the year were as follows:

In millions of Czech crowns	2016	2015
Dividends payable at 1 January	–	–
Dividends declared and paid during the year	1,540	1,566
Dividends payable at 31 December	–	–

Advance dividends paid during the year were as follows:

In millions of Czech crowns	2016	2015
Advance dividends paid	1,650	2,900
Total advance dividends paid	**1,650**	**2,900**

All dividends were declared in Czech Crowns and paid in a different currency mix (CZK, EUR and USD).

On 15 December 2016 (on 10 December 2015) the Statutory Directors of the Company decided about the advance dividend payment of CZK 1,650 million (2015: 2,900 CZK million). The payment of the advance dividend is subsequently subject to approval of the general meeting of the sole shareholder of the Company. The advance dividend payments are recognised as a decrease in equity as at the date of the payment.

A description of the nature and purpose of each reserve is provided below the table.

In millions of Czech crowns	Capital contributions outside registered capital	Cash flow hedges	Total other reserves
Balance as at 1 January 2015	**29**	**(1,206)**	**(1,177)**
Revaluation – gross	–	(1,342)	(1,342)
Reclassification to profit or loss (Revenues) – gross	–	275	275
Reclassification to profit or loss (Finance costs) – gross	–	44	44
Deferred tax effect	–	194	194
Balance as at 31 December 2015	**29**	**(2,035)**	**(2,006)**
Revaluation – gross	–	(2)	(2)
Reclassification to profit or loss (Revenues) – gross	–	275	275
Reclassification to profit or loss (Finance costs) – gross	–	1	1
Deferred tax effect	–	(52)	(52)
Non-cash contribution to equity (Note 18)	6,602	–	6,602
Balance as at 31 December 2016	**6,631**	**(1,813)**	**4,818**

Capital contributions outside registered capital
Capital contributions outside registered capital comprises of cash and non-cash capital contributions that does not give rise to the registered capital.

Cash flow hedges
Cash flow hedges are used to record gains or losses on hedging instruments that are designated and qualify as cash flow hedges and that are recognised in other comprehensive income, as described in Note 3(c). Amounts are reclassified to profit or loss when the associated hedged transaction affects profit or loss.

18. Borrowings

In millions of Czech crowns	31 December 2016	31 December 2015
Short-term borrowings from related parties (cash pooling BRAWA)	524	–
Short-term borrowings from related parties (cash pooling NET4GAS Holdings)	25	–
Subordinated borrowings from related parties (originally repayable on 28 July 2044)	–	11,000
Current portion of bonds and bank borrowings		
– CZK denominated bank borrowings (repayable on 28 July 2018)	–	–
– USD denominated bank borrowings (repayable on 28 July 2018)	–	–
– CZK denominated bond (repayable on 28 January 2021)	117	119
– EUR denominated bond (repayable on 28 July 2021)	70	72
– EUR denominated bond (repayable on 28 July 2026)	59	61
– EUR denominated bond (repayable on 28 July 2026) – issued in 2015	15	16
Non-current bonds and bank borrowings		
– CZK denominated bank borrowings (repayable on 28 July 2018)	5,736	5,724
– USD denominated bank borrowings (repayable on 28 July 2018)	1,381	1,334
– CZK denominated bond (repayable on 28 January 2021)	6,952	6,936
– EUR denominated bond (repayable on 28 July 2021)	8,055	8,042
– EUR denominated bond (repayable on 28 July 2026)	4,291	4,289
– EUR denominated bond (repayable on 28 July 2026) – issued in 2015	1,346	1,345
Total borrowings – current	**810**	**268**
Total borrowings – non-current	**27,761**	**38,670**
Total borrowings	**28,571**	**38,938**

Borrowings from related parties
Part of loans from related parties Borealis Novus Holdings B.V. and Allianz Infrastructure Luxembourg I S.à.r.l. in total amount of CZK 11,000 million was settled in cash (CZK 2,500 million). Remaining amount of CZK 8,500 million was cessed to NET4GAS Holdings. It was subsequently netted against receivable from contribution to Company's other reserves of CZK 6,602 million and also netted against loan provided to NET4GAS Holdings of CZK 1,898 million.

Bank borrowings and bonds

The Company borrowings are constituted by bank borrowings acquired in 2014 and bonds borrowings issued in 2014 and 2015.The bank borrowings were acquired pari-passu as well as bonds were issued pari-passu and have the senior position to the subordinated borrowings from related parties. The bank borrowings were denominated in CZK and USD.

Further, the Company acquired the committed revolving facility agreement in equivalent of EUR 100 million (CZK 2,702 million per Czech National Bank foreign exchange rate as at 31 December 2016). The revolving facility agreement might be utilized in CZK or EUR. In 2015 the revolving facility agreement was undrawn. During 2016 the revolving facility agreement was drawn and repaid, as at 31 December 2016 was undrawn.

Nine banks with different share participated on the total bank borrowings as at 31 December 2016 (seven banks as at 31 December 2015).

There is no collateral related to the above mentioned bank borrowings or bonds.

The bank borrowings and bonds have no quantitative financial covenants. There are several qualitative covenants applied, i.e. negative pledge, change of control put and loss of finance put. Violation of these covenants can lead to immediate maturity of the debt.

The Company's right to lien its property in favour of another creditor is restricted due to conditions stated in bank and bond financing contracts.

Bank borrowings and bonds denominated in foreign currency represent a constituent of hedge accounting, which represents the hedging instrument for securing of foreign exchange risk associated with a highly probable forecasted future cash flows resulting from natural gas transmission revenues (cash flow hedge) – Note 32, Note 3c).

Bonds issued:

In millions of Czech Crowns	Issue nominal value	Due date	Annual coupon repayment due date	31 December 2016	31 December 2015
Bond EUR, serial no. 1, ISIN XS1090450047	300,000,000 EUR	28 Jul 2021	Each 28.7. in arrears	8,125	8,114
Bond EUR, serial no. 2, ISIN XS 1090449627	160,000,000 EUR	28 Jul 2026	Each 28.7. in arrears	4,350	4,350
Bond CZK, serial no. 3, ISIN XS1090620730	7,000,000,000 CZK	28 Jan 2021	Each 28.1. in arrears	7,069	7,055
Bond EUR, serial no. 4, ISIN XS 1172113638	50,000,000 EUR	28 Jul 2026	Each 28.7. in arrears	1,361	1,361
Total bonds				**20,905**	**20,880**

Coupon rates to the above mentioned bonds are in range of 2.25% – 3.5% p.a. On 28 July 2014 bonds, serial no. 1–3, were accepted for trading on a regulated market of the Irish Stock Exchange PLC. The terms of issue of all above stated bonds have been approved by the decision of the Central Bank of Ireland. The 2015 bond, serial no. 4, was issued via private placement.

The fair value of borrowings is disclosed in Note 34.

