



PETRÓLEOS DEL PERÚ -  
PETROPERÚ S.A.

**Financial Statements**

**December 31, 2016 and 2015**

**(including Independent Auditors' Report)**

**(TRANSLATION OF FINANCIAL STATEMENTS  
ORIGINALLY ISSUED IN SPANISH)**



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*(Translation of Financial Statements originally issued in Spanish)*

## INDEPENDENT AUDITORS' REPORT

### **To the Stockholder and Board of Directors Petróleos del Perú – PETROPERÚ S.A.**

We have audited the accompanying financial statements of Petróleos del Perú - PETROPERÚ S.A., (hereinafter the Company), which comprise the statement of financial position as of December 31, 2016 and 2015, the statements of profit or loss and other comprehensive loss, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### **Management's responsibility for the financial statements**

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

#### **Auditors' responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with International Standards on Auditing approved for its application in Perú by the Deans' Council of the Peruvian Professional Associations of Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the 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 Company'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 financial statements.

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



**Opinion**

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Petróleos del Perú – PETROPERÚ S.A. as of December 31, 2016 and 2015, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Lima, Peru

April 4, 2017

Countersigned by:

CAIPO Y ASOCIADOS

Henry Córdova C. (Partner)  
Peruvian Certified Public Accountant  
Registration number 01-28989

**PETRÓLEOS DEL PERÚ – PETROPERÚ S.A.**

# Financial Statements

**December 31, 2016 and 2015**

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S/ = Sol

US\$ = U.S. dollars

EUR = Euro

JPY = Japanese yen

(Translation of Financial Statements originally issued in Spanish)

**Petróleos del Perú – PETROPERÚ S.A.**

Statement of Financial Position

As of December 31, 2016 and 2015

<i>In thousands of soles</i>	<i>Note</i>	<b>2016</b>	<b>2015</b>
<b>Assets</b>			
<b>Current assets</b>			
Cash	6	248,656	64,971
Trade accounts receivable, net	7	894,175	798,529
Other accounts receivable, net	8	698,179	192,713
Inventories	9	2,001,567	1,707,722
Prepaid expenses		14,814	18,142
<b>Total current assets</b>		<b>3,857,391</b>	<b>2,782,077</b>
<b>Non-current assets</b>			
Other accounts receivable	8	848,359	721,978
Investments in associates	10	19,294	7,213
Property, plant and equipment, net	11	9,254,453	5,825,724
Intangible assets	12	54,402	59,339
<b>Total non-current assets</b>		<b>10,176,508</b>	<b>6,614,254</b>
<b>Total assets</b>		<b>14,033,899</b>	<b>9,396,331</b>

<i>In thousands of soles</i>	<i>Note</i>	<b>2016</b>	<b>2015</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Other financial liabilities	13	5,751,693	2,498,485
Trade accounts payable	14	2,427,912	1,083,636
Other accounts payable	15	598,238	304,731
Other provisions	16	388,979	135,361
<b>Total current liabilities</b>		<b>9,166,822</b>	<b>4,022,213</b>
<b>Non-current liabilities</b>			
Other financial liabilities	13	836,383	1,422,083
Other provisions	16	18,989	569,119
Income tax liabilities	17	262,198	180,060
<b>Total non-current liabilities</b>		<b>1,117,570</b>	<b>2,171,262</b>
<b>Total liabilities</b>		<b>10,284,392</b>	<b>6,193,475</b>
<b>Equity</b>			
	18		
Issued capital		2,465,048	1,949,969
Additional capital		370,411	62,679
Other capital reserves		54,395	4,128
Other equity reserves		(1,251)	-
Retained earnings		860,904	1,186,080
<b>Total equity</b>		<b>3,749,507</b>	<b>3,202,856</b>
<b>Total liabilities and equity</b>		<b>14,033,899</b>	<b>9,396,331</b>

The accompanying notes on pages 6 to 73 are an integral part of these financial statements.

(Translation of Financial Statements originally issued in Spanish)

**Petróleos del Perú – PETROPERÚ S.A.**

Statement of Profit or Loss and Other Comprehensive Loss  
For the years ended December 31, 2016 and 2015

<i>In thousands of soles</i>	<b>Note</b>	<b>2016</b>	<b>2015</b>
Revenue	19	11,199,109	11,543,095
Other operating income	20	243,897	362,960
<b>Total gross income</b>		<b>11,443,006</b>	<b>11,906,055</b>
Cost of sales	21	(9,529,432)	(9,884,163)
<b>Gross profit</b>		<b>1,913,574</b>	<b>2,021,892</b>
Selling and distribution expenses	22	(452,683)	(408,061)
Administrative expenses	23	(587,410)	(572,203)
Other income	25	111,648	55,655
Other expenses	25	(589,238)	(152,181)
<b>Total operating expenses</b>		<b>(1,517,683)</b>	<b>(1,076,790)</b>
<b>Operating profit</b>		<b>395,891</b>	<b>945,102</b>
Finance income	26	23,353	9,022
Finance costs	26	(78,529)	(67,538)
Exchange difference, net	4(a)	50,431	(178,455)
<b>Profit before income tax</b>		<b>391,146</b>	<b>708,131</b>
Income tax	27	(213,655)	(205,464)
<b>Profit for the year</b>		<b>177,491</b>	<b>502,667</b>
Total other comprehensive loss		(1,251)	-
<b>Total comprehensive income</b>		<b>176,240</b>	<b>502,667</b>
<b>Basic and diluted earnings per share in soles</b>	<b>29</b>	<b>0.072</b>	<b>0.258</b>

The accompanying notes 6 to 73 are an integral part of these financial statements.

(Translation of Financial Statements originally issued in Spanish)

**Petróleos del Perú – PETROPERÚ S.A.**

Statement of Changes in Equity

For the years ended December 31, 2016 and 2015

<i>In thousands of soles</i>	<b>Number of shares (note 18)</b>	<b>Issued capital (note 18)</b>	<b>Additional capital (note 18)</b>	<b>Other capital reserves (note 18)</b>	<b>Other equity reserves (note 18)</b>	<b>Retained earnings (note 18)</b>	<b>Total equity</b>
<b>Balance as of January 1, 2015</b>	<b>1,945,852,605</b>	<b>1,945,853</b>	<b>4,116</b>	<b>99,033</b>	-	<b>588,508</b>	<b>2,637,510</b>
Profit for the year	-	-	-	-	-	502,667	502,667
<b>Total comprehensive income for the year</b>	-	-	-	-	-	<b>502,667</b>	<b>502,667</b>
<b>Transactions with owners of the Company</b>							
Partial set-off of losses with legal reserve	-	-	-	(94,905)	-	94,905	-
Transfer to issued capital	4,115,795	4,116	(4,116)	-	-	-	-
Contributions from public treasury	-	-	62,679	-	-	-	62,679
<b>Total transactions with stockholders</b>	<b>4,115,795</b>	<b>4,116</b>	<b>58,563</b>	<b>(94,905)</b>	-	<b>94,905</b>	<b>62,679</b>
<b>Balances as of December 31, 2015</b>	<b>1,949,968,400</b>	<b>1,949,969</b>	<b>62,679</b>	<b>4,128</b>	-	<b>1,186,080</b>	<b>3,202,856</b>
<b>Balance as of January 1, 2016</b>	<b>1,949,968,400</b>	<b>1,949,969</b>	<b>62,679</b>	<b>4,128</b>	-	<b>1,186,080</b>	<b>3,202,856</b>
Profit for the year	-	-	-	-	-	177,491	177,491
Other comprehensive loss	-	-	-	-	(1,251)	-	(1,251)
<b>Total comprehensive income</b>	-	-	-	-	<b>(1,251)</b>	<b>177,491</b>	<b>176,240</b>
<b>Transactions with owners of the Company</b>							
Transfer to legal reserve	-	-	-	50,267	-	(50,267)	-
Contributions from public treasury	-	-	370,411	-	-	-	370,411
Transfer to additional capital	-	-	452,400	-	-	(452,400)	-
Transfer to issued capital	515,079,535	515,079	(515,079)	-	-	-	-
<b>Total transactions with stockholders</b>	<b>515,079,535</b>	<b>515,079</b>	<b>307,732</b>	<b>50,267</b>	-	<b>(502,667)</b>	<b>370,411</b>
<b>Balance as of December 31, 2016</b>	<b>2,465,047,935</b>	<b>2,465,048</b>	<b>370,411</b>	<b>54,395</b>	<b>(1,251)</b>	<b>860,904</b>	<b>3,749,507</b>

The accompanying notes on pages 6 to 73 are an integral part of these financial statements.

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**Petróleos del Perú – PETROPERÚ S.A.**

Statements of Cash Flows

For the years ended December 31, 2016 and 2015

<i>In thousands of soles</i>	<i>Note</i>	<b>2016</b>	<b>2015</b>
Operating activities:			
Cash generated from operating activities		1,331,389	1,159,006
Interest paid		(78,529)	(67,538)
Income tax paid		(751,943)	(308,721)
<b>Net cash provided by operating activities</b>		<b>500,917</b>	<b>782,747</b>
Investing activities:			
Acquisition of property, plant and equipment	11	(2,957,516)	(1,844,518)
Acquisition of intangible assets		(3,159)	(3)
Investment in joint venture		(3,201)	-
<b>Net cash used in investing activities</b>		<b>(2,963,876)</b>	<b>(1,844,521)</b>
Financing activities:			
Proceeds from short-term loans		8,332,173	9,078,817
Payments of short-term loans		(5,636,815)	(8,441,615)
Contributions from Public Treasury		-	62,679
<b>Net cash provided by financing activities</b>		<b>2,695,358</b>	<b>699,881</b>
Net increase (decrease) in cash, before the effect of exchange rate fluctuations		232,399	(361,893)
Effect of exchange rate fluctuation on cash		(43,079)	44,733
Effects of exchange rate fluctuation on other accounts		(5,635)	(235,805)
Cash at the beginning of year	6	64,971	617,936
<b>Cash at the end of year</b>		<b>248,656</b>	<b>64,971</b>
<b>Non-cash flow generating transactions</b>			
Derivative financial instruments		(1,251)	-
Transfer of liabilities for retirement pensions, net of deferred tax		370,411	-
Work-in-progress to pay		752,984	-

The accompanying notes on pages 6 to 73 are an integral part of these financial statements.



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Statements of Cash Flows

For the years ended December 31, 2016 and 2015

Adjustments to reconcile net profit to net cash provided by operating activities:

<i>In thousands of soles</i>	<i>Note</i>	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities:</b>			
Profit for the year		177,491	502,667
Adjustments to reconcile net profit for the period to cash from operating activities:			
Bad debt expense	7	2,752	12,818
Inventory write-downs	9	3,637	(948)
Retirement pension	16	226	8,522
Fringe benefits		32,671	43,642
Provision for labor, civil claims and other		48,460	78,283
Provision for environmental improvement		232,211	9,881
Derivative financial instruments		(1,251)	-
Depreciation	11	135,302	129,849
Amortization	12	8,095	7,918
Disposal of fixed		21,534	-
Recovery and impairment of assets		124,936	(91,045)
Deferred Income tax liability	17	(61,910)	58,416
Impairment of investments	10	6,986	-
Effect on the adjustment of unrealizable exchange difference		20,865	(10,929)
		<b>752,005</b>	<b>749,074</b>
Changes in:			
Trade accounts receivable		(98,398)	(84,248)
Other accounts receivable		(84,979)	(37,837)
Inventories	10	(297,482)	42,770
Prepaid expenses		3,328	(15,794)
Trade accounts payable		591,292	154,394
Other accounts payable		(364,590)	36,734
Provision for retirement pension	17	(259)	(62,346)
<b>Net cash provided by operating activities</b>		<b>500,917</b>	<b>782,747</b>

The accompanying notes on pages 6 to 73 are an integral part of these financial statements.

**Petróleos del Perú – PETROPERÚ S.A.**

Notes to the Financial Statements

December 31, 2016 and 2015

## **1. Identification and Economic Activity**

### **A. Identification**

Petróleos del Perú – PETROPERÚ S.A. (hereinafter PETROPERÚ S.A. or the Company), was incorporated on July 24, 1969 under Decree Law 17753.

It is a State-owned company incorporated under private law that develops its activities in the Energy and Mining sector, Hydrocarbons subsector. The Company is organized and works as a stock corporation according to the provisions of Legislative Decree 043, Act of Petróleos del Perú – PETROPERÚ S.A. issued on March 4, 1981 and its amendments that establish that the Peruvian Government is owner of the Company's shares. Article 12 of the Regulation of Law 28840 states that each member of the General Stockholders' Meeting will represent the number of capital shares of PETROPERÚ S.A. calculated by dividing the total shares by the number of members designated to act on behalf of the Peruvian Government.

PETROPERÚ S.A.'s main office is located at Av. Enrique Canaval y Moreyra N° 150, San Isidro, Lima, Peru.

The Second Final Provision of Law 28840 repealed Supreme Resolution 290-92-PCM which included the Company in the private investment promotion process, as well as any provision opposed to Law 28840, excluding specifically PETROPERÚ S.A. from the scope of the Peruvian Fund for Financing State-Owned Enterprise (FONAFE) and the Public Investment National System (SNIP).

The Company is governed by its Organic Law approved by Legislative Decree 043, its Bylaws, and Law 28840 - Strengthening and Modernization Law of Petróleos del Perú -PETROPERÚ S.A. (its Regulation, approved by Supreme Decree 012-2013-EM on April 27, 2013) and supplementary by the Companies Act, being subject only to the inspection of the General Controller's Office and the Hydrocarbon's Sector Regulators.

Also, the third Final Complementary Provision, Articles 9 and 12, paragraph 9.3 of Legislative Decree 1031 dated June 23, 2008 and its regulation published on August 19, 2010 are applicable. They promote Efficiency on State Business Activity and its Regulation approved by Supreme Decree 176-2010.EF and amended by Supreme Decree 162-2013-EF dated June 30, 2013.

Also, provisions of Law 30130 published on December 18, 2013 are applied, "Law that declares the primarily execution of the modernization of Talara Refinery to be of public requirement and national interest in order to guarantee the air quality preservation and public health and adopt measures to strengthen the Oil Corporate Governance of Peru- PETROPERÚ S.A. and its Regulation approved by Supreme Decree 008-2014-EM published on March 24, 2014. The Government has provided guarantees up to an annual amount of US\$ 200 million for up to a cumulative total of US\$ 1,000 million to support the financial obligations arising from the financing hired by PETROPERÚ S.A. to execute the Talara Refinery Modernization Project.

On December 31, 2016, Legislative Decree 1292 was published declaring the public requirement and national interest of safe operation in the Nor Peruano Pipeline, and establishing the reorganization and development of PETROPERÚ S.A.'s corporate governance.

**Petróleos del Perú – PETROPERÚ S.A.**

Notes to the Financial Statements

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**B. Economic activity**

By means of Law 28244 dated June 2, 2004, PETROPERÚ S.A. was authorized to negotiate contracts with PERUPETRO S.A. concerning exploration and/or exploitation, operations or services of oil as set forth by law.

The Strengthening and Modernization Law of PETROPERÚ S.A. establishes that the Company will act with economic, financial and administrative autonomy and on the basis of annual and five-year term objectives approved by the Peruvian Ministry of Energy and Mining. Documents and contracts signed in fulfilling its corporate purpose will be subject to: i) Legislative Decree 043 and its amendments, ii) its Bylaws, iii) its Internal Regulations, iv) Board of Directors' Agreements, and v) National Control System Standards and vi) specific standards for PETROPERÚ S.A.

Foreign trade operations conducted by the Company are governed by the uses and practices of generally accepted international trade and standards on International Law, and hydrocarbons and energy industry.

As part of its corporate purpose, the Company conducts activities provided by Law 26221, Hydrocarbons Organic Law. These activities comprise all oil industry and trade phases, its derivatives, basic petrochemicals and other types of energy. Its activities in the hydrocarbon industry include the exploration and exploitation, refining, trading and transport of oil and its derivatives, basic and intermediate petrochemical products and other energy sources.

Law 29970, Law that supports Energy Security and promotes development of the Petrochemical Complex in the South of the Country, stipulates the participation of PETROPERÚ S.A., individually or in association with others, in the development of the petrochemical complex referred to herein.

Law 30130 authorizes PETROPERÚ S.A. the sale or issuance of shares to place them in the Securities Market. In this process, the Government will be able to include a private sharing of up to 49% of the outstanding capital stock. Likewise, it is established that PETROPERÚ S.A. is able to conduct activities and investment projects provided that they do not generate contingent, present or future liabilities to the company, do not affect collaterals of the Modernization Project of the Talara Refinery (PMRT), and do not require resources from the Public Treasury, without limiting those projects that allow maintaining the company's operations at the entry into force of the law. These restrictions will cease when PETROPERÚ S.A. generates enough flows to guarantee the payment of debts to be incurred for investments related to the PMRT and a private shareholding of at least 40% is generated in the outstanding capital stock.

By means of Supreme Decree 031-2016-MEM, the assignment of a contractual position was approved in favor of GEOPARK PERÚ S.A.C. obtaining 75% of PETROPERÚ S.A.'s shareholding of the License Agreement for the Exploration and Exploitation of Hydrocarbons in Block 64.

Legislative Decree 1292 declared the public requirement and national interest of safe operation in Nor Peruano Pipeline establishing the Company's reorganization and the corporate governance's development, by granting a term of 720 days, regulating, among others, the amendment, entering into agreements and contracting of services related to the Company's business units; PETROPERÚ S.A.'s shareholding in the agreements for the exploration and exploitation of hydrocarbons; the possibility of the Company to participate in social responsibility actions under the Public works tax deduction mechanism; the financing for capital increase referred to in the article 8(8) of Law 29970; and, the amendment to article 4 and the Complementary Provision of Law 28840.

**Petróleos del Perú – PETROPERÚ S.A.**

Notes to the Financial Statements

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The standard states that once the reorganization and modernization of PETROPERÚ S.A. included in Article 3 (3.1) is completed, it will be under the scope of the Peruvian Fund for Financing State-Owned Enterprise - FONAFE. In March 2017, the Constitutional Committee of Congress approved to amend the Legislative Decree 1292. One of the amendments is related to the exemption of the fifth final complementary provision concerning the decree which established that PETROPERÚ S.A. will be under the scope of FONAFE.

By means of Legislative Decree 1292 and OSINERMINING proposal, the company additionally entrust the Ministry of Energy and Mines to approve a price tariff regulation for the Final Concession for the Liquid Hydrocarbons Transportation through the Norperuano Pipeline and the Ramal Norte Pipeline to be applied when the parties do not agree within 60 days.

**C. Regulatory framework of the Company's sales prices**

According to Article 77 of the Hydrocarbons Organic Law, the activities and prices related to crude oil and derivative products are governed by supply and demand.

The policy on fuel prices of PETROPERÚ S.A. approved by the Board of Directors establishes that:

- Product prices will follow the international market trend reflected in Import Parity Prices calculated by PETROPERÚ S.A.
- Net prices range of PETROPERÚ S.A. including in the contribution/compensation factors of the Price Stabilization Fund of Fuels are able to fluctuate within a range established by policy.
- In the event that prices exceed the range set for each product or basket of products during a specific term (taking into consideration the Factors of the Fund), a price readjustment proposal will be presented and supported before the Executive Committee of Prices.
- In the case of gas, gasohol, middle distillates and industrial oil, the comparison of net prices will be made with the import parity in Callao and in the case of Liquefied Petroleum Gas (LPG), Callao's export parity will be used and the acquisition cost of LPG will be used in the local market.
- The analysis of the situation of net prices of the list of PETROPERÚ S.A. will consider, reference prices published by OSINERMIN plus a commercial margin differentiated by each fuel, exchange rate, local competence prices and other relevant events that impact on the fundamentals of the hydrocarbons global markets.

