PJSC “RussNeft”

Consolidated financial statements

for the year ended 31 December 2018
together with the independent auditor’s report

PJSC “RussNeft”

Consolidated financial statements

for the year ended 31 December 2018

Contents

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Independent auditor's report

To the Shareholders of PJSC "RussNeft"

Opinion

We have audited the consolidated financial statements of PJSC "RussNeft" and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2018, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year 2018, and the notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2018, and its consolidated financial performance and its consolidated cash flows for the year 2018 in accordance with International Financial Reporting Standards (IFRS).

Basis for opinion

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

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. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matter	How our audit addressed the key audit matter
Determination of the fair value of derivative financial instruments	
In the course of our audit, we treated this matter as one of the most significant matters due to the significance of the respective transactions for the consolidated financial statements, as well as due to the fact that the fair valuation of derivative financial instruments requires management to make significant judgments. Information on the fair value of derivative financial instruments is disclosed in Note 29 to the consolidated financial statements.	We performed procedures to assess the competence of the Group's expert engaged to determine the fair value of derivative financial instruments. Our audit procedures also included a review of the methodology and the assessment of the assumptions used by the expert, including with the engagement of our experts in this area. We also reviewed the respective disclosures in the consolidated financial statements.
Allowance for expected credit losses on loans issued to related parties	
The calculation of the allowance for expected credit losses on loans issued to related parties is an area of judgment for the Group's management. The identification of impairment indicators and the determination of the impairment loss consist of a process involving the use of assumptions and the analysis of various factors, including the borrower's financial position and expected future cash flows. Due to the significance of loans issued to related parties and the complexity of judgment with regard to measurement of expected credit losses in accordance with newly-adopted IFRS 9 *Financial Instruments* ("IFRS 9"), the estimation of the allowance for expected credit losses represents one of the key audit matters. Information on loans issued to related parties is disclosed in Note 19 to the consolidated financial statements.	We assessed the approach to calculating the allowance for expected credit losses on loans issued to related parties and reviewed the assumptions used by management of the Group as the basis for determining the allowance for expected credit losses. Key assumptions include forecasts of future cash flows and an assessment of the borrower's financial position and credit rating. During our audit procedures, we analyzed the consistency and reasonableness of judgments used by management of the Group in determining the value of loans issued to related parties. We also reviewed the disclosure of the allowance for expected credit losses in the Group's consolidated financial statements.

Other matters

The information disclosed in the consolidated financial statements as additional financial information in the *Oil and gas reserves* section is presented for the purposes of additional analysis and is not within the scope of IFRS. In the course of our audit of the accompanying consolidated financial statements, we performed no audit procedures with regard to this additional financial information and, consequently, do not express any opinion thereon.

Other information included in the 2018 Annual Report of PJSC "RussNeft"

Other information consists of the information included in the Annual Report, other than the consolidated financial statements and our auditor's report thereon. Management is responsible for other information. The 2018 Annual Report of PJSC "RussNeft" is expected to be provided to us after the date of this auditor's report.

Our opinion on the consolidated financial statements does not cover the other information, and we do 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 specified above when it is provided to us 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.

Responsibility of management and the Audit Committee for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, 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 its operations, or has no realistic alternative but to do so.

The Audit Committee is responsible for overseeing the Group's financial reporting process.

Auditor's responsibility for the audit of the consolidated financial statements

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional 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 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 auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the audit of the Group. We remain solely responsible for our audit opinion.

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

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and have communicated with it all relationships and other matters that may reasonably be thought to bear on our independence and, where applicable, related safeguards.

From the matters communicated with the Audit Committee, 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 auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The partner in charge of the audit resulting in this independent auditor's report is I.A. Buyan.

I.A. Buyan
Partner
Ernst & Young LLC

25 March 2019

Details of the audited entity

Name: PJSC "RussNeft"
Record made in the State Register of Legal Entities on 17 September 2002; State Registration Number 1027717003467.
Address: Russia 115054, Moscow, Pyatnitskaya ulitsa, 69.

Details of the auditor

Name: Ernst & Young LLC
Record made in the State Register of Legal Entities on 5 December 2002; State Registration Number 1027739707203.
Address: Russia 115035, Moscow, Sadovnicheskaya naberezhnaya, 77, building 1.
Ernst & Young LLC is a member of Self-regulated organization of auditors "Russian Union of auditors" (Association) ("SRO RUA"). Ernst & Young LLC is included in the control copy of the register of auditors and audit organizations, main registration number 11603050648.

PJSC "RussNeft"

Consolidated statement of profit or loss and other comprehensive income

for the year ended 31 December 2018

(in millions of Russian rubles)

	Notes	Year ended 31 December 2018	Year ended 31 December 2017
Revenue	11	177,802	129,193
Cost of sales	12	(124,437)	(94,984)
Gross profit		**53,365**	**34,209**
Exploration expenses		(806)	(1,338)
Selling expenses	13	(10,053)	(10,096)
General and administrative expenses	13	(4,491)	(3,937)
Other operating expenses, net	15	(9,364)	(6,230)
Operating profit		**28,651**	**12,608**
Finance income	14	3,199	4,024
Finance expense	14	(8,985)	(5,699)
Foreign exchange differences, net		(1,453)	348
Profit before tax		**21,412**	**11,281**
Income tax expense	27	(6,639)	(3,976)
Profit for the period		**14,773**	**7,305**
Other comprehensive (loss)/income			
Items which may be reclassified to profit or loss in subsequent periods:			
Foreign currency translation (loss)/gain		(1,105)	220
Total comprehensive income, net of tax		**13,668**	**7,525**
Profit/(loss) attributable to:			
Shareholders of the Parent		14,993	8,126
Non-controlling interests		(220)	(821)
Total comprehensive income/(loss) attributable to:			
Shareholders of the Parent		10,984	9,119
Non-controlling interests		2,684	(1,594)
Basic and diluted earnings per share (RUB)	23	42	20
Weighted average number of common shares (millions)		294	294

E.V. Tolochek
President

O.E. Prozorovskaya
Senior Vice President
for Economics and Finance

Authorized for issue on 25 March 2019.

The accompanying notes are an integral part of these consolidated financial statements.

PJSC “RussNeft”

Consolidated statement of financial position

as at 31 December 2018

(in millions of Russian rubles)

	Notes	31 December 2018	31 December 2017
Assets			
Non-current assets			
Property, plant and equipment	16	135,465	122,180
Goodwill	17	13,480	13,543
Deferred tax assets	27	14,715	16,380
Exploration and evaluation assets	18	44	247
Other long-term financial assets	19	64,895	49,610
Other non-current assets		1,015	260
Total non-current assets		**229,614**	**202,220**
Current assets			
Inventories	20	7,793	7,108
Trade and other receivables	21	5,057	6,644
Income tax receivable		35	41
VAT receivable		833	819
Other short-term financial assets	19	4,115	4,848
Cash and cash equivalents	22	2,897	1,962
Prepayments and other current assets	21	2,704	1,401
Total current assets		**23,434**	**22,823**
Total assets		**253,048**	**225,043**
Equity and liabilities			
Equity attributable to Shareholders of the Parent			
Share capital	23	196	196
Share premium		60,289	60,289
Foreign currency translation reserve		(1,167)	2,842
Retained earnings / (accumulated loss)		50	(11,585)
Total equity attributable to Shareholders of the Parent		**59,368**	**51,742**
Non-controlling interests	8	18,560	15,084
Total equity		**77,928**	**66,826**
Long-term liabilities			
Long-term loans and borrowings	24	85,771	81,334
Deferred tax liabilities	27	7,017	6,435
Decommissioning liability	25	8,315	7,542
Other long-term liabilities	26	22,831	25,494
Total long-term liabilities		**123,934**	**120,805**
Short-term liabilities			
Short-term loans and borrowings	24	13,052	133
Trade and other payables and accrued liabilities	26	14,785	16,624
Taxes and levies payable (excluding income tax)	26	8,620	8,154
Income tax payable		1,909	165
Advances received and other short-term liabilities	26	12,820	12,336
Total short-term liabilities		**51,186**	**37,412**
Total liabilities and equity		**253,048**	**225,043**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

for the year ended 31 December 2018

(in millions of Russian rubles)

		Equity attributable to Shareholders of the Parent						
	Notes	**Share capital**	**Share premium**	**Foreign currency translation reserve**	**Retained earnings / (accumulated loss)**	**Shareholders’ equity**	**Non-controlling interests**	**Total equity**
31 December 2016		**196**	**60,289**	**1,849**	**(17,283)**	**45,051**	**16,656**	**61,707**
Profit/(loss) for the period		–	–	–	8,126	8,126	(821)	7,305
Foreign currency translation reserve		–	–	993	–	993	(773)	220
Total comprehensive income/(loss) for the period		**–**	**–**	**993**	**8,126**	**9,119**	**(1,594)**	**7,525**
Dividends		–	–	–	(2,360)	(2,360)	(4)	(2,364)
Dividends refund		–	–	–	–	–	6	6
Non-controlling interests in shareholders’ contribution to subsidiaries’ equity		–	–	–	(60)	(60)	60	–
Changes in non-controlling interests of subsidiaries		–	–	–	(9)	(9)	(40)	(49)
Other equity transactions		–	–	–	1	1	–	1
31 December 2017		**196**	**60,289**	**2,842**	**(11,585)**	**51,742**	**15,084**	**66,826**
Profit/(loss) for the period		–	–	–	14,993	14,993	(220)	14,773
Foreign currency translation reserve		–	–	(4,009)	–	(4,009)	2,904	(1,105)
Total comprehensive income/(loss) for the period		**–**	**–**	**(4,009)**	**14,993**	**10,984**	**2,684**	**13,668**
Dividends	7, 23	–	–	–	(2,551)	(2,551)	(3)	(2,554)
Dividends refund		–	–	–	–	–	3	3
Non-controlling interests in shareholders’ contribution to subsidiaries’ equity		–	–	–	(662)	(662)	662	–
Changes in non-controlling interests of subsidiaries	7	–	–	–	(147)	(147)	130	(17)
Other equity transactions		–	–	–	2	2	–	2
31 December 2018		**196**	**60,289**	**(1,167)**	**50**	**59,368**	**18,560**	**77,928**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

for the year ended 31 December 2018

(in millions of Russian rubles)

	Notes	Year ended 31 December 2018	Year ended 31 December 2017
Cash flows from operating activities			
Profit before tax		21,412	11,281
Profit before tax		**21,412**	**11,281**
Adjustments for non-cash items to reconcile profit before income tax to net cash flows			
Depreciation, depletion and amortization	12	13,272	11,904
Loss on disposal of property, plant and equipment	15	75	3
Impairment of financial investments	15	311	713
Impairment of property, plant and equipment and exploration and evaluation assets	15	501	443
Benefit obligations, allowance for expected credit losses and other provisions		345	397
Disposal of subsidiaries and other securities	15	(261)	–
Loss on cash flow hedge and exercise of options	15	6,176	4,116
Derecognition of provisions	15	(127)	–
Finance income	14	(3,199)	(4,024)
Finance expense	14	8,985	5,699
Foreign exchange differences		1,453	(348)
Other adjustments		162	17
Net operating cash flows before working capital changes		**49,105**	**30,201**
Working capital adjustments			
Increase in inventories		(201)	(370)
Increase in trade and other receivables		(484)	(1,810)
(Decrease)/increase in trade and other payables		(6,426)	6,848
Decrease in other current assets		3	21
Income tax paid		(3,215)	(2,209)
Net cash from operating activities		**38,782**	**32,681**
Cash flows from investing activities			
Purchase of property, plant and equipment and other non-current assets		(24,639)	(25,781)
Proceeds from disposal of property, plant and equipment		83	156
Proceeds from sale of other securities		250	–
Loans issued	19	(568)	(829)
Proceeds from loans issued	19	–	136
Interest received		–	104
Net cash used in investing activities		**(24,874)**	**(26,214)**
Cash flows from financing activities			
Acquisition of non-controlling interests in subsidiaries and purchase of treasury shares by subsidiaries	7	(17)	(49)
Proceeds from loans and borrowings received		–	2,237
Repayment of loans and borrowings received	24	(6)	(1,858)
Interest paid	24	(6,465)	(5,318)
Dividends paid to Shareholders of the Parent	23	(2,523)	(2,382)
Dividends paid to non-controlling shareholders	7	(2)	(3)
Exercise of options		(4,332)	–
Net cash used in financing activities	24	**(13,345)**	**(7,373)**
Effect of foreign exchange rate changes on balances of cash and cash equivalents		372	(200)
Change in cash and cash equivalents		**935**	**(1,106)**
Cash and cash equivalents at the beginning of the period		1,962	3,068
Cash and cash equivalents at the end of the period		**2,897**	**1,962**

1. Corporate information

The consolidated financial statements of Public Joint Stock Company “RussNeft” (the “Parent” or the “Company”) and its subsidiaries (collectively referred to as the “Group”) for the year ended 31 December 2018 were authorized for issue in accordance with a resolution of management on 25 March 2019.

The Group comprises joint stock companies and limited liability companies as defined in the Civil Code of the Russian Federation. In addition, the Group includes limited liability companies registered or operating in the Republic of Azerbaijan, the United Kingdom of Great Britain and Northern Ireland, the Republic of Cyprus, the Islamic Republic of Mauritania, the British Virgin Islands and the Cayman Islands.

The principal activities of the Group are prospecting, exploration, development, production and marketing of oil, gas and oil products. Principal subsidiaries included in the consolidated financial statements and respective ownership interests of the Company as at 31 December 2018 and 2017 are presented in Note 7.

The Parent was incorporated on 17 September 2002. In November 2016, the Parent made a public placement of common shares on the Moscow Exchange.

As at 31 December 2018, the person who was able to control the actions of the Company was Mikhail Safarbekovich Gutseriev.

In 2018, the average number of employees employed by the Group’s companies as at 31 December 2018 was 9,394 people (2017: 9,818 people).

The Parent is located at 69 Pyatnitskaya street, Moscow, Russian Federation, tel.: +7 (495) 411-63-09, e-mail: russneft@russneft.ru, www.russneft.ru.

2. Basis of preparation

Statement of compliance

The consolidated financial statements of the Group for the year ended 31 December 2018 have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

Basis of accounting

The Group’s companies, incorporated in the Russian Federation, maintain their accounting records in Russian rubles (“RUB”) and prepare their financial statements in accordance with the Regulations on Accounting and Reporting in the Russian Federation. The consolidated financial statements are based on the statutory accounting records, with adjustments and reclassifications recorded for the purpose of fair presentation of information in accordance with IFRS. Management believes that these consolidated financial statements reflect all significant adjustments required to present fairly the Group’s financial position, performance results, and statements of changes in equity and cash flows for the reporting and comparable periods. The principal adjustments relate to the consolidation of subsidiaries, changes in non-controlling interests, goodwill recognition, accounting for jointly controlled transactions and investments in associates, expense and revenue recognition, valuation allowances for unrecoverable assets, depreciation and valuation of property, plant and equipment, use of fair values, impairment of assets, foreign currency translation, financial instruments, deferred tax and decommissioning liability.

2. Basis of preparation (continued)

Basis of measurement

These consolidated financial statements are prepared on a historical cost basis, except as disclosed in the Note *Summary of significant accounting policies* below.

The consolidated financial statements are presented in Russian rubles, and all values are rounded to the nearest million (“RUB million”), unless otherwise indicated.

Functional currency and foreign currency translation

The financial statements of each of the Group’s companies are measured using the currency of the primary economic environment in which the company operates (the “functional currency”). The functional currency of the Group’s subsidiaries operating in Russia, the Parent and certain foreign subsidiaries of the Group incorporated due to the extension of the Parent’s operations is the Russian ruble. The functional currency of other foreign subsidiaries is the US dollar.