19. Finance Lease Liability

Minimum lease payments under finance leases and their present values are as follows:

In millions of Czech Crowns	Due in 1 year	Due between 1 and 5 years	Due after 5 years	Total
Minimum lease payments at 31 December 2016	617	2,385	20,427	23,429
Less future finance charges	421	1,943	14,091	16,455
Present value of minimum lease payments at 31 December 2016	**196**	**442**	**6,336**	**6,974**
Minimum lease payments at 31 December 2015	624	2,418	21,011	24,053
Less future finance charges	427	1,976	14,565	16,968
Present value of minimum lease payments at 31 December 2015	**197**	**442**	**6,446**	**7,085**

Leased assets with a carrying amount disclosed in Note 8 are effectively pledged for finance lease liabilities as the rights to the leased asset revert to the lessor in the event of default.

20. Government and Other Grants

The Company obtained grants from European Commission for construction projects specified below and deducted the grant value from the carrying amount of the related property, plant and equipment when all conditions attached to the grant were fulfilled. In 2013, the Company received a grant of CZK 7 million and in 2015 a grant of CZK 10 million and a part of this amount of CZK 3 million was deducted from the carrying amount of property, plant and equipment in 2015 for Action no. 2011-G190/11-ENER/11/TEN-E-SI2.636400 based on the European Commission decision concerning the granting of Union financial aid in the field of Regulation Trans-European energetic networks. The Company has not complied with all attached conditions as at 31 December 2016 and 2015 yet and therefore the amount received was presented as part of other non-financial liabilities (Note 24). During 2015 and 2016, the Company also received grants from the European Commission of approximately CZK 1 million for the above mentioned construction project and this amount was deducted from the carrying amount of property, plant and equipment in 2016.

21. Other Taxes Payable

In millions of Czech crowns	31 December 2016	31 December 2015
Other taxes payable within one year comprise:		
Property and other taxes	8	5
Social and health insurance	12	11
Other taxes payable – current	**20**	**16**

22. Provisions for Liabilities and Charges

Movements in provisions are as follows:

	2016		2015	
In millions of Czech Crowns	Current	Non-current	Current	Non-current
Carrying amount at January 1	**40**	**177**	**–**	**175**
Additions charged to profit or loss	–	2	40	5
Unused amounts reversed	–	(12)	–	(3)
Amounts used during the year	(40)	–	–	–
Carrying amount at December 31	**–**	**167**	**40**	**177**

The non-current provisions as at 31 December 2016 and 2015 were primarily set aside for restructuring on selected compressor stations. The non-current restructuring provisions as at 31 December 2016 are expected to be utilised in year 2021 (as at 31 December 2015: until 2021).

23. Trade and Other Payables

In millions of Czech crowns	31 December 2016	31 December 2015
Trade payables for purchased property, plant and equipment	145	155
Trade payables – other	68	93
Accrued liabilities for purchased property, plant and equipment	20	54
Accrued liabilities – other	165	206
Received deposits from customers	139	126
Other financial liabilities	3	7
Total financial payables within trade and other payables – current	**540**	**640**
Other payables	8	2
Total financial payables within other payables – non-current	**8**	**2**

24. Accrued Employees Benefits and Other Non-Financial Liabilities

In millions of Czech crowns	31 December 2016	31 December 2015
Accrued employee benefits		
– Salaries and bonuses	31	21
– Defined contribution costs	15	20
– Untaken holiday costs	7	–
Advance payments received	130	299
Other non-financial liabilities	6	2
Total accrued employee benefits and other non-financial liabilities – current	**189**	**342**

In millions of Czech crowns	31 December 2016	31 December 2015
Accrued employee benefits – other long-term benefits	100	68
Grant pre-payments received (Note 20)	15	15
Total accrued employee benefits and other non-financial liabilities – non-current	**115**	**83**

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25. Expenses

In millions of Czech crowns	2016	2015
Raw materials consumed*	450	790
Salaries	*337*	*297*
Statutory and private pension contribution	*172*	*169*
Employee benefits	509	466
Depreciation and amortisation	2,068	2,451
Impairment	–	2
Repairs and maintenance services	*137*	*144*
Flexibility costs	*25*	*330*
IT & Telecommunications expenses	*98*	*104*
Consultancy and advisory services	*74*	*56*
Lease charges	*88*	*94*
Marketing	*20*	*23*
Other services	*103*	*91*
Services purchased and lease charges	545	842
Gains on disposal of fixed assets	(3)	(4)
Losses / (gains) on derivative financial instruments	(31)	1
Other operating expenses	37	96
Total operating expenses	**3,575**	**4,644**

* Represents mainly consumption of natural gas.

26. Other Operating Income

In millions of Czech crowns	2016	2015
Dividend from subsidiary for financial year 2016 – received in December 2016	432	–
Dividend from subsidiary for year 2015 – received in December 2015	–	408
Dividend from subsidiary for year 2014 – received in March 2015*	–	549
Other operating income	26	13
Total other operating income	**458**	**970**

* By the decision of the sole shareholder of BRAWA, a.s dated 4 August 2015, the company NET4GAS, s.r.o. in the course of General Meeting of BRAWA, a.s. has changed its statutes in article 29/3, which is connected with accounting period of BRAWA, a.s. With the effect from 2015, the new accounting period of BRAWA, a.s. ends 30 November. Accounting period for year 2015 begins on 1 January 2015 and ends on 30 November 2015. Accounting period 2016 and the following periods begin on 1 December of the previous calendar year and end on 30 November of the current calendar year.

27. Finance Income

In millions of Czech crowns	2016	2015
Interest income on other financial assets	7	15
Other finance income	1	2
Total finance income recognised in profit or loss	**8**	**17**

28. Finance Costs

In millions of Czech crowns	2016	2015
Net foreign exchange differences on financing activities	262	260
Interest expense – finance lease	513	521
Interest expense – other	1,016	1,369
Other finance costs	61	66
Total finance costs recognised in profit or loss	**1,852**	**2,216**

29. Income Taxes

For details about the risks related to tax position refer to Note 4.

(a) Components of income tax expense

Income tax expense / (credit) recorded in profit or loss comprises the following:

In millions of Czech crowns	2016	2015
Supplementary income tax return for prior years filed (Note 4)	–	162
Adjustment in respect of current income tax from prior year	48	–
Current income tax expense for the year	923	808
Deferred income tax expense / (credit)	1,933	(201)
Income tax expense for the year in statement of profit and loss	**2,904**	**769**

(b) Reconciliation between the tax expense and profit or loss multiplied by applicable tax rate

The income tax rate applicable to the majority of the Company's 2016 and 2015 income is 19%. The reconciliation between the expected and the actual tax charge is provided below.

In millions of Czech crowns	2016	2015
Profit before tax	**4,326**	**4,048**
Theoretical tax charge at statutory rate of 19%:	822	769
Tax effect of items which are not deductible or assessable for income tax purposes:		
– Non-taxable items – Dividend income from subsidiary	(82)	(182)
– Non-deductible expenses	6	18
Difference between current income tax provision and final current income tax return	48	4
Supplementary income tax returns for prior years (2012–2014) (Note 4)	–	162
Other effects	(15)	(2)
Increase of deferred tax liability – change in estimate (Note 4)	2,125	–
Income tax expense for the year	**2,904**	**769**

(c) Deferred taxes analysed by type of temporary difference

Differences between IFRS and tax regulation in the Czech Republic give rise to temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below.

