

**Public Joint Stock Company
“National Joint Stock Company
“NAFTOGAZ OF UKRAINE”**

**Consolidated Financial Statements
as at and for the Year Ended
31 December 2014**

**PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY
“NAFTOGAZ OF UKRAINE”**

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INDEPENDENT AUDITOR'S REPORT

To the shareholder of Public Joint Stock Company “National Joint Stock Company “Naftogaz of Ukraine”:

We have audited the accompanying consolidated financial statements of Public Joint Stock Company “National Joint Stock Company “Naftogaz of Ukraine” (the “Company”) and its subsidiaries (collectively, the “Group”), which comprise the consolidated statement of financial position as at 31 December 2014, and the consolidated statement of profit or loss, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”), and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

- 1) As discussed in Note 25 to the consolidated financial statements, the Group has adopted the revaluation model for measurement of property, plant and equipment, which requires revaluations to be carried out with sufficient regularity so that the carrying amount of property, plant and equipment as at the reporting date does not differ materially from its fair value. The Group has revalued its property, plant and equipment as at 31 December 2014 and the revaluation demonstrated that the fair value of property, plant and equipment was materially different from its carrying amount before revaluation. Given the significant economic developments since previous revaluation as at 31 December 2009, including changes in natural gas transportation tariffs and costs, selling prices of the Group's own produced natural gas and construction costs, we believe the difference between the fair value and carrying amount of property, plant and equipment was also material as at 31 December 2013. Since no revaluation of property, plant and equipment was performed as at that date, we were unable to obtain sufficient and appropriate audit evidence about the impact of this matter on the Group's property, plant and equipment with the carrying amount of UAH 89,526 million and related impact on revaluation reserve as at 31 December 2013 and the depreciation, depletion and amortisation expense for the years ended 31 December 2014 and 2013. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.
- 2) As discussed in Note 25 to the consolidated financial statements, the Group's oil and gas assets are depleted using a unit-of-production method in proportion to proved developed hydrocarbon reserves. Management engaged an independent expert to conduct a valuation of the Group's hydrocarbon reserves as at 31 December 2014. Thus, such valuation was inconsistent with the valuation as at 31 December 2013 as the 2014 valuation involved an independent expert, while the 2013 valuation was based on internal management estimates only. Due to inconsistency of the valuations, we were unable to obtain sufficient and appropriate audit evidence about the impact of this matter on the Group's oil and gas assets stated at UAH 20,416 million as at 31 December 2013, and the related impact on the depreciation, depletion and amortisation expense for the years ended 31 December 2014 and 2013. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.
- 3) As discussed in Note 20 to the consolidated financial statements, in March 2014 the Group lost control over one of its subsidiaries, JSC Chornomornaftogaz, the majority of whose assets are located on the territory of the Autonomous Republic of Crimea. As we were not provided with access to the financial information of this subsidiary as at 31 December 2013, we were not able to obtain sufficient and appropriate audit evidence about carrying value of the total assets and liabilities of this subsidiary as at that date in the amounts of UAH 15,744 million and UAH 14,089 million, respectively, and its total revenues and expenses for the year ended 31 December 2013 in the amounts of UAH 525 million and UAH 1,399 million, respectively. Additionally, we were not able to observe other assets of the Group located on the territory of the Autonomous Republic of Crimea stated at UAH 2,898 million as at 31 December 2013. The Group deconsolidated the assets and liabilities of JSC Chornomornaftogaz and fully impaired the other assets located in Crimea during the year ended 31 December 2014. Since the carrying amounts of such assets and liabilities as at 31 December 2013 affect the determination of the loss from discontinued operations and operating expenses for the year ended 31 December 2014, we were unable to determine whether adjustments to the results of operations were necessary.
- 4) Because we were appointed auditors of the Group in 2014, we were not able to observe the counting of the physical inventories as at 31 December 2013 or satisfy ourselves concerning inventory quantities as at 31 December 2013 (except for the natural gas in stock) by alternative means. Since these inventories stated at UAH 607 million affect the determination of the results of operations for the years ended 31 December 2014 and 2013, we were unable to determine whether adjustments to the results of operations for respective years were necessary.

- 5) As discussed in Note 6 to the consolidated financial statements, the Group has investments in associates and joint ventures, which are accounted for using the equity method of accounting. We were unable to obtain sufficient and appropriate audit evidence regarding recoverability of trade and other receivables of one of the associates as at 31 December 2014 with the Group's share amounting to UAH 515 million and substance of certain expenses incurred by one of the associates during the years ended 31 December 2014 and 2013 with the Group share of such expenses amounting to UAH 179 million and UAH 925 million, respectively. Also, some of the associates and joint ventures did not adopt the revaluation model for measurement of their property, plant and equipment, which constitutes a departure from IAS 28 "Investments in Associates and Joint Ventures" requiring use of uniform accounting policies with Group. The effect of this departure on the carrying value of the Group's investments in its associates and joint ventures as at 31 December 2014 and 2013, and related impact on the Group's share of their after-tax results for the years then ended is not reasonably determinable.
- 6) As discussed in Notes 16, 17 and 25, during the first quarter of the year ended 31 December 2014 and during the year ended 31 December 2013, the Group has incurred expenditures for:
- Purchases of services and inventories amounting to UAH 334 million and UAH 1,082 million, respectively, included into cost of sales and research, development and exploration costs amounting to UAH 160 million and UAH 455 million, respectively, included into other operating expenses, for which the source documents were sequestered and are under investigation by the office of State Prosecutor of Ukraine;
 - Purchases of property, plant and equipment of UAH 660 million and UAH 4,335 million, respectively; and
 - Purchases of services and inventories included into cost of sales and other operating expenses of UAH 1,102 million UAH 2,927 million, respectively.

As stated in the Notes indicated above the substance of these expenditures may not reflect their legal form according to the source documents. We were unable to obtain sufficient and appropriate audit evidence to satisfy ourselves as to the amounts and nature of the above expenditures and their classification in the consolidated financial statements for the years ended 31 December 2014 and 2013. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

- 7) We were unable to obtain sufficient and appropriate audit evidence regarding completeness of revenue recorded in the accompanying consolidated financial statements of the Group on sales of petroleum products to certain customers in the amount of UAH 2,853 million for the year ended 31 December 2013. As a result of this matter, we were unable to determine whether any adjustments to this amount were necessary. Our audit opinion on the consolidated financial statements for the year ended 31 December 2013 was modified accordingly. Our opinion on the current period's consolidated financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures and the corresponding figures.

Qualified Opinion

In our opinion, except for the possible effects of the matters described in the Basis for Qualified Opinion paragraphs, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2014, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

The accompanying consolidated financial statements have been prepared assuming that the Group will continue as a going concern. As discussed in Note 2 and Note 21 to the consolidated financial statements, the excess of the Group's current liabilities over its current assets as at 31 December 2014 and 2013 amounted to UAH 17,908 million and UAH 53,893 million, respectively, and for the years then ended the Group incurred net losses in the amounts of UAH 88,433 million and UAH 17,957 million, respectively, and there is uncertainty as to the outcome of significant ongoing litigations for the Group. These conditions raise substantial doubt about the Group's ability to continue as a going concern without continuing support from the Government of Ukraine. Management's plans concerning these matters are discussed in Note 2 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not qualified in respect of this matter.

We also draw your attention to Note 21 to the consolidated financial statements, which describes uncertainty with regard to claim in Stockholm arbitration tribunal issued by the Company to JC "Gazprom" and counterclaim from JC "Gazprom" to the Company. Our opinion is not qualified in respect of this matter.

We further draw your attention to Note 2 to the consolidated financial statements, which describes that the impact of the continuing economic crisis and political turmoil in Ukraine and their final resolution are unpredictable and may adversely affect the Ukrainian economy and the operations of the Group. Our opinion is not qualified in respect of this matter.

Original signed:

PJSC Deloitte and Touche

31 July 2015

**PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY
“NAFTOGAZ OF UKRAINE”**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2014**

<i>In millions of Ukrainian hryvnias</i>	Note	31 December 2014	31 December 2013
ASSETS			
<i>Non-current assets</i>			
Property, plant and equipment	5	454,991	181,428
Investments in associates and joint ventures	6	11,169	9,942
Prepaid corporate income tax		1,195	709
Other non-current assets	7	4,346	2,737
Total non-current assets		471,701	194,816
<i>Current assets</i>			
Inventories	8	9,983	17,024
Trade accounts receivable	9	15,097	20,539
Prepayments made and other current assets	10	12,501	2,823
Prepaid corporate income tax		942	378
Cash and bank balances	11	4,361	2,138
Restricted cash		394	200
Total current assets		43,278	43,102
TOTAL ASSETS		514,979	237,918
EQUITY			
Share capital	12	59,997	53,997
Revaluation reserve		366,204	125,663
Unregistered contributed capital	12	104,610	14,000
Cumulative exchange difference		1,405	-
Accumulated deficit		(175,258)	(86,685)
Equity attributable to owners of the Parent		356,958	106,975
Non-controlling interest in equity		20	60
TOTAL EQUITY		356,978	107,035
LIABILITIES			
<i>Non-current liabilities</i>			
Borrowings	13	26,188	14,388
Provisions	14	1,852	1,601
Deferred tax liabilities	19	68,726	17,521
Other long-term liabilities		49	378
Total non-current liabilities		96,815	33,888
<i>Current liabilities</i>			
Borrowings	13	34,820	45,170
Provisions	14	778	304
Trade accounts payable		14,137	29,478
Advances received and other current liabilities	15	11,124	22,016
Corporate income tax payable		327	27
Total current liabilities		61,186	96,995
TOTAL LIABILITIES		158,001	130,883
TOTAL LIABILITIES AND EQUITY		514,979	237,918

These consolidated financial statements were authorised for issue on behalf of the Board of the Company on 31 July 2015.

Andriy Kobolyev
Chairman of the Board

Sergiy Konovets
Deputy Chairman of the Board

The accompanying notes are integral part of these consolidated financial statements

**PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY
“NAFTOGAZ OF UKRAINE”**

**CONSOLIDATED STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2014**

<i>In millions of Ukrainian hryvnias</i>	Note	2014	2013
Continuing operations:			
Revenue	3	78,444	75,374
Compensation of price difference from the State Budget	2	-	-
Cost of sales	16	(86,951)	(76,126)
Gross loss		(8,507)	(752)
Other operating income		808	749
Other operating expense	17	(23,621)	(6,778)
Operating loss		(31,320)	(6,781)
Finance costs	18	(9,003)	(8,868)
Finance income		417	206
Share of after-tax results of associates and joint-ventures	6	1,488	536
Net foreign exchange loss		(39,185)	(585)
Loss before income tax*		(77,603)	(15,492)
Income tax benefit/(expense)	19	2,956	(1,591)
Net loss from continuing operations		(74,647)	(17,083)
Discontinued operations:			
Loss for the year from discontinued operations	20	(13,786)	(874)
Net loss for the year		(88,433)	(17,957)
Net loss is attributable to:			
Equity holders of the Company		(88,373)	(17,948)
Non-controlling interest		(60)	(9)
Net loss for the year		(88,433)	(17,957)

* (Loss)/profit before tax from regulated and non-regulated businesses was as follows:

<i>In millions of Ukrainian hryvnias</i>	2014	2013
- from regulated businesses	(88,893)	(26,765)
- from non-regulated businesses	11,290	11,273
Total loss before tax	(77,603)	(15,492)

Regulated businesses are activities where sales prices and tariffs and purchase prices are regulated by the State (as described in Note 2), and include (loss)/profit before tax of the reporting segments “Production of natural gas”, “Storage of natural gas”, and “Wholesale distribution and trading of natural gas” as described in Note 3.

**PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY
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**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2014**

<i>In millions of Ukrainian hryvnias</i>	Note	2014	2013
Net loss for the year		(88,433)	(17,957)
<i>Other comprehensive income</i>			
<i>Items that will not be reclassified subsequently to profit or loss, net of income tax:</i>			
Gain/(loss) on revaluation of property, plant and equipment (net of income tax of UAH 55,254 million (2013: UAH 987 million))	19	240,975	(5,199)
Share of other comprehensive income of associates (net of income tax of UAH 38 million (2013: UAH 4 million))	19	(171)	19
Remeasurement of defined benefit obligation (net of income tax of UAH 64 million (2013: UAH 5 million))	19	(294)	33
Remeasurement of decommissioning liability (net of income tax of UAH 1 million)	19	7	-
<i>Items that may be reclassified subsequently to profit or loss, net of income tax:</i>			
Cumulative exchange difference		1,405	-
Reclassification adjustments relating to disposal of available-for-sale investments in the year (net of income tax of UAH 8 million)		-	(44)
Other comprehensive income/(loss) for the year		241,922	(5,191)
Total comprehensive income/(loss) for the year		153,489	(23,148)
Total comprehensive income/(loss) is attributable to:			
Equity holders of the Company		153,529	(23,139)
Non-controlling interest		(40)	(9)
Total comprehensive income/(loss) for the year		153,489	(23,148)

The accompanying notes are integral part of these consolidated financial statements

PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY “NAFTOGAZ OF UKRAINE”

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2014**

<i>In millions of Ukrainian hryvnias</i>	Share capital	Revaluation reserve	Unregistered contributed capital	Cumulative exchange difference	Accumulated deficit	Total	Non- controlling interest	Total equity
Balance at 31 December 2012	53,997	131,238	6,000	-	(69,076)	122,159	69	122,228
Loss for the year	-	-	-	-	(17,948)	(17,948)	(9)	(17,957)
Other comprehensive income/(loss) for the year	-	(5,219)	-	-	28	(5,191)	-	(5,191)
Total comprehensive income/(loss) for the year	-	(5,219)	-	-	(17,920)	(23,139)	(9)	(23,148)
Transfer of revaluation reserve	-	(356)	-	-	356	-	-	-
Transfer of investments to the State Property Fund	-	-	-	-	(2)	(2)	-	(2)
State treasury bonds received (Note 12)	-	-	8,000	-	-	8,000	-	8,000
Profit share payable to the State Budget (Note 12)	-	-	-	-	(43)	(43)	-	(43)
Balance at 31 December 2013	53,997	125,663	14,000	-	(86,685)	106,975	60	107,035
Loss for the year	-	-	-	-	(88,373)	(88,373)	(60)	(88,433)
Other comprehensive income/(loss) for the year	-	240,791	-	1,405	(294)	241,902	20	241,922
Total comprehensive income/(loss) for the year	-	240,791	-	1,405	(88,667)	153,529	(40)	153,489
Transfer of revaluation reserve	-	(250)	-	-	250	-	-	-
State treasury bonds received (Note 12)	-	-	96,610	-	-	96,610	-	96,610
Registration of shares (Note 12)	6,000	-	(6,000)	-	-	-	-	-
Profit share payable to the State Budget (Note 12)	-	-	-	-	(156)	(156)	-	(156)
Balance at 31 December 2014	59,997	366,204	104,610	1,405	(175,258)	356,958	20	356,978

The accompanying notes are integral part of these consolidated financial statements

**PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY
“NAFTOGAZ OF UKRAINE”**

**CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2014**

<i>In millions of Ukrainian hryvnias</i>	Note	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES			
Loss before income tax		(77,603)	(16,089)
Adjustments for:			
Depreciation of property, plant and equipment and amortisation of intangible assets	5	5,225	5,959
Loss on disposal of property, plant and equipment	17	7	105
Impairment of property, plant and equipment	17	5,625	852
Write down of inventories	8	12,485	422
Net movement in provision for trade accounts receivable and prepayments made, other current assets, financial investments and VAT receivable.	17	9,839	2,335
Change in provisions	14	430	358
Write off of accounts payable and other current liabilities		(110)	(139)
Share of after-tax results of associates and joint-ventures	6	(1,488)	(536)
Unrealised foreign exchange loss		25,901	-
Finance costs, net		8,586	8,704
Operating cash flows before working capital changes		(11,103)	1,971
(Increase)/decrease in other non-current assets		(249)	677
(Increase)/decrease in inventories		(5,857)	10,015
Increase in trade accounts receivable		(2,136)	(9,809)
(Increase)/decrease in prepayments made and other current assets		(12,684)	2,086
Increase/(decrease) in other long-term liabilities		10	(3)
Decrease in provisions	14	(126)	(214)
(Decrease)/increase in trade accounts payable		(15,765)	17,448
Decrease in advances received and other current liabilities		(10,694)	(12,730)
Cash (used in)/generated from operations		(58,604)	9,441
Income taxes paid		(1,432)	(2,295)
Interest received		298	9
Net cash (used in)/generated by operating activities		(59,738)	7,155
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment and intangible assets		(2,909)	(3,657)
Proceeds from sale of property, plant and equipment		125	588
Withdrawal of restricted cash		-	(200)
Placement of bank deposits	11	(1,221)	-
Cash attributable to discontinued operations	20	(6)	-
Dividends received		52	38
Net cash used in investing activities		(3,959)	(3,231)

The accompanying notes are integral part of these consolidated financial statements

**PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY
“NAFTOGAZ OF UKRAINE”**

**CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2014**

<i>In millions of Ukrainian hryvnias</i>	Note	2014	2013
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from borrowings		11,962	19,483
Repayment of borrowings		(35,844)	(22,367)
Interest paid		(7,873)	(6,710)
Mandatory budget contribution of profit share paid		(156)	(45)
Net proceeds from sale of State treasury bonds contributed to share capital		96,610	5,824
Net cash generated from/(used in) financing activities		64,699	(3,815)
Net increase in cash and cash equivalents		1,002	109
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		2,138	2,029
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	11	3,140	2,138

Significant Non-Cash Transactions

<i>In millions of Ukrainian hryvnias</i>	Note	2014	2013
Contribution of the State treasury bonds to the share capital	12	96,610	8,000

PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY “NAFTOGAZ OF UKRAINE”

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

1. THE ORGANISATION AND ITS OPERATIONS

Public Joint Stock Company “National Joint Stock Company “Naftogaz of Ukraine” (“Naftogaz of Ukraine”, the “Parent” or the “Company”) was founded in 1998 in accordance with the Resolution of the Cabinet of Ministers of Ukraine №747 dated 25 May 1998.

