

PJSC “FGC UES”

CONSOLIDATED FINANCIAL STATEMENTS

PREPARED IN ACCORDANCE WITH

INTERNATIONAL FINANCIAL REPORTING STANDARDS AS ADOPTED BY THE EU

FOR THE YEAR ENDED 31 DECEMBER 2016

AND INDEPENDENT AUDITORS’ REPORT

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JSC "KPMG"
10 Presnenskaya Naberezhnaya
Moscow, Russia 123112
Telephone +7 (495) 937 4477
Fax +7 (495) 937 4400/99
Internet www.kpmg.ru

Independent Auditors' Report

To the Shareholders and the Board of Directors of the Public Joint-Stock Company "Federal Grid Company of Unified Energy System".

Opinion

We have audited the consolidated financial statements of PJSC "FGC UES" (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

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 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU.

Basis for Opinion

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

Audited entity: PJSC "Federal Grid Company of Unified Energy System"
Registration No. in the Unified State Register of Legal Entities
1024701893336, Certificate series 47 No. 000872082.

Moscow, Russia

Independent auditor: JSC "KPMG", a company incorporated under the Laws of the Russian Federation, a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Registration No. in the Unified State Register of Legal Entities 1027700125628.

Member of the Self-regulated organization of auditors "Russian Union of auditors" (Association). The Principal Registration Number of the Entry in the Register of Auditors and Audit Organisations: No. 11603053203.



Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Revaluation of property, plant and equipment	
Please refer to Note 6 in the consolidated financial statements.	
The key audit matter	How the matter was addressed in our audit
<p>The Group uses revaluation model for accounting for property, plant and equipment.</p> <p>As at 31 December 2016 the Group performed revaluation of its property, plant and equipment. The fair value of property, plant and equipment was primarily determined using depreciated replacement cost.</p> <p>The management engaged an independent appraiser to determine the depreciated replacement cost.</p> <p>This cost was then adjusted for physical, functional or economical depreciation and obsolescence using discounted cash flow model.</p> <p>This model uses several key assumptions, including estimates of future sales volumes and tariffs, operating costs, terminal value growth rates and the weighted-average cost of capital (discount rate).</p> <p>The revaluation process requires using significant judgment in determining those assumptions and hence, is a key audit matters that our audit was concentrated on.</p>	<p>We involved our own valuation specialists to assist us in evaluating the assumptions and methodologies used by the Group to determine the depreciated replacement cost. Since the determination of the depreciated replacement cost was based on previous revaluation results, the procedures included the following:</p> <ul style="list-style-type: none"> - evaluating the correctness of depreciated replacement cost by comparing, amongst other things, the indexes applied and useful lives with the available market information and our own knowledge of the client and the industry. <p>The procedures in relation to the discounted cash flows have been performed by involving our own valuation specialists and included the following:</p> <ul style="list-style-type: none"> - evaluating the appropriateness of the discount rate applied, which included comparing the weighted average cost of capital with sector averages for the relevant markets in which the Group operates; - evaluating the appropriateness of the assumptions applied to key inputs such as sales volumes and tariffs, operating costs, inflation and long-term growth rates, which included comparing these inputs with externally derived data as well as our own assessments based on our knowledge of the client and the industry; - performing our own sensitivity analysis which included assessing the effect of reasonably possible changes in discount rate, terminal growth rate and revenue to



The key audit matter	How the matter was addressed in our audit
	<p>evaluate the impact on the recoverable amount of property, plant and equipment, and comparing the disclosures given in note 6 to our calculations.</p> <p>We evaluated the adequacy of the financial statement disclosures, including disclosures of key assumptions, judgments and sensitivities.</p> <p>We recalculated the allocation of the revaluation effects to individual items of property, plant and equipment. We also recalculated the allocation of revaluation results between other comprehensive income and profit or loss.</p>

Control over Nurenergo	
Please refer to Note 2 and Note 30 in the consolidated financial statements.	
The key audit matter	How the matter was addressed in our audit
<p>In June 2016 the Group's subsidiary JCS Nurenergo was declared bankrupt by the court ruling, and an external bankruptcy manager was appointed.</p> <p>In January 2017 the court ruling declaring Nurenergo bankrupt and appointing external bankruptcy manager was overturned by the Cassation Court ruling and the case was sent to the Court of First Instance for re-trial.</p> <p>Given the significant judgment involved in assessment of control over subsidiary and uncertainty regarding the further legal proceedings, we have considered this issue to be a key audit matter.</p>	<p>We involved our legal specialists to assess the management analysis and to perform our own analysis of court decisions, and considered other facts and circumstances to determine whether the control over subsidiary existed as at the reporting date.</p> <p>We analyzed events after the reporting date to determine whether the Cassation Court ruling should be considered as adjusting event.</p>

Other Information

Management is responsible for the other information. The other information comprises the Annual report but does not include the consolidated financial statements and our auditors' report thereon. The Annual report is expected to be made available to us after the date of this auditors' 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.

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

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material



uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and 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. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is:

L.R. Kisseleva
JSC "KPMG"
Moscow, Russia
21 March 2017



PJSC “FGC UES”

Consolidated Statement of Financial Position


(in millions of Russian Rouble unless otherwise stated)

	Notes	31 December 2016	31 December 2015
ASSETS			
Non-current assets			
Property, plant and equipment	6	846,695	821,114
Intangible assets	7	7,320	7,752
Investments in associates and joint ventures	8	1,160	1,691
Available-for-sale investments	9	76,537	22,271
Deferred income tax assets	16	14	260
Long-term accounts receivable	10	45,145	15,180
Other non-current assets	10	1,853	1,799
Total non-current assets		978,724	870,067
Current assets			
Cash and cash equivalents	11	44,404	28,176
Bank deposits	12	450	30,269
Accounts receivable and prepayments	13	58,187	50,043
Income tax prepayments		305	432
Inventories	14	14,900	16,063
Other current assets		140	278
Total current assets		118,386	125,261
TOTAL ASSETS		1,097,110	995,328
EQUITY AND LIABILITIES			
Equity			
Share capital: Ordinary shares	15	637,333	637,333
Treasury shares	15	(4,719)	(4,719)
Share premium		10,501	10,501
Reserves	15	281,759	229,578
Accumulated deficit		(198,273)	(252,980)
Equity attributable to shareholders of FGC UES		726,601	619,713
Non-controlling interest		1,816	(75)
Total equity		728,417	619,638
Non-current liabilities			
Deferred income tax liabilities	16	25,433	14,589
Non-current debt	17	236,954	250,076
Deferred income		919	1,105
Retirement benefit obligations	18	5,959	7,357
Total non-current liabilities		269,265	273,127
Current liabilities			
Accounts payable to shareholders of FGC UES		73	6
Current debt and current portion of non-current debt	17,19	29,660	31,466
Accounts payable and accrued charges	20	62,059	71,036
Income tax payable		7,636	55
Total current liabilities		99,428	102,563
Total liabilities		368,693	375,690
TOTAL EQUITY AND LIABILITIES		1,097,110	995,328

Authorised for issue and signed on behalf of the Management Board:

21 March 2017

Chairman of the Management Board

 A.E. Murov

Head of Accounting and Financial Reporting – Chief Accountant

 A.P. Noskov

The accompanying notes are an integral part of these Consolidated Financial Statements

PJSC “FGC UES”

Consolidated Statement of Profit or Loss and Other Comprehensive Income (in millions of Russian Rouble unless otherwise stated)

	Notes	Year ended 31 December 2016	Year ended 31 December 2015
Revenues	21	255,603	187,041
Other operating income	21	6,039	4,001
Operating expenses	22	(155,508)	(130,963)
Gain on derecognition of subsidiary	30	11,868	-
Impairment and revaluation loss on property, plant and equipment, net	6	(38,155)	(2,850)
Operating profit		79,847	57,229
Finance income	23	6,974	8,701
Finance costs	24	(8,010)	(9,635)
Share of loss of associates and joint ventures	8	(327)	(8)
Profit before income tax		78,484	56,287
Income tax expense	16	(10,102)	(12,189)
Profit for the period		68,382	44,098
Other comprehensive income / (loss)			
<i>Items that will not be reclassified subsequently to profit or loss</i>			
Change in revaluation reserve for property, plant and equipment	6	14,280	117
Remeasurements of retirement benefit obligations	18	1,500	(3,005)
Income tax relating to items that will not be reclassified	16	(2,948)	570
Total items that will not be reclassified to profit or loss		12,832	(2,318)
<i>Items that are or may be reclassified subsequently to profit or loss</i>			
Change in fair value of available-for-sale investments	9	54,266	7,776
Foreign currency translation difference	8	(204)	(152)
Income tax relating to items that may be reclassified	16	(10,853)	(1,556)
Total items that are or may be reclassified to profit or loss		43,209	6,068
Other comprehensive income for the period, net of income tax		56,041	3,750
Total comprehensive income for the period		124,423	47,848
Profit / (loss) attributable to:			
Shareholders of FGC UES	25	68,159	44,768
Non-controlling interest		223	(670)
Total comprehensive income / (loss) attributable to:			
Shareholders of FGC UES		123,705	48,499
Non-controlling interest		718	(651)
Earnings per ordinary share for profit attributable to shareholders of FGC UES – basic and diluted (in Russian Rouble)	25	0.054	0.036

The accompanying notes are an integral part of these Consolidated Financial Statements

PJSC “FGC UES”

Consolidated Statement of Cash Flows

(in millions of Russian Rouble unless otherwise stated)

	Notes	Year ended 31 December 2016	Year ended 31 December 2015
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income tax		78,484	56,287
<i>Adjustments to reconcile profit before income tax to net cash provided by operations</i>			
Depreciation of property, plant and equipment	22	39,397	39,447
(Gain) / loss on disposal of property, plant and equipment	22	(72)	3,699
Amortisation of intangible assets	22	1,330	1,481
Impairment and revaluation loss of property, plant and equipment, net	6	38,155	2,850
Gain on derecognition of subsidiary	30	(11,868)	-
Share of result of associates	8	327	8
Accrual of allowance for doubtful debtors	22	2,666	7,063
Accrual of other provision for liabilities and charges	20	2,502	434
Finance income	23	(6,974)	(8,701)
Finance costs	24	8,010	9,635
Other non-cash operating income		(39)	(74)
Operating cash flows before working capital changes and income tax paid		151,918	112,129
<i>Working capital changes:</i>			
Increase in accounts receivable and prepayments		(43,273)	(12,824)
Decrease / (increase) in inventories		1,144	(5,607)
(Increase) / decrease in other non-current assets		(69)	387
Increase in accounts payable and accrued charges		7,375	5,865
Decrease in retirement benefit obligations		(511)	(2,833)
Income tax (paid) / received		(5,108)	906
Net cash generated by operating activities		111,476	98,023
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, plant and equipment		(78,872)	(75,604)
Proceeds from disposal of property, plant and equipment		4,864	1,980
Purchase of intangible assets		(898)	(948)
Redemption of promissory notes		206	667
Investment in bank deposits		(5,257)	(30,422)
Redemption of bank deposits		35,085	337
Dividends received		353	21
Loans given		(18)	(1,000)
Purchase of subsidiary		(4)	(293)
Sale of subsidiary		14	568
Interest received		6,569	7,452
Net cash used in investing activities		(37,958)	(97,242)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from non-current borrowings		10,165	40,099
Proceeds from current borrowings		350	-
Repayment of current and non-current borrowings		(23,172)	(23,210)
Repayment of lease		(150)	(150)
Dividends paid		(16,751)	(840)
Interest paid		(27,732)	(30,572)
Net cash used in financing activities		(57,290)	(14,673)
Net increase / (decrease) in cash and cash equivalents		16,228	(13,892)
Cash and cash equivalents at the beginning of the period	11	28,176	42,068
Cash and cash equivalents at the end of the period	11	44,404	28,176

The accompanying notes on are an integral part of these Consolidated Financial Statements

PJSC “FGC UES”

Consolidated Statement of Changes in Equity (in millions of Russian Rouble unless otherwise stated)