In millions of Czech Crowns	1 January 2016	(Charged) / credited to profit or loss	(Charged) / credited to other comprehensive income	31 December 2016
Tax effect of deductible/(taxable) temporary differences				
Difference between tax and accounting carrying amounts of property, plant and equipment (different tax depreciation)	(4,500)	(1,931)	–	(6,431)
Other liabilities; tax deductible in different period	24	–	–	24
Provisions for liabilities and charges	33	(2)	–	31
Cash flow hedges	477	–	(52)	425
Net deferred tax asset/(liability)	**(3,966)**	**(1,933)**	**(52)**	**(5,951)**

Management estimates that net deferred tax liabilities of CZK 5,951 million (2015: CZK 3,966 million) are recoverable after more than twelve months after the end of the reporting period.

The tax effect of the movements in the temporary differences for the year ended 31 December 2015 were:

In millions of Czech Crowns	1 January 2015	(Charged) / credited to profit or loss	(Charged) / credited to other comprehensive income	31 December 2015
Tax effect of deductible/(taxable) temporary differences				
Difference between tax and accounting carrying amounts of property, plant and equipment (different tax depreciation)	(4,688)	188	–	(4,500)
Other liabilities; tax deductible in different period	11	13	–	24
Provisions for liabilities and charges	33	–	–	33
Cash flow hedges	283	–	194	477
Net deferred tax asset/(liability)	**(4,361)**	**201**	**194**	**(3,966)**

(d) Tax effects in the other comprehensive income

Disclosure of tax effects relating to cash flow hedge reserve (see also Note 17):

	31 December 2016			31 December 2015		
In millions of Czech Crowns	Before tax	Tax effects	After tax	Before tax	Tax effects	After tax
Cash flow hedge	(2,238)	425	(1,813)	(2,512)	477	(2,035)
Other comprehensive income for the period	**(2,238)**	**425**	**(1,813)**	**(2,512)**	**477**	**(2,035)**

30. Contingencies and Commitments

Operating lease commitments in respect of lease agreements for offices Kavčí hory Office Park and car fleet are as follows:

In millions of Czech crowns	2016	2015
Not later than 1 year	44	51
Total operating lease commitments	**44**	**51**

Capital expenditure commitments. As at 31 December 2016 the Company has contractual capital expenditure commitments in respect of property, plant and equipment totalling CZK 274 million (31 December 2015: CZK 198) mainly related to Czech-Polish Interconnector gas pipeline of CZK 125 million (31 December 2015: CZK 14 million) and Optimus project – optimisation project on compressor stations of CZK 70 million (31 December 2015: CZK 98 million).

Guarantees. The Company did not record any obligations from financial guarantees as at 31 December 2016 and 2015.

Assets pledged and restricted. In connection with the Company's bank borrowings, the Company's right to lien its property in favour of another creditor is restricted.

Compliance with covenants. The Company is subject to certain qualitative covenants related to its borrowings. Non-compliance with such covenants may result in immediate maturity of the debt. The Company was in compliance with covenants at 31 December 2016 and 31 December 2015.

Leased assets with a carrying amount disclosed in Note 8 are effectively pledged for finance lease liabilities as the rights to the leased asset revert to the lessor in the event of default.

31. Derivative Financial Instruments

The table below sets out fair values, at the end of the reporting period, of currencies receivable or payable under cross–currency interest rate swaps and foreign exchange swap contracts entered into by the Company. The table reflects gross positions before the offsetting of any counterparty positions (and payments) and covers the contracts with settlement dates after the respective end of the reporting period.

Cross currency interest rate swap contracts are long-term while foreign exchange swap contracts are short-term in nature. The respective part of fair value of a hedging derivative is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months.

The Company did not have any other derivative financial instruments besides cross currency interest rate swaps and foreign exchange swaps.

The disclosure below provides aggregated overview of the fair value of receivable and payable legs of individual contracts per currency mix.

	31 December 2016			
	Current		Non-Current	
In millions of Czech Crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Cross currency interest rate swaps: fair values, as at the reporting period, of				
EUR/USD currency mix				
– USD payable on settlement (-)	–	(578)	–	(13,884)
– EUR receivable on settlement (+)	–	287	–	11,527
EUR/CZK currency mix				
– CZK payable on settlement (-)	–	(39)	–	(1,764)
– EUR receivable on settlement (+)	–	38	–	1,643
Net fair value of cross currency interest rate swaps	**–**	**(292)**	**–**	**(2,478)**

Inputs used: Market data provided by commercial bank holding the related instruments, Czech National Bank foreign exchange rates

	31 December 2015			
	Current		Non-Current	
In millions of Czech Crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Cross currency interest rate swaps: fair values, as at the reporting period, of				
EUR/USD currency mix				
– USD payable on settlement (-)	–	(562)	–	(13,910)
– EUR receivable on settlement (+)	–	287	–	11,495
EUR/CZK currency mix				
– CZK payable on settlement (-)	–	(39)	–	(1,730)
– EUR receivable on settlement (+)	–	38	–	1,611
Net fair value of cross currency interest rate swaps	**–**	**(276)**	**–**	**(2,534)**

Inputs used: Market data provided by commercial bank holding the related instruments, Czech National Bank foreign exchange rates

The Company had one outstanding obligation from foreign exchange swaps as at 31 December 2016. The Company had no outstanding obligations foreign exchange swaps as at 31 December 2015 since all these derivatives were settled during 2015.

	31 December 2016		31 December 2015	
In millions of Czech Crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Foreign exchange swaps: fair values, as at the reporting period, of				
CZK receivable on settlement (+)	(108)	–	–	–
– EUR payable on settlement (-)	108	–	–	–
Net fair value of foreign exchange swaps – current	**–**	**–**	**–**	**–**

Cross currency interest rate swaps and foreign exchange swaps entered into by the Company are generally traded in an over-the-counter market with professional market counterparties on standardized contractual terms and conditions. Aforementioned financial instruments have potentially favourable (assets) or unfavourable (liabilities) conditions as a result of fluctuations in foreign exchange rates, market interest rates or other variables relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly during the life time of derivatives.

Cross currency interest rate swaps
The nominal principal amounts of the outstanding cross currency interest rate swap contracts at 31 December 2016 were EUR 410 million / USD 484 million / CZK 1,397 million (2015: EUR 410 million / USD 484 million / CZK 1,397 million). All cross currency interest rate swaps have fixed interest rates on both legs. At 31 December 2016, the fixed interest rates vary from 2.50 % to 5.23 % p.a.(as at 31 December 2015: 2.50% to 5.23% p.a.).