Naftogaz of Ukraine and its subsidiaries (hereinafter collectively referred to as the “Group”) are beneficially owned by the State of Ukraine. The Government of Ukraine, as represented by the Cabinet of Ministers of Ukraine, controls the Company through participation in the shareholders’ meetings and the Supervisory Board meetings, as well as through the appointment of the Chairman of the Board and the Board members.

Naftogaz of Ukraine is a vertically integrated oil and gas company engaged in full cycle of operations in gas and oil field exploration and development, exploratory drilling and production, gas and oil transportation and storage, supply of natural gas and liquefied petroleum gas (“LPG”) to customers.

The Company holds stakes in various entities that form the national system of production, refinery, distribution, transportation, and storage of natural gas, condensate, and oil.

The Company is registered at 6 B. Khmelnytskoho Street, Kyiv, Ukraine.

The Group conducts its business and holds its production facilities mainly in Ukraine. The principal subsidiaries are presented as follows:

Name/Segment	% Interest held as at 31 December		Country of registration
	2014	2013	
Production of gas, oil and refinery products			
Ukrasvydobyvannia, PJSC	100.00	100.00	Ukraine
Chornomornaftogaz, State-owned JSC* (“Chornomornaftogaz”)	100.00	100.00	Ukraine
Zakordonnaftogaz, Subsidiary Enterprise	100.00	100.00	Ukraine
Oil and gas transportation			
Ukrtransgaz, PJSC	100.00	100.00	Ukraine
Ukrtransnafta, PJSC	100.00	100.00	Ukraine
Ukrspetstransgaz, PJSC	100.00	100.00	Ukraine
Wholesale and retail distribution of oil, gas and refinery products			
Gaz Ukrainy, Subsidiary Enterprise	100.00	100.00	Ukraine
Naftogaz Overseas S.A.	100.00	100.00	Switzerland
Kirovogradgaz, Open JSC	51.00	51.00	Ukraine
Ukravtogaz, Subsidiary Enterprise	100.00	100.00	Ukraine
Other			
Vuglesyntezgaz Ukrainy, Subsidiary Enterprise	100.00	100.00	Ukraine
Ukrnaftogazkomplekt, Subsidiary Enterprise	100.00	100.00	Ukraine

* As discussed in Note 20, during 2014 the Company has lost control over the assets of its subsidiary Chornomornaftogaz located in Crimea due to occupation of Autonomous Republic of Crimea by the troops of the Russian Federation.

PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY “NAFTOGAZ OF UKRAINE”

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

2. OPERATING ENVIRONMENT

Emerging markets such as Ukraine are subject to different risks than more developed markets, including economic, political and social, legal and legislative risks. Laws and regulations affecting businesses in Ukraine continue to change rapidly, tax and regulatory frameworks are subject to varying interpretations. The future economic direction of Ukraine is heavily influenced by the fiscal and monetary policies adopted by the government, together with developments in the legal, regulatory, and political environment.

In 2014, the Ukrainian Hryvnia has devalued against major foreign currencies. The National Bank of Ukraine introduced a range of stabilisation measures aimed at limiting outflow of customer deposits from the banking system, improving liquidity of banks and supporting of the exchange rate of the Ukrainian Hryvnia against major foreign currencies.

In 2014, the economy of Ukraine displayed characteristics of being in recession. Since the end of 2013, Ukraine has been in a political and economic turmoil. As a result of a number of protests, the President was dismissed and newly formed Parliament majority coalition was formed. In February 2014 the new Prime Minister and new Government were appointed. Following the changes in the Government, the Company's management had been changed in March-June 2014, and new Board was formed.

The Group is a guaranteed supplier of natural gas in Ukraine to certain groups of customers, and its ability to adjust prices to the end customers, together with increased prices for the imported gas, is limited, since such prices are regulated at each stage from exploration to end customers by the National Energy and Utilities Regulatory Commission (“NEURC”, before 27 August 2014 – National Committee for Energy Regulation, NCRE). The domestic natural gas supply in Ukraine satisfies at about half of the total demand. Consequently, significant level of gas import is required to meet needs of domestic consumption. During 2014 there were significant fluctuations in natural gas purchase prices in Ukrainian Hryvnia equivalent due to destabilisation of the Ukrainian Hryvnia against major foreign currencies.

The Government of Ukraine controls the Group's operations through its ownership rights in the Company. Such an impact may result in social and economic initiatives that may lead to an adverse effect on the Group's operations. Management is unable to predict a potential impact of such initiatives on the Group's consolidated financial position and its performance.

State regulation of the natural gas market in Ukraine

State regulation of the natural gas market in Ukraine is performed by the Cabinet of Ministers of Ukraine and by the NEURC. State regulation covers both technical and financial aspect of the market functioning. Technical measures relate to effective use of natural gas resources, ensuring secure technical exploitation of the gas transportation system, maintaining correct and safe supply, distribution and consumption of the natural gas. Financial measures mainly relate to the tariff and price setting and to the keeping the correct financial means allocation between the market participants.

PUBLIC JOINT STOCK COMPANY “NATIONAL JOINT STOCK COMPANY “NAFTOGAZ OF UKRAINE”

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

2. OPERATING ENVIRONMENT (Continued)

The Cabinet of Ministers of Ukraine must approve annual forecast of natural gas supply and its distribution.

NEURC performs regulation of tariffs and prices set at the each stage from production to sales of natural gas, by setting appropriate prices and tariffs and approving procedures of calculating those prices and tariffs. Accordingly, NEURC approves the maximum sales price of natural gas for entities financed from the State and local budgets, the maximum sales price of natural gas for industrial customers and other entities (including heat generating entities, producing heat for households), retail sales prices of natural gas for households, tariffs for transportation services via transmission and distribution pipelines within Ukraine, tariffs for distribution and supply of natural gas under the regulated tariffs, tariffs for storage and pumping services. NEURC approves procedures of setting sales prices for natural gas for natural gas production entities, sales prices for natural gas for households, and setting transportation, distribution and storage tariffs for natural gas. Additionally, NEURC is responsible for protection of the customer rights in the area of tariff setting, security of supplies and quality of services.

The following tariffs and prices were set:

	30 June 2015	31 December 2014
Retail prices of natural gas for households depend on the volume of consumption and availability of gas meters (UAH per cubic meter), including VAT, duties in the form of additional levy to the existing tariffs, tariffs for transportation and distribution of natural gas under the regulated tariffs. Starting from 1 April 2015, differentiation depending on the volume of consumption and availability of gas meters is no longer applied. Two types of prices are used: regular and preferential, the latter applied in the period from 1 October to 30 April (heating season) for customers using gas in a single package of 200 cubic meters per month.	Effective from 1 April 2015: UAH 7.19 per cubic meter; UAH 3.6 per cubic meter within 200 cubic meters per month for customers using gas in a single package during the period from 1 October to 30 April (heating season)	From UAH 1.18 to UAH 4.01 per cubic meter, effective from May 2014
Maximum purchase price of natural gas for industrial customers, net of VAT, duties in the form of additional levy to the existing tariffs, tariffs for transportation and distribution of natural gas under the regulated tariffs. The following maximum purchase prices of natural gas for industrial customers and entities financed from the state and local budgets, net of VAT, duties in the form of additional levy to the existing tariffs, and tariffs for gas transportation, distribution, and supply services at the regulated tariffs.	UAH 6,600 per thousand cubic meters starting from 1 June 2015 (from 1 April 2015 to 1 June 2015 – UAH 7,200)	UAH 4,020 per thousand cubic meters
Total tariff for storage (storage and pumping services), net of VAT, UAH per thousand cubic meters per one season of storage.	112	112
Total tariff for transportation services via transmission and distribution pipelines within Ukraine, net of VAT, UAH per thousand cubic meters.	656.20 from 1 April 2015	287.00
Maximum natural gas prices for entities generating heat for household needs, including VAT and duties in the form of additional levy, UAH per cubic meter.	UAH 2.99 per cubic meter from 1 April 2015	UAH 1.31 per cubic meter

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2. OPERATING ENVIRONMENT (Continued)

According to the Law of Ukraine “On the natural gas market functioning”, the total volume of natural gas produced in Ukraine, net of natural gas used for technological purposes and other needs as stipulated by this law, by the entities owned 50% and more by the State, should be sold to the households via the Company at regulated prices. If the demand of the households exceeds the production volumes, it is satisfied from the other sources of supply, including imports. Natural gas volumes consumed by households are reported via the gas meters. If no meters are available the sales volume is reported at the average normal consumption rates set by the respective regulations.

All customers, except for heat generating companies, settle their debts on natural gas consumed via special purpose bank accounts. The list of banks creating such accounts is approved by the Cabinet of Ministers of Ukraine. According to current procedure, guaranteed natural gas suppliers and distributors of natural gas for all groups of customers should open special purpose bank accounts to receive payments for natural gas consumed. Amounts accumulated on the special purpose bank accounts are allocated to current accounts of the transmission pipelines operator, distribution pipelines operators and guaranteed suppliers according to ratios calculated by the guaranteed suppliers and approved by NEURC. Balances on the special purpose accounts could not be arrested or blocked.

Heat generating companies also open special purpose banks accounts for the settlement of debts for heat supplied. Cash received by heat generating entities on their special purpose bank accounts then allocated, among others, to current bank accounts of the guaranteed suppliers of natural gas according to ratios approved by NEURC monthly. The special purpose bank accounts of heat generating companies also could not be blocked or arrested.

Compensation of price difference between sales tariffs and price of imported gas and other types of financial support by the State

As described above, the Company imports significant amount of natural gas to meet the domestic demand. The price of imported gas is significantly higher than the sales tariff set by NEURC and invoiced by the Company to certain groups of domestic customers, namely households and heat generating companies. The negative difference is compensated by the State to the Company, as prescribed by the Resolution of the Cabinet of Ministers of Ukraine No.605 dated 29 April 2006 (“compensation of price difference”). Historically, such compensation of price difference covered 70-75% of the price of imported gas. The timing and legal form of such compensation is not set in the Ukrainian legislation. The actual amount of price difference to be compensated in respective period is approved by the State as an expense in the Law on the State Budget for respective period.

The Company calculates the full amount of price difference accumulated during each year and submits it to the Government. However, during the reporting periods and up to the date of these consolidated financial statements there were no documents stating the amount of compensation of price difference due to the Company. The Company recognises income from the compensation actually received on a cash basis.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

2. OPERATING ENVIRONMENT (Continued)

The following information summarises the information on the price difference estimated by the Company for compensation, and financial support provided by the Government to the Company in 2013-2014 (unaudited):

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Estimated price difference for the period	12,802	6,264
Financial support from the State:		
Compensation of price difference received in cash during the period	-	-
State treasury bonds received from the Government in exchange for the new share issue during the period	96,610	8,000
Total financial support received from the State	96,610	8,000

Estimated price difference is calculated as a difference in fair import prices and NEURC sales tariffs of gas sold to regional gas distribution entities and heat generating companies for selling to households. As described in Note 21, the Company has requested the Arbitral Tribunal to render an award in relation to the level of the natural gas import prices for 2010-2014. The price actually paid to JSC “Gazprom” (“Gazprom”), is higher than the fair price as claimed by the Company. Had the Company calculated the price difference at amounts actually paid to Gazprom, the estimated price difference for 2014 and 2013 would be UAH 19,091 million and UAH 20,753 million, respectively.

Together with the compensation of price difference, the Company receives financial support from the State in the form of the State treasury bonds received in exchange of new share issue of the Company (Note 12). The funds received are aimed to cover the current liquidity gap of the Company. It could be claimed that the amount of State treasury bonds received by the Company in exchange of the new share issue partially covers compensation of the price difference, however, there is no legal support or documents confirming this statement, and there is no reconciliation act or similar document signed between the Company and the Government of Ukraine, stating the outstanding amount of compensation of the price difference. As a result, the Group’s capital structure is not balanced, representing significant amount of share capital and accumulated losses.

Political instability and military actions in Eastern regions of Ukraine

In early 2014 Ukraine has suffered from the armed aggression of the Russian Federation resulting in occupation of the Autonomous republic of Crimea (“Crimea”) and occupation of the parts of Luhansk and Donetsk regions by terrorist formations armed, controlled, directed and financed by the Russian Federation as well as in the result of an overt intervention of regular military forces of the Russian Federation. Part of the Group’s assets is located in these regions. As a result of these actions, the Group has reflected impairment of assets (property, plant and equipment, receivables and inventories) located at occupied territories of Luhansk and Donetsk regions amounting to UAH 7,203 million as at 31 December 2014 (Note 17).

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2. OPERATING ENVIRONMENT (Continued)

Additionally, as a result of occupation of Crimea by the Russian Federation, the Group has lost control over its assets located at this area. To reflect the temporary inability to control its business activities in Crimea, the Group has presented respective part of net assets of its subsidiary Chornomornaftogaz as discontinued operations (Note 20). Management assumes that as control over Crimea or the net assets of the Group located in Crimea is renewed in the future, these net assets will be restored in the consolidated financial statements in respective period. Additionally, the Group reflected impairment of assets (property, plant and equipment, receivables and inventories) located in Crimea amounting to UAH 5,810 million at 31 December 2014 (Note 17). Management continues to pursue available legal and diplomatic routes aiming to recover damages and restore control over the Group's assets in the affected regions.

Going Concern

The excess of current liabilities over current assets as at 31 December 2014 amounted to UAH 17,908 million (31 December 2013: UAH 53,893 million); for the year ended 31 December 2014 negative cash flow from operating activities amounted to UAH 59,738 million; for the year then ended the Group incurred net losses in the amount of UAH 88,433 million (2013: loss of UAH 17,957 million).

Management of the Group believes that it is appropriate to prepare these consolidated financial statements on a going concern basis as the Group and the Government of Ukraine has undertaken several initiatives aimed to improve the financial performance and liquidity of the Group, including, but not limited by the following:

- Since the beginning of 2014, the Government of Ukraine has undertaken a number of measures aiming to gradually bring the retail gas and heating prices to cost recovery levels based on international gas prices. The Government announced its plans to change energy subsidy system by increasing the direct subsidies to final consumers (mainly households and heat producing entities) and reducing the extent of the price regulation. Successful implementation of these plans would significantly reduce the Group's financial deficit in 2015-2016 and completely eliminate it by 2017. As mentioned above in this Note, retail prices for natural gas for households, maximum purchase price of natural gas for industrial customers and tariffs for storage were increased several times in 2014 and 2015. Additionally, following recent changes to the legislation in July 2015, the Parliament of Ukraine adopted changes to the current legislation that prohibits setting heat tariffs below the economically justified level. This measure should enhance liquidity and profitability of the heat generating entities, improving their ability to settle debts due to the Group.
- The Government of Ukraine and the Group have been undertaking steps to diversify the sources of gas supplies primarily from European companies through gas transportation networks of Slovakia, Poland and Hungary. In addition, the Group can reasonably expect that market prices for gas will go down following a substantial reduction of oil prices that occurred in the end of 2014 and onwards.
- During 2014 and 2015 the Government of Ukraine has provided to the Company State treasury bonds amounting to UAH 96.6 billion and UAH 29.7 billion (received up to the date of these consolidated financial statements were authorised for issue), respectively, in exchange for the new share issue. The Company registered share capital increase of UAH 6.0 billion in 2014, and received a temporary share registration certificates for UAH 104.6 billion. The bonds received in 2014 and 2015 were sold for cash, except for treasury bonds amounting to UAH 1.5 billion, received in 2015.

