RUSNEFTEGAZ 2017

CONSOLIDATED FINANCIAL STATEMENTS

Contents

Corporate Information

Principal activities

The nature of the entities operations and its principal activities are set out in note 1.

Directors

J. King
M. Avdeyev
A. Filyurin
V. Kalzyuzhniy

Company Secretary

A. Uraev

Registered Office

Rusneftegaz
Floor 15, WTC-II
Krasnopresnenskaya Naberezhnaya 12
Moscow
Russian Federation
123610

Bankers

Gazprombank, ul. Krasnaya Presnya 21, Moscow, Russian Federation, 123242

Solicitors

Pepeliaev Group, Krasnopresnenskaya Naberezhnaya 12, Moscow, Russian Federation, 123610

Auditors

ZAO Deloitte & Touche CIS, ul. Lesnaya 5, Moscow, Russian Federation, 125047

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors of Rusneftegaz Ltd.

We have audited the consolidated financial statements of Rusneftegaz Ltd. and its subsidiaries (collectively – the "Group"), which comprise the consolidated statement of financial position as at 31 December 2017 and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

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

Basis for Opinion

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

Other Information

Directors are responsible for the other information. The other information comprises the information included in the Annual report, but does not include the consolidated financial statements and our auditor’s report thereon. The Annual report is expected to be made available to us after the date of this auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

When we read the Annual reports, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements

Directors are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as Directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

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

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

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and 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 those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters.

Olga Tabakova,
Engagement partner

Deloitte & Touche

ЗАКРЫТОЕ АКЦИОНЕРНОЕ ОБЩЕСТВО "ДЕЛОЙТ И ТУШ СНГ"
для аудиторских заключений и отчетов
Россия, г. Москва, ул. Лесная, д. 5

14 February 2018

The Entity: Rusneftegaz Ltd.

Address: 123104, Russian Federation, Moscow, Krasnopresnenskaya Naberezhnaya, 12

Audit Firm: ZAO "Deloitte & Touche CIS"

Certificate of state registration № 018.482, issued by the Moscow Registration Chamber on 30.10.1992.

Primary State Registration Number: 1027700425444

Certificate of registration in the Unified State Register № 77 004840299 of 13.11.2002, issued by Moscow Interdistrict Inspectorate of the Russian Ministry of Taxation № 39.

Member of Self-regulated organization of auditors "Russian Union of auditors" (Association), ORNZ 11603080484.

Consolidated statement of profit or loss and other comprehensive income

For the year ended 31 December 2017

	Notes	2017	2016
		USD ($) '000	**USD ($) '000**
Revenue	8	502,315	440,977
Cost of sales	7	(250,962)	(235,626)
Gross profit		**251,353**	**205,351**
Other income		129	71
Operating expenses	9	(9,574)	(10,253)
General and administrative expenses	10	(8,987)	(9,311)
Foreign exchange loss		(10,023)	(8,184)
Operating profit		**222,898**	**177,674**
Finance income	13	543	503
Finance expense	13	(3)	(3)
Profit for the period		**223,438**	**178,174**
Tax expense	14	(48,057)	(38,577)
Profit for the period after tax		**175,381**	**139,597**
Foreign currency translation reserve	28	5,425	4,765
Revaluation surplus		32,319	179,404
Other comprehensive income		**37,744**	**184,169**
Total comprehensive income		**213,125**	**323,766**

Consolidated statement of financial position

For the year ended 31 December 2017

	Notes	2017	2016
		USD ($) '000	**USD ($) '000**
Assets			
Non-current assets			
Property, plant and equipment	15	1,150,095	987,668
Deferred tax assets	14.2	183	172
Intangible assets	16	144	141
Derivative financial instruments	22	916	787
Total non-current assets		**1,151,338**	**988,768**
Current assets			
Inventories	19	24,497	15,466
Trade and other receivables	20	20,524	10,206
Cash at bank and in-hand	24	62,846	65,283
Assets held for sale	18	5,487	5,487
Total current assets		**113,354**	**96,442**
Total assets		**1,264,692**	**1,085,210**

Consolidated statement of financial position

For the year ended 31 December 2017

	Notes	2017	2016
		USD ($) '000	USD ($) '000
Equity and Liabilities			
Equity			
Issued capital	26	1	1
Retained earnings		1,448,545	1,273,164
Share premium		450,000	450,000
Currency translation reserve	28	(787,655)	(819,974)
Revaluation reserve		34,187	28,762
Total shareholders' equity		**1,145,078**	**931,953**
Non-current liabilities			
Deferred tax liabilities	14.2	20,675	18,894
Provisions	25	27,518	26,889
Total non-current liabilities		**48,193**	**45,783**
Current liabilities			
Taxes and royalties payable	14.3	8,410	10,246
Accounts payable and other payables	23	63,011	76,395
Short-term borrowings	21	–	20,833
Total current liabilities		**71,421**	**107,474**
Total liabilities		**119,614**	**153,257**
Total shareholders' equity and liabilities		**1,264,692**	**1,085,210**

The financial statements were approved and authorised for issue by the board and were signed on its behalf on 30 March 2018.

M. Avdeyev

Consolidated statement of changes in equity

For the year ended 31 December 2017

	Notes	Issued and fully paid shares	Retained earnings	Share premium	Asset revaluation reserve	Foreign currency translation reserve	Total equity
		USD ($) '000	USD ($) '000	USD ($) '000	USD ($) '000	USD ($) '000	USD ($) '000
Balance on 1 January 2016	26	**1**	**1,133,567**	**450,000**	**23,997**	**(999,378)**	**608,187**
Profit for the year		–	139,597	–	–	–	139,597
Other comprehensive income		–	–	–	4,765	179,404	184,169
Total comprehensive income		**–**	**139,597**	**–**	**4,765**	**179,404**	**323,766**
Balance on 31 December 2016	26	**1**	**1,273,164**	**450,000**	**28,762**	**(819,974)**	**931,953**
Balance on 1 January 2017	26	**1**	**1,273,164**	**450,000**	**28,762**	**(819,974)**	**931,953**
Profit for the year		–	175,381	–	–	–	175,381
Other comprehensive income		–	–	–	5,425	32,319	37,744
Total comprehensive income		**–**	**175,381**	**–**	**5,425**	**32,319**	**213,125**
Balance on 31 December 2017	26	**1**	**1,448,545**	**450,000**	**34,187**	**(787,655)**	**1,145,078**

Consolidated statement of cash flows

For the year ended 31 December 2017

	Notes	2017	2016
		USD ($) '000	USD ($) '000
Operating activities			
Profit before tax		223,438	178,174
Adjustments to reconcile profit before tax to net cash flows:			
Depreciation, depletion and amortisation	7	53,142	45,657
Impairment	7	1,598	2,065
Finance income	13	(543)	(503)
Finance cost	13	3	3
Unrealised gain on derivative financial instruments		(129)	(71)
Foreign exchange loss/(gain)		10,023	8,184
Working capital adjustments:			
Change in trade and other receivables	20	(10,318)	1,212
Change in inventories	19	(9,031)	(7,944)
Change in accounts payable and other payables	23	(13,384)	28,773
Change in taxes payable	14.3	(1,836)	5,059
Income tax paid	14.1	(38,577)	(32,710)
Net cash flows from operating activities		**214,386**	**227,899**
Investing activities			
Expenditures on property, plant and equipment	15	(179,421)	(274,539)
Net cash used in investing activities		**(179,421)**	**(274,539)**
Financing activities			
Proceeds from loans and borrowings	21	–	250,000
Repayment of loans and borrowings	21	(20,833)	(229,167)
Net cash used in financing activities		**(20,833)**	**20,833**
Change in cash and cash equivalents		14,132	(25,807)
Translation difference		(16,569)	8,304
Cash and cash equivalents, beginning of period	24	65,283	82,786
Cash and cash equivalents, end of period		**62,846**	**65,283**

Index to notes to the consolidated financial statements

Notes to consolidated financial statements

1. Corporate information

The consolidated financial statements of the Rusneftegaz Group for the year ended 31 December 2017, which comprise Rusneftegaz Ltd. and its subsidiaries, were authorised for issue in accordance with a resolution of the directors on 30 March 2018. Rusneftegaz Ltd. is a company registered in the British Virgin Islands and domiciled in Russian Federation, whose principal activity is the generation of electricity. The registered office is located at Krasnopresnenskaya Naberezhnaya 12, Moscow, Russian Federation.

Information pertaining to the Rusneftegaz Group's structure and other related parties are presented in note 31.

2.1. Basis of preparation

The consolidated financial statements of the Rusneftegaz Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

All of the companies within the Rusneftegaz Group maintain their own financial statements in accordance with the laws and requirements of the state or country which that company is incorporated. The Rusneftegaz Group's consolidated financial statements are based on the records of these companies and adjusted to adhere to the standards required under IFRS.

The consolidated financial statements have been prepared on a historical cost basis, except for revalued items which have been measured at fair value. The consolidated financial statements are presented in US dollars, and all values are rounded to the nearest million (USD), except where otherwise indicated.

2.2. Basis of consolidation

The consolidated financial statements comprise the financial statements of all of the entities that the Rusneftegaz Group is deemed to control as at 31 December 2017. Control is achieved when the Rusneftegaz Group has the right to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Rusneftegaz Group is considered to be in control if it has the authority to influence the aforementioned returns.

It is presumed that holding a majority of voting rights results in control. Such a presumption is made when assessing whether the Rusneftegaz Group holds power over a company, including from any contractual arrangements or potential future voting rights. The Rusneftegaz Group determines if it controls a company when there is a material change in circumstances, such as a merger or acquisition.

Notes to consolidated financial statements

2.2. Basis of consolidation *continued*

A company is consolidated when the Rusneftegaz Group obtains control and ceases when the Rusneftegaz Group loses control. All income, expenses, assets and liabilities of a subsidiary acquired or disposed of
during the financial year are consolidated in the financial statements from the date the Rusneftegaz Group gains control or the date the Rusneftegaz Group loses control of the entity.

Any intergroup assets, liabilities, equity, income, expenses and cash flows relating to transactions between members of the Rusneftegaz Group are eliminated upon consolidation. Adjustments may be made to the consolidated financial statements to align the accounting policies of the subsidiary with the Rusneftegaz Group's existing accounting policies.

3.1. Significant accounting judgements, estimates and assumptions

The preparation of the Rusneftegaz Group's consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported revenues, expenses, assets liabilities and accompanying disclosures at the date of the consolidated financial statements. In particular, the management has identified areas where these significant judgements, estimates and assumptions are required, and how each of these areas affect the various accounting policies of the Rusneftegaz Group's consolidated financial statements.

The Rusneftegaz Group has based its estimates and assumptions on parameters available when the consolidated financial statements were prepared. However, current circumstances and assumptions about future developments may change due circumstances beyond the control of the Rusneftegaz Group. Changes in judgements, estimates and assumptions are accounted for prospectively.

3.2. Joint arrangements

Management judges if it has joint control over an arrangement by establishing whether decisions made in relation to its agreed operations require unanimous consent. The Rusneftegaz Group has determined that the activities for its joint arrangements are those relating to the operating and capital decisions of the arrangement, including the approval of the annual capital and operating expenditure work program and budget for the joint arrangement, and the approval of chosen service providers for any major capital expenditure as required by the joint operating agreements applicable to the entity's joint arrangements.

3.2. Joint arrangements *continued*

The classifications of joint arrangements are determined by the Rusneftegaz Group, requiring assessment into the rights and obligations of the Rusneftegaz Group arising from such arrangement. Conclusions regarding both joint control and whether the arrangement is a joint venture or a joint operation can materially impact the accounting for such arrangements. To classify as either a joint venture or a joint operation, the Rusneftegaz Group considers whether the arrangement is structured through a separate vehicle, due to the fact that under such circumstances the Rusneftegaz Group must also consider the rights and obligations arising from the legal form of the entity and the terms of the arrangement contractually.