**D. Approval of financial statements**

The financial statements as of December 31, 2016 have been approved by the General Management of the Company on February 14, 2017 and they will be presented to Board of Directors for corresponding approval for issuance, and then put for consideration of the General Stockholders' Meeting that will be held within the terms established by Law, for final approval. In management's opinion, the accompanying financial statements will be approved by the Board of Directors and the General Stockholders' Meeting without amendments. The General Stockholders' Meeting, held on March 31, 2016 approved the financial statements as of December 31, 2015.

**Petróleos del Perú – PETROPERÚ S.A.**

Notes to the Financial Statements

December 31, 2016 and 2015

## **2. Basis for the Preparation of Financial Statements**

### **A. Statement of compliance**

The Company's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) issued by International Accounting Standards Board (IASB) in force as of December 31, 2016

### **B. Information responsibility**

The information contained in these financial statements is the responsibility of the Company's Board of Directors which expressly states that all the principles and criteria included in the IFRS issued by the IASB have been applied.

### **C. Basis of measurement**

These financial statements arise from the Company's accounting records and have been prepared based on historical cost, except for derivative financial instruments presented at their fair value.

### **D. Functional and presentation currency**

The items included in the financial statements are measured in the currency of the primary economic environment in which the Company operates. The financial statements are presented in soles (S/), which is the Company's functional and presentation currency.

### **E. Use of estimates and judgments**

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions to determine the reported balances of assets and liabilities, exposure of contingent assets and liabilities as of the date of the financial statements, actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Review of accounting estimates are recognized in the period where estimates have been reviewed and in any future affected periods.

Information about significant judgments in applying accounting policies that have the most significant effect on the amounts recognized in these financial statements are as follows:

#### ***i. Useful life and recoverable value of property, plant and equipment (note 11)***

Depreciation is calculated at the lower of the straight-line method based on the estimated useful life of the asset, which is compared to the remaining useful life of the asset.

It results in charges for depreciation proportional to the depletion of assets measured by the number of years. The useful life of assets is evaluated based on i) physical asset's limitations and ii) evaluation of the demand. These calculations require making estimates and assumptions on the total demand of production of the Company and on capital disbursements that will be required in the future.

#### ***ii. Provision for environmental improvements and plugging of wells (note 16)***

The Company updates the valuation of the provision for improvement of the environment of the privatized and own units and for the plugging of wells to reflect new events, changes in the circumstances and any other relevant information that is available to determine which are the costs that will be incurred to cover these items. Changes in variables used to establish the amount of the environmental liability and plugging of wells may result in significant adjustments to the liability balance.

**Petróleos del Perú – PETROPERÚ S.A.**

Notes to the Financial Statements

December 31, 2016 and 2015

**iii. Contingent liabilities (note 28)**

By definition, contingent liabilities will be confirmed with the occurrence or non-occurrence of one or more uncertain future events not wholly within the Management's control. The determination of contingencies inherently involves the exercise of judgments and the use of assumptions of the outcome of future events that will materialize or not in a future. Contingent liabilities do not result in provisions.

As of December 31, 2016, the Company faces tax contingencies for an amount of S/ 150 million that are disclosed in note 28. They mainly include administrative proceedings filed against the Tax Court and the Tax Authority (SUNAT) for the review of the income tax for the years 2005 through 2008.

**iv. Review of carrying amount and impairment (note 11)**

The Company considers the value of its permanent assets will be recovered during the normal course of operations. Such estimate is supported in assumptions on the production levels and the estimates of the demand of products in a future.

The Company evaluates at the end of each period the recoverable value of each cash generating unit through a discounted cash flow analysis. Values allocated to key assumptions represent the Management's evaluation of future industry trends and are based on external and internal sources. Key assumptions used in the calculation of the recoverable value are as follows:

- Cash generating units identified by the Company's Management are: i) Production and Trading: The Production and Trading cash generating unit is composed of four refineries of PETROPERÚ S.A.: Talara, Iquitos, Conchán and El Milagro. These refineries have established synergies among them, through which products in progress are transferred in absence of an active market in which they can be traded, ii) Oil pipeline operations: They generate cash inflows for the transfer service and custody of crudes from the northern rainforest area of the country for the export of the crude Piraña and for services provided to the Production and Trading CGU; and iii) Leased units, which groups all assets originating cash flows arising from leases.
- Projection horizon 10 years.
- Selling price projections: Management estimates selling prices of derivative products of oil at PETROPERÚ S.A. import parity prices based on the evolution over time of WTI crude oil prices and spreads of derivative products, as per data of international sources specialized in prices as of IHS (PIRA Energy Group for 2015).
- Volume projection of crude oil purchases: Refinery charges are estimated by Management of Refinery and pipelines with the Refining mathematical model.
- Forecast of acquisition costs: Management, based on the projections published by the consulting company IHS (PIRA Energy Group for 2015) has prepared the projection of acquisition costs of crude and products, considering the evolution over time of WTI crude oil prices and spreads of derivative products.
- Volume projection of exports: Export of Diesel 2 to YPF Bolivia has been considered for 2016. From year 2019, surpluses of high sulfur diesel 2 shall be generated (approx. 2 500 ppm) as a result of the obligation of trading Diesel B5 of 50 ppm, and being not possible to produce it due to lack of hydro treatment units; this diesel shall be exported.

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- Discount rates (WACC), the model uses a discount rate in soles after taxes of 9.80% in nominal terms.
- Projected costs and expenses are based on budgeted expenses prepared by Management.
- Cash flow projections include sales tax (IGV) recovery up to 18% of exports.
- Capital Investment: Information of the 2017 budget approved by means of Agreement 111-2016-PP dated December 29, 2016, which considers the historical execution of the investments projections against the investments actually performed.
- Revenue in oil pipeline's CGU for exports of Piranha crude oil and Gran Tierra crude oil, in 2018 and 2022 respectively.

Assumptions used for the calculation of impairment may change if market conditions and economy change. A percentage increase in the discount rate may result in the impairment recognition on Leased Units' CGU and a higher impairment of the oil pipeline's CGU; otherwise, a lower rate would lead to higher discounted cash flows that when comparing to the carrying amount, it would imply the reversal of impairment of leased units' CGU until reaching the carrying amount and a lower impairment of the oil pipeline's CGU. Concerning the CGU of production and commercialization, an increase or decrease in the discount rate would not lead to impairment loss recognition.

<i>In thousands of soles</i>	<b>Discount rate</b>	<b>Production and</b>	<b>Oil pipeline</b>	<b>Leased units</b>
		<b>Trading</b>	<b>operations</b>	
		<b>CGU</b>	<b>CGU</b>	<b>CGU</b>
	9.30%	1,213,096	(127,104)	14,038
	9.55%	1,156,824	(136,415)	6,681
Sensitivity analysis	9.80%	1,101,781	(145,592)	(528)
	10.05%	1,047,935	(154,477)	(7,593)
	10.30%	995,257	(163,236)	(14,517)

**v. Obligations for pension plans (note 16)**

The present value of the obligation for retirement pensions depends on a number of factors determined on actuarial basis using a number of assumptions. Assumptions used when determining the cost of pensions include the discount rate. Any change in these assumptions will have an impact on the carrying amount of the obligation of the retirement plan.

Other key assumptions to establish obligations for retirement pensions are based in part, on current market conditions. In note 16.C additional information is presented on this concern.

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**F. Going concern**

Financial statements have been prepared based on the going concern assumptions, which implies that the Company will be able to meet the obligatory payment terms of bank obligations as disclosed in note 13.

The Company has recognized a profit after taxes amounting to S/ 177,491 thousand for the year ended December 31, 2016. At that date, the current liabilities exceed the current assets by S/ 5,309,431 thousand. The working capital position in year 2016 and in the last years mainly arises from financial commitments related to financing obtained for the Modernization Project of Talara Refinery.

In order to cover this working capital differential, the Company has access to short-term revolving credit lines granted by local and foreign banks for up to US\$ 1,709,024 thousand, of which US\$ 76,830 thousand are available at that date. During March 2017, the Company expanded its revolving credit lines granted by foreign banks for US\$ 400,000 thousand. By means of Supreme Decree 005-2017-EF dated January 13, 2017, the Company received a capital contribution of S/ 1,056,000 thousand, under Article 8 of Law 29970, in accordance with Legislative Decree 1292. Likewise, the Company has a bridge loan with banks in charge of structuring the issuance of bonds in the international market for up to US\$ 1,000,000 thousand with a 9-month term in case it could not be possible to obtain resources from international markets during the second quarter of 2017.

Management foresees that any additional payment requirements will be met using operating cash flows or other alternatives for capital generation such issuance of commercial papers in the local market, issuance of bonds in the foreign market, private placement in the local and foreign markets and/or syndicated loan in the foreign market.

Management recognizes that uncertainty remains concerning crude prices; however, the decrease in oil price does not affect directly the business results because the Company obtains profitability based on the net refinancing margin. Also, refined products have, on a short term basis, a price relatively independent from the oil price since they have their own dynamics. On a long-term basis, the price of products is influenced by the oil price. According to the projections prepared by Management, based on prices provided by the international consultant IHS, it is estimated that for the period 2016-2023, there will be a crack spread (3:2:1) average of 15.17 US\$/BL, reaching levels of US\$ 13.4/BL during the period 2024-2035. The crack spread decrease at the end of 2016 (13.0 US\$/BL) reflects the recovery of crude oil prices without proportional increase of refined products, especially gasoline.

**G. Segment reporting and geographic information**

Segment reporting is presented on a consistent basis with the internal reports used by the authority in charge of the Company's operational decision-making. General Management is the authority in charge of operational decision making of the Company and it is responsible for allocating resources and evaluating performance of operating segments.

For management purposes, Management analyzed the performance of PETROPERÚ S.A. based on three independent cash generating units which have been defined as operating segments for financial information exposure (note 5).

The management evaluates the development of operating segments based on the operating profit. The management determines the assets and liabilities for the segments as the total assets or total liabilities attributable to each segment. The accounting policies used to determine the segment reporting are those used for the preparation of financial statements.

Revenues per geographical area are determined according to the client's location. For the years ended December 31, 2016 and 2015, no revenues from foreign geographical areas exceed 10% of total revenues. All non-current assets of the Company are located in Peru. Therefore, no geographic information on non-current assets is presented.



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### **3. Significant Accounting Policies**

Significant accounting policies applied to prepare the financial statements are detailed below. These policies have been applied consistently to all years presented, unless otherwise indicated.

#### **A. Cash**

It comprises cash on hands and on checking accounts.

#### **B. Trade accounts receivable**

Trade accounts receivable correspond to amounts that the Company has the right to require to its clients for the sale of finished products in the ordinary course of business. Those accounts whose maturity is under 12 months as from the closing date of the financial statements, are initially recognized at their fair value and since the effect of its discount is irrelevant; they are subsequently valued at their face value, net of the allowance for doubtful accounts.

Accounts receivable whose maturity is after 12 months as from the date of the statement of financial position are initially recognized at fair value and subsequently at their amortized cost using the effective interest rate method. Impairment of trade accounts receivable is determined when there is objective evidence that the Company will not collect all the amounts overdue according to terms originally established.

#### **C. Financial assets**

##### ***Classification***

The Company classifies its financial assets in the following categories: financial assets at fair value through profit or loss, held-to-maturity-financial assets, loans and receivables and available-for-sale financial assets. The classification depends on the purpose for which financial assets were acquired. Management determines the classification of its financial assets at initial recognition date. As of December 31, 2016 and 2015, the Company only holds financial assets in the loans and receivables category.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities exceeding 12 months from the date of the statement of financial position. The latter are classified as non-current assets. Loans and receivables are included in trade accounts receivable, other accounts receivable, and cash in the statement of financial position.

##### ***Recognition and measurement***

The Company initially recognizes loans and receivables issued on the date when they are originated. All other financial assets and liabilities are initially recorded on the trading date when the Company assumes the contractual commitment.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards related to the ownership of the financial asset are transferred, or it neither transfers nor retains substantially all of the risks and rewards of ownership and does not retain control over the transferred asset. Any interest in assets that are derecognized which are retained by the Company are recognized as a separate asset or liability.

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**D. Financial liabilities**

***Classification, recognition and measurement***

Financial liabilities are classified as: i) financial liabilities at fair value through profit or loss, and ii) other financial liabilities. Management determines the classification of its financial liabilities at initial recognition date.

The Company's financial liabilities include other financial liabilities, trade accounts payable and other accounts payable.

All financial liabilities are initially recognized at fair value and subsequently, they are valued at amortized cost using the effective interest rate method. Amortized costs include costs directly attributable to the transaction.

**E. Offsetting of financial instruments**

Financial assets and liabilities are offset and the net amount is presented in the statement of financial position provided that there is the legally enforceable right to compensate recognized amounts, and there is the intention of paying them on a net basis or negotiating the asset, and paying the liability simultaneously.

**F. Impairment of financial assets**

The Company evaluates at the end of each period whether there is objective evidence of the impairment of a financial asset or group of financial assets. A financial asset or group of financial assets is impaired, if and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset ("loss event"), and if such loss event (or events) had an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be estimated reliably.

The evidence of impairment can be an indication that debtors or a group of debtors are experiencing significant financial difficulties, defaults or delays in payments of interest or principal, probability to enter bankruptcy or other financial reorganization and when the observable data indicate that there is a significant decrease in estimated future cash flows such as changes in delays or economic conditions that are correlated to unpaid accounts.

Impairment losses of loans and receivables are measured as the difference between the asset carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest. The carrying amount of the asset is reduced and losses are recognized in the statement of profit or loss and other comprehensive income.

If, in a further period, the impairment loss decreases and such decrease is objectively related to an event occurred after its recognition, the reversal of the previously recognized impairment loss is recognized in the statement of profit or loss and other comprehensive income.

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**G. Inventories**

Inventories are valued at the lower of cost or net realizable value. The cost includes costs of direct materials, and in this case, direct labor costs, general manufacturing costs (based on the standard production capacity) and costs incurred in the transfer of inventories to its location and current conditions excluding financing costs and exchange differences. Costs of crude oil and by-products are determined using the first-in and first-out method. Refined products in transit and finished products are determined at average production cost. Materials and supplies, at average acquisition cost. Inventories in transit, at specific acquisition cost.

The estimation for impairment of inventories of refined products in transit, finished products and acquired by-products is directly applied to the inventory value charged to the cost of sales, reducing the carrying amount of inventories at net realizable value in the same period.

In the case of supplies, Management makes annually the estimation for obsolescence based on a technical study or taking as basis the items without activity for more than two years, recognizing such inventory write-down as charge to profit or loss in the corresponding period.

**H. Investment in associate**

Associates are all entities on which the Company has the ability to exercise significant influence but not control. Investment in associates are accounted for by the equity participation method through which investment is initially recognized at cost and subsequently increases or decreases to recognize the Company's shareholding in profit or losses obtained by the associate after the acquisition date.

The Company's equity in profits or losses after the acquisition of associates is recognized in the statement of profit or loss and other comprehensive income and its shareholding in other comprehensive income of associates that arise after its acquisition, is recognized in the same manner as other comprehensive income through an adjustment to the investment cost. When the equity of the Company's share in the losses of an associate is equal or exceeds the amount of participation on it plus any non-guaranteed account receivable, the Company does not recognize losses over the investment amount unless it is legally or implicitly bounded or payments are made on behalf of the associate.

As of the date of each statement of financial position, the Company determines if there is objective evidence of impairment in investment in associates. If it were the case, the Company calculates the impairment loss that corresponds to the net difference between the recoverable value of investment in associate and its carrying amount. If the carrying amount is higher than the recoverable value of investment, the difference is recognized in the statement of profit or loss and other comprehensive income in line profit (loss)/sharing of associates.

**I. Investment in joint venture**

Investments in joint venture are recorded under the equity method.

The agreements in which the Company and one or more parties have joint control on relevant activities are joint arrangements. They are classified as joint operations or joint venture depending on the contractual rights and obligations of each investor. The Company has evaluated the joint arrangements nature and has determined that it has a joint venture.

The joint ventures are recorded under the equity method. Under this method, the investment is initially recognized at cost and the carrying amount is increased or decreased to recognize the Company's interest in profit or loss and other movements after the acquisition in other comprehensive income. This investment dividends are recognized in the Company's financial

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statements when the right to receive such dividends is established. Dividends are recorded as a reduction of the carrying amount of the investment. As of December 31, 2016, the operations of the joint venture are in initial stage; therefore, no allocation to profit or loss is recorded.

**J. Property, plant and equipment**

***General***

Property, plant, and equipment items are recorded at cost less their accumulated depreciation, and if applicable, accumulated impairment losses. The cost of an item of property, plant and equipment comprises its purchase price or manufacturing costs, including non-reimbursable customs fees and purchase taxes as well as any other necessary cost, the initial estimate of the obligation of decommissioning an asset, and in the case of qualifying assets, the financing costs. The purchase price or the cost of construction correspond to the total amount paid and the fair value of any other compensation delivered in the asset acquisition. Property, plant and equipment items are recognized at relevant component level.

Expenses incurred to replace a component of an item of property, plant and equipment are capitalized as a separate component and the carrying amount of the replaced component is written off. In the case that the replaced component has not been considered as a separate component of assets, the replacement value of the new component is used to estimate the carrying amount of replaced assets.

Incremental costs attributable to fixed assets are capitalized provided that it is probable that future economic benefits embodied within the asset will flow to the Company, and the cost of the assets can be measured reliably, otherwise are charged to costs of production or to expenses, as appropriate.

Assets under construction are capitalized, together with interest on qualifying assets, as a separate component. At the end of the construction, the cost of these assets are transferred to a definitive category: Assets under construction shown in the works-in-progress account are not subject to depreciation until they are transferred to a definitive account.

Property, plant and equipment items are derecognized when they are sold or when no future economic benefits are expected from its use or subsequent sale.

Gains and losses for sale of assets correspond to the difference between the income from the transaction and the asset book value. They are recognized in the statement of profit or loss and other comprehensive income.

The residual value and the useful life of an asset and applied depreciation methods are reviewed and adjusted, as needed, at each date of statement of financial position. Any change in these estimates are prospectively adjusted.

***Routine maintenance and higher maintenance***

Routine maintenance and repair expenses are charged to production costs or expenses, as appropriate, in the period when they are incurred.

The higher maintenance of fixed assets corresponds to the one that will be made every few years in order to maintain the operating capacity of assets in accordance with technical specifications of the asset's provider. The higher maintenance of assets comprises the replacement cost of relevant spare parts and reconditioning costs. The estimation of the higher maintenance cost of assets is capitalized at the initial recognition date as a separate component and is depreciated in the estimated time when it will be required to make the following maintenance of this type.

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**Depreciation**

Land is not depreciated. Annual depreciation is recognized as expenses and is calculated using the straight-line method based on estimated useful life of assets as follows:

	<b>Average Years</b>
Buildings and constructions	25
Plant and equipment	12
Storage tanks	20
Various equipment	10
Furniture and fixture	5
IT equipment	3
Vehicles	5

The carrying amount of an asset is written off immediately at its recoverable amount when the carrying amount of the asset exceeds its recoverable value.

**Hydrocarbon exploration activities**

Exploration costs such as seismic studies and exploratory wells drilling are capitalized until the technical and commercial viability for extracting resources from the corresponding Block are demonstrated.