	Notes	Attributable to shareholders of FGC UES					Total	Non-controlling interest	Total equity
		Share capital	Share premium	Treasury shares	Reserves	Accumulated deficit			
As at 1 January 2016		637,333	10,501	(4,719)	229,578	(252,980)	619,713	(75)	619,638
Total comprehensive income for the period									
Profit for the period		-	-	-	-	68,159	68,159	223	68,382
<i>Other comprehensive income / (loss), net of related income tax</i>									
Derecognition of revaluation reserve on disposed property, plant and equipment	15	-	-	-	(3,365)	3,365	-	-	-
Change in revaluation reserve for property, plant and equipment	6, 15	-	-	-	10,929	-	10,929	495	11,424
Change in fair value of available-for-sale investments	9, 15	-	-	-	43,413	-	43,413	-	43,413
Remeasurements of retirement benefit obligations	15, 18	-	-	-	1,408	-	1,408	-	1,408
Foreign currency translation difference	8, 15	-	-	-	(204)	-	(204)	-	(204)
Total other comprehensive income		-	-	-	52,181	3,365	55,546	495	56,041
Total comprehensive income for the period		-	-	-	52,181	71,524	123,705	718	124,423
Transactions with shareholders of FGC UES recorded directly in equity									
Dividends declared		-	-	-	-	(16,817)	(16,817)	(1)	(16,818)
Total transactions with shareholders of FGC UES		-	-	-	-	(16,817)	(16,817)	(1)	(16,818)
Changes in ownership									
Derecognition of subsidiary		-	-	-	-	-	-	1,174	1,174
Total changes in ownership		-	-	-	-	-	-	1,174	1,174
As at 31 December 2016		637,333	10,501	(4,719)	281,759	(198,273)	726,601	1,816	728,417

The accompanying notes on are an integral part of these Consolidated Financial Statements

PJSC “FGC UES”

Consolidated Statement of Changes in Equity (in millions of Russian Rouble unless otherwise stated)

	Notes	Attributable to shareholders of FGC UES					Total	Non-controlling interest	Total equity
		Share capital	Share premium	Treasury shares	Reserves	Accumulated deficit			
As at 1 January 2015		637,333	10,501	(4,719)	226,382	(297,237)	572,260	971	573,231
Total comprehensive income for the period									
Profit for the period		-	-	-	-	44,768	44,768	(670)	44,098
<i>Other comprehensive income / (loss), net of related income tax</i>									
Change in revaluation reserve for property, plant and equipment	15	-	-	-	75		75	19	94
Change in fair value of available-for-sale investments	9, 15	-	-	-	6,221	-	6,221	-	6,221
Remeasurements of retirement benefit obligations	15, 18	-	-	-	(2,413)	-	(2,413)	-	(2,413)
Foreign currency translation difference	8, 15	-	-	-	(152)	-	(152)	-	(152)
Total other comprehensive income		-	-	-	3,731	-	3,731	19	3,750
Total comprehensive income for the period		-	-	-	3,731	44,768	48,499	(651)	47,848
Transactions with shareholders of FGC UES recorded directly in equity									
Dividends declared		-	-	-	-	(832)	(832)	(1)	(833)
Total transactions with shareholders of FGC UES		-	-	-	-	(832)	(832)	(1)	(833)
Changes in ownership									
Acquisition of subsidiary		-	-	-	-	(214)	(214)	58	(156)
Disposal of subsidiary		-	-	-	(535)	535	-	(452)	(452)
Total changes in ownership		-	-	-	(535)	321	(214)	(394)	(608)
As at 31 December 2015		637,333	10,501	(4,719)	229,578	(252,980)	619,713	(75)	619,638

The accompanying notes on are an integral part of these Consolidated Financial Statements

PJSC “FGC UES”

Notes to the Consolidated Financial Statements

(in millions of Russian Rouble unless otherwise stated)

Note 1. PJSC “FGC UES” and its operations

Public Joint-Stock Company “Federal Grid Company of Unified Energy System” (“FGC UES” or the “Company”) was established in June 2002 for the purpose of operating and managing the electricity transmission grid infrastructure of the Russian Unified National Electric Grid (the “UNEG”).

FGC UES and its subsidiaries (the “Group”) act as the natural monopoly operator for the UNEG. The Group’s principal operating activities consist of providing electricity transmission services, providing connection to the electricity grid, maintaining the electricity grid system, technical supervision of grid facilities and investment activities in the development of the UNEG. The majority of the Group’s revenues are generated via tariffs for electricity transmission, which are approved by the Russian Federal Antimonopoly Service (the “FAS” – legal successor of the Federal Tariff Service, abolished on 21 July 2015) based on the Regulatory Asset Base (“RAB”) regulation. FGC UES’s main customers are distribution grid companies (“IDGCs”), certain large commercial end customers and retail electricity supply companies.

On 14 June 2013 the Government of the Russian Federation (the “RF”) transferred its stake in FGC UES to PJSC “Russian Grids” (former OJSC “IDGC Holding”), the holding company of an electricity distribution group, controlled by the Government of the RF. As at 31 December 2016, FGC UES was 80.13% owned and controlled by PJSC “Russian Grids”. The remaining shares are traded on Moscow Interbank Currency Exchange and as Global Depository Receipts on the London Stock Exchange.

The registered office of the Company is located at 5A Akademika Chelomeya Street, Moscow 117630, Russian Federation.

Relationships with the state. The Government of the RF is the ultimate controlling party of FGC UES. The Government directly affects the Group’s operations via regulation over tariff by the FAS and its investment program is subject to approval by both the FAS and the Ministry of Energy. Ultimately the Government supports the Group due to its strategic position in the Russian Federation. The Government’s economic, social and other policies could have a material impact on the Group’s operations.

Business environment. The Group’s operations are primarily located in the Russian Federation. Consequently, the Group is exposed to the economic and financial markets of the Russian Federation which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in the Russian Federation. (Note 26).

The conflict in Ukraine and related events has increased the perceived risks of doing business in the Russian Federation. The imposition of economic sanctions on Russian individuals and legal entities by the European Union, the United States of America, Japan, Canada, Australia and others, as well as retaliatory sanctions imposed by the Russian government, has resulted in increased economic uncertainty including more volatile equity markets, a depreciation of the Russian Ruble, a reduction in both local and foreign direct investment inflows and a significant tightening in the availability of credit. In particular, some Russian entities may be experiencing difficulties in accessing international equity and debt markets and may become increasingly dependent on Russian state banks to finance their operations. The longer term effects of recently implemented sanctions, as well as the threat of additional future sanctions, are difficult to determine.

The consolidated financial statements (“Consolidated Financial Statements”) reflect management’s assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management’s assessment.

Note 2. Basis of preparation

Statement of compliance. These Consolidated Financial Statements have been prepared in accordance with, and comply with, International Financial Reporting Standards (“IFRS”) and its interpretations as adopted by the European Union (the “EU”).

Each enterprise of the Group individually maintains its own books of accounts and prepares its statutory financial statements in accordance with the Regulations on Accounting and Reporting of the RF (“RAR”). The accompanying Consolidated Financial Statements are based on the statutory records and adjusted and reclassified for the purpose of fair presentation in accordance with IFRS.

Functional and presentation currency. The Russian Rouble (“RR”) is functional currency for FGC UES and the currency in which these Consolidated Financial Statements are presented. All financial information presented in RR have been rounded to the nearest million, unless otherwise stated.

New accounting developments not yet adopted. A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2016 and have not been applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group’s operations. The Group plans to adopt these pronouncements when they become effective.

PJSC “FGC UES”

Notes to the Consolidated Financial Statements

(in millions of Russian Rouble unless otherwise stated)

Note 2. Basis of preparation (continued)

New or amended standard	Summary of the requirements	Possible impact on consolidated financial statements
IFRS 9 <i>Financial Instruments</i>	In July 2014, the International Accounting Standards Board issued the final version of IFRS 9 <i>Financial Instruments</i> . IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted	The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 9.
IFRS 15 <i>Revenue from Contracts with Customers</i>	IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 <i>Revenue</i> , IAS 11 <i>Construction Contracts</i> and IFRIC 13 <i>Customer Loyalty Programmes</i> . IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted	The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 15.
IFRS 16 <i>Leases</i>	IFRS 16 introduces a single, on-balance lease sheet accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases. IFRS 16 replaces existing leases guidance including IAS 17 <i>Leases</i> , IFRIC 4 <i>Determining whether an Arrangement contains a Lease</i> , SIC-15 <i>Operating Leases—Incentives</i> and SIC-27 <i>Evaluating the Substance of Transactions Involving the Legal Form of a Lease</i> . The standard is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted for entities that apply IFRS 15 <i>Revenue from Contracts with Customers</i> at or before the date of initial application of IFRS 16.	The Group is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 16

The following new or amended standards are not expected to have a significant impact of the Group’s consolidated financial statements.

- *Disclosure Initiative (Amendments to IAS 7)*.
- *Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)*.
- *Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)*.
- *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)*.

Critical accounting estimates and assumptions Management makes a number of estimates and assumptions that are continually evaluated and may differ from the related actual results. The estimates and assumptions that have the most significant effect on the amounts recognised in these Consolidated Financial Statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Carrying value of property, plant and equipment (Note 6). The Group uses the revaluation model for property, plant and equipment. The last external valuation was performed as at 31 December 2016.

Carrying value of investment in PJSC “INTER RAO UES” (Note 9). As at 31 December 2016 the Group owns 18.57% of the voting shares of PJSC “INTER RAO UES” (“INTER RAO”). Management has assessed the level of influence that the Group has on INTER RAO, taking into account its limitation to obtain any additional financial information which may be an indicator of such influence, and determined that it does not have significant influence. Consequently, this investment is classified as available-for-sale investment.

PJSC “FGC UES”

Notes to the Consolidated Financial Statements

(in millions of Russian Rouble unless otherwise stated)

Note 2. Basis of preparation (continued)

Loss of control over OJSC “Nurenergo” (Note 30). On 29 June 2016 the Commercial Court of the Republic of Chechnya declared OJSC “Nurenergo”, the subsidiary of FGC UES, bankrupt and appointed an external bankruptcy manager. In accordance with Russian legislation on insolvency (bankruptcy), since the date a debtor is declared bankrupt, the power of all executive bodies of a debtor is terminated and transferred to a bankruptcy manager. Due to this fact FGC UES lost the right to direct relevant activities of the subsidiary and, therefore, lost control over the entity. As a result the Group derecognized the assets and liabilities of the OJSC “Nurenergo” as at 30 June 2016 and recognised gain amounted to RR 11,868 million in statement of profit and loss and other comprehensive income.

On 27 of January 2017, the North-Caucasian District State Commercial Court (the Court of Cassation) overturned the Court Ruling and sent the case to the Court of First Instance for re-trial. As at 31 December 2016 the Group analysed all the facts and conditions and concluded that the control over the subsidiary was not regained.

Tax contingencies. Russian tax legislation is subject to varying interpretations and changes, which can occur frequently. Where the Group management believes it is probable that their interpretation of the relevant legislation and the Group’s tax positions cannot be sustained, an appropriate amount is accrued in the consolidated financial statements. The possible tax claims in respect of certain open tax positions of the Group companies are disclosed in Note 26.

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

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

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

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

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

- Note 6 – Property, plant and equipment;
- Note 10 – Long-term receivables and other non-current assets;
- Note 17 – Non-current debt;
- Note 27 – Financial instruments and financial risks.

PJSC “FGC UES”

Notes to the Consolidated Financial Statements

(in millions of Russian Rouble unless otherwise stated)

Note 3. Summary of significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements, and have been applied consistently by Group entities.

Certain comparative amounts have been reclassified to conform with the current year’s presentation.

Principles of consolidation. Subsidiaries are entities (including special purpose entities) controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group. Losses applicable to the non-controlling interests in a subsidiary are allocated to the non-controlling interests even if doing so causes the non-controlling interests to have a deficit balance.

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated.

Purchases of subsidiaries from parties under common control. Purchases of subsidiaries from parties under common control are accounted for using the predecessor values method. Under this method the consolidated financial statements of the combined entity are presented as if the businesses had been combined prospectively from the date on which business combination between entities under common control occurred. The assets and liabilities of the subsidiary transferred under common control are at the predecessor entity’s carrying amounts. The predecessor entity is considered to be the highest reporting entity in which the subsidiary’s IFRS financial information was consolidated. Related goodwill inherent in the predecessor entity’s original acquisitions is also recorded in the consolidated financial statements. Any consideration for the acquisition is accounted for in the consolidated financial statements as an adjustment to retained earnings within equity.

Associates and joint ventures. Associates and joint ventures are entities over which the Company has significant influence (directly or indirectly), but not control, generally accompanying a shareholding of between 20 and 50 percent of the voting rights. Investments in associates and joint ventures are accounted for using the equity method of accounting and are initially recognised at cost. The carrying amount of associates and joint ventures includes goodwill identified on acquisition and is reduced by accumulated impairment losses, if any. The Group discontinues the use of the equity method of accounting from the date when it ceases to have significant influence in the associate.

The Group’s share of the post-acquisition profits or losses of associates and joint ventures is recorded in profit or loss, and its share of other comprehensive income of associates and joint ventures is recognised in the Group’s other comprehensive income. When the Group’s share of losses in an associate and joint ventures equals or exceeds its interest in the associate and joint ventures, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associates and joint ventures.