3.3. Contingencies

Contingencies may arise from claims against the Rusneftegaz Group, and will only be resolved when one or more events occur, or fail to occur, in the future. These claims may be legal, contractual or any other type of claims. The assessment of the existence of contingencies involves making estimates and judgements as to the outcome of these future events.

3.4. Hydrocarbon reserve and resource estimates

The Rusneftegaz Group reports the value of its hydrocarbon reserves according to the Petroleum Resources Management Reporting System using an annual assessment by a qualified auditor, who estimates the extent of hydrocarbon reserves based upon technical and geological data on the depth, size, shape and grade of the reserve. The fair value of reserves are quantified using estimates of future commodity prices and expected recovery rates, on the basis of the amount of hydrocarbons that can be legally and economically extracted.

The financial and geological information used to make estimates and assumptions is subject to change, and as additional information is obtained during the operation of a field, estimates of the quantity, quality and fair value of recoverable reserves may change. These may impact the Rusneftegaz Group’s reported financial position and results. Any impact on the total amount of recoverable reserves and the proportion of the gross reserves may also impact contracts with third parties under the terms of existing agreements.

Future costs are estimated using assumptions as to the number of wells necessary for production, the cost of such wells and associated production facilities, and other capital costs. The current long-term Brent oil price used in the estimation of commercial reserves is USD $50/bbl.

Notes to consolidated financial statements

3.5. Exploration and evaluation expenditure

Potential future economic benefits from prior expenditures on exploration and evaluation can be as a result of future production or from a sale. The Rusneftegaz Group judges whether future economic benefits are likely, or whether the reported resources are not yet at a stage where an assessment of their existence is permissible.

The determination of these resources requires estimating within a degree of uncertainty, but can nonetheless impact whether the Rusneftegaz Group defers exploration and evaluation expenditure. Such deferrals require management to make assumptions about future events, such as if a viable extraction operation can be established. Any such estimates and assumptions may change as new information becomes available.

If there is a change to material facts indicating that the recovery of any expenditure is unlikely after expenditure is capitalised, the amount is instead expensed in the statement of profit or loss and other comprehensive income in the period in which the new information becomes apparent.

3.6. Recoverability of assets

The Rusneftegaz Group assesses assets at the end of the financial year for impairment. When an asset is considered impaired, an estimate of the recoverable amount is made, which is considered to be the higher of the fair value, less costs of disposal, and value in use. Such assessments require the use of estimates, including long-term oil price projections, current operating performance, existing reserves, future operating costs, expected decommissioning costs and any future capital requirements. Estimates are subject to a degree of risk and volatility, and future changes in circumstances may impact these projections.

3.7. Decommissioning costs

Decommissioning costs are expected to be incurred at the end of the operating life of some of the Rusneftegaz Group’s assets. The final decommissioning costs are uncertain and are influenced by certain factors, including changes to the expected timing, changes to legal requirements and or the emergence of new, relevant technologies.

Management assesses its decommissioning provision at each reporting date, although adjustments may be necessary to the provision established which could affect future financial results. The provision reported in the consolidated financial statements is the Rusneftegaz Group's current estimate of the future decommissioning costs required. External valuation may be necessary to project future decommissioning costs, with its necessity being determined on a case by case basis, and in regards to factors such as the expiry date of the operating agreement and expected gross cost.

Notes to consolidated financial statements

3.8. Recoverability of deferred tax assets

Judgement is required to determine whether deferred tax assets are recognised in the statement of financial position, such as deferred tax assets from previous tax losses. Management assesses whether the Rusneftegaz Group will generate sufficient taxable earnings in future periods to claim these deferred tax assets. This also requires management to make estimates of future taxable profits, based upon forecast cash flows from operations.

These projections may be influenced by future commodity prices, projected production rates, sales volumes, future operating costs, hydrocarbon reserves, projected capital expenditure, capital management transactions, existing hydrocarbon reserves and changes to regional and national taxation legislation and rules. Future changes in legislation in the jurisdictions in which the Rusneftegaz Group operates could limit tax deductions in future periods.

3.9. Fair value measurement

At the end of each reporting period, the Rusneftegaz Group recognises its financial instruments at fair value, which is the consideration that would be paid or received to transfer an asset on the measurement date between market participants. In order to report fair value, the relevant valuation methods are used under the circumstances for which sufficient data and observable inputs are available, with the use of unreliable data and unobservable inputs mitigated when possible.

External valuation may be used to assess the fair value of non-financial assets, with qualified surveyors being selected on the basis of current market knowledge, independence, professionalism and reputation. The decision to use external valuation is made by the Audit Committee, with the committee making the final decision as to which valuation techniques to use after consultation with the surveyors.

The fair values of non-financial assets are estimated by determining the potential economic benefits of an asset at its best use or by transferring it to another market participant that would realise the asset at its best use. The fair value of financial instruments, such as derivatives, are calculated by using the same judgements, estimates and assumptions that a market participant would use, assuming that said market participants act in their own best interest. Changes to judgements, estimates and assumptions could affect the fair value reported in the consolidated statement of financial position.

Notes to consolidated financial statements

4.1. Summary of significant accounting policies

The Rusneftegaz Group has predetermined a number of significant accounting policies relevant to its operations and the jurisdictions where its activities are conducted. These are set forth in the following section.

4.2.1. Interests in joint arrangements

A joint arrangement is an agreement over which two or more parties exert joint control. Joint control is established once the parties have contractually agreed to share control of an arrangement and when decisions about the relevant activities of the arrangement require the unanimous agreement of the relevant parties. A joint arrangement is classified as a joint operation or a joint venture.

4.2.2. Joint operations

Joint operations are an arrangement where the parties that possess joint control can claim rights to the assets and obligations for the liabilities of the arrangement. The Rusneftegaz Group recognises the revenue from the sale of its share of the output from the joint operation as well as a share of any revenue from the joint operation incurred jointly. Likewise, the Rusneftegaz Group also recognises any of its own assets or liabilities attributed to the joint operation, including its share of any assets or liabilities that are held or incurred jointly.

4.2.3. Joint ventures

Joint ventures are a type of joint arrangement where the parties that assert joint control can claim rights to the net assets of the arrangement. The Rusneftegaz Group's investments in joint ventures are accounted for using the equity method, under which the investment in the joint venture is recognised at cost until any necessary adjustments are made to acknowledge any recognised changes in the Rusneftegaz Group's share of the net assets.

The share of the financial results from the joint venture attributed to the Rusneftegaz Group is included in the statement of profit or loss and other comprehensive income, with any transactions between the Rusneftegaz Group and the venture being eliminated to the extent of the interest in the joint venture upon consolidation. The aggregate of the Rusneftegaz Group's share of profit or loss from the joint venture is recorded after tax as part of operating profit. Adjustments may be made to the financial statements of the joint venture in order to align accounting policies and the financial year with the Rusneftegaz Group.

4.2.3. Joint ventures *continued*

The investment in the joint venture is tested for impairment at the end of the financial year, being calculated as the difference between the recoverable amount of the joint venture and its recorded book value. Any loss is then deducted from operating profit in the statement of profit or loss and other comprehensive income. Goodwill affiliated with the joint venture is included in the book value of the investment but is not tested for impairment separately.

The Rusneftegaz Group measures and recognises any retained investment at its fair value upon losing joint control over the venture, with difference between the proceeds from disposal, the fair value of the retained investment and the final reported book value of the joint venture being recognised in the statement of profit or loss and other comprehensive income.

4.2.4. Reimbursement of costs of the operator of the joint arrangement

When the Rusneftegaz Group receives reimbursement of the costs recharged to the joint arrangement to act as the operator of a joint arrangement, such recharges are the reimbursement of costs incurred as an agent for the joint arrangement and has no effect on the statement of profit or loss and other comprehensive income.

The Rusneftegaz Group is considered to be not acting as an agent if it charges a management fee to cover the costs incurred when carrying out operations for a joint arrangement. Under such circumstances any fees received and expenses incurred are reported in the statement of profit or loss and other comprehensive income as income and an expense respectively. Such charges are based on a fixed percentage of total costs incurred for the year.

4.3. Foreign currencies

The consolidated financial statements are presented in United States Dollars (USD), which is the Rusneftegaz Group’s presentational currency. The Rusneftegaz Group’s functional currency is the Russian Ruble (RUB), with any transactions occurring in currencies other than the United States Dollar being recorded at the rate of exchange on the date of the transaction.

At the reporting date, all monetary assets and liabilities that are denominated in currencies that are not the United States Dollar are converted to the closing exchange rate. Non-monetary items that are measured at historical cost in a foreign currency are converted using the exchange rates as at the date of the initial transaction, and are measured at a revalued amount in a foreign currency are converted using the exchange rate on the date the fair value of an asset or liability was determined.

All differences are recorded in the statement of profit or loss and other comprehensive income.

Notes to consolidated financial statements

4.4. Business combinations

Under IFRS 3, a business combination is recognised when a business takes control of another under an acquisition or merger. Such transactions are accounted for using the acquisition method, which measures the aggregate of the consideration at fair value and the amount of any non-controlling interests. After the transaction is formally completed, the recognised assets and liabilities are classified and designated in line with the economic circumstances, conditions and contractual terms under the Rusneftegaz Group's accounting policies, with any derivatives embedded in host contracts being recognised separately. The value of any asset acquired that cannot be reliably estimated is subsumed in goodwill and reassessed at the end of the financial year.

At the acquisition date, the Rusneftegaz Group judges whether it recognises such non-controlling interests at fair value or as a proportionate share of the recognised assets. Any equity interests held in the purchased business before the acquisition date are then measured at fair value once the transaction is completed, with any gains or losses in value being reported in the statement of profit and loss and other comprehensive income, along with the costs relating to business combinations are recorded as administrative expenses.

Under the acquisition agreement, any obligations to transfer additional assets or equity to the previous shareholders of a purchased business are recognised as contingent consideration, with such transfers being recognised at fair value on the date of acquisition. If the consideration is deemed to be an asset or liability classified under IAS 39 then any changes in the recorded fair value is recognised in the statement of profit and loss and other comprehensive income, with any assets or liabilities not under the remit of IAS 39 being measured with the appropriate valuation methods. Any contingent consideration recorded as equity is not revalued or recognised in the statement of profit or loss and other comprehensive income.

Under a business combination that occurs when both parties are under the common control of the same shareholder, the acquisition or merger is accounted for under the existing methods. All acquired assets and liabilities are reported at the book value previously recorded, but any consideration paid for the transaction is recognised directly as equity.

4.5. Goodwill

Goodwill is an intangible asset occurring from the acquisition of a business at a price different to its fair value. Such an asset is reported initially at cost, the aggregate of the transferred consideration at book value and the amount of any non-controlling interests over the fair value of the acquired assets and liabilities, and is subsequently measured at cost minus any accumulated impairment losses.

4.5. Goodwill *continued*

In order to test for impairment, any goodwill arising from the acquisition of a business is allocated to cash-generating units that are expected to benefit from the combination on the acquisition date, regardless of whether other acquired assets or liabilities are assigned to those units. If goodwill forms part of a cash-generating unit, and also as part of the operation in which that unit is disposed of, the goodwill associated with the disposed operation is included in the book value of the operation when determining the gain or loss from said disposal. Any goodwill disposed under such circumstances being reported based on the value of the disposed operation and the portion retained.

After initial recognition, the Rusneftegaz Group assesses whether it has correctly identified all of the assets and liabilities acquired. If the fair value of the acquired net assets acquired exceeds the amount of consideration transferred, the Rusneftegaz Group reviews the procedures used to measure the recognised fair values on the date of acquisition. A gain is only recognised in the statement of profit or loss and other comprehensive income if the review still reports a positive balance between the fair values of net assets being acquired over the aggregate of the consideration transferred as part of the acquisition.