If it is estimated that exploration and evaluation of resources will not be successful, such assets will be allocated to profit or loss, recognizing an impairment loss in the statement of profit or loss and other comprehensive income. In case feasible reserves are identified, assets for exploration and evaluation shall be reclassified from such category to development costs (wells), after evaluating their recoverability. No depreciation is recognized during the exploration and evaluation stage.

If there are facts and circumstances indicating a possible impairment of assets of exploration and evaluation of resources, their recoverability is evaluated grouping them into the smallest levels for which identifiable cash flows are generated (cash-generating units) based on considerations that include geographical areas with similar geological characteristics, the common use of facilities and contractual agreements. Such facts and circumstances include the evaluation of seismic data, requirements for relinquishment of areas, drilling results, remaining time for fulfillment of the terms of exploration commitments, remaining plans of capital investments and political, economic and market conditions.

**Hydrocarbon development activities**

Costs associated to development activities corresponding to disbursements made in the drilling and completion of wells in-progress, are capitalized as part of property, plant and equipment, and amortized from the beginning of the commercial activity of related projects.

**K. Intangible assets**

**Software License**

Acquired software licenses are capitalized based on the costs incurred to acquire or implement a specific computing software. They are amortized over an estimated useful life (between 3 and 10 years).

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***Computer software internally generated***

Costs related to the maintenance of software are recognized as expenses when incurred. Development costs that are directly attributable to the design and testing of identifiable and single computer software controlled by the Company are recognized as intangible assets when the following criteria are met:

- It is technically feasible to complete the software in a manner that can be used;
- Management has the intention to terminate the computer software, use or sell it;
- There is the capacity to use or sell the computer software;
- It is possible to demonstrate that the computer software will probably generate future economic benefits;
- There are the technical and financial resources, as well as other necessary resources to complete the development of the computer software allowing its use or sale; the expense attributable to the computer software during its development can be reliably measured.

Direct costs that are capitalized as part of the cost of computer software include costs of employees that develop the computer software and a portion of corresponding indirect costs.

Other development costs that do not comply with certain criteria are recognized in the statement of profit or loss and other comprehensive income to the extent they are incurred and are not recognized as an asset in subsequent periods.

Costs incurred in the development of computer software recognized as assets are amortized during their estimated useful lives (between 3 and 5 years).

**L. Indebtedness costs**

General and specific costs that are directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that take considerable time to be ready for sale or expected use are attributed to cost of these assets. The capitalization begins when necessary activities are being carried out to prepare the qualifying asset for its expected use and disbursements and finance costs are being incurred and it concludes when the asset qualifies for its expected use.

Income from the temporary investment of funds received as loans are deducted from capitalized indebtedness costs.

Other indebtedness costs are recognized in the results of the period in which they are incurred.

**M. Impairment of non-financial assets of long-useful life**

The Company conducts an assessment of impairment in conformity with IAS 36 Impairment of Assets; therefore, the Company annually assesses the net carrying amount of long-lived tangible and intangible assets to determine if there is an impairment loss of such assets. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs. Common assets are also distributed to individual cash-generating unit, otherwise, the smallest cash generating units to which a consistent and reasonable basis has been identified, provided that a consistent and reasonable distribution basis is identified.

The recoverable amount is the higher amount between its value in use and market value less direct sale costs. Value in use corresponds to the present value of the estimated discounted cash flows at its current value, using a pre-tax discount rate that reflects current market conditions and specific risks of each asset or CGU.

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Impairment losses, calculated with reference to the value in use of assets that have been recognized in previous years, are reversed only if there is a change in the estimates used since the last time the impairment loss was recognized.

Impairment losses of assets related to continuing operations are recognized in the statement of profit or loss and other comprehensive income within the expenses category to which the impaired asset belongs.

On the other hand, the Company evaluates annually whether there is an indication that impairment losses previously recognized have been partially or fully reversed.

If any such indication exists, the Company estimates the asset's recoverable amount whose carrying amount was previously reduced due to impairment. Previously recognized impairment losses are reversed only if the increase in the recoverable value of the asset resulted from changes in the estimates used when the impairment loss was recognized. In these circumstances, the carrying amount of the asset is increased to its recoverable value. The recognition of an impairment reversal previously recorded cannot result in an asset carrying amount greater than the amount that would have corresponded to that asset, net from depreciation, should the impairment loss previously recorded had not been recognized. The reversal of the impairment loss is recognized in the statement of profit or loss and other comprehensive income.

**N. Leases**

The Company is the lessor in operating leases.

Properties under operating leases are included in Property, Plant and Equipment item in the statement of financial position. Leasing contracts is considered as operating if significant portion of the risks and rewards of ownership are owned by the lessor. Lease payments are recognized in the statement of profit or loss and other comprehensive income on a straight-line basis over the leasing period.

**O. Financial obligations**

Loans are classified based on contractual agreements signed and considering the economic substance of the agreement.

Loans held by the Company are initially recognized at their fair value, net of the costs incurred in the transaction. These obligations are subsequently recorded at their amortized cost, and any resulting difference between the funds received (net of transaction costs) and the redemption value is recognized in the statement of profit or loss and other comprehensive income over the period of the loan using the effective interest rate method.

Incurred commissions to obtain loans are recognized as transaction costs to the extent that it is probable that a part or the whole loan will be received. In this case, commissions are deferred until the loan is received. To the extent that there is no evidence that it is probable that a part or all the loan is received, commissions are capitalized as payments for services to obtain liquidity and are amortized in the period of the credit line to which it relates.

Loans are classified as current liability unless the Company has the unconditional right to differ settlement of the liability for at least twelve months as of the date of the statement of financial position.

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**P. Trade accounts payable**

Trade accounts payable are payment obligations for goods or services acquired from providers in the ordinary course of business. Accounts payable are classified as current liabilities when shall be paid within one year. On the contrary, they are presented as non-current liabilities. Accounts payable are initially recognized at their fair value and, since its discount effect is irrelevant, and they are subsequently valued at face value.

**Q. Employee benefits**

***Profit sharing and bonuses***

The Company recognizes a liability and an expense for legal gratifications and workers' profit sharing based on current legal requirements. Legal gratifications correspond to two remunerations that are paid in July and December annually. Workers' profit sharing is equivalent to 10% of taxable income determined according to the income tax legislation.

***Severance indemnities***

Severance indemnities of the personnel corresponds to indemnities for a current remuneration in force as of the date of deposit. According to current legislation, severance payment shall be deposited in May and November annually in bank accounts designated by employees. The Company has no obligation to make any additional payments once it has made the annual deposits of funds.

***Pension plans***

The Company operates a pension scheme that benefits its retired personnel. This pension plan is governed by the standards of the Pension System by Decree Law 20530. In conformity with IAS 19 Employee Benefits, the provision for retirement pensions plans represents a Government Plan of Defined Benefits, in which the company's obligations consists on supplying benefits agreed by Decree Law 20530 and complementary standards. These benefits correspond, exclusively, to former employees that acquired the right of a pension when completing the actual and remunerated service to be part of this pension system. This benefit does not reach current workers whose pension plans depend mainly on the Peruvian Private Pension System.

The Government Defined Benefit Plan establishes an amount of benefits that will be received by former workers (pensioners) that complied with one or more requirements to be considered beneficiaries of the plan. Among these requirements are the actual and paid services to be part of this retirement plan (15 years for men and 12 years and six months for women). A total of 21 former employees (pensioners) are the current beneficiaries of the plan.

The liability recognized in the statement of financial position corresponds to the present value of the defined benefit obligation at the closing of the period less fair value of pension plan assets together with the adjustments for cost of services received in the past that were not recognized. The defined benefit obligation is calculated annually by independent actuaries using the forecasted credit unit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using technical interest rates authorized by Oficina Nacional Previsional- ONP.

Law 30372 Law for Public Sector Budget for Fiscal Year 2016 in Article 64 of the Final Complementary Provisions indicates that from the effectiveness of such law, the National Pension Office (ONP) will be responsible for the administration and payment of pensions under Decree Law 20530 and its complementary rules and amendments thereto, corresponding to pensioners of PETROPERÚ S.A. and contingencies arising from the administration and payment. For payment of pensions, the ONP shall refer to the amount of pensions paid in the last month prior to the effective date of this law. It also indicates that by means of Supreme Decree countersigned by the Ministry of Economy and Finance, complementary rules that are necessary for the best application of the provision will be issued.



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Article 1 of Supreme Decree 003-2016-EF, issued on January 19, 2016, authorizes the transfer of public sector allocations for Fiscal Year 2016, for up to the amount of S/ 59.5 million in favor of the folio 095: National Pension Office (ONP), to finance the payment of pensions of the Decree Law 20530 of PETROPERÚ S.A., as indicated in the standard.

Actuarial gains and losses arising from the experience of adjustments and changes on the actuarial assumptions are charged or credited to profit or loss in the period when they are originated. In accordance with IAS 19 *Employee Benefits*, the actuarial risk is assumed by the Company and supported by its assets and operations.

**R. Provisions, contingent liabilities and contingent assets**

***General***

Provisions are recognized when, as a result of a past event, the Company has a present legal or constructive obligation, and it is probable that an outflow of resources embodying economic benefit will be required to settle the obligation, and the amount of the obligation can be reliably estimated. If the time value of money is significant, provisions are discounted using a pre-tax rate that reflects, when appropriate, specific risks of liabilities. The accrual of the discount for the passage of time arises from the increase in the obligation with charge to 'financial expense' of the statement of income and other comprehensive income (note 16).

A contingent liability is: (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognized because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or; ii) the amount of the obligation cannot be measured with sufficient reliability. Contingent liabilities do not result in provisions, but rather are disclosed unless the possibility of any outflow in settlements is remote.

Contingent assets are not recognized and are disclosed only if it is probable that the Company will generate economic benefits in the future.

***Provision for environmental improvement and plugging of wells***

The obligation for environmental improvement and plugging of wells arises from the operating unit transferred by the Peruvian Government to the private sector and a specific legal obligation, respectively. The Peruvian Government through the Company, assumed responsibility for covering these obligations. The Peruvian Government will reimburse the Company for the disbursements it may incur to satisfy these obligations. The obligation assumed by the Peruvian Government was recognized with charge to the results as of December 31, 2001. The provided amount as of that date is updated at the closing of each year.

On the other hand, the Company recognizes a provision for restoring the environment and for plugging of wells which constitute its legal obligation to restore the environment at each year-end. At the date of the initial recognition of the liability that arises from this obligation, measured at its fair value and discounted to its present value, the same amount is simultaneously debited to the property, plant and equipment account in the statement of financial position. Subsequently, liability is increased in each period to reflect the financial cost considered in the initial discount measurement, and in addition, the capitalized cost is depreciated over useful life of related asset. The Company will recognize any resulting gain or loss upon provision settlement. Changes in the estimated fair value of the initial obligation and interest rates are recognized as an increase or decrease in the carrying amount of the obligation and the related asset, following the criteria of IAS 16 Property, plant and equipment.

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Any reduction in this provision, and therefore, any reduction in the related assets which exceeds the carrying amount of the asset, will be immediately recognized in the statement of profit or loss and other comprehensive income.

If the review of the obligation resulted in the need to increase the provision, and as a result, the carrying amount of the related asset also increases, the Company takes into account whether this increase corresponds to an indication that the asset has become impaired and if so, impairment tests required by IAS 36 *Impairment of Assets* are carried out.

**S. Income tax**

***Current tax***

The current tax, asset and liability, is measured as the amount expected to be recovered or paid to the tax authorities. Income tax is calculated based on the Company's financial information.

***Deferred tax***

Deferred tax is determined using the liability method based on temporary differences derived from tax base of assets and liabilities, and their balances in financial statements, applying current legislation and tax rates that are expected to be applied when the deferred tax asset is realized or the deferred tax liability is settled.

Deferred tax asset and liability are recognized without considering the estimated time when the temporary differences will disappear. Deferred tax asset is only recognized so far as it is probable that there will be future tax benefits, so that the asset can be used.

**T. Issued capital**

Incremental costs directly attributable to the issue of ordinary shares are presented in equity as a deduction, net of taxes from amounts received.

**U. Revenue recognition**

Revenues are recognized at fair value of the consideration received or receivable and represents amounts receivable for the sale of assets, net of discounts and recovery of sale taxes. The Company recognizes revenues when the amount can be reliably measured, all the risks and rewards of ownership are transferred, it is probable that future economic benefits will flow to the Company, and the transaction meets with specific criteria per type of Company's activities as described below. The amount of revenues cannot be reliably measured if all contingencies related to the sale are not resolved.

***Sale of products and services***

Revenues from sale of refined products are recognized when they are delivered which corresponds to the moment when risks and rewards inherent to the ownership of goods have been transferred. Revenue from services is recognized when service is rendered.

***Interest***

Interest income is recognized on a time proportion basis, using the effective interest method.

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**V. Dividend distribution**

Dividend distribution is recognized as liability in the statement of financial position in the period when dividends are approved by General Stockholders' Meeting. Dividends policy is defined in the Bylaws in accordance with Securities Market standards.

**W. Significant non-operating items**

These items are disclosed separately in the financial statements when they are necessary to provide a better information on the Company's performance. They correspond to significant items of income or expenses that are shown separately due to the significance or nature of the amount.

**X. Foreign currency translation**

Foreign currency transactions are translated into functional currency using exchange rates ruling at the dates of the transactions or the valuation dates when items are redeemed. Gains or losses on exchange difference resulting from payment of such transactions and from the translation at exchange rates at the closing of the period of monetary assets and liabilities stated in foreign currency are recognized in the statement of profit or loss and other comprehensive income, except when they are deferred as other comprehensive income in transactions that qualify as cash flow hedges and net investment hedges.

Exchange gains and losses related to loans, cash and other monetary accounts are presented in the statement of profit or loss and other comprehensive income in the "Exchange Difference, net".

**Y. New accounting pronouncements not yet adopted**

The next table includes the new pronouncements issued until August 1, 2016 applicable to the Company, which were considered in the preparation of the financial statements under IFRS for annual periods beginning on January 1, 2016, as well as the forthcoming standards applicable to annual periods beginning on January 1, 2017.

***New standards effective from January 1, 2016***

<b>Effective date:</b>	<b>New standards or amendments</b>
January 1, 2016	<ul style="list-style-type: none"><li>▪ IFRS 14 <i>Regulatory Deferral Accounts</i></li><li>▪ <i>Accounting for Acquisitions of Interests in Joint Operations</i> (Amendments to IFRS 11)</li><li>▪ <i>Clarification of Acceptable Methods of Depreciation and Amortization</i> (Amendments to IAS 16 and IAS 38)</li><li>▪ <i>Equity Method in Separate Financial Statements</i> (Amendment to IAS 27)</li><li>▪ Annual Improvements to IFRSs 2012–2014 Cycle</li><li>▪ <i>Investment Entities: Applying the Consolidation Exception</i> (Amendments to IFRS 10, IFRS 12 and IAS 28)</li><li>▪ <i>Disclosure Initiative</i> (amendments to IAS 1)</li></ul>

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**Forthcoming requirements**

<b>Effective date:</b>	<b>New standards or amendments</b>
January 1, 2017	<ul style="list-style-type: none"><li>▪ <i>Disclosure Initiative</i> (amendments to IAS 7)</li><li>▪ <i>Income Taxes - Recognition of deferred tax assets for unrealized losses</i> (amendments to IAS 12)</li></ul>
January 1, 2018	<ul style="list-style-type: none"><li>▪ <i>IFRS 15 Revenue from Contracts with Customers</i></li><li>▪ <i>IFRS 9 Financial Instruments.</i></li><li>▪ <i>Classification and measurement of share-based payment transactions</i> (amendments to IFRS 2)</li></ul>
January 1, 2019	<ul style="list-style-type: none"><li>▪ <i>IFRS 16 Leases</i></li></ul>

The Company's management is evaluating the impact, if any, of the adoption of these amendments and new International Financial Reporting Standards (IFRS) issued but not yet effective as of the date of the financial statements

**4. Financial Risk Management**

Management has overall responsibility for the establishment and oversight of the Company's risk management structure. Finance Corporate Management is in charge of risk management. Management identifies, evaluates, and manages the financial risks.

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

The Company, through its management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Company has exposure to the following risks related to its use of financial instruments.

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**A. Exchange rate risk**

The Company's activities expose it to exchange rate fluctuation risk concerning the U.S. dollar, which mainly arise from its business activities. The Company has decided to assume this risk and uses derivative financial instruments to mitigate it (note 4.I)

Balance in foreign currency as of December 31, are summarized as follows:

<i>In thousands of</i>	2016			2015		
	US\$	EUR	JPY	US\$	EUR	JPY
Assets:						
Cash	33,646	-	-	5,789	-	-
Trade accounts receivable, net	19,327	-	-	139,565	-	-
Other accounts receivable, net	12,699	-	-	26,615	-	-
	<b>65,672</b>	-	-	<b>171,969</b>	-	-
Liabilities:						
Other financial liabilities	(841,774)	-	-	(500,000)	-	-
Trade accounts payable	(640,153)	(42,141)	(477,292)	(302,969)	(1,283)	-
Other accounts payable	(5,202)	-	-	(2,899)	-	-
Provisions and other liabilities	(25,829)	-	-	(29,086)	-	-
	<b>(1,512,958)</b>	<b>(42,141)</b>	<b>(477,292)</b>	<b>(836,393)</b>	<b>(1,283)</b>	-
<b>Net exposure</b>	<b>(1,447,286)</b>	<b>(42,141)</b>	<b>(477,292)</b>	<b>(664,424)</b>	<b>(1,283)</b>	-

The Company's monetary assets and liabilities stated in U.S. dollars have been translated into functional currency using the supply and demand exchange rates published by the Banking, Insurance and Pension Plan Agency (SBS). The following exchange rates were applied for each type of currency:

	Exchange rates ruling at period-end closing	
	2016	2015
US\$	3.360	3.413
EUR	3.601	3,811
JPY	0.031	0.028

The Company for the year ended December 31, 2016, recognized an exchange net gain for S/ 50,431 thousand (net loss amounting to S/ 178,455 thousand as of December 31, 2015) that is shown in the exchange difference, net item of the statement of profit or loss and other comprehensive income.

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**Sensitivity analysis**

A reasonably possible strengthening (weakening) in the sol, US\$, EUR and JPY against all other currencies as of December 31 would have affected the measurement of financial instruments denominated in a foreign currency and affected profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates remain constant, and ignores any impact of forecast sales and purchases.

<i>In thousands of soles</i>	<b>Movement of</b>	<b>Effects in profit or loss before tax</b>	
		<b>Strengthening</b>	<b>Weakening</b>
<b>December 31, 2016</b>			
US\$	10%	(547,030)	547,030
EUR	10%	(15,175)	15,175
JPY	10%	(1,480)	1,480
<b>December 31, 2015</b>			
US\$	10%	(226,768)	226,768
EUR	10%	(489)	489
JPY	10%	-	-

**B. Interest rate risk**

The Company does not maintain significant interest-bearing assets, its income and operating cash flows are substantially independent from changes in the market interest rates.

The Company's interest rate risk arises from its long-term debts. Variable rate debts expose the Company to the cash flow interest rate risk. Fixed-rate debts expose the Company to interest rate risk on fair value of liabilities. The Company's policy is to maintain all its loans in financial instruments accruing fixed rates. The Company's management considers that the risk of the fair value of interest rates is not significant because interest rates applied to its financing contracts do not differ significantly from market interest rates which are available to the Company for similar financial instruments.

As of December 31, 2016, the Company records an indebtedness with a variable rate, on a long term basis to partially finance the PMRT, which will be determined at the first quarter after the first disbursement based on the interest rate (LIBOR plus 1.75% during the two years, later LIBOR plus 2.00%).