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

Classification of financial assets. The Group holds financial assets of the following measurement categories: loans and receivables and available-for-sale financial assets.

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Group intends to sell in the near term.

All other financial assets are included in the available-for-sale category, which includes investment securities which the Group intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Classification of financial liabilities. The Group classifies non-derivative financial liabilities into the other financial liabilities category. These financial liabilities are carried at amortised cost using the effective interest method. Other financial liabilities comprise loans and borrowings, bank overdrafts, and trade and other payables.

PJSC “FGC UES”

Notes to the Consolidated Financial Statements

(in millions of Russian Rouble unless otherwise stated)

Note 3. Summary of significant accounting policies (continued)

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

Derecognition of financial assets. The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

Available-for-sale investments. The Group classifies investments as available-for-sale at the time of purchase. Available-for-sale investments are carried at fair value. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Group’s right to receive payment is established and it is probable that the dividends will be collected. All other elements of changes in the fair value are recognised in other comprehensive income until the investment is derecognised or impaired at which time the cumulative gain or loss is reclassified from other comprehensive income to profit or loss for the period.

Impairment losses are recognised in profit or loss when incurred as a result of one or more events (“loss events”) that occurred after the initial recognition of available-for-sale investments.

Any change in fair value of equity instruments is initially accumulated in other comprehensive income. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. If asset is considered to be impaired at the reporting date, the cumulative impairment loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in profit or loss) is removed from other comprehensive income and recognised in profit or loss. Impairment losses on equity instruments are not reversed through profit or loss.

Foreign currency. Monetary assets and liabilities, which are held by the Group entities and denominated in foreign currencies at the end of the reporting period, are translated into Russian Roubles at the official exchange rates prevailing at that date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss.

As at 31 December 2016, the official rate of exchange as determined by the Central Bank of the Russian Federation, between the Russian Rouble and the US Dollar was RR 60.66:US Dollar 1.00 (31 December 2015: RR 72.88:US Dollar 1.00); between the Russian Rouble and Euro: RR 63.81:Euro 1.00 (31 December 2015: RR 79.70:Euro 1.00).

Property, plant and equipment. Property, plant and equipment are stated at revalued amounts less any subsequent accumulated depreciation and any subsequent accumulated impairment losses, where required.

Property, plant and equipment are subject to revaluation on a regular basis to ensure that the carrying amount does not differ materially from that which is determined using the fair value at the end of the reporting period. The frequency of revaluation depends upon the movements in the fair values of the assets being revalued. Increases in the carrying amount arising on revaluation of property, plant and equipment are credited to other comprehensive income and increase the revaluation reserve in equity; the increase is recognised in current period profits to the extent that it reverses previously recognised impairment loss of the same assets.

Decreases that offset previous increases of the same asset are recognised in other comprehensive income and decrease the previously recognised revaluation reserve in equity; all other decreases are recognised in profit or loss for the period. Any accumulated depreciation at the date of revaluation is eliminated against the gross amount of the assets, and the net amount is restated to the revalued amount of the asset.

The revaluation reserve in respect of an item of property, plant and equipment is transferred directly to retained earnings when the item is derecognised (on the retirement or disposal of the asset).

Renewals and improvements are capitalised and the assets replaced are retired. The cost of minor repair and maintenance are expensed as incurred. Gains and losses arising from the retirement of property, plant and equipment are included in profit or loss as incurred.

PJSC “FGC UES”

Notes to the Consolidated Financial Statements

(in millions of Russian Rouble unless otherwise stated)

Note 3. Summary of significant accounting policies (continued)

Depreciation on property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the asset when it is available for use. The useful lives are reviewed at each financial year end and, if expectations differ from previous estimates, the changes are recognised prospectively.

The useful lives, in years, of assets by type of facility are as follows:

	Useful lives
Buildings	50-80
Electric power transmission grids	20-50
Substations	15-30
Other	5-50

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

Intangible assets. All of the Group's intangible assets have definite useful lives and primarily include capitalised computer software and licences.

Acquired computer software and licences are capitalised on the basis of the costs incurred to acquire and bring them to use. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits, are recognised as intangible assets. After initial recognition, intangible assets are carried at cost less accumulated amortisation and any accumulated impairment losses. Amortisation of intangible assets is calculated on a straight-line basis over the useful lives.

At each reporting date the management assesses whether there is any indication of impairment of intangible assets. If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less cost to sell.

Research costs are recognised as an expense as incurred. Costs incurred on development projects are recognised as intangible assets only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete and the ability to measure reliably the expenditure incurred during the development. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. The carrying value of development costs is reviewed for impairment annually.

Cash and cash equivalents. Cash comprises cash in hand and cash deposited on demand at banks. Cash equivalents comprise short-term highly liquid investments that are readily convertible into cash and have a maturity of three months or less from the date of origination and are subject to insignificant changes in value. Cash and cash equivalents are carried at amortised cost using the effective interest method.

Bank deposits. Bank deposits comprise cash deposited at banks with a maturity date of more than three months from the acquisition date. Bank deposits are carried at amortised cost using the effective interest method.

Promissory notes. Promissory notes are financial assets with fixed or determinable cash flows recognised initially at fair value and subsequently carried at amortised cost using the effective interest method.

Trade and other receivables. Trade and other receivables are recorded inclusive of value added tax (VAT). Trade and other receivables are initially recognised at fair value and subsequently carried at amortised cost using the effective interest method.

Impairment of financial assets carried at amortised cost. Impairment losses are recognised in profit or loss when incurred as a result of one or more events (“loss events”) that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. The primary factors that the Group considers in determining whether a financial asset is impaired are its overdue status and realisability of related collateral, if any.

Note 3. Summary of significant accounting policies (continued)

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the counterparty, impairment is measured using the original effective interest rate before the modification of terms.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

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

Prepayments. Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss.

Inventories. Inventories mostly include repair materials and spare parts for transmission assets. Inventories are valued at the lower of cost and net realisable value. Cost of inventory is determined on the weighted average basis. Net realisable value is the estimated selling price in the ordinary course of business, less selling expenses.

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

Income taxes. Income taxes have been provided for in these Consolidated Financial Statements in accordance with Russian legislation enacted or substantively enacted by the end of the reporting period. The income tax charge comprises current tax and deferred tax and is recognised in the profit or loss unless it relates to transactions that are recognised, in the same or a different period, in other comprehensive income.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits/losses for the current and prior periods. Taxes other than on income are recorded as operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit.

Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

Deferred income tax is provided on post-acquisition retained earnings and other post acquisition movements in reserves of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

Note 3. Summary of significant accounting policies (continued)

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

Trade accounts payable and accrued charges. Trade accounts payable are stated inclusive of value added tax. Trade payables are accrued when the counterparty performed its obligations under the contract. Accounts payable are initially recognised at fair value and subsequently carried at amortised cost using the effective interest method.

Advances received. Advances received are primarily a deferred income for the future connection services and are stated at nominal amount.

Debt. Debt is recognised initially at its fair value plus transaction costs that are directly attributable to its issue. Fair value is determined using the prevailing market rates of interest for similar instruments, if significantly different from the transaction price. In subsequent periods, debt is stated at amortised cost using the effective interest method; any difference between the fair value of the proceeds (net of transaction costs) and the redemption amount is recognised in profit or loss as an interest expense over the period of the debt obligation.

Borrowing costs are expensed in the period in which they are incurred if not related to purchase or construction of qualifying assets. Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets. The commencement date for capitalisation is when the Group (a) incurs expenditures for the qualifying asset; (b) incurs borrowing costs; and (c) undertakes activities that are necessary to prepare the asset for its intended use or sale. Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale. The Group capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Group's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred less any investment income on the temporary investment of those borrowings are capitalised.

Pension and post-employment benefits. In the normal course of business the Group makes mandatory social security contributions to the Pension Fund of the RF on behalf of its employees. These contributions are expensed when incurred and included in employee benefit expenses and payroll taxes in profit or loss.

In addition, the Group maintains a number of post-employment and other long-term benefit plans which are defined benefit in nature. These plans include life pension, lump sum upon retirement, financial support after retirement, jubilee and death benefits and cover majority of the Group's employees. Under the pension plan amount of pension benefits that an employee will receive after retirement depends on his date of birth, number of years of service, position, salary and presence of awards. The Group settles its liability to provide life pension through a non-state pension fund. However, the assets held in the non-state pension fund do not meet definition of plan assets in accordance with IAS 19(2011). These assets are accounted for as other non-current assets. Other benefits, apart from life pension payable via the non-state pension fund, are provided when they are due directly by the Group.

The liability recognised in the consolidated statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds that have terms to maturity approximating the terms of the related pension liabilities.

PJSC “FGC UES”

Notes to the Consolidated Financial Statements

(in millions of Russian Rouble unless otherwise stated)

Note 3. Summary of significant accounting policies (continued)

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past-service costs are recognised immediately in profit or loss.

Operating leases. Where the Group is a lessee in a lease which does not transfer substantially all the risk and rewards incidental to ownership from the lessor to the Group, the total lease payments, including those on expected termination, are charged to profit or loss on a straight-line basis over the period of the lease.

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

Treasury shares. Treasury shares are stated at weighted average cost. Any gains or losses arising on the disposal of treasury shares are recorded directly in shareholders' equity.

Dividends. Dividends are recognised as a liability and deducted from equity at the end of the reporting period only if they are declared (approved by shareholders) before or on the end of the reporting period. Dividends are disclosed when they are declared after the end of the reporting period, but before the consolidated financial statements are authorised for issue.

Non-controlling interest. Non-controlling interest represents minority's proportionate share of the equity and comprehensive income of the Group's subsidiaries. This has been calculated based upon the non-controlling interests' ownership percentage of these subsidiaries. Specific rights on liquidation for preference shareholders of subsidiaries are included in the calculation of non-controlling interests. The Group uses the 'economic entity' approach to the recognition of non-controlling interest. Any gains or losses resulting from the purchases and sales of the non-controlling interests are recognised in the consolidated statement of changes in equity.

Revenue recognition. Revenue amounts are presented exclusive of value added tax. Revenue from rendering the electricity transmission services is recognised in the period when the services are provided. Revenue from sales of electricity is recognised on the delivery of electricity. Revenue from connection services represents a non-refundable fee for connecting the customer to the electricity grid network and is recognised when the customer is connected to the grid network and the amount of remuneration can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable.

Revenue from construction services are recognised in the accounting period in which the services are rendered, by reference to stage of completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Government grants. Government grants are recognised initially as deferred income at fair value when there is reasonable assurance that they will be received and that the Group will comply with the conditions associated with the grant and are then recognised in profit or loss as other income on a systematic basis over the useful life of the asset. Grants that compensate the Group for expenses incurred are recognised in profit or loss as other income on a systematic basis in the same periods in which the expenses are recognised.

Share capital. Ordinary shares with discretionary dividends are classified as equity upon completion of share issue and registration of the issue in the Federal Financial Markets Service. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

Earnings per share. Earnings per share are determined by dividing the profit or loss attributable to owners of the Company by the weighted average number of participating shares outstanding during the reporting period.

PJSC “FGC UES”

Notes to the Consolidated Financial Statements

(in millions of Russian Rouble unless otherwise stated)

Note 4. Principal subsidiaries

All subsidiaries are incorporated and operate in the Russian Federation.

The principal subsidiaries as at 31 December 2016 and 31 December 2015 are presented below:

Name	31 December 2016		31 December 2015	
	Ownership, %	Voting, %	Ownership, %	Voting, %
<i>Transmission companies:</i>				
OJSC “The Kuban trunk grids”	49.0	49.0	49.0	49.0
OJSC “The Tomsk trunk grids”	52.0	59.9	52.0	59.9
<i>Other companies</i>				
JSC “Mobile gas-turbine electricity plants”	100.0	100.0	100.0	100.0
JSC “Research and development centre of FGC UES”	100.0	100.0	100.0	100.0
JSC “Dalenergosetproject”	100.0	100.0	100.0	100.0
JSC “Specialised electricity transmission service company of the UNEG”	100.0	100.0	100.0	100.0
JSC “Engineering and construction management centre of Unified Energy System”	100.0	100.0	100.0	100.0
LLC “Index energetiki – FGC UES”	100.0	100.0	100.0	100.0

Transmission companies. OJSC “The Kuban trunk grids” and OJSC “The Tomsk trunk grids” own the UNEG assets which are maintained and operated by the Company.