4.6. Farmout agreements

A farmout agreement is an arrangement whereby a party acquires fractional ownership of a mineral lease in exchange for the provision of services, differing from a lease where the consideration is financial. Under an agreement, the Rusneftegaz Group derecognises the proportion of the asset it has sold to and reports any consideration received or receivable, such as the amount of cash paid or the value of the obligation to fund capital expenditure proportional to the percentage of rights sold.

Any expenditures, gains or losses by the counterparty are not reported on the Rusneftegaz Group's financial statements. However, any costs previously capitalised in relation to the whole interest are redesignated proportionately to the value of the interest retained. Any cash consideration received from the counterparty is credited against previously capitalised costs to the value of the interest in the asset, with any excess accounted for as a gain on disposal by the counterparty. The Rusneftegaz Group also tests the retained interests for impairment if the terms of the arrangement indicate that the value of the agreement has decreased.

The consideration received for any assets disposed of under a farmout agreement is initially reported at fair value, unless payment is deferred whereby the consideration is originally recognised at the cash price equivalent. The difference between the cash price equivalent and the nominal amount of consideration is then reported as interest revenue. Any consideration receivable as cash is recognised as a financial asset and accounted for at amortised cost.

Notes to consolidated financial statements

4.6. Farmout agreements *continued*

Furthermore, gains or losses are reported on the statement of profit or loss and other comprehensive income in respect of the difference between the net proceeds and the book value of the disposed asset. A gain is only recognised if the value of consideration can be reliably determined, otherwise the Rusneftegaz Group reports the received consideration as a devaluation of the underlying assets.

4.7.1. Oil and natural gas exploration, evaluation and development expenditure

Exploration, evaluation and development expenditures are accounted for using the successful efforts method of accounting, with exploration licenses granted being reported as intangible assets and any costs relating to the purchase of these licences, and or property, being capitalised and also reported as an intangible asset.

Licence costs paid in relation to the right to explore in an existing exploration area are capitalised and amortised over the term of the permit, with any pre-licence costs being expensed during the reporting period. Expenditures on the construction, installation and completion of infrastructure, including pipelines and the drilling of wells are capitalised as tangible assets regardless of whether such wells are considered successful.

For works not yet complete, licence and property acquisition costs are analysed to clarify that the book value exceeds the recoverable amount of the recorded asset at the end of the financial year. Analysis includes confirming that exploratory drilling is planned or has been started, and that work is under way to determine that the discovery is financially viable. This is based on progress being made on establishing development plans and or the commercial and technical information available.

The book value of the licence and or property acquisition costs are written off in the statement of profit or loss and other comprehensive income if the licence has expired or been relinquished, or no future activity is planned.

4.7.2. Exploratory and evaluation costs

Exploratory and evaluation activities involve the search for hydrocarbon reserves and the determination of technical and commercial viability of the discovered resources. Once the Rusneftegaz Group has obtained the legal right to explore, any costs associated with the development of exploratory wells are capitalised as intangible assets until the drilling of the well has been completed and analysed. Such costs include the materials and fuel used, equipment costs, employee remuneration and payments made to contractors. Amortisation is not charged during the exploratory and evaluation of a site, except to license costs, whereas any geological costs are expensed in the statement of profit or loss and other comprehensive income.

4.7.2. Exploratory and evaluation costs *continued*

Any capitalised costs are subjected to a commercial and technical review, as well as a review for impairment, at least once a year. Reviews of undeveloped reserves highlight the Rusneftegaz Group's intention to develop the site and extract value from the discovery. If a site is not reviewed, it means that the Rusneftegaz Group no longer considers a reserve to be viable and the costs are written off through the statement of profit or loss and other comprehensive income.

Costs attributed with reviews to determine the characteristics and commercial potential of a reserve, including the costs of wells where hydrocarbons were not discovered, are also initially capitalised as an intangible asset. If no commercially viable reserves are discovered, the exploration asset is written off through the statement of profit or loss and other comprehensive income. Once any reserves are commercially developed, the costs remain capitalised as an intangible asset until the final fair value of the reserve can be reported. The capitalised expenditure is then assessed for impairment and any losses are recognised, with the remaining balance being transferred to property, plant and equipment.

4.8.1. Property, plant and equipment

Property, plant and equipment is any asset that the Rusneftegaz Group's interest compromises the contractual or legal right of use, and is reported at cost minus any accumulated depreciation and impairment losses. Such assets are initially recognised at cost, this being either the purchase price of the asset or the cost of construction, plus any costs that are considered directly attributable to bring an asset into operation, such as wages and salaries. The Rusneftegaz Group recognises the price to purchase an asset or the construction cost of an asset as the aggregate of the amount paid and the fair value of any other consideration.

Any gains and losses from the transfer of assets to another party are determined by comparing the proceeds of sale with the book value recorded in the statement of financial position, and is reported as other income in the statement of profit and loss and other comprehensive income. If an asset is disposed of without receiving payment from another party, then the cost of disposal is recorded as an expense. Expenditure on the purchase or construction of new assets are recognised as additions, including any investments in the enhancement or extension of existing assets and any spending on safety or the environment that do not qualify as expenses. Once a new development begins its economic life, the capitalisation of any expenditure is stopped and the costs are recognised as either an expense or the cost of inventory.

Notes to consolidated financial statements

4.8.1. Property, plant and equipment *continued*

Most assets are depreciated annually on a straight-line basis in order to reduce its book value over the course of its estimated useful economic life, with the majority of assets being depreciated over a 5 to 20 year period. At the end of the financial year, the useful economic life of an asset is reassessed, with due consideration given to any contractual or operational requirements for certain assets or groups of assets. Certain properties are recognised as depletable assets, such as an oil field, and are amortised on a cost basis over the course of the estimated life of the asset. The estimated life of a depletable asset is calculated by totalling the proven quantity of both developed and undeveloped reserves. Cost depletion is computed by allocating a proportional amount of the initial investment to the total extraction in the reporting period in relation to the total quantity of unextracted resources.

Property, plant and equipment is tested for impairment annually, or if there is an indication that the book value of the asset may have been impaired, and is recorded as an expense in the statement of profit and loss and other comprehensive income. Impairment is computed as the difference between the book value of an asset and its recoverable amount, although assets that have been recognised as impaired in a previous reporting period may be reviewed and have this impairment reversed.

4.8.2. Repairs, inspections and maintenance

Expenditure on repairs, inspections and maintenance comprises the inspection costs, cost of replacement assets or parts of assets, and overhaul costs. Inspection costs affiliated with maintenance programs are capitalised and amortised over the period of time until the next inspection. All other maintenance and repair costs are expensed in the statement of profit and loss and other comprehensive income.

Expenditure is capitalised when an asset, or part of an asset, that was previously depreciated and or impaired separately, is replaced and potential future economic benefits associated with the item will be utilised. Likewise, when part of a replaced asset was not considered as a component, and thus depreciated separately, the replacement value is used to estimate the book value of the replaced asset and the amount is reported as an expense.

4.9. Intangible assets

All intangible assets are recorded at cost less accumulated amortisation after initial recognition, which is computed on a straight line basis over the course of its useful economic life. Any changes to the useful economic life of an asset affect the amortisation calculation method or period, and are treated as changes in accounting estimates. Accumulated amortisation is recognised in the statement of profit and loss and other comprehensive income as an expense, as is the fair value of any impairment.

4.9. Intangible assets *continued*

Intangible assets are assessed as either finite or indefinite, with any indefinite intangible assets not being assessed for amortisation, but are tested for impairment accordingly. Assets with finite lives are also evaluated for impairment if there are any indications that it may be impaired, but the useful lives of such assets are reviewed annually at the end of the financial year.

Intangible assets created internally by the Rusneftegaz Group, such as computer software, are only recognised in the statement of financial position if it can be identified as an asset, or has potential future economic benefits. If such expenditure is not treated as an asset, then the amount is expensed. If an intangible asset is acquired during a business combination under IFRS 3, then the asset is recorded at fair value on the date of the acquisition.

4.10.1. Impairment of non-financial assets

An asset is considered to be impaired if it no longer generates the same level of economic benefits that it did at the time of acquisition, and its book value must be reduced accordingly. Impairment is recognised as an expense in the statement of profit and loss and other comprehensive income in the category relevant to the impaired asset, as well as in the statement of financial position with the corresponding reduction in the book value of the asset. At the end of the financial year the Rusneftegaz Group evaluates all assets, and groups of assets, for any indications of impairment. If an asset or an asset group is deemed to be impaired, the assets' recoverable amount is estimated as the higher of fair value less costs of disposal or value in use unless its cash flows are dependent on another asset or group of assets, in which case, said asset is analysed as part of a relevant group. An asset must always be considered impaired if the recorded book value of an asset is greater than its recoverable amount.

Impairment is calculated separately for each of the asset groups, with individual assets being allocated to said groups, by preparing cash flow forecasts in line with the expected performance of an asset over a five year period, or longer if considered necessary. Calculations are corroborated by using available fair value indicators, such as quoted prices and valuation multiples. In order to measure the fair value less cost of disposal of an asset, the Rusneftegaz Group reviews recent market transactions and determines relevant valuation techniques if there is no sufficient data available. Estimated future cash flows are reduced to their fair value using a discount rate that takes into account risks specific to the asset and the time value of money to determine an assets' fair value in use, although the value in use calculation does not take into account any enhancements or improvements to asset performance that could affect estimated future cash flows positively, with any improvements being recognised in the calculations for the fair value less cost of disposal.

Notes to consolidated financial statements

4.10.1. Impairment of non-financial assets *continued*

Assets that were previously reported as impaired are reassessed at the end of the financial year and evaluated to determine whether any impairment reported in prior periods has been reversed or decreased. The level of impairment is restated if there has been a material change in the judgements, estimates and assumptions used to determine the recoverable amount of the asset since the initial recognition of the impairment. The value of any reversal of impairment is limited so that the book value of an asset does not exceed the figure that would have been recorded, net of all depreciation and amortisation, had the asset not been recognised as impaired in previous years, or the determined recoverable amount of the asset. The new book value of the asset is recorded once the reassessment is complete, with the reversal being recognised in the statement of profit and loss and other comprehensive income.

4.10.2. Impairment of goodwill

At the end of the financial year, goodwill is assessed for impairment by evaluating the recoverable amount of the assets to which goodwill is affiliated. An impairment loss is recognised in the statement of profit and loss and other comprehensive income if the recognised recoverable amount of an asset is less than the recorded book value, including goodwill. Any recognised impairment losses affiliated to goodwill cannot be reversed in later periods, regardless of the outcome of any future reassessments.

4.11.1. Financial instruments

Financial instruments are any type of monetary contract between two or more parties that can be created, traded, modified or settled and from which a financial asset arises for one party and a financial liability or equity instrument is recognised consequentially by the counterparty. Financial assets include cash and cash equivalents, receivables and derivative financial assets.

4.11.2. Initial recognition and subsequent measurement

At initial recognition, financial assets are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets or derivatives designated as hedging instruments in an effective hedge. All classifications of financial assets are initially reported at fair value plus attributable transaction costs, except for any financial assets at fair value through profit or loss which are reported solely on the basis of its fair value.

The trading of any financial assets that requires delivery within a timeframe in line with market regulations and or conventions are recognised on the date of sale or purchase rather than the date of delivery.

Notes to consolidated financial statements

4.11.3. Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include any financial liabilities held for trading or any financial assets designated at the reporting date as such upon initial recognition. An asset is reported as being held for trading if it is acquired in order to sell within the next financial year, these include any derivative financial instruments that are not designated as hedging instruments under IAS 39 or any separated embedded derivatives that are not designated as effective hedging instruments. Financial assets at fair value through profit or loss and embedded derivatives are recorded at fair value, with any changes in fair value presented as finance income or costs in the statement of profit or loss and other comprehensive income, depending on whether the change in fair value is positive or negative respectively.