**Exposure to interest rate risk**

The situation in the interest rate of the financial instruments as of December 31 is as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
<b>Fixed-rate instruments</b>		
Other financial liabilities (note 13)	5,191,692	2,214,068
<b>Variable-rate instruments</b>		
Other financial liabilities (note 13)	1,400,000	1,706,500

**Fair value sensitivity analysis for variable rate instruments**

A change in interest rates at the date of the statement of financial position would not have increased (decreased) the profit or loss for the year, because interest is capitalized as part of the cost of fixed assets.

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**C. Commodities risk (commodities)**

Selling prices are exposed to commercial risks resulting from the volatility of international prices. Prices billed by the Company are modified following the variations of international prices (note 1.C)

As explained in note 1.C local market prices are determined considering international prices of crude oil and by-products. Prices are stated in soles at current exchange rates, considering the legal standards that were issued on prior years according to the system established by the Fuel Price Stabilization Fund for which the Peruvian Government can make compensations or receive contributions to stabilize prices for end consumers. This mechanism mitigates the effect of changes in prices of some products that are not passed on to the end consumer. Note 8.A shows the net balance of compensations and contributions made by the Peruvian Government as of December 31, 2016 and 2015.

The Company seeks to enter into agreements with crude oil suppliers and manufacturers in the country that consider minimizing price risk exposure on a medium and long term basis through prices agreements related to reference basket of crude oil or price formula that consider expectations of international market margins. Likewise, when purchasing crude oil and imported products, the best quotations are obtained on the basis of international public tenders.

**D. Credit risk**

Credit risk concentration mostly relates to wholesale clients which are renowned and leading companies nationwide. Management has established policies aimed at assuring that the sale of goods is made to wholesale clients with appropriate credit background. These policies comprise, among other aspects, approval of credit lines for each client, continuous follow-up and monitoring procedures of the payment history. Concerning contracts signed with Government entities (Armed Forces and Peruvian Police), the Company provides a 45-day term for payment. The Company does not expect significant losses arising from the credit risk of their counterparties.

**E. Liquidity risks**

Prudent management of liquidity risk implies maintaining sufficient cash and the possibility to have financing available through an adequate number of credit sources; thus, maintaining reasonable cash levels and available credit lines.

As of December 31, 2016, the Company holds revolving credit lines granted by local and foreign banks for up to US\$ 1,709,024 thousand, of which US\$ 76,830 thousand are available at that date. This amount is enough to cover its purchase operations in the national territory and in foreign markets and other obligations related to working capital. These credit lines do not have neither requirements of maintenance costs nor collaterals.

Part of this line of credit has been used to finance the PMRT, which will be covered by the transfer received in January 2017 of S/ 1,056 million approved by Supreme Decree 005-2017-EF and the long-term financing expected to be issued during the first half of 2017.

Management administers liquidity risks ensuring to have enough credit lines and settling its capital work with cash flows of operating activities.

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The following are the Company's financial liabilities classified according to maturity and considering the remaining period to maturity:

<i>In thousands of soles</i>	<b>Carrying amount</b>	<b>Contractual cash flow</b>	<b>Less than one year</b>	<b>More than 1 year</b>	<b>More than 2 years</b>
<b>2016</b>					
Other financial liabilities	6,588,076	6,588,076	5,751,693	560,000	276,383
Trade accounts payable	2,427,912	2,427,912	2,427,912	-	-
Other accounts payable (*)	102,136	102,136	102,136	-	-
Provisions and other liabilities	407,968	407,968	388,979	8,670	10,319
	<b>9,526,092</b>	<b>9,526,092</b>	<b>8,670,720</b>	<b>568,670</b>	<b>286,702</b>
<b>2015</b>					
Other financial liabilities	3,920,568	3,920,568	2,498,485	568,833	853,250
Trade accounts payable	1,083,636	1,083,636	1,083,636	-	-
Other accounts payable (*)	52,949	52,949	52,949	-	-
Provisions and other liabilities	704,480	704,480	135,361	548,692	20,427
	<b>5,761,633</b>	<b>5,761,633</b>	<b>3,770,431</b>	<b>1,117,525</b>	<b>873,677</b>

(\*) Other accounts payable exclude tax liabilities, advances and labor liabilities.

The Company holds a syndicated loan that contains debt restrictions. A future failure to comply with the restriction may require that PETROPERÚ S.A. pay the borrowing before the dates above indicated (note 13).

**F. Capital risk management**

The Company's objectives in the administration of capital are to safeguard the Company's ability to continue as going concern in order to generate returns to its stockholders, benefits to stakeholders, and keep an optimal capital structure to reduce capital cost.

The Company monitors its capital based on the leverage ratio. This ratio is determined by dividing net debt by the total stockholders' equity. The net debt corresponds to the total indebtedness less cash and cash equivalents. Total capital corresponds to equity as shown in the statement of financial position.

The PETROPERÚ S.A.'s degree of investment was provided by the following risk rating agencies: Standard & Poor's (BBB- for long-term debt) and Fitch (BBB+ for long-term debt in foreign currency) and AA+ local rating provided by Apoyo & Asociados.



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As of December 31, leverage ratios were as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Other financial liabilities	6,588,076	3,920,568
Trade accounts payable	2,427,912	1,083,636
Other accounts payable	598,238	304,731
Provisions and other liabilities	407,968	704,480
Less: cash	(248,656)	(64,971)
<b>Net debt</b>	<b>9,773,538</b>	<b>5,948,444</b>
<b>Total equity</b>	<b>3,749,507</b>	<b>3,202,856</b>
<b>Leverage ratio</b>	<b>2.61</b>	<b>1.86</b>

The increase in the leverage ratio as of December 31, 2016 mainly arises from the increase in other current financial liabilities for the PMRT of S/ 2,074 million, an increase of S/ 904 million for working capital financing, trade accounts payable, which includes the debt with foreign suppliers of crude oil for S/ 380 million and the debt with the PMRT supplier, Técnicas Reunidas for S/ 737 million.

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**G. Accounting classifications and fair values**

The following table analyses the carrying amounts and fair values of financial assets and liabilities including their fair value hierarchy levels.

	Carrying amount			Fair value		
	Designated at fair value	Loans and items receivable	Other financial liabilities	Total	Level 2	Total
<i>In thousands of soles</i>						
December 31, 2016						
<b>Financial assets not measured at fair value:</b>						
Cash	-	248,656	-	248,656	-	-
Trade accounts receivable, net	-	894,175	-	894,175	-	-
Other accounts receivable, net (*)	-	827,398	-	827,398	-	-
	-	<b>1,970,229</b>	-	<b>1,970,229</b>	-	-
<b>Financial assets measured at fair value:</b>						
Other accounts receivable, net (*)	237	-	-	237	237	237
	<b>237</b>	-	-	<b>237</b>	<b>237</b>	<b>237</b>
<b>Financial liabilities not measured at fair value:</b>						
Other financial liabilities	-	-	6,588,076	6,588,076	-	-
Trade accounts payable	-	-	2,427,912	2,427,912	-	-
Other accounts payable (*)	-	-	102,136	102,136	-	-
Provisions and other liabilities	-	-	407,968	407,968	-	-
	-	-	<b>9,526,092</b>	<b>9,526,092</b>	-	-

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	Carrying amount			Total	Fair value	
	Designated at fair value	Loans and items receivable	Other financial liabilities		Level 2	Total
<i>In thousands of soles</i>						
December 31, 2015						
<b>Financial assets not measured at fair value:</b>						
Cash	-	64,971	-	64,971	-	-
Trade accounts receivable, net	-	798,529	-	798,529	-	-
Other accounts receivable, net (*)	-	786,680	-	786,680	-	-
	-	<b>1,650,180</b>	-	<b>1,650,180</b>	-	-
<b>Financial liabilities not measured at fair value:</b>						
Other financial liabilities	-	-	3,920,568	3,920,568	-	-
Trade accounts payable	-	-	1,083,636	1,083,636	-	-
Other accounts payable (*)	-	-	52,949	52,949	-	-
Provisions and other liabilities	-	-	704,480	704,480	-	-
	-	-	<b>5,761,633</b>	<b>5,761,633</b>	-	-

(\*) Excluding taxes, advances received and granted and all the labor liabilities.

The Company has not disclosed the fair values of financial instruments that have current maturity, because the carrying amount is a reasonable approximation of fair value.

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**H. Measurement of fair value**

**i. Valuation techniques and significant unobservable inputs**

The following table shows the valuations techniques used in the determination of fair values of financial instruments - Level 2 as well as the significant unobservable inputs used.

**Financial instruments measured at fair value**

Type	Valuation techniques	Significant unobservable inputs	Inter-relationship between key unobservable inputs and fair value measurement
Forward exchange contract	Standard valuation technique that uses the agreed exchange rate compared to the exchange rate in force at the settlement date, discounted at the measurement date.	None	None

**Financial instruments not measured at fair value**

Type	Valuation techniques	Significant unobservable inputs
Other financial liabilities	Discounted cash flows using market interest rate.	None

The fair value of current loans equals their carrying amounts; the impact of the discount is not significant. The fair values of other long-term financial liabilities are based on discounted cash flows using market rates.

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**I. Assets for derivative instruments**

As of December 31, 2016, this caption is composed of two forward exchange contract with Citibank del Perú S.A. and BBVA Banco Continental, recorded at fair value.

The detail is as follows:

	Original amount in thousands of	Maturity	Receives variable at	Fair value 2016	Cash flows to be settled			Fair value 2015	Cash flows to be settled		
					US\$	Total	Less than 1 year		More than 1 year	Total	Less than 1 year
<i>In thousands of soles</i>											
<b>Counterparty</b>											
Citibank del Perú S.A.	10,091	02/01/2017	3.3489	112	112	112	-	-	-	-	-
BBVA Banco Continental	20,608	27/07/2017	3.4470	125	125	125	-	-	-	-	-
				<b>237</b>	<b>237</b>	<b>237</b>	-	-	-	-	-
Less current portion					237	-	-	-	-	-	-
<b>Non-current portion</b>					-	-	-	-	-	-	-

For current derivatives, the Company monthly pays or receives (at each payment date of loan interest) the difference between the agreed exchange rate and the market exchange rate applicable on the settlement date. The flows effectively received or paid by the Company are recognized as gain or loss for the period. Changes in fair value of assets (liabilities) for derivative financial instruments are recognized by the Company affecting profit or loss.

The Company did not maintain contracts in force for derivative financial instruments as of December 31, 2015.

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**5. Segment Reporting**

The Company determined three operating segments: i) production and trading, ii) oil pipeline operations and iii) leased and privatized units.

Segment asset and liabilities information is summarized below:

<i>In thousands of soles</i>	<b>Production and trading (*)</b>	<b>Oil pipeline Operations</b>	<b>Leased and privatized units</b>	<b>Total</b>
As of December 31, 2016:				
Assets:				
Current	3,774,155	72,893	10,343	3,857,391
Non-current	9,065,702	579,691	531,115	10,176,508
<b>Total assets</b>	<b>12,839,857</b>	<b>652,584</b>	<b>541,458</b>	<b>14,033,899</b>
Liabilities:				
Current	8,681,301	454,542	30,979	9,166,822
Non-current	1,117,342	228	-	1,117,570
<b>Total liabilities</b>	<b>9,798,643</b>	<b>454,770</b>	<b>30,979</b>	<b>10,284,392</b>
As of December 31, 2015:				
Assets:				
Current	2,687,773	78,844	15,460	2,782,077
Non-current	5,398,974	624,401	590,879	6,614,254
<b>Total assets</b>	<b>8,086,747</b>	<b>703,245</b>	<b>606,339</b>	<b>9,396,331</b>
Liabilities:				
Current	3,894,026	128,178	9	4,022,213
Non-current	2,170,150	1,112	-	2,171,262
<b>Total liabilities</b>	<b>6,064,176</b>	<b>129,290</b>	<b>9</b>	<b>6,193,475</b>

(\*) it includes refineries, a gas station, commercial area and main office.

The following table provides property, plant and equipment information by operating segment:

<i>In thousands of soles</i>	<b>Cost</b>	<b>Accumulated depreciation</b>	<b>Impairment of assets</b>	<b>Provision for impairment of gratuitous loans</b>	<b>Net cost</b>
<b>Operating segments:</b>					
As of December 31, 2016:					
Production and trading	9,270,390	(971,702)	-	(898)	8,297,790
Oil pipeline operations	800,808	(229,668)	(145,592)	-	425,548
Leased and private units	856,822	(325,707)	-	-	531,115
	<b>10,928,020</b>	<b>(1,527,077)</b>	<b>(145,592)</b>	<b>(898)</b>	<b>9,254,453</b>
As of December 31, 2015:					
Production and trading	5,625,509	(889,530)	(20,656)	(898)	4,714,425
Oil pipeline operations	756,905	(207,664)	-	-	549,241
Leased and private units	858,752	(296,694)	-	-	562,058
	<b>7,241,166</b>	<b>(1,393,888)</b>	<b>(20,656)</b>	<b>(898)</b>	<b>5,825,724</b>

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Segment results information is summarized as follows:

<i>In thousands of soles</i>	<b>Production and trading (*)</b>	<b>Oil pipeline operations</b>	<b>Leased and private units</b>	<b>Total</b>
As of December 31, 2016:				
Income from ordinary activities	11,199,109	-	-	11,199,109
Other operating income	76,819	16,963	150,115	243,897
<b>Total gross income</b>	<b>11,275,928</b>	<b>16,963</b>	<b>150,115</b>	<b>11,443,006</b>
Cost of sales	(9,242,003)	(287,429)	-	(9,529,432)
Transfers	(6,325)	6,325	-	-
<b>Gross profit</b>	<b>2,027,600</b>	<b>(264,141)</b>	<b>150,115</b>	<b>1,913,574</b>
Selling and distribution expenses	(451,187)	-	(1,496)	(452,683)
Administrative expenses	(455,620)	(97,144)	(34,646)	(587,410)
Other income and expenses	90,858	(547,392)	(21,056)	(477,590)
<b>Operating gain</b>	<b>1,211,651</b>	<b>(908,677)</b>	<b>92,917</b>	<b>395,891</b>
Financing, net	1,645	(7,867)	1,477	(4,745)
<b>Profit before income tax</b>	<b>1,213,296</b>	<b>(916,544)</b>	<b>94,394</b>	<b>391,146</b>
Income tax	(361,092)	175,737	(28,300)	(213,655)
<b>Profit for the year</b>	<b>852,204</b>	<b>(740,807)</b>	<b>66,094</b>	<b>177,491</b>
As of December 31, 2015:				
Income from ordinary activities	11,543,095	-	-	11,543,095
Other operating income	42,541	185,573	134,846	362,960
<b>Total gross income</b>	<b>11,585,636</b>	<b>185,573</b>	<b>134,846</b>	<b>11,906,055</b>
Cost of sales	(9,733,099)	(151,064)	-	(9,884,163)
Transfers	(32,980)	32,980	-	-
<b>Gross profit</b>	<b>1,819,557</b>	<b>67,489</b>	<b>134,846</b>	<b>2,021,892</b>
Selling and distribution expenses	(408,061)	-	-	(408,061)
Administrative expenses	(454,195)	(88,707)	(29,301)	(572,203)
Other income and expenses	(103,444)	6,918	-	(96,526)
<b>Operating gain</b>	<b>853,857</b>	<b>(14,300)</b>	<b>105,545</b>	<b>945,102</b>
Financing, net	(233,061)	(7,466)	3,556	(236,971)
<b>Profit before income tax</b>	<b>620,796</b>	<b>(21,766)</b>	<b>109,101</b>	<b>708,131</b>
Income tax	(162,551)	(8,419)	(34,494)	(205,464)
<b>Profit for the year</b>	<b>458,245</b>	<b>(30,185)</b>	<b>74,607</b>	<b>502,667</b>

(\*) it includes refineries, a gas station, commercial area and main office.

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**6. Cash**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Checking accounts	248,540	64,880
Cash fund	116	91
	<b>248,656</b>	<b>64,971</b>

The Company holds cash deposited in financial institutions in checking accounts in local and foreign currency. The funds of these accounts have free withdrawal option and accrue preferred interest rates.

According to the information provided by Apoyo & Asociados Internacionales S.A.C., the quality of the financial institutions in which the Company deposits its cash is classified as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
A+	117,249	41,730
A	97,399	23,110
A-	33,892	32
A-	-	8
<b>Total</b>	<b>248,540</b>	<b>64,880</b>

**7. Trade Accounts Receivable, net**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Wholesaler	632,964	504,191
Peru's armed forces and national police	43,405	84,895
Fuel traders	62,172	53,202
Oil companies	25,923	50,019
Aviation business	14,411	27,659
Mining sector	41,291	25,663
Electric power sector	11,791	10,808
External market	31,652	2,114
Maritime business	4,324	9,846
Construction sector	3,397	7,935
Transport sector	7,260	7,062
Fishing sector	12,844	3,744
Industrial sector	1,453	2,204
Various clients	1,288	9,187
Doubtful accounts	20,373	21,497
	<b>914,548</b>	<b>820,026</b>
Less – allowance for doubtful accounts	20,373	21,497
	<b>894,175</b>	<b>798,529</b>

The balances of trade accounts receivable comprise invoices stated in soles and U.S. dollars, resulting primarily from the sale of refined products. Accounts receivable from Peru's armed forces and national police forces are payable within 45 days. Accounts receivable from wholesale suppliers and other clients are payable within 7 and 45 days. According to the Company's internal policies, accounts receivable shall be secured by letters of guarantee and other instruments from the Peruvian Financial System in compliance with the credit policy approved by the Board of Directors.



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The balance corresponding to accounts receivable from oil companies, includes S/ 14,547 thousand for transport services of hydrocarbons for the Section I and II of the Nor-Peruano Pipeline in conformity with contracts entered into the Company and PLUSPETROL, and Pacific Stratus Energy,

The aging analysis of these trade accounts receivable is as follows:

<i>In thousands of soles</i>	<b>2016</b>		<b>2015</b>	
	<b>Impaired</b>	<b>Not impaired</b>	<b>Impaired</b>	<b>Not impaired</b>
Current	-	847,531	-	664,663
1 to 90 days	-	31,550	-	80,653
91 to 360 days	-	12,099	-	50,296
More than 1 year	20,373	2,995	21,497	2,917
	<b>20,373</b>	<b>894,175</b>	<b>21,497</b>	<b>798,529</b>
Classification of debtors:				
Group 1	-	691	-	444
Group 2	-	147,439	-	105,174
Group 3	20,373	746,045	21,497	692,911
	<b>20,373</b>	<b>894,175</b>	<b>21,497</b>	<b>798,529</b>

- Group 1 – new clients (less than 6 months).
- Group 2 – existing clients (more than 6 months) with no defaults in the past.
- Group 3 – existing clients (more than 6 months) with some defaults in the past. All defaults were recovered.

Movement in the allowance for doubtful accounts is as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Opening balance	21,497	21,361
Bad debt expense (note 22)	665	515
Exchange difference	(41)	128
Recoveries and write-offs	(1,748)	(507)
	<b>20,373</b>	<b>21,497</b>

In opinion of Management, the allowance for doubtful accounts recognized in the financial statements and the requested guarantees are enough to cover any eventual risk in the collection of trade accounts receivable at the date of the statement of financial position.

Trade accounts receivable past due but not impaired relate to independent customers for whom there is no recent history of default.

The estimate for impairment of trade accounts receivable is included in 'administrative expenses' of the statement of income and other comprehensive income (note 22). The impairment charged to profit or loss for the year are generally written off when there are no expectations on recoverability of cash.