The Group holds 49% of the voting rights in OJSC “The Kuban trunk grids”, a fully consolidated subsidiary. The Group controls this entity as it has the power to govern the financial and operating policies of this subsidiary on the basis of a significant shareholding combined with other factors which allow the Group to exercise control, most importantly: FGC UES has appointed the majority or of the members of the Board of Directors, FGC UES is the dominant owner and FGC UES has in substance full control of all aspects of the entity’s assets and operations.

JSC “Mobile gas-turbine electricity plants”. The primary activity of the company is generating and sale of electricity provided by mobile gas-turbine electricity plants used in power deficient points of the power system or in peak periods as temporary source of additional capacity.

JSC “Research and development centre of FGC UES” is a research and development project institution in the sphere of electric power.

JSC “Dalenergosetproject” is a grid engineering company.

JSC “Specialised electricity transmission service company of the UNEG”. The main activities of this company are technical inspection, maintenance and regular and emergency repairs of power grids and other electric power facilities of the UNEG.

JSC “Engineering and construction management centre of Unified Energy System”. The main activity of this company is functioning as a customer-developer in capital construction projects associated with the reconstruction and technical modernisation of electricity supply facilities and infrastructure.

LLC “Index energetiki – FGC UES” (“Index Energetiki”) owns minority shares in PJSC “INTER RAO UES” and PJSC “Russian Grids” (former OJSC “IDGC Holding”).

Note 5. Balances and transactions with related parties

Government-related entities. In the normal course of business the Group enters into transactions with government-related entities – entities, controlled, jointly controlled or significantly influenced by the Government of the RF. Large portion of the Group's primary activity – transmission services are rendered to government-related entities at the regulated tariffs. The Group borrows funds from government-related banks at the prevailing market rates. Taxes are accrued and settled in accordance with Russian tax legislation.

PJSC “FGC UES”

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Note 5. Balances and transactions with related parties (continued)

During the years ended 31 December 2016 and 31 December 2015 the Group had the following significant transactions with government-related entities:

	Year ended 31 December 2016	Year ended 31 December 2015
Transmission revenue	145,518	135,244
Electricity sales	17,940	3,066
Construction services	15,573	6,483
Connection services	36,137	12,046
Purchased electricity for production needs	(8,176)	(7,971)

Significant balances with government-related entities are presented below:

	31 December 2016	31 December 2015
Cash and cash equivalents	32,794	19,634
Bank deposits	450	16,269
Long-term accounts receivable	44,512	14,229
Other non-current assets	16	21
Other current assets	7	16
Trade receivables (net of allowance for doubtful debtors of RR 7,555 million as at 31 December 2016 and RR 7,656 million as at 31 December 2015)	40,831	29,237
Other receivables (net of allowance for doubtful debtors of RR 1,161 million as at 31 December 2016 and RR 1,235 million as at 31 December 2015)	2,221	2,009
Available-for-sale investments	76,537	22,271
Advances to construction companies and suppliers of property, plant and equipment (included in construction in progress)	604	912
Accounts payable to the shareholders of FGC UES	(73)	(6)
Non-current debt	(300)	(416)
Current debt	(465)	(104)
Accounts payable and accrued charges	(13,214)	(22,537)

As at 31 December 2016 and 2015 the Group had long-term undrawn committed financing facilities with government-related banks of RR 105,000 million with the interest rates not exceeding 14% and the maturity dates from 2018 to 2026. There were no short-term undrawn committed financing facilities with government-related banks as at 31 December 2015 and 2016.

Tax balances and charges are disclosed in Notes 16, 20 and 22. Tax transactions are disclosed in the Consolidated Statement of Comprehensive Income.

Directors' compensation. Compensation is paid to the members of the Management Board for their services in full time management position. The compensation is made up of a contractual salary, non-cash benefits, and a performance bonus depending on results for the period according to Russian statutory financial statements. Also, additional medical coverage is provided to the members of Management Board and their close family members.

Fees, compensation or allowances to the members of the Board of Directors for their services in that capacity and for attending Board meetings are paid depending on results for the year. Fees, compensation or allowances, are not paid to the members of the Board of Directors who are government employees.

Total remuneration in the form of salary, bonuses and non-cash benefits (social security contributions are not included) provided to the members of the Management Board for the year ended 31 December 2016 and 31 December 2015 was as follows:

	Year ended 31 December 2016	Year ended 31 December 2015
Short-term compensation, including salary and bonuses	322	323
Termination benefits	26	23
Post-employment benefits and other long-term benefits	20	10
Total	368	356

The amount of the short-term compensation to members of the Management Board represents remuneration accrued during the respective period.

Remuneration provided to the members of the Board of Directors for the year ended 31 December 2016 amounted to RR 6 million (31 December 2015: RR 7 million).

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Note 6. Property, plant and equipment

	Buildings	Power transmission grids	Substations	Construction in progress	Other	Total
Appraisal value or cost						
Balance as at 1 January 2016	20,820	392,762	256,529	155,704	37,177	862,992
Additions	155	299	605	91,591	995	93,645
Transfers	2,719	18,519	51,712	(77,504)	4,554	-
Disposals	(356)	(127)	(1,926)	(2,093)	(739)	(5,241)
Elimination of accumulated depreciation and impairment	(766)	(31,645)	(34,233)	(6,706)	(11,332)	(84,682)
Reversal of impairment provision	1,429	8,703	28,237	707	4,448	43,524
Revaluation increase	1,025	12,567	11,276	174	4,490	29,532
Decrease in revaluation reserve	(184)	(11,414)	(3,077)	(1)	(576)	(15,252)
Revaluation loss	(975)	(18,463)	(19,597)	(36,975)	(1,813)	(77,823)
Balance as at 31 December 2016	23,867	371,201	289,526	124,897	37,204	846,695
Including PPE under finance lease	-	-	-	-	805	805
Accumulated depreciation and impairment						
Balance as at 1 January 2016	(356)	(15,350)	(17,335)	(2,850)	(5,987)	(41,878)
Depreciation charge	(416)	(16,303)	(17,059)	-	(5,619)	(39,397)
Impairment loss	-	-	-	(3,856)	-	(3,856)
Disposals	6	8	161	-	274	449
Elimination of accumulated depreciation and impairment	766	31,645	34,233	6,706	11,332	84,682
Balance as at 31 December 2016	-	-	-	-	-	-
Including PPE under finance lease	-	-	-	-	-	-
Net book value as at 1 January 2016	20,464	377,412	239,194	152,854	31,190	821,114
Net book value as at 31 December 2016	23,867	371,201	289,526	124,897	37,204	846,695

	Buildings	Power transmission grids	Substations	Construction in progress	Other	Total
Appraisal value or cost						
Balance as at 1 January 2015	20,145	372,659	222,250	147,765	32,210	795,029
Acquisition of subsidiaries	232	-	-	-	17	249
Additions	503	41	122	73,523	883	75,072
Transfers	1,864	21,772	35,652	(63,762)	4,474	-
Disposals	(1,924)	(1,710)	(1,495)	(1,822)	(407)	(7,358)
Balance as at 31 December 2015	20,820	392,762	256,529	155,704	37,177	862,992
Including PPE under finance lease	-	-	-	-	1,432	1,432
Accumulated depreciation and impairment						
Balance as at 1 January 2015	-	-	-	-	-	-
Depreciation charge	(385)	(15,389)	(17,541)	-	(6,132)	(39,447)
Impairment loss	-	-	-	(2,850)	-	(2,850)
Disposals	29	39	206	-	145	419
Balance as at 31 December 2015	(356)	(15,350)	(17,335)	(2,850)	(5,987)	(41,878)
Including PPE under finance lease	-	-	-	-	(72)	(72)
Net book value as at 1 January 2015	20,145	372,659	222,250	147,765	32,210	795,029
Net book value as at 31 December 2015	20,464	377,412	239,194	152,854	31,190	821,114

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Note 6. Property, plant and equipment (continued)

Borrowing costs of RR 19,334 million for the year ended 31 December 2016 were capitalised within additions (for the year ended 31 December 2015: RR 23,927 million). A capitalisation rate of 9.09% was used for the year ended 31 December 2015 (for the year ended 31 December 2015: 10.96%) to determine the amount of borrowing costs eligible for capitalisation, representing the weighted average of the borrowing costs applicable to the borrowings of the Group that were outstanding during the periods.

Construction in progress is represented by the carrying amount of property, plant and equipment that has not yet been put into operation and advances to construction companies and suppliers of property, plant and equipment. As at 31 December 2016 such advances amounted to RR 9,244 million (as at 31 December 2015: RR 11,646 million, net of impairment of RR 4,308 million).

Other property, plant and equipment include motor vehicles, computer equipment, office fixtures and other equipment. Land plots are classified together with items of property, plant and equipment located on them.

Revaluation. In 2016, management commissioned an independent appraiser for revaluation of property, plant and equipment as at 31 December 2016. The fair value of property, plant and equipment was determined to be RR 846,233 million, which has been categorised as a Level 3 fair value based on the inputs to the valuation techniques used (see Note 2).

The majority of the Group’s property, plant and equipment is specialised in nature and is rarely sold on the open market other than as part of a continuing business. The market for similar property, plant and equipment is not active in the Russian Federation and does not provide a sufficient number of sales of comparable property, plant and equipment for using a market-based approach for determining fair value.

Consequently the fair value of property, plant and equipment was primarily determined using depreciated replacement cost. This method considers the cost to reproduce or replace the property, plant and equipment, adjusted for physical, functional or economical depreciation, and obsolescence.

Depreciated replacement cost was estimated based on internal sources and analysis of the Russian and international markets for similar property, plant and equipment. Various market data were collected from published information, catalogues, statistical data etc., and industry experts and suppliers of property, plant and equipment were contacted both in the Russian Federation and abroad.

In addition to the determination of the depreciated replacement cost, cash flow testing was conducted for each cash generating unit. The Group’s Transmission segment (Note 29) was considered as a single cash generating unit. This resulted in depreciated replacement cost values being decreased by RR 823,745 million in arriving at the above value.

The following key assumptions were used in performing the cash flow testing of Transmission segment:

- Forecast period is determined as 10 years – from 2017 to 2026.
- A nominal after-tax discount rate of 8.96% was determined based on the weighted average cost of capital.
- Revenue projections are based on following assumptions:
 - Approved Regulatory Asset Base tariff calculation for 2017-2019;
 - Key parameters for tariff-setting (rates of return for “old” and “new” capital (10%); normal useful live for calculation of return of capital (35 years); Net Working Capital to revenue ratio (7.9%));
 - Increase of operating expenses at a compound annual growth rate of 3.5% that is determined with reference to expected inflation rate in RF and takes into account planned economy on controllable costs;
 - Decrease of the volume of “old” capital employed under RAB methodology –down to nil;
 - Fixed volume of contracted capacity from 2020 onwards;
 - Revenue included fees from technological connection services based on forecasted amount of consideration and relate to assets which are under construction as at period end..
- The amount of expenditure for the period from 2017 through 2026 required for the maintenance of the current property, plant and equipment is assumed to be equal to the amount of such expenditure determined as allowable for the purpose of tariff regulation.
- Terminal value was determined based on Gordon growth model with terminal growth rate of 2.89% (in line with long-term consumer price index forecast published by Ministry of Economic Development).

The sensitivity of the recoverable amount of property, plant and equipment included in Transmission segment to changes in the weighted principal assumptions is as follows:

	Increase	Decrease
Discount rate (0.5% movement)	(7.1%)	8,3%
Terminal growth rate (1% movement)	10.5%	(7.6%)
Revenue (3% movement)	8.4%	(8.4%)

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Note 6. Property, plant and equipment (continued)

Revaluation results. Accumulated depreciation and impairment at 31 December 2016 are eliminated against the gross carrying amount of the property, plant and equipment and the net amount of PPE is restated to the revalued amount. The results of revaluation of PPE as well as elimination are shown in the table above.

Historical cost. For each class of property, plant and equipment stated at revalued amount in these Consolidated Financial Statements, the carrying amount that would have been recognised had the assets been carried under the historical cost basis is as follows:

	Buildings	Power transmission grids	Substations	Construction in progress	Other	Total
Net book value as at 31 December 2016	23,370	294,376	311,045	187,173	29,945	845,909
Net book value as at 31 December 2015	20,824	294,689	280,836	205,598	29,688	831,635
Net book value as at 31 December 2014	18,713	274,793	247,829	223,140	26,553	791,028

Leased property, plant and equipment. Included in property, plant and equipment are certain items under finance leases. As at 31 December 2016 the net book value of leased property, plant and equipment was RR 805 million (as at 31 December 2015: RR 1,360 million). The leased equipment is pledged as security for the lease obligations.

