

Urals Energy Public Company Limited

Consolidated Financial Statements

As of and for the Year Ended 31 December 2016

Urals Energy Public Company Limited
Consolidated Financial Statements

CONTENTS

	Page
Independent Auditor's Report	
Consolidated Statement of Financial Position	10
Consolidated Statement of Comprehensive Income	11
Consolidated Statement of Cash Flows	12
Consolidated Statement of Changes in Equity	13
Notes to the Consolidated Financial Statements	14-49
1 Activities	
2 Significant Accounting Policies	
3 Going Concern	
4 Adoption of New or Revised standards and interpretations	
5 New Accounting Pronouncements	
6 Critical Accounting Estimates and Judgements in Applying Accounting Policies	
7 Cash and Cash Equivalents	
8 Accounts Receivable and Prepayments	
9 Inventories	
10 Property, Plant and Equipment	
11 Other Non-Current Assets	
12 Accounts Payable and Accrued Expenses	
13 Provisions	
14 Taxes	
15 Borrowings	
16 Dismantlement Provision	
17 Equity	
18 Non-controlling Interest	
19 Revenues	
20 Segment Information	
21 Cost of Sales	
22 Selling, General and Administrative Expenses	
23 Foreign Currency Gain/(Loss)	
24 Contingencies, Commitments and Operating Risks	
25 Financial Risk Management	
26 Balances and Transactions with Related Parties	
27 Acquisition of Controlling Interest in Subsidiaries	
28 Events After the Reporting Period	

Independent Auditor's Report
To the Members of Urals Energy Public Company Limited

INDEPENDENT AUDITOR'S REPORT

Urals Energy Public Company Limited
Consolidated Statement of Financial Position
(presented in US\$ thousands)

	Note	31 December	
		2016	2015
<i>Assets</i>			
Current assets			
Cash and cash equivalents	7	1,202	1,695
Accounts receivable and prepayments	8	3,998	2,903
Inventories	9	13,527	7,576
Total current assets		18,727	12,174
Non-current assets			
Property, plant and equipment	10	65,089	53,110
Supplies and materials for capital construction		1,668	1,469
Deferred income tax assets	14	265	-
Other non-current assets	11	192	115
Total non-current assets		67,214	54,694
Total assets		85,941	66,868
<i>Liabilities and equity</i>			
Current liabilities			
Accounts payable and accrued expenses	12	1,703	1,871
Provisions	13	266	-
Income tax payable		2,009	4,559
Other taxes payable	14	5,897	2,990
Short-term borrowings and current portion of long-term borrowings	15	2,549	2,419
Advances from customers		712	604
Total current liabilities		13,136	12,443
Long-term liabilities			
Long-term borrowings	15	4,243	1,516
Long-term finance lease obligations	10	714	559
Dismantlement provision	16	1,673	971
Long-term accounts payable		120	-
Deferred income tax liabilities	14	4,651	3,519
Total long-term liabilities		11,401	6,565
Total liabilities		24,537	19,008
<i>Equity</i>			
Share capital	17	1,589	1,589
Share premium	17	656,855	656,855
Translation difference		(62,252)	(67,667)
Accumulated deficit		(535,554)	(543,464)
Equity attributable to shareholders of Urals Energy Public Company Limited		60,638	47,313
Non-controlling interest	18	766	547
Total equity		61,404	47,860
Total liabilities and equity		85,941	66,868

Approved on behalf of the Board of Directors on 13 June 2017

L. Y. Dyachenko
Chief Executive Officer

S. E. Uzornikov
Chief Financial Officer

The accompanying notes on pages 14 to 49 are an integral part of these consolidated financial statements

Urals Energy Public Company Limited
Consolidated Statement of Comprehensive Income
(presented in US\$ thousands)

	Note	Year ended 31 December	
		2016	2015
Revenues after excise taxes and export duties	19	29,052	27,213
Cost of sales	21	(21,795)	(20,098)
Gross profit		7,257	7,115
Selling, general and administrative expenses	22	(4,358)	(3,915)
Other operating (loss)/profit	8, 10, 12, 13, 14	(853)	137
Operating profit		2,046	3,337
Interest income	15	50	39
Interest expense	15	(1,066)	(443)
Net foreign exchange gain/(loss)	23	4,914	(7,186)
Total net finance income/(expense)		3,898	(7,590)
Profit/(loss) before income tax		5,944	(4,253)
Income tax benefit	14	2,057	198
Profit/(loss) for the year		8,001	(4,055)
Profit/(loss) for the year attributable to:			
- Non-controlling interest		91	18
- Shareholders of Urals Energy Public Company Limited		7,910	(4,073)
Profit/(loss) per share from profit attributable to shareholders of Urals Energy Public Company Limited:	17		
- Basic profit/(loss) per share (in US dollar per share)		0.63	(0.32)
- Diluted profit/(loss) per share (in US dollar per share)		0.63	(0.32)
Weighted average shares outstanding attributable to:			
- Basic shares		12,622,303	12,622,303
- Diluted shares		12,622,303	12,622,303
Profit/(loss) for the year		8,001	(4,055)
Other comprehensive profit/(loss) that may be reclassified subsequently to profit (loss), net of income tax:			
- Effect of currency translation		5,543	(7,827)
Total comprehensive income/(loss) for the year		13,544	(11,882)
Attributable to:			
- Non-controlling interest	18	219	(159)
- Shareholders of Urals Energy Public Company Limited		13,325	(11,723)

The accompanying notes on pages 14 to 49 are an integral part of these consolidated financial statements

Urals Energy Public Company Limited
Consolidated Statements of Cash Flows
(presented in US\$ thousands)

	Note	Year ended 31 December	
		2016	2015
Cash flows from operating activities			
Profit/(loss) before income tax		5,944	(4,253)
Adjustments for:			
Depreciation, amortization and depletion	21	5,331	4,621
Interest income	15	(50)	(39)
Interest expense	15	1,066	443
Loss/(gain) on disposal of property, plant and equipment		53	(35)
Charge for/(release of) provision on claims	13	138	(864)
Foreign currency (gain)/loss, net	23	(4,914)	7,186
Other non-cash transactions	8, 12, 14	566	801
Operating cash flows before changes in working capital		8,134	7,860
Increase in inventories		(3,574)	(2,062)
Increase in accounts receivables and prepayments		(7,217)	(7,809)
(Decrease)/increase in accounts payable and accrued expenses		(244)	244
Decrease in advances from customers		(12)	(924)
Increase/(decrease) in other taxes payable		1,880	(295)
Cash used in operations		(1,033)	(2,986)
Interest received		24	9
Interest paid		(779)	(194)
Income tax paid		(350)	(219)
Net cash used in operating activities		(2,138)	(3,390)
Cash flows from investing activities			
Purchase of property, plant and equipment and intangible assets		(4,391)	(4,163)
Acquisition of subsidiaries, net of cash acquired and indemnification asset received	27	(757)	(2,662)
Repayment of loans issued		-	239
Loans given		(354)	(84)
Net cash used in investing activities		(5,502)	(6,670)
Cash flows from financing activities			
Proceeds from borrowings	15	13,636	8,687
Repayment of borrowings	15	(6,459)	-
Finance lease principal payments		(55)	(55)
Net cash generated from financing activities		7,122	8,632
Effect of exchange rate changes on cash and cash equivalents		25	(494)
Net decrease in cash and cash equivalents		(493)	(1,922)
Cash and cash equivalents at the beginning of the year		1,695	3,617
Cash and cash equivalents at the end of the year		1,202	1,695

The accompanying notes on pages 14 to 49 are an integral part of these consolidated financial statements

Urals Energy Public Company Limited
Consolidated Statements of Changes in Equity
(presented in US\$ thousands)

	Notes	Share capital	Share premium	Difference from conversion of share capital into US\$	Cumulative Translation Difference	Accumulated deficit	Equity attributable to Shareholders of Urals Energy Public Company Limited	Non-controlling interest	Total equity
Balance at 31 December 2014	17, 18	1,589	656,968	(113)	(60,017)	(539,391)	59,036	706	59,742
Effect of currency translation		-	-	-	(7,650)	-	(7,650)	(177)	(7,827)
(Loss)/profit for the year		-	-	-	-	(4,073)	(4,073)	18	(4,055)
Total comprehensive loss		-	-	-	(7,650)	(4,073)	(11,723)	(159)	(11,882)
Balance at 31 December 2015	17, 18	1,589	656,968	(113)	(67,667)	(543,464)	47,313	547	47,860
Effect of currency translation		-	-	-	5,415	-	5,415	128	5,543
Profit for the year		-	-	-	-	7,910	7,910	91	8,001
Total comprehensive income		-	-	-	5,415	7,910	13,325	219	13,544
Balance at 31 December 2016	17, 18	1,589	656,968	(113)	(62,252)	(535,554)	60,638	766	61,404

The accompanying notes on pages 14 to 49 are an integral part of these consolidated financial statements

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

1 Activities

Urals Energy Public Company Limited (“Urals Energy” or the “Company” or “UEPCL”) was incorporated as a limited liability company in Cyprus on 10 November 2003. Urals Energy and its subsidiaries (the “Group”) are primarily engaged in oil and gas exploration and production in the Russian Federation and processing of crude oil for distribution on both the Russian and international markets.

The Group’s average number of employees employed for year ended 31 December 2016 was 461 (for year ended 31 December 2015: 394).

The registered office of Urals Energy is at Glafkos Tower, Office 501, 5th Floor, 3 Menandrou Street, 1066 Nicosia, Cyprus. UEPCL’s shares are traded on the AIM Market operated by the London Stock Exchange.

As at 31 December 2016 and 2015 the Group's major shareholder with 44.59% ownership interest was Adler Impex S.A. which is beneficially owned by Mr. Roman Shvets. Other shares belong to management (6.01%), Petraco Oil Company (3.44%) and other insignificant shareholders.

The Group comprises UEPCL and the following main subsidiaries:

Entity	Jurisdiction	Effective ownership interest at 31 December	
		2016	2015
<i>Exploration and production</i>			
AO Petrosakh (“Petrosakh”) (Note 18)	Sakhalin Region	97.2%	97.2%
AO Arcticneft (“Arcticneft”)	Nenetsky Region	100%	100%
OOO Arctic Oil Company (“Arctic Oil Company”) (Note 27)	Nenetsky Region	100%	-
OOO BVN-Oil (“BVN-Oil”) (Note 27)	Komi Republic	100%	100%
OOO RK-Oil (“RK-Oil”) (Note 27)	Komi Republic	100%	100%
<i>Management company</i>			
OOO Urals Energy ¹	Moscow	100%	100%

¹In April 2017 AO Petrosakh was merged with OOO Urals Energy (Note 28).

2 Significant Accounting Policies

Basis of preparation. The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) under the historical cost convention as modified by the initial recognition of financial instruments based on fair value.

These policies have been consistently applied to all the periods presented, unless otherwise stated.

The preparation of consolidated financial statements in conformity with IFRS as adopted by the EU requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the reporting date and the reported amounts of revenues and expenses during the reporting period. Critical accounting estimates and judgements are disclosed in Note 6. Actual results could differ from the estimates.

Functional and presentation currency. The United States dollar (“US dollar or US\$ or \$”) is the presentation currency for the Group’s operations as management have used the US dollar accounts to manage the Group’s financial risks and exposures, and to measure its performance. Financial statements of the Russian subsidiaries are measured in Russian Roubles, their functional currency.

The functional currency of the Company is the US Dollar as substantially all the cash flows affecting the Company are in US Dollars.