4.11.4. Financial assets carried at amortised cost

Financial assets carried at amortised cost include loans and receivables, and the Rusneftegaz Group assesses whether such assets are impaired individually for assets that are deemed individually significant, or collectively for financial assets that are deemed to be not individually significant. Any impairment loss is measured as the difference between the recorded book value of the asset and the current value of estimated future cash flows, excluding any expected future losses that have not yet been incurred. For loans and receivables, the present value of the estimated future cash flows is discounted at the asset's original effective interest rate. If there is no objective evidence of impairment for an individually assessed financial asset, it is grouped with other financial assets with similar characteristics and then the entire group is assessed for impairment collectively, regardless of whether these assets are considered individually significant. Any assets that have been individually assessed for impairment, and for which an impairment loss is recognised, are not grouped or assessed collectively for impairment throughout the remaining life of the asset.

For interest-bearing loans and receivables, losses occurring from impairment are recognised in the statement of profit or loss and other comprehensive income, with the book value of the asset being reduced through an allowance account. Interest income continues to be accrued, but is not recognised, on any bad debts using the agreed contractual rate of interest, this is then used to discount the future cash flows to quantify the monetary impact of the impairment loss. Loans, receivables and the associated allowance are only derecognised once there is considered to be no realistic prospect of the asset or any affiliated cash flows from being recovered, and any collateral has been realised or transferred. If the amount of the impairment loss increases or decreases because of events occurring after recognition, the reported impairment loss is increased or reduced by adjusting the allowance account, with a derecognised financial asset being credited to the statement of profit or loss and other comprehensive income if it is recovered at a later date.

4.11.5. Loans and receivables

Loans and receivables are non-derivative, interest-bearing financial assets with determinable or fixed receipts or payments. After initial measurement, such financial assets are subsequently valued at amortised cost using the effective interest rate method, less any impairment. Amortised cost is calculated by taking into account any premium or discount on acquisition, and any costs that are an integral part of the effective interest rate.

The effective interest rate amortisation is included in finance income in the statement of profit or loss and other comprehensive income, with losses arising from impairment being recognised in finance costs for loans, and in cost of sales or other operating expenses for receivables.

4.11.6. Derecognition

An asset is primarily derecognised when the rights to receive cash flow from the asset have expired or been transferred. This is as a result of the Rusneftegaz Group having transferred substantially all the risks and rewards of the asset, or neither transferring nor retaining substantially all the risks and rewards of the asset, but has transferring control of the asset.

Any gain or loss arising on derecognition of the asset is included in the statement of profit or loss and other comprehensive income, and calculated as the difference between the net disposal proceeds and the book value of the asset.

4.11.7. Impairment of financial assets

A financial asset is deemed to be impaired if any event has occurred since initial recognition that has impacted on the projected future cash flows of the asset, and that the monetary loss can be reliably estimated. At the end of the financial year assessments are made as to whether there are any indications of impairment of the asset, including any evidence that a debtor may not be able to meet its obligations through difficulty, delinquency or default. The Rusneftegaz Group also uses data to test for impairment, such as looking for indicators that estimated future cash flows will be diminished, observing current and future economic conditions that could correlate with defaults on payments and or bankruptcy.

4.12.1. Financial liabilities

Financial liabilities include loans, borrowings, payables and derivative financial liabilities. These are initially recognised at fair value, with all barring derivative financial instruments being reported net of any direct costs. At initial recognition, financial liabilities are classified as either financial liabilities at fair value through profit or loss, loans and borrowings, payables, or as derivatives, as appropriate.

4.12.2. Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include any financial liabilities held for trading or any financial liabilities designated at the reporting date as such upon initial recognition under the conditions in IAS 39. A Liability is reported as being held for trading if it is acquired in order to sell it within the next financial year, these include any derivative financial instruments that are not designated as hedging instruments under IAS 39 or any separated embedded derivatives that are not designated as effective hedging instruments. Any gains or losses on financial liabilities held for trading are reported in the statement of profit or loss and other comprehensive income.

4.12.3. Loans and borrowings

Loans and borrowings are reported at amortised cost using the effective interest rate method. Any gains or losses are reported in the statement of profit or loss and other comprehensive income through effective interest rate amortisation, which is included as a finance cost. Effective interest rate amortisation measures any discount or premium on acquisition and costs that should be considered as integral part of the effective interest rate. When loans and borrowings are derecognised, this is also reported in the statement of profit or loss and other comprehensive income.

4.12.4 Derecognition

Derecognition of financial liabilities occurs when an existing obligation is settled, cancelled, expired or replaced. Under the terms of replacement, the previous liability is recognised with the new liability being recognised concurrently, with the difference in book value being recorded in the statement of profit or loss and other comprehensive income. A liability is only considered to have been replaced if the terms of the liability are sufficiently modified, such as a change of interest rate, and or the liability is still held by the same party under sufficiently modified terms.

4.12.5. Offsetting of financial instruments

When there is an enforceable legal right to offset an amount and there is an intention to settle on a net basis, or realise the assets and settle the liabilities simultaneously, then financial assets and liabilities are offset with the net amount recognised in the consolidated statement of financial position, with any affiliated income and expenses also being offset in the statement of profit and loss and other comprehensive income.

Notes to consolidated financial statements

4.13. Trade and other receivables

All receivables are amounts which are due from customers for products and services the Rusneftegaz Group have provided, or prepayments for products and services that has not yet provided. After initially being measured at fair value, trade and other receivables are subsequently measured at amortised cost less an estimated allowance for any irrecoverable amounts. A provision is created for any irrecoverable amount where there is evidence to suggest that the amount due on the agreed payment terms will not be collected.

4.14. Assets classified as held for sale

Subsequent to initial recognition, assets classified as held for sale are stated at fair value, which reflects market conditions at the reporting date. Gains or losses arising from changes in the fair value are included in the statement of profit or loss and other comprehensive income. Assets classified as held for sale are measured initially at cost, including transaction costs, which include fees for legal services and any applicable taxes.

Assets classified as held for sale are classified as such when it is held to earn rentals or and for capital appreciation, rather than for sale in the ordinary course of business or for use in production or administrative functions. Capital appreciation is recognised when the property is revalued and then reported on the statement of profit or loss and other comprehensive income. Assets classified as held for sale are classified as both completed property, and property under construction or substantial re-development.

4.15. Cash and short-term deposits

Cash and short-term deposits consist of cash, both at bank and in hand, and short-term deposits with a maturity of less than three months which are readily convertible to cash. Cash at bank earns interest at a fixed or variable rate. All cash and short-term deposits held in foreign currencies other than US dollars have been converted into US dollars using the exchange rate at the end of the reporting period. Any cash that is not considered liquid, such as cash set aside, is not reported in the statement of financial position, and recorded net of any outstanding bank overdrafts.

Notes to consolidated financial statements

4.16. Derivative financial instruments

The Rusneftegaz Group sometimes uses derivative financial instruments to hedge the risk associated with fluctuations in currency exchange rates. These are initially recognised at fair value and then revalued at the end of the reporting period. Any gains and losses associated with the changes in value of derivatives are recorded in the statement of profit and loss and other comprehensive income. Derivative financial instruments, such as forward foreign currency contracts, are reported in the statement of financial position as financial assets if the fair value is positive and as financial liabilities when the fair value is negative. In regards to such assets and liabilities, the Rusneftegaz Group utilises hedge accounting and relevant risk management policies to evaluate the effectiveness of changes in the fair value of hedging instruments in offsetting the exposure to changes in the fair value of the hedged items or cash flows attributable to the hedged risk throughout the periods for which they were designated.

4.17. Inventory

Inventories represent assets that are intended to be used in order to generate revenue in future periods, either by being used to fulfil a service or to be sold by the Rusneftegaz Group. Inventories are stated at the lower of cost and net realisable value, on a first-in, first-out basis. Where applicable, cost compromises direct material and labour costs as well as any other costs that have been incurred in bringing the inventories to their present condition and location.

The net realisable value of oil and gas products is based on the estimated price on the market. The cost of oil and gas products is the purchase cost, which includes the cost of refining and any additional overheads based on normal operating capacity, less depreciation, depletion and amortisation.

4.18. Leases

A lease is a contractual arrangement whereby one party makes payments to the owner of property, plant or equipment for the use of an asset over the time that the contract is legally binding, after which time both parties will make an arrangement of how to return, sell or dispose of the leased asset. Leases are recognised if an arrangement conveys the right to use an asset, regardless of whether such a right is explicitly specified, and the arrangement is dependent on the use of a specific asset. A lease arrangement under which all the risks and benefits of ownership are transferred is classified as a finance lease, whereas, arrangements under which all the risks and benefits have not been transferred are classified as an operating lease.

Notes to consolidated financial statements

4.18. Leases *continued*

In the consolidated financial statements, all payments made under an operating lease are recorded as an operating expense on a straight line basis over the lease term. Moreover, finance leases are capitalised upon the initiation of the arrangement at the lower value of either the present value of the minimum lease payments, or the fair value of the leased property. Payments made under such contracts are allocated proportionally as either a finance expense, being recognised in the statement of profit or loss and other comprehensive income, or as a reduction of the lease liability, maintaining a constant rate of interest on the remaining balance of the liability. All assets held under lease arrangements are depreciated over the useful life of the asset, unless there is no reasonable certainty that the Rusneftegaz Group will obtain ownership by or at the end of the arrangement. In which case, the asset is depreciated over the shorter of its estimated useful life or the lease term.

4.19. Employee benefits

Wages, salaries and any other short-term employee benefits, including bonuses, are reported as an expense on the statement of profit and loss and other comprehensive income after the service is provided by the employee. If the Rusneftegaz Group has obligations for services provided by employees that have not yet been paid, a corresponding liability is reported for the amount due regardless of whether the amount can be estimated reliably.

Contributions are made towards post-employment benefit plans for current employees, where payments are made to an independent party in return for said post-employment benefits and there is not an obligation to pay further amounts. As well as contributions made to independent parties, any payments made that are considered to provide a benefit after the cessation of employment, such as a government pension plan, are also qualified as a post-employment benefit plan. After the employees' service has been provided, all contributions are recorded in the statement of profit and loss and other comprehensive income as an expense. If additional payments to the plan are made that result in a reduction or elimination of future payments, the fair value of said payments is recognised as an asset in the statement of financial position.

4.20. Provisions

Provisions are recognised in the consolidated financial statements when there is a legal obligation as a result of current or previous activities conducted by the Rusneftegaz Group, and future resources will be necessary to settle the obligation. An estimate is made as to the future financial cost of the obligation and reports this figure as a non-current liability. Expenses related to any provision are presented net of any reimbursement in the statement of profit or loss and other comprehensive income. When the Rusneftegaz Group can reasonably expect some or all of a provision to be reimbursed, it is recognised as an asset once the restitution is certain.

Where any provision is previously discounted, the increase in the provision due to the passage of time is recognised as part of finance costs in the statement of profit or loss and other comprehensive income.

4.21. Decommissioning liabilities

A decommissioning liability is recognised where it has a present legal obligation as a result of current or previous activities conducted by the Rusneftegaz Group, and future resources will be necessary to settle such obligations. Such a liability arises after the development of an oil field under the terms of a licence granted by a governmental authority or under the terms stipulated under a mineral lease. When the liability is recognised initially, the value of the estimated future costs is capitalised by increasing the book value of the affiliated assets to the extent that it was incurred during the development of the field.