Operating leases. The Group leases a number of land areas owned by local governments under operating lease. The expected lease payments due are determined based on the lease agreements and are payable as follows:

	31 December 2016	31 December 2015
Under one year	585	559
Between one and five years	1,276	1,041
Over five years	8,643	7,357
Total	10,504	8,957

The above lease agreements are usually signed for a period of 1 to 49 years and may be extended for a longer period. The lease payments are subject to review on a regular basis to reflect market rent prices.

As at 31 December 2016 the carrying value of property, plant and equipment leased out under operating lease was RR 10,176 million (as at 31 December 2015: RR 8,071 million).

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Note 7. Intangible assets

	Corporate information management system (SAP R/3)	Other intangible assets	Total
Cost as at 1 January 2015	5,512	11,168	16,680
Accumulated amortisation	(3,617)	(4,778)	(8,395)
Carrying value as at 1 January 2015	1,895	6,390	8,285
Additions	564	399	963
Transfers	368	(368)	-
Disposals – cost	(11)	(4)	(15)
Amortisation charge	(568)	(913)	(1,481)
Carrying value as at 31 December 2015	2,248	5,504	7,752
Cost as at 31 December 2015	6,433	11,195	17,628
Accumulated amortisation	(4,185)	(5,691)	(9,876)
Carrying value as at 31 December 2015	2,248	5,504	7,752
Cost as at 1 January 2016	6,433	11,195	17,628
Accumulated amortisation	(4,185)	(5,691)	(9,876)
Carrying value as at 1 January 2016	2,248	5,504	7,752
Additions	441	736	1,177
Disposals – cost	(175)	(1,865)	(2,040)
Disposals - accumulated amortisation	116	1,645	1,761
Amortisation charge	(578)	(752)	(1,330)
Carrying value as at 31 December 2016	2,052	5,268	7,320
Cost as at 31 December 2016	6,699	10,066	16,765
Accumulated amortisation	(4,647)	(4,798)	(9,445)
Carrying value as at 31 December 2016	2,052	5,268	7,320

The Corporate information management system (SAP R/3) consists of several modules (parts) and related licences. As at 31 December 2016 only certain modules (parts) were placed in operation and are subject to amortisation. These modules are amortised during 5 years, on a straight-line basis. SAP R/3 includes development costs of RR 251 million as at 31 December 2016 (as at 31 December 2015: RR 676 million).

Other intangible assets include capitalised development costs that meet the definition of an intangible asset of RR 354 million as at 31 December 2016 (as at 31 December 2015: RR 265 million).

Note 8. Investments in associates and joint ventures

The movements in the carrying value of investments in associates and joint ventures are as follows:

	Year ended 31 December 2016	Year ended 31 December 2015
Carrying value as at 1 January	1,691	2,109
Share of result of associates and joint ventures	(327)	(8)
Disposal of associates	-	(258)
Translation difference	(204)	(152)
Carrying value as at 31 December	1,160	1,691

The carrying value of investments in associates and joint ventures is as follows:

	31 December 2016	31 December 2015
JSC UES “SakRusEnergo”	1,052	1,586
Other associates	108	105
Total investments in associates	1,160	1,691

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Note 9. Available-for-sale investments

	1 January 2016	Additions	Change in fair value	Disposals	31 December 2016
PJSC “INTER RAO UES”	21,480	-	53,040	-	74,520
PJSC “Russian Grids”	680	-	1,226	-	1,906
Other	111	4	-	(4)	111
Total	22,271	4	54,266	(4)	76,537

	1 January 2015	Additions	Change in fair value	31 December 2015
PJSC “INTER RAO UES”	13,759	-	7,721	21,480
PJSC “Russian Grids”	625	-	55	680
Other	-	111	-	111
Total	14,384	111	7,776	22,271

For the year ended 31 December 2016 the increase in the fair value of these available-for-sale investments in the total amount of RR 54,266 million was recognised in other comprehensive income (for the year ended 31 December 2015: RR 7,776 million).

Valuation of PJSC “INTER RAO UES” and PJSC “Russian Grids” is made on a recurring basis using quoted market prices (Level 1 inputs) at the end of each reporting period.

Note 10. Long-term receivables and other non-current assets

	31 December 2016	31 December 2015
Long-term trade receivables (net of allowance for doubtful debtors of RR 524 million as at 31 December 2016 and RR 118 million as at 31 December 2015)	45,145	15,180
Loans given	1,000	1,030
Long-term promissory notes	220	204
Total financial assets	46,365	16,414
VAT recoverable	72	7
Other non-current assets	561	558
Total other non-current assets	46,998	16,979

Long-term trade receivables mainly relate to the contracts of technological connection services provided that imply deferred inflow of cash and to restructured receivable balances for transmission services that are expected to be settled within the period exceeding 12 months from the period end.

Long-term receivables relating to the contracts of technological connection are paid in equal parts every six months with an interest accrued on the actual outstanding balances at the rate of 6% per annum. Fair value of consideration receivable for these contracts is determined using present value technique based on estimated future cash flows and the discount rates of 9.33-9.63%.

All promissory notes are denominated in Russian Rouble. Fair value of promissory notes approximates their carrying value.

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Note 11. Cash and cash equivalents

	31 December 2016	31 December 2015
Cash at bank and in hand	20,223	7,518
Cash equivalents	24,181	20,658
Total cash and cash equivalents	44,404	28,176

Cash at bank and in hand	Rating	Rating agency	31 December 2016	31 December 2015
JSC “Gazprombank”	BB+	Fitch Ratings	7,704	469
PJSC “Sberbank”	Ba2	Moody’s	5,892	733
PJSC “RNCB”	A++	Expert RA	3,465	4,180
Federal Treasury Department	-	-	1,809	-
JSC “Alfa-Bank”	BB+	Standard & Poor’s	1,288	1,767
Cash in hand			1	16
Other banks			64	353
Total cash at bank and in hand			20,223	7,518

Cash equivalents include short-term investments in bank deposits:

Bank deposits	Interest rate	Rating	Rating agency	31 December 2016	31 December 2015
PJSC “VTB”	9,40-10,32%	BB+	Standard & Poor’s	12,972	6,599
PJSC “Bank Otkritie Financial Corporation”	9,00-10,30%	BB-	Standard & Poor’s	5,907	-
JSC “Alfa-Bank”	10,35%	BB+	Standard & Poor’s	4,177	6,364
JSC “Gazprombank”	8,00-9,35%	BB+	Fitch Ratings	435	5,818
PJSC “Sberbank”	7,23-9,50%	Ba2	Moody’s	398	1,770
Other banks				242	88
Total bank deposits				24,131	20,639

As at 31 December 2016 cash and cash equivalents include amounts denominated in foreign currency totalling RR 721 million (as at 31 December 2015: nil).

Note 12. Bank deposits

	Interest rate	Rating	Rating agency	31 December 2016	31 December 2015
JSC “Gazprombank”	9,55-11,15%	BB+	Fitch Ratings	295	3,060
PJSC “VTB”	10,75-11,50%	BB+	Standard & Poor’s	155	13,116
JSC “Alfa-Bank”	10,40-11,00%	BB+	Standard & Poor’s	-	7,700
JSC “Bank “ROSSIYA”	4,00-10,20%	A++	Expert RA	-	6,300
PJSC “Sberbank”	10,85-11,00%	Ba2	Moody’s	-	93
Total bank deposits				450	30,269

The carrying amount of bank deposits approximates their fair value.

There were no bank deposits denominated in foreign currency as at 31 December 2016 and 31 December 2015.

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Note 13. Accounts receivable and prepayments

	31 December 2016	31 December 2015
Trade receivables (net of allowance for doubtful debtors of RR 12,117 million as at 31 December 2016 and RR 14,232 million as at 31 December 2015)	47,824	37,904
Other receivables (net of allowance for doubtful debtors of RR 3,513 million as at 31 December 2016 and RR 2,107 million as at 31 December 2015)	6,410	3,751
Total financial assets	54,234	41,655
VAT recoverable	580	2,676
Advances to suppliers (net of allowance for doubtful debtors of RR 2,054 million as at 31 December 2016 and RR 2,002 million as at 31 December 2015)	3,127	5,635
Tax prepayments	246	77
Total accounts receivable and prepayments	58,187	50,043

Trade and other receivables are not interest-bearing and are largely due in 30 to 90 days. Given the short period of the trade and other receivables repayment, the fair value of such receivables approximates their book value.

Tax prepayments will be settled against future tax liabilities.

Management has determined the provision for doubtful debtors based on specific customer identification, customer payment trends, subsequent receipts and settlements and analyses of expected future cash flows. The effects of discounting are reflected in the doubtful debtor allowance and expense. Management believes that the Group entities will be able to realise the net receivable amount through direct collections and other non-cash settlements, and that therefore the recorded value of receivables approximates their fair value.

The movement of the provision for doubtful debtors is shown below:

Year ended 31 December 2016	Long-term trade receivables	Short-term trade receivables	Other short-term receivables	Advances to suppliers	Total
As at 1 January	118	14,232	2,107	2,002	18,459
Provision accrual	429	3,314	1,014	110	4,867
Provision reversal	-	(2,147)	(54)	-	(2,201)
Debt written-off	-	(285)	(9)	(58)	(352)
Amortisation of discount	(23)	-	(5)	-	(28)
Derecognition of subsidiary	-	(2,997)	460	-	(2,537)
As at 31 December	524	12,117	3,513	2,054	18,208

Year ended 31 December 2015	Long-term trade receivables	Short-term trade receivables	Other short-term receivables	Advances to suppliers	Total
As at 1 January	505	8,397	1,466	1,981	12,349
Provision accrual	85	8,137	971	22	9,215
Provision reversal	-	(1,960)	(188)	(4)	(2,152)
Debt written-off	-	(239)	(146)	(1)	(386)
Amortisation of discount	(472)	(84)	5	-	(551)
Acquisition of subsidiaries	-	-	10	4	14
Derecognition of subsidiary	-	(30)	-	-	(30)
Reclassifications	-	11	(11)	-	-
As at 31 December	118	14,232	2,107	2,002	18,459

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Note 13. Accounts receivable and prepayments (continued)

As at 31 December 2016 the overdue accounts receivable for which the provision had not been recorded amounted to RR 17,762 million (as at 31 December 2015: RR 18,846 million).

The ageing of trade and other receivables that were not impaired at the reporting date was as follows:

	31 December 2016	31 December 2015
Neither past due nor impaired	37,961	22,809
Past due:		
Less than 3 months	1,996	7,919
3 to 6 months	2,084	3,572
6 to 12 months *	4,548	5,487
1 year to 3 years *	9,134	1,868
Total	55,723	41,655

* - As at 31 December 2016 the overdue amounts mainly relate to balances from fellow subsidiaries for the total amount of RR 10,365 million. Impairment amounted RR 378 million was accrued for those balances, where settlement is expected to occur beyond normal credit terms. The remaining part of these balances were not impaired as these amounts are expected to be settled in full (including an interest accrued at the rate of Russian Federation Central Bank key interest rate per annum).

As at 31 December 2016 overdue accounts receivable for the total amount of RR 1,489 million were presented within long-term accounts receivable based on management's expectation of future settlement.

Note 14. Inventories

	31 December 2016	31 December 2015
Spare parts	3,507	3,298
Repair materials	3,818	3,073
Other inventories	7,575	9,692
Total inventories	14,900	16,063

The cost of inventories is shown net of an obsolescence provision for RR 2 million as at 31 December 2016 (as at 31 December 2015: RR 47 million). As at 31 December 2016 and 31 December 2015 the Group had no inventories pledged as security under loan and other agreements.

Note 15. Equity

Share capital

	Number of shares issued and fully paid		Share capital	
	31 December 2016	31 December 2015	31 December 2016	31 December 2015
Ordinary shares	1,274,665,323,063	1,274,665,323,063	637,333	637,333

As at 31 December 2016 the authorised share capital comprised 1,346,805,824 thousand ordinary shares with a nominal value of RR 0.5 per share.

Treasury shares. As at 31 December 2016 the Group held through a subsidiary 13,727,165 thousand ordinary shares in treasury at the total cost of RR 4,719 million (as at 31 December 2015: RR 4,719 million).

Reserves. Reserves included Revaluation reserve for property, plant and equipment and available-for-sale investments, foreign currency translation reserve and remeasurement reserve for retirement benefit obligations. The Foreign currency translation reserve relates to the exchange differences arising on translation of net assets of a foreign associate.