In individual companies, transactions in foreign currencies are initially recorded in the functional currency by applying the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the official exchange rate set by the Central Bank of Russia (the “CBR”) at the reporting date. All resulting exchange differences are included in the consolidated statement of profit or loss and other comprehensive income. Non-monetary assets and liabilities that are measured at historical cost and denominated in a foreign currency are translated into the functional currency using the rates of exchange as at the dates of the initial transactions. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined.

At the reporting date, assets and liabilities (including related goodwill) of non-RUB functional currency subsidiaries, joint ventures and associates are translated in the consolidated financial statements into the presentation currency of the Group using the rate of exchange effective at the reporting date. The performance results and cash flows of non-RUB functional currency subsidiaries, joint ventures and associates are translated into Russian rubles using the average rates of exchange for the reporting period; in case of significant exchange rate fluctuations, certain significant transactions are translated at the exchange rate ruling at the date of the transaction. The exchange differences arising on such translation are recorded as a separate equity component. On disposal of a company whose functional currency is different from the presentation currency, the deferred cumulative amount of the foreign currency translation reserve recorded within equity and related to that particular company is recognized in the consolidated statement of profit or loss and other comprehensive income.

In the Russian Federation, official exchange rates are set daily by the CBR. As at 31 December 2018 and 31 December 2017, the exchange rates used for the translation of USD-denominated transactions and balances were equal to the official CBR exchange rate of RUB 69.4706 and RUB 57.6002 per one US dollar respectively. As at 25 March 2019, the official exchange rate was RUB 63.7705 per one US dollar.

Going concern

These consolidated financial statements have been prepared on a going concern basis that assumes the sale of assets and the settlement of any liabilities (including contractual) in the normal course of business. This statement was made based on the assessment of the Group’s ability to continue as a going concern for at least twelve months after the end of the reporting period.

2. Basis of preparation (continued)

Basis of consolidation

Subsidiaries

Subsidiaries are the companies controlled by the Parent. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The Group has control over the investee when the following conditions are met:

- The Group has power over the investee;
- The Group is exposed to, or has rights, to variable returns from its involvement with the investee;
- The Group has the ability to use its authority over the investee to affect its returns.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date when control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the Parent, using consistent accounting policies. Where necessary, the accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group. All intercompany transactions, balances and unrealized gains on transactions between the Group entities are eliminated; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

A change in the ownership interest without a loss of control is accounted for as an equity transaction.

In case of a loss of control over a subsidiary, the Group:

- Derecognizes the assets and liabilities of the subsidiary, including goodwill;
- Derecognizes the carrying amount of any non-controlling interests;
- Derecognizes the cumulative foreign currency translation recorded in equity;
- Recognizes the fair value of the consideration received;
- Recognizes the fair value of any investment retained;
- Recognizes profit or loss due to a loss of control related to the controlling interest of the disposed subsidiary in the consolidated statement of profit or loss and other comprehensive income;
- Reclassifies the Parent company’s share of components previously recognized in other comprehensive income to profit or loss or retained earnings in accordance with IFRS requirements.

Non-controlling interests stand for the equity in subsidiaries not attributable, directly or indirectly, to the Parent company. Non-controlling interests are presented in the consolidated statement of financial position of the Group within equity, separately from the Parent’s shareholders’ equity. Profit or loss, as well as every component within comprehensive income, are attributable to Shareholders of the Parent and non-controlling interests even if that results in a deficit balance of non-controlling interests.

Joint arrangements and joint venture

Joint arrangements stand for arrangements jointly controlled by two or more parties under contractual agreements. Joint arrangements can take the form of either a joint operation or a joint venture.

2. Basis of preparation (continued)

Basis of consolidation (continued)

A joint venture is an agreement on a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Generally, joint ventures are established in the form of a legal entity where the Group and other participants have respective equity interests.

Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

A joint operation implies that the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. In accordance with its interest in a joint operation, the Group recognizes its assets and share in joint obligations as well as in revenue from the sales of goods and expenses, including the share in joint expenses.

Associates

Associates are those entities in which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but not to control or jointly control it.

When deciding whether significant influence or joint control exists, the Group considers the same factors used to evidence the existence of control in subsidiaries.

The Group accounts for investments in joint ventures and associates using the equity method. Under the equity method the investments in associates or joint ventures are initially recognized at cost. The carrying amount of the investment is adjusted in subsequent periods for the post-acquisition changes in the Group’s share of the net assets of associates or joint ventures. Goodwill relating to the associate or joint venture is included in the carrying amount of the investment and is neither amortized nor individually tested for impairment; the entire carrying amount is tested for impairment where there is evidence of impairment of an investment.

The consolidated statement of profit or loss and other comprehensive income reflects the Group’s share in the results of the associate or joint venture. Changes in other comprehensive income of such investees are recognized in other comprehensive income of the Group. Further, when there has been a change recognized directly in the equity of the associate or joint venture, the Group recognizes its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity.

Unrealized gains and losses resulting from transactions between the Group and the associate or joint venture are eliminated to the extent of the interest in the associate or joint venture.

The Group’s share of profits or losses of the associate and joint venture is shown directly in the consolidated statement of profit or loss and other comprehensive income separately from the operating income of the Group. It is represented by profits or losses after tax and non-controlling interests in the subsidiaries of the associate or joint venture. The financial statements of the associate or joint venture are prepared for the same reporting period as the Group’s financial statements. Adjustments are made where necessary to bring the accounting policies into line with those of the Group.

2. Basis of preparation (continued)

Basis of consolidation (continued)

After application of the equity method, the Group determines whether it is necessary to recognize an additional impairment loss on the Group’s investment in the associate or joint venture. The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of an associate or joint venture and its carrying amount and recognizes the amount in the consolidated statement of profit or loss and other comprehensive income in the line “Share in income/(loss) of associates and joint ventures”.

If the significant influence over the associate or joint venture is lost, the Group assesses and recognizes the investments retained at fair value. Any difference between the carrying amount of the associate or joint venture upon loss of significant influence or joint control and the fair value of the retained investment and proceeds from disposal is recognized in profit or loss.

Changes in accounting policies

The accounting policies adopted are consistent with those of the previous reporting period, except for the adoption of new standards and interpretations (including those requiring additional disclosures) effective as at 1 January 2018, which had no significant impact on the Group’s financial position and performance. The Group has not adopted early any other standard, interpretation or amendment that has been issued but is not yet effective.

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments*, which replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard brings together all three phases of the financial instruments accounting project: classification and measurement, impairment, and hedge accounting.

The Group analyzed the classification of all of its available financial instruments as per the consolidated statement of financial position as at 31 December 2017 and concluded that they had not been significantly affected by IFRS 9. At the same time, the Group implemented an internal model to assess expected credit losses. The model was developed in accordance with IFRS 9 and is designed to assess credit risk exposure of counterparties subject to financial asset characteristics. The Group did not identify any significant differences between the amounts of provisions recognized in the consolidated financial statements as at 31 December 2017 and those obtained using the model. Therefore, the Group did not restate respective indicators as at 1 January 2018 and does not include any additional disclosures in the consolidated financial statements. In respect of trade accounts receivable, the Group estimates expected credit losses using a simplified approach as envisaged by IFRS 9.

IFRS 15 Revenue from Contracts with Customers

A new standard IFRS 15 *Revenue from Contracts with Customers* was issued in May 2014. The new standard contains complete guidance for revenue recognition and establishes a new five-step model that will apply to revenue arising from contracts with customers and includes a comprehensive set of the relevant disclosure requirements for financial statements. The new standard replaces IAS 18 *Revenue*, IAS 11 *Construction Contracts* and a number of IFRS interpretations on revenue recognition.

2. Basis of preparation (continued)

Changes in accounting policies (continued)

The Group analyzed all key contracts with customers using a modified retrospective approach and estimated the effect of the application of IFRS 15 as insignificant. In respect of advances received from customers, the Group accrues interest for early payments, except for short-term advances for goods to be delivered and/or services to be provided within one year. For these advances, the Group assesses the effect of a significant financing component as insignificant.

The amendments to IFRS summarized below did not have a significant effect on these consolidated financial statements of the Group:

- Amendments to IAS 28 *Investments in Associates and Joint Ventures*;
- Amendments to IFRS 2 *Classification and Measurement of Share-based Payment Transactions*;
- IFRIC Interpretation 22 *Foreign Currency Transactions and Advance Consideration*;
- Amendments to IAS 40 *Transfers of Investment Property*;
- Amendments to IFRS 4 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*;
- Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

3. Significant accounting judgments, estimates and assumptions

Judgments

Information about significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements is described in particular in the following notes:

Note 9 − Business combinations, acquisition of associates and joint ventures;

Note 10 – Investments in associates and joint ventures;

Note 16 − Property, plant and equipment;

Note 17 − Goodwill;

Note 18 − Exploration and evaluation assets;

Note 19 – Other long-term and short-term financial assets;

Note 21 − Trade and other receivables, prepayments and other current assets;

Note 24 – Long-term and short-term loans and borrowings;

Note 25 – Decommissioning liability;

Note 27 – Income tax;

Note 29 – Fair value measurement;

Note 30 – Contingencies, commitments and operating risks;

Note 31 − Financial risk management;

Note 32 − Oil and gas reserves (unaudited).

3. Significant accounting judgments, estimates and assumptions (continued)

Judgments (continued)

In the process of applying the Group’s accounting policies, management has made the following judgments, based on its professional experience, that have the most significant effect on the amounts recognized in the consolidated financial statements.

Reserves base

Oil and gas development and production assets are depreciated on a unit-of-production basis at a rate calculated by reference to total proved or proved developed reserves determined in accordance with the standards set by the Society of Petroleum Engineers (SPE standards for estimating reserves) and incorporating the estimated future cost of developing and extracting those reserves. Commercial reserves are determined using estimates of oil in place, recovery rates and expected oil prices. Future development costs are estimated using assumptions as to production facilities required to extract commercial reserves and their costs. The level of estimated commercial reserves is also a key determinant in assessing whether the carrying amount of any of the Group’s non-current assets, including goodwill, has been impaired. Revaluation according to new data is possible during the process of field development. The Group’s reserves are disclosed in Note 32.

Carrying amount of oil and gas properties

Oil and gas properties, excluding wells, are depreciated using the unit-of-production (UOP) method at a rate calculated by reference to proved mineral reserves of certain fields and other oil and gas infrastructure facilities. Wells are depreciated at a rate calculated by reference to proved developed reserves. The calculation of the unit-of-production rate of depreciation could be impacted to the extent that actual production in the future is different from current forecast production based on proved developed reserves. This would generally result from significant changes in any of the factors or assumptions used in estimating reserves.

These factors could include:

- Changes in proved or proved developed reserves;
- The effect on total proved or proved developed reserves of differences between actual commodity prices and commodity price assumptions;
- Unforeseen operational issues.

Impairment indicators

The recoverable amounts of cash-generating units and individual assets have been determined based on the higher of value-in-use calculations and fair values less costs to sell. These calculations require the use of estimates and assumptions. It is reasonably possible that the oil price assumption may change which may then impact the estimated life of the field and may then require a material adjustment to the carrying amount of goodwill and other non-current assets. The Group monitors internal and external indicators of impairment relating to its financial and non-financial assets.

3. Significant accounting judgments, estimates and assumptions (continued)

Judgments (continued)

Fair value of financial assets and liabilities

Fair value of financial assets and liabilities, except for financial instruments traded in major markets, is determined using various valuation techniques. Management applies professional judgment in accepting assumptions at each reporting date. Discounted cash flow analysis is applied in relation to financial assets and liabilities not traded in major markets. The effective interest rate is determined based on the market interest rates of financial instruments available to the Group. When such instruments are unavailable, the effective interest rate is determined based on the market interest rates as adjusted by the Group’s management for the risks inherent to the Group. Fair values and sensitivity analysis of financial assets and liabilities are disclosed in Notes 29 and 31.

Decommissioning liability

Decommissioning costs will be incurred by the Group mainly at the end of the operating life of the fields. The ultimate decommissioning costs are uncertain and cost estimates can vary in response to many factors, including changes to relevant legal requirements, the emergence of new restoration techniques and/or experience at other production sites. The expected timing and amount of expenditure may also change, for example, in response to changes in reserves or changes in laws and regulations or their interpretation. As a result, there could be significant adjustments to the provisions recognized which, in turn, would affect future financial results.

Useful life of other property, plant and equipment

The Group assesses the remaining useful lives of items of other property, plant and equipment at least at each financial year-end. If expectations differ from the previous estimates, the changes are accounted for as a change in the accounting estimates in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. These estimates may have a material impact on the carrying amounts of property, plant and equipment and on depreciation recognized in the consolidated statement of profit or loss and other comprehensive income.

Allowance for expected credit losses

In accordance with IFRS 9, the Group applies the ECL model to determine the amount of allowance for financial instruments. A counterparty’s credit risk is assessed on initial recognition of the financial asset using the Company’s internal credit risk assessment matrix and during monitoring at each subsequent reporting date. The assessment matrix represents a set of parameters to be individually assessed according to a pre-defined scale, with factors such as settlement terms under agreements, the counterparty’s credit rating, its market reputation and credibility, nature of relationship of the parties, collateral under agreements, existing and projected unfavorable events, etc., taken into consideration. The counterparty’s credit risk is assessed by summing up the scores and may fall into one of three categories (high, medium or low). The ECL allowance for each risk category is estimated based on certain indicators. If the financial condition of the counterparty were to deteriorate, actual write-offs might be higher than expected at the reporting date.

3. Significant accounting judgments, estimates and assumptions (continued)

Judgments (continued)

Income tax

The Group recognizes the net future tax benefit in respective of deferred income tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred income tax assets requires the Group to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on projected cash flows from operating activities and the application of existing tax laws in each jurisdiction.

To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Group to realize the net deferred tax assets recorded at the reporting date could be impacted. Additionally, future changes in tax laws in the jurisdictions in which the Group operates could limit the ability of the Group to obtain tax deductions in future periods.

Contingencies

By their nature, contingencies will be resolved only when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgment and the use of estimates regarding the outcome of future events.

4. Summary of significant accounting policies

Business combinations and goodwill

Acquisitions by the Company of controlling interests in third parties (or interest in their share capital) are accounted for using the acquisition method. The acquisition date is the date when effective control over the acquiree passes to the Company.

The cost of an acquisition is measured as the aggregate of the consideration transferred measured at the acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the Company elects whether to measure the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree’s identifiable net assets. Acquisition-related costs are included in administrative expenses.

Any contingent consideration to be transferred by the acquirer should be recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability will be recognized either in profit or loss or as a change to other comprehensive income. If the contingent consideration is classified as equity, it will not be remeasured.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognized for a non-controlling interest over the net identifiable assets acquired and liabilities assumed. If the fair value of the net assets of the subsidiary acquired is in excess of the consideration, the difference is recognized in the consolidated statement of profit or loss and other comprehensive income.

4. Summary of significant accounting policies (continued)

Oil and natural gas exploration and evaluation expenditure

License and property acquisition costs

Exploration license and leasehold property acquisition costs are capitalized within exploration and evaluation assets. Each property is reviewed on an annual basis to confirm that drilling activity is planned and that it is not impaired. If no future activity is planned, the balance of the license and property acquisition costs is written off. Upon determination of economically recoverable reserves (“proved reserves” or “commercial reserves”), and when development is approved by the Group, the relevant expenditure is transferred to oil and gas properties.