The Company designates certain cross currency interest rate swaps, in combination with bonds denominated in EUR, as hedging instrument of a foreign exchange risk associated with a highly probable forecasted cash flows from natural gas transmission revenues (cash flow hedge) – Note 32, Note 3c).

The Company designates certain cross currency interest rates swaps as hedging instrument of a foreign exchange risk associated with a highly probable forecasted cash flows from bond issued (cash flow hedge) – Note 32, Note 3c).

32. Financial Risk Management

The risk management function within the Company is carried out in respect of financial risks, operational risks, market risks and environment risks. Financial risk comprises market risk (including currency risk and interest rate risk), credit risk and liquidity risk. Management sets a strategy for each of the risk, including a limit on open position that may be accepted. The primary objectives of the financial risk management function are then ensure that exposure to risks stays within these limits. Monitoring is performed continuously but minimum on a monthly basis.

Credit risk. Exposure to credit risk arises as a result of cash and cash equivalents held with banks, loans provided to related parties, the Company's sales of services on credit terms and other transactions with counterparties giving rise to financial assets.

The Company structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to counterparties. Limits on the level of credit risk are approved by management. The risks are monitored on a revolving basis and are subject to a monthly review. The Company is exposed to credit concentration risk considering the receivables from financial institutions.

The credit risk is mitigated by advance payments and a system of creditworthiness conditions which are applied to the Company's customers, suppliers of services with potential significant credit position and financial counterparties such as banks or insurance companies. The conditions are incorporated in the Network Code, relevant tender documentations and internal guidelines.

The Company's management reviews ageing analysis of outstanding trade and other receivables and follows up on past due balances. Management therefore considers it appropriate to provide ageing and other information about credit risk as disclosed in Note 14 and in Note 16.

Market risks. The Company takes on exposure to market risks. Market risks arise from open positions in (a) foreign currencies and (b) interest bearing assets and liabilities, all of which are exposed to general and specific market movements.

Sensitivities to market risks included below are based on a change in a factor while holding all other factors constant. In practice this is unlikely to occur and changes in some of the factors may be correlated – for example, changes in interest rate and changes in foreign currency rates.

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Currency risk. The Company treasury's risk management policy is to hedge the long-term contracted cash flows (mainly revenues from the gas transmission) in each major foreign currency up until 2034.

Management approves the strategy of the currency risk management. The positions are monitored continuously but at minimum on a monthly basis. The amount of risk is evaluated in terms of open positions.

The offsetting of currency positions is applied where possible. When needed the outstanding positions are managed by means of buying or selling the relevant currency in the short term derivative forward or swap contract. The Company reports one outstanding obligation from foreign exchange swaps as at 31 December 2016. In 2015 there were no obligations.

The table below summarises the Company's exposure to foreign currency exchange rate risk at the end of the reporting period:

	At 31 December 2016					At 31 December 2015			
In millions of Czech Crowns	Monetary financial assets	Monetary financial liabilities	Derivatives (assets)	Derivatives (liabilities)	Net position	Monetary financial assets	Monetary financial (liabilities)	Derivatives (liabilities)	Net position
US Dollars	2	1,383	–	12,404	(13,785)	48	1,334	12,009	(13,295)
Euros	691	13,868	108	(11,078)	(1,991)	2,257	13,844	(11,080)	(507)
Total exposed to currency risk	**693**	**15,251**	**108**	**1,326**	**(15,776)**	**2,305**	**15,178**	**929**	**(13,802)**
Czech Crowns	413	20,618	(108)	1,397	(21,710)	1,007	31,275	1,398	(31,666)
Total	**1,106**	**35,869**	**–**	**2,723**	**(37,486)**	**3,312**	**46,453**	**2,327**	**(45,468)**

As at 31 December 2016 and 2015 the outstanding derivatives, cross currency interest rate swaps and foreign exchange swaps, were disclosed in their notional amounts translated to Czech Crowns using foreign exchange rate as at 31 December 2016 and 2015. The fair values are disclosed in Note 34.

The above analysis includes only monetary assets and liabilities. Investments in non-monetary assets are not considered to give rise to any material currency risk.

Hedging of currency risk. In 2014, the Company decided to introduce two cash-flow hedges to manage the foreign exchange currency risk in revenues in line with the Company treasury's policy. The financial instruments designated as hedging instruments are represented by (a) bank borrowing denominated in USD, (b) 33 % of bonds maturing in 2021 denominated in EUR and (c) joint hedging instrument of 66 % of bonds maturing in 2021 denominated in EUR and bonds maturing in 2026 denominated in EUR and cross currency interest rate swaps EUR/USD (Note 18, Note 31). The hedged item is represented by contracted or highly probable forecasted natural gas transmission revenues denominated in foreign currencies (in USD and in EUR) that are expected to occur on a monthly basis up until 2034. The dynamic hedging strategy is applied to hedged item. This strategy allows identification of hedged item in any period of the hedge accounting and is based on the continuous designation and re-designation of hedged item on a monthly basis from 28 July 2014 to 31 December 2034. Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until the repayment of the hedging instruments and within revenue up until 2034 which is beyond the repayment date of the hedging instruments (Note 18, Note 31). There was no ineffectiveness to be recorded from cash flow hedges in 2016 and 2015.

In 2015, the Company introduced additional, third, cash-flow hedge. The financial instruments designated as hedging instruments are represented by cross currency interest rate swap EUR/CZK (Note 18, Note 31). The hedged item is represented by cash flow related to private placement EUR bond maturing in 2026. Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until 2026 (Note 18, Note 31). In 2016, there were no additional hedges. The hedged item is represented by cash flow related to private placement EUR bond maturing in 2026.

Gains and losses recognised in other reserves in equity will be continuously released to profit or loss within finance costs up until 2026 (Note 18, Note 31). There was no ineffectiveness to be recorded from cash flow hedges in 2016 and 2015. The table below analyses the volume of hedged cash flows that were designated as hedged item:

In millions of Czech Crowns	Within 1 year	1–3 years	3–5 years	5–10 years	Over 10 years	Total
31 December 2016						
Currency risk exposure:						
Hedging of future cash flows – future receivables USD	1,711	2,497	1,958	5,441	1,345	12,952
Hedging of future cash flows – future receivables EUR	–	1,337	1,189	–	–	2,526
Hedging of future cash flows – future payables EUR	(38)	(76)	(76)	(1,540)	–	(1,730)
TOTAL	**1,673**	**3,758**	**3,071**	**3,901**	**1,345**	**13,748**

In millions of Czech Crowns	Within 1 year	1–3 years	3–5 years	5–10 years	Over 10 years	Total
31 December 2015						
Currency risk exposure:						
Hedgidging of future cash flows – future receivables USD	1,657	3,154	1,833	4,085	996	11,725
Hedging of future cash flows – future receivables EUR	–	599	1,485	442	–	2,526
Hedging of future cash flows – future payables EUR	(38)	(76)	(76)	(189)	(1,388)	(1,767)
TOTAL	**1,619**	**3,677**	**3,242**	**4,338**	**(392)**	**12,484**

The amount of reclassified other comprehensive income to revenues during 2016 decreased revenues by CZK 275 million (2015: decreased revenues by CZK 275 million). The amount of reclassified other comprehensive income to financial costs during 2016 increased financial costs by CZK 1 million (2015: increased financial costs by CZK 44 million).