Translation to functional currency. Monetary assets and liabilities denominated in foreign currencies are retranslated into the functional currency at the rate of exchange ruling at the reporting date. Any resulting exchange differences are included in the profit or loss component of the consolidated statement of 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. The US dollar to Russian Rouble exchange rates were 60.66 and 72.88 as of 31 December 2016 and 2015, respectively.

2 Significant Accounting Policies (Continued)

Translation to presentation currency. The Group's consolidated financial statements are presented in US dollars in accordance with IAS 21, *The Effects of Changes in Foreign Exchange Rates*. The results and financial position of each group entity having a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) Assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position. Goodwill and fair value adjustments arising on the acquisitions are treated as assets and liabilities of the acquired entity.
- (ii) Income and expenses for each statement of comprehensive income are translated to the presentation currency of the Company at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions).
- (iii) All resulting exchange differences are recognised as a separate component of equity.

When a subsidiary is disposed of through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity, the exchange differences deferred in other comprehensive income are reclassified to the profit and loss.

Consolidated financial statements. Subsidiaries are those investees, including structured entities, that the Group controls because the Group (i) has power to direct the relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of the investor's returns. The existence and effect of substantive rights, including substantive potential voting rights, are considered when assessing whether the Group has power over another entity. For a right to be substantive, the holder must have a practical ability to exercise that right when decisions about the direction of the relevant activities of the investee need to be made. The Group may have power over an investee even when it holds less than the majority of the voting power in an investee. In such a case, the Group assesses the size of its voting rights relative to the size and dispersion of holdings of the other vote holders to determine if it has de-facto power over the investee. Protective rights of other investors, such as those that relate to fundamental changes of the investee's activities or apply only in exceptional circumstances, do not prevent the Group from controlling an investee. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date on which control ceases.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

The Group measures non-controlling interest that represents present ownership interest and entitles the holder to a proportionate share of net assets in the event of liquidation on a transaction by transaction basis, either at: (a) fair value, or (b) the non-controlling interest's proportionate share of net assets of the acquiree. Non-controlling interests that are not present ownership interests are measured at fair value.

Non-controlling interest is that part of the net results and of the equity of a subsidiary attributable to interests which are not owned, directly or indirectly, by the Company. Non-controlling interest forms a separate component of the Group's equity.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all of its subsidiaries use uniform accounting policies consistent with the Group's policies. When necessary amounts reported by subsidiaries have been adjusted to conform with the Group's accounting policies.

Purchases and sales of non-controlling interests. The Group applies the economic entity model to account for transactions with owners of non-controlling interest. Any difference between the purchase consideration and the carrying amount of non-controlling interest acquired is recorded as a capital transaction directly in equity. The Group recognises the difference between sales consideration and carrying amount of non-controlling interest sold as a capital transaction in the consolidated statement of changes in equity.

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

2 Significant Accounting Policies (Continued)

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

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

A portfolio of financial derivatives or other financial assets and liabilities that are not traded in an active market is measured at the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (i.e. an asset) for a particular risk exposure or paid to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date. This is applicable for assets carried at fair value on a recurring basis if the Group: (a) manages the group of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy; (b) it provides information on that basis about the group of assets and liabilities to the entity's key management personnel; and (c) the market risks, including duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities is substantially the same.

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees are used to measure fair value of certain financial instruments for which external market pricing information is not available. Fair value measurements are analysed by level in the fair value hierarchy as follows: (i) Level 1 are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) Level 2 measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is prices) or indirectly (that is, derived from prices), and (iii) Level 3 measurements are valuations not based on solely observable market data (that is, the measurement requires significant unobservable inputs).

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

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

Classification of financial assets. Financial assets have the following categories: (a) loans and receivables; (b) available-for-sale financial assets; (c) financial assets held to maturity and (d) financial assets at fair value through profit or loss. Financial assets at fair value through profit or loss have two sub-categories: (i) assets designated as such upon initial recognition, and (ii) those classified as held for trading.

Financial assets that would meet the definition of loans and receivables may be reclassified if the Group has the intention and ability to hold these financial assets for the foreseeable future or until maturity.

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

In 2016 and 2015 all financial assets of the Group related to loans and receivables.

2 Significant Accounting Policies (Continued)

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

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

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

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

Property, plant and equipment. Property, plant and equipment acquired as part of a business combination is recorded at fair value at the acquisition date and adjusted for accumulated depreciation, depletion and impairment. All subsequent additions are recorded at historical cost of acquisition or construction and adjusted for accumulated depreciation, depletion and impairment.

Oil and gas exploration and production activities are accounted for in a manner similar to the successful efforts method. Costs of successful development and exploratory wells are capitalised. The cost of property, plant and equipment includes provisions for dismantlement, abandonment and site restoration (refer to Provisions below).

The Group accounts for exploration and evaluation activities in accordance with IFRS 6, *Exploration for and Evaluation of Mineral Resources*. The costs incurred in finding, acquiring, and developing reserves are capitalised on a 'field by field' basis.

Exploration and evaluation assets are measured at cost less provision for impairment, where required. Costs directly associated with an exploration well are initially capitalised in exploration and evaluation assets, which are presented within Property, plant and equipment. These costs include employee remuneration, materials and fuel used, rig costs, delay rentals and payments made to contractors. Geological and geophysical exploration costs are expensed as incurred. Amounts paid for the acquisition of exploration and development licenses are also capitalised as exploration and evaluation assets.

If hydrocarbons are not found, the exploration expenditure is written off as a dry hole. If hydrocarbons are found and, subject to further appraisal activity, which may include the drilling of further wells (exploration or exploratory-type stratigraphic test wells), are likely to be capable of commercial development, the costs continue to be carried as an asset. All such carried costs are subject to technical, commercial and management review at least once a year to confirm the continued intent to develop or otherwise extract value from the discovery. When this is no longer the case, the costs are written off.

An exploration and evaluation asset is reclassified from special category of exploration and evaluation assets presented within Oil and gas properties to ordinary Oil and gas properties when the technical feasibility and commercial viability of extracting a mineral resource are demonstrable. Exploration and evaluation assets are assessed for impairment, and any impairment loss is recognised, before reclassification.

Development and production assets are accumulated generally on a field-by-field basis and represent the cost of developing the commercial reserves discovered and bringing them to production together with Exploration and Evaluation (E&E) expenditures incurred in finding commercial reserves and transferred from the intangible E&E assets described above. The cost of development and production assets also include the costs of acquisitions and purchases of such assets, directly attributable overheads, finance costs capitalised and the costs of recognising provisions for future restoration and decommissioning.

2 Significant Accounting Policies (Continued)

Depletion of capitalized costs of proved oil and gas properties is calculated using the unit-of-production method for each field based upon proved reserves for property acquisitions and proved developed reserves for exploration and development costs. Oil and gas reserves for this purpose are determined in accordance with Society of Petroleum Engineers definitions and were last estimated by Miller and Lents, the Group's independent reservoir engineers in 2014. The Miller and Lents information from the 2014 reserves review is updated annually by management by reference to production information and the equivalent Russian ABC reserves classification. Gains or losses from retirements or sales of oil and gas properties are included in the determination of profit for the year.

Depreciation of non-oil and gas property, plant and equipment is calculated using the straight-line method over their estimated remaining useful lives, as follows:

	Estimated useful life
Refinery and related equipment	19
Buildings	20
Other assets	6 to 20

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'Other operating (loss)/profit' in the profit and loss section of consolidated statement of comprehensive income.

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

Provisions, including those related to dismantlement, abandonment and site restoration, are evaluated and re-estimated annually, and are included in the consolidated financial statements at each reporting date at the present value of the expenditures expected to be required to settle the obligation using pre – tax discount rates which reflect the current market assessment of the time value of money and the risks specific to the liability.

Changes in provisions resulting from the passage of time are reflected in the profit and loss section of consolidated statement of comprehensive income each year. Other changes in provisions, relating to a change in the expected pattern of settlement of the obligation, changes in the discount rate or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change. Changes in provisions relating to dismantlement, abandonment and site restoration are added to, or deducted from, the cost of the related asset in the current period. The amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess is recognised immediately in profit or loss.

The provision for dismantlement liability is recorded on the consolidated statement of financial position, with a corresponding amount being recorded as part of property, plant and equipment in accordance with IAS 16.

Leases. Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the commencement of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are presented as finance lease obligations on the consolidated statement of financial position. The interest element of the finance cost is charged to the profit or loss in the consolidated statement of comprehensive income over the lease period. Property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated statement of comprehensive income on a straight-line basis over the period of the lease.

Impairment of assets. Assets that are subject to depreciation and depletion are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell or value in use. For the purposes of assessing impairment, assets are grouped by license areas, which are the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Reversal of impairment. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of impairment at each reporting date.

2 Significant Accounting Policies (Continued)

Inventories. Inventories of extracted crude oil, oil products, materials and supplies and construction materials are valued at the lower of the weighted-average cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and selling expenses. General and administrative expenditure is excluded from inventory costs and expensed in the period incurred.

Trade receivables. Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, net of provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Such objective evidence may include significant financial difficulties of the debtor, an increase in the probability that the debtor will enter bankruptcy or financial reorganization, and actual default or delinquency in payments. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The change in the amount of the provision is recognised in the profit and loss section of consolidated statement of comprehensive income.

Cash and cash equivalents. Cash and cash equivalents includes cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method. Restricted balances are excluded from cash and cash equivalents for the purposes of the consolidated statement of cash flow. Balances restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date are included in other non-current assets. Restricted cash balances are segregated from cash available for the business to use until such time as restrictions are removed.

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

Borrowings. Borrowings are recognised initially at the fair value of the liability, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective interest method; any difference between amount at initial recognition and the redemption amount is recognised as interest expense over the period of the borrowings. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

Capitalisation of borrowing costs. Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets.

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

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

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

Loans receivable. The loans advanced by the Group are classified as "loans and receivables" in accordance with IAS 39 and stated at amortised cost using the effective interest method. These loans are individually tested for impairment at each reporting date.

Income taxes. Income taxes have been provided for in the consolidated financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge or benefit comprises current tax and deferred tax and is recognised in profit or loss for the year except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity.

2 Significant Accounting Policies (Continued)

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

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

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

Employee benefits. Wages, salaries, contributions to the Russian Federation state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and kindergarten services) are accrued in the year in which the associated services are rendered by the employees of the Group. The Group has no legal or constructive obligation to make pension or similar benefit payments beyond the payments to the statutory defined contribution scheme.

Social costs. The Group incurs employee costs related to the provision of benefits such as health insurance. These amounts principally represent an implicit cost of employing production workers and, accordingly, are included in the cost of sales.

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

Revenue recognition. Revenues from sales of goods are recognised at the point of transfer of risks and rewards of ownership of the goods, normally when the goods are shipped. If the Group agrees to transport goods to a specified location, revenue is recognised when the goods are passed to the customer at the destination point.

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

Sales are shown net of VAT and discounts.

Revenues are measured at the fair value of the consideration received or receivable. When the fair value of goods received in a barter transaction cannot be measured reliably, the revenue is measured at the fair value of the goods or service given up.

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

2 Significant Accounting Policies (Continued)

Segments. The Group operates in one business segment which is crude oil exploration and production. The Group assesses its results of operations and makes its strategic and investment decisions based on the analysis of its profitability as a whole. The Group operates within geographic segments as disclosed in Note 20.

Share capital. Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is presented as a share premium.

Share-based payments. The fair value of the employee services received in exchange for the grant of options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, using market prices, taking into account the terms and vesting conditions upon which those equity instruments were granted.