Exploration and evaluation costs

Prior to acquisition of the legal right to explore, all costs are recorded in the consolidated statement of profit or loss and other comprehensive income as incurred. Once such legal right has been acquired, exploration and evaluation costs directly associated with an exploration well are capitalized as exploration and evaluation assets until the drilling of the well is complete and the results have been evaluated. These costs include employee remuneration, materials and fuel used, rig costs and payments made to contractors. Other exploration and evaluation costs are expensed as incurred.

If extractable hydrocarbons are found and, subject to further appraisal activity, which may include the drilling of further wells, are likely to be developed commercially, the costs continue to be carried as an exploration and evaluation asset while sufficient/continued progress is made in assessing the commerciality of the hydrocarbons.

All such carried costs are subject to technical, commercial and management review for impairment at least once a year to confirm the continued intent of the Group to develop or otherwise extract value from the discovery.

When this is no longer the case, the costs are written off. When proved reserves of oil are determined and development is sanctioned, the relevant expenditure is transferred to oil and gas properties after impairment is assessed and any resulting impairment loss is recognized.

Development costs

Expenditure on the construction, installation or completion of infrastructure facilities such as pipelines and the drilling of development wells is capitalized within oil and gas properties.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to making the asset operational and the initial estimate of the decommissioning obligation, if applicable. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalized value of a finance lease is also included within property, plant and equipment.

At each reporting date, the Group management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management of the Group’s entities 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.

4. Summary of significant accounting policies (continued)

Property, plant and equipment (continued)

In assessing value in use the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded companies or other available fair value indicators.

The carrying amount is reduced to the recoverable amount, and the difference is recognized as an expense (impairment loss) in the consolidated statement of profit or loss and other comprehensive income. Impairment losses related to continuing operations are recognized in the consolidated statement of profit or loss and other comprehensive income in those expense categories that are consistent with the function of the impaired asset.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset’s recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such increase is recognized in the consolidated statement of comprehensive income.

Depreciation

Oil and gas properties, except for wells, but including related future decommissioning costs are depreciated using the unit-of-production method at a rate calculated by reference to proved mineral reserves of the license areas and other infrastructural oil and gas properties. Wells are depreciated at a rate calculated by reference to proved developed reserves. The unit-of-production rate for the amortization of field development costs takes into account expenditures incurred to date, together with sanctioned future development expenditure.

Other property, plant and equipment is generally depreciated on a straight-line basis over its estimated useful life. Property, plant and equipment held under finance leases is depreciated over the shorter of the lease term and the estimated useful life.

The depreciation periods that represent the estimated remaining useful economic lives of the respective assets are as follows:

	Years
Buildings	10-60
Plant and machinery	3-15
Equipment and motor vehicles	5-10
Office and other equipment	3-10

Major maintenance and repairs

Expenditure on major maintenance refits or repairs comprises the cost of replacement assets or parts of assets and inspection costs.

4. Summary of significant accounting policies (continued)

Major maintenance and repairs (continued)

Where an asset or part of an asset that was separately depreciated and is now written off is replaced and it is probable that future economic benefits associated with the item will flow to the Group, the expenditure is capitalized. Where part of the asset was not separately considered as a component, the replacement value is used to estimate the carrying amount of the replaced assets which is immediately written off. Inspection costs associated with major maintenance programs are capitalized and amortized over the period to the next inspection. All other maintenance costs are expensed as incurred.

Construction in progress

Construction in progress includes all expenses on the acquisition of property, plant and equipment, including respective variable overheads directly attributable to their construction. Accrual of depreciation and amortization of these assets commences when they actually begin operation. The Group measures the carrying amount of construction in progress on a regular basis to identify any indication of impairment of construction in progress and to accrue a respective allowance.

Goodwill and other intangible assets

Goodwill and other intangible assets are carried at initial cost less any accumulated amortization and any accumulated impairment losses. The initial cost of intangible assets is the aggregate amount paid or the fair value of any other consideration given to acquire the asset at the moment of its acquisition or establishment. The cost of intangible assets acquired in a business combination is initially recognized at fair value as at the date of acquisition.

Following initial recognition, intangible assets are carried at cost less any accumulated amortization on a straight-line basis over their useful lives (except goodwill) and any accumulated impairment losses. Internally generated intangible assets are not capitalized and expenditure is reflected in the consolidated statement of profit or loss and other comprehensive income in the reporting period in which the expenditure is incurred.

Non-current assets held for sale and discontinued operations

Non-current assets and disposal groups classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered mainly through a sale transaction rather than continuing use. This condition is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Management must be committed to a sale which qualifies for recognition as a completed sale within one year from the date of classification.

In the consolidated statement of profit or loss and other comprehensive income for the reporting period, and the comparable period of the previous year, income and expenses from discontinued operations are reported separately from income and expenses from continuing activities, down to the level of profit after taxes, even when the Group retains a non-controlling interest in the subsidiary after the sale. The resulting profit or loss (after taxes) is reported in the consolidated statement of profit or loss and other comprehensive income.

Property, plant and equipment and intangible assets once classified as held for sale are not depreciated or amortized.

4. Summary of significant accounting policies (continued)

Impairment of non-financial assets

Impairment of intangible assets other than goodwill is determined in a way consistent with that of the impairment of property, plant and equipment.

The Group conducts internal reviews of values of goodwill and indefinite life intangible assets annually at 31 December or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount of the cash-generating unit (group of cash-generating units) to which goodwill has been allocated, an impairment loss is recognized in the consolidated statement of profit or loss and other comprehensive income.

The loss recognized in the reporting period on goodwill impairment is not reversible in the next reporting period.

Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one party and a financial liability or equity instrument of another party to the contract.

Under IFRS 9, the Group classifies financial assets at initial recognition as subsequently measured at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVPL). The Group classifies its financial assets on the basis of a business model used to manage the assets and contractual cash flow characteristics.

The Group classifies most of its financial assets as subsequently measured at amortized cost, as both recognition criteria are satisfied (as part of the SPPI test): the assets are held under a business model to collect contractual cash flows on specified dates and solely through payments of principal and interest on the principal amount outstanding. Loans issued, trade and other receivables, cash and cash equivalents are measured at amortized cost. Certain loans issued and other financial assets may be measured at fair value through profit or loss.

Financial assets at amortized cost are subsequently measured using the effective interest rate method and subject to the impairment requirements. Gains or losses are recognized in profit or loss when such assets are derecognized, modified or impaired.

The Group derecognizes a financial asset only when its contractual rights to the cash flows from the asset expire, or it transfers its contractual rights to receive cash flows from such a financial asset to another party which obtains substantially all the risks and rewards of ownership of the financial asset. The rights and liabilities created or retained upon the transfer may be recognized separately as an asset or a liability.

4. Summary of significant accounting policies (continued)

Financial instruments (continued)

At each reporting date, the Group recognizes an allowance for expected credit losses on all financial assets measured at amortized cost. The allowance represents the difference between the contractual cash flows and the cash flows that the Group expects to receive, discounted at the original effective interest rate or its approximate value. The impairment allowance is estimated based on either 12-month ECL, representing ECL arising from defaults by the counterparty within 12 months after the reporting date, or lifetime ECL, provided the credit risk has significantly increased since the initial recognition of the asset. Allowances for impairment of trade receivables are assessed using a simplified approach in the amount equal to lifetime ECL. A financial asset is written off if the Group does not have any reasonable expectations regarding the recoverability of contractual cash flows.

Fair value

The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the reporting date (Level 1 of the fair value hierarchy). Inputs which are not quoted prices included within Level 1 and which are observable for the asset or liability, either directly or indirectly, represent Level 2 of the fair value hierarchy. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm’s length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow analysis or other valuation models taking into account possible adjustments to Level 2 inputs (Level 3 of the fair value hierarchy). Generally, they include unobservable inputs for the asset or liability. Management of the Group uses its own judgment in allocating financial assets to a particular level of the fair value hierarchy. In view of significant adjustments to Level 2 and other inputs, management measures the fair value of its financial instruments within Level 3 of the fair value hierarchy.

Derivative financial instruments

Derivative financial instruments are recognized in the consolidated statement of financial position at fair value as financial assets when their fair value is positive or financial liabilities when their fair value is negative. Realized and unrealized gains and losses are shown in financial statements on a net basis in profit or loss, except for those financial instruments to which hedge accounting applies.

The fair value of derivative financial instruments is determined on the basis of mathematical models, using publicly available market information and other valuation methods, including forecast values.

Loans and borrowings and accounts payable

The Group recognizes a financial liability in its consolidated statement of financial position when, and only when, it becomes party to the contractual provisions of such a financial instrument. All financial liabilities are recognized initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs. The Group’s financial liabilities include trade and other payables, loans and borrowings, and derivative financial instruments.

Loans and borrowings and other payables are the most significant of the Group’s financial liabilities. After initial recognition, loans and borrowings are measured at amortized cost using the effective interest rate (EIR) method. Gains and losses related to such financial liabilities are recognized in profit or loss when the liabilities are derecognized, as well as through the EIR amortization process.

4. Summary of significant accounting policies (continued)

Loans and borrowings and accounts payable (continued)

A financial liability is derecognized when it is discharged or canceled (forgiven) or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, such an exchange is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in the statement of profit or loss.

The Group's financial liabilities classified at initial recognition as at fair value through profit or loss comprise derivative financial liabilities.

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalized as part of the cost of the respective assets. Other borrowing costs are expensed in the period in which they are incurred. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowings.

Cash and cash equivalents

Cash and cash equivalents recorded in the statement of financial position comprise cash at banks and on hand, short-term deposits and other short-term highly liquid financial assets with an original maturity of three months or less. For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Restricted cash is disclosed separately in the consolidated statement of financial position or related notes.

Inventories

Finished goods are recorded at the lower of cost and net realizable value. Cost is determined by the weighted average method and comprises direct purchase costs, cost of production, transportation and manufacturing expenses. Raw materials are valued at cost using the weighted average cost method or net realizable value, whichever is the lower. The measurement unit for crude oil is one batch.

Leases

The determination of whether an arrangement is, or contains an operating lease or a finance lease is based on the substance of the arrangement at inception. Accordingly, it should be determined whether the execution of the agreement depends on the use of a certain asset or assets and whether the agreement conveys the right to use this asset as a result of this transaction.

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the commencement of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance expenses and a reduction of the lease liability. Finance charges are allocated to each period so as to achieve a constant rate of interest on the remaining balance of the liability and are recognized directly in the consolidated statement of profit or loss and other comprehensive income.

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

4. Summary of significant accounting policies (continued)

Leases (continued)

Operating lease payments are recognized as an expense in the consolidated statement of profit or loss and other comprehensive income on a straight line basis over the lease term.

Provisions

General

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Where the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of profit and loss and other comprehensive income net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as finance costs.

Decommissioning liability

Decommissioning liability is recognized when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. In accordance with license agreements, the Group has to liquidate wells and oil and gas pipelines and to restore the surface. A corresponding amount equivalent to the provision is also recognized as part of the cost of the related property, plant and equipment. The amount recognized is the estimated cost of decommissioning, discounted to its present value.

Changes in the estimated timing of property, plant and equipment decommissioning or their abandonment cost estimates are dealt with prospectively by recording an adjustment to the provision, and corresponding adjustments to the carrying amount of the property, plant and equipment. By management's decision, the estimate of demolition and land restoration costs, net of VAT, was prospectively changed in the reporting period. The unwinding of the discount on the decommissioning provision is accounted for as a finance expense.

The Group does not recognize any deferred tax asset from the temporary difference on the decommissioning liability or the corresponding deferred tax liability from the temporary difference on the decommissioning asset.

Taxes

Income tax for the reporting period includes the amount of current tax and deferred tax.

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date in each of the countries where the Group operates and generates taxable income. Current income tax relating to items recognized directly in equity is recognized in equity.

4. Summary of significant accounting policies (continued)

Taxes (continued)

Deferred income tax

Deferred income tax is provided for using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes at the reporting date.

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

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

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

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

The carrying value of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

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

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

4. Summary of significant accounting policies (continued)

Equity

Share capital issued and outstanding

Common shares issued are classified as equity.

Non-controlling interests

A non-controlling interest is the interest in a subsidiary not held by the Group. A non-controlling interest as at the reporting date is the equity in a subsidiary not attributable, directly or indirectly, to the Parent and the non-controlling shareholders’ portion of movements in equity since the date of the business combination. The non-controlling interest is presented within equity, separately from the Parent shareholders’ equity.

Revenue and income recognition

Revenue from contracts with customers on the sale of oil, oil products and other products, as well as work or services, is recognized when control of the goods, work or services is transferred to the customer in the amount that reflects the consideration to which the Group expects to be entitled to in exchange for those goods, work or services. When determining whether control is transferred, the Group assesses whether the criteria supporting such transfer of control over goods, work and services are met.

Revenue represents the fair value of the consideration received or receivable for the sale of goods, work and services, net of discounts, export duties, value added tax, excise duties and similar levies. Revenue from oil production, where the Group cooperates with other participants, is recognized based on the Group’s share and under respective production-sharing agreements.

In respect of advances received from customers for goods to be dispatched, the Group accrues interest for early payments, except for advances for goods to be delivered and/or services to be provided within one year. For these advances, the Group assesses the effect of the financing component as insignificant.

Interest income is accrued on a regular basis by reference to the outstanding principal amount and the applicable effective interest rate, which is the rate that discounts estimated future cash receipts through the expected life of the financial asset to that asset’s net carrying amount.

Dividend income is recognized where the shareholder’s right to receive a dividend payment is established. The amount of retained earnings distributable to the shareholders is usually determined on the basis of the financial statements of the subsidiaries prepared in accordance with Russian accounting principles and the financial statements of the foreign subsidiaries of the Group. These amounts may differ significantly from the amounts calculated on the basis of IFRS.

Contract assets

A contract asset represents an entity’s right to consideration in exchange for goods or services that will be transferred to a customer. If the Group delivers goods or services to a customer before the customer pays the consideration or the consideration becomes payable, a contract asset is recognized in respect of the contingent consideration received. Currently, the Group does not have any rights for contingent consideration, for which it should recognize contract assets.

4. Summary of significant accounting policies (continued)

Revenue and income recognition (continued)

Contract liabilities

A contract liability is the Group’s obligation to transfer goods or services to a customer, for which the Group has received consideration (or consideration is due) from the customer. If the consideration is paid before the Group delivers goods or services to the customer, the Group recognizes a contract liability when the payment is made or becomes due, whichever comes first. Contract liabilities are recognized as revenue when the Group filfills its contractual obligations.

Employee benefits

The Group pays wages and salaries to its employees, as well as quarterly bonuses for achieving key performance indicators (“KPI”) by the Group companies, which include annual bonuses after the year-end closing period. Vacations and sick leaves are paid in accordance with the existing collective labor agreements of the Group.

The Group makes contributions to the State Pension Fund of the Russian Federation. These payments are calculated by the employer as a percentage of gross salary expense and are expensed as accrued.

The Group provides its employees with various defined retirement benefits in accordance with collective labor agreements. The Group uses defined contribution plans. The costs of providing such benefits are recognized in the consolidated statement of profit or loss and other comprehensive income. The Company concludes non-state pension insurance agreements and recognizes them as defined contribution pension plans in the consolidated financial statements.

5. Future changes in accounting policies

New standards and interpretations issued but not yet effective

The Group has not adopted early any standards, interpretations or amendments that have been issued but are not yet effective at the reporting date.