The following table presents sensitivities of profit or loss or equity (cash flow hedge) to reasonably possible changes in exchange rates applied at the end of the reporting period relative to the functional currency, with all other variables held constant:

	At 31 December 2016		At 31 December 2015	
In millions of Czech Crowns	Impact on profit or loss	Impact on equity	Impact on profit or loss	Impact on equity
US Dollar strengthening by 10%	10	(1,284)	5	(1,282)
US Dollar weakening by 10%	(10)	1,284	(5)	1,282
Euro strengthening by 10%	77	(31)	224	(35)
Euro weakening by 10%	(77)	31	(224)	35

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the respective entity of the Company and for currency sensitive derivatives.

The Company's exposure to currency risk with impact to profit or loss as at 31 December 2016 is influenced by (i) cash balances held in foreign currency and (ii) by existing loans to related parties provided in EUR (Note 13, Note 27 and Note 28).

Interest rate risk. The Company´s bank borrowings are contracted at floating interest rates. Some instruments, like bonds and fix-to-fix cross currency interest rate swaps, are priced at fixed rates and are exposed to re-pricing risk at maturity. The fair value is among other factors also sensitive to interest rates through the discounted cash flow model which is used for the valuation (see Note 34a).

The table below summarises the Company's exposure to interest rate risks (e.g. term deposits; bonds and borrowings from related parties on fixed rate, both with re-pricing risk). The table presents the aggregated amounts of the Company's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest re-pricing or maturity dates.

In millions of Czech Crowns	On demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
31 December 2016					
Financial assets – floating rate	412	–	–	–	412
Financial assets – fixed rate with re-pricing risk	650	–	–	–	650
Financial liabilities – floating rate	(7,666)	–	–	–	(7,666)
Financial liabilities – fixed rate with re-pricing risk	–	–	(15,194)	(5,711)	(20,905)
Financial liabilities – fixed rate with re-pricing risk – finance lease	(113)	(83)	(442)	(6,336)	(6,974)
Net interest sensitivity gap at 31 December 2016	**(6,717)**	**(83)**	**(15,636)**	**(12,047)**	**(34,483)**
31 December 2015					
Financial assets – floating rate	874	–	–	–	874
Financial assets – fixed rate with re-pricing risk	2,423	–	–	–	2,423
Financial liabilities – floating rate	(7,046)	–	–	–	(7,046)
Financial liabilities – fixed rate with re-pricing risk	–	–	–	(31,892)	(31,892)
Financial liabilities – fixed rate with re-pricing risk – finance lease	(114)	(83)	(442)	(6,446)	(7,085)
Net interest sensitivity gap at 31 December 2015	**(3,863)**	**(83)**	**(442)**	**(38,338)**	**(42,726)**

As the Company's bank assets and liabilities (borrowings) are directly exposed to the floating interest rate, the change in interest rates has an impact on the Company's profit or loss for the current year.

The following table presents sensitivities of profit or loss to reasonably possible changes in short term interest rates applied at the end of the reporting period, with all other variables held constant:

	At 31 December 2016
In millions of Czech crowns	Impact on profit or loss
1M CZK PRIBOR increase by 25 bps	(14)
1M CZK PRIBOR decrease by 25 bps	14
1M USD LIBOR increase by 25 bps	(3)
1M USD LIBOR decrease by 25 bps	3
Overnight PRIBOR increase by 25 bps	(1)
Overnight PRIBOR decrease by 25 bps	1

	At 31 December 2015
In millions of Czech crowns	Impact on profit or loss
1M CZK PRIBOR increase by 25 bps	(14)
1M CZK PRIBOR decrease by 25 bps	14
1M USD LIBOR increase by 25 bps	(3)
1M USD LIBOR decrease by 25 bps	3
Overnight PRIBOR increase by 25 bps	3
Overnight PRIBOR decrease by 25 bps	(3)

The Company interest rate risk management policy requires that at least 70% of the interest rate exposure arising from bonds and term loans is at fixed rate. The existing financing structure achieves this requirement.

The Company's exposure to interest rate risk at the end of the reporting period is representative of the typical exposure during the year, starting from July 2014.

The Company monitors interest rates for its financial instruments. The table below summarises effective interest rates at the respective end of the reporting period based on reports reviewed by key management personnel:

	31 December 2016			31 December 2015		
In % p.a.	CZK	USD	EUR	CZK	USD	EUR
Assets						
Cash and cash equivalents	0.10	0.01	0.01	0.10	0.01	0.01
Loans to related parties	0.96	n/a	0.39	n/a	n/a	0.70
Liabilities						
Borrowings	2.10	2.28	3.00	4.20	1.95	3.00
Finance lease liability	7.35	n/a	n/a	7.35	n/a	n/a

Liquidity risk. Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company is exposed to daily calls on its available cash resources. Liquidity risk is managed by Treasury department of the Company and monitored in terms of monthly (one month forward), short-term (one year forward) and mid-term (five years forward) forecasts. Management monitors short-term forecasts of the Company's cash flows provided on the monthly basis.

The Company has strong liquidity position and is able to secure its operating funding needs through the cash collected from the business operations continuously throughout the year. The Company's liquidity portfolio comprises cash and cash equivalents (Note 16) and bank term deposits and deposit bills. Management estimates that the liquidity portfolio can be realised in cash within few days in order to meet unforeseen liquidity requirements.

The tables below show liabilities at 31 December 2016 and 2015 by their remaining contractual maturity. The amounts disclosed in the table below are the contractual undiscounted cash flows and gross loan commitments. Such undiscounted cash flows differ from the amount included in the balance sheet because the balance sheet amount is based on discounted cash flows. Financial derivatives are included at the contractual amounts to be paid or received, unless the Company expects to close the derivative position before its maturity date in which case the derivatives are included based on the expected cash flows.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. Foreign currency payments are translated using the spot exchange rate at the end of the reporting period.