Amendments to the cost or time of decommissioning are reported by adjusting the provision and a corresponding adjustment to oil and gas asset. Any reduction to the liability and any deduction from the asset to which it relates may not exceed the book value of that asset, any excess over this value is reported on the statement of profit or loss and other comprehensive income.

If amendments to estimates result in an increase in the decommissioning liability and a corresponding change to the book value of the asset, the Rusneftegaz Group considers whether this is an impairment of the asset. If the estimate for the revised value of any asset, net of decommissioning liabilities, exceeds the total recoverable value, that increase is charged to the statement of profit or loss and other comprehensive income. Over time, the discounted liability is increased for the change in present value based on the discount rate that reflects current market valuation and the risks specific to the liability. The periodic unwinding of the discount is recognised in the statement of profit or loss and other comprehensive income as a finance cost.

4.21. Decommissioning liabilities *continued*

The Rusneftegaz Group recognises neither the deferred tax asset in respect of the temporary difference on the decommissioning liability nor the corresponding deferred tax liability in respect of the temporary difference on a decommissioning asset.

4.22. Environmental expenditures and liabilities

Under the terms of existing licenses and or leases, environmental expenditures that are required to facilitate current or future revenues are capitalised or expensed, with any expenditures relating to past operations that do not contribute to current or future earnings being reported as an expense.

Environmental liabilities are recognised when the costs can be estimated, and this usually coincides with the closure of a site, or a commitment to close a site. The amount recognised is the Rusneftegaz Group's best estimate of the expenditure required to fulfil its legal obligations.

4.23.1. Taxation

The tax charge for the period is recognised in the statement of financial position. Current tax assets and liabilities for the current reporting period are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amounts are those that are enacted, or substantively enacted, at the end of the reporting period in the countries where the Rusneftegaz Group operates and generates taxable income.

All revenue, expenses and assets are recognised net of the amount of sales tax, except when any sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the sales tax is recognised as part of the cost of acquisition or as an expense. The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the statement of financial position.

The computation of the Rusneftegaz Group’s total tax charge involves a degree of estimation and judgement, and management periodically evaluates the positions taken in tax returns, with respect to situations in which applicable tax regulations are subject to interpretation, and establishes provisions, where appropriate, for any additional amounts expected to be paid to tax authorities.

4.23.2. Deferred tax

Deferred tax assets and liabilities are the unused tax credits and tax losses carried forward from previous periods that can influence future tax payments resulting from the temporary differences between the tax base and the book value of assets and liabilities at the end of the financial year. Such assets and liabilities are recorded in relation to the tax rates that are projected when the asset is expected to be realised or the liability settled. Judgements, estimates and assumptions made about tax rates are based on enacted or substantively enacted tax laws during the financial year.

The deferred tax assets and liabilities are reported using the balance sheet method for all taxable temporary differences, except in regard to any temporary differences associated with investments in subsidiaries and joint ventures where the reversal of the temporary differences can be controlled by another party and these temporary differences are not likely to reverse in the foreseeable future. Equally, where a deferred tax liability arises from the recognition of an asset, liability or of goodwill, which would be in a transaction that is not a business combination and does not affect the accounting profit nor taxable profit or loss at the time of transaction.

At the end of the financial year, the book value of any deferred tax assets and liabilities, including any unrecognised assets and liabilities, are reassessed and if it is deemed that the taxable profits recorded will result in all or part of the deferred tax asset to be utilised or recovered, then the value of the deferred tax asset or liability will be reduced or recognised accordingly. Deferred tax assets and liabilities relating to items reported as other comprehensive income or as equity are not recognised in the main profit or loss statement but as other comprehensive income as required.

Deferred tax assets and liabilities are offset if the Rusneftegaz Group has a right set off current tax assets and liabilities, and the deferred tax asset and liabilities are affiliated with taxes levied by the same taxation authority on the same entity or an entity which has the intention to settle current tax assets and liabilities on a net basis or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax assets or liabilities are expected to be settled or recovered.

Any tax benefits that do not qualify for separate recognition after a business combination are only recognised subsequently if any new circumstances or facts result in material changes to the statement of financial position. In such cases, any adjustment will result in recognition in the statement of profit or loss and other comprehensive income if said changes are recorded during the measurement period, otherwise any recognition is treated as a reduction in goodwill, as long as it does not exceed the value of the recorded goodwill.

Notes to consolidated financial statements

4.23.3. Other taxes

The Rusneftegaz Group's consolidated financial statements include and recognise other types of taxes on income including royalties; resource rent taxes and revenue-based taxes as income taxes. These taxes have the characteristics of an income tax as the amount payable is based upon taxable income rather than a percentage of revenue or production quantities and are imposed under government authority.

Other taxes are accounted for under IAS 12, for which current and deferred tax is recognised on the same basis as regular corporate income tax. Obligations from other types of taxes that do not satisfy criteria under IAS 12 are included in cost of sales, such as the mineral extraction tax. Only corporate income taxes payable by the Rusneftegaz Group are considered to meet the criteria to be treated as part of income taxes.

4.23.4. Sales tax

All assets, revenues, expenses are recognised net of the amount of sales tax, except when the sales tax incurred on a purchase is not recoverable from the taxation authority. In which case, the sales tax is recognised as part of the cost of acquisition or as an expense on the statement of profit and loss and other comprehensive income. Receivables and payables include the net amount of sales tax payable or recoverable from the taxation authority in the consolidated statement of financial position.

4.24.1. Revenue

Revenue represents the value of sales received or receivable for goods sold, excluding discounts, intra-group sales, sales taxes, excise duties and similar levies. Revenue is recognised when it is probable that the corresponding economic benefits will flow to the Rusneftegaz Group and can be reliably measured. All revenue is recorded net of any taxes accrued.

Revenue can also be recognised when the significant risks of ownership have been transferred, which is considered to have occurred once any title has passed to the customer. For example, revenue from oil production is recognised based on the Rusneftegaz Group's working interest and the terms of the relevant production sharing contracts. Where forward sale and purchase contracts for oil or gas have been determined to be for trading purposes, the associated sales and purchases are reported net of any deductions.

Notes to consolidated financial statements

4.24.2. Revenue from electricity production

Any revenue derived from the private sale of electricity is recognised based on monthly meter readings, under the terms of supply agreements signed by the corresponding parties. Under such agreements, the price-per-unit is determined and the total payment due is calculated, with the amount being recorded as a receivable in the statement of financial position until payment is received. All revenue is then reported in the statement of profit and loss and other comprehensive income once an appropriate payment has been made.

4.24.3. Take-or-pay contracts

Under a take-or-pay contract, the Rusneftegaz Group makes a commitment to supply goods in return for a commitment from the counter-party to purchase a minimum quantity, regardless of whether the order is fulfilled. Revenue is recognised in the statement of profit and loss and other comprehensive income once the counter-party has received the goods ordered. If the counter-party does not take receipt of the quantity ordered under the terms of the contract, revenue is recognised when the corresponding penalty is triggered. The take-or-pay contract may allow the buyer to reconcile their commitments in their future orders without a penalty being triggered.

4.24.4. Government subsidies

Any government grant or subsidy is recognised once the Rusneftegaz Group has a reasonable expectation that payment will be received and any terms and conditions will be met, with payments of compensation being recorded in the statement of profit and loss and other comprehensive income in the period in which the revenue is earned. Payments affiliated with an asset or an expense are also recognised as income and distributed over the expected life of the asset, or over the period that the compensation relates to the expense.

4.24.5. Interest revenue

Interest revenue is included in finance income in the statement of profit or loss and other comprehensive income for revenue or expenses derived from interest-bearing financial assets or liabilities. Interest income or expense is recorded using the effective interest rate, which is the rate that discounts the estimated future cash receipts or payments over the expected life of the financial instrument to the net carrying amount of the financial asset or liability.

Notes to consolidated financial statements

4.25. Borrowing costs

Borrowing costs consist of interest and other costs incurred with the borrowing of funds. Such costs that are attributable to the acquisition or construction of a qualifying asset are capitalised as part of the cost of the respective assets, with the amount capitalised representing the costs incurred. Borrowing costs that are not attributable to the asset expenditures are recognised in the statement of profit or loss and other comprehensive income in the period incurred.

Where surplus funds are available from borrowings to finance a project, any income generated is also capitalised and deducted from the total capitalised borrowing costs. Where the funds used to finance a project form part of general borrowings, the amount capitalised is calculated using a weighted average of rates applicable to relevant general borrowings of the Rusneftegaz Group during the period.

4.26. Fair value measurement

At the end of each reporting period, the Rusneftegaz Group recognises assets and liabilities at fair value, which is the consideration that would be paid or received to transfer an asset on the measurement date between market participants, assuming that a transaction takes place in either the principal market or the most advantageous market for the asset or liability in a market accessible to the Rusneftegaz Group. In order to report fair value, the relevant valuation methods are used under the circumstances for which sufficient data and observable inputs are available, with the use of insufficient or unreliable data and unobservable inputs mitigated when possible.

Accounting policies for fair value measurements are determined by the audit committee, for both recurring and non-recurring fair value measurements, by assessing the changes to the value of any assets or liabilities that are required to be revalued at the end of each financial year. The committee determines whether the changes made are accurate by comparing any alterations to fair value with external sources, and by verifying the major inputs in the latest valuation of an asset or liability by corroborating the data used for the valuation with contracts and other relevant documents.

Notes to consolidated financial statements

4.26. Fair value measurement *continued*

Assets and liabilities are classified based on their characteristics, nature, risks and level on the fair value hierarchy, with the fair value of non-financial assets being estimated by determining the potential economic benefits of an asset at its best use or by transferring it to another market participant that would realise the asset at its best use. Some of the Rusneftegaz Group's non-financial assets are recorded at fair value less costs of disposal to determine the recoverable amount for the purpose of testing for impairment. Fair value is calculated by using the same judgements, estimates and assumptions that a market participant would use, assuming that said market participants act in their own best interest. Changes to judgements, estimates and assumptions could affect the fair value reported in the consolidated statement of financial position.

Any asset or liability measured at fair value is recognised within the fair value hierarchy, with assets and liabilities being attributed to the lowest possible level that the Rusneftegaz Group can provide evidence for. If an asset or liability has been previously recognised at fair value, it is assessed whether any of these assets or liabilities has transferred between the levels of the hierarchy if any new data or inputs are available and the asset has not been transferred outside of the Rusneftegaz Group. The fair value hierarchy is as follows:

► Level 1 — Market prices quoted on an active market for assets or liabilities identical to those held by the Rusneftegaz Group
► Level 2 — Valuations for assets and liabilities where the lowest-level input that is significant are directly or indirectly observable
► Level 3 — Valuations for assets and liabilities where the lowest-level input that is significant are unobservable

4.27. Current versus non-current classification

Assets and liabilities reported in the statement of financial position are recognised as either current or non-current. Assets are deemed to be current if it is expected to be realised, consumed or intended to be sold in the current or subsequent financial year. Also, the Rusneftegaz Group considers any asset to be current if it is held primarily for the purpose of trading, including cash or cash equivalents, unless such assets are restricted from being used or exchanged in the 12 months after the conclusion of the reporting period.

A liability is considered to be current if it is expected to be settled in the current or subsequent reporting period or there is no right to defer the settlement of the liability for at least the 12 months following the conclusion of the financial year. The Rusneftegaz Group classifies any other assets and liabilities that do not meet the disclosed parameters as non-current, including deferred tax assets and liabilities.

Notes to consolidated financial statements

5. Changes in accounting policies and disclosures

For this reporting period, the Rusneftegaz Group adopted the new standards and interpretations that were brought into force by the International Accounting Standards Board on the 1 January 2017. Beyond the accounting policies that have been altered, all other standards and interpretations that were used in the last reporting period remain in force and were used in order to produce the financial statements in this period. Any of the new standards that may have a material impact on the financial statements immediately or in the future are disclosed below, with polices that are not considered relevant to the Rusneftegaz Group not being reported.