IFRS 16 Leases

IFRS 16 *Leases* issued in January 2016 and becoming effective for annual periods beginning on or after 1 January 2019 replaces IAS 17 *Leases* and clarifications thereto. IFRS 16 *Leases* sets out the principles for the recognition, measurement and disclosure of agreements qualifying for recognition, with major changes affecting the lessee accounting model similar to accounting for finance leases under IAS 17. The right-of-use model assumes that, at the commencement date of a lease, the lessee will have an obligation to make lease payments to the lessor for the right to use the underlying asset that is recognized by the lessee in accordance with the estimate. Should any significant changes be introduced (with respect to the lease term, amount of lease payments, etc.), both the previously recognized lease liability and the right-of-use asset should be remeasured. At the same time, lessor accounting under IFRS 16 has not significantly changed, and is similar to the approach currently applied under IAS 17.

5. Future changes in accounting policies (continued)

New standards and interpretations issued but not yet effective (continued)

In 2018, the Group started analyzing whether its current lease agreements qualify as leases under IFRS 16 *Leases*, and developing a lease accounting model and related disclosures as part of the consolidated financial reporting process. A quantitative analysis of information on the Group’s lease agreements is still under way, and preliminary deliverables are likely to change as at the date of the application of IFRS 16 *Leases*. At the date of the initial application, the Group plans to adopt the modified retrospective approach to lease agreements and use a range of significant exceptions and exemptions on transition: with regard to leases that expire within 12 months as at the date of initial application, with regard to leases with low-value underlying assets, and with regard to leases related to the exploration or use of mineral resources, oil, natural gas and similar non-renewable resources. In subsequent reporting periods, the Group will recognize amortization of the right of use of the underlying asset for lease agreements, as well as interest within finance expense on liabilities under such agreements. Key expenses were previously recognized within operating leases over the lease term.

IFRS 17 Insurance Contracts

IFRS 17 *Insurance Contracts* was issued in May 2017 and effective for annual periods beginning on or after 1 January 2021. It will have no impact on the consolidated financial statements as it is not applicable to the Group. IFRS 17 *Insurance Contracts* replaces IFRS 4 *Insurance Contracts*. It is applicable to all types of insurance contracts and establishes a comprehensive accounting standard for insurance contracts.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

IFRIC Interpretation 23 *Uncertainty over Income Tax Treatment* that was issued in June 2017 and becomes effective for annual periods beginning on or after 1 January 2019 addresses accounting for current income tax and deferred income tax when tax treatments involve uncertainties that are likely to be accepted by tax authorities and provides for an approach to better predict the outcome of uncertainties.

Amendments to IFRS 9: Financial Instruments – Prepayment Features with Negative Compensation

Amendments to IFRS 9 *Financial Instruments – Prepayment Features with Negative Compensation* issued in October 2017 and effective for annual periods beginning from of after 1 January 2019 clarify that prepayable financial assets can be measured at amortized cost or at fair value through other comprehensive income. Further, the amendments clarify that a financial asset passes the SPPI criterion regardless of any event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

The Conceptual Framework for Financial Reporting

In March 2018, a new version of *Conceptual Framework for Financial Reporting* that becomes effective for annual periods starting on or after 1 January 2020 was published. It contains new definitions of assets and liabilities, as well as clarifying definitions of income and expenses.

5. Future changes in accounting policies (continued)

New standards and interpretations issued but not yet effective (continued)

Amendments to IAS 28: Long-Term Investments in Associates and Joint Ventures

Amendments to IAS 28: *Long-Term Investments in Associates and Joint Ventures* clarify that an entity applies IFRS 9 to long-term investments in an associate or a joint venture to which the equity method is not applied but that, in substance, form part of the net investment in such long-term investments; the expected credit losses model is applied to such long-term investments in IFRS 9. The amendments should be applied retrospectively and are effective for annual periods beginning on or after 1 January 2019, with early application permitted.

The Group is currently evaluating the impact of adoption of the above new standards, clarifications and amendments on the consolidated financial statements. According to preliminary estimates, the cumulative effect of adopting the new standards will not have a significant effect on the consolidated financial statements, unless otherwise described above.

6. Segment information

Operations of the Group are represented by the exploration and production segment comprising the Parent, production subsidiaries and subsidiaries providing operator and other services relating to oil and gas exploration, development, production and transportation. Operating results of the other subsidiaries are generally insignificant and management of the Group does not use them for the purpose of taking financial or operational decisions.

Revenue from external customers broken down by key products and services and geographical areas, as well as information about major customers, is disclosed in Note 11 *Revenue*. The geographical distribution of the Group’s non-current assets except for financial instruments, deferred tax assets and other assets is disclosed in Note 16 *Property, plant and equipment*.

7. Subsidiaries of the Group

Company	Principal activity	Country of incorporation	Effective ownership 31 December 2018	Effective ownership 31 December 2017
Russneft (UK) Limited	Marketing of crude oil and petroleum products	United Kingdom	100%	100%
Russneft Cyprus Limited[1]	Other	Republic of Cyprus	20%	20%
Kura Valley Petroleum Company	Evaluation and exploration of oil and gas	Cayman Islands	20%	20%
Kura Valley Development Company[1] (undergoing liquidation)	Evaluation and exploration of oil and gas	Cayman Islands	20%	20%
Kura Valley Operating Company[1] (undergoing liquidation)	Evaluation and exploration of oil and gas	Cayman Islands	16%	16%
Russneft (BVI) Limited[1]	Other	BVI	20%	20%
Edmarnton Limited[1]	Other	BVI	20%	20%
International Petroleum Grouping S.A.[1]	Evaluation and exploration of oil and gas	Islamic Republic of Mauritania	11%	11%
CJSC IP Slavneftehim	Marketing of crude oil and petroleum products	Republic of Belarus	–	99%
LLC Torgovy Dom Russneft	Other	Russian Federation	100%	100%
LLC M-Trade	Other	Russian Federation	100%	100%
JSC Belkam-Trade	Other	Russian Federation	100%	100%
LLC Rustrade	Other	Russian Federation	100%	100%
OJSC Saratovneftegaz	Extraction and marketing of crude oil and gas	Russian Federation	96%	96%
JSC Saratov-Burenie	Extraction and marketing of crude oil	Russian Federation	96%	96%
LLC SO Agro	Other	Russian Federation	96%	96%
JSC Upravlenie Povysheniya Nefteotdachi Plasta i Kapitalnogo Remonta Skvazhin	Other	Russian Federation	96%	96%
LLC Neftebytservis	Other	Russian Federation	96%	96%
JSC Geofizservis	Other	Russian Federation	97%	96%
CJSC Servis-Centr Neftepromyslovogo i Burovogo Oborudovania (liquidated)	Other	Russian Federation	–	96%
LLC Saratovenergoneft	Other	Russian Federation	96%	96%
LLC Zavolzhskoe Upravlenie Technologicheskogo Transporta	Transportation services	Russian Federation	96%	96%
CJSC Upravlenie Promishlennoy Avtomatiki (liquidated)	Other	Russian Federation	–	96%
LLC RedOil	Extraction and marketing of crude oil and gas	Russian Federation	96%	96%
PI DOC Rovesnik	Other	Russian Federation	96%	96%
OJSC MPK Aganneftegazgeologiya	Extraction and marketing of crude oil and gas	Russian Federation	98%	97%
LLC Agan-Trans (liquidated)	Other	Russian Federation	–	97%

[1] Entities in which the Group has a direct and/or indirect interest via Russneft Cyprus Limited, a subsidiary, 100% of whose voting shares are held by the Parent.

7. Subsidiaries of the Group (continued)

Company	Principal activity	Country of incorporation	Effective ownership 31 December 2018	Effective ownership 31 December 2017
OJSC Ulyanovskneft	Extraction and marketing of crude oil	Russian Federation	100%	100%
LLC Geophisic (merged with JSC Geofizservis)	Other	Russian Federation	–	100%
LLC KOLOS	Other	Russian Federation	100%	100%
JSC Nefterazvedka (former OJSC Nefterazvedka)	Extraction and marketing of crude oil	Russian Federation	100%	51%
JSC Mohtikneft	Extraction and marketing of crude oil	Russian Federation	100%	100%
OJSC Varyeganneft	Extraction and marketing of crude oil and gas	Russian Federation	95%	93%
LLC Valyuninskoe	Extraction and marketing of crude oil	Russian Federation	95%	93%
LLC Novo-Aganskoe	Extraction and marketing of crude oil	Russian Federation	95%	93%
LLC Upravlenie Avtomatizatsii i Energetiki Neftyanogo Proizvodstva	Other	Russian Federation	95%	93%
LLC Upravlenie po Remontu i Obsluzhivaniyu Neftepromyslovogo Oborudovaniya	Other	Russian Federation	95%	93%
LLC Proizvodstvenno-Bytovoe Upravlenie	Other	Russian Federation	95%	93%
LLC Upravlenie Technologicheskogo Transporta (undergoing liquidation)	Transportation services	Russian Federation	95%	93%
ST JSC Goloil	Extraction and sales of crude oil	Russian Federation	100%	100%
LLC Belye Nochi	Extraction and marketing of crude oil	Russian Federation	100%	100%
LLC INA-Neftetrans (undergoing liquidation)	Transportation services	Russian Federation	100%	100%
OJSC NAK Aki-Otyr	Extraction and marketing of crude oil	Russian Federation	100%	100%
JSC Nazymskaya Neftegazorazvedochnaya Ekspeditsiya	Extraction and marketing of crude oil and gas	Russian Federation	100%	100%
JSC Khanty-Mansiyskaya Neftyanaya Kompaniya	Extraction and marketing of crude oil and gas	Russian Federation	100%	100%
JSC Chernogorskoe	Extraction and marketing of crude oil	Russian Federation	100%	100%
LLC Tomskaya Neft	Extraction and marketing of crude oil	Russian Federation	100%	100%
LLC NK Russneft-Bryansk	Transportation services	Russian Federation	51%	51%
Global Energy Cyprus Limited[1]	Other	Republic of Cyprus	20%	20%
GEA Holdings Limited[1]	Other	BVI	20%	20%
Kura Valley Holding Company[1]	Other	Cayman Islands	20%	20%
Karasu Petroleum Company[1]	Other	Cayman Islands	20%	20%
Karasu Development Company[1, 2]	Extraction and marketing of crude oil under PSA	Cayman Islands	20%	20%

[2] Jointly with Karasu Operating Company recognized in these consolidated financial statements as a joint operation under a product sharing agreement.

7. Subsidiaries of the Group (continued)

In 2018, the Group sold its 100% interest in CJSC IP Slavneftehim for RUB 113 million (USD 2 million at the exchange rate as at the date of transaction) to a third party. Under the agreement, the payment will be made in 2019.

At annual shareholders meetings, OJSC Varyeganneft and OJSC Saratovneftegaz decided to pay dividends to preference shareholders for 2017, due to which these shares ceased to be voting at the reporting date. The dividends accrued on preference shares to non-controlling shareholders are recognized in the consolidated statement of changes in equity.

The summarized financial information on assets, liabilities, profit or loss and cash flows of subsidiaries with material non-controlling interests is provided below:

31 December 2018	**OJSC Varyeganneft and its subsidiaries**	**OJSC Saratovneftegaz and its subsidiaries**	**Russneft Cyprus Limited and its subsidiaries and joint ventures**
	RUB million	**RUB million**	**RUB million**
Non-current assets	24,674	9,042	61,383
Current assets	11,519	17,529	5,781
Total assets	**36,193**	**26,571**	**67,164**
Long-term liabilities	(3,626)	(3,255)	(26,033)
Short-term liabilities	(7,617)	(2,784)	(18,777)
Total liabilities	**(11,243)**	**(6,039)**	**(44,810)**
Net assets	**24,950**	**20,532**	**22,354**
Equity attributable to Shareholders of the Parent	23,620	19,817	5,214
Equity attributable to non-controlling interests	1,330	715	17,140
For the year ended 31 December 2018			
Revenue	**42,555**	**6,125**	**2,812**
Profit/(loss) for the period	**3,171**	**(36)**	**(446)**
Profit/(loss) attributable to Shareholders of the Parent	3,012	(33)	(84)
Profit/(loss) attributable to non-controlling interests	159	(3)	(362)

For the year ended 31 December 2018	**OJSC Varyeganneft and its subsidiaries**	**OJSC Saratovneftegaz and its subsidiaries**	**Russneft Cyprus Limited and its subsidiaries and joint ventures**
	RUB million	**RUB million**	**RUB million**
Operating activities	1,371	467	(97)
Investing activities	(1,578)	(480)	(214)
Financing activities	207	14	514
Total change in cash and cash equivalents for the period	**–**	**1**	**203**

7. Subsidiaries of the Group (continued)

31 December 2017	OJSC Varyeganneft and its subsidiaries	OJSC Saratovneftegaz and its subsidiaries	Russneft Cyprus Limited and its subsidiaries and joint ventures
	RUB million	**RUB million**	**RUB million**
Non-current assets	26,264	9,435	42,803
Current assets	9,690	16,817	11,174
Total assets	**35,954**	**26,252**	**53,977**
Long-term liabilities	(3,889)	(2,915)	(28,154)
Short-term liabilities	(11,024)	(2,762)	(7,640)
Total liabilities	**(14,913)**	**(5,677)**	**(35,794)**
Net assets	**21,041**	**20,575**	**18,183**
Equity attributable to Shareholders of the Parent	19,861	19,854	4,248
Equity attributable to non-controlling interests	1,180	721	13,935
Year ended 31 December 2017			
Revenue	**33,864**	**6,347**	**1,626**
Profit/(loss) for the period	**1,903**	**(374)**	**(1,133)**
Profit/(loss) attributable to Shareholders of the Parent	1,804	(358)	(215)
Profit/(Loss) attributable to non-controlling interests	99	(16)	(918)

Year ended 31 December 2017	OJSC Varyeganneft and its subsidiaries	OJSC Saratovneftegaz and its subsidiaries	Russneft Cyprus Limited and its subsidiaries and joint ventures
	RUB million	**RUB million**	**RUB million**
Operating activities	2,093	346	3,837
Investing activities	(1,967)	(267)	(3,969)
Financing activities	(126)	(80)	(284)
Total change in cash and cash equivalents for the period	**–**	**(1)**	**(416)**

8. Non-controlling interests

Non-controlling interests include:

	31 December 2018		2018	31 December 2017		2017
	Non-controlling interests (%)	Non-controlling interests in net assets	Non-controlling interests in profit/(loss)	Non-controlling interests (%)	Non-controlling interests in net assets	Non-controlling interests in profit/(loss)
		RUB million	RUB million		RUB million	RUB million
Russneft Cyprus Limited and its subsidiaries and joint ventures	80%, 84%, 89%	17,140	(362)	80%, 84%, 89%	13,935	(918)
OJSC Varyeganneft and its subsidiaries	5%	1,330	159	5%	1,180	99
OJSC Saratovneftegaz and its subsidiaries	4%	715	(3)	4%	721	(16)
Other	1%-49%	(625)	(14)	1%-49%	(752)	14
Non-controlling interests at the end of the period		**18,560**	**(220)**		**15,084**	**(821)**

As at 31 December 2018, non-controlling voting interests in OJSC Varyeganneft, OJSC MPK Aganneftegazgeologiya and OJSC Saratovneftegaz comprised 1.466%, 2.198% and 0.82%, respectively. The voting interest of PJSC “RussNeft” in Russneft Cyprus Limited was 100%.

As at 31 December 2017, non-controlling voting interests in OJSC Varyeganneft, OJSC MPK Aganneftegazgeologiya and OJSC Saratovneftegaz comprised 1.543%, 2.231% and 0.859%, respectively. The voting interest of PJSC “RussNeft” in Russneft Cyprus Limited was 100%.

9. Business combinations, acquisition of associates and joint ventures

Business combinations in 2018 and 2017

The Group did not acquire any new assets in 2018 or 2017.