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2. OPERATING ENVIRONMENT (Continued)

- During 2015 the Parliament enacted a series of amendments to existing laws to improve the Group's liquidity position, including but not limited to: the right of the Company not to conclude contracts for the sale of natural gas with customers declared bankrupt and those which cannot provide any security for future natural gas sales; the obligation of the Company to stop natural gas sales in case of non-timely payments for natural gas sold etc. These amendments became effective on 6 June 2015. A set of secondary legislation shall be put in place to make them operational.
- The Parliament also cancelled the moratorium on the forced property sale in respect of entities with the State shareholding of 25 and more per cent which had not settled their debts to the Company and its subsidiary, Gaz of Ukraine, for gas sold in past periods. This change allows the forced sale of property of such companies in order to settle their gas debts to the Company and its subsidiary, Gaz of Ukraine. The procedure for the forced property sale in such cases shall be approved by the Cabinet of Ministers of Ukraine. The Company and its subsidiary, Gaz of Ukraine, are entitled to claim debt settlements from such customers in the court following cancellation of the respective moratorium from 1 September 2015.

Management believes that the combination of the above mentioned and other measures from the Government of Ukraine will enable the Group to continue as a going concern. These consolidated financial statements do not include any adjustments relating to recoverability and classification of the recorded assets amounts, or to the amounts and classification of liabilities that may be necessary if the Group is unable to continue as a going concern.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

3. SEGMENT INFORMATION

The Board is the Group’s chief operating decision maker. Management has determined the operating segments used for disclosure by the Group based on reports reviewed by the Board and the Ministry of Energy and Coal Industry of Ukraine for assessing their financial performance.

Management assesses the performance of the operating segments based on the amount of net profit/(loss) before income tax from continuing operations. Reportable segments are defined by management in accordance with the type of activity as follows:

- *Production of natural gas.* Natural gas production is mainly performed in Poltava, Kharkiv, Sumy, Dnipropetrovsk, Lviv and Zakarpattia regions. Exploration works are mainly performed in Carpathian and Dniprovs’ko-Donetsk regions. The Group controls about 70% of all natural gas produced in Ukraine.
- *Production of crude oil and gas condensate.* Oil exploration was performed in Crimea. After occupation of Crimea by the Russian Federation in early 2014, the Company has lost its control over the assets located there and respective cash flows (Note 20). Production of gas condensate is performed in the area of natural gas exploration.
- *Transportation of natural gas.* This segment is presented by the gas transmission and distribution pipelines operated by the Group. Ukrainian gas transportation system is one of the largest in the world in terms of its transportation capacities. The total length of gas transmission pipelines in Ukraine is 38.5 thousand km. Over 40% of natural gas supplied from the Russian Federation to European countries was transported through Ukrainian transmission gas pipelines in 2014 (2013: over 50%).
- *Storage of natural gas.* Ukrainian gas transportation system includes 11 underground gas storage facilities located in mainland Ukraine. The total capacity of the underground gas storage system located in Ukraine is 31 billion cubic meters of gas.
- *Transportation of crude oil.* This segment is presented by the transmission oil pipelines operated by the Group. The total length of oil transmission pipelines in Ukraine is 4.7 thousand km. Segment also includes oil storage, presented by 11 oil reservoirs with total capacity of 1.1 million tonnes of oil.
- *Refinery of crude oil and gas condensate.* This segment is presented by 5 oil and gas refineries. The refinery products mainly include gasoline and diesel fuel, and LPG.
- *Wholesale distribution and trading of natural gas.* As described in the Note 2 above, the natural gas producers in Ukraine, owned 50% and more by the State, should sell total volume of natural gas produced, net of natural gas used for technological purposes and other needs as stipulated by the law, to the households via the Company.
- *Other.* Revenues of this segment include revenues from sales of material and services by supporting Group entities, mainly supporting services.

The accounting policies of the reportable segments are the same as the Group’s accounting policies described in Note 25.

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3. SEGMENT INFORMATION (Continued)

Segment information for the reportable business segments of the Group for the year ended 31 December 2014 is as follows:

<i>In millions of Ukrainian hryvnias</i>	Production of natural gas	Production of crude oil and gas condensate	Transportation of natural gas	Storage of natural gas	Transportation of crude oil	Refinery of crude oil and gas condensate	Wholesale distribution and trading of natural gas	Other	Elimination	Total
Sales – external	130	320	24,171	338	1,957	5,197	45,493	838	-	78,444
Sales to other segments	4,685	-	57	1,092	-	27	7,764	-	(13,625)	-
Compensation of price difference	-	-	-	-	-	-	-	-	-	-
Total revenue and Compensation of price difference	4,815	320	24,228	1,430	1,957	5,224	53,257	838	(13,625)	78,444
Segment result	(4,696)	291	7,448	(2,986)	1,115	1,995	(81,211)	(274)	-	(78,318)
Unallocated income/(expense), net										715
Loss before income tax										(77,603)

Management considers segments “Production of natural gas”, “Storage of natural gas”, and “Wholesale distribution and trading of natural gas” as regulated businesses as sales prices and tariffs and purchase prices in those types of business are regulated by the State (as described in Note 2). All other segments are considered as non-regulated businesses as they are fully or their major parts are independent of special price and tariff regulations by the State.

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3. SEGMENT INFORMATION (Continued)

<i>In millions of Ukrainian hryvnias</i>	Production of natural gas	Production of crude oil and gas condensate	Transportation of natural gas	Storage of natural gas	Transportation of crude oil	Refinery of crude oil and gas condensate	Wholesale distribution and trading of natural gas	Other	Elimination	Total
Material non-cash items included in segment results:										
Depreciation, depletion and amortisation	(2,210)	-	(2,344)	(257)	(139)	(111)	(12)	(152)	-	(5,225)
Net movement in provision for trade and other receivables and prepayments made and other current assets	(135)	-	29	-	(18)	-	(9,715)	-	-	(9,839)
Impairment of property, plant and equipment and intangible assets	(2,394)	-	(52)	(2,725)	(134)	(78)	(141)	(101)	-	(5,625)
Net foreign exchange (loss)/gain	(783)	-	(548)	-	468	-	(38,322)	-	-	(39,185)
Capital expenditure	2,598	-	295	28	120	106	262	263	-	3,672
Segment assets	42,367	3,424	239,746	146,195	19,959	5,007	28,347	10,968	-	496,013
Investments in associates and joint ventures										11,169
Unallocated assets										7,797
Total assets										514,979

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3. SEGMENT INFORMATION (Continued)

Segment information for the reportable business segments of the Group for the year ended 31 December 2013 is as follows:

<i>In millions of Ukrainian hryvnias</i>	Production of natural gas	Production of crude oil and gas condensate	Transpor- tation of natural gas	Storage of natural gas	Transpor- tation of crude oil	Refinery of crude oil and gas condensate	Wholesale distribution and trading of natural gas	Other	Elimination	Total
Sales – external	446	207	30,131	443	1,411	5,778	36,447	511	-	75,374
Sales to other segments	4,687	-	-	425	-	-	9,828	-	(14,940)	-
Compensation of price difference	-	-	-	-	-	-	-	-	-	-
Total revenue and Compensation of price difference	5,133	207	30,131	868	1,411	5,778	46,275	511	(14,940)	75,374
Segment result	(1,163)	207	9,435	(661)	435	1,437	(24,941)	(349)	-	(15,600)
Finance costs, not included in segment result										-
Unallocated income/(expense), net										108
Loss before income tax										(15,492)

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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3. SEGMENT INFORMATION (Continued)

<i>In millions of Ukrainian hryvnias</i>	Production of Production of natural gas	Production of crude oil and gas condensate	Transportation of natural gas	Storage of natural gas	Transportation of crude oil	Refinery of crude oil and gas condensate	Wholesale distribution and trading of natural gas	Other	Elimination	Total
Material non-cash items included in segment results:										
Depreciation, depletion and amortisation	(2,309)	-	(2,393)	(312)	(162)	(157)	-	(348)	-	(5,681)
Net movement in provision for trade and other receivables and prepayments made and other current assets	(5)	-	(238)	-	(25)	-	(1,888)	-	-	(2,156)
Impairment of property, plant and equipment and intangible assets	-	-	(837)	-	-	-	-	(15)	-	(852)
Capital expenditure	2,053	429	1,195	75	58	250	30	144	-	4,234
Segment assets	30,053	9,402	61,917	70,304	12,283	2,387	29,869	5,513	-	221,728
Investments in associates and joint ventures										9,942
Unallocated assets										6,248
Total assets										237,918

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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3. SEGMENT INFORMATION (Continued)

External customers concentration, exceeding 10% of total revenues

During the years ended 31 December 2014 and 2013 the only external customer with concentration of revenue exceeding 10% of total revenues was Gazprom. Amount of revenue from Gazprom related to transportation of natural gas in 2014 amounted to UAH 16,831 million (2013: UAH 22,732 million).

Revenues, gross profit and receivables of the segment ‘Transportation of natural gas’ by main types of transportation services are as follows:

31 December 2014

<i>In millions of Ukrainian hryvnias</i>	Revenue	Gross profit	Trade accounts receivable, carrying amount
Domestic transportation	7,340	4,310	449
International transit	16,831	11,891	1,729
Total	24,171	16,201	2,178

31 December 2013

<i>In millions of Ukrainian hryvnias</i>	Revenue	Gross profit	Trade accounts receivable, carrying amount
Domestic transportation	7,399	3,798	2,282
International transit	22,732	15,722	-
Total	30,131	19,520	2,282

Revenues, gross (loss)/profit and receivables of the segment ‘Wholesale distribution and trading of natural gas’ by main groups of customers are as follows:

31 December 2014

<i>In millions of Ukrainian hryvnias</i>	Revenue	Gross (loss)/profit	Trade accounts receivable, gross amount	Trade accounts receivable, provision for impairment	Trade accounts receivable, carrying amount
Heat generating entities for heat produced for households	5,341	(19,329)	5,249	(2,327)	2,922
Heat generating entities for heat produced for other customers	5,653	856	7,208	(3,268)	3,940
Regional gas distribution entities – for reselling to households	7,390	(7,968)	1,897	(429)	1,468
Regional gas distribution entities – for reselling to other customers	2,380	324	1,608	(28)	1,580
Industrial and other customers	24,729	7,691	8,328	(6,088)	2,240
Total	45,493	(18,426)	24,290	(12,140)	12,150

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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3. SEGMENT INFORMATION (Continued)

31 December 2013

<i>In millions of Ukrainian hryvnias</i>	Revenue	Gross (loss)/ profit	Trade accounts receivable, gross amount	Trade accounts receivable, provision for impairment	Trade accounts receivable, carrying amount
Heat generating entities for heat produced for households	6,487	(11,875)	9,085	(1,367)	7,718
Heat generating entities for heat produced for other customers	6,401	338	5,689	(856)	4,833
Regional gas distribution entities – for reselling to households	5,668	(4,460)	2,138	(322)	1,816
Regional gas distribution entities – for reselling to other customers	3,333	623	174	(26)	148
Industrial and other customers	14,558	1,647	10,762	(7,218)	3,544
Total	36,447	(13,727)	27,848	(9,789)	18,059

Main sales prices and tariffs for the Group’s sales of natural gas are set out in Note 2.

Geographical information

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Ukraine	61,292	52,434
The Russian Federation	16,831	22,732
Egypt	320	207
Europe	1	1
Total revenue and Compensation of price difference	78,444	75,374

Allocation of sales in the table above is made based on the country of residence of the Group’s customers.

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4. 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 or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

As discussed in the Note 1, The Group is ultimately controlled by the Government of Ukraine, and therefore, all state-controlled entities are considered as related parties under common control.

Transactions with related parties are performed on terms that would not necessarily be available to unrelated parties.

Significant transactions and balances with related parties as at and for the years ended 31 December 2014 and 2013 are presented in the table below.

Revenue, trade accounts receivable, prepayments made and other current assets

	2014		2013	
	State-controlled entities and entities under significant influence of the State	Associates	State-controlled entities and entities under significant influence of the State	Associates
<i>In millions of Ukrainian hryvnias</i>				
Revenue	6,982	11,628	6,439	10,480
Share of after-tax results of associates and joint-ventures	-	1,488	-	536
Trade accounts receivable	5,052	3,723	7,640	764
Provision for impairment of trade accounts receivable	(4,524)	(73)	(1,351)	(57)
Other non-current assets	488	27	468	28
Prepayments made and other current assets	466	628	205	423
Provision for impairment of prepayments made and other current assets	(258)	(180)	(129)	(171)
Cash and bank balances	2,075	-	1,033	-

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4. BALANCES AND TRANSACTIONS WITH RELATED PARTIES (Continued)

Purchases, trade and other payables and borrowings

	2014		2013	
	State- controlled entities and entities under significant influence of the State	Associates	State- controlled entities and entities under significant influence of the State	Associates
<i>In millions of Ukrainian hryvnias</i>				
Cost of purchased oil, natural gas and petroleum products	-	-	-	1,024
Other purchases	683	1,341	150	1,147
Other operating expense	31	239	12	4
Net movement in provision for trade accounts receivable, prepayments made and other current assets and direct write-offs	(3,292)	(25)	227	146
Finance costs	3,265	-	-	-
Trade accounts payable	461	4,239	389	3,997
Borrowings	30,304	-	27,261	-
Advances received and other current liabilities	875	61	751	966

Key management remuneration. Key management personnel during 2014 consisted on average of 8 Board members (2013: 14 Board members). Compensation to the key management personnel included into other operating expense consists of salary and additional current bonuses and comprises UAH 6 million for the year ended 31 December 2014 (2013: UAH 11 million). As at 31 December 2014 key management personnel consisted of 5 Board members.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

5. PROPERTY, PLANT AND EQUIPMENT

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

<i>In millions of Ukrainian hryvnias</i>	Pipelines and related equipment	Oil and gas producing properties	Machinery and equipment	Buildings	Techno- logical oil and gas	Drilling and exploration equipment	Other fixed assets	Construc- tion in progress	Total
At 31 December 2012									
Cost or valuation	56,026	24,885	13,938	14,526	83,077	732	3,510	16,263	212,957
Accumulated depreciation and impairment	(6,324)	(4,904)	(3,210)	(3,054)	-	(304)	(1,788)	(2,127)	(21,711)
Net book value at 31 December 2012	49,702	19,981	10,728	11,472	83,077	428	1,722	14,136	191,246
Additions	919	1,476	1,077	449	-	26	269	119	4,335
Revaluation	-	-	-	-	(6,186)	-	-	-	(6,186)
Disposals	(7)	-	(20)	(23)	(348)	-	(148)	(147)	(693)
Depreciation charge	(2,265)	(1,810)	(1,174)	(763)	-	(79)	(379)	-	(6,470)
Impairment	(54)	-	(45)	(10)	-	-	-	(695)	(804)
Net book value at 31 December 2013	48,295	19,647	10,566	11,125	76,543	375	1,464	13,413	181,428
Cost or valuation	56,936	26,361	14,931	14,928	76,543	758	3,486	16,235	210,178
Accumulated depreciation and impairment	(8,641)	(6,714)	(4,365)	(3,803)	-	(383)	(2,022)	(2,822)	(28,750)
Additions and transfers	354	1,712	526	(177)	-	18	101	687	3,221
Revaluation	124,679	12,232	61,536	36,260	56,852	169	4,501	-	296,229
Disposals	-	-	(1)	(100)	(23)	-	(8)	-	(132)
Depreciation charge	(1,990)	(1,608)	(970)	(760)	-	(28)	(285)	-	(5,641)
Reclassification to discontinued operations (Note 20)	(4,275)	(968)	(2,295)	-	(800)	(216)	(25)	(5,910)	(14,489)
Impairment	(1,637)	(347)	(660)	(201)	(404)	(1)	(65)	(2,310)	(5,625)
Net book value at 31 December 2014	165,426	30,668	68,702	46,147	132,168	317	5,683	5,880	454,991
Cost or valuation	165,447	30,668	68,827	46,172	132,168	317	5,900	8,669	458,168
Accumulated depreciation and impairment	(21)	-	(125)	(25)	-	-	(217)	(2,789)	(3,177)

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5. PROPERTY, PLANT AND EQUIPMENT (Continued)

The Group engaged independent appraisers to determine the fair value of its property, plant and equipment as at 31 December 2014. Fair value was determined with reference to depreciated replacement cost or market-based evidence, in accordance with International Valuation Standards.

