(Free translation from the original in Spanish)

PETRÓLEOS DEL PERÚ - PETROPERÚ S.A.

FINANCIAL STATEMENTS
DECEMBER 31 2018 AND 2017

Gaveglio Aparicio y Asociados Sociedad Civil de Responsabilidad Limitada.
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www.pwc.pe

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PETRÓLEOS DEL PERÚ - PETROPERÚ S.A.

FINANCIAL STATEMENTS
DECEMBER 31 2018 AND 2017

CONTENTS Page

S/ = Sol
US$ = United States dollar
EUR = Euro

(Free translation from the original in Spanish)

INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors
Petróleos del Perú - PETROPERÚ S.A.

March 20, 2019

We have audited the accompanying financial statements of **Petróleos del Perú - PETROPERÚ S.A.**, which comprise the statements of financial position at December 31, 2018 and 2017 and the statements of comprehensive income, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory notes from 1 to 32.

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 (IFRS) issued by the International Accounting Standards Board, 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.

Auditor's 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 application in Peru by the Board of Deans of Institutes of Peruvian Certified Public Accountants and in accordance with the Governmental Financial Audit Manual. 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 auditor's judgment, including the assessment of the risk of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management, as well as evaluating the overall presentation of the financial statements.

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Gaveglio Aparicio y Asociados Sociedad Civil de Responsabilidad Limitada es una firma miembro de la red global de PricewaterhouseCoopers International Limited (PwCIL). Cada una de las firmas es una entidad legal separada e independiente que no actúa en nombre de PwCIL ni de cualquier otra firma miembro de la red.
Inscrita en la Partida No. 11028527, Registro de Personas Jurídicas de Lima y Callao.

March 20, 2019
Petróleos del Perú - PETROPERÚ S.A.

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 financial statements referred to above, present fairly, in all material respects, the financial position of Petróleos del Perú - PETROPERÚ S.A. at December 31, 2018 and 2017, its financial performance and cash flows for the years then ended, in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board.

Gaveglio Aparicio y Asociados

Countersigned by

---(partner)
Hernán Aparicio P.
Peruvian Certified Public Accountant
Registration No.01-020944

(Free translation from the original in Spanish)

PETRÓLEOS DEL PERÚ - PETROPERÚ S.A.

STATEMENT OF FINANCIAL POSITION

ASSETS	Note	At December 31, 2018 US$000	At December 31, 2017 US$000
Current assets			
Cash and cash equivalents	7	528,700	666,141
Trade receivables	8	438,698	343,303
Other receivables	9	1,455,757	661,227
Inventories	10	590,537	643,611
Prepaid expenses		431	4,889
Assets held for sale		1,963	-
Total current assets		3,016,086	2,319,171
Non-current assets			
Other receivables	9	241,751	215,168
Other assets		-	67
Property, plant and equipment	11	3,978,456	3,291,409
Investment properties	12	74,156	79,430
Intangible assets		33,554	33,498
Total non-current assets		4,327,917	3,619,572
TOTAL ASSETS		7,344,003	5,938,743

LIABILITIES AND EQUITY	Note	At December 31, 2018 US$000	At December 31, 2017 US$000
Current liabilities			
Other financial liabilities	13	1,673,112	1,319,200
Trade payables	14	529,801	772,247
Other payables	15	105,092	115,189
Other provisions	16	34,662	59,611
Total current liabilities		2,342,667	2,266,247
Non-current liabilities			
Other financial liabilities	13	3,147,610	1,985,124
Other provisions	16	7,067	14,461
Deferred income tax liabilities	17	109,349	55,307
Total non-current liabilities		3,264,026	2,054,892
Total liabilities		5,606,693	4,321,139
Equity	18		
Capital share		1,337,989	1,171,395
Legal reserve		40,160	21,650
Other equity reserves		-	(154)
Retained earnings		359,161	424,713
Total equity		1,737,310	1,617,604
TOTAL LIABILITIES AND EQUITY		7,344,003	5,938,743

The attached notes from pages 8 to 82 form part of the financial statements.