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Note 15. Equity (continued)

Reserves comprised the following:

	31 December 2016	31 December 2015
Revaluation reserve (net of tax) for:		
- property, plant and equipment (Note 6)	232,667	225,103
- available-for-sale investments (Note 9)	49,634	6,221
Remeasurement reserve for retirement benefit obligations (Note 18)	(912)	(2,320)
Foreign currency translation reserve (Note 8)	370	574
Total reserves	281,759	229,578

Reserves for the year ended 31 December 2016 (net of tax):

	<u>Revaluation reserve for:</u>		Remeasure- ment reserve for retirement benefit obligations (Note 18)	Foreign currency translation reserve (Note 8)	Total reserves
	property, plant and equipment (Note 6)	available- for-sale investments (Note 9)			
As at 1 January 2016	225,103	6,221	(2,320)	574	229,578
Change in revaluation reserve for property, plant and equipment	7,564	-	-	-	7,564
Change in fair value of available-for-sale investments	-	43,413	-	-	43,413
Remeasurements of retirement benefit obligations	-	-	1,408	-	1,408
Foreign currency translation difference	-	-	-	(204)	(204)
As at 31 December 2016	232,667	49,634	(912)	370	281,759

Reserves for the year ended 31 December 2015 (net of tax):

	<u>Revaluation reserve for:</u>		Remeasure- ment reserve for retirement benefit obligations (Note 18)	Foreign currency translation reserve (Note 8)	Total reserves
	property, plant and equipment (Note 6)	available- for-sale investments (Note 9)			
As at 1 January 2015	225,563	-	93	726	226,382
Change in revaluation reserve for property, plant and equipment	(460)	-	-	-	(460)
Change in fair value of available-for-sale investments	-	6,221	-	-	6,221
Remeasurements of retirement benefit obligations	-	-	(2,413)	-	(2,413)
Foreign currency translation difference	-	-	-	(152)	(152)
As at 31 December 2015	225,103	6,221	(2,320)	574	229,578

Dividends. The annual statutory accounts of the parent company, FGC UES, form the basis for the annual profit distribution and other appropriations. The specific Russian legislation identifies the basis of distribution as the net profit. For the year ended 31 December 2016, the net profit of FGC UES, as reported in the published statutory financial statements, was RR 106,070 million (net profit for the year ended 31 December 2015: RR 17,870 million).

The Annual General Meeting in June 2016 approved the decision to declare dividends for the year 2015 in the total amount of RR 16,977 million, RR 160 million of them relate to treasury shares. Dividends per ordinary share amounted to RR 0.01332.

The Annual General Meeting in June 2015 approved the decision to declare dividends for the year 2014 in the total amount of RR 847 million, RR 15 million of them relate to treasury shares. Dividends per ordinary share amounted to RR 0.00066.

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Note 16. Income tax

Income tax expense comprises the following:

	Year ended 31 December 2016	Year ended 31 December 2015
Current income tax charge	(12,816)	(146)
Deferred income tax charge	2,714	(12,043)
Total income tax expense	(10,102)	(12,189)

During the years ended 31 December 2016 and 31 December 2015 the Company and its principal subsidiaries were subject to tax rate of 20 percent on taxable profit.

In accordance with Russian tax legislation, tax losses in different Group companies may not be offset against taxable profits of other Group companies. Accordingly, tax may be accrued even where there is a net consolidated tax loss.

Profit before income tax for financial reporting purposes is reconciled to income tax expenses as follows:

	Year ended 31 December 2016	Year ended 31 December 2015
Profit before income tax	78,484	56,287
Theoretical income tax charge at the statutory tax rate of 20 percent	(15,697)	(11,257)
Tax effect of derecognition of subsidiary	2,767	-
Tax effect of items which are not deductible for taxation purposes	463	(1,151)
Movement in unrecognised deferred tax assets	2,365	219
Total income tax expense	(10,102)	(12,189)

Deferred income tax. Differences between IFRS and Russian statutory taxation regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for income tax purposes. Deferred income tax assets and liabilities were measured at 20 percent as at 31 December 2016 and 31 December 2015, the rates expected to be applicable when the asset or liability will reverse.

Deferred income tax assets and liabilities for the year ended 31 December 2016:

	31 December 2016	Movements for the year			1 January 2016
		Recognised in profit or loss	Recognised in other compre- hensive income	Derecognition of subsidiary	
Deferred income tax liabilities					
Property, plant and equipment	21,686	373	2,856	-	18,457
Investments in associates	22	1	-	-	21
Available-for-sale investments	11,347	-	8,829	-	2,518
Other	184	(206)	-	-	390
Total deferred income tax liabilities	33,239	168	11,685	-	21,386
Deferred income tax assets					
Property, plant and equipment	(861)	248	-	304	(1,413)
Long-term promissory notes	(4,085)	5	-	-	(4,090)
Available-for-sale investments	-	(24)	2,024	-	(2,000)
Accounts receivable and prepayments	(1,373)	(692)	-	1,500	(2,181)
Intangible assets	(387)	(1)	-	-	(386)
Retirement benefit obligation	(422)	59	92	-	(573)
Current and non-current debt	(83)	21	-	-	(104)
Accounts payable and accruals	(1,318)	(357)	-	-	(961)
Other	(261)	204	-	5	(470)
Tax losses	(666)	20	-	900	(1,586)
Unrecognised deferred tax assets	1,636	(2,365)	-	(2,706)	6,707
Total deferred income tax assets	(7,820)	(2,882)	2,116	3	(7,057)
Deferred income tax liabilities, net	25,419	(2,714)	13,801	3	14,329

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Note 16. Income tax (continued)

Deferred income tax assets and liabilities for the year ended 31 December 2015:

	31 December 2015	Movements for the year			1 January 2015
		Recognised in profit or loss	Recognised in other compre- hensive income	Disposal of subsidiary	
Deferred income tax liabilities					
Property, plant and equipment	18,457	12,887	23	(267)	5,814
Investments in associates	21	(56)	-	-	77
Available-for-sale investments	2,518	22	1,171	-	1,325
Other	390	(663)	-	(27)	1,080
Total deferred income tax liabilities	21,386	12,190	1,194	(294)	8,296
Deferred income tax assets					
Property, plant and equipment	(1,413)	(46)	-	72	(1,439)
Long-term promissory notes	(4,090)	12	-	-	(4,102)
Available-for-sale investments	(2,000)	-	385	-	(2,385)
Accounts receivable and prepayments	(2,181)	(664)	-	-	(1,517)
Intangible assets	(386)	33	-	-	(419)
Retirement benefit obligation	(573)	508	(593)	-	(488)
Current and non-current debt	(104)	19	-	-	(123)
Accounts payable and accruals	(961)	(395)	-	-	(566)
Other	(470)	114	-	5	(589)
Tax losses	(1,586)	491	-	-	(2,077)
Unrecognised deferred tax assets	6,707	(219)	-	-	6,926
Total deferred income tax assets	(7,057)	(147)	(208)	77	(6,779)
Deferred income tax liabilities, net	14,329	12,043	986	(217)	1,517

Unrecognised deferred tax assets in the amount of RR 1,636 million as at 31 December 2016 (as at 31 December 2015: RR 6,707 million) include deferred income tax assets on tax losses carried forward and deferred income tax assets on temporary differences arising in respect of loss-making subsidiaries. These deferred tax assets are not recognised because it is not probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised.

Tax losses carried forward in respect of which deferred tax assets were not recognised are presented by companies in the table below:

	31 December 2016	31 December 2015
JSC “Mobile gas-turbine electricity plants”	2,103	2,314
OJSC “Nurenergo”	-	4,635
Others	1,226	583
Total tax losses carried forward	3,329	7,532

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Note 17. Non-current debt

	Effective interest rate	Due	31 December 2016	31 December 2015
Certified interest-bearing non-convertible bearer bonds:				
with fixed rates	7.5-9.35%	2017-2051	96,179	109,493
with floating rates	CPI+1-2.5%	2022-2050	151,727	153,586
Loan participation notes (LPNs)	8.45%	2019	17,943	17,943
Finance lease liabilities	9.50%	2018	415	520
Total debt			266,264	281,542
Less: current portion of non-current bonds and LPNs			(29,195)	(31,362)
Less: current portion of finance lease liabilities			(115)	(104)
Total non-current debt			236,954	250,076

All debt instruments are denominated in Russian Rouble.

Reconciliation between carrying and fair values of financial liabilities is presented below. Fair value of level 1 bonds are determined based on quoted market prices at MICEX and Irish Stock Exchange.

		31 December 2016		31 December 2015	
	Level	Fair value	Carrying value	Fair value	Carrying value
Non-convertible bearer bonds with fixed rates and loan participation notes	1	109,355	113,856	117,161	127,337
Non-convertible bearer bonds with variable rates	1	9,761	10,411	10,281	10,722
Total debt classified into fair value hierarchy level 1		119,116	124,267	127,442	138,059

Other non-current debt with floating rates classified into fair value hierarchy level 3 represent non-quoted non-convertible bearer bonds with floating rate lined to inflation with a premium of 1-2.5%, which is a unique instrument with specific market. Hence, the management believes carrying amount of these instruments approximates its fair value.

As at 31 December 2016 the Group had long-term undrawn committed financing facilities of RR 152,500 million (as at 31 December 2015: RR 152,500 million) which could be used for the general purposes of the Group.

Finance lease. Minimum lease payments under finance leases and their present values are as follows:

	Due in 1 year	Due between 1 and 5 years	Due after 5 years	Total
Minimum lease payments as at 31 December 2016	150	308	-	458
Less future finance charges	(35)	(8)	-	(43)
Present value of minimum lease payments as at 31 December 2016	115	300	-	415
Minimum lease payments as at 31 December 2015	150	457	-	607
Less future finance charges	(46)	(41)	-	(87)
Present value of minimum lease payments as at 31 December 2015	104	416	-	520

Leased assets with carrying amount disclosed in Note 6 are effectively pledged for finance lease liabilities as the rights to the leased asset revert to the lessor in the event of default.

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Note 18. Retirement benefit obligations

The Group’s post-employment benefits policy includes the employee pension scheme and other various post-employment, retirement and jubilee payments. The post-employment and retirement benefit system is a defined benefit program as part of which every participating employee receives benefits calculated in accordance with certain formula or rules. The program’s core element is the corporate pension scheme implemented by the Group in cooperation with the Non-State Pension Fund of Electric Power Industry.

The Group also pays various other long-term post-employment benefits, including lump sum benefits in case of death of employees or former employees receiving pensions, lump sum benefits upon retirement and in connection with jubilees.

Additionally, financial aid in the form of defined benefits is provided to former employees who have state, industry or corporate awards. Such financial aid is provided both to employees entitled and not entitled to non-state pensions.

The most recent actuarial valuation was performed as at 31 December 2016.

The tables below provide information about benefit obligations and actuarial assumptions as at 31 December 2016 and 31 December 2015.

The amounts recognised in the Consolidated Statement of Financial Position are determined as follows:

	Year ended 31 December 2016	Year ended 31 December 2015
Present value of defined benefit obligation	5,692	7,021
Present value of other long-term employee benefit obligation	267	336
Total net defined benefit liability	5,959	7,357

The movement in the net defined benefit obligation over the year is as follows:

	Year ended 31 December 2016	Year ended 31 December 2015
Defined benefit obligations at 1 January	7,357	6,456
Included in profit or loss		
Current service cost	495	433
Past service cost	(82)	(2,634)
Interest expense	613	728
	1,026	(1,473)
Remeasurements of defined benefit liability		
Remeasurements:		
(Gain) / loss from change in financial assumptions	(200)	1,802
Experience (gains) / losses	(1,384)	1,324
	(1,584)	3,126
Benefits paid by the plan	(840)	(752)
Defined benefit obligations at 31 December	5,959	7,357

Amounts recognized in profit or loss:

	Year ended 31 December 2016	Year ended 31 December 2015
Service cost	413	(2,201)
Remeasurements of other long-term employee benefit obligations	(84)	120
Interest expense	613	728
Total	942	(1,353)

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Notes to the Consolidated Financial Statements

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Note 18. Retirement benefit obligations (continued)

Amounts recognized in other comprehensive income:

	Year ended 31 December 2016	Year ended 31 December 2015
(Gain) / loss from change in financial assumptions	(191)	1,749
Experience (gains) / losses	(1,309)	1,256
Total	(1,500)	3,005

The movement of remeasurements in other comprehensive income are as follows:

	Year ended 31 December 2016	Year ended 31 December 2015
At 1 January	3,028	23
Movement of remeasurements	(1,500)	3,005
At 31 December	1,528	3,028

The significant actuarial assumptions are as follows:

Financial actuarial assumptions:	Year ended 31 December 2016	Year ended 31 December 2015
Discount rate (nominal)	8.50%	9.50%
Future financial support benefit increases	4.70%	6.00%
Future salary increases (nominal)	4.70%	6.00%

Financial assumptions are based on market expectations, at the end of the reporting period, for the period over which the obligations are to be settled. The average period over which the Group obligations are to be settled is 12.02 years.