Taking into account the nature of the Group's property, plant and equipment, fair value was determined using depreciated replacement cost for specialised assets, and using market-based evidence for non-specialised assets. Consequently, the fair value of main producing properties and equipment was primarily determined using depreciated replacement cost. This method considers the cost to reproduce or replace the property, plant and equipment, adjusted for physical, functional or economic depreciation, and obsolescence. The depreciated replacement cost was estimated based on internal sources and analysis of available market information for similar property, plant and equipment (published information, catalogues, statistical data etc), and industry experts and suppliers.

Included in oil and gas producing properties carrying value of gas producing licenses as at 31 December 2014 of UAH 343 million (31 December 2013: UAH 325 million).

In 2014, the depreciation expense of UAH 5,126 million (2013: UAH 5,847 million) was included in cost of sales, UAH 99 million (2013: UAH 70 million) in other operating expense, and UAH 428 million (2013: UAH 553 million) were capitalised in the cost of property, plant and equipment.

As at 31 December 2014 and 2013 the Group has pledged its property, plant and equipment with carrying amount of UAH 15,240 million and UAH 7,794 million, respectively, to secure its borrowings (Note 13).

Had the Group's property plant and equipment been measured on a historical cost basis, their carrying amount would have been as shown in the table below (unaudited):

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Oil and gas producing properties	8,480	9,553
Pipelines and related equipment	6,520	13,119
Machinery and equipment	5,934	8,417
Buildings	5,446	5,835
Technological oil and gas	1,131	1,017
Drilling and exploration equipment	153	360
Other fixed assets	882	989
Total	28,546	39,290

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6. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

The Group’s investments in associates and joint ventures were as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Investments in associates	9,739	9,165
Investments in joint ventures	1,430	777
Total	11,169	9,942

Investments in associates

Details of each of the Group’s associates at the end of the reporting period are as follows:

Name of associate	Principal activity	Place of incorporation and principal place of business	Proportion of ownership interest	
			31 December 2014	31 December 2013
“Ukrnafta” PJSC	Oil and gas production	Ukraine	50.00%+1 share	50.00%+1 share
“Ukrtatnafta” PJSC	Oil refinery	Ukraine	43.05%	43.05%

All of the above associates are accounted for using the equity method in these consolidated financial statements.

Summarised financial information in respect of each of the Group’s associates is set out below. The summarised financial information below represents amounts shown in the associate’s financial statements prepared in accordance with IFRS.

“Ukrnafta” PJSC

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Current assets	14,983	9,118
Non-current assets	18,227	19,123
	33,210	28,241
Current liabilities	15,922	8,703
Non-current liabilities	2,468	1,795
	18,390	10,498

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6. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES (Continued)

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Revenue	27,892	21,101
Profit for the year	1,265	190
Other comprehensive (loss)/income for the year	(389)	31
Total comprehensive income for the year	876	221

Reconciliation of the above summarised financial information to the carrying amount of the interest in “Ukrnafta” PJSC recognised in the consolidated financial statements:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Net assets of the associate	14,820	17,743
Dividends declared by associate but not yet paid	3,799	-
Proportion of the Group’s ownership interest in “Ukrnafta” PJSC	50.00% +1 share	50.00% +1 share
Carrying amount of the Group’s interest in “Ukrnafta” PJSC	9,310	8,872

“Ukratnafta” PJSC

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Current assets	7,411	4,302
Non-current assets	2,048	1,946
	9,459	6,248
Current liabilities	8,256	5,397
Non-current liabilities	206	170
	8,462	5,567

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6. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES (Continued)

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Revenue	20,647	18,398
Profit for the year	350	251
Other comprehensive (loss)/income for the year	(33)	19
Total comprehensive income for the year	317	270

Reconciliation of the above summarised financial information to the carrying amount of the interest in “Ukrtatnafta” PJSC recognised in the consolidated financial statements:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Net assets of the associate	997	681
Proportion of the Group’s ownership interest in “Ukrtatnafta” PJSC	43.05%	43.05%
Carrying amount of the Group’s interest in “Ukrtatnafta” PJSC	429	293

Investments in joint ventures

Details of the Group’s material joint venture at the end of the reporting period are as follows:

Name of joint venture	Principal activity	Place of incorporation and principal place of business	Proportion of ownership interest	
			31 December 2014	31 December 2013
Misen Enterprices AB (LLC Carpatygas)	Oil and gas production	Ukraine	49.99%	49.99%

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6. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES (Continued)

Summarised financial information in respect of the Group’s material joint venture is set out below. The summarised financial information below represents amounts shown in the joint venture’s financial statements prepared in accordance with IFRS not adjusted by the Group for equity accounting purposes.

Misen Enterprices AB (LLC Carpatygas)

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Current assets	935	1,141
Non-current assets	2,906	1,819
	3,841	2,960
Current liabilities	1,025	1,199
Non-current liabilities	86	227
	1,111	1,426

The above amounts of assets and liabilities include the following:

Cash and cash equivalents	297	-
Current financial liabilities (excluding trade accounts payable and provisions)	(483)	(418)
Non-current financial liabilities (excluding trade accounts payable and provisions)	(52)	(221)

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Revenue	3,942	1,676
Profit for the year	1,228	643
Other comprehensive income for the year	-	-
Total comprehensive income for the year	1,228	643
Dividends received from the joint venture during the year	-	-

The above profit for the year include the following:

Depreciation and amortisation	(96)	(18)
Finance income	9	-
Finance costs	(429)	(11)
Income tax expense	(285)	(108)

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6. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES (Continued)

Reconciliation of the above summarised financial information to the carrying amount of the interest in the joint venture recognised in the consolidated financial statements:

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Net assets of the joint venture	2,730	1,534
Proportion of the Group's ownership interest in the joint venture	49.99%	49.99%
Contribution to capital	9	-
Other adjustments	25	(25)
Carrying amount of the Group's interest in the joint venture	1,390	742

7. OTHER NON-CURRENT ASSETS

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Accounts receivable on product sharing agreement	2,176	903
Restructured accounts receivable of gas consumers	1,122	1,130
Intangible assets	371	376
Other	677	328
Total	4,346	2,737

Accounts receivable on product sharing agreement. The Company entered into a concession agreement for oil exploration and development with the Arab Republic of Egypt and Egyptian General Petroleum Corporation (“EGPC”) on 13 December 2006. Under the terms of the concession agreement the Company have the right to recover all exploration and development costs incurred in connection with the concession agreement (Note 25). The amount presented in the table above represents such costs claimed by the Group for recovery, and which are expected to be refunded after one year since the reporting date.

Restructured accounts receivable of gas consumers. In May 2011, the Law of Ukraine “On certain matters on indebtedness for natural gas and electricity consumed” #3319-VI was approved. According to this Law, accounts receivable due from entities supplying natural gas under the regulated tariff that were originated in 2010, were restructured for the period from 1 to 20 years and are stated at amortised cost using effective interest rate which at the restructuring dates varied from 14% to 15% per annum.

During the year ended 31 December 2014 the Group recognised additional provision in respect of restructured accounts receivable of gas customers in the amount of UAH 95 million (2013: additional provision of UAH 21 million).

Other non-current assets. As at 31 December 2014 and 2013, included in other non-current assets are research and development expenditures amounting to UAH 525 million and UAH 200 million, respectively, that were incurred within the concession agreement for oil exploration and development with the EGPC on 13 December 2006, but not yet claimed for recovery (Note 25).

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8. INVENTORIES

The Group’s inventories were as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Natural gas	7,885	14,146
Spare parts	844	1,388
Crude oil and petroleum products	363	459
Raw materials	327	704
Other	564	327
Total	9,983	17,024

Management estimates the necessity of write-down of inventories to their net realisable value taking into consideration the ageing of inventories and indications of economical, technical and physical obsolescence. In 2014 total write-down adjustment amounted to UAH 3,893 million, included in other operating expense and UAH 8,592 million included in cost of sales (2013: UAH 422 million included in other operating expense).

As at 31 December 2014 and 2013 inventories with carrying value of UAH 5,308 million and UAH 11,803 million, respectively, were pledged as a collateral for borrowings (Note 13).

9. TRADE ACCOUNTS RECEIVABLE

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Trade accounts receivable	34,095	32,424
Less: provision for impairment	(18,998)	(11,885)
Total	15,097	20,539

Out of total carrying value of trade accounts receivable as at 31 December 2014 there are UAH 12,150 million of accounts receivable for natural gas (31 December 2013: UAH 18,059 million) (Note 3).

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9. TRADE ACCOUNTS RECEIVABLE (Continued)

Movements in provision for impairment of trade accounts receivable were as follows:

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Balance at 1 January	11,885	11,222
Provision for impairment recognised during the year	8,027	2,047
Reversal of provision	(611)	(808)
Amounts written off during the year as uncollectible	(227)	(576)
Transfer to discontinued operations (Note 20)	(76)	-
Balance at 31 December	18,998	11,885

Analysis of credit quality of trade accounts receivable is as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
<i>Neither past due nor impaired</i>	10,599	4,814
<i>Past due but not impaired:</i>		
Less than 30 days overdue	2,578	4,263
31 to 90 days overdue	1,201	5,486
91 to 180 days overdue	438	669
181 to 365 days overdue	2,323	3,288
Over 365 days overdue	74	2,019
<i>Past due and individually impaired (gross):</i>		
Less than 30 days overdue	265	68
31 to 90 days overdue	34	53
91 to 180 days overdue	64	113
181 to 365 days overdue	1,155	125
Over 365 days overdue	15,364	11,526
Less: provision for impairment	(18,998)	(11,885)
Total	15,097	20,539

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10. PREPAYMENTS MADE AND OTHER CURRENT ASSETS

The Group’s prepayments made and other current assets were as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Prepayments to suppliers for natural gas	11,083	-
Promissory notes receivable	1,698	1,513
Prepayments to suppliers for materials, works and services	1,463	2,646
Receivables under assignment agreements in respect of natural gas sales	1,384	1,737
Taxes prepaid, other than income tax	473	798
VAT recoverable	35	300
Other	2,580	1,543
Less: Provision for impairment	(6,215)	(5,714)
Total	12,501	2,823

Movements in provision for impairment of prepayments made and other current assets were as follows:

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Balance at 1 January	5,714	5,248
Provision for impairment recognised during the year	1,812	802
Reversal of provision	(86)	(103)
Amounts written off during the year as uncollectible	(1,225)	(233)
Balance at 31 December	6,215	5,714

11. CASH AND BANK BALANCES

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Cash in banks	2,475	1,697
Term deposits	1,869	416
Other	17	25
Total	4,361	2,138

Included in term deposits are bank deposits amounting to UAH 1,221 million with original maturity of more than three months and less than one year, which are excluded from cash and cash equivalents for the purpose of cash flow statement.

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12. SHARE CAPITAL

As at 31 December 2014 the registered, issued and fully paid share capital of the Company was UAH 59,997 million, comprising 55,840,905 ordinary shares with a par value of UAH 1,000 per share (31 December 2013: UAH 53,997 million, comprising 49,840,905 ordinary shares with a par value of UAH 1,000 per share).

As at 31 December 2014 and 2013 share capital of the Company has been adjusted for the effect of hyperinflation in accordance with IAS 29 “Financial Reporting in Hyperinflationary Economies” by UAH 4,156 million.

During 2014 the Company has completed a new share issue, started in 2013, of UAH 6,000 million to the Government of Ukraine in return of the State treasury bonds with maturities up to 2015 with nominal coupon rates in a range of 9.45%-9.95% per annum.

Unregistered contributed capital

In 2014 and 2013, according to several Resolutions of the Cabinet of Ministers of Ukraine, the Government issued UAH 96,610 million and UAH 8,000 million, respectively, of the State treasury bonds in exchange to the new share issue of the Company. The State treasury bonds have maturities in 2018-2024 and bear 12.5%-14.3% coupon rates. As at 31 December 2014 the Company has sold these State treasury bonds for cash at price equal to face value or above.

As at 31 December 2014 new share issues were not registered and presented as unregistered contributed capital.

Profit share payable to the state budget

In accordance with the Budget Code of Ukraine and the Law of Ukraine “On Management of State-owned Items”, the Company, being a state-owned enterprise, has to transfer to the state budget 30% of its statutory net profits calculated under Ukrainian Accounting Standards. For the year ended 31 December 2014, the obligatory profit amount payable to the State Budget amounted to UAH 156 million (2013: UAH 43 million).

Distribution of profits

Profits available for distribution to the owner in respect of any reporting period are determined by reference to the statutory financial statements prepared in accordance with Ukrainian Accounting Standards. Under Ukrainian legislation, dividends are limited to the net profits of the reporting year or any other distributable reserves not exceeding retained earnings as set out in the statutory financial statements.

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13. BORROWINGS

The Group’s borrowings were as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Non-current		
Bank borrowings	26,188	14,388
<i>Total non-current portion</i>	<i>26,188</i>	<i>14,388</i>
Current		
Bank borrowings	34,274	31,734
Eurobonds	-	12,749
Interest accrued	546	717
Unamortised issuance costs	-	(30)
<i>Total current portion</i>	<i>34,820</i>	<i>45,170</i>
Total	61,008	59,558

The effective interest rates and currency denomination of borrowings were as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014		31 December 2013	
	Balance	% per annum	Balance	% per annum
UAH	25,014	15%	27,232	14%
US Dollars	35,919	9%	32,326	9%
EUR	75	12%	-	-
Total	61,008		59,558	

Pledges

The Group’s borrowings in the context of secured and non-secured balances were as follows:

	31 December 2014	31 December 2013
Secured	61,008	58,839
Non-secured	-	719
Total	61,008	59,558

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13. BORROWINGS (Continued)

The Group’s bank borrowings were secured by the following pledged assets:

	31 December 2014	31 December 2013
Proceeds from future sales	108,603	81,145
Property, plant and equipment (Note 5)	15,240	7,794
Inventories (Note 8)	5,308	11,803
Total	129,151	100,742

Guarantees. As at 31 December 2014 the Group’s borrowings were guaranteed by the State in the amount of UAH 11,611 million (31 December 2013: UAH 24,381 million).

Compliance with borrowing terms. As at 31 December 2014 the carrying amount of bank borrowings past due comprised UAH 939 million. Before the date of these consolidated financial statements the borrowings in amount of UAH 710 million were settled. As at 31 December 2013, the Group did not comply with certain covenants on borrowings from third party banks, with the carrying amount of UAH 15,073 million. Those borrowings were classified as short-term as at 31 December 2013.

14. PROVISIONS

Movements in provisions for the year were as follows:

<i>In millions of Ukrainian hryvnias</i>	Provisions for litigations	Employee benefit obligations	Decommis- sioning provision	Total
Balance at 31 December 2012	231	1,253	161	1,645
Charge for the year	304	54	-	358
Unwinding of discount (Note 18)	-	142	20	162
Used or paid during the year	(64)	(142)	(8)	(214)
Unused amount reversed	-	-	(8)	(8)
Remeasurements	-	(38)	-	(38)
Balance at 31 December 2013	471	1,269	165	1,905
<i>Non-current</i>	<i>176</i>	<i>1,269</i>	<i>156</i>	<i>1,601</i>
<i>Current</i>	<i>295</i>	<i>-</i>	<i>9</i>	<i>304</i>
Charge for the year	323	115	-	438
Unwinding of discount (Note 18)	-	148	21	169
Used or paid during the year	(17)	(107)	(2)	(126)
Unused amount reversed	-	-	(8)	(8)
Transferred to discontinued operations (Note 20)	-	(58)	(48)	(106)
Remeasurements	-	358	-	358
Balance at 31 December 2014	777	1,725	128	2,630
<i>Non-current</i>	<i>16</i>	<i>1,725</i>	<i>111</i>	<i>1,852</i>
<i>Current</i>	<i>761</i>	<i>-</i>	<i>17</i>	<i>778</i>

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14. PROVISIONS (Continued)

Provisions for Litigations

The Group is involved into a number of litigations both as a plaintiff and as a defendant. Provision for litigations represents management assessment of the probable outflow of the Group's resources arising from a negative (adverse) outcome of the court and arbitration procedures.

Employee Benefit Obligations

The Group companies have certain obligations to its employees, prescribed by the collective agreements. Those benefits include lump sum benefits payable upon retirement and post-retirement benefit programs. Those employee benefits plans are not funded, and there are no plan assets.

Of the current service cost expensed in 2014, an amount of UAH 107 million (2013: UAH 48 million) was included to cost of sales and UAH 8 million (2013: UAH 6 million) was included to other operating expense.