10. Investments in associates and joint ventures

GEA Holdings Limited Group

The Group recognizes its participation in production sharing agreements (“PSAs”) in the consolidated financial statements as joint operations involving subsidiaries and joint ventures of GEA Holdings Limited Group (“GEA group”). GEA Holdings Limited through its subsidiaries and joint ventures participates in exploration and extraction projects in the Republic of Azerbaijan under PSAs with the State Oil Company of Republic of Azerbaijan (SOCAR) and SOCAR Oil Affiliate (SOA). Assets and liabilities, revenue and expenses of the operating companies in which the Group participates as a contractor under PSAs are recorded in accordance with the interests of the Group. Joint operations are structured through the incorporation of separate legal entities (operating companies). Where control is acquired or exercised jointly, the companies within GEA group are accounted for as business combinations (Note 7) or under the equity method.

10. Investments in associates and joint ventures (continued)

GEA Holdings Limited Group (continued)

Joint ventures of GEA group are as follows:

Company	Principal activity	Country of incorporation	Share in equity 31 December 2018[3]	Share in equity 31 December 2017[3]	Consolidation method
Global Energy Azerbaijan Limited	Other	BVI	50%	50%	Equity method
Global Energy Azerbaijan Management Limited	Other	BVI	50%	50%	Equity method
Neftechala Petroleum Limited	Other	BVI	50%	50%	Equity method
Neftechala Investments Limited	Extraction and sales of crude oil under PSA	BVI	50%	50%	Equity method
Neftechala Operating Company	Extraction and sales of crude oil under PSA	BVI	40%	40%	Assets, liabilities, revenue and expenses related to the Group's interest
Absheron Petroleum Limited	Other	BVI	50%	50%	Equity method
Apsheron Investments Limited	Extraction and sales of crude oil under PSA	BVI	50%	50%	Equity method
Absheron Operating Company Limited	Extraction and sales of crude oil under PSA	BVI	38%	38%	Assets, liabilities, revenue and expenses related to the Group's interest
Shirvan Petroleum Limited	Other	BVI	50%	50%	Equity method
Shirvan Investments Limited	Extraction and sales of crude oil under PSA	BVI	50%	50%	Equity method
Shirvan Operating Company Limited	Extraction and sales of crude oil under PSA	BVI	40%	40%	Assets, liabilities, revenue and expenses related to the Group's interest
Repleton Enterprises Limited	Other	Republic of Cyprus	50%	50%	Equity method
AZEN OIL COMPANY B.V.	Extraction and sales of crude oil under PSA	Kingdom of the Netherlands	50%	50%	Equity method
Binagadi Oil Company	Extraction and sales of crude oil under PSA	Cayman Islands	38%	38%	Assets, liabilities, revenue and expenses related to the Group's interest
Global Energy Caspian Limited	Other	BVI	50%	50%	Equity method

[3] Excluding the interest of PJSC "RussNeft" in the parent company of GEA group, Russneft Cyprus Limited (Note 7).

10. Investments in associates and joint ventures (continued)

GEA Holdings Limited Group (continued)

Summarized financial information of the joint ventures of GEA group and carrying amounts of investments in joint ventures is provided below.

The statement of financial position as at 31 December 2018 and 31 December 2017:

	31 December 2018	31 December 2017
	RUB million	RUB million
Non-current assets	44,232	41,708
Current assets	10,792	2,446
including cash and cash equivalents	*1,477*	*32*
Long-term liabilities	(16,410)	(51,414)
including long-term financial liabilities	*(15,272)*	*(50,317)*
Short-term liabilities	(55,240)	(5,530)
including short-term financial liabilities	*(52,975)*	*(3,547)*
Total equity	**(16,626)**	**(12,790)**

The statement of profit or loss and other comprehensive income for 2018 and 2017:

	2018	2017
	RUB million	RUB million
Revenue	7,596	5,739
Cost of sales	(5,007)	(4,834)
including depreciation, depletion and amortization	*(1,924)*	*(2,148)*
Other operating expenses	(685)	(93)
Operating profit	**1,904**	**812**
Finance income	497	402
Finance expense	(3,127)	(4,013)
Loss before income tax	**(726)**	**(2,799)**
Income tax expense	(358)	(154)
Loss for the period	**(1,084)**	**(2,953)**
Group’s share in loss for the period	**(542)**	**(1,477)**
Unrecognized share in loss for the period	542	1,477
Share in loss of associates and joint ventures	**–**	**–**
Unrecognized share in loss for the period	(542)	(1,477)
Foreign currency translation reserve for the period	(1,377)	282
Total unrecognized share in loss at the end of the period	**(8,314)**	**(6,395)**

As at 31 December 2018 and 31 December 2017, the carrying amount of investments in associates and joint ventures equaled zero.

11. Revenue

Revenue from external customers broken down by geographical segments is presented based on the location of customers.

The Group operates in three principal geographical areas: Europe, the Commonwealth of Independent States (the “CIS”) and the Russian Federation (Russia). The Group’s non-current assets are located primarily in the Russian Federation except for those disclosed in Note 10.

Information on revenue is presented in the table below:

	Europe and other export		CIS (other than Russia)		Russian Federation		Total	
	2018	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
	RUB million	**RUB million**	**RUB million**	**RUB million**	**RUB million**	**RUB million**	**RUB million**	**RUB million**
Revenue from external customers								
Crude oil sales	54,267	39,576	10,392	9,084	106,691	74,977	171,350	123,637
Petroleum product sales	726	509	1,354	1,516	221	–	2,301	2,025
Gas sales	–	–	–	–	2,695	2,551	2,695	2,551
Other sales	–	–	–	–	1,456	980	1,456	980
Total revenue	**54,993**	**40,085**	**11,746**	**10,600**	**111,063**	**78,508**	**177,802**	**129,193**

Revenue includes revenue from two customers for the reporting period (revenue from each customer exceeds 10% of the total revenue), net of export duty:

		Geographical location	2018	2017
			RUB million	**RUB million**
Major customer 1	Crude oil sales	Russian Federation	34,617	26,261
Major customer 2	Crude oil sales	Europe and other export	30,111	22,726
Total revenue from sales to major customers			**64,728**	**48,987**

12. Cost of sales

	2018	2017
	RUB million	**RUB million**
Mineral extraction tax	71,387	48,799
Depreciation, depletion and amortization	13,272	11,904
Cost of crude oil and petroleum products sold	11,453	7,869
Payroll and related taxes	7,421	6,728
Utilities	5,950	6,244
Raw materials and supplies used in production	3,060	2,943
Production services	2,954	2,857
Equipment repair, operation and maintenance	2,360	1,989
Transportation expenses	1,307	1,080
Other expenses	5,273	4,571
Total cost of sales	**124,437**	**94,984**

13. Selling, general and administrative expenses

Selling expenses comprise:

	2018 RUB million	2017 RUB million
Pipeline tariffs and transportation expenses	10,026	9,948
Excise	11	128
Other selling expenses	16	20
Total selling expenses	**10,053**	**10,096**

General and administrative expenses comprise the following:

	2018 RUB million	2017 RUB million
Payroll and related taxes	2,443	2,281
Entertainment and business travel	354	362
Office rent	346	345
Consulting, management and other services	330	235
Software	300	183
Allowance for expected credit losses	208	29
Repair and maintenance	67	92
Bank services	54	58
Operating leases	34	36
Allowance for inventory obsolescence	(28)	39
Other expenses	383	277
Total general and administrative expenses	**4,491**	**3,937**

14. Finance income and expense

Finance income comprises the following:

	2018 RUB million	2017 RUB million
Interest income on loans issued	3,067	3,935
Other finance income	132	89
Total finance income	**3,199**	**4,024**

Finance expense comprises the following:

	2018 RUB million	2017 RUB million
Interest expense on loans and borrowings, for early payments	8,096	4,735[4]
Unwinding of the discount on long-term provisions (Note 25)	768	806
Other finance expense (Notes 19, 24)	121	158
Total finance expense	**8,985**	**5,699**

[4] The amount includes changes which occurred in 2017 in previously recognized interest expense for early payments in the amount of RUB 2,626 million (USD 45 million).

15. Other operating income and expenses

	2018 RUB million	2017 RUB million
Loss on cash flow hedge and exercise of options (Note 29)	6,176	4,116
Charity and other gratuitous expenses	1,811	961
Income tax fines, penalties	691	49
Impairment of property, plant and equipment (Note 16)	501	443
Impairment of financial investments	311	713
Fines and penalties for contractual breaches	156	28
Marketing, advertising expenses	141	19
Public service advertising	50	52
Disposal of subsidiaries and other securities[5]	(261)	–
Other income	(354)	(347)
Other expenses	142	196
Total other operating expenses, net	**9,364**	**6,230**

16. Property, plant and equipment

1 January 2017	**Oil and gas properties**	**Other property, plant and equipment**	**Construction in progress**	**Total**
Cost	186,691	3,087	–	189,778
Accumulated depreciation and impairment	(74,900)	(2,813)	–	(77,713)
Net book value as at 1 January 2017	**111,791**	**274**	**–**	**112,065**
Additions	26,185	274	51	26,510
Decommissioning liability	(2,609)	–	–	(2,609)
Transfer from construction in progress	–	51	(51)	–
Depreciation	(11,851)	(53)	–	(11,904)
Impairment	(675)	(1)	–	(676)
Reversal of impairment	232	1	–	233
Disposals, net	(774)	–	–	(774)
Foreign currency translation, net	(665)	–	–	(665)
31 December 2017				
Cost	207,232	3,390	–	210,622
Accumulated depreciation and impairment	(85,598)	(2,844)	–	(88,442)
Net book value as at 31 December 2017	**121,634**	**546**	**–**	**122,180**
Additions	25,612	1	35	25,648
Decommissioning liability	72	–	–	72
Disposal of subsidiaries, net	–	(83)	–	(83)
Transfer from construction in progress	–	35	(35)	–
Depreciation	(13,235)	(36)	–	(13,271)
Impairment	(680)	(4)	–	(684)
Reversal of impairment	183	–	–	183
Disposals, net	(1,149)	(18)	–	(1,167)
Foreign currency translation, net	2,581	6	–	2,587
31 December 2018				
Cost	233,858	3,106	–	236,964
Accumulated depreciation and impairment	(98,840)	(2,659)	–	(101,499)
Net book value as at 31 December 2018	**135,018**	**447**	**–**	**135,465**

[5] Including a gain of RUB 249 million from the disposal of an interest in LLC RusGasUnion (the investment was accounted for as other financial investments).

16. Property, plant and equipment (continued)

The Group’s non-current assets are located primarily in the Russian Federation, except for assets located in the Republic of Azerbaijan in accordance with the Group’s participation in the PSAs (Note 10).

As at 31 December 2018 and 2017, the Group has no significant pledges of property, plant and equipment.

Impairment losses

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. Based on the assessment, the Group recorded a net allowance in the amount of RUB 501 million and RUB 443 million in 2018 and 2017, respectively. The allowance as at 31 December 2018 and 31 December 2017 amounts to RUB 5,151 million and RUB 4,873 million, respectively.

Given the nature of the Group’s activities, information on the fair value of assets is in general difficult to obtain, unless negotiations are held with potential buyers. As a result, the recoverable amount used for the purpose of estimating the impairment to be accrued is determined based on a discounted cash flow model.

17. Goodwill

	RUB million
1 January 2017	**13,544**
Foreign currency translation	(1)
31 December 2017	**13,543**
Disposal of subsidiaries	(66)
Foreign currency translation	3
31 December 2018	**13,480**

Goodwill impairment tests

The Group conducts regular goodwill impairment tests. Based on the assessment as at 31 December 2018 and 31 December 2017 no impairment of goodwill was identified.

For goodwill impairment test purposes the Group uses the discounted cash flow model. The main assumptions used consist of estimates made by the Company’s management with regard to the future development trends in the oil and gas sector, and are based on both external and internal data sources. Future cash flows are based on reports on oil and gas reserves prepared by Miller and Lents, Ltd within a range of 20 years.

17. Goodwill (continued)

Goodwill impairment tests (continued)

The Company uses the following assumptions, sensitivity to which may significantly affect the valuation results:

- Discount rate: this determines the current estimates of the time value of money and risks. It is equal to the weighted average cost of capital in Russian rubles (WACC) for Russian peer companies (11.8%).
- Forecast oil price: the basic price for Brent oil is in the range of USD 70-78 per barrel, which is adjusted with regard to the spread between Brent and Urals oil prices, transportation expenses and changes in mineral extraction tax (MET).
- Sales structure by markets (exports, CIS and the domestic market): this remains the same during the valuation period.
- Difference in the netback (net price) existing in the markets (exports, CIS and the domestic market): this remains unchanged.

A 1% increase in the discount rate reveals no evidence of impairment.

Change in forecast oil price	Effect on profit before tax 2018	Effect on profit before tax 2017
USD/bbl	**RUB million**	**RUB million**
-10	(2,669)	(338)

The carrying amount of goodwill is allocated to each of the cash-generating units as follows:

		31 December 2018	31 December 2017
		RUB million	**RUB million**
OJSC Saratovneftegaz	Exploration and production	9,024	9,046
OJSC MPK Aganneftegazgeologiya	Exploration and production	3,118	3,161
OJSC Varyeganneft	Exploration and production	624	624
OJSC Ulyanovskneft	Exploration and production	228	228
OJSC NAK Aki-Otyr	Exploration and production	95	95
Other		391	389
		13,480	**13,543**

18. Exploration and evaluation assets

At the reporting date, the allowance for impairment of exploration and evaluation assets under certain projects in the Republic of Azerbaijan and the Islamic Republic of Mauritania, which was recognized in previous reporting periods, amounts to RUB 7,840 million. As at 31 December 2017, the allowance for impairment of exploration and evaluation assets amounted to RUB 6,501 million.

19. Other long-term and short-term financial assets

	Currency	31 December 2018 RUB million	31 December 2017 RUB million
Long-term loans issued to related parties	USD	64,726	49,222
Long-term loans issued to related parties	RUB	210	206
Long-term loans issued to other companies	RUB	2,463	2,378
Long-term loans issued to other companies	BYN	–	182
Allowances for expected credit losses from long-term loans issued		(2,504)	(2,378)
		64,895	**49,610**
Short-term loans issued to related parties	USD	4,117	4,848
Allowances for expected credit losses from short-term loans issued		(2)	–
		4,115	**4,848**

During the reporting period, the Group did not perform significant operations with loans issued. Loans issued and repaid are recorded within investing activities in the consolidated statement of cash flows and within other long-term and short-term financial assets in the consolidated statement of financial position. Loans issued are recognized in these consolidated financial statements at amortized cost. The Group assessed loans issued using IFRS 9, including the expected credit loss model. The aggregate effect was insignificant for this type of financial assets.

The Parent records loans issued to related parties to GEA group companies under the equity method as long-term financial assets in these consolidated financial statements (Note 10). As at 31 December 2018 and 31 December 2017, the loans receivable (including accumulated interest and impairment) were USD 793 million and USD 758 million (RUB 55,115 million and RUB 43,643 million at the exchange rate as at the respective reporting dates).

As at 31 December 2018 and 31 December 2017, outstanding balances on long-term and short-term financial investments (including accumulated interest and impairment) comprise the outstanding balances of loans issued to related parties by GEA group companies in the amount of USD 97 million and USD 87 million (RUB 6,728 million and RUB 5,037 million at the exchange rate as at the reporting dates), respectively. During the reporting period, certain loans were extended, which had no significant effect on the financial statements.

As at 31 December 2018 and 31 December 2017, RUB-denominated loans to Claymon Enterprises Limited were fully covered by allowances in the amount of RUB 2,448 million and RUB 2,363 million, respectively.