Earnings per share. Earnings per share are determined by dividing the profit or loss attributable to equity holders of the Group by the weighted average number of participating shares outstanding during the reporting year.

3 Going Concern

A significant portion of the Group's consolidated net assets of \$60.6 million (31 December 2015: \$47.3 million) comprises undeveloped oil reserves requiring significant additional investment. The Group is dependent upon external debt to fully develop the oil reserves and realise the value attributed to such assets.

The Group had net current assets of \$5.6 million as of 31 December 2016 (31 December 2015: net current liabilities of \$0.3 million).

Management have prepared monthly cash flow projections for 2017. Judgements, which are significant to management's conclusion that no material uncertainty exists about the Group's ability to continue as a going concern, include future oil prices and planned production, which were required for the preparation of the cash flow projections and model. Positive overall cash flows are dependent on future oil prices (a price of \$45 per barrel was used for 2017). Despite the uncertainties, based on the cash flow projections performed and taking into account financing received from Petraco and several banks (Note 28), management considers that the application of the going concern assumption for the preparation of these consolidated financial statements is appropriate.

4 Adoption of New or Revised standards and interpretations

The following standards or amended standards and interpretations, relevant to the Group, became effective for the Group from 1 January 2016, but did not have any material impact on the Group:

- Disclosure Initiative Amendments to IAS 1 - Presentation of Financial Statements (issued in December 2014 and effective for annual periods on or after 1 January 2016).
- Amendments to IFRS 7 - Financial instruments: Disclosures (issued in September 2014 and effective for annual periods on or after 1 January 2016).

Annual Improvements to IFRSs 2012 (effective in EU for annual periods beginning on or after 1 February 2015). IFRS 2 was amended to clarify the definition of a 'vesting condition' and to define separately 'performance condition' and 'service condition'; The amendment is effective for share-based payment transactions for which the grant date is on or after 1 February 2015.

IFRS 3 was amended to clarify that (1) an obligation to pay contingent consideration which meets the definition of a financial instrument is classified as a financial liability or as equity, on the basis of the definitions in IAS 32, and (2) all non-equity contingent consideration, both financial and non-financial, is measured at fair value at each reporting date, with changes in fair value recognised in profit and loss. Amendments to IFRS 3 are effective for business combinations where the acquisition date is on or after 1 February 2015.

IFRS 8 was amended to require (1) disclosure of the judgements made by management in aggregating operating segments, including a description of the segments which have been aggregated and the economic indicators which have been assessed in determining that the aggregated segments share similar economic characteristics, and (2) a reconciliation of segment assets to the entity's assets when segment assets are reported.

4 Adoption of New or Revised standards and interpretations (Continued)

The basis for conclusions on IFRS 13 was amended to clarify that deletion of certain paragraphs in IAS 39 upon publishing of IFRS 13 was not made with an intention to remove the ability to measure short-term receivables and payables at invoice amount where the impact of discounting is immaterial.

IAS 16 and IAS 38 were amended to clarify how the gross carrying amount and the accumulated depreciation are treated where an entity uses the revaluation model.

IAS 24 was amended to include, as a related party, an entity that provides key management personnel services to the reporting entity or to the parent of the reporting entity ('the management entity'), and to require to disclose the amounts charged to the reporting entity by the management entity for services provided.

5 New Accounting Pronouncements

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2017 or later, and which the Group has not early adopted. Only those amendments that are relevant to the Group are discussed below.

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

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

The Group is currently assessing the impact of the new standard on its consolidated financial statements.

IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal.

5 New Accounting Pronouncements (Continued)

Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The Group is currently assessing the impact of the new standard on its consolidated financial statements.

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

The amendments to IAS 7 - Statement of Cash Flow (issued in January 2016 and not yet endorsed in EU) require entities to provide disclosures that enable investors to evaluate changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes.

The following other new standards are not expected to have any material impact on the Group when adopted:

- The amendments to IAS 12 - Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses (issued in January 2016 and not yet endorsed in EU).
- Amendments to IFRS 15 - Revenue from Contracts with Customers (issued in April 2016 and not yet endorsed in EU).
- Amendments to IFRS 2 - Share-based Payment (issued in June 2016 and not yet endorsed in EU).

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

IFRS 17 "Insurance Contracts" (issued on 18 May 2017 and not yet endorsed in EU). IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare and contrast the financial performance of otherwise similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately. The Group is currently assessing the impact of the new standard on its consolidated financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Group's consolidated financial statements.

6 Critical Accounting Estimates and Judgements in Applying Accounting Policies

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

Tax legislation. Russian tax 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 may be challenged by the relevant authorities. Please see Note 24 for more details.

Initial recognition of related party transactions. In the normal course of business the Company enters into transactions involving various financial instruments with its related parties. IAS 39, Financial Instruments: recognition and measurement, requires initial recognition of financial instruments based on their fair values. Judgement was applied in determining if transactions are priced at market or nonmarket interest rates, where there is no active market for such transactions. This judgement was based on the pricing for similar types of transactions with unrelated parties and effective interest rate analyses.

Estimation of oil and gas reserves. Engineering estimates of hydrocarbon reserves are inherently uncertain and are subject to future revisions. Accounting measures such as depreciation, depletion and amortization charges, impairment assessments and asset retirement obligations that are based on the estimates of proved reserves are subject to change based on future changes to estimates of oil and gas reserves.

Proved reserves are defined as the estimated quantities of hydrocarbons which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic conditions. Proved reserves are estimated by reference to available reservoir and well information, including production and pressure trends for producing reservoirs. Furthermore, estimates of proved reserves only include volumes for which access to market is assured with reasonable certainty. All proved reserves estimates are subject to revision, either upward or downward, based on new information, such as from development drilling and production activities or from changes in economic factors, including product prices, contract terms or development plans. In some cases, substantial new investment in additional wells and related support facilities and equipment will be required to recover such proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change over time as additional information becomes available.

The Group last obtained an independent reserve engineers report as at 1 January 2014.

In general, estimates of reserves for undeveloped or partially developed fields are subject to greater uncertainty over their future life than estimates of reserves for fields that are substantially developed and depleted. As those fields are further developed, new information may lead to further revisions in reserve estimates. Reserves have a direct impact on certain amounts reported in the consolidated financial statements, most notably depreciation, depletion and amortization as well as impairment expenses. Depreciation rates on production assets using the units-of-production method for each field are based on proved developed reserves for development costs, and total proved reserves for costs associated with the acquisition of proved properties. Assuming all variables are held constant, an increase in proved developed reserves for each field decreases depreciation, depletion and amortization expenses. Conversely, a decrease in the estimated proved developed reserves increases depreciation, depletion and amortization expenses. Moreover, estimated proved reserves are used to calculate future cash flows from oil and gas properties, which serve as an indicator in determining whether or not property impairment is present. The possibility exists for changes or revisions in estimated reserves to have a significant effect on depreciation, depletion and amortization charges and, therefore, reported net profit/(loss) for the year. Management believes that in 2015 and 2016 there were no reasonably possible changes in oil reserves that would have significant impact on the depreciation, depletion and amortization charges recognised in these consolidated financial statements.

Deferred income tax asset recognition. The recognised deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the consolidated statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. The future taxable profits and the amount of tax benefits that are probable in the future are based on the medium term business plan prepared by management and extrapolated results thereafter. The business plan is based on management expectations that are believed to be reasonable under the circumstances.

6 Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

Management considered the potential tax consequences from the internal reorganisation that was underway in 2016 (as described in note 28) and concluded that any tax benefit should be recognised only upon finalisation of the reorganisation.

Dismantlement provision. Management makes provision for the future costs of decommissioning hydrocarbon production facilities, pipelines and related support equipment based on the best estimates of future cost and economic lives of those assets. Estimating future dismantlement provision is complex and requires management to make estimates and judgments with respect to removal obligations that will occur many years in the future. Changes in the measurement of existing obligations can result from changes in estimated timing, future costs or discount rates used in valuation. Management believes that in 2015 and 2016 there were no reasonably possible change in any of the above key assumptions used that would have significant impact on the dismantlement provision recognised in these consolidated financial statements.

Useful lives of non-oil and gas properties. Items of non-oil and gas properties are stated at cost less accumulated depreciation. The estimation of the useful life of an asset is a matter of management judgement based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any of these conditions or estimates may result in adjustments to future depreciation rates. Useful lives applied to oil and gas properties may exceed the license term where management considers that licenses will be renewed. Assumptions related to renewal of licenses can involve significant judgment of management. Management believes that in 2015 and 2016 there were no reasonably possible changes in useful lives of non-oil and gas properties that would have significant impact on the depreciation charge recognised in these consolidated financial statements.

Acquisition of companies. Management applies judgements to determine whether the acquired entities represent business or assets. In making such judgements management considers whether the acquired entities are able to produce desired output, plan to produce outputs is being pursued, access to customers that will purchase the outputs can be obtained and employees, intellectual property, and other inputs and processes are present. Please refer to Note 27 for specific judgements applied in accounting of BVN-Oil and RK-Oil acquisitions.

In accounting for business combinations, the purchase price paid to acquire a business is allocated to its assets and liabilities based on the estimated provisional fair values of the assets acquired and liabilities assumed as of the date of acquisition. A significant amount of judgment is involved in estimating the individual fair values of property, plant and equipment and identifiable intangible assets.

The estimates used in determining provisional fair values are based on projected cash flows believed to be reasonable but which are inherently uncertain. Accordingly, actual results may differ from the projected results used to determine fair value.

7 Cash and cash equivalents

	31 December	
	2016	2015
Short-term bank deposits with maturities of 3 months or less	737	864
Cash at bank and on hand	465	831
Total cash and cash equivalents	1,202	1,695

Based on Fitch's rating, the credit quality of Public Joint-Stock Company Sberbank of Russia in which the Group mostly held its cash and cash equivalents as at 31 December 2016 and 2015 is BBB-.

Based on Standard & Poor's rating, the credit quality of Public Joint-Stock Company Promsvyazbank in which the Group held its cash and cash equivalents as at 31 December 2016 and 2015 is BB-.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

8 Accounts Receivable and Prepayments

	Year ended 31 December	
	2016	2015
Trade and other accounts receivable	953	936
Loans receivable	442	70
Total financial assets	1,395	1,006
Recoverable and prepaid taxes including VAT	1,261	882
Advances to suppliers	933	295
Prepaid expenses	-	549
Other	409	171
Total accounts receivable and prepayments	3,998	2,903

In 2016 the Group issued a short-term loan to an unrelated third party at a market rate.

8 Accounts Receivable and Prepayments (Continued)

Included in total accounts receivable and prepayments are \$0.6 million and \$0.7 million at 31 December 2016 and 2015, respectively, denominated in US dollars and substantially all remaining amounts are denominated in Russian Roubles.

As at 31 December 2015 Trade and other accounts receivable included \$0.5 million fines and penalties accrued to contractor. The amount of this transaction in 2015 included in Other operating profit/loss for the period.

In 2016 the Group wrote-off prepaid expenses in the amount of \$520 thousand. The amount of this transaction was included in Other operating profit/loss for the period for the year ended 31 December 2016.

Trade accounts receivable arise primarily from sales to ongoing customers with standard payment terms. The category 'Other' primarily relates to prepaid amounts to customs and tax authorities, which will be returned to the Group either in cash or through an offset against future payments.

Changes in the provision for impairment of trade and other receivables were as follows:

	Year ended 31 December	
	2016	2015
At 1 January	49	65
Using of provision	(59)	-
Effect of currency translation	10	(16)
At 31 December	-	49

The carrying values of trade and other receivables and loans issued approximate their fair value (Level 3 of fair value hierarchy). The maximum exposure to credit risk at the reporting date is the carrying value of each class of financial receivables mentioned above. The Group does not hold any collateral as security for trade and other receivables and loans issued (see Note 25 for credit risk disclosures).