The principal actuarial assumptions used were as follows:

	<u>2014</u>	<u>2013</u>
Nominal discount rate, %	14.1-14.5	12.8-13.0
Nominal salary increase rate, %	7.0-15.0	5.6-11.0
Staff turnover ratio, %	2.0-8.9	2.4-8.6

The sensitivity of the employee benefit obligations to changes in the principal assumptions is as follows:

	<u>2014</u>	<u>2013</u>
Nominal discount rate increase/decrease by 1%, %	(10.5) / 11.9	(7.1) / 8.2
Nominal salary increase/decrease by 1%, %	10.0 / (8.5)	6.2 / (5.5)
Staff turnover increase/decrease by 1%, %	(3.9) / 4.4	(6.9) / 7.9

The sensitivity analysis presented above may not be representative of the actual change in the employee benefit obligations as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

Furthermore, in presenting the above sensitivity analysis, the present value of the employee benefit obligations has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the obligation recognised in the consolidated statement of financial position.

There were no changes in the methods and assumptions used in preparing the sensitivity analysis from prior years.

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14. PROVISIONS (Continued)

Decommissioning Provision

In accordance with the legislation requirements, the Group is obliged to restore the lands that underwent changes in the relief structure, environmental state of soils and parent rocks, as well as hydrological regime due to drilling, geological survey, constructing and other works. The decommissioning provision represents present value of decommissioning costs relating to oil and gas properties.

The principal assumptions used in determining the decommissioning provision were as follows:

	<u>31 December 2014</u>	<u>31 December 2013</u>
Pre-tax discount rate, %	18.0	18.0
Long-term inflation rate, %	9.0	9.0

15. ADVANCES RECEIVED AND OTHER CURRENT LIABILITIES

The Group’s advances received and other current liabilities were as follows:

<i>In millions of Ukrainian hryvnias</i>	<u>31 December 2014</u>	<u>31 December 2013</u>
Advances for natural gas transportation	2,366	15,241
Advances for natural gas supplies	793	1,694
Other advances received	1,070	299
<i>Total advances received</i>	<u>4,229</u>	<u>17,234</u>
VAT payable	3,227	210
Liabilities for purchase of property, plant and equipment	1,061	1,182
Taxed payable other than income tax	744	1,240
Wages, salaries and related social charges payable	442	728
Accrual of employees’ unused vacations	269	261
Other current liabilities	<u>1,152</u>	<u>1,161</u>
Total	<u>11,124</u>	<u>22,016</u>

Out of total carrying value of advances for natural gas transportation as at 31 December 2014 there were UAH 2,306 million of advances received from single customer for natural gas transportation services via main gas pipelines through the territory of Ukraine (31 December 2013: UAH 14,293 million).

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16. COST OF SALES

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Cost of purchased natural gas	69,587	54,283
Depreciation, depletion and amortisation	5,126	5,568
Taxes, other than on income	4,354	4,433
Staff costs and related social charges	4,178	4,098
Oil and gas transportation costs	1,967	2,584
Repair and maintenance costs	667	794
Cost of purchased oil and petroleum products	359	2,993
Other	713	1,373
Total	86,951	76,126

Rent charge, included in taxes, other than on income, is calculated with reference to the volume of crude oil, gas condensate or natural gas produced, and volume of crude oil and natural gas transportation.

Included in cost of sales are expenses incurred on works performed by contractors and inventory used in the amounts of UAH 334 million for the first quarter of 2014 (year ended 31 December 2013: UAH 1,082 million). Current management of the Group does not have enough evidence to prove the nature of those expenditures, and recognises them as expense when incurred and as was evidenced by the primary documents. In respect of certain expenses criminal proceedings were initiated in 2014, and primary documents were withdrawn by the state prosecutor officials.

17. OTHER OPERATING EXPENSE

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Losses incurred on occupied territories (Note 2)	7,203	-
Losses incurred in Crimea (Note 2)	5,809	-
Impairment of property, plant and equipment	3,283	852
Net movement in provision for trade accounts receivable, prepayments made and other current assets and direct write-offs	2,382	2,009
Staff costs and related social charges	1,129	923
Write down on inventories to net realisable value	494	426
Impairment of cash	336	-
Change in provision for litigations (Note 14)	323	304
Fines and penalties	221	163
Impairment of VAT receivable	185	146
Research, development and exploration costs	184	543
Professional fees	130	94
Charity and social assets maintenance	91	160
Loss on disposal of property, plant and equipment	7	105
Other	1,844	1,053
Total	23,621	6,778

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17. OTHER OPERATING EXPENSE (Continued)

Included in losses incurred on occupied territories are impairment loss on property, plant and equipment of UAH 1,543 million, net movement in provision for trade accounts receivable, prepayments made and other current assets of UAH 3,848 million, write down on inventories of UAH 1,473 million, and VAT liabilities written off of UAH 339 million.

Included in losses incurred in Crimea are net movement in provision for trade accounts receivable, prepayments made and other current assets of UAH 3,057 million, write down on inventories of UAH 1,925 million, impairment loss on property, plant and equipment of UAH 799 million, and VAT liabilities written off of UAH 28 million.

Both losses incurred on occupied territories in Crimea, Luhansk and Donetsk regions were recognised by the Group as a result of the armed aggression of the Russian Federation including the occupation of Crimea and military invasion and occupation of Luhansk and Donetsk regions in early 2014 (Note 2).

Included in research, development and exploration costs are expenditures on geological survey amounting to UAH 160 million for the first quarter of 2014 (year ended 31 December 2013: UAH 455 million). The Group paid respective amounts to the contractors to perform those works and recognised them as expense when incurred and as was evidenced by the primary documents. In respect of these expenses criminal proceedings were initiated in 2014 and primary documents were withdrawn by the state prosecutor officials.

Included in other operating expense are oil storage costs of UAH 164 million for 2014 related to the Company’s subsidiary “Ukrtransnafta” PJSC. Management of the Group believes that these costs are overstated as a result of subsidiary’s management override of controls. Subsequently, subsidiary’s management was replaced in the first half 2015.

18. FINANCE COSTS

In millions of Ukrainian hryvnias

	2014	2013
Interest expense on bank borrowings	6,325	7,323
Interest expense on Eurobonds	1,256	1,211
Interest on payment deferral	1,106	-
Unwinding of discount on employee benefit obligations (Note 14)	148	142
Unwinding of issuance costs	30	40
Unwinding of discount of decommissioning provision (Note 14)	21	20
Other finance costs	117	132
Total	9,003	8,868

Interest expense on payment deferral represents interest on late payment to a natural gas supplier.

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19. INCOME TAX

The components of income tax expense for the years ended 31 December were as follows:

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Current tax expense	665	1,867
Deferred tax benefit	(3,621)	(276)
Income tax (benefit)/expense	(2,956)	1,591

The Group is subject to taxation in Ukraine. In 2014 Ukrainian corporate income tax was levied on taxable income less allowable expenses at the rate of 18% (2013: 19%).

Reconciliation between the expected and the actual taxation charge is provided below.

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Loss before income tax from continuing operations	(77,603)	(15,492)
Income tax at statutory rate of 18% (2013: 19%)	(13,969)	(2,943)
Adjustments to deferred tax attributable to tax rates different from tax rates effective as at 31 December 2014	(121)	(51)
Indexation of property, plant and equipment for tax purposes	(149)	-
Tax effect of items not deductible or assessable for taxation purposes:		
- Non-deductible expenses	8,426	815
- Non-taxable income	(206)	(86)
Tax effect of items taxed at a rate different from 19%	-	1,520
Additional income tax accrued based on a lost court decision	139	557
Change in unrecognised deferred tax asset	2,924	1,779
Income tax (benefit)/expense	(2,956)	1,591

The Parent and its subsidiaries are separate tax payers and, therefore, the deferred tax assets and liabilities are presented on an individual basis. The deferred tax liabilities and assets reflected in the consolidated statement of financial position after appropriate set off are as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Deferred tax asset	-	-
Deferred tax liability	(68,726)	(17,521)
Net deferred tax liability	(68,726)	(17,521)

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19. INCOME TAX (Continued)

Net deferred tax liability as at 31 December 2014 related to the following:

<i>In millions of Ukrainian hryvnias</i>	31 December 2013	Recognised in profit or loss	Recognised in other comprehensive income	Transferred to discontinued operations (Note 20)	31 December 2014
Property, plant and equipment	(18,314)	904	(55,254)	327	(72,337)
Trade accounts receivable	82	2,853	-	-	2,935
Investments in associates and joint ventures	(627)	116	38	-	(473)
Advances received and other current liabilities	1,049	(626)	-	-	423
Provisions	261	21	63	-	345
Inventories	74	225	-	-	299
Prepayments made and other current assets	6	67	-	-	73
Trade accounts payable	6	(1)	-	-	5
Other non-current assets	(58)	62	-	-	4
Net deferred tax liability	(17,521)	3,621	(55,153)	327	(68,726)

Net deferred tax liability as at 31 December 2013 related to the following:

<i>In millions of Ukrainian hryvnias</i>	31 December 2012	Recognised in profit or loss	Recognised in other comprehensive income	Transferred to discontinued operations	31 December 2013
Property, plant and equipment	(19,518)	217	987	-	(18,314)
Trade accounts receivable	83	(1)	-	-	82
Investments in associates and joint ventures	(593)	(38)	4	-	(627)
Advances received and other current liabilities	1,176	(127)	-	-	1,049
Provisions	265	1	(5)	-	261
Inventories	(100)	174	-	-	74
Prepayments made and other current assets	(9)	15	-	-	6
Trade accounts payable	3	3	-	-	6
Other non-current assets	(67)	9	-	-	(58)
Net deferred tax liability	(18,760)	253	986	-	(17,521)

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

19. INCOME TAX (Continued)

As at 31 December 2014 and 2013 unrecognised deductible temporary differences and unused tax losses are as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Tax losses carried forward	43,484	2,906
Inventories	14,157	9,367
Trade accounts receivable, prepayments made and other current assets	10,099	20,975
Provisions	469	248
Trade accounts payable	314	699
Property, plant and equipment	62	-
Available-for-sale investments	-	14,000
Advances received and other current liabilities	-	3,263
Other non-current assets	-	940
Borrowings	-	273
Other	330	-
	68,915	52,671

According to provisions of the Tax Code of Ukraine tax losses accumulated by the Group as at 31 December 2014 can be carried forward for unlimited periods of time.

20. DISCONTINUED OPERATIONS

Since November 2013, Ukraine has been subject to political unrest. On 27 February 2014, pro-Russian fractions under military support of the regular forces of the Russian Federation illegally took control over the Parliament of the Autonomous republic of Crimea, an autonomous region of Ukraine, which then voted to hold a pseudo-referendum on the status of Crimea in March 2014. Following this pseudo-referendum and having the region under military occupation of the Russian regular forces, Crimea was unlawfully annexed by the Russian Federation. On 17 March 2014, Crimean occupational authorities announced the nationalisation of the assets of Chornomornaftogaz, the Company's subsidiary, located in Crimea.

These events led to a loss of control of the Group over Chornomornaftogaz's assets in Crimea.

According to paragraph 9 of the Law of Ukraine “On protecting citizen rights and law enforcement on the temporarily occupied territory of Ukraine”, any authority, its officials and activities on the temporarily occupied territory are considered as unlawful, if this authority and officials are created or elected in order not prescribed by the law of Ukraine. Any document issued by such authorities or officials are not legally binding and do not create any legal consequences.

The Group had no access to financial statements, primary documents or any other financial information of Chornomornaftogaz for period from 1 January 2014 to date of loss of control in 2014. Based on this fact management of the Group decided to account for loss of control based on Chornomornaftogaz's net assets as of 31 December 2013.

Management continues to pursue available legal and diplomatic routes aiming to recover damages and restore control over the Group's assets in Crimea.

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20. DISCONTINUED OPERATIONS (Continued)

Chornomornaftogaz’s net assets as at the date of loss of control were as follows:

<i>In millions of Ukrainian hryvnias</i>	31 December 2013
Property, plant and equipment (Note 5)	14,489
Other non-current assets	64
Inventories	413
Trade accounts receivable	32
Prepayments made and other current assets	690
Prepaid corporate income tax	17
Cash and cash equivalents	6
Deferred tax liabilities (Note 19)	(327)
Provisions (Note 14)	(106)
Other long-term liabilities	(339)
Borrowings	(504)
Trade accounts payable	(572)
Advances and other current liabilities	(77)
Net assets at the date of loss of control	13,786

Chornomornaftogaz’s financial results for the year from discontinued operations:

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Revenue	-	525
Other gains	-	24
	-	549
Expenses	-	(1,146)
Loss before income tax	-	(597)
Attributable income tax expense	-	(277)
Loss on disposal of operation	(13,786)	-
Loss for the year from discontinued operations (attributable to owners of the Parent)	(13,786)	(874)

Cash flows from discontinued operations:

<i>In millions of Ukrainian hryvnias</i>	2014	2013
Cash flows from discontinued operations		
Net cash inflows from operating activities	-	212
Net cash outflows from investing activities	-	(235)
Net cash outflows from financing activities	-	(33)
Net cash inflows	-	(56)

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21. CONTINGENCIES, COMMITMENTS AND OPERATING RISKS

Tax legislation. Ukraine’s tax environment is characterised by complexity in tax administering, arbitrary interpretation by tax authorities of tax laws and regulations that, inter alia, can increase fiscal pressure on tax payers. Inconsistent application, interpretation, and enforcement of tax laws can lead to litigation which, as a consequence, may result in the imposition of additional taxes, penalties, and interest, and these amounts could be material. Facing current economic and political issues, the Government has implemented certain reforms in the tax system of Ukraine by adopting the Law of Ukraine “On Amending the Tax Code of Ukraine and Certain Laws of Ukraine” which is effective from 1 January 2015, except for certain provisions which will take effect at a later date.

In the ordinary course of business the Group is engaged in transactions that may be interpreted differently by the Group and tax authorities. Where the risk of outflow of financial resources associated with this is deemed to be probable and the amount is measured with sufficient reliability, the Group provides for those liabilities. Where management of the Group estimates the risk of financial resources outflow as possible, the Group makes a disclosure of these contingent liabilities. As at 31 December 2014, management estimated possible tax exposures in total amount of UAH 6,175 million (2013: UAH 5,553 million) with respect to the following:

- Corporate income tax amounting to UAH 3,122 million (2013: UAH 2,421 million) and related penalties amounting to UAH 863 million (2013: UAH 745 million);
- Value added tax amounting to UAH 1,514 million (2013: UAH 1,656 million) and related penalties amounting to UAH 538 million (2013: UAH 429 million);
- Other taxes amounting to UAH 138 million (2013: UAH: 302 million).

Management believes that it is not likely that any significant settlement will arise from the above cases and, therefore, the Group’s consolidated financial statements do not include any amount of provision in this respect.

The Group conducts transactions with its subsidiaries. It is possible with evolution of the interpretation of tax law in Ukraine and changes in the approach of tax authorities under the new Tax Code, that such transactions could be challenged in the future. The impact of any such challenge cannot be estimated, however, management believes that it should not be significant.

Starting from 1 September 2013 the Tax Code of Ukraine introduced new, based on the OECD transfer pricing guidelines, rules for determining and applying fair market prices, which significantly changed transfer pricing (“TP”) regulations in Ukraine. The Group exports refinery products and transportation services, performs intercompany transactions and is involved in transactions with related parties, which may potentially be in the scope of the new Ukrainian TP regulations. Part of the Group’s companies has submitted the controlled transaction report within the required deadline. Another part of the Group’s companies has prepared all necessary documentation on controlled transactions as required by legislation and plans to submit the reports. Management believes that the Group is in compliance with TP requirements.

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21. CONTINGENCIES, COMMITMENTS AND OPERATING RISKS (Continued)

Arbitral Tribunal requests. In June 2014 the Company has requested the Arbitration Institute of the Stockholm Chamber of Commerce to render an award in respect of the price determination according to the Agreement on gas purchase between the Company and Gazprom. The Company claims that the import prices for natural gas supplied during 2010-2014 are overstated. The import prices for natural gas, as prescribed by the Agreement on gas purchase, are calculated using the formula. The Company claims that the formula components were not calculated properly, the formula stipulated by the Agreement on gas purchase does not reflect current level of gas market prices and that the import prices should be revised downwards. As at 31 December 2014, management of the Group believes that it has settled all its liabilities for natural gas supplied during 2010-2014, and requests a compensation of excessively paid amounts of USD 12 billion.

In June 2015 Gazprom submitted its Statement of Defence and Counterclaim to the arbitration, updating and qualifying its claim for payments of USD 26.7 billion (USD 18.5 billion as claimed before) for natural gas which Gazprom did not deliver but the Company allegedly was obliged to pay for pursuant to the current contract (so-called take-or-pay provision in the Agreement on gas purchase). Management cannot predict the final outcomes of those claims, and does not recognise any obligation or related provisions in this respect.