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The maturity analysis of financial liabilities at 31 December 2016 is as follows:

In millions of Czech Crowns	Demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities					
Bank borrowings, bonds and borrowings from related parties (Note 18)	735	485	24,503	6,620	32,343
Finance lease liability (Note 19)	155	462	2,385	20,427	23,429
Trade and other payables (Note 23)	540	–	8	–	548
Gross settled cross currency interest rate swaps (Note 31)					
– inflows	–	(324)	(6,701)	(6,620)	(13,645)
– outflows	–	620	9,374	8,567	18,561
Total future payments, including future principal and interest payments	**1,430**	**1,243**	**29,569**	**28,994**	**61,236**

The maturity analysis of financial liabilities at 31 December 2015 is as follows:

In millions of Czech Crowns	Demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities					
Bank borrowings, bonds and borrowings from related parties (Note 18)	362	1,009	12,281	49,839	63,491
Finance lease liability (Note 19)	157	467	2,418	21,011	24,053
Trade and other payables (Note 23)	640	–	2	–	642
Gross settled cross currency interest rate swaps (Note 31)					
– inflows	–	(324)	(1,297)	(12,351)	(13,972)
– outflows	–	603	2,409	15,619	18,631
Total future payments, including future principal and interest payments	**1,159**	**1,756**	**15,812**	**74,119**	**92,846**

The net current liquidity position calculated as difference between current assets and current liabilities at 31 December 2016 is net current liability of CZK 768 million (31 December 2015 net current asset: CZK 1,856 million). The decrease in net liquidity position in 2016 does not result in liquidity issue of the Company.

Payments in respect of cross-currency interest rate swaps will be accompanied by related cash inflows which are disclosed at their present values in Note 31.

33. Management of Capital

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders. The Company is managing its capital ratios to ensure a strong credit rating (e.g. the Company may adjust the amount of dividends paid to shareholders in order to maintain or adjust the capital structure).

According to the Company's policy, capital structure consists mainly of equity, subordinated borrowings from related parties, non-subordinated borrowings from banks and bonds.

In millions of Czech crowns	At 31 December 2016	At 31 December 2015
Equity	7,589	2,533
Subordinated borrowings from related parties that received the equity-like treatment from the rating agencies Fitch and S&P	–	11,000
Non-subordinated borrowings from banks and bonds	28,022	27,938
Non-subordinated short-term borrowings from related parties	549	–
Total	**36,160**	**41,471**

Subordinated borrowings from related parties were settled during 2016 (Note 18).

The Company has complied with all requirements arising from the borrowings as at 31 December 2016 and 2015.

34. Fair Value of Financial Instruments

Fair value measurements are analysed by level in the fair value hierarchy. Management applies judgement in categorising financial instruments using the fair value hierarchy. If a fair value measurement uses observable inputs that require significant adjustment, that measurement is a Level 3 measurement. The significance of a valuation input is assessed against the fair value measurement in its entirety.

(a) Recurring fair value measurements
Recurring fair value measurements are those that the accounting standards require or permit in the balance sheet at the end of each reporting period:

(b) Financial instruments carried at fair value
Only derivatives measured at fair value.

All recurring fair value measurements are categorised in the fair value hierarchy into level 2 as at 31 December 2016 and 2015.

There were no changes in valuation technique for level 2 recurring fair value measurements since 31 December 2015.

The description of valuation technique and description of inputs used in the fair value measurement for level 2 measurements at 31 December 2016:

In millions of Czech crowns	Fair value	Valuation technique	Inputs used
Derivative financial instruments			
Cross currency interest rate swap contracts	(2,770)	Discounted cash flow method	Czech National Bank foreign exchange rates, inter-bank swap rates
TOTAL RECURRING FAIR VALUE MEASUREMENTS AT LEVEL 2	**(2,770)**	**–**	**–**

The description of valuation technique and description of inputs used in the fair value measurement for level 2 measurements at 31 December 2015:

In millions of Czech crowns	Fair value	Valuation technique	Inputs used
Derivative financial instruments			
Cross currency interest rate swap contracts	(2,810)	Discounted cash flow method	Czech National Bank foreign exchange rates, inter-bank swap rates
TOTAL RECURRING FAIR VALUE MEASUREMENTS AT LEVEL 2	**(2,810)**	**–**	**–**

The following table presents movements in fair values of derivative financial instruments:

In millions of Czech crowns	2016	2015
Opening balance	**(2,810)**	**(1,256)**
Change in fair value of contracts held at the beginning of the period settled during the period	–	–
Settlement of contracts held at the beginning of the period	–	–
Change in fair value of contracts concluded and realised during the period	31	(1)
Settlement of contracts concluded and realised during the period	(31)	1
Change in unrealised gains or losses for the period included in other comprehensive income for contracts held at the end of the reporting period	40	(1,554)
Closing balance	**(2,770)**	**(2,810)**

(c) Non-recurring fair value measurements

There are no assets held for sale or other items with non-recurring fair value measurements as of 31 December 2016 and 31 December 2015.

(d) Financial assets and liabilities not measured at fair value but for which fair value is disclosed

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

	31 December 2016				31 December 2015			
In millions of Czech Crowns	Level 1	Level 2	Level 3	Carrying value	Level 1	Level 2	Level 3	Carrying value
ASSETS								
Other financial assets								
– Loans to related parties	–	–	653	652	–	–	1,899	1,892
Total ASSETS	–	–	653	652	–	–	1,899	1,892
LIABILITIES								
Borrowings								
– Borrowings from related parties – current – BRAWA	–	–	524	524	–	–	–	–
– Borrowings from related parties – current – NET4GAS Holdings	–	–	25	25	–	–	–	–
– Borrowings from related parties – non-current	–	–	–	–	–	–	11,939	11,000
– Bank borrowings	–	–	7,127	7,117	–	–	7,085	7,046
– Bonds	20,941	–	1,394	20,905	20,024	–	1,314	20,880
Finance lease liability								
– Finance lease from BRAWA	–	–	9,976	6,974	–	–	10,043	7,086
Total LIABILITIES	**20,941**	**–**	**19,046**	**35,545**	**20,024**	**–**	**30,381**	**46,012**

Trade and other receivables' carrying values approximate to their fair values.

The fair values in level 1 of fair value hierarchy reflects the price of fixed interest rate bonds listed in active markets in public stock exchanges.

The fair values in level 3 of fair value hierarchy were estimated using the discounted cash flows valuation technique. Inputs used for loans to related parties are market observable (PRIBOR, LIBOR, EURIBOR) adjusted by unobservable estimated credit spreads. Inputs used for bank borrowings, borrowings from related parties and financial leasing are market observable (PRIBOR, LIBOR and IRS) adjusted by unobservable estimated credit spreads.

The fair value of unquoted bonds was determined based on estimated future cash flows expected to be received discounted by market observable yield curve adjusted by unobservable estimated credit spread.

Financial assets carried at amortised cost. The estimated fair value of asset instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

Financial liabilities carried at amortised cost. The estimated fair value of liability instruments is based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

35. Events After the Reporting Period

New cross-border capacity was offered and successfully marketed at the annual capacity auction on March 6, 2017 – a result of the joint efforts between the transmission operators in the Federal Republic of Germany, the Czech Republic and the Slovak republic. Based on the results of this auction, NET4GAS is ready to invest into relevant new gas infrastructure in the Czech Republic in the upcoming years. The extension of the transmission system represents an opportunity for the Czech Republic to maintain its strong position as a European transit country, and thus enhance the security of supply in the region. In connection with this construction, the Company must reassess changes with regards to continued operation of some compressor stations, reassess their useful lifes and reconsider the provision for liquidation, construction work on selected compressor stations and the provision for restructuring – termination payments to employees (provisions in total amount of CZK 160 million as at 31 December 2016).