As at 31 December 2016 and 2015 there were no past due, but not impaired accounts receivable.

9 Inventories

	31 December	
	2016	2015
Crude oil	6,718	4,331
Oil products	3,768	910
Materials and supplies	3,041	2,335
Total inventories	13,527	7,576

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

10 Property, Plant and Equipment

<i>Cost at</i>	Oil and gas properties	Refinery and related equipment	Buildings	Other Assets	Assets under construction	Total
1 January 2015	89,513	4,529	506	3,491	5,524	103,563
Translation difference	(21,810)	(1,098)	(118)	(898)	(1,017)	(24,941)
Additions	451	-	-	661	3,337	4,449
Transfers	4,405	302	-	-	(4,707)	-
Capitalised borrowing costs (Note 15)	-	-	-	-	40	40
Changes in estimate of dismantlement provision	100	94	-	-	-	194
Acquisition of subsidiaries (Note 27)	5,234	-	-	-	-	5,234
Disposals	-	-	-	(35)	(157)	(192)
31 December 2015	77,893	3,827	388	3,219	3,020	88,347
Translation difference	16,308	792	78	698	400	18,276
Additions	2,250	198	-	463	1,539	4,450
Transfers	2,527	-	-	-	(2,527)	-
Capitalised borrowing costs (Note 15)	-	-	-	-	128	128
Acquisition of subsidiary (Note 27)	1,567	-	-	678	-	2,245
Disposals	-	-	-	(437)	(33)	(470)
31 December 2016	100,545	4,817	466	4,621	2,527	112,976

Additions to assets under construction included capitalised depreciation in the amount of \$72 thousand (for the year ended 31 December 2015: \$163 thousand).

The average capitalisation rate for the year ended 31 December 2016 is 14.28% (for the year ended 31 December 2015: 14.28%).

The Group recorded the change in estimate of dismantlement provision for oil and gas properties and for refinery and related equipment due to the change in discount rate (Note 16) in 2015 due to the change in discount rate and expected long-term inflation rate (Note 16) in 2015. No changes in estimates were made in 2016.

In 2015 the Group wrote-off the unsuccessful drilling of development well in the amount of \$143 thousand. The amount of this transaction was 2015 included in Other operating (loss)/profit for the period for the year ended 31 December 2015.

<i>Accumulated Depreciation, Amortization and Depletion at</i>	Oil and gas properties	Refinery and related equipment	Buildings	Other Assets	Assets under construction	Total
1 January 2015	(35,580)	(2,258)	(395)	(2,274)	-	(40,507)
Translation difference	8,827	551	93	548	-	10,019
Depreciation	(4,346)	(220)	(24)	(194)	-	(4,784)
Disposals	-	-	-	35	-	35
31 December 2015	(31,099)	(1,927)	(326)	(1,885)	-	(35,237)
Translation difference	(6,796)	(411)	(68)	(348)	-	(7,623)
Depreciation	(4,857)	(214)	(22)	(310)	-	(5,403)
Disposals	-	-	-	376	-	376
31 December 2016	(42,752)	(2,552)	(416)	(2,167)	-	(47,887)
<i>Net Book Value at</i>						
31 December 2015	46,794	1,900	62	1,334	3,020	53,110
31 December 2016	57,793	2,265	50	2,454	2,527	65,089

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

10 Property, Plant and Equipment (Continued)

As at 31 December 2016 and 31 December 2015 the Group pledged its property, plant and equipment in amount of \$3.0 million and \$2.0 million under loan agreements with PJSC Sberbank of Russia (Note 15).

Included within oil and gas properties at 31 December 2016 and 2015 were exploration and evaluation assets:

	Cost at 31 December 2015	Additions	Translation difference	Cost at 31 December 2016
<i>Exploration and evaluation assets</i>				
Petrosakh	12,871	2,098	2,814	17,783
Arcticneft	7,448	-	1,499	8,947
BVN-Oil	4,257	152	875	5,284
RK-Oil	395	-	79	474
Arctic Oil Company	-	664	46	710
Total cost of exploration and evaluation assets	24,971	2,914	5,313	33,198

	Cost at 1 January 2015	Additions	Translation difference	Cost at 31 December 2015
<i>Exploration and evaluation assets</i>				
Petrosakh	16,674	-	(3,803)	12,871
Arcticneft	9,160	451	(2,163)	7,448
BVN-Oil	-	4,790	(533)	4,257
RK-Oil	-	444	(49)	395
Total cost of exploration and evaluation assets	25,834	5,685	(6,548)	24,971

At the each reporting date management assess whether there is any indication that the recoverable value has declined below the carrying value of property, plant and equipment. Management considered continuing deterioration in economic environment and volatility of oil prices as impairment indicators and performed a full impairment test of its assets.

The Group conducted impairment tests assessing whether the carrying amount of each cash-generating unit exceeds the recoverable amount of the respective cash-generating unit. The recoverable amount has been determined as values in use of respective assets. The values in use of cash-generating units have been calculated as the present values of projected future cash flows discounted using the rates derived from the weighted average cost of capital of the Group, as adjusted, where applicable, to take into account any specific risks of business operations related to the cash-generating units. For the purposes of assessing impairment, assets are grouped by license areas, which are the lowest levels for which there are separately identifiable cash flows (cash-generating units). Key assumptions for impairment test are a 12% discount rate, an average oil price of \$45 for 2017 and \$45 in real terms for future sales. Based on the results of the impairment test the Group did not identify impairment. Estimated production volumes are based on detailed data for the fields and take into account development plans for the fields agreed by management as part of the long-term planning process. Consequently, management believes no reasonably possible change in the production and discount rate assumption would cause the carrying amount of non-current assets to exceed their recoverable amount.

The Group's oil fields are located in the Russian Federation on land owned by the Russian government. The Group holds production licenses and pays production taxes to extract oil and gas from the fields. The licenses expire between 2018 and 2067 and may be extended. Management intends to renew the licenses as the properties are expected to remain productive subsequent to the license expiration date.

Estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, amount to \$0.1 million and \$0.1 million at 31 December 2016 and 2015, respectively, are included in the cost of oil and gas properties. The Group has estimated its liability based on current environmental legislation using estimated costs when the expenses are expected to be incurred.

On 15 June 2016 the Company was awarded a 25 year exploration and development licence for the South Dagi oil field on Sakhalin Island, following an auction by the Russian State Authorities. The licence, with an area of 27.8 sq. kms, was the subject of an earlier exploration and appraisal programme in the 1970s, followed by additional seismic

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

10 Property, Plant and Equipment (Continued)

work done in the middle of 1990s and 2007. During these periods two exploratory and six appraisal wells were drilled.

The auction bid price payable by the Company is Russian Roubles 134.6 million, equivalent to US\$2.1 million. The funding of this transaction was made from the Company's existing capital resources. The transaction was made as a part of the Company's strategy to acquire licences and defer significant development decisions until conditions (oil price, exchange rates and taxes) become more favourable.

The Group leases certain items within oil and gas properties under a number of finance lease agreements. The Group classified these leases as finance lease based on contract terms that include transfer of ownership rights at the end of contract.

As at 31 December 2016 cost of the leased assets amounted to \$1,406 thousand (2015: \$987 thousand). Accumulated depreciation for the leased assets as at 31 December 2016 amounted to \$674 thousand (2015: \$433 thousand). Additions of the leased assets amounted to \$200 thousand (for the year ended 31 December 2015: nil).

Future minimum lease payments were as follows:

	31 December 2016		
	Minimum lease payments	Future finance charges	Present value of minimum lease payments
Financial lease obligations payable			
Less than one year	225	112	113
Between one year and five years	666	313	353
More than five years	469	108	361
Total	1,360	533	827

	31 December 2015		
	Minimum lease payments	Future finance charges	Present value of minimum lease payments
Financial lease obligations payable			
Less than one year	128	76	52
Between one year and five years	483	285	198
More than five years	472	111	361
Total	1,083	472	611

11 Other Non-Current Assets

	Year ended 31 December	
	2016	2015
Advances to contractors and suppliers for construction in process	119	11
Intangible assets	73	73
Other non-current assets	-	31
Total other non-current assets	192	115

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

12 Accounts Payable and Accrued Expenses

	Year ended 31 December	
	2016	2015
Trade payables	478	254
Other payable and accrued expenses	162	36
Short-term finance lease obligations	113	52
Accounts payable for non-current assets	15	771
Total financial liabilities	768	1,113
Wages and salaries	935	758
Total accounts payable and accrued expenses	1,703	1,871

Total accounts payable and accrued expenses in the amount of \$0.2 million and \$0.1 million at 31 December 2016 and 2015, respectively, are denominated in US dollars. Substantially all remaining amounts are denominated in Russian Roubles.

In 2016 the Group wrote-off Trade payables and Accounts payable for non-current assets in the amount of \$112 thousand. The amount of these transactions were included in Other operating (loss)/profit for the year ended 31 December 2016.

13 Provisions

	Provision on claims	Provision for severance	Total
1 January 2015	911	-	911
Release of provision	(864)	-	(864)
Release of provision due to exchange differences	(47)	-	(47)
31 December 2015	-	-	-
Addition due to acquisition of subsidiary (Note 27)	-	223	223
Accrual of provision for legal claims	138	-	138
Use of provision	-	(116)	(116)
Increase of provision due to exchange difference	14	7	21
31 December 2016	152	114	266

Provision on claims

On 2 June 2010 the Company was notified that Finfund Limited has exercised its rights to acquire 13,000,000 existing Urals shares with a nominal value of US\$0.0063 from entities beneficially owned by two directors (being Leonid Y. Dyachenko and Aleksey V. Ogarev) and another significant shareholder (being Vyacheslav V. Rovneiko) (together the "Shareholders") pursuant to a share pledge agreement dated 26 November 2007 (the "Share Pledge Agreement").

The Shares beneficially owned and transferred to Finfund Limited as a result of such exercise of its rights against each Shareholder were as follows:

Name	Number of Pledged Shares
Vyacheslav V. Rovneiko	8,010,000
Leonid Y. Dyachenko (Executive Chairman)	3,422,000
Aleksey V. Ogarev (Executive Director)	1,568,000
Total	13,000,000

As a consequence of the exercise of Finfund Limited's rights, as described above, any liability owed by Urals to Finfund Limited was reduced by the value of the shares transferred, estimated to equal \$2.2 million. The Company recorded a provision for the potential reimbursement to these shareholders. The company recorded this provision based on the historical value of 13,000,000 shares.

On 26 December 2014 the Company signed a comprehensive settlement agreement with Mr V Rovneiko. As part of the overall settlement, Mr Rovneiko agreed to withdraw his claim for collateral allegedly provided by the Company in relation to the 8,010,000 pledged shares to Finfund.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

13 Provisions (Continued)

In June 2016 the deed of release between Leonid Y. Dyachenko, Aleksey V. Ogarev, the entity beneficially owned by them and the Company to withdraw the claims for collateral allegedly provided by the Company in relation to the 4,990,000 pledged shares to Finfund was signed. The release was effective from 31 December 2015.

Management has concluded that the deed of release together with confirmation from the entity beneficially owned by Leonid Y. Dyachenko and Aleksey V. Ogarev not to claim for any reimbursement in relation to pledged shares, strike off of that Company and lack of other creditors in that entity results in the release of provision for the potential reimbursement to Leonid Y. Dyachenko and Aleksey V. Ogarev in the amount of \$0.9 million. The gain resulted from this release is recognised within Other operating (loss)/profit in the profit and loss section of consolidated statement of comprehensive income for the year ended 31 December 2015.