IAS 7 Statement of Cash Flows

An amendment that obliges entities to disclose any changes to liabilities resulting from financing activities, including non-cash changes, such as those arising from foreign exchange gains or losses, and changes due to cash flows. Liabilities arising from financing activities are defined as liabilities when the cash flows were, or future cash flows will be, reported in the statement of cash flows from financing activities. The alterations also correspond to any changes to financial assets if the same criteria are met.

IAS 12 Income Taxes

An alteration to establish whether an entity should consider if tax law restricts the sources of taxable profits against which it may make deductions on the reversal of deductible temporary difference related to unrealised losses. The changes to the standard also provide directions as to how future taxable profits should be calculated and explains the way in which taxable profit may include the recovery of assets for more than their reported book value.

The amendments have been applied retrospectively by the Rusneftegaz Group, and have not resulted in any changes to the consolidated financial statements due to the fact that the Rusneftegaz Group does not hold any assets or temporary difference that are covered under the terms of the alterations to the standard.

These revisions also purport that entities may use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already using IFRS and electing to change to the equity method in their separate financial statements have to apply the change retrospectively. These amendments also do not result in any material changes to the Rusneftegaz Group's consolidated financial statements.

Notes to consolidated financial statements

6.1. Segmental information

Segmentation is used internally by the Rusneftegaz Group for management purposes, for reasons such as long-term strategic planning, short-term decision making and the allocation of resources. Rusneftegaz is organised into two segments based upon its operations; the oil and gas segment and the electricity segment. Transfer prices between operating segments are on an arm's length basis in a manner similar to transactions with third parties. These segments have not been aggregated, and account solely for the production and distribution of the operating activities described.

The results of each segment are evaluated based on earnings before interest, taxes, depreciation, depletion and amortisation, or EBITDA. This is calculated as the profit or loss recorded for the period excluding finance income and expenses, income taxes, the depreciation, depletion, amortisation and impairment of assets, the cost of any provisions, any income from the disposal of assets and any other corresponding income and or expenses. The results of each segment are analysed in relation to the financial results recorded in the consolidated financial statements, with the accounting policies used by each segment being identical to those of the rest of the Rusneftegaz Group. Certain activities are managed on a Group basis, such as financing, and are not attributed to any operating segments.

Notes to consolidated financial statements

6.1. Segmental information *continued*

Year ended 31 December 2017	Oil and gas	Electricity	Unallocated	Total
	USD ($) '000	USD ($) '000	USD ($) '000	USD ($) '000
Revenue				
External customers	205,965	296,350	–	502,315
Inter-segment revenues	–	–	–	–
Total segment revenues	**205,965**	**296,350**	–	**502,315**
Results				
Depreciation, depletion and amortisation	(17,029)	(34,893)	(1,220)	(53,142)
Impairment	(1,198)	(397)	(3)	(1,598)
Finance income	–	–	543	543
Finance expense	–	–	(3)	(3)
Other income	129	–	–	129
Other costs	(98,021)	(117,798)	(8,987)	(224,806)
Profit before tax	**89,846**	**143,262**	**(9,670)**	**223,438**
Income tax expense				(48,057)
Net profit for the year				**175,381**
Segment assets	**448,595**	**780,571**	**35,526**	**1,264,692**
Segment liabilities	**76,389**	**41,072**	**2,153**	**119,614**
Disclosures				
Capital expenditure	(19,400)	(159,818)	(203)	(179,421)

1. All Inter-segment revenues are eliminated on consolidation.
2. The unallocated category represents corporate costs incurred and all finances managed at Group level.
3. The profit reported for each operating segment does not include finance income of USD $0.543m, or finance costs of USD $0.003m. Such costs are managed on a group basis.
4. Capital expenditure includes any additions to property, plant and equipment and intangible assets, including any assets under construction or development, and any expenditure capitalised and recorded as an asset.

Notes to consolidated financial statements

6.1. Segmental information *continued*

Year ended 31 December 2016	Oil and gas	Electricity	Unallocated	Total
	USD ($) '000	USD ($) '000	USD ($) '000	USD ($) '000
Revenue				
External customers	161,081	279,896	–	440,977
Inter-segment revenues	–	–	–	–
Total segment revenues	**161,081**	**279,896**	**–**	**440,977**
Results				
Depreciation, depletion and amortisation	(15,176)	(29,265)	(1,216)	(45,657)
Impairment	(1,217)	(843)	(5)	(2,065)
Finance income	–	–	503	503
Finance expense	–	–	(3)	(3)
Other income	71	–	–	71
Other costs	(66,230)	(139,751)	(9,671)	(215,652)
Profit before tax	**78,529**	**110,037**	**(10,392)**	**178,174**
Income tax expense				(38,577)
Net profit for the year				**139,597**
Segment assets	**383,830**	**667,894**	**33,486**	**1,085,210**
Segment liabilities	**73,285**	**56,827**	**23,145**	**153,257**
Disclosures				
Capital expenditure	(20,017)	(254,054)	(468)	(274,539)

1. All Inter-segment revenues are eliminated on consolidation.
2. The unallocated category represents corporate costs incurred and all finances managed at Group level.
3. The profit reported for each operating segment does not include finance income of USD $0.503m, or finance costs of USD $0.003m. Such costs are managed on a group basis.
4. Capital expenditure includes any additions to property, plant and equipment and intangible assets, including any assets under construction or development, and any expenditure capitalised and recorded as an asset.

Notes to consolidated financial statements

6.2. Geographic information

All of the Rusneftegaz Group's operations and non-current assets recognised in the last financial year were located in Russian Federation. The Rusneftegaz Group's historical revenues are derived from domestic and international sales from the following regions:

	2017	2016
	USD ($) ‘000	**USD ($) ‘000**
Russian Federation	502,315	430,070
European Union	–	10,907
Total	**502,315**	**440,977**

Revenue derived from three major customers exceeded 10% of the revenue recognised in the consolidated financial statements in the last financial year. In 2017, such amounts were USD $296.35m, USD $55.68m and USD $53.72m, whereas in 2016, three customers paid amounts of USD $279.90m, USD $49.16m and USD $47.93m that were more than 10% of recognised revenue. These amounts were earned from the sale of electricity and petroleum products.

Notes to consolidated financial statements

7. Cost of sales

Cost of sales is stated after charging/crediting:

	2017	2016
	USD ($) '000	**USD ($) '000**
Depreciation, depletion and amortisation	(53,142)	(45,657)
Mineral extraction tax	(43,587)	(21,845)
Maintenance and repairs	(7,241)	(15,342)
Cost of labour	(37,641)	(38,133)
Rents	(4,230)	(5,965)
Taxes other than income tax	(4,881)	(4,198)
Fuel expenses	(95,865)	(99,392)
Fines and penalties	(296)	(263)
Water supply expenses	(2,481)	(2,766)
Impairment	(1,598)	(2,065)

8. Revenue

	2017	2016
	USD ($) '000	**USD ($) '000**
Revenue from petroleum	205,965	161,081
Revenue from electricity	296,350	279,896
Total revenue	**502,315**	**440,977**

9. Operating expenses

	2017	2016
	USD ($) '000	**USD ($) '000**
Oil transportation services	7,503	6,235
Export duties	–	2,312
Thermal power transmission expenses	1,958	1,660
Electricity transmission costs	113	46
Total operating expenses	**9,574**	**10,253**

Notes to consolidated financial statements

10. General and administrative expenses

	2017	2016
	USD ($) '000	USD ($) '000
Wages and salaries	5,610	5,368
Legal and professional fees	2,764	3,578
Insurance	170	173
Repairs and maintenance	22	30
Other expenses	421	162
Total general and administrative expenses	**8,987**	**9,311**

11. Employee benefit expense

	2017	2016
	USD ($) '000	USD ($) '000
Wages and salaries	2,185	2,145
Pension contributions	334	321
Employment programs and other costs	35	33
Total employee benefit expenses	**2,554**	**2,499**

12. Directors remuneration

	2017	2016
	USD ($) '000	USD ($) '000
Wages and salaries	2,719	2,539
Long-term benefits	337	330
Total directors' remuneration	**3,056**	**2,869**

13. Finance income and expense

	2017	2016
	USD ($) '000	USD ($) '000
Finance income		
Interest accrued on cash in bank	4	4
Interest accrued on long term deposits	539	499
Total finance income	**543**	**503**
Finance expense		
Interest on overdrafts	(3)	(3)
Total finance expense	**(3)**	**(3)**
Net finance income	**540**	**500**

Notes to consolidated financial statements

14.1. Taxation

The major components of the tax expense for the year ended 31 December 2017 are:

	2017	2016
	USD ($) '000	**USD ($) '000**
Consolidated statement of profit and loss and other comprehensive income		
Income tax expense		
Current income tax:		
Current income tax charge	44,688	35,635
Adjustments	7,467	6,686
Deferred income tax:		
Temporary differences	(4,098)	(3,744)
Total income tax expense	**48,057**	**38,577**

Corporate income tax is calculated at 20% of profit for the year ended 31 December 2017.

14.2. Deferred taxes

	2017	2016
	USD ($) '000	**USD ($) '000**
Property, plant and equipment	183	172
Gross deferred tax asset	**183**	**172**
Property, plant and equipment	20,675	18,894
Gross deferred tax liability	**20,675**	**18,894**
Net deferred tax liability	**4,098**	**3,744**

Reflected in the consolidated statement of financial position as follows:

Deferred tax assets	**183**	**172**
Deferred tax liabilities	**20,675**	**18,894**

14.3 Taxes and royalties payable

	2017	2016
	USD ($) '000	**USD ($) '000**
Taxes payables	8,410	10,246
Total taxes and royalties payable	**8,410**	**10,246**

Notes to consolidated financial statements

15. Property, plant and equipment

	USD ($) '000
Cost	
At 1 January 2016	**586,786**
Additions	274,539
Depreciation, depreciation and amortisation	(45,659)
Revaluations	4,765
Impairment	(2,065)
Transfers	(468)
Foreign currency conversion differences	169,770
At 31 December 2016	**987,668**
Additions	179,421
Depreciation, depreciation and amortisation	(53,142)
Revaluations	5,425
Impairment	(1,598)
Transfers	–
Foreign currency conversion differences	32,321
At 31 December 2017	**1,150,095**
Net book value:	
At 31 December 2016	**987,667**
At 31 December 2017	**1,150,095**

Useful lives

The useful lives of the assets are estimated as follows:

Buildings = 20 years
Plant and equipment = 3 - 15 years

The table above presents the changes in the fair value of the property, plant and equipment at the end of the year.

Total cash outflow for the purchase of property, plant and equipment was USD $179.4 million at the year ended 31 December 2017.

The net book value at 31 December 2017 also includes USD $40.52 million of assets currently under construction which are not being depreciated in this financial year.

Notes to consolidated financial statements

16. Intangible assets

	USD ($) '000
Cost	
At 1 January 2016	**126**
Additions	–
Depreciation, depreciation and amortisation	–
Foreign currency conversion differences	15
At 31 December 2016	**141**
Additions	–
Depreciation, depreciation and amortisation	–
Foreign currency conversion differences	3
At 31 December 2017	**144**
Net book value:	
At 31 December 2016	**141**
At 31 December 2017	**144**

The majority of intangible assets recorded are classified as either licenses or computer software, both of which are amortised over the course of its useful economic life. For reporting purposes, computer software is amortised over three years.

17. Impairment losses

Impairment losses for property, plant and equipment in the last financial year amounted to USD $1.60m, down from USD $2.07m reported in the previous year. The Rusneftegaz Group tests for impairment of an asset by comparing the book value of the asset with the recoverable amount, which is the higher of value in use or fair value less costs of disposal, with said amount being determined by calculating its value in use.