No other events have occurred subsequent to year-end that would have a material impact on the separate financial statements for the year ended 31 December 2016.

Signature of the members of the statutory body of the Company:

4 April 2017

Andreas Rau
Statutory Director

Radek Benčík
Statutory Director

Václav Hrach
Statutory Director

The General Meeting approved the separate financial statements for publication on 25 April 2017.

Annex no. 3: Independent Auditor's Report to the Shareholder of NET4GAS, s.r.o.

Our Opinion

In our opinion:

– The accompanying consolidated financial statements give a true and fair view of the consolidated financial position of NET4GAS, s.r.o., with its registered office at Na Hřebenech II 1718/8, Praha 4 – Nusle ("the Company") and its subsidiary (together "the Group") as at 31 December 2016, of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.
– The accompanying separate financial statements give a true and fair view of the financial position of the Company standing alone as at 31 December 2016, of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

What we have audited

The Group's consolidated financial statements comprise:
– the consolidated balance sheet as at 31 December 2016;
– the consolidated statement of profit or loss and other comprehensive income for the year then ended;
– the consolidated statement of changes in equity for the year then ended;
– the consolidated statement of cash flows for the year then ended; and
– the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

The Company's separate financial statements comprise:
– the balance sheet as at 31 December 2016;
– the statement of profit or loss and other comprehensive income for the year then ended;
– the statement of changes in equity for the year then ended;
– the statement of cash flows for the year then ended; and
– the notes to the separate financial statements, which include significant accounting policies and other explanatory information.

Basis for Opinion

We conducted our audit in accordance with the Act on Auditors and Standards on Auditing of the Chamber of Auditors of the Czech Republic. These standards consist of International Standards on Auditing (ISAs) which may be supplemented and modified by related application guidance. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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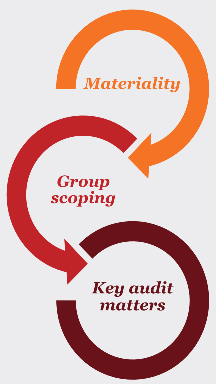
Independence

We are independent of the Group and the Company in accordance with the Act on Auditors and the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA) and accepted by the Chamber of Auditors of the Czech Republic, and we have fulfilled our other ethical responsibilities in accordance with these regulations.

Our audit approach

Overview



Group materiality is determined as 5 % from Group's consolidated profit before tax for the year ended 31 December 2016.
Materiality for separate financial statements is determined as 5 % from Company's profit before tax for the year ended 31 December 2016 decreased by dividend received.

The Company and its subsidiary were subject to a full scope audit performed by PwC Prague office, Czech Republic.

Key audit matter: Deferred tax (Risk related to tax position).

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated and separate financial statements (together "financial statements"). In particular, we considered where the directors made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Note:
Our report has been prepared in the Czech language and in English. In all matters of interpretation of information, views or opinions, the Czech version of our report takes precedence over the English version.

Overall Group materiality	CZK 221 million (CZK 182 million in prior year)
How we determined it	5% of Group's profit before tax for the year ended 31 December 2016
Rationale for the materiality benchmark applied	Materiality is a matter of professional judgment. In drawing conclusions about materiality, we considered both quantitative and qualitative factors, and we chose profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Group is most measured by users, and is a generally accepted benchmark. The 5 % threshold is within the range of acceptable quantitative materiality thresholds and best reflects the risk profile of the Group audit.
Overall materiality for the separate financial statements	CZK 194 million (CZK 154 million in prior year)
How we determined it	5% of the Company's profit before tax for the year ended 31 December 2016 decreased by dividend received.
Rationale for the materiality benchmark applied	Materiality is a matter of professional judgment. In drawing conclusions about materiality, we considered both quantitative and qualitative factors, and we chose profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Company is most measured by users, and is a generally accepted benchmark. The 5 % threshold is within the range of acceptable quantitative materiality thresholds and best reflects the risk profile of the audit of the Company.

We agreed with the Audit Committee and Supervisory Board that we would report to them misstatements identified during our audit of the consolidated financial statements above CZK 22 million (audit of the separate financial statements above CZK 19 million), as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

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Key Audit Matters

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

Key audit matter	How our audit addressed the key audit matter
Deferred tax (Risk related to tax position) The Company/Group faces an uncertain tax position stemming from revaluation of the Company's gas transmission assets in the local-GAAP based books. The tax regulation in the Czech Republic assesses income tax based on profit before tax in the local-GAAP accounting books and is generally based on historical values without such revaluation. Significant part of the Company's revenues is generated from regulated activities. Revaluation of fixed assets for tax purposes is not explicitly defined in the tax legislation but there is a general rule that costs under a cost-plus pricing mechanism are accepted as tax-deductible expense. Divergent views of experts exist on this topic. In the past, management took a view, based on advice provided by the Company's tax advisors, that all eligible costs under the cost-plus pricing mechanism are accepted as tax-deductible expense. Management assessed that, given the regulatory formula, which derives revenue from costs (including depreciation expense under local-GAAP), the local-GAAP-based accounting depreciation is a tax deductible expense. The related increase in tax base of the network assets resulted in decrease of the Group's deferred tax liability by CZK 2,125 million as at 31 December 2015 (CZK 2,164 million as at 31 December 2014). This amount represents nearly half of the Company's 2016 profit before tax. During 2016, management changed its view and no longer believes that the Company is able to sustain its position. The change in position primarily stems from perceivable changes in views of tax experts and general enforcing practice of tax authorities that indicate unfavourable development for the Company. As a result of the change in the management's estimate, the deferred tax liability was increased by CZK 2,125 million as at 31 December 2016. (See Note 4 and Note 29 (Note 26 respectively) of the Company's separate and the Group's consolidated financial statements respectively).	We held meetings with management, studied the relevant tax legislation and recent developments in interpretations and agreed with management's assessment that it is no longer probable that the Company sustains its position that the entire amount of the local-GAAP based depreciation of the gas network assets is a tax-deductible expense. We obtained understanding over relevant tax legislation and legal cases that might form a precedent in assessment of the Company's income tax position. We evaluated independence, objectivity and competency of management's tax advisors and the result of their work and we compared it with expert opinion of our own tax specialists. We performed calculations and reconciliations to obtain sufficient audit evidence over the deferred tax balances and transactions. We concluded that the management's assessment of risk related to the tax position as well as the change in management estimate performed in the Company's separate and the Group's consolidated financial statements is adequate, including relevant disclosures.

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How we tailored our audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which the Group operates.

The Group comprises of the Company and its subsidiary (consolidated entity). Both entities are considered as significant components therefore we performed audit of both entities.

Other Information

In compliance with Section 2(b) of the Act on Auditors, the other information comprises the information included in the Annual Report other than the financial statements and auditor's report thereon. The Statutory Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge about the Group and the Company obtained in the audit or otherwise appears to be materially misstated. In addition, we assess whether the other information has been prepared, in all material respects, in accordance with applicable law and regulation, in particular, whether the other information complies with law and regulation in terms of formal requirements and procedure for preparing the other information in the context of materiality, i.e. whether any non-compliance with these requirements could influence judgments made on the basis of the other information.