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**8. Other Accounts Receivable, Net**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Price stabilization fund - Ministry of Energy and Mines (note 1(c)) - (a)	81,675	-
Claims for Price Stabilization Fund - Ministry of Energy and Mines - (b)	58,026	58,026
Claims before Peruvian tax - (c)	595,333	595,333
Sales tax credit	481,443	83,984
Sales tax credit - long term (d)	195,000	-
Payment on account of income tax, credit balance	-	29,724
Claims to insurance - long term (e)	-	68,619
Claims to insurance	-	8,456
Claims to third parties	9,938	7,341
Loans to personnel	16,879	13,482
Advances to suppliers	25,581	821
Accounts receivable association – GeoPark	57,204	-
Various	25,459	48,905
Doubtful accounts	111,750	112,764
	<b>1,658,288</b>	<b>1,027,455</b>
Less, allowance for doubtful accounts (f)	(111,750)	(112,764)
	<b>1,546,538</b>	<b>914,691</b>
<b>Current portion</b>	<b>698,179</b>	<b>192,713</b>
<b>Non-current portion (b), (c), (d) and (e)</b>	<b>848,359</b>	<b>721,978</b>

**(a) Oil fuel price stabilization Fund - Ministry of Energy and Mines**

Movement in this balances is as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Opening balance	52,624	53,029
Price compensation (revenues)	224,911	336,488
Price contribution (expense)	(20,693)	(49,215)
<b>Net credited to revenues (note 19)</b>	<b>204,218</b>	<b>287,273</b>
Collection of compensation and/or contribution payments	(117,141)	(287,678)
<b>Final balance</b>	<b>139,701</b>	<b>52,624</b>

The amount receivable from the General Hydrocarbons Agency - DGH- as of December 31, 2016 and 2015, is S/ 139,701 thousand and S/ 52,624 thousand, respectively. As of December 31, 2016, this amount includes the proceeding regarding constitutional guarantees recorded in 'claims' for S/ 58,026 thousand and the amount receivable of S/ 81,675 thousand.

The balance receivable from the Ministry of Energy and Mines correspond to the compensation that the Company receives from the Fund for stabilization of fuel price, created by the Peruvian government pursuant to Emergency Decree 010-2004, regulations and amendments. In conformity with this regulation, the Peruvian government created a contingency fund to prevent the high volatility of hydrocarbon prices from being transferred to the end consumers.

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In accordance with these regulations, General Hydrocarbons Agency from the Ministry of Energy and Mines sets a price band for each fuel product that is traded in the country. Article 6 of Supreme Decree 133-2010-EF, dated June 23, 2010, states that the Supervisory Entity for Investment in Energy and Mining -OSINERGMIN- shall update and publish every two months, in the official gazette *El Peruano*, the price bands of each of the products on the last Thursday of the second month, beginning on the effective date of the latest price band update.

Weekly, OSINERGMIN shall publish a reference price for each fuel product traded in the country also known as import parity price (IPP). When the IPP is greater than the upper band limit, the resulting difference is the Compensation Factor and when the IPP is lower than the lower limit of the band, the difference is the Contribution Factor. The compensation is recorded as an account receivable and revenue from sales, while the contribution is recognized with a charge to revenue and a rebate of the account receivable.

**(b) Claims to the oil-fuel price stabilization fund of the Ministry of Energy and Mines**

In April 2010, the General Hydrocarbons Agency -DGH- issued Resolution 075-2010-EM/DG, ordering that producers and importers of fuel shall amend their weekly reports presented since August 2008 applying, on a retroactive basis, the reference values containing such Resolution.

The Company has filed a Constitutional Appeal with the second constitutional court in Lima amounting to S/ 58,026 thousand related to the application of this Directorial Resolution.

On March 25, 2014, PETROPERÚ S.A. received notification of the judgment of the lower court declaring the claim groundless. On May 12, 2014, the Legal Department appealed such judgment. To date, its evaluation by the corresponding Civil Court of the Lima Superior Court is pending. In response to the monitoring due to the delay in the transfer of the case to a higher court, the Court issued Resolution 9, dated November 25, 2014, notified on January 6, 2015, referring again the case to a higher court with the charges of the respective notifications.

As of December 31, 2016, this proceeding is still pending at the second constitutional court in Lima. The sentence issuance is pending.

Management considers that, based on the reports of its external legal advisors, once the court proceedings are completed, the outcome will be favorable to the Company and will enable it to recover the whole account receivable recorded.

**(c) Claims to Peruvian Tax Authorities -SUNAT**

As of December 31, 2016 and 2015, they mainly correspond to claims for S/ 575 million related to objections for Turbo A-1 fuel detailed below:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Expediente N° 02529-2011-2-1801-JR-CA-14 (i)	120,012	120,012
Expediente N° 6002-2011-0-1801-JR-CA-17 (ii)	170,009	170,009
Expediente N° 07873-2012-0-1801-JR-CA-13 (iii)	192,902	192,902
Expediente N° 00114-2012-1801-JR-CA-07 (iv)	59,433	59,433
Expediente N° 03490-2012-0-1801-JR-CA-08 (v)	2,627	2,627
Expediente 17806-2012 (vi)	30,669	30,669
	<b>575,652</b>	<b>575,652</b>

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- i) In April 2011, Tax Authorities conducted a preventive seizure of S/ 120 million on the grounds of taxes allegedly unpaid (excise tax) by the Company on the import of A-1 Turbo fuel in 2003. The case was resolved on appeal by Resolution 37, dated October 14, 2015, issued by the Sixth Court for Administrative Disputes specialized in tax and customs issues of Superior Court of Lima, that revoked Resolution 26, dated August 8, 2014, which declared groundless the claim filed by PETROPERU S.A. In this regard, the aforementioned Sixth Court supported the claim filed by the Company with respect to the objections made concerning excise tax exemption for the Turbo A-1 aircraft fuel import in 2003. To date, the case has been appealed for reversal to the Constitutional and Social Law Chamber of the Supreme Court of Justice, in response to the appeals filed by SUNAT and the Ministry of Economy and Finance dated November 3, 2015 under the File 00397-2016. Internal qualification of this file was scheduled for August 2, 2016.
- ii) Additionally, in November 2011, the Company received Resolution for collection 011-006-0042559 for S/ 65 million; management decided to pay such taxes on an installment plan basis, to avoid any other future seizures. In 2012, the Company settled all the installments of the payment plan of S/ 71.6 million (including the tax and interest). By means of Resolution 29, dated June 24, 2015, the Seventh Court for Administrative Disputes of the Superior Court of Justice of Lima, specialized in tax and custom issues, declared grounded the claim in relation to the excise tax exemption for the sales of Turbo A-1 aircraft fuel during 2003 and 2006. On November 24, 2016, the Constitutional and Social Law Chamber of the Supreme Court of Justice declared groundless the appeal filed by Ministry of Economy and Finance and the Tax Administration and, consequently, Resolution 29, dated June 24, 2015 was not appealed.
- iii) In February 2013, the Company paid S/ 180.7 million for excise tax and penalties for year 2004; in July 2013, it paid S/ 12.1 million corresponding to the excise tax of October 2004, for related resolutions for collections issued by SUNAT. By means of Resolution 38, dated December 24, 2015, issued by the Sixth Court for Administrative Disputes of the Superior Court of Justice of Lima, confirmed Judgment 19, which partially declared grounded the claim filed by the Company against Tax Court Resolution 08636-1-2012 and confirming the objections concerning excise tax exemption for the sale of A-1 Turbo aircraft fuel in 2004. To date, the case has been appealed for reversal to the Constitutional and Social Law Chamber of the Supreme Court of Justice, in response to the appeals filed by SUNAT and the Ministry of Economy and Finance under the File 03644-2016. The appeal was qualified as applicable by Resolution dated August 29, 2016. The file is in the Public Prosecutor's Office for Administrative Disputes for the corresponding opinion.
- iv) In July and August 2013, the Company paid a total amount of S/ 59.4 million for sales tax and excise tax for year 2005. By means of Resolution 29, dated December 17, 2015, issued by the Sixth Court for Administrative Disputes of the Superior Court of Justice of Lima, revoked Resolution 15, dated December 19, 2014, which declared groundless the claim filed by the Company against Tax Court Resolution 15320-3-2011 and confirming the objections concerning excise tax exemption for the sale of A-1 Turbo aircraft fuel in 2005. To date, the case has been appealed for reversal to the Constitutional and Social Law Chamber of the Supreme Court of Justice, in response to the appeals filed by SUNAT and the Ministry of Economy and Finance under the File 03791-2016. The appeal was qualified as applicable by Resolution dated August 29, 2016.

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- v) In February 2013, the Company paid the amount of S/ 2.6 million for the objections made in relation to alleged omitted payments of the excise tax for year 2002. By means of Resolution 31, dated August 27, 2015, issued by the Sixth Court for Administrative Disputes of the Superior Court of Justice of Lima, revoked Resolution 19, dated September 29, 2014, which declared groundless the claim filed by the Company against Tax Court Resolution 21910-4-2011 and confirming the objections concerning excise tax exemption for the sale of A-1 Turbo aircraft fuel in 2002. To date, the case has been appealed for reversal to the Constitutional and Social Law Chamber of the Supreme Court of Justice, in response to the appeals filed by SUNAT and the Ministry of Economy and Finance dated September 17, 2015, under the File 17984-2016. Internal qualification of this file was scheduled for July 11, 2016.
- vi) In November 2012, the Company paid the amount of S/ 29,2 million concerning various tax Assessment and Fine Resolutions issued for alleged omitted payments of excise tax and sales tax for year 2007. As of December 31, 2016, the proceeding is pending resolution in the room 4 of the Tax Court, under the File 17806-2012.

Management considers that taking into account the favorable result to the Company in File 6002-11 (court proceeding described in b), a similar criterion would be established when the remaining files concerning excise tax exemption for the sale of Turbo A-1 aircraft fuel are solved.

In conclusion, the Company believes that pending outcomes by Supreme Court of Justice concerning proceedings for Turbo A-1 will be favorable, since the company has the aforementioned antecedent, the same one that has confirmed our sound fundamentals regarding the unconstitutionality of the regulation that created the tax levied on the sale of Turbo A-1 fuel.

**(d) Sales tax credit, long-term**

It corresponds to the balance in favor of such tax, paid for the acquisition of goods and services related mainly to the Talara Refinery Modernization Project. The Company expects to recover most of this amount in the short term.

**(e) Claims to insurance**

As of December 31, 2015, they mainly correspond to disbursements made by the Company for claims incurred in KM 41+833 and KM 20+190 of the Nor-Peruano Oil Pipeline for S/ 44,292 thousand and S/ 24,327 thousand, respectively.

As of December 31, 2016, this amount was transferred to other expenses, because the recovery procedures before the insurance company are still in the evaluation and analysis stage.

**(f) Movement of the allowance for doubtful accounts**

The movement of allowance for doubtful accounts is as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Opening balance	112,764	92,295
Bad debt expense (note 22)	2,087	12,303
Exchange difference	(1,201)	8,166
Recoveries and write-offs	(1,900)	-
	<b>111,750</b>	<b>112,764</b>

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Aging analysis of other accounts receivable is as follows:

<i>In thousands of soles</i>	<b>2016</b>		<b>2015</b>	
	<b>Impaired</b>	<b>Not impaired</b>	<b>Impaired</b>	<b>Not impaired</b>
Current	-	781,132	-	161,969
1 to 90 days	-	75,714	-	19,408
91 to 360 days	-	27,562	-	71,503
More than 1 year	111,750	662,130	112,764	661,811
	<b>111,750</b>	<b>1,546,538</b>	<b>112,764</b>	<b>914,691</b>

**9. Inventories**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Crude oil	311,142	314,836
Refined products:		
Finished	546,956	405,599
In-process	545,494	433,655
Acquired refined products	193,687	152,308
	<b>1,597,279</b>	<b>1,306,398</b>
In-transit inventories	343,052	342,860
Supplies	66,298	63,874
	<b>2,006,629</b>	<b>1,713,132</b>
Less - allowance for impairment of supplies	(5,062)	(5,410)
	<b>2,001,567</b>	<b>1,707,722</b>

As of December 31, 2016, crude oil prices had an upward trend, closing its price at US\$ 53.72 per barrel (2015: US\$ 37.58 per barrel). The average price for the month of December 2016 was US\$ 52.03 per barrel (December 31, 2015: US\$ 52.03 per barrel).

The movement of the allowance for impairment of supplies was as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Opening balance	(5,410)	(6,358)
Write-down charges to results (note 25)	(3,637)	(3,985)
Recoveries	3,985	4,933
	<b>(5,062)</b>	<b>(5,410)</b>

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**10. Investments in Associates**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
GNC Energía del Perú S.A. (a)	7,213	7,213
Estimate for investment impairment	(6,986)	-
Joint venture – GeoPark (b)	19,067	-
	<b>19,294</b>	<b>7,213</b>

a) By means of public deed dated September 28, 2007, GNC Energía Perú S.A. was incorporated with a capital stock of S/ 1,200,000 represented by 1,200,000 shares with a par value of S/ 1.00 each, fully subscribed and paid by the following stockholders:

- Virtual Gasnet Internacional S.A. owns 612,000 shares (51%).
- PETROPERÚ S.A. owns 588,000 shares (49%).

At General Stockholders' Meeting held on October 14, 2008, the Company's capital stock was increased to S/ 12,000 thousands through monetary contribution for S/ 10,800 thousands.

At General Stockholders' Meeting held on October 24, 2011, the Company's capital stock was increased to S/ 14,720 thousands through monetary contribution for S/ 2,720 thousands. Consequently, GNC Energía Perú S.A.'s stockholding was divided as follows:

- Virtual Gasnet Internacional S.A. owns 7,507,200 shares (51%).
- PETROPERÚ S.A. owns 7,212,800 shares (49%).

By means of Board of Directors' agreement 088-2015-PP dated October 27, 2015, the presentation to Virtual Gasnet Internacional - VGI of the proposal to transfer the total shares of PETROPERÚ S.A. in GNC Energía Perú S.A. was approved.

Subsequently, through Board of Directors' agreement 011-2016-PP dated January 27, 2016, the arrangements approved through Board of Directors' agreement 088-2015-PP dated October 27, 2015 were delayed for six months.

By means of Board of Directors' agreement 088-2016-PP dated November 14, 2016, the dissolution and liquidation of GNC Energía Perú S.A. was approved, as well as the request of dissolution in court in case it does not summon to General Stockholders' Meeting within the terms established by Law or in case the dissolution and liquidation was refused by this Company. The Board of Directors' agreement 088-2015-PP dated October 27, 2015, was terminated. For this reason, management determined the impairment of the investment in associate for S/ 6,986 thousand based on this analysis.

b) It comprises the Project of Exploration and Exploitation of Hydrocarbons in Block 64, which consists of the implementation of the "Development and Exploitation of the Situche Central oil field, Block 64" project to put into production discovered reserves of crude oil in Block 64.

As of December 31, 2016, by means of Supreme Decree 031-2016-MEM dated December 1, 2016, the assignment of a contractual position of the License Agreement for the Exploration and Exploitation of Hydrocarbons in Block 64 by PETROPERÚ in favor of GEOPARK PERU S.A.C. was approved, the latter being designated as Operator of the License Agreement. Likewise, on December 2, 2016, the public deed related to this assignment was signed. As of December 31, 2016, the Company has an investment in joint venture with GEOPARK PERÚ S.A.C.

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**11. Property, Plant and Equipment, Net**

This caption comprises the following:

<i>In thousands of soles</i>	Land	Buildings and other constructions	Plant and equipment	Vehicles	Furniture and fixture	Various equipment and IT	Equipment not in use	In-transit units	Work-in-progress	Additional investment	Total
<b>Cost:</b>											
Balance as of January 1, 2015	721,575	350,900	1,958,950	67,237	11,963	103,127	40,207	411	1,971,147	60,125	5,285,642
Additions	-	-	-	-	-	-	-	-	1,834,383	10,135	1,844,518
Impairment reversal	-	-	91,045	-	-	-	-	-	-	-	91,045
Disposals	-	(414)	-	-	(1)	(2)	(257)	-	(21)	-	(695)
Transfers	2,174	56,106	207,453	856	707	20,764	4,144	-	(250,766)	(41,438)	-
<b>Balance as of December 31, 2015</b>	<b>723,749</b>	<b>406,592</b>	<b>2,257,448</b>	<b>68,093</b>	<b>12,669</b>	<b>123,889</b>	<b>44,094</b>	<b>411</b>	<b>3,554,743</b>	<b>28,822</b>	<b>7,220,510</b>
Balance as of January 1, 2016	723,749	406,592	2,257,448	68,093	12,669	123,889	44,094	411	3,554,743	28,822	7,220,510
Additions	2,201	48,185	101,080	7,246	1,562	10,387	-	-	3,592,671	23,440	3,786,772
Impairment	-	-	(145,592)	-	-	-	-	-	-	-	(145,592)
Impairment reversal	-	-	20,656	-	-	-	-	-	-	-	20,656
Disposals	(21,056)	(2,500)	(5)	(64)	(1)	-	(21)	-	-	-	(23,647)
Transfers	(6,197)	6,250	(746)	(624)	(77)	(713)	2,107	-	(76,271)	-	(76,271)
<b>Balance as of December 31, 2016</b>	<b>698,697</b>	<b>458,527</b>	<b>2,232,841</b>	<b>74,651</b>	<b>14,153</b>	<b>133,563</b>	<b>46,180</b>	<b>411</b>	<b>7,071,143</b>	<b>52,262</b>	<b>10,782,428</b>
<b>Accumulated depreciation:</b>											
Balance as of January 1, 2015	-	250,185	850,034	48,197	10,459	66,531	40,207	-	-	-	1,265,613
Additions	-	13,153	103,153	5,277	742	7,337	188	-	-	-	129,850
Disposals	-	(414)	(3)	-	(1)	(2)	(257)	-	-	-	(677)
Transfers	-	-	(1,390)	(1,859)	(178)	(529)	3,956	-	-	-	-
<b>Balance as of December 31, 2015</b>	<b>-</b>	<b>262,924</b>	<b>951,794</b>	<b>51,615</b>	<b>11,022</b>	<b>73,337</b>	<b>44,094</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,394,786</b>
Balance as of January 1, 2016	-	262,924	951,794	51,615	11,022	73,337	44,094	-	-	-	1,394,786
Additions	-	14,609	105,941	6,126	909	7,667	50	-	-	-	135,302
Disposals	-	(2,024)	(5)	(62)	-	(1)	(21)	-	-	-	(2,113)
Transfers	-	52	(714)	(620)	(75)	(700)	2,057	-	-	-	-
<b>Balance as of December 31, 2016</b>	<b>-</b>	<b>275,561</b>	<b>1,057,016</b>	<b>57,059</b>	<b>11,856</b>	<b>80,303</b>	<b>46,180</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,527,975</b>
<b>Net cost:</b>											
<b>As of December 31, 2016</b>	<b>698,697</b>	<b>182,966</b>	<b>1,175,825</b>	<b>17,592</b>	<b>2,297</b>	<b>53,260</b>	<b>-</b>	<b>411</b>	<b>7,071,143</b>	<b>52,262</b>	<b>9,254,453</b>
<b>As of December 31, 2015</b>	<b>723,749</b>	<b>143,668</b>	<b>1,305,654</b>	<b>16,478</b>	<b>1,647</b>	<b>50,552</b>	<b>-</b>	<b>411</b>	<b>3,554,743</b>	<b>28,822</b>	<b>5,825,724</b>



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**Main projects**

**A. Talara Refinery Modernization Project - PMRT**

The objective of the project is to develop technology involved in the construction of new industrial facilities, modernization and expansion of existing ones to achieve the following:

- i. Production of diesel and gasoline with less than 50 ppm (parts per million) of sulfur,
- ii. Increase in the production capacity of the refinery from 65 to 95 thousand bpd (barrels per day), and
- iii. The processing of heavy and most economical crudes to produce light fuel of higher commercial value.