(Free translation from the original in Spanish)

PETRÓLEOS DEL PERÚ - PETROPERÚ S.A.

STATEMENT OF COMPREHENSIVE INCOME

	Note	For the year ended December 31, 2018 US$000	2017 US$000
Revenue from ordinary activities	19	4,884,006	3,979,292
Other operating profit	20	81,064	72,282
Total revenue		4,965,070	4,051,574
Cost of sales	21	(4,617,600)	(3,537,093)
Gross profit		347,470	514,481
Selling and distribution expenses	22	(77,409)	(70,206)
Administrative expenses	23	(156,225)	(178,984)
Other income	25	135,487	68,812
Other expenses	25	(33,480)	(35,548)
Total operating expenses		(131,627)	(215,926)
Operating profit		215,843	298,555
Financial income	26	17,021	3,395
Financial expenses	26	(48,928)	(51,844)
Exchange difference, net	3.1.a.i	(6,661)	(2,043)
Profit before income tax		177,275	248,063
Income tax expense	27	(57,723)	(62,959)
Profit for the year		119,552	185,104
Other comprehensive income that may be reclassified as profit or loss:			
Proceeds from derivatives instruments		154	219
Total comprehensive income		119,706	185,323
Basic and diluted earning per share	29	0.030	0.054

The attached notes from pages 8 to 82 form part of the financial statements.

(Free translation from the original in Spanish)

PETRÓLEOS DEL PERÚ - PETROPERÚ S.A.

STATEMENT OF CHANGES IN EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017 (Note 18)

	Number of shares	Share capital US$000	Additional capital US$000	Legal reserve US$000	Other equity reserves US$000	Retained earnings US$000	Total equity US$000
Balances at January 1, 2017	2,465,047,935	733,645	110,241	16,189	(373)	256,222	1,115,924
Comprehensive income:							
Profit for the year	-	-	-	-	-	185,104	185,104
Other comprehensive income:							
Proceeds from derivative	-	-	-	-	219	-	219
Total comprehensive income	-	-	-	-	219	185,104	185,323
Transactions with shareholders:							
Shareholder's cash contribution	-	-	316,357	-	-	-	316,357
Transfers to additional capital and legal reserve	-	-	11,152	5,461	-	(16,613)	-
Transfers to share capital from cash contribution	1,056,000,000	316,357	(316,357)	-	-	-	-
Transfers to share capital from additional capital	406,665,360	121,393	(121,393)	-	-	-	-
Total transactions with shareholders	1,462,665,360	437,750	(110,241)	5,461	-	(16,613)	316,357
Balance at December 31, 2017	3,927,713,295	1,171,395	-	21,650	(154)	424,713	1,617,604
Balances at January 1, 2018	3,927,713,295	1,171,395	-	21,650	(154)	424,713	1,617,604
Comprehensive income:							
Profit for the year	-	-	-	-	-	119,552	119,552
Other comprehensive income:							
Proceeds from derivative	-	-	-	-	154	-	154
Total comprehensive income	-	-	-	-	154	119,552	119,706
Transactions with shareholders:							
Transfers to additional capital and legal reserve	-	-	166,594	18,510	-	(185,104)	-
Transfers to share capital	520,703,700	166,594	(166,594)	-	-	-	-
Total transactions with shareholders	520,703,700	166,594	-	18,510	-	(185,104)	-
Balance at December 31, 2018	4,448,416,995	1,337,989	-	40,160	-	359,161	1,737,310

The attached notes from pages 8 to 82 form part of the financial statements.

(Free translation from the original in Spanish)

PETRÓLEOS DEL PERÚ - PETROPERÚ S.A.