The Rusneftegaz Group computes value in use by making a reasonable estimate using any new evidence acquired, or by using a discounted cash flow model derived from the post-tax weighted average cost of capital. The majority of assets tested for impairment by the Rusneftegaz Group are assessed using the discounted cash flow model, with appropriate adjustments to determine the pre-tax rate and to reflect the risks specific to the asset or asset group.

The weighted average costs of capital takes into account both debt and equity equally. The cost of debt is derived from the interest-bearing borrowings that the Rusneftegaz Group is obliged to service, and the cost of equity is based on the expected return on investment to the Rusneftegaz Group's investors. Risks specific to certain segments are consolidated by assessing beta factors, which are based on publicly available market data and evaluated annually.

Notes to consolidated financial statements

18. Assets classified as held for sale

	USD ($) '000
Gold bullion	2,478
Silver bullion	2,391
Other assets held for sale	618
Total assets held for sale	**5,487**

19. Inventories

	2017	2016
	USD ($) '000	USD ($) '000
Crude oil	8,610	3,802
Fuel	10,087	6,383
Spare parts and materials	3,651	3,197
Other petrochemical products	2,149	2,084
Total inventories	**24,497**	**15,466**

20. Trade and other receivables

	2017	2016
	USD ($) '000	USD ($) '000
Trade receivables	9,240	4,581
Other receivables and prepayments	11,284	5,625
Total trade and other receivables	**20,524**	**10,206**

Trade receivables do not bear any interest, and are offered to parties considered creditworthy after assessment, on terms from 30 to 60 days.

The recoverability of trade and other receivables is on the basis of the age and type of the outstanding amount, and the current and projected creditworthiness of the third party. If it is deemed that the third party may not fulfil its contractual obligations then the amount is considered impaired.

At 31 December 2017, no trade receivables were considered impaired.

Notes to consolidated financial statements

21. Loans and borrowings

	Maturity	Effective interest rate	2017	2016
		(%)	USD ($) '000	USD ($) '000
USD $125 million loan facility	4 January 2017	0.0	–	10,416
USD $125 million loan facility	18 January 2017	0.0	–	10,417
Total borrowings			**–**	**20,833**

USD $125 million loan facility

The loan was secured with a charge on USD $125 million of the Rusneftegaz Group's non-current assets, and commenced on 4 January 2016. The balance was repaid in full on 4 January 2017.

USD $125 million loan facility

The loan was secured with a charge on USD $125 million of the Rusneftegaz Group's non-current assets, and commenced on 18 January 2016. The balance was repaid in full on 18 January 2017.

22.1. Derivative financial instruments

The fair values of the Rusneftegaz Group's derivative financial instruments are as follows:

	2017	2016
	USD ($) '000	USD ($) '000
Foreign currency forward contracts	486	408
Commodity price swaps	430	379
Total derivative financial instruments	**916**	**787**

The Rusneftegaz Group's accounting policies in relation to derivative financial instruments are described below in the following sections.

22.2. Cash flow hedges

A derivative is classified as a cash flow hedge when there is an exposure to variability in cash flows, often associated with a recognised asset, liability or an expected future transaction. The Rusneftegaz Group's cash flow hedges consist of forward foreign exchange contracts and commodity price swaps.

Forward foreign exchange contracts are used to protect against exchange rate volatility in expected transactions denominated in a foreign currency. Commodity price swaps are undertaken to hedge against volatility in the price of commodities, the sales of which compose the majority of the Rusneftegaz Group's revenue.

On 31 December 2017, the Rusneftegaz Group has outstanding foreign currency forward contracts designated as hedges for expected future purchases from foreign suppliers for which the Rusneftegaz Group has a firm, unrealised commitment. The foreign currency forward contracts are used to hedge the foreign currency risk of these commitments. The Rusneftegaz Group also has outstanding commodity price swaps marked as cash flow hedges for future sales of petroleum products. The price swaps are used to hedge the future prices of these products. If any transaction is no longer expected to occur, the gain or loss recognised in equity would also be recognised in the statement of profit and loss and other comprehensive income.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument is retained in equity until subsequent recognition in the statement of profit and loss and other comprehensive income.

23. Accounts payable and other payables

	2017	2016
	USD ($) '000	USD ($) '000
Trade payables	47,381	63,861
Other payables	15,630	12,534
Total accounts payable and other payables	**63,011**	**76,395**

Trade payables do not bear any interest, and are settled within 60 days of the contract commencing.

Other payables do not bear any interest, and have an average term of six months.

Notes to consolidated financial statements

24. Cash and cash equivalents

	2017	2016
	USD ($) '000	USD ($) '000
Cash in bank and in hand	55,962	58,938
Long-term deposits	6,884	6,345
Total cash and cash equivalents	**62,846**	**65,283**

All cash deposited into bank accounts earns interest at a fixed rate and is considered highly liquid. All long-term deposits are considered illiquid and have been made for periods of longer than three months. At 31 December 2017, approximately 20% of deposits are made at a variable rate and the remaining 80% of deposits are made at a fixed rate.

The Rusneftegaz Group only deposits cash and cash equivalents into banks it considers of being in good standing.

Notes to consolidated financial statements

25. Provisions

The Rusneftegaz Group allocates provisions on the basis of costs that are expected to be incurred in the future, for example, at the end of the working life of an asset group. The provisions designated by the Rusneftegaz Group are listed below.

	2017	2016
	USD ($) '000	**USD ($) '000**
Balance at the beginning of the period	26,889	23,397
Translation differences	629	3,492
Total provisions	**27,518**	**26,889**

Decommissioning provision

A provision is allocated on a discounted basis for the projected future cost of decommissioning oil property, plant and equipment under the terms of the lease agreement. These costs are expected to be incurred after the expiration of the lease, or when the site ceases to be economically viable.

Provisions have been reported on the basis of the estimates and assumptions of the Rusneftegaz Group, such as projections of future oil and gas prices, which are inherently uncertain and can affect the economic viability of an oil field. All estimates and assumptions are made by management are subject to review, and take into account any material changes to the information used to project the future costs. Such information includes data from the oil field, including the expected timing of decommissioning, any changes to legal requirements or standards and the availability or emergence of new, relevant technologies.

The final cost of decommissioning will be subject to external evaluation and will depend on future market prices and the extent of decommissioning works required, which are both subject to a degree of uncertainty.

26. Issued capital

Authorised shares	**USD ($) '000**
1,000 ordinary shares	1
Total authorised shares	**1**
Total share premium reserve	**450,000**

Fully paid ordinary shares carry one vote per share and carry the right to dividends.

Notes to consolidated financial statements

27. Capital Management

Capital management is the administration of the Rusneftegaz Group's equity reserves, including issued capital, and any other reserves attributable to the parent company. Such policies are utilised to maintain an adequate ratio of capital-to-debt and a secure credit rating, allowing for sustainable growth and the maximisation of shareholder value in the long term. Capital management policies are adjusted in regards to changes in economic and financial conditions, as such the Rusneftegaz Group may elect to issue new shares, pay or withhold a dividend in the following financial year and or return funds to shareholders. No alterations were made to the policies or processes during the last financial year.

Capital is analysed using a gearing ratio, with the Rusneftegaz Group upholding a policy to maintain the ratio at a maximum of 50%. It is calculated by dividing net debt by equity, plus net debt. Incorporated into net debt are loans and borrowings, trade and other payables, less cash and short-term deposits.

28. Reserves

The following reserves have been allocated as a portion of equity during the reporting period:

	USD ($) '000
Foreign currency translation reserve	(787,655)
Asset revaluation reserve	34,187

The foreign currency translation reserve compromises the exchange rate differences from the conversion of the Rusneftegaz Group's foreign operations.

Likewise, the asset revaluation reserve records increases in the fair value of recognised assets.

Notes to consolidated financial statements

29.1. Risk Management

Certain activities and transactions conducted expose the Rusneftegaz Group to a number of risks. These are risks that could affect assets, liabilities or cash flows, Risk management policies aim to alleviate the volatility of financial markets and minimise its impact on financial performance, whilst protecting the future financial security.

Actions regarding risk management are agreed and reviewed by the Board of Directors, who considers whether the Rusneftegaz Group's risk management activities are governed by sufficient and appropriate policies and safeguarding procedures. The Board of Directors also consider whether all financial risks are adequately identified, measured and managed in accordance with the Rusneftegaz Group's broader policies and objectives. All activities conducted for risk management purposes are carried out by those whom have the relevant skills and experience.

The Rusneftegaz Group's principal financial assets, other than derivatives, comprise trade and other receivables and cash and short-term deposits that arise directly from its operations.

29.2. Market risk

Market risk recognises that market volatility and fluctuations could affect the fair value of future cash flows from a financial instrument. This is managed by segmenting different areas of risk, including commodity price risk, interest rate risk, foreign currency risk and credit risk.

Therefore, risk management policies are designed and implemented to mitigate market risk, and intend to alleviate the sensitivity to changes in market variables on the Rusneftegaz Group's financial instruments, and project the impact of such changes on profit, loss and equity, where applicable.

29.3. Commodity price risk

The Rusneftegaz Group is exposed to commodity price risk due to fluctuations in market commodity prices for the oil, gas and electricity it produces. Rusneftegaz's policy is to assess profit-at-risk, thus analysing its exposure to fluctuations in commodity prices. The Rusneftegaz Group then manages these risks by keeping between 20% and 40% of its production revenue on fixed price contracts, with the main source of production revenue earned from derivative commodity contracts where exposure to the risk is higher.

29.4. Interest rate risk

The Rusneftegaz Group's exposure to interest rate risk is due to the fact that the fair value of a financial instrument or the future cash flows of a financial instrument could fluctuate due to changes in market interest rates. The risk of changes in market interest rates relates primarily to the Rusneftegaz Group's short-term deposits with variable interest rates. Rusneftegaz's policy is to keep at least 50% of its cash in bank at fixed rates of interest, and manage its other deposits using both fixed and variable interest rates, depending on external interest rate forecasts.

29.5. Foreign currency risk

The Rusneftegaz Group has foreign currency exposures that arise from valuations of financial assets and liabilities, foreign contractual commitments and transactions in currencies other than the Rusneftegaz Group's functional currency. The risk is that the fair value or future cash flows of a financial instrument will be susceptible to volatility in foreign exchange rates. The Rusneftegaz Group attempts to alleviate this risk by creating cash flow hedges and monitoring movements in exchange rates on a regular basis.

29.6. Credit risk

Rusneftegaz is exposed to the risk that a counterparty will not meet its obligations under a contract or financial instrument, leading to a financial loss. The risk is inherent in the Rusneftegaz Group's commercial business activities. The Rusneftegaz Group is exposed to credit risk through outstanding trade receivables and financial instruments. Credit risk also arises from the Rusneftegaz Group's other financial assets, which comprise cash, short-term investments and derivative financial assets. The Rusneftegaz Group's vulnerability to credit risk arises from the counterparty or counterparties defaulting, with a maximum exposure to the risk equal to the book value of these instruments.

To mitigate the risk, the Rusneftegaz Group undertakes various policies and actions, including regularly monitoring receivable balances on an ongoing basis, and ensuring that such balances are paid in full and on or before the required date. Also, the Rusneftegaz Group only conducts transactions with creditworthy parties. Any customer that wishes to trade on credit terms are subject to an assessment of their credit report from a recognised credit reference agency, and an analysis of their recent financial statements. In some instances, collateral may be obtained from customers as a means of mitigating the risk of a financial loss, and also abates the risk from shipments by obtaining letters of credit or other forms of credit insurance.

The Rusneftegaz Group manages the risk concerning financial assets by using the services of financial institutions that it considers to be reputable. The audit committee annually reviews the performance, suitability and long-term viability of the financial institutions it co-operates with.