**B. New Ilo Terminal Construction and Operation Project**

It consists of the construction, installation and commissioning of a new Supply Terminal in Ilo, for reception, storage and dispatch of fuels (diesel, gasoline and gasohol), in order to meet the demand in its area of influence.

**C. Supply Plant Construction and Operation at Pasco Ninacaca**

It consists of the construction, installation and commissioning of a new supply plant in Pasco, for the reception, storage and dispatch of fuels (diesel and gasohol), in order to meet the demand of its zone of influence.

**D. Selling Plant Construction and Operation project at Puerto Maldonado**

It consists of the construction of a Sales Plant, with a 111 MB storage capacity which will then be expanded to 167 MB in a second phase, for dispatch of B5 Diesel and 84 octane gasoline.

**Terminal concessions**

The objective of the Terminals Operating Contracts is to contract operators to conduct, at their sole responsibility, the operations of the terminals. Likewise; committed and additional investments shall be made throughout the term of the contract. Operations of the terminals include hydrocarbons reception, warehousing and dispatching activities, including also maintenance and compliance with security and environment standards.

The maintenance of the assets under concession is foreseen in the respective operating contracts which establish that the assets, upon termination of the contracts, shall be returned in the same conditions in which they were delivered, the normal wear and tear of use being accepted.

During 2014, the Company opened a public bid to select the Operators of the Northern, Central and Southern Terminals; where the consortium composed by Graña y Montero Petrolera S.A. and Oiltanking Perú S.A.C. (hereinafter Terminales del Perú) was awarded the project for the Northern and Central Terminals; the corresponding Operating Contracts were signed for a 20-year term. The bid for the Southern Terminals was declared void.

Based on the results of the Public Bid to select the operator for the Southern Terminal, on September 5, 2014, Consorcio Terminales signed the Addenda to the Operating Contract for the Southern Terminals, in order to extend the term of the contract for the period from August 2, 2014 to August 1, 2015, establishing the conditions for such extension necessary for the conduction of a new bid.

On July 31, 2015, an additional addendum was signed, in order to extend the Operating Agreement for Southern Terminals for the period from August 2, 2015 to August 1, 2017. The conditions negotiated in this document include that the operator shall pay to the contracting party the sum of

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US\$ 1 million for the signing of the extension and also for the execution of additional investment for the amount of US\$ 25 million approximately, according to Additional Investment Program.

As of December 31, 2016, the Operating Agreement for Southern Terminals signed with Consorcio Terminales shall be in force until August 1, 2017. The Operating Contracts of the Northern and Central Terminals signed with Terminales del Perú shall be in force until October 31, 2034 (Northern Terminals) and September 1, 2034 (Central Terminals).

**Insurance**

The assets and operations of PETROPERÚ S.A. have been insured with an against-all-risk insurance policy covering property damage, loss or profit, sabotage and terrorism for an insured limit of US\$ 600 million and with declared values totaling US\$ 5,795 million. This policy also has liability indemnity provisions for a total of US\$ 100 million.

The aviation product supply and resupply operations are covered with an aviation liability and indemnity insurance for US\$ 500 million.

**Depreciation**

The depreciation expense was distributed between the following costs centers:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Cost of sales (note 21)	82,112	81,445
Selling expenses (note 22)	8,907	6,053
Administrative expenses (note 23)	44,283	42,352
	<b>135,302</b>	<b>129,850</b>

As of December 31, 2016, the Company has not granted any component of its fixed assets in guarantee of loans.

**Main disbursements related to work-in-progress**

During 2016, additions for work-in-progress mainly correspond to the EPC of the PMRT amounting to S/ 3,384 million (2015: S/ 1,682 million).

In addition, cost for capitalized loans related to the Modernization Project of Talara Refinery amounted to S/ 150,243 thousand (2015: S/ 42,015 thousand).

**Asset transfer**

The balance of S/ 76,271 thousand was transferred to 'other accounts receivable' for S/ 57,204 thousand and to 'financial investments' for S/ 19,067 thousand, respectively. The transfer was made as a result of the financial effects of the addendum signed for the Assignment of Contractual Position in the License Agreement for the Exploration and Exploitation of Hydrocarbons in Block 64.

**Impairment of assets**

As of December 31, 2016, the Company evaluated the impairment of its assets, with the following results: i) reversal of the impairment loss of the assets of the Production and Commercialization's CGU for S/ 20,656 thousand, and ii) impairment of assets of the Oil pipeline's CGU for S/ 145,592 thousand, mainly due to the stoppage of activities due to the disasters occurred during 2016 and due to environmental remediation expenses recognized as a result of the aforementioned disasters.

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The Company as of December 31, 2015 made the assessment of impairment of assets and reversed S/ 91,045 thousand corresponding to the previously recognized impairment loss due to the increase in the recoverable value of its assets based on the estimates used. Such estimates relate mainly to the sale price forecast, the forecast volume of exports, capital investment and recovery of sales tax up to 18% of exports (note 2.E iv).

Reversal of impairment loss on property, plant and equipment was recognized under operating expenses of the cost of sales (note 21).

As of December 31, 2014, the Company recognized impairment of assets for S/ 111,701 thousand, corresponding to the Cash Generating Unit (CGU) of Production and Trading, arising from the following indicators: i) projected future revenue from assets of Talara Refinery that were inside the Cash Generating Unit of Production and Trading, were only considered until year 2019 because in that year the Modernization Project of Talara Refinery will begin operations., ii) the calculation of the discount rate was not consistent with the methodologies of the market for the discount of assets as well as the range of discount rates used in the market of the hydrocarbons sector.

***Asset disposal***

As of December 31, 2016, it mainly includes the cost of land expropriated by the Ministry of Transport and Communications (MTC) (note 25.e).

**12. Intangible Assets**

As of December 31, 2016, it corresponds to S/ 54 million for intangible assets, net, mainly for the ERP SAP system (2015: S/ 59 million).

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**13. Other Financial Liabilities**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
<b>Current liabilities</b>		
Unsecured bank loans	5,191,693	2,214,068
Syndicated loan (b)	560,000	284,417
	<b>5,751,693</b>	<b>2,498,485</b>
<b>Non-current liabilities</b>		
Syndicated loan (b)	836,383	1,422,083
	<b>836,383</b>	<b>1,422,083</b>

As of December 31, 2016, short-term financial obligations, excluding the current portion of the long-term debt of the PMRT, is composed of 60.79% in local currency and 39.21% in foreign currency.

As of December 31, 2016, approximately S/ 867.4 million of the debt in local currency were used as working capital, as part of the strategy to mitigate exchange rate risk, and S/ 2,288.5 million were used to temporarily meet the obligations of the PMRT according to Board of Directors' agreements 068-2015-PP, 111-2015, 030-2016, 063-2016 and 079-2016 dated August 27, 2015; December 22, 2015; March 22, 2016; July 5, 2016 and September 23, 2016, respectively.

**A. Terms and repayment schedule**

The terms and conditions of outstanding loans are as follows:

<i>In thousands of soles</i>	<b>Original currency</b>	<b>Nominal interest rate</b>	<b>Maturity</b>	<b>December 31, 2016</b>		<b>December 31, 2015</b>	
				<b>Face value</b>	<b>Carrying amount</b>	<b>Face value</b>	<b>Carrying amount</b>
Unsecured bank loans	Sol	4.40 – 5.41%	2016	-	-	2,204,329	2,204,329
Unsecured bank loans	Sol	49%	2016	-	-	9,739	9,739
Syndicated loan	Dollars	LIBOR3M+MGN	2019	1,400,000	1,396,383	1,706,500	1,706,500
Unsecured bank loans	Sol	4.80 – 6.50%	2017	3,155,913	3,155,913	-	-
Unsecured bank loans	Dollars	1.64 – 3.11 %	2017	2,035,780	2,035,780	-	-
<b>Total interest-bearing liabilities</b>				<b>6,591,693</b>	<b>6,588,076</b>	<b>3,920,568</b>	<b>3,920,568</b>

**B. Terms of the syndicated loan agreement**

As of December 31, 2016, the Company recorded a long-term financing for US\$ 417 million of US\$ 500 million (two installments were amortized in September and December 2016), subscribed on June 4, 2014, whose administrative agent is Mizuho Bank Ltd., intended to finance a first tranche corresponding to the EPC phase of PMRT. The Company assumed the obligation to pay the financing within five years:

According to the credit agreement signed, the Company assumes the obligation to pay within five years the debt service, as follows:

- i. The amortization is made in 12 equal quarterly installments from September 2016.
- ii. Interest is quarterly paid from September 2014 based on the interest rate (Libor 3m) and a spread, according to the agreement entered into with the banks.

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**Restrictions:**

As part of the contract signed, the Company shall comply with financial commitments, which are measured quarterly. Financial commitments require that PETROPERÚ S.A. is not allowed to the following:

- Ratio of continuing operations net income before the effect of extraordinary items, income, finance costs and taxes on financial expenses lower than 2.5 from the last day of each fiscal quarter.
- The borrower shall not allow, from the last day of each fiscal quarter that its equity be lower than US\$ 800 million.

As of December 31, 2016 and 2015, the Company is in compliance with such ratios.

Also, the Company has granted blank promissory notes payable to each lender.

**C. Classification of loans per type of use**

The Company allocated the funds obtained by financing as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Working capital	2,292,123	1,392,168
PMRT	4,295,953	2,528,400
	<b>6,588,076</b>	<b>3,920,568</b>

**14. Trade Accounts Payable**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
National suppliers of crude and refined products	292,306	154,163
Foreign suppliers of crude and refined products	1,189,608	751,018
Suppliers of goods and services	890,137	149,708
Shipping companies, terminal operators and sales plants	55,861	28,747
	<b>2,427,912</b>	<b>1,083,636</b>

As of December 31, 2016, the crude leading national supplier is Savia Perú S.A. with a balance of S/ 75.8 million (2015: S/ 27.6 million). The main foreign supplier is Koch Refining International Pte. Ltd. with an account payable amounting to S/ 267.5 million.

This account reflects the Company's obligations related to the acquisition of crude oil and refined products, transport services, operation of plants and the acquisition of supplies and spare parts. Invoices are issued in U.S. dollars, have current maturity, are non-interest bearing and have no specific guarantees.

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**15. Other Accounts Payable**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Taxes	247,431	87,278
Workers' profit sharing (a)	109,351	58,353
Remunerations (b)	100,510	55,430
Interest (c)	72,676	19,003
Advances from customers (d)	38,810	50,721
Various (e)	29,460	28,544
Price Stabilization Fund for Fuels	-	5,402
	<b>598,238</b>	<b>304,731</b>

- (a) In conformity with current legislation, the Company's workers are entitled to a profit sharing plan to be computed at 10% of net gain. This profit sharing is considered as a deductible expense for income tax calculation purposes.

As of December 31, 2016, the Company determined profit sharing of S/ 104,015 thousand (S/ 58,353 thousand as of December 31, 2015) which was recognized with a charge to the results of the year under the following items:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Cost of sales (note 21)	42,759	23,081
Selling expenses (note 22)	19,189	10,395
Administrative expenses (note 23)	47,403	24,877
	<b>109,351</b>	<b>58,353</b>

- (b) The increase corresponds mainly to accrued interest payable from collective negotiations in 2016.
- (c) They correspond to accrued interest payable on loans obtained.
- (d) They comprises funds received from local and foreign companies for S/ 12,482 thousand and S/ 26,328 thousand, respectively, to assure the supply of fuel that remains to be delivered.
- (e) As of December 31, 2016, it mainly includes deposits received as guarantee for S/ 19,063 thousand (2015: S/ 7,539 thousand).

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**16. Other Provisions**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Current		
Provision for environmental improvement (a)	303,092	45,044
Provision for civil claims (b)	75,726	48,857
Accrued pension plans obligations (c)	174	-
Provision for labor claims	7,533	34,134
Provision for plugging of wells (a)	1,928	1,928
Other	526	5,398
	<b>388,979</b>	<b>135,361</b>
Non-current		
Provision for environmental improvement (a)	18,761	54,224
Accrued pension plans obligations (c)	228	514,895
	<b>18,989</b>	<b>569,119</b>

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Movement of provisions and other liabilities during the year:

<i>In thousands of soles</i>	<b>Accrued retirement pension obligations</b>	<b>Provision for improvements to environment</b>	<b>Provision for civil claims</b>	<b>Provision for civil claims</b>	<b>Provision for plugging of wells</b>	<b>Other</b>	<b>Total</b>
<b>Balances as of January 1, 2015</b>	<b>568,719</b>	<b>85,240</b>	<b>16,116</b>	<b>10,667</b>	<b>1,928</b>	<b>526</b>	<b>683,196</b>
Charges for the year	8,522	9,881	27,351	44,129	-	6,803	96,686
Payments	(62,346)	(8,951)	(9,333)	(5,660)	-	(1,931)	(88,221)
Exchange difference	-	13,098	-	(279)	-	-	12,819
<b>Balance as of December 31, 2015</b>	<b>514,895</b>	<b>99,268</b>	<b>34,134</b>	<b>48,857</b>	<b>1,928</b>	<b>5,398</b>	<b>704,480</b>
Charges for the year	226	232,211	4,443	44,017	-	-	280,897
Payments	(259)	(8,138)	(4,781)	(3,081)	-	-	(16,259)
Recovery	-	-	(26,263)	(14,041)	-	(4,872)	(45,176)
Disposals and transfers to ONP (c)	(514,460)	-	-	-	-	-	(514,460)
Exchange difference	-	(1,488)	-	(26)	-	-	(1,514)
<b>Balance as of December 31, 2016</b>	<b>402</b>	<b>321,853</b>	<b>7,533</b>	<b>75,726</b>	<b>1,928</b>	<b>526</b>	<b>407,968</b>



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**(a) Provision for environmental improvements and plugging of wells**

The Peruvian government promotes environmental conservation and wise use of natural resources in hydrocarbon activities, in harmony with the Political Constitution of Peru, Law 26221 Hydrocarbons Law, Law 26821 Law for the Sustainable Use of Natural Resources, Law 27446 Law of the National System of Environmental Impact Assessment, Law 28245 Framework Law of the National Environmental Management, Law 28611 General Environmental Law, and Law 29134 Law Governing the Hydrocarbons Subsector Environmental Liabilities, among others.

The Ministry of Energy and Mines by means of Supreme Decree 039-2014-EM published on November 12, 2014 approved the new Rules for the Environmental protection of the Hydrocarbons Activities, which set forth the standards and regulations for the national territory, the Environmental Management of the activities of exploration, exploitation, refining, processing, transport, trade, warehousing and distribution of hydrocarbons, over their useful lives, as a way to prevent, control, mitigate and repair the adverse environmental impact of such activities.

Also, under the Legislative Decree 674 Law on Promotion of Private Investment in State Enterprises, the Company assumed environmental remediation contractual commitments of its units that were privatized, guaranteed by the Peruvian government. Thus, in accordance with the legal regulations, the signed contracts and their business management policies, as of December 31, 2015, PETROPERÚ S.A. holds environmental remediation commitments in privatized units.

Of a total of 230 projects of its environmental remediation and management programs (PAMA) executed and complied with by the Company since 1995 to adapt its operations to the new regulation for environmental protection in hydrocarbon activities (D.S. 046-93-EM), the approval of the Complementary Environmental Program (PAC) for the Talara Refinery is still pending by the general environmental office (General Directorate of Environmental Affairs and Energy -DGAAE).

In compliance with these provisions, the Company has recognized provisions for the remediation of any environmental damages caused in its privatized units and in its own operating units.

In the case of privatized units (Pampilla refinery, Lubricants Plant, Block X, Block 8, Terminals and Sales Plants, and Power Generation and Natural Gas Plant), estimates were based on Environmental Studies, which had a favorable opinion from the General Hydrocarbons Agency - DGH- or General Environmental Office - DGAAE. The provision is updated annually based on the cost of works completed or in progress and estimated remaining work to be performed, corresponding to the respective environmental remediation contracts.

With respect to its own operating units, estimates were made on the basis of information of the ISO 14001 Environmental Management System of the Company and cost data available of privatized units and are also updated annually based on their own operational needs, the cost of the works carried out, actually executed or under execution, market prices and estimates of remaining work to be executed in accordance with information from the own operational units.

For own operational units, there are new legal environmental obligations, referring to compliance with the Environmental Quality Standards for Soil Pollution - ECA (S.D 002-2013-MINAM, S.D. 002-2014-MINAM, M.R. 085-2014-MINAM, M.R. 034-2015-MINAM and S.D. 013-2015-MINAM) that will require new spending by the Company for the execution of different technical studies required by this new legislation. For 2016 an expense of S/ 18,802 thousand has been estimated for conducting initial assessments of ECA Soil (exploratory sampling and identification of contaminated soil) which have been incorporated in the provision for Environmental Remediation Program of Operations of Talara, Conchán, Pipeline, forest and Commercial Managers and Exploration and Exploitation for S/ 2,469 thousand, S/ 1,648 thousand, S/ 4,117 thousand, S/ 2,469 thousand, S/ 2,469 thousand and S/ 3,295 thousand, respectively.

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The service for the 'Identification of potentially contaminated sites (sample identification) that exceed Environmental Quality Standards for Soil in the Operations of PETROPERÚ' was awarded to TEMA/LITOCLEAN consortium after a second call on May 2, 2016, in the amount of S/ 8,468 thousand. At the end of December 2016, the TEMA Consortium concluded fieldworks at Conchán refinery, Station 9, Station 7, Chiclayo airport plant, Trujillo airport plant, Morona Station, Bayovar Terminal, Yurimaguas Sales Plant, Piura Sales Plant, Talara Airport plant, Block 64, Station 6, Former Station of Cañete Services, Talara Sales Plant, Pisco Airport plant and Andoas Station.