20. Inventories

	31 December 2018 RUB million	31 December 2017 RUB million
Crude oil	4,142	3,904
Raw materials and components	3,854	3,694
Petroleum products	136	191
Allowance for inventory obsolescence	(339)	(681)
Total inventories	**7,793**	**7,108**

21. Trade and other receivables, prepayments and other current assets

	31 December 2018 RUB million	31 December 2017 RUB million
Trade receivables	4,301	5,445
Other receivables	1,591	1,884
Allowance for expected credit losses	(835)	(685)
Total trade and other receivables	**5,057**	**6,644**

	31 December 2018 RUB million	31 December 2017 RUB million
Prepayments	3,012	1,610
Other current assets	9	11
Allowance for prepayments	(317)	(220)
Total prepayments and other current assets	**2,704**	**1,401**

Analysis of movements in the allowance for expected credit losses from trade and other receivables and in the allowance for prepayments is as follows:

	31 December 2018 RUB million	31 December 2017 RUB million
As at 1 January	**(905)**	**(911)**
Charge	(208)	(29)
Allowance used	2	25
Foreign currency translation	(41)	10
As at 31 December	**(1,152)**	**(905)**

22. Cash and cash equivalents

	31 December 2018 RUB million	31 December 2017 RUB million
Foreign currency-denominated cash at bank and on hand	2,844	1,125
RUB-denominated cash at bank and on hand	53	835
Deposits and other cash equivalents	–	2
Total cash and cash equivalents	**2,897**	**1,962**

23. Share capital

As at the reporting date, the Parent had placed 294,120,000 common shares and 98,032,000 cumulative preference shares with a nominal value of RUB 0.5 each.

As at the reporting date, the Company may place 105,880,000 more common shares and 101,968,000 more cumulative preference shares with the same nominal value of RUB 0.5 each.

23. Share capital (continued)

Interests in the share capital of the Parent as at the reporting date are presented below (shareholders owning at least 5 percent of share capital or at least 5 percent of common shares):

Name	Percentage of share capital, %	Percentage of common shares, %
OJSC IC Nadezhnost	4.95	6.60
CJSC Mlada	7.70	10.27
RAMBERO HOLDING AG	23.46	31.28
BELYRIAN HOLDINGS LIMITED	12.05	16.07
NB TRUST	27.71	3.61

The annual general shareholders meeting of the Company held in June 2018 declared dividends on cumulative preference shares for 2017: dividends per one share were declared in the amount of USD 0.40803 at the CBR rate effective at the date of actual payment. The declared dividends totaled USD 40 million or RUB 2,551 million at the exchange rate as at the date of the dividend accrual. As at the reporting date, the declared dividends were fully paid, with the payment amounting to RUB 2,523 million as at the payment date. In the reporting period and for 2017, no dividends were declared or paid on the Parent’s common shares.

Pursuant to Russian legislation, the basis for the dividend distribution is net profit calculated in accordance with the Russian Accounting Standards (“RAS”). As a rule, these amounts differ from those calculated in accordance with IFRS in these consolidated financial statements. According to the RAS financial statements audited by BDO Unicon JSC, retained earnings of the Parent as at 31 December 2018 and 31 December 2017 amount to RUB 20,455 million and RUB 11,254 million, respectively.

Earnings per share

Basic earnings per share are calculated by dividing the profit for the year attributable to common equity holders of the Parent, as adjusted, by the weighted average number of common shares outstanding during the year. The Company made preliminary estimates of the potential amount of dividends distributable among holders of cumulative preference shares, for which profit attributable to shareholders of the Parent was adjusted. As at the date of the financial statements, the general meeting of shareholders had not made any decision on the dividend distribution. The respective amounts might therefore be different if a decision is made.

The average weighted number of the Company’s outstanding common shares did not change in the reporting period. The Group did not place any securities which may have had a potential diluting effect, therefore basic and diluted earnings per share are the same.

		2018	2017
Profit attributable to Shareholders of the Parent	RUB million	14,993	8,126
Dividends on cumulative preference shares	RUB million	(2,779)[6]	(2,304)
Profit attributable to Shareholders of the Parent, as adjusted	RUB million	**12,214**	**5,822**
Weighted average number of common shares outstanding	million	294	294
Effect of dilution		–	–
Basic and diluted earnings per share	RUB per share	42	20

[6] Dividends on cumulative preference shares are shown in accordance with a preliminary estimate as the general shareholders meeting had not made a dividend payment decision as at the reporting date.

24. Long-term and short-term loans and borrowings

	Currency	Weighted average interest rate by type of liability as at 31 December 2018	31 December 2018
		%	RUB million
Long-term loans and borrowings			
Bank loans	USD	8.32%	81,427
Loans received	USD	8.00%	3,615
Loans received	RUB	6.50%	729
Total long-term loans and borrowings			**85,771**
Short-term loans and borrowings			
Bank loans	USD	8.32%	6,475
Loans received	RUB	6.87%	10
Loans received	USD	8.49%	6,567
Total short-term loans and borrowings			**13,052**

	Currency	Weighted average interest rate by type of liability as at 31 December 2017	31 December 2017
		%	RUB million
Long-term loans and borrowings			
Bank loans	USD	7.16%	72,766
Loans received	USD	8.60%	7,866
Loans received	RUB	6.50%	702
Total long-term loans and borrowings			**81,334**
Short-term loans and borrowings			
Bank loans	USD	7.16%	129
Loans received	RUB	7.00%	4
Total short-term loans and borrowings			**133**

In May 2015, PJSC VTB Bank issued a loan of USD 2,302 million (RUB 115,048 million at the exchange rate as at the date of receipt) to the Company with original maturity in March 2023 and an original fixed interest rate of 8.3%. The parties revised the loan agreement with PJSC VTB Bank several times. The latest amendments in the terms of PJSC VTB Bank loan to the Company under an addendum signed in December 2016 included a revision of the payment schedule and the maturity date (extended until March 2026). The interest rate was 3M LIBOR plus a margin of 5.5% p.a.

24. Long-term and short-term loans and borrowings (continued)

The Company repays accrued interest on a quarterly basis in accordance with the schedule and the interest rate set for the date of payment. During the reporting period, the Company made scheduled interest payments of USD 101 million or RUB 6,458 million at the exchange rate effective at the payment date under the loan issued by PJSC VTB Bank. Outstanding principal payable to PJSC VTB Bank amounted to RUB 87,762 million or USD 1,263 million at the exchange rate as at the reporting date, including a short-term portion of USD 91 million (RUB 6,335 million) payable in quarterly installments during 2019. Current interest payable amounts to RUB 140 million, or USD 2 million at the exchange rate as at the reporting date.

The loan from PJSC VTB Bank was secured by a pledge of the common shares of the Parent and the equity interests that the Parent holds in certain subsidiaries. At the same time, certain subsidiaries of the Group and other related parties are joint guarantors to the creditor with regard to the Parent's liabilities.

The loan agreement contains a number of financial and operational covenants that the Company shall comply with during the term of the agreement. Non-fulfillment of some of the agreed covenants makes the creditor entitled to claim early repayment of the principal amount and accrued interest, including interest penalties.

The outstanding amount payable under the loan in foreign currency received from a related party by a GEA group company is recorded at amortized cost using a market discount rate of 8.5% p.a. The outstanding amount is USD 77 million, or RUB 5,326 million at the exchange rate at the reporting date.

Interest accrued is primarily repaid simultaneously with the principal amount, unless otherwise specified in the loan agreements, and presented as long-term loans and borrowings.

Reconciliation of movements in financing activities from the consolidated statement of cash flows with long-term and short-term loans and borrowings from the consolidated statement of financial position is as follows:

	2018			2017		
	Long-term and short-term loans and borrowings	**Other financial liabilities**	**Total**	**Long-term and short-term loans and borrowings**	**Other financial liabilities**	**Total**
	RUB million	**RUB million**	**RUB million**	**RUB million**	**RUB million**	**RUB million**
At the beginning of the period	**81,467**	**–**	**81,467**	**85,094**	**–**	**85,094**
Cash flow used in financing activities	(6,471)	–	(6,471)	(4,939)	–	(4,939)
Interest accrued	6,933	–	6,933	5,585	–	5,585
Discounting of financial liabilities	121	–	121	(52)	–	(52)
Foreign exchange difference	15,083	–	15,083	(3,823)	–	(3,823)
Foreign currency translation	1,690	–	1,690	(398)	–	(398)
At the end of the period	**98,823**	**–**	**98,823**	**81,467**	**–**	**81,467**
Other cash flows used in financing activities, including:	–	(6,874)	(6,874)	–	(2,434)	(2,434)
Dividends paid	–	(2,525)	(2,525)	–	(2,385)	(2,385)
Exercise of options	–	(4,332)	(4,332)	–	–	–
Other movements	–	(17)	(17)	–	(49)	(49)
Net cash used in financing activities	**(6,471)**	**(6,874)**	**(13,345)**	**(4,939)**	**(2,434)**	**(7,373)**

25. Decommissioning liability

	2018		2017	
	Decom-missioning liability	Land restoration liability	Decom-missioning liability	Land restoration liability
	RUB million	RUB million	RUB million	RUB million
At the beginning of the period	**5,734**	**1,808**	**7,413**	**1,959**
Acquisitions	97	109	295	457
Disposals	(146)	(25)	(355)	(197)
Change in estimate	72	(162)	(2,239)	(580)
Unwinding of the discount on decommissioning liability	579	189	637	169
Foreign currency translation	60	–	(17)	–
At the end of the period	**6,396**	**1,919**	**5,734**	**1,808**

The Group makes provisions for the future cost of decommissioning oil production facilities on a discounted basis as the facilities begin operation or sites are damaged. The Group estimated the provision based on existing oil extraction technologies and current estimates of decommissioning costs (adjusted for inflation projections) and discounted the provision at a rate of 8.88% (2017: 10.48%).

The decommissioning liability represents the present value of decommissioning costs relating to oil and gas properties which are expected to be incurred up to 2093 depending on the recovery period of proved reserves for each group of oil and gas fields. Management makes assumptions based on the current economic environment and believes that they are a reasonable basis upon which the future liability is estimated. These estimates are reviewed regularly to take into account any material changes in the assumptions. Actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning work which will reflect specific market conditions at the relevant time. Furthermore, the timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates. This, in its turn, will depend on future oil and gas prices, which are inherently uncertain.

26. Other long-term liabilities, trade and other payables and accrued liabilities

Other long-term liabilities	31 December 2018	31 December 2017
	RUB million	RUB million
Long-term advances received	18,107	21,502
Derivative instruments at fair value (Note 29)	3,581	2,890
Long-term trade payables	1,142	1,090
Other long-term payables and accrued liabilities	1	12
Total other long-term liabilities	**22,831**	**25,494**

Trade and other payables and accrued liabilities	31 December 2018	31 December 2017
	RUB million	RUB million
Trade payables	10,024	13,248
Other short-term payables and accrued liabilities	2,441	2,150
Derivative instruments at fair value (Note 29)	2,320	1,226
Total trade and other payables and accrued liabilities	**14,785**	**16,624**

26. Other long-term liabilities, trade and other payables and accrued liabilities (continued)

Taxes and levies payable (excluding income tax)	31 December 2018	31 December 2017
	RUB million	RUB million
Mineral extraction tax	5,231	5,331
Value added tax	2,652	2,152
Property tax	391	345
Other taxes and levies (excluding income tax)	346	326
Total taxes and levies payable (excluding income tax)	**8,620**	**8,154**

Advances received and other short-term liabilities	31 December 2018	31 December 2017
	RUB million	RUB million
Advances received	12,758	11,986
Other short-term liabilities	62	350
Total advances received and other short-term liabilities	**12,820**	**12,336**

27. Income tax

The major components of income tax benefit and income tax expense are:

	2018	2017
	RUB million	RUB million
Current income tax		
Current income tax expense	2,795	1,941
Current income tax relating to previous years	1,597	441
Deferred income tax		
Relating to origination and reversal of temporary differences	2,951	2,095
Change in deferred income tax relating to previous periods	(704)	(501)
Income tax expense reported in the consolidated statement of profit or loss and other comprehensive income	**6,639**	**3,976**

The reconciliation between tax benefit / tax expense and accounting profit multiplied by the Group’s country of origin official tax rate is as follows:

	2018	2017
	RUB million	RUB million
Accounting profit before tax	**21,412**	**11,281**
Income tax at applicable tax rate (20%)	**4,282**	**2,256**
Tax effect of non-deductible expense and non-taxable income	1,314	1,489
Tax effect of rates other than 20%	(84)	125
Change in unrecognized deferred tax assets	229	124
Change in deferred income tax relating to previous periods	(704)	(501)
Current income tax relating to previous years	1,597	441
Other	5	42
Income tax expense reported in the consolidated statement of profit or loss and other comprehensive income	**6,639**	**3,976**

Generally, the subsidiaries of the Group incorporated in the Russian Federation used a 20% tax rate in 2018 and 2017; the separate subsidiaries engaged in exploration activities applied a reduced income tax rate in accordance with regional tax legislation. The subsidiaries incorporated outside the Russian Federation applied rates and exemptions stipulated by local legislation.

27. Income tax (continued)

Deferred income tax

Deferred tax assets and liabilities as at 31 December 2018 by the lines of the consolidated statement of financial position as well as their movements in 2018 are presented below:

	Consolidated statement of financial position 31 December 2017	Consolidated statement of profit or loss and other comprehensive income 2018	Disposal of subsidiaries	Consolidated statement of financial position 31 December 2018
	RUB million	RUB million	RUB million	RUB million
Deferred tax liabilities				
Oil and gas properties	(8,698)	(1,397)	–	(10,095)
Inventories	(546)	(12)	–	(558)
Other	(80)	(123)	–	(203)
Deferred tax assets				
Tax loss carry forward	20,869	(1,579)	(2)	19,288
Oil and gas properties	338	(233)	–	105
Inventories	31	(9)	–	22
Trade and other receivables	15	11	–	26
Other	955	1,327	(1)	2,281
Unrecognized tax assets	(2,939)	(229)	–	(3,168)
Total deferred tax liabilities and assets	**9,945**	**(2,244)**	**(3)**	**7,698**
Deferred income tax expense	**–**	**2,244**	**3**	**–**
Consolidated statement of financial position				
Deferred tax assets	16,380	–	–	14,715
Deferred tax liabilities	(6,435)	–	–	(7,017)

Deferred tax assets and liabilities as at 31 December 2017 by the lines of the consolidated statement of financial position as well as their movements in 2017 are presented below:

	Consolidated statement of financial position 31 December 2016	Consolidated statement of profit or loss and other comprehensive income 2017	Consolidated statement of financial position 31 December 2017
	RUB million	RUB million	RUB million
Deferred tax liabilities			
Oil and gas properties	(7,952)	(746)	(8,698)
Inventories	(492)	(54)	(546)
Loans and borrowings payable	–	–	–
Other	(180)	100	(80)
Deferred tax assets			
Tax loss carry forward	21,438	(569)	20,869
Oil and gas properties	390	(52)	338
Inventories	99	(68)	31
Trade and other receivables	10	5	15
Other	1,041	(86)	955
Unrecognized tax assets	(2,815)	(124)	(2,939)
Total deferred tax liabilities and assets	**11,539**	**(1,594)**	**9,945**
Deferred income tax expense	**–**	**1,594**	**–**
Consolidated statement of financial position			
Deferred tax assets	17,777	–	16,380
Deferred tax liabilities	(6,238)	–	(6,435)

27. Income tax (continued)

Deferred income tax (continued)

Deferred tax liabilities in respect of the retained earnings of the subsidiaries are not recognized because the Group has the power to control future distributions among investors and has no intention of making such distributions in the foreseeable future.