STATEMENT OF CASH FLOWS

	Note	For the year ended December 31, 2018 US$000	2017 US$000
OPERATING ACTIVITIES			
Net cash (applied to) provided by operating activities		(2,298)	307,529
Interest payment		(23,665)	(34,812)
Income tax payment		(108,439)	(107,700)
Net cash (applied to) provided by operating activities		(134,402)	165,017
INVESTING ACTIVITIES			
Value added tax early refund related to investing activities	9	44,002	-
Value added tax related to investing activities		(71,353)	(149,151)
Payment for purchase of property, plant and equipment		(604,140)	(717,304)
Capitalized interest payment		(107,425)	(85,792)
Payment for purchase of intangible assets		(2,020)	(32)
Retirement of investment in fixed term deposits		1,151,837	75,000
Investment in fixed term deposits		(1,912,462)	(351,240)
Net cash applied to investing activities		(1,501,561)	(1,228,519)
FINANCING ACTIVITIES			
Loans from financial institutions	13-c	4,452,234	3,968,753
Bonds received	13-c	-	2,000,000
CESCE loans	13-c	1,236,717	-
Payment of transactional costs	13-c	(74,695)	(14,876)
Payment of loans to financial institutions	13-c	(4,113,312)	(4,617,520)
Shareholder's cash contribution	18	-	316,357
Net cash provided by financing activities		1,500,944	1,652,714
Net (decrease) increase in cash and cash equivalents		(135,019)	589,212
Effect of changes in exchange rate on cash		(2,422)	2,924
Cash and cash equivalents at beginning of year	7	666,141	74,005
Cash and cash equivalents at end of year		528,700	666,141
NON-CASH TRANSACTIONS FROM FINANCING AND INVESTMENT ACTIVITIES			
- Unpaid accrued interest	13	22,219	7,229
- Work in progress payable		79,730	80,000
- Profit capitalization	18	166,594	121,393

The attached notes from pages 8 to 82 form part of the financial statements.

(Free translation from the original in Spanish)

PETRÓLEOS DEL PERÚ - PETROPERÚ S.A.

STATEMENT OF CASH FLOWS

	Note	At December 31, 2018 US$000	2017 US$000
Profit for the year		119,552	185,104
Adjustments to reconcile the profits for the year with cash from operating activities:			
Estimate for impairment of trade receivables	8	382	126
Estimate for impairment of other receivables	9	553	3,218
Estimate for impairment of inventories	10	591	8
Provision for retirement pensions	16	33	32
Provision for contingencies	16	24,665	6,241
Provision for plugging and environmental remediation	16	10,806	34,953
Depreciation	11-12	48,379	47,241
Amortization		2,173	2,400
Deferred income tax	17	54,042	(22,728)
Reversal/provision for impairment of fixed assets	11	(11,536)	(31,790)
Disposal of property, plant and equipment	25	102	1,802
Other adjustments		(826)	-
Impairment of investments		67	-
Effect on adjustment of non-realizable exchange difference		2,422	(2,924)
		251,405	223,683
Net changes in operating assets and liabilities:			
Trade receivables		(95,777)	(27,179)
Other receivables		(33,690)	(44,069)
Inventories		52,483	(47,915)
Prepaid expenses		4,458	(480)
Trade payables		(251,345)	204,793
Other payables		(61,936)	(143,816)
Net cash (applied to) provided by operating activities		(134,402)	165,017

The attached notes from pages 8 to 82 form part of the financial statements.

(Free translation from the original in Spanish)

PETRÓLEOS DEL PERÚ - PETROPERÚ S.A.

NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017

1 BACKGROUND AND ECONOMIC ACTIVITY

a) Background -

Petróleos del Perú - PETROPERÚ S.A. (hereinafter, PETROPERÚ S.A. or the Company) was incorporated on July 24, 1969 under Decree Law No.17753.

The Company is a government-owned company under private law operating in the hydrocarbons subsector within the Energy and Mining Industry. The Company was organized and incorporated as a stock company, under the provisions of Legislative Decree No.043, *Ley de la Empresa Petróleos del Perú - PETROPERÚ S.A.*, published on March 4, 1981, as amended, by which the Peruvian Government holds the Company's total share capital. The Company is also subject to the provisions of article 12 of the rules for application of Law No.28840, setting forth that each member of the General Shareholders' Meeting shall represent the number of equity shares of PETROPERÚ S.A. resulting from dividing the total number of shares by the number of members designated to act on behalf of the Peruvian Government.