Demographic actuarial assumptions:

	Year ended 31 December 2016	Year ended 31 December 2015
Expected retirement age		
Male	60	60
Female	55	55
Employee turnover	5.0%	5.1%
Mortality table	1998_adjusted	1998_adjusted

The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions is as follows:

	Change in assumption		Impact on defined benefit liability	
Discount rate	Increase / decrease by	0.5%	Decrease/ Increase by	4.56%
Future salary increases (nominal)	Increase / decrease by	0.5%	Increase / decrease by	2.39%
Future pension increases (nominal)	Increase / decrease by	0.5%	Increase / decrease by	2.33%
Employee turnover	Increase / decrease by	10%	Decrease/ Increase by	2.15%
Mortality level	Increase / decrease by	10%	Decrease/ Increase by	0.90%

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as when calculating the pension liability recognised within the consolidated statement of financial position.

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Note 19. Current debt and current portion of non-current debt

	Effective interest rate	31 December 2016	31 December 2015
Bank loans	10.5%	350	-
Current portion of non-current debt (Note 17)		29,310	31,466
Total current debt and current portion of non-current debt		29,660	31,466

As at 31 December 2016 and 2015 the Group had no short-term undrawn committed financing facilities.

Note 20. Accounts payable and accrued charges

	31 December 2016	31 December 2015
Accounts payable to construction companies and suppliers of property, plant and equipment	23,759	29,140
Trade payables	8,670	21,949
Accrued liabilities	10	201
Other creditors	1,303	1,451
Total financial liabilities	33,742	52,741
Advances received	15,091	12,936
Accounts payable to employees	2,313	2,242
Taxes other than on income payable	7,221	2,169
Other provisions for liabilities and charges	3,692	948
Total accounts payable and accrued charges	62,059	71,036

Movement in other provisions for liabilities and charges:

	Year ended 31 December 2016	Year ended 31 December 2015
Carrying amount at 1 January	948	500
Additional amounts charged to profit or loss	3,678	878
Unused amounts reversed	(617)	(428)
Utilisation of provision	(317)	(2)
Carrying amount at 31 December	3,692	948

Note 21. Revenues and other operating income

	Year ended 31 December 2016	Year ended 31 December 2015
Transmission fee	170,189	157,821
Connection services	39,088	12,425
Electricity sales	22,093	6,442
Construction services	21,320	7,014
Rental income	996	1,117
Design works	545	508
Grids repair and maintenance services	543	700
Communication services	517	545
Research and development services	312	469
Total revenue	255,603	187,041

Other operating income primarily includes income from non-core activities.

	Year ended 31 December 2016	Year ended 31 December 2015
Penalties and fines	4,710	2,860
Insurance compensation	531	284
Other income	798	857
Total other operating income	6,039	4,001

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Note 22. Operating expenses

	Year ended 31 December 2016	Year ended 31 December 2015
Depreciation of property, plant and equipment	39,397	39,447
Employee benefit expenses and payroll taxes	26,782	25,218
Purchased electricity for production needs	25,967	15,192
Subcontract works for construction contracts	11,779	5,267
Property tax	9,056	7,408
Materials for construction contracts	8,090	653
Fuel for mobile gas-turbine electricity plants	7,817	1,878
Accrual of allowance for doubtful debtors	2,666	7,063
Movement in provision for legal claims	2,502	434
Electricity transit	2,295	4,019
Materials for repair	2,061	2,243
Repairs and maintenance of equipment	2,039	2,171
Rent	1,991	1,474
Business trips and transportation expenses	1,976	2,182
Other materials	1,524	1,747
Security services	1,476	1,568
Consulting, legal and auditing services	1,342	1,093
Amortisation of intangible assets	1,330	1,481
Information system maintenance	1,083	1,206
Other subcontract works	900	1,070
Utilities and maintenance of buildings	755	754
Insurance	642	845
Communication service	539	609
(Gain) / loss on disposal of property, plant and equipment	(72)	3,699
Other expenses	1,573	2,242
Total	155,508	130,963

In 2016 based on the recent legal practice the Group recognized allowance for doubtful debts for certain balances with customers where the Group had disputes related to certain terms of transmission services in the amount of RR 4,079 million (In 2015: RR 3,934 million). This expense was included in amount of allowance for doubtful debtors.

Employee benefit expenses and payroll taxes include the following:

	Year ended 31 December 2016	Year ended 31 December 2015
Wages and salaries	20,919	21,809
Social security contributions to the Pension Fund	3,974	3,912
Social security contributions to other state non-budgetary funds	1,560	1,578
Pension costs – defined benefit plans (Note 18)	329	(2,081)
Total employee benefit expenses and payroll taxes	26,782	25,218

Note 23. Finance income

	Year ended 31 December 2016	Year ended 31 December 2015
Interest income	6,418	8,255
Foreign currency exchange differences	17	392
Dividends	353	21
Other finance income	186	33
Total finance income	6,974	8,701

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Note 24. Finance costs

	Year ended 31 December 2016	Year ended 31 December 2015
Interest expense	25,612	32,455
Net interest on defined benefit liability	613	728
Foreign currency exchange differences	182	379
Other finance costs	937	-
Total finance costs	27,344	33,562
Less capitalised interest expenses on borrowings related to qualifying assets (Note 6)	(19,334)	(23,927)
Total finance costs recognised in profit or loss	8,010	9,635

Note 25. Earnings per ordinary share for profit attributable to shareholders of FGC UES

	Year ended 31 December 2016	Year ended 31 December 2015
Weighted average number of ordinary shares (millions of shares)	1,260,938	1,260,938
Profit attributable to shareholders of FGC UES (millions of RR)	68,159	44,768
Weighted average earnings per share – basic and diluted (in RR)	0.054	0.036

The Group has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal the basic earnings per share.

Note 26. Contingencies, commitments and operating risks

Political environment. The operations and earnings of the Group continue, from time to time and in varying degrees, to be affected by the political, legislative, fiscal and regulatory developments, including those related to environmental protection, in Russian Federation.

Insurance. The Group held limited insurance policies in relation to its assets, operations, public liability or other insurable risks. Accordingly, the Group is exposed to those risks for which it does not have insurance.

Legal proceedings. In the normal course of business the Group entities may be a party to certain legal proceedings. As at 31 December 2016 claims made by suppliers of property, plant and equipment and other counterparties to the Group amounted to RR 3,859 million. Management of the Group is unable to assess the ultimate outcome of the claims and the outflow of financial resources to settle such claims, if any.

Management believes that it has made adequate provision for other probable claims (Note 20). In the opinion of management, currently there are no other existing legal proceedings or claims outstanding, which, upon final disposition, will have a material adverse effect on the financial position of the Group.

Tax contingency. Russian tax and customs legislation is subject to varying interpretation when being applied to the transactions and activities of the Group. Consequently, tax positions taken by management and the formal documentation supporting the tax positions may be successfully challenged by the relevant regional and federal authorities. Russian tax administration is gradually strengthening, including the fact that there is a higher risk of review of tax transactions without a clear business purpose or with tax incompliant counterparties. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of decision to perform tax review. Under certain circumstances reviews may cover longer periods.

Transfer pricing legislation enacted in the Russian Federation starting from 1 January 2012 provides for major modifications making local transfer pricing rules closer to OECD guidelines, but creating additional uncertainty in practical application of tax legislation in certain circumstances.

Currently there is lack of practice of applying the transfer pricing rules by the tax authorities and courts, however, it is anticipated that transfer pricing arrangements will be subject to very close scrutiny potentially having effect on these consolidated financial statements.

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Note 26. Contingencies, commitments and operating risks (continued)

As at 31 December 2016 management believes that its interpretation of the relevant legislation is appropriate and the Group’s tax, currency and customs positions will be sustained.

Environmental matters. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. Group entities periodically evaluate their obligations under environmental regulations.

Potential liabilities might arise as a result of changes in legislation and regulation or civil litigation. The impact of these potential changes cannot be estimated, but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

Capital commitments related to construction of property, plant and equipment. Future capital expenditures for which contracts have been signed amount to RR 210,968 million as at 31 December 2016 (as at 31 December 2015: RR 232,219 million) including VAT. These amounts include accounts payable to construction companies and suppliers of property, plant and equipment in the amount of RR 23,759 million as at 31 December 2016 (as at 31 December 2015: RR 29,140 million) (Note 20).

Note 27. Financial instruments and financial risks

Financial risk factors. The Group’s ordinary financial and business activities expose it to a variety of financial risks, including but not limited to the following: market risk (foreign exchange risk, interest rate risks related to changes in the fair value of the interest rate and the cash flow interest rate, and price risk), credit risk, and liquidity risk. Such risks give rise to the fluctuations of profit, reserves and equity and cash flows from one period to another. The Group’s financial management policy aims to minimise or eliminate possible negative consequences of the risks for the financial results of the Group. The Group could use derivative financial instruments from time to time for such purposes as part of its risk management strategy.

Financial instruments by categories:

31 December 2016	Loans and receivables	Investments available for sale	Other financial liabilities	Total
Financial assets				
Available-for-sale investments (Note 9)	-	76,537	-	76,537
Long-term promissory notes (Note 10)	220	-	-	220
Long-term receivables and other non-current assets (Note 10)	45,145	-	-	45,145
Cash and cash equivalents (Note 11)	44,404	-	-	44,404
Bank deposits (Note 12)	450	-	-	450
Short-term promissory notes	10	-	-	10
Loans given	1,130	-	-	1,130
Accounts receivable (Note 13)	54,234	-	-	54,234
Total financial assets	145,593	76,537	-	222,130
Financial liabilities				
Non-current debt (Note 17)	-	-	236,954	236,954
Accounts payable to the shareholders of FGC UES	-	-	73	73
Current debt and current portion of non-current debt (Note 19)	-	-	29,660	29,660
Accounts payable and accrued charges (Note 20)	-	-	33,742	33,742
Total financial liabilities	-	-	300,429	300,429

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Note 27. Financial instruments and financial risks (continued)

31 December 2015	Loans and receivables	Investments available for sale	Other financial liabilities	Total
Financial assets				
Available-for-sale investments (Note 9)	-	22,271	-	22,271
Long-term promissory notes (Note 10)	204	-	-	204
Long-term receivables and other non-current assets (Note 10)	15,180	-	-	15,180
Cash and cash equivalents (Note 11)	28,176	-	-	28,176
Bank deposits (Note 12)	30,269	-	-	30,269
Short-term promissory notes	194	-	-	194
Loans given	1,114	-	-	1,114
Accounts receivable (Note 13)	41,655	-	-	41,655
Total financial assets	116,792	22,271	-	139,063
Financial liabilities				
Non-current debt (Note 17)	-	-	250,076	250,076
Accounts payable to the shareholders of FGC UES	-	-	6	6
Current debt and current portion of non-current debt (Note 19)	-	-	31,466	31,466
Accounts payable and accrued charges (Note 20)	-	-	52,741	52,741
Total financial liabilities	-	-	334,289	334,289

(a) Market risk

(i) **Foreign exchange risk.** The Group operates within the Russian Federation. The major part of the Group’s purchases is denominated in Russian Roubles. Therefore, the Group’s exposure to foreign exchange risk is insignificant.

(ii) **Interest rate risk.** The Group’s operating profits and cash flows from operating activity are not largely dependent on the changes in market interest rates. Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group’s exposure should be to fixed or variable rates. However, at the time of raising new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

The Group does not account for any fixed-rate borrowings at fair value through profit or loss. Therefore a change in interest rates at the reporting date would not have an effect in profit or loss or in equity. There is no significant impact on the Group’s profit or loss or equity from the change in interest rates for variable rate borrowings as most of the Group’s interest on borrowings is being capitalised in property, plant and equipment.

The increase of inflation by 1% would result in additional cash outflow of RR 1,500 million per year.

(iii) **Price risk.** Equity price risk arises from available-for-sale investments. Management of the Group monitors its investment portfolio based on market indices. Material investments within the portfolio are managed on an individual basis and all buy and sell decisions are taken by the management of the Group. The primary goal of the Group’s investment strategy is to maximise investment returns in order to meet partially the Group’s investment program needs. Transactions in equity products are monitored and authorised by the Group’s corporate finance department. As at 31 December 2016, the total amount of investments available-for-sale exposed to the market risk equals RR 76,426 million. If equity prices at that date had been 10% higher (lower), with all other variables held constant, the Group’s other comprehensive income would increase (decrease) by RR 7,643 million.

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Note 27. Financial instruments and financial risks (continued)

(b) Credit risk.