28. Transactions with related parties

The Group's transactions with its subsidiaries that are related parties are excluded from the consolidated financial statements and are not disclosed in this Note. Transactions with joint ventures before consolidation adjustments are fully disclosed herein.

The nature of the related party relations for those related parties with whom the Group entered into significant transactions in 2018 and 2017 or had significant balances outstanding as at 31 December 2018 and 2017 is detailed below.

Transactions with related parties in 2018 and 2017:

2018	**Sales**	**Other transactions**	**Acquisitions**	**Finance income**	**Finance expense**
	RUB million	**RUB million**	**RUB million**	**RUB million**	**RUB million**
Entities/Individuals with significant influence over the Group	30,111[7]	–	43	–	1,163
Associates and joint ventures	95	22	513	2,591	497
Other related parties	40,432	184	6,628	422	–
Total	**70,638**	**206**	**7,184**	**3,013**	**1,660**

2017	**Sales**	**Other transactions**	**Acquisitions**	**Finance income**	**Finance expenses**	**Dividends accrued**
	RUB million	**RUB million**	**RUB million**	**RUB million**	**RUB million**	**RUB million**
Entities/Individuals with significant influence over the Group	22,726[8]	–	89	–	(850)	2,360[9]
Associates and joint ventures	134	121	756	3,560	439	–
Other related parties	31,145	(687)	7,271	403	–	–
Total	**54,005**	**(566)**	**8,116**	**3,963**	**(411)**	**2,360**

As at 31 December 2018 and 31 December 2017, amounts due to and due from related parties are as follows:

31 December 2018	**Receivables**	**Loans issued**	**Payables**	**Loans received**	**Guarantees issued**
	RUB million	**RUB million**	**RUB million**	**RUB million**	**RUB million**
Entities/Individuals with significant influence over the Group	11	–	23,142	–	24,671
Associates and joint ventures	224	61,845	278	6,567	–
Other related parties	3,880	7,167	141	–	61
Total	**4,115**	**69,012**	**23,561**	**6,567**	**24,732**

7 Excluding export duty.

8 Excluding export duty.

9 At the exchange rate as at the date of announcement of dividends on cumulative preference shares.

28. Transactions with related parties (continued)

31 December 2017	Receivables	Loans issued	Payables	Loans received	Guarantees issued	Guarantees issued to secure liabilities
	RUB million	RUB million	RUB million	RUB million	RUB million	RUB million
Entities/Individuals with significant influence over the Group	199	–	29,508	–	–	–
Associates and joint ventures	273	48,680	287	4,988	–	–
Other related parties	2,721	5,596	2,912	–	59	21,234
Total	**3,193**	**54,276**	**32,707**	**4,988**	**59**	**21,234**

Pricing policy

The Group determines prices for related party transactions within the range of market prices. In addition, the Group’s management performs control envisaged by the regulation governing transactions between related parties.

Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, either directly or indirectly, including directors (executive and other directors) of the Group. There were no significant transactions carried out during the reporting year with directors and key management personnel.

In 2018, key management personnel compensation expense, consisting of salaries and payroll taxes, totaled RUB 1,359 million (2017: RUB 1,207 million).

In 2017, the Company adopted a new three-year long-term motivation program for senior and middle management. The program recognizes the phantom shares to be paid off in cash as a liability expensed to bonuses during the period the services are rendered. Planned payments are calculated upon reaching the target program criteria in each reporting period. At the end of 2018, the Company accrued RUB 210 million (including insurance contributions) for the second year of the program based on the preliminary estimate of planned performance progress. At the end of 2017, the Company accrued RUB 109 million for the first year of the program; the actual year-end payment amounted to RUB 103 million.

29. Fair value measurement

All financial instruments are measured at fair value using a valuation model based on Level 3 non-market observable inputs that require additional evaluations and corrections. There were no transfers between the levels of the fair value hierarchy during the reporting period.

Management believes that the fair value of the Group’s cash, current financial assets, short-term trade payables and short-term loans and borrowings is equal to their carrying amount. The fair value of long-term loans and borrowings received by the Group, long-term trade payables and loans issued is determined using a discounted cash flow model based on the discount rates that are equal to the market rates effective at the reporting date. As at 31 December 2018, management classified the risk of default as remote.

29. Fair value measurement (continued)

The accounting classification of each category of financial instruments, their carrying amounts and fair values are as follows:

	31 December 2018		31 December 2017	
	Carrying amount	Fair value	Carrying amount	Fair value
	RUB million		RUB million	
Loans and receivables				
Loans issued	69,010	68,377	54,458	54,148
Trade and other receivables	5,055	5,017	5,417	5,417
Cash and cash equivalents	2,897	2,897	1,962	1,962
Financial liabilities measured at amortized cost				
Trade and other payables	11,166	10,961	14,338	14,145
Loans and borrowings	98,823	106,464	81,467	89,819

The sensitivity of the fair value of long-term loans issued and loans and borrowings received to a fluctuation in the interest rate by 1% is disclosed below. This analysis has been based on the assumption that the change in foreign exchange rates occurred at the reporting date and has been applied to the foreign currency balances, while all other variables, in particular, payment schedules, remain constant.

	Change in the foreign currency exchange rate	Effect on profit before tax for 2018	Effect on profit before tax for 2017
		RUB million	RUB million
Long-term loans issued	+1%	(749)	(985)
Long-term loans issued	-1%	769	1,016
Long-term trade and other receivables	+1%	(5)	–
Long-term trade and other receivables	-1%	5	–
Long-term loans received	+1%	4,148	4,282
Long-term loans received	-1%	(4,438)	(4,617)
Long-term trade and other payables	+1%	28	33
Long-term trade and other payables	-1%	(29)	(35)

In 2017, the Company purchased non-deliverable put options (in foreign currency) and sold compound call options (in Russian rubles). Fair values of derivative financial instruments (options) are measured using designated mathematical models at the reporting date; an effect of RUB 1,785 million from the revaluation (loss) for the year ended 31 December 2018 in addition to the revaluation (loss) for the year ended 31 December 2017 was recognized within other operating expenses in the consolidated statement of profit or loss and other comprehensive income (year ended 31 December 2017: RUB 4,116 million). Given the specific structure of the instruments (a combination of the foreign currency and RUB components in the option structure), the Group does not account for hedges on the options through other comprehensive income. In the reporting period, the Company made payments to exercise call options of RUB 4,332 million.

29. Fair value measurement (continued)

The fair value measurement of derivative financial instruments is as follows:

Derivative financial instruments at fair value	31 December 2018 RUB million	31 December 2017 RUB million
Long-term derivative financial assets	560	727
Short-term derivative financial assets	359	68
Long-term derivative financial liabilities	(4,141)	(3,617)
Short-term derivative financial liabilities	(2,679)	(1,294)
Total[10]	**(5,901)**	**(4,116)**

	31 December 2018 RUB million	31 December 2017 RUB million
Change in fair value of options	1,785	4,116
Exercise of options	4,391	–
Loss on cash flow hedge and exercise of options (Note 15)	**6,176**	**4,116**

30. Contingencies, commitments and operating risks

Operating environment of the Group

The Group’s principal activities are performed in the Russian Federation. Business operations in the Russian Federation involve risks that typically do not exist in other markets. The Russian economy is characterized by significant vulnerability to the world price for crude oil, market downturns and economic slowdowns elsewhere in the world. The sanctions imposed against the Russian Federation continue to lead to reduced capital availability, higher costs of capital and uncertainty regarding economic growth, thus giving rise to the risk of an adverse effect on the Group’s financial position, performance and business prospects. The existing trends may persist for an indefinite period of time.

The consolidated financial statements reflect management’s assessment of the impact of the Russian business environment on the financial position and performance of the Group. The future business environment may differ from the current management assessment.

The Company’s management regularly monitors the potential risks, including the analysis of country risks. Should any risk occur, the Company will develop measures to minimize potential adverse effects on the Group. The extent of such effects cannot currently be determined.

Taxation

Russian tax, currency and customs legislation is subject to varying interpretations and changes which can occur frequently. Management’s interpretation of such legislation as applied to the transactions and activity of the Group’s entities may be challenged by the relevant regional and federal authorities. The tax authorities may take a more assertive position in their interpretation of legislation and tax assessments. It is therefore possible that transactions and accounting methods that have not been challenged in the past may be challenged by the tax authorities. As such, additional taxes, penalties and interest may be assessed.

[10] The fair value of derivative instruments is measured on a net basis and recorded in other long-term liabilities and payables (Note 26).

30. Contingencies, commitments and operating risks (contunied)

Taxation (contunied)

Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances, reviews may cover longer periods. The fact that a year has been reviewed does not close that year, or any tax return applicable to that year, from further review during the three-year period.

For taxes where uncertainty exists, the Group has accrued tax liabilities based on management’s best estimate of the probable outflow of resources embodying economic benefits which will be required to settle these liabilities.

Russian transfer pricing legislation allows the Russian tax authorities to apply transfer pricing adjustments and impose additional profits tax liabilities in respect of all “controlled” transactions if the transaction price differs from the market price. Transactions between related parties in the domestic market are deemed controlled if the proceeds (the amount of all transactions) between related parties in 2017 and 2018 exceed RUB 1 billion for the respective calendar year. In case a domestic transaction results in an accrual of additional income tax liabilities for one party, the other party may correspondingly adjust its income tax liabilities.

In 2017 and 2018, the Company determined its tax liabilities arising from these controlled transactions using actual transaction prices or, in cases where the transaction price deviated from the market price, using prices adjusted pursuant to the Russian Tax Code. With respect to transactions for 2017, the tax base was adjusted in the annual income tax return for 2017. In 2017, the Company and a number of its subsidiaries determined their tax liabilities arising from controlled transactions using actual transaction prices or, in case the transaction price deviated from the market price, using prices adjusted pursuant to the Russian Tax Code. Symmetric adjustments were made, and revised income tax returns were filed.

There are control procedures applied to all types of controlled transactions to ensure consistency between the prices used in the controlled transactions and the level of market prices for the purpose of taxation, which are updated on an annual basis taking into account current legal requirements. The activities performed focus on minimizing tax risks of the Group.

Due to the uncertain nature and lack of practice of the application of current Russian transfer pricing legislation, the Russian tax authorities may challenge the level of prices applied by the Group under the controlled transactions and accrue additional tax liabilities unless the Group is able to prove the use of market prices with respect to the controlled transactions, and that there has been proper reporting to the Russian tax authorities, supported by appropriate available transfer pricing documentation. At the same time, the Company will be entitled to symmetrical adjustments with regard to arrears provided that the other party to the controlled transaction complies with the decision of the tax authority regarding the accrual of additional tax liabilities.

To ensure compliance with legislation governing the taxation of controlled foreign companies and mitigate related tax risks, the Group’s management has developed a set of internal routine procedures. Legislation governing the taxation of controlled foreign companies requires that the Company’s income tax calculation for 2017 include financial results of individual controlled foreign companies of the Group whose income is subject to taxation as part of the income of the Parent. Such a calculation will also be submitted together with the Company’s income tax return for 2018.

The Group takes measures to reduce its tax risks on a regular basis. Management believes that the Group has complied with all regulations, and paid and accrued all taxes that are applicable. The Group’s companies are subject to periodic tax reviews.

30. Contingencies, commitments and operating risks (contunied)

Taxation (contunied)

Following a field tax audit for 2014-2016, the tax authorities assessed additional taxes, penalties and fines on the Parent in the total amount of RUB 2,303 million, including fines of RUB 315 million and penalties of RUB 348 million. The decision of the tax authority became effective on 31 January 2019 (Note 33). In these consolidated financial statements, the additional accruals are recorded in full in the reporting period. The Company has begun to settle the payables.

The Group takes measures to reduce its tax risks on a regular basis. Management believes that the Group has complied with all regulations, and paid and accrued all taxes that are applicable.

Compliance with the terms and conditions for subsoil use

Licenses for subsoil use are issued by the Russian Federal Subsoil Use Agency. Management believes that, under current legislation, the Group is entitled to renew the licenses after expiry of the initially stated periods.

Authorized state agencies regularly review the Group's activities for compliance with the terms and conditions for subsoil use. Failure to meet the terms and conditions for subsoil use may result in penalty accruals and sanctions, including license suspension or revocation. Management takes appropriate measures to comply with the terms and conditions for subsoil use, including rectification of all shortcomings identified in reviews and instructions from the authorized state agencies within the established timeframes.

Liabilities concerning environmental and safety matters

In recent years, Russian environmental and safety legislation has developed rapidly, taking into account both general requirements and international law enforcement practice in this field.

Management of the Group understands its responsibilities concerning environmental and safety matters and undertakes to comply with the requirements of federal, regional and industry regulations concerning environmental protection, sustainable use of mineral resources, and labor protection, including international environmental and labor protection management standards. The Group follows a corporate policy on environmental protection and safety matters in accordance with the requirements of Russian legislation and international standards on environmental and safety matters. Management believes that, considering existing controls and current legislation, the Group is not exposed to significant risks or liabilities except for those that are recognized in these consolidated financial statements and relate to ordinary business operations.

Insurance

The Group does not have full coverage for its plant facilities, business interruption, or third party liability in respect of property or environmental damage arising from accidents at the Group's facilities or relating to the Group's operations.

The Group applies the Insurance Policy, which describes the Company's key insurance principles and procedures. In accordance with the applied Insurance Policy, the Group insures its major oil and gas extraction facilities. The Group's subsidiaries insure especially hazardous facilities pursuant to Federal law No. 225-FZ *On Compulsory Insurance of Civil Liability of the Owner of a Hazardous Facility for Damages Caused by an Accident at a Hazardous Facility* dated 27 July 2010. The Group also takes out selective motor own damage insurance for vehicles. In addition, the Group purchases mandatory third party liability insurance policies for all automobiles, special purpose equipment,

30. Contingencies, commitments and operating risks (contunied)

Insurance (contunied)

trailers and other vehicles.

Retirement and post-retirement benefit obligations

The Group makes contributions to the Pension Fund of the Russian Federation. These payments are calculated by the employer as a percentage of gross salary expense and are expensed as accrued. The Group follows a Regulation on Non-state Pension Benefits for the Group’s Employees. The Group’s subsidiaries have signed pension insurance agreements with NPF Elektroenergetiki (JSC NPF Otkrytiye since 27 December 2018).

Litigation

Management believes that there are no current claims outstanding which could have a material effect on the results of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated financial statements.

Guarantees issued in favor of third parties

The Group’s subsidiaries are joint guarantors to PJSC VTB Bank with regard to the Parent’s liabilities under a loan agreement with an outstanding balance (including interest) of RUB 87,902 million, or USD 1,265 million at the exchange rate at the reporting date (Note 24). Simultaneously, certain subsidiaries of the Group transfer revenue under operator contracts in an amount agreed with the lender as collateral under the Parent’s loan agreement.

The Parent is a guarantor for its subsidiary’s liabilities to a related party in the amount of RUB 24,671 million, or USD 355 million at the exchange rate at the reporting date.

31. Financial risk management

The Group’s principal financial instruments include bank loans and borrowings received, and accounts payable. The main purpose of these financial instruments is to raise finance for the Group’s operations. The Group has various other financial assets and liabilities, such as trade receivables and trade payables, loans issued and cash and cash equivalents, which arise directly from its operations. In September 2017, the Company entered into a number of agreements to hedge future cash flows (Note 29). During the year, the Group did not undertake trading in financial instruments.