Although the agreement was signed in 2016, it canceled the liability as of 31 December 2015 and resulted from the events and preliminary agreements reached in 2015 and is viewed by management as a formalisation of these. Therefore, management recorded release of the provision for the potential reimbursement to shareholders in 2015.

In 2016 the Group accrued provision for legal claims amounting to \$0.1 million. The amount of this transaction in 2016 included in Other operating (loss)/profit for the period.

14 Taxes

Income taxes for the years ended 31 December 2016 and 2015 comprised the following:

	Year ended 31 December	
	2016	2015
Current tax (benefit)/expense	(2,103)	538
Deferred tax charge/(benefit)	46	(736)
Income tax benefit	(2,057)	(198)

Below is a reconciliation of profit before tax to income tax charge:

	Year ended 31 December	
	2016	2015
Profit/(loss) before income tax	5,944	(4,253)
Theoretical charge/(benefit) at the statutory rate of 20%	1,189	(851)
(Utilization)/write-off of statutory tax loss carry forward, net	(594)	1,324
Effects of different tax rate	2	20
Reversal of uncertain tax position provision	(2,684)	-
Other non-deductible expenses/(income), net of non-taxable (income)/expenses	30	(691)
Income tax benefit	(2,057)	(198)
Effective tax rate	-34.6%	4.7%

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

14 Taxes (Continued)

The movements in deferred tax assets and liabilities during the years ended 31 December 2016 were as follows:

	31 December 2016	Recognized in equity for translation differences	Credited/(charged) to the profit and loss section of consolidated statement of comprehensive income	Acquisition of subsidiary (Note 27)	31 December 2015
<i>Deferred income tax liabilities</i>					
Property, plant and equipment	(7,934)	(1,318)	59	(161)	(6,514)
Inventories	(1,211)	(186)	(406)	144	(763)
<i>Deferred income tax assets</i>					
Dismantlement provision	335	47	34	60	194
Payables	157	27	243	(188)	75
Tax losses	4,246	708	49	-	3,489
Provisions	21	1	(25)	45	-
Net deferred income tax liabilities	(4,651)	(745)	(254)	(133)	(3,519)
Net deferred income tax assets	265	24	208	33	-
Net deferred income tax liabilities	(4,386)	(721)	(46)	(100)	(3,519)

The movements in deferred tax assets and liabilities during the years ended 31 December 2015 were as follows:

	31 December 2015	Recognized in equity for translation differences	Credited/(charged) to the profit and loss section of consolidated statement of comprehensive income	31 December 2014
<i>Deferred income tax liabilities</i>				
Property, plant and equipment	(6,514)	1,954	346	(8,814)
Inventories	(763)	199	(314)	(648)
<i>Deferred income tax assets</i>				
Dismantlement provision	194	(56)	19	231
Payables	75	(17)	62	30
Tax losses	3,489	(979)	623	3,845
Net deferred income tax liabilities	(3,519)	1,101	736	(5,356)

The amount of deferred tax assets and liabilities that will be settled in 2017 is not significant.

Starting from 1 January 2017 the amendments to the Russian tax legislation became effective in respect of tax loss carry forwards. The amendments affect tax losses incurred and accumulated since 2007 that have not been utilised. The 10-year expiry period for tax loss carry-forwards no longer applies. The amendments also set limitation on utilisation of tax loss carry forwards that will apply during the period from 2017 to 2020. The amount of losses that can be utilised each year during that period is limited to 50% of annual taxable profit. The amendments are not expected to have significant impact on the Group's consolidated financial statements.

The Company is subject to corporation tax on taxable profits at the rate of 12.5%. Under certain conditions interest expense may be exempt from income tax and be subject only to special contribution for defense at the rate of 30%. In certain cases dividends received from abroad may be subject to defense contribution at the rate of 17%.

Most of the individual operating entities are taxed in the Russian Federation at the rate of 20%.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

14 Taxes (Continued)

In the context of the Group's current structure, tax losses and current tax assets of different group companies may not be offset against current tax liabilities and taxable profits of other group companies and, accordingly, taxes may accrue even where there is a consolidated tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity. At 31 December 2016 and 2015, deferred tax assets of \$13.8 million and \$11.7 million, respectively, have not been recognized for deductible temporary differences for which it is not probable that sufficient taxable profit will be available to allow the benefit of that deferred tax assets to be utilised. Accumulated tax losses were \$90.1 million and \$76.0 million at 31 December 2016 and 2015, respectively.

Other taxes payable at 31 December 2016 and 2015 were as follows:

	31 December	
	2016	2015
Mineral extraction tax	2,324	1,033
VAT	2,060	1,527
Excise	1,103	183
Other taxes payable	410	247
Total other taxes payable	5,897	2,990

In 2016 and 2015 the Group accrued penalties and fines related taxes amounting to \$0.1 million and \$0.8 million. The amount of these transactions in 2016 and 2015 included in Other operating (loss)/profit for the period.

15 Borrowings

Long-term and short-term borrowings. Long-term and short-term borrowings were as follows at 31 December 2016 and 2015:

	31 December	
	2016	2015
<i>Long-term borrowings</i>		
Transnational Bank (Note 27)		
- Principal	1,611	1,396
- Interest	456	160
Sberbank		
- Principal	4,121	2,247
- Interest	20	12
Other	122	120
Subtotal	6,330	3,935
Less: current portion of long-term borrowings	(2,087)	(2,419)
Total long-term borrowings	4,243	1,516
<i>Short-term borrowings</i>		
Kamchatcomagroprombank	462	-
Subtotal	462	-
Plus: current portion of long-term borrowings	2,087	2,419
Total short-term borrowings	2,549	2,419
Total borrowings	6,792	3,935

On 19 November 2015, the Group acquired two private Russian companies, OOO RK-Oil and OOO BVN Oil that carried long-term and short-term borrowings in the amount of \$1.8 million (Note 27) including loans of Transnational Bank in the amount of \$1.7 million at an interest rate 15-20% per annum due for repayment from November 2018 to January 2019. In April 2015, Transnational Bank lost its Central Bank of Russia license and started to be managed by The State Corporation Deposit Insurance Agency in accordance with established procedure in the Russian Federation. After this event legal owners of the bank cannot participate in the decision making

15 Borrowings (Continued)

process of the bank. Loss of the licence by Transnational bank did not change the terms of long term loans of OOO RK-Oil and OOO BVN Oil, and such changes are not expected. The companies suspended loan interest payments in 2015, following the bank's license being revoked. In 2016, the State Corporation Deposit Insurance Agency filed a lawsuit against BVN-Oil for breach of the respective loan agreements' terms and claiming immediate repayment of the principal, accrued interest and penalties for non-payment of the loan interest. The Group recorded a provision in relation to this lawsuit (Note 13).

On 30 June 2015 Petrosakh entered into an 18 month revolving credit facility with the Sakhalin branch of PJSC Sberbank of Russia ("Sberbank") for a total amount of 300 million Roubles (representing approximately US\$5.4 million at prevailing exchange rates) to Petrosakh for working capital financing.

The key terms of the Loan are that:

- it is repayable on 29 December 2016 (the agreement also provides for early repayment of the Loan);
- interest is chargeable at the rate of 14.28% plus 1%. The lowest rate of 14.28% is subject to Petrosakh meeting monthly turnover targets and having average cash balances in its bank account;
- it is secured by way of a pledge over property (Note 10) and cash flows from Petrosakh.

The loan including the accrued interest was fully paid in 2016.

On 20 September 2016 Petrosakh entered into an 18 month revolving credit facility with the Sakhalin branch of PJSC Sberbank of Russia ("Sberbank") for a total amount of 300 million Roubles (representing approximately US\$4.6 million at prevailing exchange rates) to Petrosakh for working capital financing.

The key terms of the loan are that:

- it is repayable on 19 March 2018 (the agreement also provides for early repayment of the loan without incurring any penalties);
- interest is chargeable at the rate of 13% plus 1%. The lowest rate of 13% is subject to Petrosakh meeting monthly turnover targets and having average cash balances in its bank account;
- it is secured by way of a pledge over property (Note 10) and cash flows from Petrosakh.

In December 2016 Arcticneft signed an agreement to raise a short-term non-revolving secured credit facility with Kamchatcomagroprombank. Total amount of the credit facility is 40 million Roubles (representing approximately US\$0.7 million at prevailing exchange rates). As of 31 December 2016 the company had drawn down US\$462 thousand. The loan is repayable on 31 August 2017. Interest is chargeable at 15%. The Company pledged its 7 thousand tons of crude oil stored at AO Arcticneft's warehouse under the loan agreement with Kamchatcomagroprombank.

Petraco

In May 2016 the Company obtained a short-term secured loan from Petraco in the amount of US\$6.0 million at an interest rate of six months Libor plus 5% per annum due on the 30 day after the date of next tanker shipment. From the date of the next tanker shipment the interest rate is six month Libor plus 2% per annum. The Company pledged its 100% shares in its subsidiary AO Arcticneft and 22 thousand tons of crude oil stored at AO Arcticneft's warehouse under the loan agreement with Petraco. The loan including the accrued interest was fully paid as a result of the non-cash settlement transactions with trade receivables due to crude oil sales to Petraco in August 2016.

In May 2015 the Company obtained a short-term secured loan from Petraco in the amount of US\$6.0 million at an interest rate of six months Libor plus 5% per annum due on the 30 day after the date of next tanker shipment. From the date of the next tanker shipment the interest rate is six month Libor plus 2% per annum. Company pledged its 100% shares in Arcticneft and 17 thousand tons of crude oil stored at Arcticneft warehouse under the loan agreement with Petraco. The loan including the accrued interest was fully paid as a result of the non-cash settlement transactions with trade receivables due to crude oil sales to Petraco in September 2015.

The carrying values of borrowings approximate their fair value.

Other than stated above, the Group is in compliance with the debt covenants under loan agreements as of 31 December 2016 and 2015.

Weighted average interest rate. The Group's weighted average interest rates on borrowings was 14.28% and 15.1% at 31 December 2016 and 2015, respectively.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

15 Borrowings (Continued)

Interest income and expense. Interest income and expense for the years ended 31 December 2016 and 2015, respectively, comprised the following:

	Year ended 31 December	
	2016	2015
Interest income		
Loans issued	23	30
Interest on deposits	27	9
Total interest income	50	39
Interest on loan from Sberbank	(490)	(111)
Interest on loans from OOO KB Transnational Bank	(253)	(25)
Change in dismantlement provision due to unwinding of discount (Note 16)	(167)	(140)
Interest on loan from Petraco Oil Company Limited	(102)	(110)
Interest on loans from Kamchatcomagroprombank	(91)	-
Finance leases	(84)	(97)
Interest on other loans	(7)	-
Less: capitalised in PP&E (Note 10)	128	40
Total interest expense	(1,066)	(443)
Net finance cost	(1,016)	(404)

16 Dismantlement Provision

The dismantlement provision represents the net present value of the estimated future obligation for dismantlement, abandonment and site restoration costs which are expected to be incurred at the end of the production lives of the oil and gas fields, which vary from 10 to 52 years depending on the field and type of assets. Nominal discount rate was 14.5% and 14.5% as of 31 December 2016 and 2015, respectively. As at 31 December 2016 and 2015 there were no reasonably possible changes in the key assumptions which would have a significant impact on dismantlement provision.