The amounts exposed to credit risk are as follows:

	Long-term promissory notes (Note 10)	Other non-cur- rent assets (Note 10)	Cash and cash equi- valents (Note 11)	Bank deposits (Note 12)	Short-term promissory notes	Loans given	Accounts receivable (Note 13)
31 December 2016							
Not overdue, not impaired	220	43,656	44,404	450	10	1,130	37,961
Not overdue, but impaired:	-	-	-	-	-	-	-
- gross amount	-	232	-	-	-	-	4,758
- less impairment provision	-	(232)	-	-	-	-	(4,758)
Overdue, but not impaired	-	1,489	-	-	-	-	16,273
Overdue and impaired:	-	-	-	-	-	-	-
- gross amount	-	292	-	-	12,022	-	10,872
- less impairment provision	-	(292)	-	-	(12,022)	-	(10,872)
Total amount	220	45,145	44,404	450	10	1,130	54,234

	Long-term promissory notes (Note 10)	Other non-cur- rent assets (Note 10)	Cash and cash equi- valents (Note 11)	Bank deposits (Note 12)	Short-term promissory notes	Loans given	Accounts receivable (Note 13)
31 December 2015							
Not overdue, not impaired	204	15,180	28,176	30,269	194	1,114	22,809
Not overdue, but impaired:	-	-	-	-	-	-	-
- gross amount	-	33	-	-	-	-	2,719
- less impairment provision	-	(33)	-	-	-	-	(2,719)
Overdue, but not impaired	-	-	-	-	-	-	18,846
Overdue and impaired:	-	-	-	-	-	-	-
- gross amount	-	85	-	-	12,022	-	13,620
- less impairment provision	-	(85)	-	-	(12,022)	-	(13,620)
Total amount	204	15,180	28,176	30,269	194	1,114	41,655

As at 31 December 2016 the amount of financial assets, which were exposed to credit risk, was RR 145,593 million (as at 31 December 2015: RR 116,792 million). Although collection of receivables could be influenced by economic factors, management of the Group believes that there is no significant risk of loss to the Group beyond the provision for impairment of receivables already recorded.

The Group's trade debtors are quite homogenous as regards their credit quality and concentration of credit risk. They are primarily comprised of large, reputable customers, most of which are controlled by, or related to the Government of the RF. Historical data, including payment histories during the recent credit crisis, would suggest that the risk of default from such customers is very low.

Credit risk is managed at the Group level. In most cases the Group does not calculate their customers' credit status but rates their creditworthiness on the basis of the financial position, prior experience and other factors. The cash has been deposited in the financial institutions with no more than minimal exposure to the default risk at the time of account opening. Although some of the banks and companies have no international credit rating, management believes that they are reliable counterparties with a stable position on the Russian market.

(c) **Liquidity risk.** Liquidity risk is managed at the Group level and includes maintaining the appropriate volume of monetary funds, conservative approach to excess liquidity management, and access to financial resources by securing credit facilities and limiting the concentrations of cash in banks. The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows including estimated interest payments. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

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Note 27. Financial instruments and financial risks (continued)

	Less than 1 year	1 to 2 years	2 to 5 years	Over 5 years	Total
As at 31 December 2016					
Non-current and current debt and interest payable (Notes 17, 19)	47,917	35,161	98,751	312,322	494,151
Accounts payable to the shareholders of FGC UES	73	-	-	-	73
Accounts payable and accrued charges (Note 20)	33,742	-	-	-	33,742
Total as at 31 December 2016	81,732	35,161	98,751	312,322	527,966
As at 31 December 2015					
Non-current and current debt and interest payable (Notes 17, 19)	55,652	42,873	102,855	351,941	553,321
Accounts payable to the shareholders of FGC UES	6	-	-	-	6
Accounts payable and accrued charges (Note 20)	52,741	-	-	-	52,741
Total as at 31 December 2015	108,399	42,873	102,855	351,941	606,068

(d) **Fair value.** Management believes that the fair value of financial assets and liabilities carried at amortised cost is not significantly different from their carrying amounts. The carrying value of trade payables and trade receivables less provision for doubtful debtors is assumed to approximate their fair value due to their short-term nature. The financial instruments of the Group carried at fair value represent available-for-sale investments (Note 9). The fair value of the available-for-sale investments is determined by the quoted prices (Level 1 inputs) in active markets for identical financial assets. There are no significant unobservable inputs used in measuring fair values of financial assets and liabilities.

Note 28. Capital risk management

The Group’s management of the capital of its entities aims to comply with the capital requirements established by the legislation of the Russian Federation for joint stock companies, in particular:

- share capital cannot be lower than RR 100 thousand;
- in case the share capital of an entity is greater than statutory net assets of the entity, such entity must reduce its share capital to the value not exceeding its statutory net assets;
- in case the minimum allowed share capital exceeds the entity’s statutory net assets, such entity is subject for liquidation.

As at 31 December 2016 several companies of the Group namely JSC “Mobile gas-turbine electricity plants”, OJSC “The Kuban trunk grids”, JSC “Specialised electricity transmission service company of the UNEG”, JSC “Engineering and construction management centre of Unified Energy System”, JSC “Dalenergosetproject”, JSC “APBE”, were not in compliance with all requirements mentioned above. Management of the Group is currently implementing measures to ensure compliance with all legislation requirements within a short period. Management considers that a breach of above mentioned requirements will not have material effect on the Group’s consolidated financial statements. The Group’s capital management objectives are to ensure that its operations be continued at a profit for the shareholders and with benefits for other stakeholders, and to maintain the optimal capital structure with a view to reduce the cost of capital. In order to maintain or adjust the capital structure, the Group can adjust the dividends paid to the shareholders or their contributions to the authorised capital by issuing new shares or by selling assets to reduce debts.

The Group monitors capital ratios, including the gearing ratio, calculated on the basis of figures of financial statements prepared under the Russian Accounting Regulations. The Group should ensure that its gearing ratio, being the total debt divided by the total equity, does not exceed 0.50. As at 31 December 2016 the Company’s gearing ratio calculated under Russian Accounting Regulations was 0.27 (as at 31 December 2015: 0.32).

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Note 29. Segment information

The Group operates within one operating segment. The Group’s single primary activity is provision of electricity transmission services within the Russian Federation which is represented as Transmission segment.

The Board of Directors of the Company has been determined as chief operating decision maker (the “CODM”) of the Group which generally analyses information relating to Transmission segment. The Board of Directors does not evaluate financial information of other components of the Group to allocate resources or assess performance and does not determine these components as segments. The key indicator of the transmission segment performance is return on equity ratio (ROE). It is calculated based on the statutory financial statements prepared according to Russian Accounting Regulations (RAR) as net profit divided by net assets. Accordingly, the measure of transmission segment profit or loss analysed by the CODM is net profit of segment based on the statutory financial statements prepared according to RAR. The other information provided to the CODM is also based on statutory financial statements prepared according to RAR.

	Transmission segment – based on statutory financial statements prepared according to RAR	
	Year ended 31 December 2016	Year ended 31 December 2015
Revenue from external customers	216,904	173,003
Intercompany revenue	1,585	362
Total revenue	218,489	173,365
Depreciation and amortisation *	82,075	77,744
Interest income	8,100	8,334
Interest expenses	6,314	8,517
Current income tax	12,582	81
Profit for the year	119,869	19,186
Capital expenditure	104,757	75,597
	31 December 2016	31 December 2015
Total reportable segment assets	1,398,048	1,287,303
Total reportable segment liabilities	428,746	433,413

* Depreciation charge under RAR is based on useful lives determined by statutory regulations.

	Year ended 31 December 2016	Year ended 31 December 2015
Total revenue from segment (RAR)	218,489	173,365
Reclassification between revenue and other income	317	(1,625)
Non-segmental revenue	45,332	15,679
Elimination of intercompany revenue	(1,585)	(362)
Recognition of revenue from connection services based on fair value	(6,391)	-
Other adjustments	(559)	(16)
Total revenue (IFRS)	255,603	187,041

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Note 29. Segment information (continued)

	Year ended 31 December 2016	Year ended 31 December 2015
Profit for the year (RAR)	119,869	19,186
Property, plant and equipment		
Adjustment to the carrying value of property, plant and equipment	8,135	35,510
Reversal of impairment / (impairment) of property, plant and equipment, net	1,357	(1,183)
Financial instruments		
Re-measurement of available-for-sale investments	(53,692)	(7,750)
Discounting of promissory notes	37	78
Discounting of long-term accounts receivable	(7,825)	551
Consolidation		
Reversal of impairment of investments in subsidiaries	(14)	851
Adjustments to intercompany promissory notes	(13,233)	(2,137)
Reversal of re-measurement of treasury shares	806	(202)
Other		
Adjustment to provision for legal claims	(2,180)	(449)
Adjustment to allowance for doubtful debtors	(3,424)	2,760
Accrual of retirement benefit obligations	(85)	1,796
Write-off of research and development to expenses	(86)	70
Share of result of associates	(327)	(8)
Deferred tax adjustment	8,378	(2,021)
Other adjustments	(2,627)	(2,329)
Gain on derecognition of subsidiary	11,868	-
Non-segmental other operating loss	1,425	(615)
Profit for the year (IFRS)	68,382	44,098
	31 December 2016	31 December 2015
Total reportable segment liabilities (RAR)	428,746	433,413
Netting of VAT recoverable and payable	(5,349)	(3,703)
Netting of advances and payables	(1,410)	(5,934)
Recognition of finance lease liabilities	270	519
Accrual of retirement benefit obligations	5,607	7,034
Deferred tax liabilities adjustment	(24,284)	(29,384)
Accrual of payables recognised in another accounting period	3,192	1,091
Non-segmental liabilities	19,747	39,126
Elimination of intercompany balances	(57,826)	(66,472)
Total liabilities (IFRS)	368,693	375,690

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Note 29. Segment information (continued)

	31 December 2016	31 December 2015
Total reportable segment assets (RAR)	1,398,048	1,287,303
Property, plant and equipment		
Adjustment to the carrying value of property, plant and equipment	184,953	197,355
Impairment and revaluation of property, plant and equipment, net	(444,037)	(466,452)
Recognition of property, plant and equipment under finance lease	194	576
Financial instruments		
Adjustment to cost of investments in associates	447	979
Adjustment to cost of available-for-sale investments	2,098	12,377
Discounting of promissory notes	(304)	(350)
Consolidation		
Reversal of impairment of investments in subsidiaries	9,284	9,298
Reversal of impairment of promissory notes	20,646	33,880
Reversal of re-measurement of treasury shares	-	(806)
Unrealised profit adjustment	(1,243)	(426)
Elimination of investments in subsidiaries	(24,649)	(23,847)
Elimination of intercompany balances	(57,826)	(66,472)
Other		
Write-off of research and development to expenses	(2,268)	(2,182)
Adjustment to allowance for doubtful debtors	4,587	8,011
Discounting of long-term trade receivables	(7,863)	(38)
Deferred tax assets adjustment	(1,314)	(11,851)
Netting of VAT recoverable and payable	(5,349)	(3,703)
Netting of advances and payables	(1,410)	(5,934)
Other adjustments	(2,974)	(1,317)
Non-segmental assets	26,090	28,927
Total assets (IFRS)	1,097,110	995,328

The main differences between financial information prepared in accordance with IFRS and the financial information reported to the chief operating decision-maker related to profit or loss, and assets and liabilities results from the differences in the accounting methods under IFRS and RAR. Financial information on segments reported to the CODM under RAR does not reflect the adjustments made in accordance with IFRS.

Non-segmental revenue, non-segmental other operating loss, non-segmental assets and non-segmental liabilities represent corresponding revenue, loss (profit), assets and liabilities of components (subsidiaries) that are not determined as segments by the CODM.

Information on revenue for separate services and products of the Group is presented in Note 21. The Group performs most of its activities in the Russian Federation and does not have any significant revenue from foreign customers or any non-current assets located in foreign countries.

The major customers of the Group are government-related entities. The amounts of revenue from such entities are disclosed in Note 5. The Group has no other major customers with turnover over 10 percent of the Group revenue.

Note 30. Derecognition of subsidiary

On 30 June 2016 the Group derecognised its investment in OJSC “Nurenergo” as the Group lost control over the entity (Note 2).

The derecognition of the subsidiary had the following effect on the Group’s assets and liabilities at the date of derecognition:

	Carrying amount at date of disposal
Accounts receivable	533
Other current assets	49
Accounts payable	15,589
Total negative net assets and liabilities of subsidiary	15,007
Impairment of intercompany accounts receivable and loans given	(1,965)
Non-controlling interest	(1,174)
Gain on derecognition of subsidiary	11,868