In October 2014, the Company has also requested the Stockholm Arbitral Tribunal to render an award in respect of the natural gas transit charge through the territory of Ukraine according to the agreement on gas transit between the Company and Gazprom. The actual transit charge was calculated for the certain volume of the natural gas transit from the Russian Federation via Ukraine (“basic transit volume”). Expenditures of the Ukrainian natural gas transmission pipelines operator Ukrtransgaz are mainly fixed costs, and thus, decrease in volume of transit should cause higher transit charge per unit. However, taking that the actual transit volumes in 2010-2014 were significantly lower than the basic transit volume, the natural gas transit charge has never been revised. The Company requests a compensation for unpaid revenues from international transit above USD 11.7 billion.

Legal proceedings. From time to time and in the normal course of business, claims against the Group arise. Where the risk of outflow of financial resources associated with such claims is assumed as probable, a respective liability is recognised as a component of provision for litigations (Note 14). Where management estimates the risk of outflow of financial resources associated with such claims as possible, or amount of outflow cannot be measured reliably, no provision is recognised, and respective amount is disclosed in the consolidated financial statements. Management believes that it has provided for all material losses in these consolidated financial statements.

The Group and certain natural gas suppliers have disputes in respect of volumes and/or prices for natural gas supplied to the Group. Management assesses its contingent liabilities under such disputes at the level of UAH 4,681 million. Management cannot reliably estimate amount of potential losses on these obligations, if any.

The Group and certain suppliers have disputes in respect of payables not settled by the Group. Management assesses its contingent liabilities under such disputes at the level of UAH 382 million. Management cannot reliably estimate amount of potential losses on these obligations, if any.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

21. CONTINGENCIES, COMMITMENTS AND OPERATING RISKS (Continued)

Possible transfer of the Company’s equity interest in the subsidiaries to the State. In 1998, upon creation of the Company, the Government of Ukraine contributed certain shares of joint-stock companies to the share capital of the Company. These joint-stock companies included JSC Long-Distance Pipeline “Druzhba” and JSC “Prydniprovskiy” Long-Distance Pipeline that were reorganised in 2001 into JSC Ukrtransnafta, JSC Ukrspetstransgaz, Chornomornaftogaz National JSC, JSC Ukrnafta and fifty-four regional gas distribution entities.

The Government of Ukraine may transfer ownership or control over all or part of the Company’s equity interest in those joint-stock companies and/or other state-owned oil and gas transportation and storage facilities to other companies or Government agencies, and those actions could have a material adverse effect to the Company’s operations.

State property not subject to privatisation. In 1998, the Company entered into an agreement “On use of State owned property not subject to privatisation” (“Agreement”) with the State Property Fund of Ukraine, and received oil and gas transportation system into the operational control. The Agreement was signed for one year, and its term is prolonged automatically for one year, unless terminated by notice from either party, and is binding on the legal successor of each party. Historically, the agreement has been prolonged automatically, as neither party initiated its termination. As the State property not subject to privatisation forms an essential part of the Group’s business, the future operations and financial performance of the Group depends on the prolongation of the Agreement. The Company’s management believes that the Group will continue to operate with this property in the foreseeable future.

Pursuant to the Agreement, the Company is required, inter alia, to handle oil and gas transmission and distribution pipelines owned by the State of Ukraine, keep the state property in adequate operational condition, and transfer 50% share of profits received from using those assets to the State. The amount of such transfer could be reduced by the amount of capital investments in those assets. The Agreement does not provide a mechanism of such calculations, and historically there were no payments from the Group to the State in respect of using such assets. The Group believes that had the mechanism for calculating the state share in profits from using the assets been determined by the State, the capital investments performed by the Group would be greater, and no payment in favour of the State would occur. Accordingly, no liability for such payment was recognised in these consolidated financial statements.

Licenses. The State controls the oil and gas exploration and production activities in Ukraine via issuing respective licenses. According to the current legislation, separate licenses are issued for exploration, development and production activities for each oil and gas field. Separate licenses are issued for oil and gas transportation, supply and storage. Licenses are provided for the period from two to twenty years, and could be prolonged for the same period.

Certain licenses for exploration, development and production activities were transferred as a contribution to joint ventures. However, this is not allowed according to the current legislation and the State has the right to suspend such licenses. Currently no licenses of the Group were suspended due to this reason and there are no litigations in respect of the matter. The Group management believes that licenses will not be suspended due to the matter in the foreseeable future.

Capital commitments. Capital commitments for purchase of property, plant and equipment, and exploration and development of oil and gas fields comprise UAH 400 million as at 31 December 2014 (31 December 2013: UAH 742 million).

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22. FINANCIAL RISK MANAGEMENT

The Group’s activities expose it to a variety of financial risks: market risk (including currency risk and interest rate risk), concentration risk, credit risk and liquidity risk. The Group reviews and agrees risk management policies to minimise the potential adverse effects on the Group’s financial performance for those risks.

Major categories of financial instruments:

<i>In millions of Ukrainian hryvnias</i>	Note	31 December 2014	31 December 2013
Trade accounts receivable	9	15,097	20,539
Other non-current assets	7	3,309	2,130
Prepayments made and other current assets	10	588	1,427
Cash and bank balances	11	4,361	2,138
Restricted cash		394	200
Total financial assets		23,749	26,434

<i>In millions of Ukrainian hryvnias</i>	Note	31 December 2014	31 December 2013
Borrowings	13	(61,008)	(59,558)
Trade accounts payable		(10,384)	(25,725)
Advances received and other current liabilities	15	(1,772)	(2,171)
Other long-term liabilities		(49)	(378)
Total financial liabilities		(73,213)	(87,832)

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

Currency risk. The Group operates within Ukraine and its exposure to foreign currency risk is determined mainly by purchase of natural gas from foreign suppliers, which are denominated in USD. The Group also receives borrowings in foreign currencies. The Group does not hedge its foreign currency positions.

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22. FINANCIAL RISK MANAGEMENT (Continued)

The Group’s exposure to foreign currency risk is as follows, based on carrying amounts of respective currency assets and liabilities:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014			31 December 2013		
	USD	EUR	Others	USD	EUR	Others
Restricted cash	394	-	-	200	-	-
Cash and bank balances	507	71	9	21	110	-
Bank deposits	94	1,124	-	-	-	-
Trade accounts receivable	2,356	-	-	-	-	-
Prepayments made and other current assets	495	4	-	-	-	-
Other non-current assets	2,176	81	-	-	-	-
Borrowings	(35,919)	(75)	-	(32,326)	-	-
Advances received and other current liabilities	(363)	-	(96)	-	-	-
Trade accounts payable	(7,107)	(120)	(2)	(22,067)	-	-
Net (short) long currency position	<u>(37,367)</u>	<u>1,085</u>	<u>(89)</u>	<u>(54,172)</u>	<u>110</u>	<u>-</u>

The following table presents sensitivities of profit or loss and equity to reasonably possible changes in exchange rates applied at the reporting date, with all other variables held constant.

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the Group’s entities.

<i>In millions of Ukrainian hryvnias</i>	At 31 December 2014		At 31 December 2013	
	Impact on profit or loss	Impact on equity	Impact on profit or loss	Impact on equity
USD strengthening by 10%	(3,737)	(3,737)	(5,417)	(5,417)
USD weakening by 10%	3,737	3,737	5,417	5,417
EUR strengthening by 10%	109	109	11	11
EUR weakening by 10%	(109)	(109)	(11)	(11)

Interest rate risk. The Group normally has no significant interest bearing assets, and its income and operating cash flows are substantially independent of changes in market interest rate. The Group’s interest rate risk exposure arises from borrowings at variable interest rates. Borrowings at fixed rate expose the Group to fair value interest rate risk.

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22. FINANCIAL RISK MANAGEMENT(Continued)

The Group mainly attracts borrowings at fixed rate.

The borrowing activities are reviewed on an annual budget. Long-term investing activities and associated funding are considered separately, and are subject on the Government of Ukraine approval.

The maturity dates and effective interest rates of financial instruments are further disclosed in this note.

Concentration risk. The Group is exposed to concentration risk on advances received and revenues from natural gas transportation, other current liabilities and trade accounts payable as 54% of all total advances received and 50% of trade accounts payable as at 31 December 2014 (31 December 2013: 83% and 93%, respectively) comprise advances received from and trade payables to a single supplier (Note 15). Concentration on revenues from natural gas transportation is disclosed in Note 3.

Credit risk. The Group takes on exposure to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the Group's sales of products on credit terms and other transactions with counterparties giving rise to financial assets. The Group's policy is that the customers that wish to pay on credit terms are subject to the solvency check. Significant outstanding balances are also reviewed on an ongoing basis. At the same time, the Group must follow the state regulations as a guaranteed supplier of natural gas to the population and state-owned entities irrespective whether they are delinquent or not.

The Group establishes a provision for impairment that represents its estimate of incurred losses in respect of trade accounts receivable. The main component of this provision is a specific loss component that relates to individually significant exposures.

The maximum exposure to credit risk as at 31 December 2014 is UAH 23,749 million (31 December 2013: UAH 26,434 million).

The Group does not hold any collateral as security.

Liquidity risk. Prudent liquidity management implies maintaining sufficient cash and the availability of funding to meet existing obligations as they fall due. The Group's objective is to maintain a balance between the continuity of funding and flexibility through the use of credit terms provided by suppliers and banks. Prepayments are commonly used to manage both liquidity and credit risks. The Group analyses ageing of its assets and maturity of its liabilities and plans liquidity depending on their expected repayment. The Group has capital construction programs which are funded both through existing business cash flows and borrowed funds. Borrowed funds are also used to finance the Group's working capital needs.

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22. FINANCIAL RISK MANAGEMENT (Continued)

The following table analyses the Group’s financial liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are undiscounted cash flows of principal and interest payments. The maturity analysis of financial liabilities as at 31 December 2014 was as follows:

<i>In millions of Ukrainian hryvnias</i>	Up to 6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
Borrowings	29,879	8,703	14,977	14,077	-	67,636
Other long-term liabilities	-	-	49	-	-	49
Trade accounts payable	10,384	-	-	-	-	10,384
Advances received and other current liabilities	1,772	-	-	-	-	1,772
Total	42,035	8,703	15,026	14,077	-	79,841

The maturity analysis of financial liabilities as at 31 December 2013 was as follows:

<i>In millions of Ukrainian hryvnias</i>	Up to 6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Total
Borrowings	27,678	22,637	12,610	5,745	-	68,670
Other long-term liabilities	-	-	349	29	-	378
Trade accounts payable	25,725	-	-	-	-	25,725
Advances received and other current liabilities	1,820	351	-	-	-	2,171
Total	55,223	22,988	12,959	5,774	-	96,944

Gearing ratio. Consistent with others in the industry, the Group monitors capital on the basis of gearing ratio. This ratio is calculated as net debt divided by total capital under management. Net debt is calculated as total borrowing (current and non-current as shown in the consolidated statement of financial position) less cash and cash equivalents. Total capital under management equals equity as shown in the consolidated statement of financial position plus net debt.

The gearing ratio at the end of the reporting period was as following:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014	31 December 2013
Total borrowings (Note 13)	61,008	59,558
Less: cash and cash equivalents (Note 11)	(3,140)	(2,138)
Total Net Debt	57,868	57,420
Total Equity	356,978	107,035
Total Equity plus Total Net Debt	414,846	164,455
Gearing ratio	0.14	0.35

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23. FAIR VALUE

IFRS defines fair value as 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 estimated fair values have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. Management has used all available market information in estimating the fair value. The estimates presented herein are not necessarily indicative of the amounts the Group could realise in a market exchange from the sale of its full holdings of a particular instrument or pay in the transfer of liabilities.

Fair value of the Group's financial assets and financial liabilities measured at fair value on a recurring basis and fair value of property, plant and equipment

The Group's available-for-sale investments and property, plant and equipment are measured at fair value at the end of each reporting period. The following table provides information about how the fair values of these assets are determined (in particular, the valuation techniques and inputs used):

Assets	Fair value hierarchy	Valuation techniques and key inputs
Property, plant and equipment	3	<p>The Group engages professional independent appraisers to determine the fair value of its property, plant and equipment by using a replacement cost method for the majority of groups. The fair value is determined as the cost of construction of these items at current prices less the economic obsolescence and physical tear and wear to date. The main parameter used in this valuation technique are current prices on construction.</p> <p>For items for which there are market analogs (mainly buildings), the sales comparison method is used, the prices of market-based sales of comparable properties in the immediate proximity are adjusted with reference to differences in main parameters (such as floor space of the property). The main parameter used in this valuation technique is the price per square meter of a property.</p>
Property, plant and equipment	2	<p>The fair value of technological oil and gas is determined by application of the market price of oil and gas at the end of the reporting date to the volume of technological oil and gas. The main parameters used in this valuation technique are market prices for oil and gas at the end of the reporting period. The market value of the technological gas equal to the market price of gas less costs of it's pumping and transportation to the point of sale.</p>

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23. FAIR VALUE (Continued)

The following table summarises financial instruments and property, plant and equipment recognised at fair value after initial recognition using a fair value hierarchy:

31 December 2014

In millions of Ukrainian hryvnias

	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Property, plant and equipment	<u>132,168</u>	<u>316,943</u>	<u>449,111</u>
Total	<u>132,168</u>	<u>316,943</u>	<u>449,111</u>

31 December 2013

In millions of Ukrainian hryvnias

	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Property, plant and equipment	<u>76,543</u>	<u>91,472</u>	<u>168,015</u>
Total	<u>76,543</u>	<u>91,472</u>	<u>168,015</u>

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23. FAIR VALUE (Continued)

Details of the Group’s property, plant and equipment and information about the fair value hierarchy as at 31 December 2014 are as follows:

Description	Group of assets	Valuation technique	Unobservable inputs	Range of unobservable inputs	Interrelationship between key unobservable inputs and fair value measurement
Gas transmission system and gas storages	Pipelines and related equipment	Depreciated replacement cost method using the income approach for economic obsolescence determination	Date of implementation of incentive tariff regulation system	Regulatory Asset Base (RAB) start in 2016	The later the implementation of new tariff system, the lower the fair value
	Buildings		Rates of return on Regulatory Asset Base	Same rates of return for old and new capital	The higher the rate, the lower the fair value
	Machinery and equipment		Nominal WACC for USD-denominated cash flow	8%	The higher the WACC, the lower the fair value
	Other fixed assets				
Gas extraction assets	Pipelines and related equipment	Depreciated replacement cost method using the income approach for economic obsolescence determination	The remaining period of the deposit extraction, years (based on proven and probable reserves determined by independent expert)	0 – 35	The lower the period, the lower the fair value because of lower remaining useful life of infrastructure assets
	Oil and gas producing properties		Gas sale price	Market price based on a parity with the import gas price	The higher the gas sale price, the higher the fair value
	Buildings		Royalty tax rate long-term	29%	The higher the tax rate, the lower the fair

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23. FAIR VALUE (Continued)

Description	Group of assets	Valuation technique	Unobservable inputs	Range of unobservable inputs	Interrelationship between key unobservable inputs and fair value measurement
	Machinery and equipment		projection (as calculated on sale price)		value
	Other fixed assets		Nominal WACC for UAH-denominated cash flow	20.55%	The higher the WACC, the lower the fair value
Oil transmission system and storages	Pipelines and related equipment	Depreciated replacement cost method using the income approach for economic obsolescence determination	Cumulative factor of physical and functional depreciations	0.79	The higher the factor, the lower the fair value
	Building		Nominal WACC for UAH-denominated cash flow	16.4%	The higher the WACC, the lower the fair value
	Machinery and equipment				
	Other fixed assets				

Other assets of Group’s property, plant and equipment comprise other fixed assets of level 3 and amounted to UAH 3,489 million.

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23. FAIR VALUE (Continued)

Fair value of financial assets and financial liabilities that are not measured at fair value on a recurring basis (but fair value disclosures are required)

The Group’s management believes that, except for item included in the table below, the carrying amounts of financial assets and financial liabilities recognised in the consolidated financial statements approximate their fair values due to short-term nature:

<i>In millions of Ukrainian hryvnias</i>	31 December 2014		31 December 2013	
	Carrying amount	Fair value	Carrying amount	Fair value
Borrowings	61,008	59,185	59,558	59,495
Total	61,008	59,185	59,558	59,495

The following table provides information about how the fair value of borrowings is determined (in particular, the valuation techniques and inputs used):

Liabilities	Fair value hierarchy	Valuation techniques and key inputs
Borrowings	2	Discounted cash flows. Future cash flows are estimated based on the inputs that are observable, either directly or indirectly, and the estimates use one or more observable quoted prices for orderly transactions in the markets that are not considered active. Fair value of borrowings was determined applying range of interest rates for UAH denominated borrowings from 17.0% p.a. to 20.0% p.a. (31 December 2013: 12.5% p.a. to 14.5% p.a.) and for USD denominated borrowings from 9.5% p.a. to 12.0% p.a. (31 December 2013: 8.5% p.a. to 10.5% p.a.).