The Company is registered with the Peruvian company and securities regulator (Superintendencia de Mercados de Valores - SMV).

The legal address of PETROPERÚ S.A. is at Av. Enrique Canaval y Moreyra No.150, San Isidro, Lima Perú.

Under the provisions of Law No. 28840, "Ley de Fortalecimiento y Modernización de la Empresa de Petróleos del Perú - PETROPERÚ S.A.", for the modernization of Petroperú, PETROPERÚ S.A. was expressly excluded from the scope of the governmental agency that provides financing to government-owned companies, ("Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado - FONAFE) and the public investment system ("Sistema Nacional de Inversión Pública - SNIP"). Further, by means of the second final provision of Law No. 28840, the Supreme Resolution No. 290-92-PCM - by which the Company was included within the scope of the process of private investment promotion, and any other regulation opposing Law No. 28840 - was superseded.

The Company's activities are governed by its Organic Law approved under Legislative Decree No. 043, its Bylaws, Law 28840 - Law for the Strengthening and Modernization of Empresa de Petróleos del Perú, PETROPERÚ S.A. (its internal rules, approved under Supreme Decree No.012-2013-EM dated April 27, 2013); it is also governed by the Peruvian Corporate Law on a supplementary basis and is under the oversight of the Peruvian Comptroller's Office ("Contraloría General de la República (CGR), the Peruvian tax and customs Regulator ("Superintendencia Nacional de Aduanas y de Administración Tributaria - SUNAT") and the local hydrocarbons regulator.

More over, under the third final provisions of Legislative Decree No. 1031, by which the efficiency of the government-run companies is promoted, dated June 23, 2008, the Company is subject to subsection 9.3, article 9th and article 12th of Legislative Decree No 1031. With respect to the former, the Company's financial statements are audited, on an annual basis, by external independent auditors who are designated at the General Shareholders' Meeting; with respect to the latter, under decision at the General Shareholders' Meeting the minimum level of capital stock to be registered with the Peruvian Securities Stock Market is to be determined in adherence to the regulations issued by the SMV.

Other applicable laws and regulations are the provisions of the legislation stating the need for the modernization of the Talara Oil Refinery, Law No.30130 enacted on December 18, 2013 (originally called "Ley que declara de necesidad pública e interés nacional la prioritaria ejecución de la modernización de la Refinería de Talara para asegurar la preservación de la calidad del aire y la salud pública y adopta medidas para fortalecer el Gobierno Corporativo de Petróleos del Perú - PETROPERÚ S.A."), hereinafter the PMRT as well as its rules for application, as approved under Supreme Decree No.008-2014-EM, published on March 24, 2014. The Law No.30130 approved the grant by the Peruvian Government of up to US$200 million per year and up to a cumulative total of US$1,000 million to secure the financial obligations derived from the financing to be contracted by PETROPERÚ S.A. to execute the PMRT in the event the Company is not able to obtain the necessary resources to honor its obligations. At December 31, 2018 and 2017 there has been no need to use those guarantees.

Additionally, on December 30, 2016, Legislative Decree No.1292 was enacted declaring of public need and national interest the safe operation of "Oleoducto Norperuano (hereinafter the, ONP)" and stipulating the re-organization and improvement of the corporate governance of PETROPERÚ S.A.

b) Economic activity -

By means of Law No.28244 enacted on June 2, 2004, PETROPERÚ S.A. is authorized to enter into contracts with PERUPETRO S.A. for exploration and exploitation operations as well as petroleum-related services as permitted by law.