The movement of the provision for environmental improvements is detailed below:

<i>In thousands of soles</i>	<b>Balances as of 01.01.2016</b>	<b>Payments</b>	<b>Exchange difference</b>	<b>Charges to profit and loss / (recovery)</b>	<b>Balances as of 12.31.2016</b>
Block 8	13,201	(679)	(193)	(701)	11,628
Block X	18,874	(4)	(287)	(912)	17,671
Pampilla	697	(629)	(7)	(31)	30
Lubricants	456	-	(7)	(21)	428
Northern terminals	972	-	(15)	-	957
Southern terminals	781	(5)	(12)	(21)	743
Central terminals	6,724	(5)	(102)	(311)	6,306
Natural gas electrical system	70	-	(1)	-	69
<b>Total privatized units</b>	<b>41,775</b>	<b>(1,322)</b>	<b>(624)</b>	<b>(1,997)</b>	<b>37,832</b>
Talara operations	33,659	(2,143)	(534)	(590)	30,392
Conchán operations	4,397	(581)	(66)	(75)	3,675
Oil pipeline operations	6,175	(2,328)	(73)	235,034	238,808
Iquitos refinery operations	6,723	(1,253)	(95)	(101)	5,274
Commercial operations	2,803	(288)	(41)	(25)	2,449
Exploration and exploitation management	3,736	(223)	(55)	(35)	3,423
<b>Total own units</b>	<b>57,493</b>	<b>(6,816)</b>	<b>(864)</b>	<b>234,208</b>	<b>284,021</b>
<b>Total</b>	<b>99,268</b>	<b>(8,138)</b>	<b>(1,488)</b>	<b>232,211</b>	<b>321,853</b>

<i>In thousands of soles</i>	<b>Balances as of 01.01.2015</b>	<b>Payments</b>	<b>Exchange difference</b>	<b>Charges to profit and loss / (recovery)</b>	<b>Balances as of 12.31.2015</b>
Block 8	10,023	(8)	1,712	1,474	13,201
Block X	14,770	(8)	2,440	1,672	18,874
Pampilla	647	(197)	103	144	697
Lubricants	382	-	58	16	456
Northern terminals	852	-	120	-	972
Southern terminals	655	(8)	100	34	781
Central terminals	5,420	(8)	871	441	6,724
Natural gas electrical system	61	-	9	-	70
<b>Total privatized units</b>	<b>32,810</b>	<b>(229)</b>	<b>5,413</b>	<b>3,781</b>	<b>41,775</b>
Talara operations	33,372	(8,223)	4,724	3,786	33,659
Conchán operations	3,443	-	553	401	4,397
Oil pipeline operations	4,874	(494)	745	1,050	6,175
Iquitos refinery operations	5,449	(5)	845	434	6,723
Commercial operations	2,268	-	351	184	2,803
Exploration and exploitation management	3,024	-	467	245	3,736
<b>Total own units</b>	<b>52,430</b>	<b>(8,722)</b>	<b>7,685</b>	<b>6,100</b>	<b>57,493</b>
<b>Total</b>	<b>85,240</b>	<b>(8,951)</b>	<b>13,098</b>	<b>9,881</b>	<b>99,268</b>

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PETROPERÚ S.A. has incurred expenses for Environmental Remediation in the privatized units which have been recognized with a charge to the respective provision. Article 6 of Law 28840, the Strengthening and Modernization Law of PETROPERÚ S.A. provides that the General Directorate of the Public Treasury shall transfer to PETROPERÚ S.A., through capital contributions, all the resources needed to cover the environmental remediation costs of the privatized business units that belonged to the Company.

The Twenty-Sixth Final Complementary Provision of Law 30114 Law for Public Sector Budget for Fiscal Year 2014 reaffirmed Article 6 of Law 28840 in the sense that the Peruvian State must compensate the Company for environmental remediation of its privatized units. Such provision authorizes the Ministry of Energy and Mines to make financial transfers to the Company for environmental remediation of privatized businesses that belonged to it. As of December 31, 2015, it was pending the transfer of S/ 34 million for future expenses, which has been also recognized by the MINEM.

Following proceedings initiated in 2006, PETROPERÚ S.A. has submitted invoices and similar underlying costs incurred for environmental remediation to the Ministry of Energy and Mines in the period January 2007 - October 2014. The Ministry of Energy and Mines (hereinafter MINEM) deposited in the accounts of the Company dated December 31, 2014, the amount of S/ 4,115,795.

The Company has continued sending communications requesting MEF and MINEM to make the financial transfers for environmental remediation; as a result, during 2015, there was a disbursement of S/ 62.6 million, which covers all the expenses made by the Company as of December 31, 2016 in respect of environmental remediation in their privatized units. Management estimates the amounts of both provisions are sufficient to comply with environmental remediation liabilities.

Article 3 of Supreme Decree 002-2006-EM, Provisions for the Presentation of the Supplementary Environmental Plan (PAC, for its Spanish acronym) enacted on January 5, 2006, establishes that OSINERGMIN (competence transferred to the Agency for Environmental Assessment and Inspection (OEFA) as per Resolution of the Executive Council 001-2011-OEFA/CD dated March 2, 2011) shall notify the Company the list of unfulfilled activities related to PAMA requirements so as to coordinate with the Bureau of Energy and Environmental Issues of the Ministry of Energy and Mines, the PAC execution schedule within a period not greater than four (4) years.

The Supplementary Environmental Plan - PAC for operations in Talara is currently undergoing the approval process with Bureau of Energy and Environmental Issues of the Ministry of Energy and Mines - DGAAE, after which the contract period shall be four (4) years, becoming a long-term project.

As of December 31, 2016 the Company has recognized a provision for environmental remediation in Oil Pipeline operations in the amount of S/ 235,034 thousand (note 25.c)

**(b) Provision for civil claims**

As of December 31, 2016, the Company has made provisions of S/ 52 million for civil, administrative and environmental claims. From this amount, S/ 34 million correspond to claims for administrative proceedings with the Agency for Environmental Assessment and Inspection -OEFA- and S/ 13 million for administrative proceedings with OSINERGMIN.

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**(c) Accrued retirement pension obligations**

The accrued liabilities for pension plans obligations includes mainly the compensating pension plans (Regimen Pensionario) of Decree-Law 20530, comprising only former workers and calculated and settled in soles.

Law 30372 "Law for Public Sector Budget for Fiscal Year 2016" published in December 6, 2015, in Article Sixty-Fourth of the Final Complementary Provisions indicates that, from January 1, 2016, the effectiveness of such law, the National Pension Office (ONP) will be responsible for the administration and payment of pensions under Decree Law 20530 and its complementary rules and amendments thereto, corresponding to pensioners of PETROPERÚ S.A. and contingencies arising from the administration and payment. For payment of pensions, the ONP shall refer to the amount of pensions paid to the last month prior to the effective date of this law. It also indicates that by means of Supreme Decree countersigned by the Minister of Economy and Finance, complementary rules that are necessary for the best application of the provision will be issued.

In this sense, since January 2016, the Company registered the transferring of obligation for retirement pension to ONP as additional capital considering the reason:

Law 30372 "Law for Public Sector Budget for fiscal year 2016" is prepared by the Ministry of Economic and Finance and approved by the Peruvian State, the Peruvian State authorized the transfer of liabilities for pensions of PETROPERÚ to ONP in order to contribute to the capacity financial of the company acting in his role of only shareholder and not like as Government. The Peruvian Government does not require the compliance of any requirement specific to PP S.A related to the activities of exploitation to access to this benefit, and this benefit has established only for the Company. The essence of the transaction is a direct support of the shareholder that should be reflected in the equity of the company as additional capital according to the Conceptual framework

In accordance with IAS 19 *Employee Benefits*, as of December 31, 2016 the Company maintained a defined benefit plan that requires the granting of the benefits agreed in Decree Law 20530 and its complementary provisions. These benefits corresponded exclusively to former employees (as a result of termination, disability, widowhood and orphanhood), who acquired the right to a pension upon completing 15 years of actual and remunerated service in the case of men, and 12 years and 6 months in the case of women (Article 4 of Section I of Decree Law 20530). The financing of these obligations is covered from own resources.

As of December 31, 2016, the amount of the provision comprised the present value of the future payments to be made by the Company in favor of its pensioners and it was updated annually on the basis of an actuarial calculation performed by an independent actuary following the projected credit method, which is validated by the National Pension Office – ONP.

Movement in the number of pensioners and direct beneficiaries is summarized as follows:

	<b>2016</b>	<b>2015</b>
Beginning of period	1,026	1,057
New (*)	-	27
Reductions	(1,007)	(58)
	<b>19</b>	<b>1,026</b>

(\*) The new beneficiaries correspond to the entry of direct beneficiaries (survivors of widowhood, orphanhood and survivorship) derived from the Regime of the Decree Law 20530 which transfer the benefit from the original beneficiary to his direct beneficiaries, at the time of death of the worker, as long as he has had the right to a pension or if he was working and complying with the requirements necessary to have a right to the indicated pension.

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**17. Income Tax Liabilities**

The movement of the deferred tax liabilities for the years ended December 31, 2016 and 2015 is detailed below:

<i>In thousands of soles</i>	<b>Balances as of 01.01.2015</b>	<b>Debit (credit) to profit and loss</b>	<b>Balances as of 12.31.2015</b>	<b>Debit (credit) to equity</b>	<b>Debit (credit) to profit and loss</b>	<b>Debit (credit) for change rates</b>	<b>Balances as of 12.31.2016</b>
<b>Deferred assets:</b>							
Provision for retirement pension (a)	151,575	(7,404)	144,171	(144,049)	(9)	7	120
Provision for environmental remediation	23,802	3,289	27,091	-	64,620	3,236	94,947
Other provisions	16,471	6,362	22,833	-	2,264	1,382	26,479
Depreciation rate differences	15,622	2,038	17,660	-	3,427	(2,705)	18,382
Impairment of property, plant and equipment.	29,042	(23,672)	5,370	-	36,856	723	42,949
Tax benefits from tax loss carry forward	39,524	(39,524)	-	-	-	-	-
	<b>276,036</b>	<b>(58,911)</b>	<b>217,125</b>	<b>(144,049)</b>	<b>107,158</b>	<b>2,643</b>	<b>182,877</b>
<b>Deferred liabilities:</b>							
Cost attributable to fixed assets	(391,639)	10,973	(380,666)	-	13,830	(61,720)	(428,556)
Capitalized interest - PMRT financing	(6,041)	(10,478)	(16,519)	-	-	-	(16,519)
	<b>(397,680)</b>	<b>495</b>	<b>(397,185)</b>	<b>-</b>	<b>13,830</b>	<b>(61,720)</b>	<b>(445,075)</b>
<b>Deferred liabilities, net</b>	<b>(121,644)</b>	<b>(58,416)</b>	<b>(180,060)</b>	<b>(144,049)</b>	<b>120,988</b>	<b>(59,077)</b>	<b>(262,198)</b>

- (a) The disposals of deferred tax gains were made with a credit to equity (additional capital), because the accounting treatment of the underlying transaction (disposals and transfer of retirement pension liabilities to the ONP) is registered in that category (see note 16.c)

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**18. Equity**

**A. Issued capital**

As of December 31, 2016, the authorized, subscribed, and paid-in capital stock is represented by 2,465,047,935 common shares with a par value of one sol each.

The share capital structure of the Company is as follows:

<b>Class</b>	<b>Number of shares</b>	<b>%</b>
A	1,972,038,348	80
B	493,009,587	20
	<b>2,465,047,935</b>	<b>100</b>

**B. Additional capital**

Subsequently, Ministerial Resolution 562-2014-MEM/DM was published on December 31, 2014, authorizing the Ministry of Energy and Mines – MEM, to make a financial transfer of S/ 4,115,795 in favor of PETROPERÚ S.A., in order to cover environmental remediation costs of the fully privatized business units; this amount was registered on December 31, 2014 as capital contribution.

By means of Board of Directors' Agreement 022-2015-PP of March 30, 2015, it was agreed to propose to the General Stockholders' Meeting to approve the capital stock increase as a result of the capitalization of the capital contribution temporarily recorded in 'additional equity' for S/ 4,115,795.

General Stockholders' Meeting, held on April 29, 2015, approved the aforementioned capital increase whose registration in the Public Registry is in process.

Subsequently, Ministerial Resolution 300-2015-MEM/DM was enacted. It was published on June 12, 2015, authorizing the Ministry of Energy and Mines – MEM, to make a financial transfer of S/ 10 million in favor of PETROPERÚ S.A., in order to cover environmental remediation costs of the fully privatized business units; this amount was transferred on June 16, 2015 and recorded as a capital contribution on that date.

Additionally, during November 2015, by means of Ministerial Resolutions 474-2015-MEM/DM, 506-2015-MEM/DM and 519-2015-MEM/DM, dated November 7, 2015, November 21, 2015 and November 28, 2015, respectively, authorizations were given to make financial transfers in favor of PETROPERÚ S.A., in the amount of S/ 50 million, S/ 1 million and S/ 1.67 million, in order to cover environmental remediation costs of the fully privatized business units; these amounts were transferred effective November 11, 2015, November 25, 2015, and December 10, 2015, respectively.

General Stockholders' Meeting, held on March 31, 2016, approved an additional capital increase of S/ 515,079 thousand as a result of the capitalization of year 2015 distributable profits. In July 2016, new Certificates of Shares were issued, considering the capital stock increase amounting to S/ 515,079 thousand.

This balance includes the net effect of the assignment and transfer of retirement pension liabilities in the amount of S/ 514,460 thousand (note 16.C) and the corresponding deferred tax asset in the amount of S/ 144,049 thousand (note 17).

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**C. Other capital reserves**

According to article 229 of the Companies Act, the Company is required to allocate not less than 10% of its net annual income to constitute a legal reserve. This allocation is required until such reserve equals 20% of the paid-in capital. The legal reserve can be used to compensate losses in the absence of non-distributed earnings or non-restricted reserves, and must be restored with future earnings.

Accordingly, the legal reserve recorded as of December 31, 2016 amounts to S/ 54,395 thousand; where the legal reserve recorded in 2016 amounted to S/ 50,267 thousand which corresponded to 10% of the net distributable profit of period 2015.

**D. Other equity reserves**

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition in profit or loss as the hedged cash flows or hedged items affect profit or loss.

**E. Retained earnings**

In session dated December 21, 2009, the General Stockholders' Meeting approved the dividends policy which states that: "Distributable profits, after the deduction of workers' profit sharing, and applicable taxes and legal reserve, will be destined to investment projects for the modernization or expansion of the activities of the company, in compliance with its approved annual and five-year objectives, in conformity with the provisions of Article 4 of Law 28840 Law for the Strengthening and Modernization of PETROPERÚ S.A. which agrees with Article Twenty Nine subsection F) of the current Corporate by-laws.

**19. Income from Ordinary Activities**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Local sales	10,098,519	10,254,609
Price stabilization fund for oil-derived fuels	204,218	287,273
	<b>10,302,737</b>	<b>10,541,882</b>
Foreign sales	896,372	1,001,213
	<b>11,199,109</b>	<b>11,543,095</b>

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As of December 31, sales are broken down as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Local sales		
Liquefied petroleum gas - LPG	718,964	502,689
Turbo and kerosene	278,284	342,842
Gasoline	2,710,518	2,915,552
Diesel – various	6,109,629	6,143,239
Industrial oil	289,286	331,417
Asphalts	149,502	244,152
Solvents	44,645	56,410
Other	1,909	5,581
<b>Total local sales</b>	<b>10,302,737</b>	<b>10,541,882</b>
Foreign sales		
Virgin naphtha	251,524	176,954
Turbo	87,457	268,133
Diesel 2	115,572	91,682
Industrial oil	379,204	432,825
Asphalts	14,150	9,186
Reduced crude oil	48,465	22,433
<b>Total foreign sales</b>	<b>896,372</b>	<b>1,001,213</b>
	<b>11,199,109</b>	<b>11,543,095</b>

**20. Other Operating Income**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Terminal operating fees (a)	112,202	96,383
Recollectible freights (b)	51,139	29,726
SAVIA PERÚ S.A. lease (c)	33,859	32,022
Leases (d)	23,075	11,195
Crude transport via pipeline (e)	16,346	173,467
Supply operation - PNP	3,430	3,430
Customer service	2,814	3,618
Cost of use of hydrocarbons	335	10,415
Fuel dispatch service	6	20
Other income from services	691	2,684
	<b>243,897</b>	<b>362,960</b>

- (a) It includes income from operating contracts for PETROPERÚ S.A.'s terminals signed with Consorcio Terminales for terminals and plants in the south of Peru, and with Terminales del Perú for terminals and plants in the north and center of Peru.
- (b) It corresponds to income from the billing of transportation expenses assumed by clients.
- (c) The Company signed a lease contract of the assets of Block Z- 2B with SAVIA PERÚ S.A. (former PETRO-TECH PERUANA S.A) for a 10-year term which expired on November 15, 2013. By virtue of this lease, SAVIA PERÚ S.A. pays US\$ 10 million annually to the Company. As of December 31, 2016, the Company is negotiating the lease contract with SAVIA PERÚ S.A. for the assets of Block Z-2B. The lease contract is still effective under article 1700 of the Peruvian Civil Code.



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- (d) PETROPERÚ S.A., as a state-owned entity subject to private law signed agreements with companies of the private sector for the lease of certain floors of the main office building, plant and exploitation equipment in refineries and production facilities such as the refinery and sales plant in Pucallpa.
- (e) It corresponds to income from the transportation of crude through the Nor- Peruano oil pipeline, which has been stopped from February 2016 mainly due to the maintenance that is being performed.

As of December 31, 2016 and 2015, the Company has agreements with:

- Pluspetrol Norte S.A.: i) operator of Block 1-AB from which the delivery of 92,746 barrels of oil Loreto is still pending. They will be returned when pumping operations are restarted and ii) operator of Block 8, from which the Company acquires its production in Station 1. However, the Transport Agreement through Section I – Section II is still in force, in the event of an emergency.
- Perenco S.A., operator of Block 67, the transport agreement expired on June 30, 2016. To date, Station I does not provide crude oil Piranha Blend.
- PERUPETRO, owner of the extracted hydrocarbons of Block 192 since August 30, 2015 until August 29, 2017. In November 2015, they signed an agreement for the transportation of crude oil, then they signed Contract CONT-005-2016 which expired on March 10, 2016, due to the stoppage of the pumping in the Nor-Peruano Oil Pipeline by order of OSINERGMIN. Addendum 1 was signed to suspend the term of execution of the contract, until the restart of the Pumping operations in Ramal Norte and Section II of the Nor-Peruano Oil Pipeline.
- Pacific Stratus Energy, for the transportation of crude oil, in force until February 29, 2016. Due to the stoppage of the Nor-Peruano Oil Pipeline, the termination of the contract was postponed until the restart of the pumping at the Andoas Station; however, by means of a letter dated December 1, 2016, Pacific Stratus Energy requested the Company to withdraw the remaining crude oil from Station 5; for this objective, a Termination Agreement was signed agreeing the return of 143,578 barrels of crude oil. Pacific Stratus Energy has carried out this transaction since December 2016.

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**21. Cost of Sales**

The cost of sales comprises:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Opening balance of inventories	1,306,398	1,465,499
Acquisition of crude oil, refined products and supplies	8,882,735	9,071,766
Consumption of supplies and operations	(46,834)	(69,064)
Production operating expenses (a)	984,412	722,360
Final balance of inventories	(1,597,279)	(1,306,398)
	<b>9,529,432</b>	<b>9,884,163</b>

(a) Production operating expenses are broken down as follows:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Third-party services (*)	449,706	403,613
Personnel Charges	182,635	181,435
Materials and supplies	74,318	100,708
Depreciation (note 11)	82,112	81,445
Impairment of assets (note 11)	124,936	(91,045)
Insurance	21,665	15,377
Various managements charges	1,808	2,283
Workers' profit sharing (note 15-a)	42,759	23,081
Amortization	41	18
Other	4,432	5,445
	<b>984,412</b>	<b>722,360</b>

(\*) including the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Freights and land transportation expenses	107,829	111,465
Freights and maritime transportation expenses	92,416	86,467
Utilities	81,782	72,743
Freights and other freight expenses	68,685	62,082
Maintenance and repair services	48,646	38,542
Industrial protection and safety	10,498	12,721
Food and storage	34,002	10,634
Other third-party services	5,848	8,959
	<b>449,706</b>	<b>403,613</b>

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**22. Selling and Distribution Expenses**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Third-party services (a)	273,277	236,406
Personnel Charges	79,364	83,994
Taxes	56,236	57,031
Workers' profit sharing (note 15-a)	19,189	10,395
Materials and supplies	8,315	8,165
Depreciation (note 11)	8,907	6,053
Insurance	3,632	4,183
Bad debt expense (note 8)	2,752	515
Various managements charges	1,010	1,318
Amortization	1	1
	<b>452,683</b>	<b>408,061</b>

(a) It includes the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Storing products	69,187	87,132
Delivering products	99,523	72,191
Advertising	15,757	9,919
Maintenance and repair services	7,511	5,579
Freights and other freight expenses	57,781	37,489
Industrial protection and safety	4,671	3,657
Other third-party services	17,778	19,318
Travel and transfer expenses	1,069	1,121
	<b>273,277</b>	<b>236,406</b>

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**23. Administrative Expenses**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Personnel charges (a)	246,663	237,009
Third-party services (b)	116,886	128,738
Various managements charges	105,609	95,883
Workers' profit sharing (note 15.a)	47,403	24,877
Depreciation (note 11)	44,283	42,351
Taxes	12,621	10,954
Amortization	8,053	7,899
Materials and supplies	3,598	3,450
Insurance	2,121	8,739
Bad debt expense (note 9)	173	12,303
	<b>587,410</b>	<b>572,203</b>

(a) Including the Board fees (wages and per diem) of S/ 249 thousand in 2016 (2015: S/ 278 thousand) and remuneration of management staff totaling S/ 15,802 thousand in 2016 (S/ 16,515 thousand in 2015).