24. SUBSEQUENT EVENTS

Share capital increase and State treasury bonds received. In July 2015 the Company has registered a new share capital issue amounting to UAH 104,610 million out of unregistered share capital existed as at 31 December 2014, taking total nominal registered and fully paid share capital to UAH 160,451 million as at 31 July 2015 (or UAH 164,607 million together with adjustment for the effect of hyperinflation of UAH 4,156 million, Note 12).

In July 2015, according to the Resolution of the Cabinet of Ministers of Ukraine, the Company’s share capital was increased by UAH 29,700 million. New share issue was made to the Government of Ukraine in return of the State treasury bonds maturing in 2020 and bearing nominal interest of 14.5% per annum. As at the date of these consolidated financial statements the Company has sold UAH 28,200 million of these State treasury bonds for cash.

Changes to the Ukrainian legislation related to quorum of the General meetings of shareholders. In March 2015, according to changes in the Law of Ukraine “On Joint-Stock Companies”, quorum of the General meetings of shareholders was lowered from 60%+1 share down to 50%+1 share. Currently, management of the Group estimates the effect of these changes to the accounting for the Group’s associates.

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24. SUBSEQUENT EVENTS (Continued)

Profit share payable to the State Budget. The General shareholders' meetings held in June 2015, PJSC Ukrghasvydobuvannia and PJSC Ukrtransgaz, 100% subsidiaries of the Company, has approved profit distribution to the State Budget of Ukraine amounting to UAH 277 million payable within 6 months after the date of respective meeting.

Economic instability in Ukraine. During the first half 2015, the Ukrainian Hryvnia continued to devalue against the US Dollar. According to the National Bank of Ukraine, the average exchange rate for the first half 2015 amounted to UAH 21.36 for USD 1.00.

In March 2015, International Monetary Fund (“IMF”) approved a four-year extended arrangement under the Extended Fund Facility for Ukraine. The arrangement amounts to the equivalent of SDR (Special Drawing Rights) 12.3 billion (equivalent to USD 17.5 billion) and was approved under the Fund's exceptional access policy. Also was announced Ukraine's decision to cancel the Stand-By Arrangement (“SBA”) for Ukraine that was approved on in April 2014. In March 2015, IMF had provided Ukraine with SDR 3.5 billion tranche (equivalent to USD 4.9 billion).

Stabilisation of the economic and political situation depends, to a large extent, upon success of the Ukrainian government's efforts, yet further economic and political developments are currently difficult to predict.

Effect of gas transportation unbundling obligations. Pursuant to Ukraine's commitments under the Energy Community Treaty and the Ukraine – European Union (“EU”) Association Agreement, by 1 June 2016 operators of gas transmission systems of Ukraine must be effectively unbundled from activities related to gas production and supply per one of the allowed unbundling models. A new gas market law in Ukraine, coming into force from 1 October 2015, envisages two options for unbundling (ownership unbundling and the ISO model) in line with the EU laws in that respect. The owner of the state-owned gas transmission system (i.e. the state acting through its authorised bodies) is responsible for selecting the applicable unbundling model. Certain preliminary steps were taken by the Ukrainian state authorities in connection with the contemplated unbundling (Government's authorisation for establishing two Public Joint-Stock Companies, Magistralni Gazoprovody Ukrayiny and Pidzemni Gazoshovusha Ukrayiny; amendments to the current natural gas market law allowing for foreign investments into the operator of the Unified Gas Transmission System). As a result, the structure of the Group, its assets, liabilities and activities might undergo certain changes, the scope of which will be determined by the selected unbundling model.

Loans repayment and prolongation. In 2015 the Group has obtained new loan of UAH 554 million due in 2016, to restructure its liabilities to other banks, which were payable in 2015.

Also the Group has prolonged successfully to 2016-2020 loans in total amount of UAH 18,238 million, which were due in 2015.

Subsequent to 31 December 2014 and up to the date of these consolidated financial statements, the Group has repaid loans amounting to UAH 9,016 million.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2014

25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance. These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

Basis of preparation. The consolidated financial statements have been prepared on the historical cost basis except for property, plant and equipment and certain financial instruments that are measured at revalued amounts or fair values at the end of each reporting period, as explained in the accounting policies below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

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, regardless of whether that price is directly observable or estimated using another valuation technique.

Included in assets (mainly property, plant and equipment) and expenses for the first quarter 2014 are expenditures and expenses related to purchase of services and inventories (except for expenses related to purchase of natural gas and crude oil, and staff costs and related social charges) amounting to UAH 660 million and UAH 938 million, respectively (year 2013: UAH 4,335 million and UAH 2,927 million, respectively). Classification and disclosure of these expenses and expenditures in the consolidated financial statements have been made on the basis of the relevant primary documents. However, given the information available to current management of the Group, there are certain grounds to believe that the nature of these expenditures could be different from their legal form according to primary documents.

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

Functional and presentation currency. Items included in the financial statements of each of the Group’s entities are measured using the currency of the primary economic environment in which the Group operates (“the functional currency”). The consolidated financial statements are presented in Ukrainian hryvnias (“UAH”), which is the Company’s functional and the Group’s presentation currency. All amounts presented in the consolidated financial statements are presented in UAH, rounded to the nearest million, if not otherwise stated.

Transactions denominated in currencies other than the relevant functional currency are translated into the functional currency, using the exchange rate prevailing at the date of the transaction. Foreign exchange gains and losses, resulting from settlement of such transactions and from the translation of foreign currency denominated monetary assets and liabilities at year end, are recognised in the consolidated statement of profit or loss. Translation at year end does not apply to non-monetary items including equity investments. The effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

As at 31 December, the exchange rates used for translating foreign currency balances were:

<i>In Ukrainian hryvnias</i>	2014	2013
USD 1.00	15.76	7.99
EUR 1.00	19.23	11.04
RUB 10.00	3.00	2.45

Exchange restrictions in Ukraine are limited to compulsory receipt of foreign receivables within 90 days of sales and to the compulsory conversion of 75% of proceeds in foreign currency to Ukrainian Hryvnia. Foreign currency can be easily converted at a rate close to the National Bank of Ukraine rate. At present, UAH is not freely convertible outside Ukraine.

Basis for consolidation. Subsidiaries are those companies over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains or losses on transactions between the Group companies are eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Group has more than a majority of the voting rights of an investee, it still considers whether the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally and, thus, has the power over the investee.

The Group considers all relevant facts and circumstances in assessing whether or not the Group's voting rights in an investee are sufficient to give it power, including:

- The size of the Group's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- Potential voting rights held by the Group, other vote holders or other parties;
- Rights arising from other contractual arrangements; and
- Any additional facts and circumstances that indicate that the Group has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Transactions with non-controlling interests. The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

When the Group ceases to have control or significant influence, the retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

Investments in associates. Associates are entities over which the Group has significant influence but not control. Investments in associates are accounted for using the equity method of accounting. The Group's investment in associate includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of its associates' post-acquisition profits or losses is recognised in the statement of profit or loss, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate. Unrealised gains on transactions between the Group and its associates are eliminated.

Accounting policies of associates have been changed where necessary to ensure consistence with the policies adopted by the Group.

Dilution gains and losses arising on investments in associates are recognised in the consolidated statement of profit or loss.

Interest in joint ventures. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The Group recognises its interest in the joint venture using the equity method applied as described above in the paragraph *Investment in associates*.

Interest in joint operations. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

When a group entity undertakes its activities under joint operations, the Group as a joint operator recognises in relation to its interest in a joint operation:

- Its assets, including its share of any assets held jointly;
- Its liabilities, including its share of any liabilities incurred jointly;
- Its revenue from the sale of its share of the output arising from the joint operation;
- Its share of the revenue from the sale of the output by the joint operation; and
- Its expenses, including its share of any expenses incurred jointly.

The Group accounts for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses.

When a group entity transacts with a joint operation in which a group entity is a joint operator (such as a sale or contribution of assets), the Group is considered to be conducting the transaction with the other parties to the joint operation, and gains and losses resulting from the transactions are recognised in the Group's consolidated financial statements only to the extent of other parties' interests in the joint operation.

When a group entity transacts with a joint operation in which a group entity is a joint operator (such as a purchase of assets), the Group does not recognise its share of the gains and losses until it resells those assets to a third party.

Concession agreement (product sharing agreement). The Company entered into a concession agreement for oil exploration and development (“Concession Agreement”) with the Arab Republic of Egypt and Egyptian General Petroleum Corporation (“EGPC”) on 13 December 2006.

The Concession Agreement includes the following conditions:

- Subject to the auditing provisions under the Concession Agreement, the Company shall recover on a quarterly basis all exploration and development costs to the extent and out of 25% of all petroleum produced and saved from all production areas and not used in petroleum operations (“Cost Recovery”). Petroleum products under the Concession Agreement include crude oil or gas and LPG.
- Remaining 75% of the petroleum produced is shared by the Company and EGPC depending on the volume of production and the product type (crude oil or gas and LPG). The Company's share varies from 15% to 19%.
- EGPC shall become the owner of all the Company's assets acquired and owned within the Concession Agreement, which assets were charged to Cost Recovery by the Company in connection with the operations carried out by the Company: land shall become the property of EGPC as soon as it is purchased; title to fixed and movable assets shall be transferred automatically and gradually from the Company to EGPC as they become subject to the Cost Recovery.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The development period under the Concession Agreement is limited to maximum 25 years from the date of commercial oil discovery or from the date of first gas deliveries, started in 2011.

Accounting for all exploration and evaluation and other costs and incomes related to the product sharing agreement is similar to the accounting for a normal production process, as described in this Note.

Segment reporting. Operating segments are reported in a manner consistent with the internal reporting provided to the Group’s chief operating decision maker. Segments whose revenue, results or assets are ten percent or more of all the segments are reported separately. Segments falling below this threshold can be reported separately at management decision.

Property, plant and equipment. The Group uses the revaluation model to measure property, plant and equipment. Fair value was based on valuations made by external independent valuers. The frequency of revaluation depends on the movements in the fair values of the assets being revalued. The last independent valuation of the fair value of the Group’s property, plant and equipment was performed as at 31 December 2014. Subsequent additions to property, plant and equipment are recorded at cost. Cost includes expenditure directly attributable to acquisition of the items. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. Cost of acquired and self-constructed qualifying assets includes borrowing costs.

Any increase in the carrying amounts resulting from revaluations are credited to revaluation reserve in equity through other comprehensive income. Decreases that offset previously recognised increases of the same asset are charged against revaluation reserve in equity through other comprehensive income; all other decreases are charged to the consolidated statement of profit or loss. To the extent that an impairment loss on the same revalued asset was previously recognised in the consolidated statement of profit or loss, a reversal of that impairment loss is also recognised in the statement of profit or loss. Each year the difference between depreciation based on the revalued carrying amount of the asset charged to the statement of profit or loss and depreciation based on the asset’s original cost is transferred from revaluation reserve to retained earnings.

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, is capitalised with the carrying amount of the replaced component being derecognised. Subsequent costs are included in the asset’s carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the statement of profit or loss during the financial period in which they are incurred. Property, plant and equipment are derecognised upon disposal or when no future economic benefits are expected to be received from the continued use of the asset. Gains and losses on disposal determined by comparing proceeds with carrying amount of property, plant and equipment are recognised in the consolidated statement of profit or loss. When revalued assets are sold, the amounts included in other reserves are transferred to retained earnings.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property, plant and equipment includes technological oil and gas which is required to be held in the pipelines and storage facilities for the operating activities of the Group companies in transportation segment.

Construction in progress includes also prepayments for property, plant and equipment.

Exploration expenses. Exploration expenses comprise the costs associated with unproved reserves. These include geological and geophysical costs for the identification and investigation of areas with possible oil and gas reserves and administrative, legal and consulting costs in connection with exploration. They also include all impairments on exploration wells where no proved reserves could be demonstrated.

Research and development expenses. Research and development (R&D) expenses include all direct and indirect materials, personnel and external services costs incurred in connection with the focused search for new development techniques and significant improvements in products, services and processes and in connection with research activities. Expenditure related to research activities is shown as R&D expenses in the period in which it is incurred. Development costs are capitalised if the recognition criteria according to IAS 38 are fulfilled.

Exploration and evaluation assets. Oil and gas exploration and evaluation expenditures are accounted for using the successful efforts method of accounting. Costs are accumulated on a field-by-field basis. Costs directly associated with an exploration well, and exploration and property leasehold acquisition costs, are capitalised as long as the following conditions are satisfied:

- Sufficient oil and gas reserves have been discovered that would justify completion as a production well;
- Sufficient progress is being made in assessing the economic and technical feasibility to justify beginning field development in the near future.

If it is determined that commercial exploitation has not been achieved, these costs are charged to expense.

Expenditures related to the following activities are initially measured at cost and capitalised within property, plant and equipment in the consolidated statement of financial position:

- Acquisition of rights to explore;
- Topographical, geological, geochemical and geophysical studies;
- Exploratory drilling;
- Trenching, sampling; and
- Activities in relation to evaluating technical feasibility and commercial viability of extracting a mineral resource.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Exploration and evaluation assets are carried forward during the exploration and evaluation stage and are not amortised but assessed for impairment in accordance with the indicators of impairment as set out in IFRS 6 *Exploration for and Evaluation of Mineral Resources*. In circumstances where a property is abandoned, the cumulative capitalised costs relating to the property are written off in the period. No amortisation is charged prior to the commencement of production.

In circumstances where a property is identified as containing economically recoverable resources then the accumulated exploration and evaluation costs associated with that property are transferred to oil and gas producing properties and are presented within the property, plant and equipment in the consolidated statement of financial position.

Depreciation and depletion. Depreciation is charged to the consolidated statement of profit or loss on a straight-line basis to allocate costs of individual assets to their residual value over their estimated useful lives. Depreciation commences on the date of acquisition or, in respect of self-constructed assets, from the time an asset is completed and ready for use.

Oil and gas assets, including oil and gas producing properties are depleted using a unit-of-production method. The cost of producing wells is amortised over proved developed reserves. Licence acquisition, common facilities and future decommissioning costs are amortised over total proved and probable reserves.

Other property, plant and equipment are depreciated on a straight line basis over its expected useful life. The typical useful lives of the Group's other property, plant and equipment are as follows:

	<u>Useful lives in years</u>
Pipelines and related equipment	9-60
Machinery and equipment	3-60
Buildings	3-60
Drilling and exploration equipment	3-30
Other fixed assets	3-30

Construction in progress and technological oil and gas are not depreciated.

Intangible assets. Intangible assets have definite useful lives and primarily include capitalised computer software. Acquired computer software are capitalised on the basis of the costs incurred to acquire and bring them to use. Intangible assets are carried at cost less accumulated amortisation and impairment losses, if any. If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less costs to sell.

Leases. 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 (net of any incentives received from the lessor) are charged to the consolidated statement of profit or loss on a straight-line basis over the period of the lease. Finance leases are capitalised at the lease commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Decommissioning liabilities. The Group’s assessment of the decommissioning liabilities is based on the estimated future costs expected to be incurred in respect of the decommissioning and site restoration, adjusted for the effect of the projected inflation for the upcoming periods and discounted using interest rates applicable to the provision. Estimated costs of dismantling and removing an item of property, plant and equipment are added to the cost of an item of property, plant and equipment when the item is acquired, and corresponding obligation is recognised. Changes in the measurement of an existing decommissioning liability, that result from changes in the estimated timing or amount of the outflows, or from changes in the discount rate used for measurement, are recognised in the statement of profit or loss or, to the extent of any revaluation balance existence in respect of the related asset, other reserves. Provisions in respect of decommissioning activities are evaluated and re-estimated annually, and are included in the consolidated financial statements at each reporting date at their expected present value, using discount rates which reflect the economic environment in which the Group operates.

Interest expense related to the provision is included in finance costs in profit or loss.

Impairment of non-financial assets. Assets are reviewed for impairment whenever events and changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the assets carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value less cost to sell and value in use. For purposes of assessing impairment, assets are grouped to the lowest levels for which there are separately identifiable cash flows (cash generating unit). Non-financial assets that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

Classification of financial assets. The Group classifies its financial assets into the following measurement categories: (a) loans and receivables; (b) available-for-sale financial assets.