	Year ended 31 December	
	2016	2015
Opening dismantlement provision	971	895
Addition due to acquisition of subsidiary (Note 27)	291	-
Translation difference	244	(258)
Changes in estimates	-	194
Unwinding of discount (Note 15)	167	140
Closing dismantlement provision	1,673	971

As further discussed in Note 24, environmental regulations and their enforcement are being developed by governmental authorities. Consequently, the ultimate dismantlement, abandonment and site restoration obligation may differ from the estimated amounts, and this difference could be significant.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

17 Equity

At 31 December 2016 and 2015 authorised share capital was \$1,890 thousand divided into 300 million shares of \$0.0063 each.

	Number of shares (thousand of shares)	Share capital	Share premium	Difference from conversion of share capital to USD
Balance at 1 January 2015	252,446	1,589	656,968	(113)
Balance at 31 December 2015	252,446	1,589	656,968	(113)
Balance at 31 December 2016	252,446	1,589	656,968	(113)

The Share premium is not available for distribution by way of dividend.

Profit/(loss) per share. Basic profit/(loss) per share is calculated by dividing the profit/(loss) attributable to equity holders of the company by the weighted average number of ordinary shares in issue during the year.

On 26 May 2017 shareholders approved the Company's share consolidation: the 252,446,060 existing ordinary shares of nominal value \$0.0063 each in the issued share capital of the Company have been consolidated and divided into 12,622,303 new ordinary shares of nominal value \$0.126 each, effective on 30 May 2017. Basic and diluted earnings per share for year ended 31 December 2016 and 2015 were adjusted retrospectively.

The weighted average number of ordinary shares issued was calculated as following:

	Year ended 31 December	
	2016	2015
Balance at 1 January		
Weighted average number of ordinary shares in issue	12,622,303	12,622,303

	Year ended 31 December	
	2016	2015
Profit/(loss) attributable to equity holders of the Company	7,910	(4,073)
Weighted average shares outstanding (thousands) attributable to:	12,622	12,622
- Basic shares	12,622	12,622
- Diluted shares	12,622	12,622
Basic profit/(loss) per share (in US dollar per share)	0.63	(0.32)
Diluted profit/(loss) per share (in US dollar per share)	0.63	(0.32)

18 Non-controlling interest

The following table summarises the consolidated information relating to the significant Group's subsidiary, AO Petrosakh, with a non-controlling interest that is material to the Group:

	Year ended 31 December	
	2016	2015
Share of non-controlling interest*	2.8%	2.8%
Profit attributable to non-controlling interest	91	18
Effect of currency translation	128	(177)
Accumulated non-controlling interest in the subsidiary	766	547

* Share of non-controlling interest is equal to the proportion of voting rights held by the non-controlling interest.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

18 Non-controlling interest (Continued)

Country of primary operation of AO Petrosakh is Russia.

	As of and for the year ended	
	31 December 2016	31 December 2015
Current assets	16,301	7,929
Non-current assets	35,750	30,665
Current liabilities	6,946	6,088
Non-current liabilities	18,139	13,245
Revenue	21,501	19,655
Profit for the year	3,280	634
Total comprehensive income/(loss) for the year	7,787	(5,599)
Net cash from/(used in):		
operating activities	4,619	2,656
investing activities	(5,564)	(5,168)
financing activities	585	2,934

AO Petrosakh did not distribute dividends during the years ended 31 December 2016 and 2015.

19 Revenues

	Year ended 31 December	
	2016	2015
Crude oil		
Export sales	9,831	10,078
Domestic sales (Russian Federation)	1,986	2,288
Petroleum (refined) products – domestic sales	23,349	18,868
Other sales	143	195
Total proceeds from sales	35,309	31,429
Less: excise taxes	(3,754)	(1,273)
Less: export duties	(2,503)	(2,943)
Revenues after excise taxes and export duties	29,052	27,213

All of the Group's export crude oil sales are made to one customer – Petraco, with whom the Group was trading for the past several years. The customer is a trader, sales are made purely on market terms, the title over the oil sold passes upon tanker loading and, accordingly, management does not monitor the ultimate consumers of its export sales.

20 Segment information

Operating segments are defined as components of the Group where separate financial information is available and reported regularly to the chief operating decision maker (hereinafter referred to as "CODM", represented by the Board of Directors of the Company), which decides how to allocate resources and assesses operational and financial performance using the information provided.

The CODM receives monthly IFRS based financial information for its production entities. There were three production entities in 2016 and two in 2015. Management has determined that the operations of these production entities are sufficiently homogenous, operating segments display similar economic characteristics and, therefore, they can be aggregated for the purpose of IFRS 8. CODM does not review performance of RK oil and BVN oil on regular basis as production on these entities has not started. Therefore, these entities do not represent operating or reportable segments. The Group has other entities that engage as either head office / corporate or as holding companies. Consequently, management has concluded that due to the above aggregation criteria there is only one reportable segment.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

20 Segment information (Continued)

Geographical information. The Group operates in two major geographical areas of the world. In the Russian Federation, its home country, the Group is mainly engaged in the exploration, development, extraction and sales of crude oil, and refining and sale of oil products. Activities outside the Russian Federation are restricted to sales activities where title passes upon tanker loading. Sales are made to Europe (sales of crude oil). Information on the geographical location of the Group's revenues is set out below.

For the year ended 31 December 2016:

	Russian Federation	Europe	Total
Crude oil	1,986	9,831	11,817
Petroleum (refined) products	23,349	-	23,349
Other sales	143	-	143
Total proceeds from sales	25,478	9,831	35,309
Less: excise taxes	(3,754)	-	(3,754)
Less: export duties	-	(2,503)	(2,503)
Revenues after excise taxes and export duties	21,724	7,328	29,052

For the year ended 31 December 2015:

	Russian Federation	Europe	Total
Crude oil	2,288	10,078	12,366
Petroleum (refined) products	18,868	-	18,868
Other sales	195	-	195
Total proceeds from sales	21,351	10,078	31,429
Less: excise taxes	(1,273)	-	(1,273)
Less: export duties	-	(2,943)	(2,943)
Revenues after excise taxes and export duties	20,078	7,135	27,213

Revenue from external customers is based on the geographical location of customers although all revenues are generated by assets in the Russian Federation. Substantially all of the Group's assets are located in the Russian Federation. Excise taxes relate to petroleum products, export duties – to crude oil.

Major customers. For the year 2016, the Group has one major customer to whom individual revenues represent 28 percent of total external revenues (2015: one major customer that represented 32 percent).

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

21 Cost of Sales

	Year ended 31 December	
	2016	2015
Mineral extraction tax	8,563	9,089
Employee costs (including payroll taxes of \$1.2 million and \$1.1 million for the years ended 31 December 2016 and 2015, respectively)	5,408	4,879
Depreciation, depletion and amortisation	5,331	4,621
Materials	4,500	2,398
Oil treating, storage and other services	982	957
Other taxes	282	238
Utilities and repair services	143	182
Rent	120	246
Other	261	136
Change in finished goods	(3,795)	(2,648)
Total cost of sales	21,795	20,098

22 Selling, General and Administrative Expenses

	Year ended 31 December	
	2016	2015
Employee costs (including payroll taxes of \$0.2 million and \$0.3 million for the years ended 31 December 2016 and 2015, respectively)	1,697	1,659
Transport and shipment services	878	298
Office rent	359	349
Professional consultancy fees	272	411
Loading services	215	217
Materials	205	65
Audit fees	151	180
Trip expenses and communication services	166	190
Office expenses	102	97
Export terminal maintenance	-	164
Other expenses	313	285
Total selling, general and administrative expenses	4,358	3,915

The audit fee stated above include \$40 thousand (2015: \$52 thousand) charged by the Company's statutory audit firm. The professional services stated above include fees of \$1 thousand (2015: \$3 thousand) for tax consultancy services and \$6 thousand (2015:\$2 thousand) for other non-assurance services charged by the Company's statutory audit firm.

Directors' fees for the years ended 31 December 2016 and 2015 were \$37 thousand and \$104 thousand, respectively.

23 Foreign currency gain/(loss)

	Year ended 31 December	
	2016	2015
Net foreign exchange gain/(loss) on financing activities, including:	4,763	(7,649)
- foreign exchange gain	8,175	13,592
- foreign exchange loss	(3,412)	(21,241)
Net foreign exchange (loss)/gain on operating activities, including:	151	463
- foreign exchange gain	569	6,144
- foreign exchange loss	(418)	(5,681)
Total foreign currency gain/(loss)	4,914	(7,186)

Net foreign exchange gain/(loss) on financing activities is related to loans between the Group entities. Loans between the Group entities and related foreign exchange gains or losses are eliminated upon consolidation.

23 Foreign currency gain/(loss) (Continued)

However, where the loan is between the Group entities that have different functional currencies, the foreign exchange gain or loss cannot be eliminated in full and is recognized in the consolidated profit or loss.

24 Contingencies, Commitments and Operating Risks

Operating Environment. Russian Federation. The Russian Federation displays certain characteristics of an emerging market. Its economy is particularly sensitive to oil and gas prices. The legal, tax and regulatory frameworks continue to develop and are subject to frequent changes and varying interpretations. During 2016 the Russian economy continued to be negatively impacted by low oil prices, ongoing political tension in the region and international sanctions against certain Russian companies and individuals, all of which contributed to the country's economic recession characterised by a decline in gross domestic product. The financial markets continue to be volatile and are characterised by frequent significant price movements and increased trading spreads. Russia's credit rating was downgraded to below investment grade. This operating environment has a significant impact on the Group's operations and financial position. Management is taking necessary measures to ensure sustainability of the Group's operations. However, the future effects of the current economic situation are difficult to predict and management's current expectations and estimates could differ from actual results.

Operating Environment. Cyprus. Following a long and relatively deep economic recession, the Cyprus economy began to record positive growth in 2015 which accelerated during 2016. The restrictive measures and capital controls which were in place since March 2013 were lifted in April 2015 and on the back of the strength of the economy's performance and the strong implementation of required measures and reforms, Cyprus exited its economic adjustment programme in March 2016. In recognition of the progress achieved on the fiscal front and the economic recovery, as well as the enactment of the foreclosure and insolvency framework, the international credit rating agencies have proceeded with a number of upgrades of the credit ratings for the Cypriot sovereign, and although the rating continues to be "non-investment grade", the Cyprus government has regained access to the capital markets. The outlook for the Cyprus economy over the medium term remains positive, however, there are downside risks to the growth projections emanating from the high levels of non performing exposures, uncertainties in the property markets, as well as potential deterioration in the external environment for Cyprus, including continuation of the recession in Russia in conditions of protracted declines in oil prices; weaker than expected growth in the euro area as a result of worsening global economic conditions; slower growth in the UK with a weakening of the pound as a result of uncertainty regarding the result of the Brexit referendum; and political uncertainty in Europe in view of Brexit and the refugee crisis.

The Company's management is unable to predict all developments which could have an impact on the Cyprus economy and consequently, what effect, if any, they could have on the future financial performance, cash flows and financial position of the Company.

On the basis of the evaluation performed, the Company's management has concluded that no provisions or impairment charges are necessary.

The Company's management believes that it is taking all the necessary measures to maintain the viability of the Company and the development of its business in the current business and economic environment.