Based on the procedures performed, to the extent we are able to assess it, we report that:

– The other information describing the facts that are also presented in the financial statements is, in all material respects, consistent with the financial statements; and

– The other information is prepared in compliance with applicable law and regulation.

In addition, our responsibility is to report, based on the knowledge and understanding of the Group and the Company obtained in the audit, on whether the other information contains any material misstatement of fact. Based on the procedures we have performed on the other information obtained, we have not identified any material misstatement of fact.

Responsibilities of the Statutory Directors and Supervisory Board for the Financial Statements

The Statutory Directors are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and for such internal control as the Statutory Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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In preparing the financial statements, the Statutory Directors are responsible for assessing the Group's and the Company'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 the Statutory Directors either intend to liquidate the Group or the Company or to cease operations, or has no realistic alternative but to do so.

The Supervisory Board is responsible for overseeing the financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the above stated requirements 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 financial statements.

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

– Identify and assess the risks of material misstatement of the 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 controls.

– Obtain an understanding of internal controls 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 and the Company's internal controls.

– Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Statutory Directors.

– Conclude on the appropriateness of the Statutory Directors' 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 and the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group or the Company to cease to continue as a going concern.

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– Evaluate the overall presentation, structure and content of the financial statements, including the notes, and whether the 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 the Statutory Directors, Supervisory Board and Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

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

4 April 2017

represented by

Václav Prýmek

Milan Zelený
Statutory Auditor, Evidence No. 2319

Note:
Our report has been prepared in the Czech language and in English. In all matters of interpretation of information, views or opinions, the Czech version of our report takes precedence over the English version.

Abbreviations Used

BACI	Bidirectional Austrian-Czech Interconnection
BAL NC	Network Code for Gas Balancing in Transmission Systems
BCA	Business Corporations Act
BTS	Border Transfer Station
CAM NC	Network Code on Capacity Allocation Mechanisms
CEF	Connecting Europe Facility
CEO	Chief Executive Officer
CFO	Chief Financial Officer
COO	Chief Operations Officer
CZK	Czech crown
ČSOP	Český svaz ochránců přírody / Czech Union for Nature Conservation
DN	Diamètre Nominal / Nominal Pipe Size
EASEE-gas	European Association for the Streamlining of Energy Exchange – gas
ENTSOG	European Network of Transmission System Operators for Gas
EU	European Union
GIE	Gas Infrastructure Europe
IGU	International Gas Union
PCI	Project of Common Interest
PN	Pressure Nominal
TAR NC	Network Code on Harmonised Tariff Structures for Gas
TEN-E	Trans-European Energy Networks
TRU	Trading Region Upgrade
TSO	Transmission System Operator
V4	Visegrad Group (an alliance of four Central European countries – the Czech Republic, Slovakia, Hungary and Poland)
ZO ČSOP	Základní organizace Českého svazu ochránců přírody / Local chapter of the Czech Union for Nature Conservation

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A PDF version of the NET4GAS Group Consolidated Annual Report 2016 is available on the NET4GAS website in Czech and in English. In all matters of interpretation, the Czech version of the annual report takes precedence over the English version.

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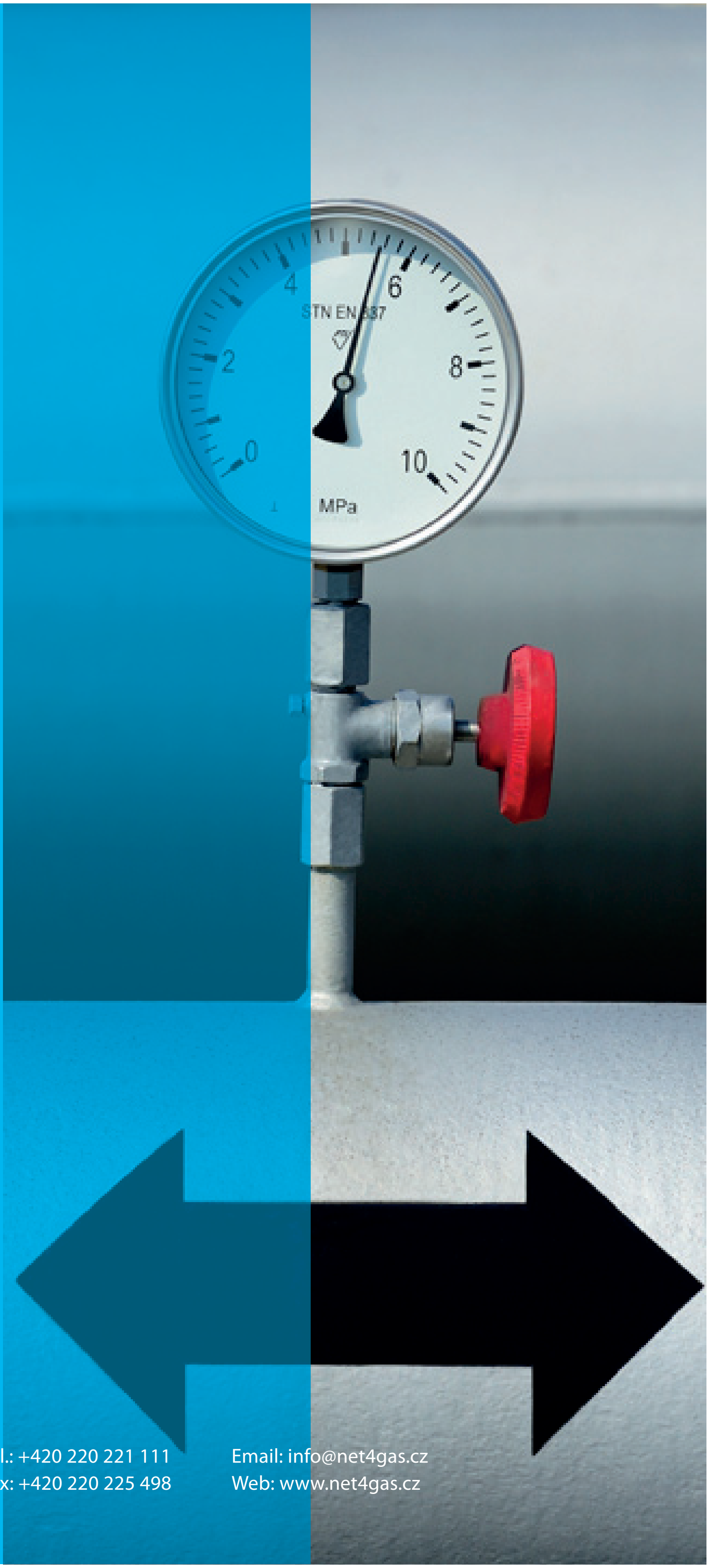

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