Loans and receivables include financial receivables created by the Group by providing money, goods or services directly to a debtor, other than those receivables which are created with the intention to be sold immediately or in the short term, or which are quoted in an active market. Loans and receivables comprise primarily loans, trade accounts receivable including purchased loans and promissory notes. All other financial assets are included in the *available-for-sale* category.

Initial recognition of financial instruments. Financial assets and financial liabilities are initially measured at fair value.

The Group’s principal financial instruments comprise available-for-sale investments, borrowings, cash and cash equivalents and short-term deposits. The Group has various other financial instruments, such as trade receivables and trade payables, which arise directly from its operations.

All purchases and sales of financial instruments that require delivery within the time frame established by regulation or market convention (“regular way” purchases and sales) are recorded at trade date, which is the date that the Group commits to deliver a financial instrument. All other purchases and sales are recognised on the settlement date with the change in value between the commitment date and settlement date not recognised for assets carried at cost or amortised cost, and recognised in equity for assets classified as available-for-sale.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Subsequent measurement of financial instruments. Subsequent to initial recognition, the Group's financial liabilities, loans and receivables are measured at amortised cost. Amortised cost is calculated using the effective interest method and, for financial assets, it is determined net of any impairment losses. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

The face values of financial assets and liabilities with a maturity of less than one year, less any estimated credit adjustments, are assumed to be their fair values. The fair value of financial liabilities is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

Gains and losses arising from a change in the fair value of available-for-sale assets are recognised directly in other comprehensive income. In assessing the fair value of financial instruments, the Group uses a variety of methods and makes assumptions based on market conditions existing at the reporting date.

When available-for-sale assets are sold or otherwise disposed of, the cumulative gain or loss recognised in other comprehensive income is included in the determination of net profit. When a decline in fair value of available-for-sale assets has been recognised in equity and there is objective evidence that the assets are impaired, the loss recognised in other comprehensive income is removed and included in the determination of net profit, even though the assets have not been derecognised.

Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in the consolidated statement of profit or loss. Dividends on available-for-sale equity instruments are recognised in the consolidated statement of profit or loss when the Group's right to receive payment is established and the inflow of economic benefits is probable. Impairment losses are recognised in the consolidated statement of profit or loss when incurred as a result of one or more events that occurred after the initial recognition of available-for-sale investments. A significant or prolonged decline in the fair value of an instrument below its cost is an indicator that it is impaired. The cumulative impairment loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in the consolidated statement of profit or loss, is removed from equity and recognised in the consolidated statement of profit or loss.

Impairment losses on equity instruments are not reversed through the consolidated statement of profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the consolidated statement of profit or loss, the impairment loss is reversed through current period's consolidated statement of profit or loss.

A provision for impairment of loans and accounts receivable is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered to be indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced through the use of a provision account, and the amount of the loss is recognised in the consolidated statement of profit or loss. When receivable is uncollectible, it is written off against the provision account for receivables. Subsequent recoveries of amounts previously written off are credited in the consolidated statement of profit or loss.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derecognition of financial instruments. The Group derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale. The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

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

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits 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 losses carried 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 liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the reporting date which are expected to apply to the period when the temporary differences will reverse or the tax losses carried 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 losses carried 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.

Inventories. Inventories are recorded at the lower of cost and net realisable value. The cost of inventories includes expenditures incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. Cost of manufactured inventories includes an appropriate share of production overheads based on normal operating capacity. The cost of inventories is determined on the first in first out basis and weighted average cost. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

Trade accounts receivable. Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Prepayments made and other current assets. 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.

Other prepayments are charged to the consolidated statement of 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 the consolidated statement of profit or loss.

Promissory notes. Some purchases may be settled by promissory notes or bills of exchange, which are negotiable debt instruments. Purchases settled by promissory notes are recognised based on management's estimate of the fair value to be given up in such settlements. The fair value is determined with reference to observable market information.

Cash and cash equivalents. Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method. Restricted balances are excluded from cash and cash equivalents for the purposes of the consolidated cash flow statement. 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.

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.

Dividends and mandatory budget contribution of profit share. Dividends and mandatory budget contribution of profit share are recognised as a liability and deducted from equity at the reporting date only if they are declared before or on the reporting date. Dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the consolidated financial statements are authorised for issue.

Value added tax (“VAT”). In Ukraine VAT is levied at two rates: 20% on sales and imports of goods within the country, works and services and 0% on the export of goods and provision of works or services to be used outside Ukraine. A taxpayer's VAT liability equals the total amount of VAT collected within a reporting period, and arises on the earlier of the date of shipping goods to a customer or the date of receiving payment from the customer. A VAT credit is the amount that a taxpayer is entitled to offset against his VAT liability in a reporting period. Rights to VAT credit arise when a VAT invoice is received, which is issued on the earlier of the date of payment to the supplier or the date goods are received. 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, the impairment loss is recorded for the gross amount of the debtor, including VAT.

Borrowings. Borrowings include bank borrowings and bonds.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Borrowing costs. Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method. Bank overdrafts are included into borrowings line item in the consolidated statement of financial position.

Trade accounts payable. Trade accounts payable are recognised and initially measured under the policy for financial instruments mentioned above. Subsequently, instruments with a fixed maturity are re-measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any transaction costs and any discount or premium on settlement.

Advances received. Advances received are carried at amounts originally received. Amounts of advances received are expected to be realised through the revenue received from usual activities of the Group.

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

Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

The expense on any provision is presented in the consolidated statement of profit or loss net of any reimbursement. If the effect of time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in provision due to the passage of time is recognised as a finance cost.

Other liabilities. Other financial liabilities are recognised initially at fair value, net of transaction costs incurred, and are subsequently stated at amortised cost using the effective interest method. Other non-financial liabilities are measured at cost.

Contingent assets and liabilities. A contingent assets are not recognised in the consolidated financial statements but disclosed when an inflow of economic benefits is probable.

Contingent liabilities are not recognised in the consolidated financial statements unless it is probable that an outflow of economic resources will be required to settle the obligation and it can be reasonably estimated. Contingent liabilities are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

Revenue recognition. Revenues from sales of goods are recognised at the point of transfer of risks and rewards associated with ownership of goods. If the goods are transported to a specified location, revenue is recognised when the goods are passed to the customer at the destination point.

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25. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue from sale and resale of natural gas are recognised at the point of transfer of risks and rewards associated with ownership of these goods. Revenues are measured at the fair value of the consideration received or receivable, and are shown net of value added tax and discounts.

Recognition of expenses. Expenses are recorded on an accrual basis. The cost of goods sold comprises the purchase price, transportation costs, commissions relating to supply agreements and other related expenses.

Finance income and costs. Finance income and costs comprise interest expense on borrowings, losses on early repayment of loans, interest income on funds invested, income or loss on origination of financial instruments, unwinding of interest of the pension obligation and provisions, and foreign exchange gains and losses.

Borrowing costs that relate to assets that take a substantial period of time to construct are capitalised as part of the cost of the asset. All other interest and other costs incurred in connection with borrowings are expensed using the effective interest method.

Interest income is recognised as it accrues, taking into account the effective yield on the asset.

Sale and repurchase agreements and lending of securities. Sale and repurchase agreements (“repo agreements”) which effectively provide a lender’s return to the counterparty are treated as secured financing transactions. Securities sold under such sale and repurchase agreements are not derecognised. The securities are not reclassified in the consolidated statement of financial position unless the transferee has the right by contract or custom to sell or repledge the securities, in which case they are reclassified as repurchase receivables. The corresponding liability is presented within amounts due to other banks or other borrowed funds.

Employee benefits: Defined Contributions Plan. The Group makes statutory unified social contributions to the Pension Fund of Ukraine in respect of its employees. The contributions are calculated as a percentage of current gross salary and are expensed when incurred. Discretionary pensions and other post-employment benefits are included in labour costs in the consolidated statement of profit or loss. The Company makes contributions to the State Pension Fund in Ukraine in respect of its employees in the amount of UAH 1,324 million and UAH 1,269 million for the years ended 31 December 2014 and 2013, respectively. The contributions are calculated as a percentage of current gross salary, and are expensed when incurred. Other post-employment benefits are included in labour costs in the statement of comprehensive income.

Employee benefits: Defined Benefit Plan. The Group provides lump sum benefits, payments on reaching certain age, and other benefits as prescribed by the collective agreement. The liability recognised in the consolidated statement of financial position in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the reporting date. The defined benefit obligation is calculated annually using the projected unit credit method.

The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

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

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26. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In the application of the Group's accounting policies, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgements in applying accounting policies. The following are the critical judgements, apart from those involving estimations, that the Group management has made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the consolidated financial statements.

Investment in “Ukrnafta” PJSC. The Group holds 50% + 1 share of voting rights in “Ukrnafta” PJSC. The rest is owned by limited number of investors. According to the Law of Ukraine “On Joint Stock Companies” General Meeting of Shareholders is a superior management body of the Public Joint Stock Company. The General Meeting of Shareholders, among other things, mandatory deals with election of the Supervisory Board members, approves decisions on significant legal actions. As at 31 December 2014, according to the Ukrainian law, the General Meeting of Shareholders is legitimate if it is attended by the shareholders owing in aggregate not less than 60%+1 of the company's voting shares. Due to the fact that the Group has no unilateral ability to conduct legitimate General Meeting of Shareholders, management believes that the Group does not have control over “Ukrnafta” PJSC. Accordingly, the investment in “Ukrnafta” PJSC is accounted for as investment in associate (Note 6). Subsequent to the balance sheet date, there were changes to the Ukrainian legislation that lowered the percentage of the voting rights from 60%+1 share to 50%+1 share to allow for the legitimate General Meeting of Shareholders (Note 24).

Impairment of trade accounts receivable. Management estimates the likelihood of the collection of trade accounts receivable based on an analysis of individual accounts. Factors taken into consideration include an ageing analysis of trade accounts receivable in comparison with the payment history, credit terms allowed to customers and available market information regarding the counterparty's ability to pay. Should actual collections be less than management's estimates, the Group would be required to record an additional impairment expense.

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26. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

Key sources of estimation uncertainty. The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Employee benefit obligations. Management assesses post-employment and other employee benefit obligations using the projected unit credit method based on actuarial assumptions which represent management's best estimates of the variables that will determine the ultimate cost of providing post-employment and other employee benefits. The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The major assumptions used in determining the net cost (income) for pensions include the discount rate and expected salary increases. Any changes in these assumptions will impact the carrying amount of pension obligations. Since there are no long-term, high quality corporate or government bonds issued in Ukrainian Hryvnias, significant judgement is needed in assessing an appropriate discount rate. Key assumptions are presented in Note 14.

Deferred tax asset recognition. The deferred tax asset, recognised in the consolidated statement of financial position, represents income taxes recoverable through future deductions from taxable profits. Deferred tax assets are recorded to the extent that realisation of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future, management makes judgements and applies estimation based on historic taxable profits and expectations of future taxable income that are believed to be reasonable under the circumstances.

Tax legislation. Ukrainian tax, currency and customs legislation continues to evolve. Conflicting regulations are subject to varying interpretations. Management believes its interpretations are appropriate and sustainable, but no guarantee can be provided against a challenge from the tax authorities (Note 21).

Decommissioning costs. The decommissioning provision represents the present value of the decommissioning costs relating to oil and gas properties, which are expected to be incurred in the future (Note 14). These provisions were recognised, based on Group's internal estimates.

Main estimates includes future market prices for the necessary decommissioning costs, and are based on market conditions and factors. Additional uncertainties relates to the timing of the decommissioning costs, which depends on depletion of the fields, future oil and gas prices and as a result – expected point of time, when there are no further economic benefit in the production.

Changes in these estimates can lead to the material changes in the provisions recognised in the consolidated statement of financial position.

Depreciation and depletion of the oil and gas assets. Oil and gas assets are depleted using a unit-of-production method. The cost of producing wells is amortised over proved developed reserves. Licence acquisition, common facilities and future decommissioning costs are amortised over total proved reserves. Changes in estimates regarding the volumes of production, proved developed reserves and total proved reserves either downward or upward, can result in the change of related assets utilisation accounting. A reduction in proved developed reserves, as result of future inspections and production will increase depreciation, depletion and amortisation expenses.

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26. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

Impairment of property, plant and equipment. Management reviews the carrying amounts of assets to determine whether there are any indicators that those assets are impaired. Latest review was performed during the revaluation of property, plant and equipment performed as at 31 December 2014 (Note 5).

In making the assessment for general impairment, assets that do not generate independent cash flows are allocated to an appropriate cash-generating unit. The assessment of whether there are any indicators of a potential impairment are based on various assumptions including market conditions, asset utilisation and the ability to utilise the asset for alternative purposes. If an indication of impairment exists, the Group estimates the recoverable value (greater of fair value less cost to sell and value in use) and compares it to the carrying value, and records impairment to the extent the carrying value is greater than the recoverable amount. The value in use is based on estimated future cash flows that are discounted to their present value. The estimated future cash flows require management to make a number of assumptions including customer demand, production capacities, future growth rates and the appropriate discount rate. Any change in these estimates may result in impairment in future periods.

The Group did not identified any indicators of impairment as at 31 December 2014.

Useful lives of other property, plant and equipment. Group’s property, plant and equipment, except oil and gas assets are depreciated using straight-line method over their estimated useful lives, which are based on management’s business plans and operational estimates.

The factors that could affect the estimation of the useful life of the asset and its residual value include the following:

- Changes in technology;
- Changes in maintenance technology;
- Changes in regulations and legislation; and
- Unforeseen operational issues.

Any of the above could affect the prospective depreciation of property, plant and equipment and their carrying and residual values. The Group reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period. The review is based on the current condition of the assets and the estimated period during which they will continue to bring economic benefit to the Group. Any change in estimated useful life or residual value is recorded on a prospective basis from the date of the change. Latest review of useful lives was performed during the revaluation of property, plant and equipment performed as at 31 December 2014 (Note 5).

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27. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

Adoption of new and revised International Financial Reporting Standards

The following standards have been adopted by the Group for the first time for the financial year beginning on or after 1 January 2014:

- Amendments to IFRS 10, IFRS 12 and IAS 27 – “Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance”;
- Amendment to IAS 27 “Separate Financial Statements” (revised 2011) – Investment entities;
- Amendments to IAS 32 “Financial instruments: Presentation” – Application guidance on the offsetting of financial assets and financial liabilities;
- Amendments to IAS 36 “Recoverable amounts disclosures for non-financial assets”;
- Amendments to IAS 39 “Novation of derivatives and continuation of hedge accounting”;
- IFRIC 21 “Levies”.

Adoption of these Standards and Interpretations did not have significant impact on the amounts reported in these consolidated financial statements.

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**27. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS
(Continued)**

Standards and Interpretations in issue, but not yet effective. At the date of authorisation of these consolidated financial statements, the following Standards and Interpretations, as well as amendments to Standards were in issue but not yet effective:

Standards/Interpretations	Effective for annual accounting period beginning on or after
Amendments to IAS 19 “Employee Benefits” – Defined Benefit Plans: Employee Contribution	1 July 2014
Amendments to IFRSs – “Annual Improvements to IFRSs 2010-2012 Cycle”	1 July 2014
Amendments to IFRSs – “Annual Improvements to IFRSs 2011-2013 Cycle”	1 July 2014
Amendments to IFRS 7 “Financial instruments: Disclosures” – Disclosures about the initial application of IFRS 9	1 January 2015
IFRS 14 “Regulatory Deferral Accounts”	1 January 2016
Amendment to IFRS 10, IFRS 12 and IAS 28: Investment Entities: Applying the consolidation exception	1 January 2016
Amendments to IAS 1: Disclosure Initiative	1 January 2016
Amendments to IAS 27: Equity Method in Separate Financial Statements	1 January 2016
Amendments to IAS 16 and IAS 41: Bearer plants	1 January 2016
Amendments to IAS 16 and IAS 38: Classification of Acceptable Methods of Depreciation and Amortisation	1 January 2016
Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	1 January 2016
Amendments to IFRS 11: Accounting for acquisitions of Interests in Joint Ventures	1 January 2016
Amendments to IFRSs – “Annual Improvements to IFRSs 2012-2014 Cycle”	1 July 2016
IFRS 15 “Revenue from contracts with customers”	1 January 2017
IFRS 9 “Financial Instruments”	1 January 2018

Management is currently evaluating the impact of the adoption of Amendments to IAS 19 “Employee Benefits”, IFRS 9 “Financial Instruments”, Amendments to IAS 1: Disclosure Initiative, Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture, Amendments to IFRS 11, Amendments resulting from Annual Improvements Cycles and IFRS 15 “Revenue from contracts with customers”.

For other Standards and Interpretations management anticipates that their adoption in future periods will not have a material effect on the consolidated financial statements of the Group in future periods.