Oilfield licenses. The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oil field licenses. Management of the Group correspond with governmental authorities to agree on remedial actions, if necessary, to resolve any findings resulting from these reviews. Failure to comply with the terms of a license could result in fines, penalties or license limitations, suspension or revocations. Management believes any issues of non-compliance will be resolved through negotiations or corrective actions without any materially adverse effect on the financial position or the operating results of the Group. Management believes that proved reserves should include quantities that are expected to be produced after the expiry dates of the Group's production licenses. These licenses expire between 2018 and 2067.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

24 Contingencies, Commitments and Operating Risks (Continued)

The principal licenses of the Group and their expiry dates are:

Field	License holder	License expiry date
Okruzhnoye	Petrosakh	December 2037
Yuzhno-Daginsky area	Petrosakh	December 2041
Peschanozerskoye (eastern and western parts)	Arcticneft	December 2067
Peschanozerskoye (central part)	Arctic Oil Company	August 2019
Ordynsky area	RK-Oil	January 2040
Babayevsky area (exploration and production)	BVN-Oil	August 2036
Babayevsky area (geological study)	BVN-Oil	October 2018

Management believes the licenses may be extended at the initiative of the Group and management intends to extend such licenses for properties expected to produce subsequent to their license expiry dates.

Tax contingencies. Russian tax and customs legislation which was enacted or substantively enacted at the end of the reporting period, is subject to varying interpretations when being applied to the transactions and activities of the Group. Consequently, tax positions taken by management and the formal documentation supporting the tax positions may be successfully challenged by relevant authorities. Russian tax administration is gradually strengthening, including the fact that there is a higher risk of review of tax transactions without a clear business purpose or with tax non-compliant counterparties. 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 Russian transfer pricing legislation is generally aligned with the international transfer pricing principles developed by the Organisation for Economic Cooperation and Development (OECD), with certain specific features. The transfer pricing legislation provides for the possibility of additional tax assessment for controlled transactions (transactions between related parties and certain transactions between unrelated parties) if such transactions are not on an arm's length basis. Management has implemented internal controls to be in compliance with current transfer pricing legislation.

Tax liabilities arising from intercompany transactions are determined using actual transaction prices. It is possible, with the evolution of the interpretation of the transfer pricing rules, that such prices could be challenged. The impact of any such challenge cannot be reliably estimated; however, it may be significant to the financial position and/or the Company's operations.

The Group includes companies incorporated outside of Russia. The tax liabilities of the Group are determined on the assumption that these companies are not subject to Russian profits tax, because they do not have a permanent establishment in Russia. This interpretation of relevant legislation may be challenged but the impact of any such challenge cannot be reliably estimated currently; however, it may be significant to the financial position and/or the overall operations of the Group.

As Russian tax legislation does not provide definitive guidance in certain areas, the Group adopts, from time to time, interpretations of such uncertain areas that reduce the overall tax rate of the Group. While management currently estimates that the tax positions and interpretations that it has taken can probably be sustained, there is a possible risk that outflow of resources will be required should such tax positions and interpretations be challenged by the relevant authorities. The impact of any such challenge cannot be reliably estimated; however, it may be significant to the financial position and/or the overall operations of the Group.

Management regularly reviews the Group's taxation compliance with applicable legislation, laws and decrees as well as interpretations published by the authorities in the jurisdictions in which the Group has operations. However, from time to time potential exposures and contingencies are identified and at any point in time a number of open matters exist, management believes that its tax positions are sustainable. Management estimates possible tax exposures that probability is higher than remote but for which no liability is required to be recognised under IFRS, could be up to \$1.1 million. These exposures primarily relate to the fact that tax authorities may challenge deductibility of certain expenses and application of certain tax regimes. This estimation is provided for the IFRS requirement for disclosure of possible taxes and should not be considered as an estimate of the Group's future tax liability.

24 Contingencies, Commitments and Operating Risks (Continued)

Restoration, rehabilitation and environmental costs. The Group companies have operated in the upstream and refining oil industry in the Russian Federation for many years, and their activities have had an impact on the environment. The enforcement of environmental regulations in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations related thereto. The outcome of environmental liabilities under proposed or future legislation, or as a result of stricter enforcement of existing legislation, cannot reasonably be estimated at present, but could be material. Under the current levels of enforcement of existing legislation, management believes there are no significant liabilities in addition to amounts which are already accrued and which would have a material adverse effect on the financial position of the Group.

Legal proceedings. From time to time and in the normal course of business, claims against the Group may be received. On the basis of its own estimates and both internal and external professional advice, management is of the opinion that no material losses will be incurred in respect of claims in excess of provisions that have been made in these consolidated financial statements.

Other capital commitments. At 31 December 2016 the Group had no significant contractual commitments for capital expenditures.

25 Financial Risk Management

The accounting policies for financial instruments have been applied to the line items below:

	At 31 December	
	2016	2015
Financial assets		
<i>Loans and receivables: current assets</i>		
Loans issued	442	70
Cash and cash equivalents	1,202	1,695
Trade and other accounts receivable	953	936
Total loans and receivables: current assets	2,597	2,701
Financial liabilities		
<i>Measured at amortized cost: current liabilities</i>		
Trade and other payables (excluding short-term portion of finance lease obligations)	655	1,061
Short-term portion of finance lease obligations	113	52
Short-term borrowings and current portion of long-term borrowings	2,549	2,419
Total current liabilities measured at amortized cost	3,317	3,532
<i>Measured at amortized cost: non-current liabilities</i>		
Long-term borrowings	4,243	1,516
Long-term finance lease obligations	714	559
Total long-term liabilities measured at amortized cost	4,957	2,075

Financial risk management objectives and policies. In the ordinary course of business, the Group is exposed to market risks from fluctuating prices on commodities purchased and sold, credit risk, liquidity risk, currency exchange rates and interest rates. Depending on the degree of price volatility, such fluctuations in market price may create volatility in the Group's financial results. As an entity focused upon the exploration and development of oil and gas properties, the Group's overriding strategy is to maintain a strong financial position by securing access to capital to meet its capital investment needs.

The Group's principal risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to these limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities.

Market risk. Market risk is the risk that changes in market prices and rates, such as foreign exchange rates, interest rates, commodity prices and equity prices, will affect the Group's financial results or the value of its holdings of financial instruments. The primary objective of mitigating these market risks is to manage and control market risk exposures. The Group is exposed to market price movements relating to changes in commodity prices such as crude

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

25 Financial Risk Management (Continued)

oil, gas condensate, petroleum products and natural gas (commodity price risk), foreign currency exchange rates, interest rates, equity prices and other indices that could adversely affect the value of the Group's financial assets, liabilities or expected future cash flows.

(a) Foreign exchange risk

The Group is exposed to foreign exchange risk arising from various exposures in the normal course of business, primarily with respect to the US dollar. Foreign exchange risk arises primarily from commercial transactions, and recognized assets and liabilities when such transactions, assets and liabilities are denominated in a currency other than the functional currency. The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble or the US dollar. **The carrying amounts of the Group's financial instruments are denominated in the following currencies (all amounts expressed in thousands of US dollars at the appropriate 31 December 2016 and 2015 exchange rates):**

At 31 December 2016	Russian rouble	US dollar	Total
<i>Financial assets</i>			
<i>Current</i>			
Loans issued	58	384	442
Cash and cash equivalents	1,177	25	1,202
Accounts receivable	953	-	953
<i>Financial liabilities</i>			
<i>Non-current</i>			
Long-term borrowings	(4,243)	-	(4,243)
Long-term finance lease obligations	(714)	-	(714)
<i>Current</i>			
Accounts payable and accrued expenses (excluding short-term portion of finance lease obligations)	(516)	(139)	(655)
Short-term finance lease obligations	(113)	-	(113)
Short-term borrowings and current portion of long-term borrowings	(2,549)	-	(2,549)
Net exposure at 31 December 2016	(5,947)	270	(5,677)

At 31 December 2015	Russian rouble	US dollar	Total
<i>Financial assets</i>			
<i>Current</i>			
Loans issued	70	-	70
Cash and cash equivalents	1,328	367	1,695
Accounts receivable	936	-	936
<i>Financial liabilities</i>			
<i>Non-current</i>			
Long-term borrowings	(1,516)	-	(1,516)
Long-term finance lease obligations	(559)	-	(559)
<i>Current</i>			
Accounts payable and accrued expenses (excluding short-term portion of finance lease obligations)	(974)	(87)	(1,061)
Short-term finance lease obligations	(52)	-	(52)
Short-term borrowings and current portion of long-term borrowings	(2,419)	-	(2,419)
Net exposure at 31 December 2015	(3,186)	280	(2,906)

25 Financial Risk Management (Continued)

In accordance with IFRS requirements, the Group has provided information about market risk and potential exposure to hypothetical loss from its use of financial instruments through sensitivity analysis disclosures. The sensitivity analysis depicted in the table below reflects the hypothetical income (loss) that would occur assuming a 30% change in exchange rates and no changes in the portfolio of instruments and other variables held at 31 December 2016 and 2015, respectively.

Effect on pre-tax profit	Increase in exchange rate	Year ended 31 December	
		2016	2015
\$/RUS	30%	81	84

The effect of a corresponding 30% decrease in exchange rate is approximately equal and opposite.

(b) Commodity price risk

The Group's overall commercial trading strategy in crude oil and related products is centrally managed. Changes in commodity prices could negatively or positively affect the Group's results of operations.

The Group sells all its crude oil and petroleum products under spot contracts. Crude oil sold internationally is based on benchmark reference crude oil prices of Brent dated, plus or minus a discount for quality and on a transaction-by-transaction basis for volumes sold domestically. As a result, the Group's revenues from the sales of liquid hydrocarbons are subject to commodity price volatility based on fluctuations or changes in the crude oil benchmark reference prices. Presently, the Group does not use commodity derivative instruments for trading purposes to mitigate price volatility.

(c) Cash flow and fair value interest rate risk

To the degree possible, the Group centralizes the cash requirements and surpluses of controlled subsidiaries and the majority of their external financing requirements, and applies, on its consolidated net debt position, a funding policy to optimize its financing costs and manage the impact of interest-rate changes on its financial results in line with market conditions. Fixed rate borrowings expose the Group to fair value interest rate risk. The carrying value of fixed rate borrowings approximate their fair value.

Credit risk. Credit risk refers to the risk exposure that a potential financial loss to the Group may occur if a counterparty defaults on its contractual obligations.

Credit risk is managed on a Group level and arises from cash and cash equivalents, including short-term deposits with banks, loans issued as well as credit exposures to customers, including outstanding trade receivables and committed transactions. Cash and cash equivalents are deposited only with banks that are considered by the Group at the time of deposit to minimal risk of default. Based on Fitch's rating, the credit quality of Public Joint-Stock Company Sberbank of Russia in which the Group mostly held its cash and cash equivalents as at 31 December 2016 and 2015 was BBB-. Based on Standard & Poor's rating, the credit quality of Public Joint-Stock Company Promsvyazbank in which the Group held its cash and cash equivalents as at 31 December 2016 and 2015 was BB-.

The Group's domestic trade and other receivables consist of a large number of customers, spread across diverse industries mainly on Sakhalin Island. All of the Group's export crude oil sales are made to one customer, Petraco, with whom the Group was trading for the past several years (see Note 19). A majority of domestic sales of petroleum products are made on a prepayment basis. Although the Group does not require collateral in respect of trade and other receivables, it has developed standard credit payment terms and constantly monitors the status of trade receivables and the creditworthiness of the customers. The maximum exposure to credit risk is represented by the carrying amount of each financial asset exposed to credit risk. As the majority of customers pay in advance (including Petraco currently) credit risk related to trade debtors is not considered to be significant.