Notes to consolidated financial statements

30. Capital commitments and contingencies

A capital commitment is created when a contract has been agreed, either orally or in writing, and its terms have not yet been fulfilled. Likewise, a contingency is a present obligation, which may or may not require repayment that has been created from a past event that has already occurred. The Rusneftegaz Group has various monetary commitments and contingencies in the next financial year arising from obligations and other contracts created in the current and previous reporting periods. The current capital commitments and contingencies of the Rusneftegaz Group are listed below.

Lease commitments

The Rusneftegaz Group has capital commitments arising from operating leases for property, plant and equipment, with an average contract length of five years. Some of these contracts are non-cancellable and or include an option to extend the lease on terms based on the market price at the time of contract renewal. No restrictions have been placed on the Rusneftegaz Group as a result of entering into any lease contracts.

Other contractual commitments

The Rusneftegaz Group has capital commitments arising from ongoing upgrades to electricity generation assets, with the budget for said improvements being set on an annual basis. As of the 31 December 2017, the Rusneftegaz Group has a value of USD $40.52m of contracted works that has not yet been completed, and a further USD $21.72m of projects that have been contracted but not yet started.

Notes to consolidated financial statements

31.1. Group information

Details pertaining to the structure and ownership of the Rusneftegaz Group are noted below:

31.2. Subsidiaries

The consolidated financial statements of the Rusneftegaz Group include the financial statements of the company and 22 subsidiaries at 31 December 2017. A list of these companies is included below.

Subsidiary	Country of incorporation	Ownership interest
AO Pechoraneftegaz	Russian Federation	100%
OOO 1Oil Management	Russian Federation	100%
OOO Devon	Russian Federation	100%
OOO Devon-Invest	Russian Federation	100%
OOO Interstroytekhproyekt	Russian Federation	100%
OOO Inzhenernyye Izyskaniya	Russian Federation	100%
OOO Kosyuneft	Russian Federation	100%
OOO Osnava Management Company	Russian Federation	100%
OOO Rufyeganneftegaz	Russian Federation	100%
OOO Tarkovskoye	Russian Federation	100%
OOO Zapadno-Novomolodezhnoye	Russian Federation	100%
1Oil Holdings Ltd.	Cyprus	100%
Benelli Ltd.	Cyprus	100%
Coleford Ltd.	Cyprus	100%
Lesson Ltd.	Cyprus	100%
RF Energy Investments Ltd.	Cyprus	100%
Uroco Ltd.	Cyprus	100%
Rusneftegaz (Commodities) Ltd.	British Virgin Islands	100%
Rusneftegaz (Development) Ltd.	British Virgin Islands	100%
Rusneftegaz (Finance) Ltd.	British Virgin Islands	100%
Rusneftegaz (Securities) Ltd.	British Virgin Islands	100%
Rusneftegaz (Trading) Ltd.	British Virgin Islands	100%

31.3. Controlling party

The immediate controlling party of Rusneftegaz Ltd. is Vitol Inc., a Delaware corporation registered at 2925 Richard Avenue, Suite 11, Houston, Texas, 77098, United States of America. Vitol Inc. owns 100% of the shares in the Company.

The ultimate parent undertaking of the Group is Vitol Holding BV, a Dutch entity incorporated at K. P. van der Mandelelaan 130, 3062 MB, Rotterdam, Netherlands.

31.4. Related party disclosures

The disposition of the related parties with whom the Rusneftegaz Group has conducted significant transactions during the financial year is detailed below:

	2017	2016
	USD ($) ‘000	USD ($) ‘000
Loans and borrowings	–	250,000
Total related party transactions	**–**	**250,000**

On 4 January 2016, a loan from Vitol Inc. was secured with a charge on USD $125 million of the Rusneftegaz Group’s non-current assets, and was repaid in full on 4 January 2017. A further loan was secured on 18 January 2016 from Vitol Inc. with a charge on an additional USD $125 million of the Rusneftegaz Group’s non-current assets. This loan was also repaid in full on 18 January 2017.

32. Events after the reporting period

No events that have occurred since the 31 December 2017 have had a material impact on the Rusneftegaz Group’s consolidated financial statements.

Notes to consolidated financial statements

33. Standards issued not yet in force

The Rusneftegaz Group has not applied any new standards or interpretations from the International Accounting Standards Board before their required implementation date, nor is it expected that any of these new standards or interpretations will have a material impact on the financial statements. Standards and interpretations that have been issued but are not yet effective are listed below, except for any that are not reasonably expected to have an impact of the Rusneftegaz Group.

IFRS 9 Financial Instruments

A final version of IFRS 9 has been published by the International Accounting Standards Board, which replaces IAS 39 Financial Instruments: Recognition and Measurement. The new standard includes guidance for hedge accounting and the classification and measurement of financial assets and liabilities, it also transfers the derecognition requirements from IAS 39.

The standard contains new hedge accounting methods that align the accounting treatment with risk management activities, as well as increasing the level of disclosure required to provide more extensive information regarding risk management policies and the effect of hedge accounting on the financial statements.

IFRS 9 introduces a new method to classify financial assets, which is driven by the cash flow characteristic of the asset and the business model in which the asset is held. A new categorisation is introduced under IFRS 9 which allows certain financial assets to be reported as fair value through other comprehensive income, under qualifying circumstances. The classification of financial liabilities is identical to IAS 39, with some alterations being made to the fair value option for financial liabilities to address issues regarding credit risk. IFRS 9 also introduces a single impairment model being applied to all financial instruments, as well as a model to calculate expected credit loss for the measurement of financial assets.

IFRS 15 Revenue from Contracts from Customers

The new standards under the International Accounting Standards Board directive supersede IAS 11 and IAS 18, as well as IFRIC 13, IFRIC 15 IFRIC 18 and SIC-31, and are expected to influence the future financial reporting of the Rusneftegaz Group. The regulations under the revised IFRS 15 will increase the level of disclosures regarding revenue reported, enhances requirements for multiple-element transactions or arrangements and provides regulations for types of transactions that were not acknowledged or addressed under the previous version. The new requirement obliges revenue to be recognised under a new methodology, consisting of five steps and encompassing all revenue recorded from contracts with customers. This new regulation depicts the transfer of goods or services to customers reflecting the consideration that is expected to be received in exchange for the goods or services provided.

Notes to consolidated financial statements

33. Standards issued not yet in force *continued*

IFRS 16 Leases

The new standard introduces principles for the recognition, measurement, presentation and disclosure of leases and obliges entities to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value, using a revised balance sheet model. At the inception of the lease, the entity will be compelled to recognise a liability for the obligation to make lease payments, and also record the right of use during the term of the contract as an asset.

The value of the right to use an asset is measured similarly to other non-financial assets, such as property, plant and equipment, and lease liabilities are recorded equivalently to other financial liabilities. Therefore, the depreciation of the value of the right to use an asset and the interest on the lease liability is reported in the consolidated financial statements. Likewise, any cash repayments of the lease liability are classified into principal and an interest portion, and presented in the consolidated statement of cash flows.

The new standards continue most of the accounting requirements of IAS 17, but also require entities to make far more extensive disclosures regarding leases. Further judgement will be required to choose information that is relevant to disclose in order to provide an objective basis to assess how leases effect financial position, performance and cash flows. The alterations require further disclosure regarding the risk exposure of the lessor, particularly to residual value risk, and will be obliged to revalue the lease liability upon the occurrence of certain events, such as a change to future lease payments or the lease term. However, entities will continue to distinguish between operating and finance leases, and account for both types accordingly.

IFRS 16 was issued in January 2016 and is effective from 1 January 2019, with certain exceptions and reliefs. The revisions replace IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. An entity is permitted to apply the standard using either a full retrospective or a modified retrospective approach, and can apply IFRS 16 earlier than 2019 if IFRS 15 is also in effect.

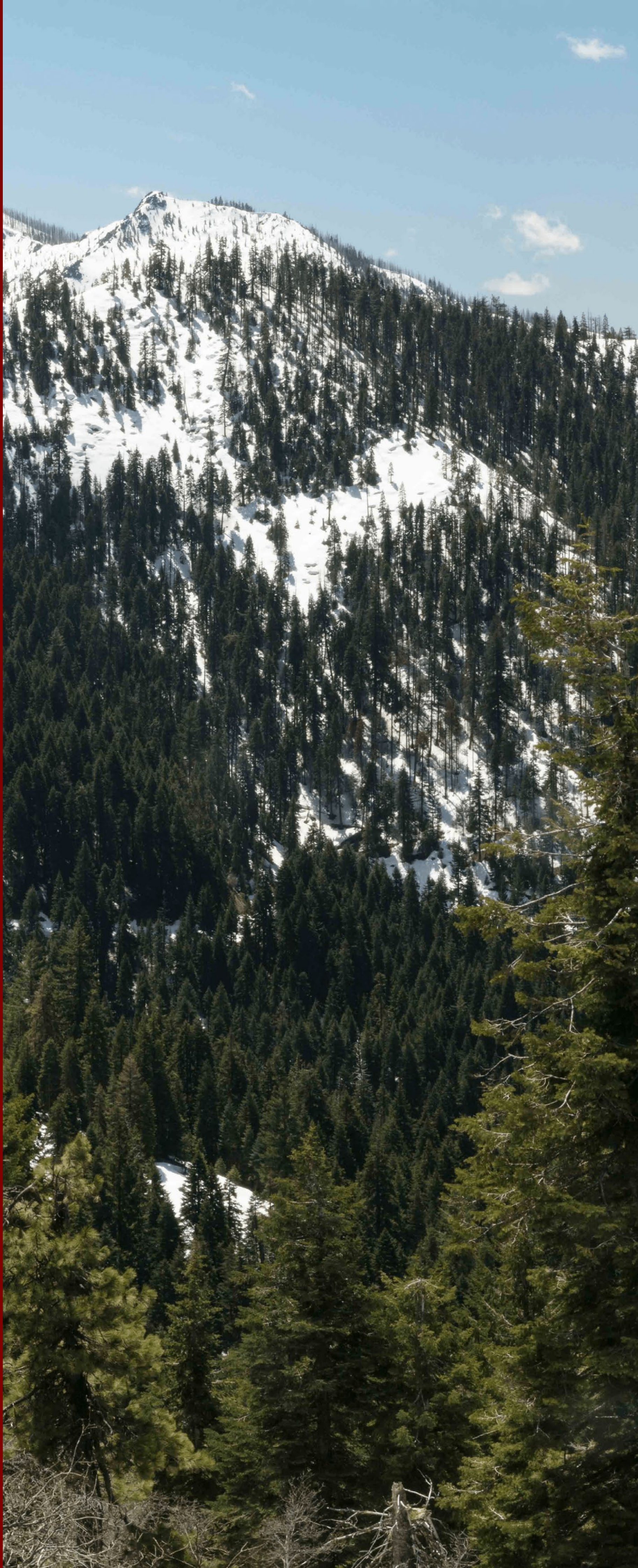
Notes to consolidated financial statements

33. Standards issued not yet in force *continued*

IFRIC 22 Foreign Currency Transactions and Advance Consideration

The new interpretation provides clarification that when initially recognising or derecognising an asset, expense, income or liability from which advanced consideration will be reported, an entity must use the exchange rate on the date of the transaction to recognise the non-monetary assets or liabilities arising from the advance consideration. Moreover, in the circumstances that multiple receipts or payments in advance require recognition, then each transaction must be accounted for separately using the date each transaction was conducted.

The changes may be adopted on a retrospective basis, namely prospectively to all relevant assets, expenses and income that are initially recognised on or after the beginning of the reporting period in which the entity applies the interpretation. Likewise, the alteration may come into effect at the beginning of a prior reporting period and presented as comparative information in the financial statements of the reporting period in which the entity first applies the reforms.



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