The main risks that could adversely affect the Group’s financial assets, liabilities and future cash flows are market risk (including foreign currency risk, interest rate risk, and commodity and service price risk), credit risk and liquidity risk. In 2018, the Group updated its risk management approaches by approving a new Risk Management Policy. The Group applies the Risk Management Policy, which includes procedures (performed on a regular basis) to identify and measure risks inherent in the key activities and to assess the possible impact of the identified risks. Based on the annual risk assessment results, the Group’s management can revise its approach to managing each type of risk. The Group’s most significant financial risks are disclosed below.

Market risk

Market risk is the risk that the fair value of financial instruments or cash flows will fluctuate as a result of changes in market prices. The Group manages market risk through periodic estimation of potential

31. Financial risk management (contunied)

Market risk (contunied)

losses that could arise from adverse changes in market conditions.

Commodity price risk

Commodity price risk is the risk of changes in prices for hydrocarbons and refining products and their potential influence on the Group’s financial and performance indicators. A reduction in prices may result in a decrease in profit for the period and cash flows. If the prices for hydrocarbons remain low during a lengthy period, this may result in a reduction of capital spending on exploration, on the development of fields and a subsequent reduction in hydrocarbon production and, thus, negatively affect the Group’s ability to fulfill its contractual obligations. However, stable oil prices and their potential growth will enable the Group to successfully pursue its strategy aimed at increasing output in the coming years.

The Group’s management calculates budgets by scenario depending on projected oil prices, exchange rates and other indicators in order to assess the potential effect of changes in the price of the main commodities on the Group’s management reports. The Group enters into standard agreements on the sale of oil and oil products with customers. As at 31 December 2018, the Group had derivative financial instruments in relation to commodity price risk and foreign currency risks on future cash flows.

Foreign currency risk

The Group is exposed to foreign currency transaction risks. Foreign currency risk exposure arises from sales, purchases and borrowing in currencies other than the respective functional currency. The Group limits foreign currency risk by monitoring changes in exchange rates of the currencies in which its cash and loans and borrowings are denominated. Meanwhile, the Group is a party to contracts on export oil sales denominated in foreign currency.

As at 31 December 2018 and 2017, the carrying amount of the Group’s financial assets and liabilities denominated in the currency used by the Group's companies is as follows:

Financial assets	**31 December 2018**	**RUB**	**USD**	**EUR**	**Other currencies**
	RUB million	**RUB million**	**RUB million**	**RUB million**	**RUB million**
Trade and other receivables	5,055	3,375	1,680	–	–
Loans issued	69,010	210	68,800	–	–
Cash and cash equivalents	2,897	53	2,484	340	20
Derivative financial instruments at fair value[11]	919	–	919	–	–

Financial liabilities	**31 December 2018**	**RUB**	**USD**	**EUR**
	RUB million	**RUB million**	**RUB million**	**RUB million**
Loans and borrowings received	(98,823)	(739)	(98,084)	–
Trade and other payables	(11,166)	(9,138)	(2,023)	(5)
Derivative financial instruments at fair value[11]	(6,820)	(6,820)	–	–

[11] Recorded net within derivative financial liabilities in the consolidated statement of financial position.

31. Financial risk management (continued)

Foreign currency risk (continued)

Financial assets	31 December 2017	RUB	USD	EUR	Other currencies
	RUB million	RUB million	RUB million	RUB million	RUB million
Trade and other receivables	5,417	3,753	1,418	–	246
Loans issued	54,458	206	54,070	–	182
Cash and cash equivalents	1,962	837	816	303	6
Derivative financial instruments at fair value[12]	795	–	795	–	–

Financial liabilities	31 December 2017	RUB	USD	Other currencies
	RUB million	RUB million	RUB million	RUB million
Loans and borrowings received	(81,467)	(706)	(80,761)	–
Trade and other payables	(14,338)	(12,598)	(1,738)	(2)
Derivative financial instruments at fair value[12]	(4,911)	(4,911)	–	–

A 14.00% strengthening or weakening of RUB against USD as at 31 December 2018, and an 11.00% strengthening or weakening as at 31 December 2017, respectively, with all other variables held constant, would have changed profit before tax by the amounts shown below. This analysis is based on the assumption that the change in foreign exchange rates occurred at the reporting date and was applied to the foreign currency balances to which the Group has significant exposure, and that all other variables, in particular, interest rates, remain constant.

Relative strengthening/(weakening) of RUB against USD	Effect on profit before tax for 2018	Effect on profit before tax for 2017
	RUB million	RUB million
+14.00%	3,367	
-14.00%	(3,367)	
+11.00%		2,532
-11.00%		(2,532)

The Group’s exposure to foreign currency risk for other currencies is not material.

The analysis of sensitivity of the net position in derivative financial instruments to the strengthening or weakening of RUB against USD is provided below.

Relative strengthening/(weakening) of RUB against USD	Effect on profit before tax for 2018	Effect on profit before tax for 2017
	RUB million	RUB million
+14.00%	(129)	
-14.00%	129	
+11.00%		(87)
-11.00%		87

12 Recorded net within derivative financial liabilities in the consolidated statement of financial position.

31. Financial risk management (continued)

Interest rate risk

Interest rate risk is the risk that the fair value and future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group assesses the interest rate risk as related to long-term financial liabilities with a floating interest rate.

In 2018 and 2017, interest rates on foreign currency-denominated loans generally tended to increase due to the growing LIBOR rate. The Group's management assessed interest rate risks as significant, as the Parent's borrowings mostly consist of a foreign currency-denominated loan with a floating interest rate pegged to the USD 3M LIBOR. In respect of financial instruments, the Group measures the interest rate risk (1Y LIBOR) for loans issued.

Financial instrument		Effect on profit before tax for 2018	Effect on profit before tax for 2017
		RUB million	RUB million
Loans and borrowings received	+0.50%	(396)	
	-0.15%	119	
	+0.70%		(516)
	-0.08%		56
Loans issued	+0.50%	164	
	-0.35%	(115)	
	+0.90%		275
	-0.10%		(31)

As at 31 December 2018, the Group had not entered into any transactions, in particular, any interest rate swaps, aimed at reducing its interest rate risk exposure.

The Group controls this risk by ongoing monitoring of market expectations in respect of interest rates and adjusting the budget as well as expected cash flows to allocate sufficient financial resources to interest repayment.

Credit risk

Credit risk is the risk that a customer or counterparty will fail to meet their obligation under financial assets causing financial loss to the Group. The Group's credit risk principally arises from cash and cash equivalents, and from the financial stability of its customers and loans provided to third parties.

The Group did not use any hedging instruments as a tool for credit risk management in this period.

The Group maintains accounts only with high-quality banks and financial institutions and believes that it therefore is not exposed to material credit risk in relation to its cash or cash equivalents.

The Group trades only with recognized, creditworthy third parties. The individual risk of a counterparty is managed through the assessment of its creditworthiness.

31. Financial risk management (continued)

Credit risk (continued)

It is the Group’s policy that all customers who wish to trade on credit terms are subject to credit verification procedures. The Group has a policy to negotiate advance payment terms where excessive concentration of credit risk exists. In addition, trade receivable balances are monitored on an ongoing basis to ensure that the Group’s exposure to bad debts is not significant. Although the collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the allowance already recorded. The details of the allowance for bad debts are disclosed in Notes 19 and 21. Information on the major types of financial assets and their maturity is presented below:

Financial assets	**31 December 2018**	**Within one year**	**1 to 2 years**	**2 to 4 years**	**Over 4 years**
	RUB million	**RUB million**	**RUB million**	**RUB million**	**RUB million**
Loans issued	69,010	4,115	62,347	106	2,442
Trade and other receivables	5,055	4,877	–	1	177
Derivative financial instruments at fair value[13]	919	359	560	–	–

Financial assets	**31 December 2017**	**Within one year**	**1 to 2 years**	**2 to 4 years**	**Over 4 years**
	RUB million	**RUB million**	**RUB million**	**RUB million**	**RUB million**
Loans issued	54,458	4,848	44,038	5,390	182
Trade and other receivables	5,417	5,408	–	9	–
Derivative financial instruments at fair value[13]	795	68	293	434	–

As at 31 December 2018, the Group believes that its maximum exposure to credit risk is the carrying amount of its financial assets recognized in the consolidated statement of financial position.

The Group has not received any collateral held as security for any financial assets.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group’s operating cash flow is subject to fluctuations resulting from high volatility of oil prices as well as changes in exchange rates and the amounts of taxes and duties paid. The above mentioned factors can affect the amount of the Group’s cash flow and, thus, its liquidity. In order to manage liquidity risk, the Group monitors and projects liquidity requirements on a regular basis. The Group’s management ensures that sufficient funds are available to meet any commitments as they fall due, and prepares detailed budgets and plan-to-fact analyses on an annual, quarterly and monthly basis. The Group’s liquidity risk management procedures are centralized. The Group’s objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans and borrowings, including loans from related parties, bank guarantees, advances received for future oil deliveries, deferral of payments under current agreements, and a loan repayment grace period provided by PJSC VTB Bank with regard to the principal amount of the loan in 2017-2018.

As at 31 December 2018, the Group’s short-term liabilities exceeded its current assets by RUB 27,752 million (31 December 2017: RUB 14,589 million).

31. Financial risk management (continued)

Liquidity risk (continued)

The Group's management has performed current analysis with regard to liquidity risk based on operating cash flows from ordinary activities, existing arrangements with major creditors and possible deferred settlement of payables to the Group's shareholders.

The following table shows undiscounted contractual cash flows for financial liabilities, including estimated interest liability, as at 31 December 2018 and 2017.

Financial liabilities	31 December 2018	Within one year	1 to 2 years	2 to 4 years	Over 4 years
	RUB million	RUB million	RUB million	RUB million	RUB million
Trade and other payables	11,166	10,025	195	315	631
Loans and borrowings received	140,023	20,168	13,807	24,536	81,512
Derivative financial instruments at fair value[13]	6,820	2,679	4,141	–	–

Financial liabilities	31 December 2017	Within one year	1 to 2 years	2 to 4 years	Over 4 years
	RUB million	RUB million	RUB million	RUB million	RUB million
Trade and other payables	14,338	13,248	174	349	567
Loans and borrowings received	117,078	5,216	16,723	19,530	75,609
Derivative financial instruments at fair value[13]	4,911	1,294	1,674	1,943	–

The Company has an Insurance Policy and a Risk Management Policy in place. In the long-term, the application of these policies will help to reduce operating cash flow volatility and will have a positive effect on both long-term and short-term liquidity.

The Group's management monitors on a regular basis the interest coverage ratio (EBITDA/interest expense) and the debt to EBITDA ratio, as well as the amount of crude oil production and movements in EBITDA in the reporting periods. Meanwhile, the algorithm for calculating EBITDA applied by the Group as required by creditors may differ from that used by other companies.

Capital management

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to maintain an optimal capital structure to reduce the cost of capital and to support its business and maximize shareholder value.

The Group manages its capital structure and makes adjustments to it in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares.

[13] Recorded net within derivative financial assets and liabilities in the consolidated statement of financial position.

31. Financial risk management (continued)

International ratings

Moody's rating agency has assigned a B1 rating with a "positive" outlook to the Company. As at the reporting date, the Fitch rating agency had assigned a B rating with a "stable" outlook to the Company (Note 33). The revision of the rating was driven by the analysis of financial results and cash flows for the reporting period and the Group's improved operating profile.

The Company's management plans to implement measures which may help to keep the rating at the current level or increase it in the next 12 months after the reporting date. The next rating revision is possible for 2019.

32. Oil and gas reserves (unaudited)

The Group's oil and gas reserves were evaluated by Miller and Lents, Ltd. in accordance with the standards of the Society of Petroleum Engineers as at 31 December 2018 on a fixed price basis (SPE-PRMS standard) using price and cost information provided by exploration and production segment companies and current Russian tax laws. Reserves were measured both within the term of license agreements and beyond – to the point in time when the threshold of economically viable extraction is reached.

The Group's oil and gas reserves are located in the Western Siberian, Central Siberian and Povolzhye regions of the Russian Federation.

As at 31 December 2018, oil and gas reserves of the Group's companies are disclosed below and comprise the following (on a 100% basis):

Reserves	Oil and condensate	Gas	Oil and condensate + gas
	million bbl	billion cu ft	million bbl oil equivalent
Total proved	1,120.0	862.4	1,263.8
including:			
Proved developed	390.7	393.8	456.4
Proved undeveloped	729.3	468.6	807.4
Probable	454.2	353.6	513.1
Possible	598.1	187.5	629.3

As at 31 December 2018, the share of non-controlling shareholders of subsidiaries in total proved oil and gas reserves was 12.8 million bbl and 22.1 billion cu ft, respectively, in probable oil and gas reserves – 0.7 million bbl and 1.2 billion cu ft, respectively, and in possible oil and gas reserves – 0.7 million bbl and 1.2 billion cu ft, respectively.

The Group is involved in development and extraction projects in the Republic of Azerbaijan under production sharing agreements (PSAs) with the State Oil Company of Azerbaijan Republic (SOCAR) and SOCAR Oil Affiliate (SOA).

32. Oil and gas reserves (unaudited) (continued)

As at 31 December 2018, oil reserves in the Republic of Azerbaijan explored by the Group under five production sharing agreements comprise the following (on a 100% basis):

Reserves	Oil and condensate	Gas	Oil and condensate + gas
	million bbl	billion cu ft	million bbl oil equivalent
Total proved	73.5	–	73.5
including:			
Proved developed	47.0	–	47.0
Proved undeveloped	26.5	–	26.5
Probable	14.4	–	14.4
Possible	12.0	–	12.0

As at 31 December 2017, oil and gas reserves of the Group’s subsidiaries are disclosed below and comprise the following (on a 100% basis):

Reserves	Oil and condensate	Gas	Oil and condensate + gas
	million bbl	billion cu ft	million bbl oil equivalent
Total proved	1,070.2	854.4	1,212.60
including:			
Proved developed	403.6	412.1	472.28
Proved undeveloped	666.6	442.3	740.32
Probable	473.6	352.5	532.35
Possible	684.7	193.8	717.00

As at 31 December 2017, the share of non-controlling shareholders of subsidiaries in total proved oil and gas reserves was 18 million bbl and 31.3 billion cu ft, respectively, in probable oil and gas reserves – 0.8 million bbl and 1.5 billion cu ft, respectively, and in possible oil and gas reserves – 0.9 million bbl and 1.5 billion cu ft, respectively.

The Group is involved in development and extraction projects in the Republic of Azerbaijan under production sharing agreements (PSAs) with the State Oil Company of Azerbaijan Republic (SOCAR) and SOCAR Oil Affiliate (SOA).

As at 31 December 2017, oil reserves in the Republic of Azerbaijan explored by the Group under five production sharing agreements comprise the following (on a 100% basis):

Reserves	Oil and condensate	Gas	Oil and condensate + gas
	million bbl	billion cu ft	million bbl oil equivalent
Total proved	68.5	–	68.5
including:			
Proved developed	44.7	–	44.7
Proved undeveloped	23.8	–	23.8
Probable	9.9	–	9.9
Possible	9.3	–	9.3

33. Subsequent events

Following a field tax audit of the Company for 2014-2016 that tax judgement was delivered in January 2019, and the tax authorities assessed additional taxes, penalties and fines in the total amount of RUB 2,303 million (including fines of RUB 315 million and penalties of RUB 348 million). The above additional accruals are recorded in full in the consolidated financial statements. In February 2019, the Company paid part of its income tax payables in the amount of RUB 700 million.

In March 2019, Fitch rating agency changed its outlook for the Company from “stable” to “positive”, keeping the Company’s rating at B.