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 approach to managing liquidity has been to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group prepares various financial and operational plans (monthly, quarterly and annually) to ensure that the Group has sufficient cash on demand to meet expected operational and administrative expenses.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

25 Financial Risk Management (Continued)

The following tables summarize the maturity profile of the Group's financial liabilities based on contractual undiscounted payments, including interest payments:

At 31 December 2016	On demand	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	After 5 years	Total
Debt at fixed rate						
<i>Principal</i>	1,611	461	4,122	99	-	6,293
<i>Interest</i>	456	602	88	44	-	1,190
Debt at fixed rate – <i>Leasing obligations</i>	-	225	223	443	469	1,360
Accounts payable and accrued expenses	-	655	-	-	-	655
Total financial liabilities	2,067	1,943	4,433	586	469	9,498

At 31 December 2015	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	After 5 years	Total
Debt at fixed rate					
<i>Principal</i>	2,247	-	1,504	-	3,751
<i>Interest</i>	703	211	249	-	1,163
Debt at fixed rate – <i>Leasing obligations</i>	128	128	355	472	1,083
Accounts payable and accrued expenses	1,113	-	-	-	1,113
Total financial liabilities	4,191	339	2,108	472	7,110

Capital management. The primary objectives of the Group's capital management policy is to ensure a strong capital base to fund and sustain its business operations through prudent investment decisions and to maintain investor, market and creditor confidence to support its business activities.

The capital as defined by management at 31 December 2016 and 2015 was as follows:

	2016	2015
Total borrowings	6,792	3,935
Less cash and cash equivalents	(1,202)	(1,695)
Net debt	5,590	2,240
Total equity	61,404	47,860
Debt to equity ratio	0.09	0.05

Management considers capital to represent net debt and total equity. Management does not use a specific target debt to equity or gearing ratio when managing the business

For the capital management, the Group manages and monitors its liquidity on a corporate-wide basis to ensure adequate funding to sufficiently meet group operational requirements. The Group controls all external debts at the Parent level, and all financing to Group entities for the operating and investing activity is facilitated through inter-company loan arrangements, except for the specific project financing, which are taken on the subsidiary level.

There were no changes to the Group's approach to capital management during the year.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

26 Balances and transactions with Related Parties

Parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 Related Party Disclosures. Key management personnel are considered to be related parties. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Substantially all related party balances at 31 December 2015 relate to balances with a shareholder and former director of the Company.

	Year ended 31 December	
	2016	2015
Transactions with related parties		
Release of provision on claims (Note 13)	-	864

Balances with Petraco – Other related party

On 29 May 2015, the Group entered into a pre-export short term loan finance arrangement with, under which Petraco advanced the sum of US\$6.0 million to the Company ahead of its tanker shipment from Arcticneft. Ingeborg Srenger was a director of the Company until her resignation on 16 December 2014 and also a director of Petraco and exercised control over Petraco, meaning that this loan was considered to be a related party transaction pursuant to Rule 13 of the AIM Rules for Companies. This loan was settled in full in September 2015.

Under IAS 24 *Related Party Disclosures* Petraco was considered a related party before 16 December 2014, when representative of Petraco resigned from the Board of Directors of Urals Energy.

Compensation to senior management. The Group's senior management team compensation, including salary, social tax, and bonuses, totaled \$0.6 million and \$0.7 million for the years ended 31 December 2016 and 31 December 2015, respectively. In 2016 and in 2015 senior management team stock compensation was nil.

Directors' fees. Directors' fees for the years ended 31 December 2016 and 2015 were \$37 thousand and \$104 thousand (Note 22), respectively. During the years ended 31 December 2016 and 2015 no non-cash benefits were received by the directors, no payments to the directors were made under share options or other long-term incentive plans (and there were no share option schemes or other long-term incentive plans in effect during the periods other than those disclosed in Note 28 and implemented after the balance sheet date), and no contributions were made to pension schemes, other than social insurance payments required by the Russian legislation.

	Year ended 31 December	
	2016	2015
Senior management		
L. Dyachenko	258	246
A. Ogarev	218	244
S. Uzornikov	171	175
Directors fees		
A. Shrager	37	51
S. Buscher	-	53
Total compensation to senior management and directors' fees	684	769

27 Acquisition of subsidiaries

Acquisition of Arctic Oil Company. On 29 August 2016 the Group acquired 100% interest of OOO Arctic Oil Company (Russia) from an unrelated third party for a total consideration of \$1.8 million paid in cash. Arctic Oil Company's asset is the central part of the Peschanoozerskoe oil field on Kolguyev Island. The eastern and western parts of the Peschanoozerskoe field are already owned by Arcticneft. By acquiring Arctic Oil Company, Group will be able to achieve significant economies of scale through combining the operations of Arctic Oil Company with its existing operations on Kolguyev Island.

27 Acquisition of subsidiaries (Continued)

The share purchase agreement also stipulated an additional payment (contingent consideration) should the Group merge Arctic Oil Company with its existing subsidiary and sell the combined company to a third party within two years since the acquisition of Arctic Oil Company. The Group has no intention to sell combined operations within the next two years. Consequently, the fair value of the contingent consideration was estimated as nil.

The acquisition of Arctic Oil Company was partly financed by a short-term secured loan provided by Kamchatcomagroprombank. Total amount of the loan is 100 million Roubles (representing approximately US\$1.6 million at prevailing exchange rates). The loan was repaid before the year end. Interest was chargeable at the rate 17%. Company pledged its crude oil stored at AO Arcticneft's warehouse under the loan agreement with Kamchatcomagroprombank.

In accordance with IFRS 3 "Business Combinations", the Group recognized the acquired assets and liabilities based upon their provisional fair values at the date when control of Arctic Oil Company was obtained. As of 31 December 2016 the Group did not finalize their assessment of the estimated fair values of assets and liabilities acquired due to the fact that the subsidiary was recently acquired. Management is required to finalise the accounting within 12 months from the date of acquisition. Any revisions to the provisional values will be reflected as of the acquisition date.

The following assets and liabilities were acquired with Arctic Oil Company:

	Provisional fair value
Property, plant and equipment (Note 10)	2,245
Deferred income tax assets (Note 14)	33
Inventories	383
Accounts receivable and prepayments	148
Cash and cash equivalents	482
Total assets	3,291
Dismantlement provision (Note 16)	291
Deferred income tax liabilities (Note 14)	133
Borrowings	482
Provisions (Note 13)	223
Trade and other payables	678
Taxes payable	221
Total liabilities	2,028
Net assets at acquisition date	1,263
Indemnification asset	515
Total consideration paid	1,778

The sales and purchase agreement included an indemnification clause in which the seller of Arctic Oil Company agreed to reimburse the Group for any liabilities that had not been repaid or accrued for at acquisition date. The Group has recognised such liabilities in full at acquisition date. As a result, the Group recognised an indemnification asset in the amount of USD 515 thousand. The indemnification asset was repaid by cash before the year end.

The acquired subsidiary contributed revenue of nil and loss of \$0.1 million to the Group for the period from the date of acquisition to 31 December 2016. If the acquisition had occurred on 1 January 2016, Group revenue for 2016 would have been higher by \$6.1 million, and profit for 2016 would have been lower by \$1.5 million.

Acquisitions of RK-Oil and BVN-Oil. On 19 November 2015 the Group acquired two private Russian companies, RK-Oil and BVN-Oil from an unrelated third party for a total consideration of \$5.7 million, including \$2.7 million paid in cash and \$3.0 million of liabilities assumed. Management has concluded that the acquisition represents an asset acquisition because there is no detailed field development plan and there are a lot of management decisions to be taken that would impact the future process.

Urals Energy Public Company Limited
Notes to the Consolidated Financial Statements
(presented in US\$ thousands)

27 Acquisition of subsidiaries (Continued)

The following assets and liabilities were acquired with BVN-Oil and RK-Oil:

Exploration and production licenses (for Babayevsky and Ordynsky oil fields) (Note 10)	5,234
Input VAT	393
Other current assets	132
Total assets	5,759
Long-term loans received from Transnational bank (Note 15)	1,727
Long-term borrowings (Note 15)	140
Accounts payable for non-current assets	1,152
Total liabilities	3,019
Net asset at acquisition date	2,740
Total consideration paid	2,740

As a part of the transaction the Group acquired accounts payable to OAO Komineftegeophysica in amount of \$0.3 million, which was subsequently offset with loan receivable from OAO Komineftegeophysica. Loan receivable from OAO Komineftegeophysica in the amount of \$0.3 million was written-off which and included in Other operating (loss)/profit for year ended 31 December 2015.

28 Events after the reporting period

On 20 January 2017 the Company announced the granting of conditional share awards over a total of 13,127,192 new ordinary shares of \$0.0063 each in the capital of the Company, pursuant to the Company's performance share plan.

Grants of Conditional Share Awards have been made to a total of seven employees, including members of the Company's Board and certain key employees within the Group's subsidiaries. In aggregate, the Performance Shares represent 5.2 per cent of the Company's current issued ordinary share capital. For the time being, the Board intends to retain the balance of a further 4.8 per cent of the Company's current issued ordinary share capital, which is approved under the Performance Share Plan.

The Conditional Share Awards will only vest once the Board has determined that certain key performance indicators allocated to the individuals have been achieved. The KPIs in all cases relate to performance in the underlying operations and developments achieved by the Group.

On 14 February 2017 Petrosakh has entered into a new 24 month non-revolving CAPEX credit facility with the Sakhalin branch of PJSC Sberbank of Russia. Under the loan, Sberbank will provide, by way of several tranches, the sum of 50 million roubles (representing approximately \$0.9 million at prevailing exchange rates) to Petrosakh. The interest rate under the loan agreement is 15.6% plus 1%. The lowest rate of 15.6% is subject to Petrosakh meeting certain conditions. The loan is secured by property, plant and equipment of Petrosakh.

On 02 March 2017 Arcticneft has entered into a new short-term non-revolving credit facility with Kamchatcomagroprombank. Under the loan the bank will provide a total of 30 million roubles (representing approximately \$0.5 million at prevailing exchange rates) to Arcticneft, via several tranches. Interest is chargeable at the rate 15%. Arcticneft pledged crude oil stored at its warehouse under the loan agreement with Kamchatcomagroprombank. The proceeds of this new loan will be used by Arcticneft for its general working capital financing. The loan is repayable in August 2017.

In April 2017 Company obtained a short-term secured loan from Petraco in the amount of \$3.0 million at an interest rate of three months Libor plus 5% per annum due on the 30 day after the date of next tanker shipment. From the date of the next tanker shipment the interest rate is three month Libor plus 2% per annum. Company pledged its 100% shares in its subsidiary AO Arcticneft under the loan agreement with Petraco.

In April 2017 the Group completed an internal reorganisation of its subsidiaries, which is intended to streamline the management of the Group and allow the Group to take advantage of modest tax advantages. As part of the internal

28 Events after the reporting period (Continued)

reorganisation, AO Petrosakh, the Group's operating company on Sakhalin Island and principal profit and cash generator, was merged with OOO Urals Energy, the Russia-incorporated management company for all of the Group's operations, which is essentially a cost centre. As a result of this merger, the Group will be able to offset accumulated tax losses of OOO Urals Energy against the future profits of AO Petrosakh for tax purposes. The accumulated tax losses transferred from OOO Urals Energy to AO Petrosakh as a result of this reorganization amounted to \$62.1 million.

On 26 May 2017 shareholders approved the Company's share consolidation: the 252,446,060 existing ordinary shares of nominal value \$0.0063 each in the issued share capital of the Company will be consolidated and divided into 12,622,303 new ordinary shares of nominal value \$0.126 each, effective on 30 May 2017.

On 26 May 2017 shareholders approved a reduction of the Company's share premium account from \$656,167,589 to nil by writing off the losses of the Company equivalent to this reduction of share premium account.