(b) It includes the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
IBM outsourcing services	30,893	34,794
Other third-party services	20,078	16,300
Maintenance and repair services	17,940	19,029
Industrial protection and safety	16,350	16,794
Advisory, appraisal and audits	8,880	19,325
Advertising	5,349	5,343
Temporary services	5,126	5,995
Travel and transfer expenses	5,686	4,628
Bank expenses	4,501	4,702
Freights	2,083	1,828
	<b>116,886</b>	<b>128,738</b>

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**24. Personnel Charges**

This caption comprises the following:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Wages and salaries	183,416	170,096
Bonuses	138,265	146,329
Workers' profit sharing	109,351	58,353
Social contributions	75,114	70,390
Legal gratifications	39,460	41,171
Severance indemnities	26,577	26,004
Vacations	14,224	15,421
Food	12,537	11,669
Other	11,128	13,434
Overtime	4,082	3,996
Transportation	3,859	3,928
	<b>618,013</b>	<b>560,791</b>

Personnel charges and workers' profit sharing expenses are charged to the results of the year in the following items:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Cost of sales (note 21)	225,394	204,516
Selling expenses (note 22)	98,553	94,389
Administrative expenses (note 23)	294,066	261,886
	<b>618,013</b>	<b>560,791</b>

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**25. Other Income and Expenses**

Other operating income and expenses comprise:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
<b>Other income</b>		
Recovery of provisions (a)	44,681	5,462
Insurance/non-compliance reimbursement	18,254	19,115
Maritime operations services	9,661	8,610
Other income and interest paid by SUNAT	39,052	22,468
	<b>111,648</b>	<b>55,655</b>
<b>Other expenses</b>		
Spill claims (b)	(321,269)	-
Provision for claims – OLE (c)	(235,079)	-
Derecognition of assets - land (d)	(21,534)	-
Impairment of investments	(6,986)	-
Impairment of supplies	(3,637)	(3,985)
Sales tax credit not used due to tax-exempt sales in the Amazon region (e)	(507)	(139,674)
Retirement pensions	(226)	(8,522)
	<b>(589,238)</b>	<b>(152,181)</b>

(a) It mainly includes the recovery of provisions for labor claims of S/ 25,378 thousand and recovery of provision for civil claims of S/ 12,640 thousand.

(b) As of December 31, 2016, the amount of S/ 68,619 thousand were transferred to other expenses of other accounts receivable, because the recovery procedures before the insurance company are still in the evaluation and analysis stage.

The Company has recorded disbursements related to cleaning, environmental monitoring, recovery and collection of materials, among others, in the statement of income and other comprehensive income for year 2016 related to the claims in Nor-Peruano Oil Pipeline.

(c) They correspond to the expense for contracts pending as of December 31, 2016 and obligations for environmental remediation arisen from crude oil spills occurred at the Nor Peruano Pipeline.

(d) Supreme Decree 266-2015-EF, dated September 24, 2015, incorporates article 3-A into Supreme Decree 005-99-EF which regulates the application of tax benefits on the sale of oil, natural gas and oil-derived fuels granted in article 14 of Law 27037, Law on Promotion of Investment in the Amazon Region. The incorporation of Article 3-A to the Supreme Decree 005-99-EF eliminates the obligation to incorporate in the pro rata formula the amount of untaxed sales, for oil companies that cannot discriminate the final disposition of their acquisitions as taxed and non-taxed transactions (as in the case of PETROPERÚ S.A.), thus resulting in a 100% recovery of tax credit.

(e) By means of Official Letter 0076-2016-MTC/10.05, dated January 19, 2016, the Ministry of Transport and Communications (MTC) requested the transfer of the expropriated property within a term of 10 working days beginning January 21, 2016, having been warned that proceedings of coercive enforcement for the taking possession of the property could be initiated. In response to the communication sent by the MTC, the Company sent official letter COSE-AA-100-2016 to the MTC indicating the consequences generated from the delivery of the expropriated property and that it was necessary to execute works to guarantee the continuity of the operations of Callao Terminal. As of December 31, 2016, the cost of expropriated land located in the Terminal of Callao was derecognized.

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**26. Finance Income and Finance Costs**

Finance income and costs comprise:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Gain on derivative financial instruments	17,204	2,026
Interest on bank deposits	3,806	2,394
Interest on accounts receivable and other	2,343	4,602
	<b>23,353</b>	<b>9,022</b>

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Interest on loans	(58,948)	(67,365)
Loss on derivative financial instruments	(19,184)	-
Others	(397)	(173)
	<b>(78,529)</b>	<b>(67,538)</b>

**27. Tax Matters**

**Tax rates**

- A. The Company is subject to Peruvian tax regime. As of December 31, 2016 and 2015, corporate income tax is calculated on the basis of the net taxable income determined by the Company at a rate of 28.0%.

By means of Legislative Decree 1261, published on December 10, 2016 and effective January 1, 2017, the rate applicable to corporate income was modified to 29.5%.

Thus, the rates applicable to Corporate Income Tax for the last taxable years are as follows:

Until year 2014	30.0%
For years 2015 and 2016	28.0%
For year 2017 onwards	29.5%

The Decree also established the modification of the income tax rate applicable to dividend distribution and any other form of profit distribution to 5%, in the case of profits generated and distributed since January 1, 2017.

For years 2016 and 2015, the income tax rate for dividend distribution and any other form of profit distribution applicable to legal persons not domiciled in Peru and natural persons is 6.8%.

In summary, the rates applicable to income tax on dividends for the last taxable years are as follows:

Until year 2014	4.1%
For years 2015 and 2016	6.8%
For year 2017 onwards	5.0%

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In accordance with current Peruvian tax legislation, non-domiciled individuals only pay taxes for its Peruvian source income. Thus, in general terms, revenues obtained by non-domiciled individuals from the services rendered in the country shall be subject to a 30% income tax on gross income, provided that no double tax treaties are applicable. Concerning the technical assistance or digital services rendered by non-domiciled individuals to domiciled individuals, regardless of the place where the service is rendered, they shall be subject to a 15% and 30% income tax rate on gross income, respectively. Technical assistance will be subject to a 15% rate, provided that Income Tax Law requirements are met.

**Income tax determination**

- B. The Company computed its taxable base for the years ended December 31, 2016 and 2015, and determined current tax of S/ 262,199 thousand and S/ 147,048 thousand, respectively.

Expense for income tax comprises:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Current	275,565	147,048
Deferred	(61,910)	58,416
	<b>213,655</b>	<b>205,464</b>

The reconciliation of the effective income tax rate to the tax rate is as follows:

<i>In thousands of soles</i>	<b>2016</b>		<b>2015</b>	
<b>Profit before income tax</b>	<b>391,146</b>	<b>100.0%</b>	<b>708,131</b>	<b>100.0%</b>
Income tax (theoretical)	109,521	28.0%	198,277	28.0%
Non-deductible permanent expenses	106,967	27.3%	(11,705)	(1.7)%
Benefits from tax loss carry forward	-	-	(39,524)	(5.6)%
Effect of change in income tax rate	59,077	15.1%	-	-
Tax effects on additions and deductions and other	(61,910)	(15.8)%	58,416	8.2%
<b>Current and deferred tax registered as per effective rate</b>	<b>213,655</b>	<b>54.6%</b>	<b>205,464</b>	<b>29.0%</b>

**Temporary tax on net assets**

- C. The Company is subject to temporary tax on net assets whose taxable base is composed of the prior period adjusted net asset value less depreciations, amortizations, legal cash reserve, and specific provisions for credit risk. The tax rate is 0.4% for years 2016 and 2015 and is applied to the amount of net assets exceeding S/ 1 million. This tax can be paid in one or nine equal payments. The paid amount may be used as a credit against payments on account of income tax for taxable periods from March to December of the fiscal period for which the tax was paid until maturity date of each of the payments on account, and against the payment for regularization of income tax of the corresponding taxable period.



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***Tax on financial transactions***

- D. Tax on Financial Transactions (ITF) for fiscal periods 2016 and 2015 was fixed at the rate of 0.005%. This tax is applied on charges and credits in bank accounts or movements of funds made through the financial system, unless the account is tax-exempt.

***Tax assessment by tax authorities***

- E. The tax authorities are entitled to audit and, if applicable, to correct the income tax calculated by the Company within the four years following the year of the tax return filing. The Company's income and sales tax returns for the years 2014 through 2016 are open for review by the Peruvian tax authority. Year 2012 and 2013 were reviewed by the Tax Authorities, being 2013 the partial assessment.

Due to the possible varied interpretations of the current legal regulations by the tax authorities, it is not possible to determine, to date, whether a future tax audit will result or not in liabilities for the Company; therefore, any major tax or surcharge that might arise from eventual tax audits would be applied to profit or loss of the period in which it is determined. However, it is the opinion of the Company's management and its legal advisors that, any possible additional settlement of taxes would not be significant for the financial statements as of December 31, 2016 and 2015.

As a result of the assessment of the 2010 income tax, PETROPERÚ S.A. paid the amount of S/ 9.6 million for taxes, interest and fines on May 30, 2016.

By means of Intendency Resolution 012-180-007173/ SUNAT, received on September 14, 2016, SUNAT authorized the refund of the not applied balance of the Temporary Tax on Net Assets (ITAN) for the year 2014, totaling S/ 2,2 million. Fiscal period 2007 is in the appeal process before SUNAT for an estimated amount of S/ 53.9 million corresponding to the general sales tax, excise tax and income tax. Income tax for fiscal year 2008 has been appealed for the income tax estimated in S/ 9.0 million.

As of December 31, 2016, PETROPERÚ S.A. is under the following tax assessments:

- FISE collection, from January to December, 2014 and 2015, by OSINERGMIN.
- Contribution for Regulation (rate), period January to December 2014, by OSINERGMIN.
- Income Tax, January to December 2011, by SUNAT.

***Tax regime applicable to sales tax***

- F. Legislative Decree 1347, published on January 7, 2017, and effective July 1, 2017, established the reduction of one percentage point in the sales tax, provided that the goal of annual sales tax collection as of May 31, 2017 is reached, net of internal refunds of 7.2% of GDP. In other words, if the aforementioned is met, the Sales Tax rate (including the municipal tax) will be reduced from 18% to 17%.

The Company has considered taking advantage of the benefit of anticipated recovery of the sales tax, since this benefit facilitates the refund of the sales tax on imports and/or local purchases of new capital goods, new intermediate goods, Services and construction contracts, carried out in the pre-production stage, to be directly employed for the implementation of the PMRT.

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On October 21, 2016, PETROPERÚ S.A., presented to PROINVERSIÓN the request for making use of the Anticipated Sales Tax Recovery System. As part of the process, the file was forwarded by PROINVERSION to the Ministry of Energy and Mines (MEM) and to the Ministry of Economy and Finance (MEF). In this regard, Legal Technical Report 101-2016-MEM-DGH-DPTC-DNH was issued, whereby the Ministry of Energy and Mines approves the investment schedule presented by PETROPERÚ S.A. for more than 99% of the requested amount (US\$ 1,710 MM).

The report was sent to the MEM on December 21, 2016; the MEM shall issue a report on the list of goods, services and construction contracts of the PMRT. Likewise, it was forwarded to PROINVERSIÓN so that after corresponding evaluation, it prepares the project of the investment contract to be signed with PETROPERÚ S.A.

If PETROPERÚ S.A.'s request is approved, the MEF shall send the favorable report to the MEM for the issuance of the respective ministerial resolution, after PETROPERU subscribing the investment agreement with PROINVERSION and MEM to finally benefit from the Anticipated Sales Tax Recovery System.

**28. Contingent Liabilities**

As of December 31, 2016, the Company maintains labor, civil, tax and customs proceedings, which are currently pending resolution:

<i>In thousands of soles</i>	<b>2016</b>	<b>2015</b>
Labor proceedings (a)	27,734	71,099
Civil proceedings (b)	64,838	71,863
Tax and customs proceedings (c)	150,649	119,290
	<b>243,221</b>	<b>262,252</b>

As of December 31, 2016, the Company maintains labor, civil, tax and customs proceedings, which are currently pending resolution.

- (a) Labor proceedings which are mainly related to fringe benefits for S/ 21 million, pension fund proceedings for S/ 1 million and other labor proceedings of the Pipeline Operating Unit for S/ 6 million.
- (b) This item mainly includes: i) civil claim filed by the Regional Government of Lambayeque for US\$ 7 million, ii) Arbitration Process filed by RELAPASA for US\$ 5 million, and iii) civil claim filed by COVISE for S/ 10 million.
- (c) As of December 31, 2016, this item mainly includes administrative proceedings against the Tax Court and SUNAT for S/ 116 million relating to the assessment of the income tax for the years 2005 through 2008. The Company's management and legal advisors consider that no significant liabilities will arise from such claims.

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**OSINERGMIN**

- (d) In the exercise of its powers, OSINERGMIN has been conducting preliminary proceedings of research, investigation or inspection, in order to determine whether circumstances exist to justify the initiation of disciplinary proceedings; in this context, it has imposed mandates and requirements of technical information related to Tranche I and Tranche II of Nor-Peruano Oil Pipeline and Ramal Norte.

Regarding the contingencies occurred in KM 440 and KM 206, some administrative sanctioning proceedings have been filed, which are still in process.

Likewise, an administrative sanctioning proceeding has been initiated in relation to the alleged non-compliance with the mandate that restrict the use of Tranch I of the Nor Peruano Pipeline, which is also in process.

**OEFA**

- (e) In relation to the environmental contingencies occurred at KM 440, KM 206, KM 213, Cuninico (KM 41), KM 54 and KM 55, OEFA, within the framework of its powers, issued five preventive measures and orders of a particular nature, which have been complied with within the time limits granted by the competent authority.
- (f) In relation to KM 440 and KM 206, there are three administrative sanctioning procedures, which are detailed below:
- i. Initiated for the alleged non-compliance with the Preventive Measure which ordered the effective, immediate and integral maintenance of those sections of the pipeline that have not suffered a severe or significant deterioration, the replacement of the pipeline with respect to those sections that have suffered severe or significant deterioration, and the preparation of a project to update the Environmental Management Instrument (PAMA) to MINEM. This procedure concluded with the issuance of a resolution declaring the administrative responsibility of PETROPERÚ S.A. and ordered Corrective Measure, which was fulfilled, but that, in the opinion of OEFA, it has not been fulfilled and therefore has reinitiated the procedure, reason why the resolution has been filed.
  - ii. Initiated for the alleged non-compliance with the Preventive Measure which ordered the presentation of a schedule in two working days, cleaning and rehabilitation activities within 40 working days, cleaning and rehabilitation report within 20 working days and final report on the actions executed within 3 months; this procedures is still in process. However, the aforementioned measure has been challenged before court, through a Contentious Administrative Action.
  - iii. Initiated in relation to environmental contingencies of KM 440 and KM 206; these proceedings are still in process.
- (d) Regarding the Sanctioning Administrative Procedure filed by Cuninico, it culminated with the resolution declaring the administrative responsibility and ordering as a corrective measure to: a) demonstrate compliance with the schedule of environmental remediation activities within a period of six months; and b) establish communication channels with the communities in the area of direct and indirect influence regarding the spill and the remediation activities carried out by PETROPERÚ. After OEFA's monitoring visit and after evaluating the presented information, OEFA has resolved to declare non-compliance with the first corrective measure and part of the second corrective measure, thus imposing fines and restarting the

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administrative sanctioning procedure; decision that has been appealed and confirmed by the Court; for this reason they have been challenged through Contentious Administrative Action.

- (e) In relation to the environmental contingency occurred in KM 213, OEFA has imposed an Environmental fine for alleged damage to flora, fauna and potential damage to human life or health, which has been annulled because the procedure is not subject to the current legal framework.

The Company has been notified by OEFA and OSINERGMIN, which have initiated sanctioning administrative proceedings for alleged noncompliance with the regulations of the hydrocarbons sector, being the following:

<b>Disciplinary procedure</b>	<b>Beginning date</b>	<b>Maximum fine</b>	<b>Maximum fine in thousands of soles</b>
405-2016-OS-GFHL/AT	2/11/2016	44,900 tax units	181,845
423-2016-OS-GFHL/AT	2/19/2016	37,000 tax units	149,850
520-2016-OS/DSHL	3/1/2016	2,600 tax units	10,530
524-2016-OS/DSHL	3/3/2016	54,750 tax units	221,738
196-2016-OEFA/DFSAI/SDI	3/8/2016	69,000 tax units	279,450
600-2016-OS/DSHL	3/30/2016	4,250 tax units	17,213
628-2016-OS/DSHL	4/6/2016	6,700 tax units	27,135
665-2016-OS/DSHL	4/29/2016	49,950 tax units	202,298
1030-2016-OS/DSHL	5/17/2016	10,136 tax units	41,051

PETROPERÚ S.A. has presented the corresponding defense within the period granted by each notice. Based on legal advice, the management expects to support the defense with the elements and technical support.

**PLUSPETROL**

Pluspetrol Norte S.A. filed an arbitration proceeding against the Company for failure to comply with the reimbursements of expenses related to the remediation works in Block 8, arising from the Contract for Transfer of Contractual Position. The proceeding is being examined and analyzed.

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**29. Basic and Diluted Earnings per Share**

The calculation of basic earnings per share as of December 31, 2016 and 2015 is presented as follows:

	<b>Gain in thousands of soles (numerator)</b>	<b>In thousands of shares (denominator)</b>	<b>Gain in soles per shares</b>
<b>2016:</b>			
Basic and diluted earnings per share	177,491	2,465,048	0.072
<b>2015:</b>			
Basic and diluted earnings per share	502,667	1,949,969	0.258

The shares issued by capitalization of profits are considered as if they had always been issued, because they do not represent a capital contribution other than that underlying the shares that gave rise to them or new resource contributions for the Company.

**30. Commitments**

As of December 31, 2016, the Company has letters of guarantee issued by local financial institutions in favor of third parties up to S/ 96.8 million and for US\$ 3.9 million.

**31. Related Parties**

The Peruvian Government is owner of shares of the Company's capital, and it's represented by each member of the General Stockholders' Meeting .The Ministry of Energy and Mines and the Ministry of Economy and Finance are representatives of the Peruvian State in the General meeting of shareholders. The transactions between the Company and the Peruvian Government, Ministry of Energy and Mines and Ministry of Economy are considered transaction with stockholders.

**32. Subsequent Events**

By means of Supreme Decree 005-2017-EF, a supplementary loan was approved to finance the capital increase to PETROPERÚ S.A. for up to S/ 1,056,000 thousand, under article 8 of Law 29970, in accordance with Legislative Decree 1292.

Under Ministerial Resolution 028-2017-MEM/D, dated January 17, 2017, the financial resources of the Ministry of Energy and Mines were transferred to PETROPERÚ S.A.

Between January 1, 2017 and until the issuance date of this report (April 4, 2017), there have not been any material events additional to those described in paragraph above that may require adjustments or disclosure to the financial statements as of December 31, 2016.