As established under the Ley de "Fortalecimiento y Modernización de Petroperú S.A.", the Company has economic, financial and administrative autonomy in accordance with its annual and five-year business objectives approved by the Ministry of Energy and Mines. The agreements and contracts entered into in order to achieve its business purpose are subject to the guidelines established under i) Legislative Decree No.043, as amended; ii) its Bylaws; iii) its internal rules; iv) Board agreements; v) the Standards of the National Control System; and vi) the standards and regulations specific to PETROPERÚ S.A.

The Company's foreign trade transactions are governed by the generally accepted practices and uses of international trade and International Law standards as well as the generally accepted practices in the hydrocarbon and energy industry.

As part of its core business purpose, the Company carries out activities in accordance with the Peruvian Hydrocarbons Law (*Ley Orgánica de Hidrocarburos) - Law No.26221.* These activities consist of all oil industry phases, such as oil trade, including its by-products, basic petrochemicals and other forms of energy. The Company's activities in the hydrocarbon industry include exploration and exploitation, refinery, trade and transport of oil and by-products, basic and intermediary petrochemical products and other forms of energy.

By means of Law No.29970 - law for the strengthening of the energy supply continuity throughout the Southern Region in Peru ("Ley que afianza la Seguridad Energética y promueve el desarrollo del Polo Petroquímico en el Sur del País") PETROPERÚ S.A. shall take part, individually or jointly, in the petrochemical development described in the above-mentioned law.

Pursuant to Law No.30130 PETROPERÚ S.A. is authorized to sell or issue shares to be placed in the Securities Market. In this process, the Peruvian Government is allowed to incorporate a private stake of up to 49% of its share capital outstanding. In addition, PETROPERÚ S.A. is allowed to carry out investment activities and projects as long as no current or future firm or contingent liabilities are incurred by the Company, do not affect the guarantees for the Talara Refinery Modernization Project (PMRT the Spanish acronym); and no Treasury resources are required; which is not restrictive of those ongoing projects that enable the Company to be operational at the effective date of this law. These restrictions will cease to exist whenever PETROPERÚ S.A. generates sufficient cash flows to be able to secure repayment of the borrowings contracted to invest in implementing the PMRT and a private stake of at least 40% has been incorporated in its outstanding share capital.

By means of Supreme Decree No.031-2016-MEM dated December 1, 2016 approved the assignment of contractual position in the License Agreement for the Hydrocarbons Exploration and Exploitation on Block 64, from PETROPERÚ to GEOPARK PERÚ S.A.C.; the latter now being designated as the Operator of the License Agreement. On December 2, 2016, the relevant public deed of the referred assignment was signed.

Pursuant to Legislative Decree No.1292, issued on December 30, 2016, the safe operation of the Peruvian northern oil pipeline ("ONP") was declared of public need and national interest; in this sense, the Company was ordered to re-organize and enhance its corporate governance, authorizing a period of 720 days for that purpose, to come due on December 30,2018, to prepare a plan to govern, among others: the contracting and amending of agreements/contracts as well as service agreements relating to the Company's business units; the participation of PETROPERÚ S.A. in contracts of hydrocarbon exploration and exploitation; the possibility for the Company to take part in social responsibility actions under the mechanism of work in exchange for taxes; using the capital increase referred to in subsection 8.1, article 8th, Law No 29970 to implement the Talara Refinery Modernization Project and the amendment of article 4 and Complementary Provision to Law No 28840 - "Ley de Fortalecimiento y Modernización de la Empresa de Petróleos del Perú - PETROPERÚ S.A." to implement the Legislative Decree N°1292" approved by the Board of Directors.

Legislative Decree No. 1292 under the above regulation, once the reorganization and modernization mentioned in subsection 3.1, article 3th is completed, PETROPERÚ S.A. will come within the scope of the national fund for financing government-run companies ("Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado - FONAFE). However, on November 28, 2018 Law No. 30873 was enacted to partially supersede the above-mentioned Legislative Decree, removing the mandatory requirement for PETROPERÚ S.A. to be within the scope of FONAFE.

By means of the above-mentioned Legislative Decree No.1292 the Energy and Mines Ministry is additionally commissioned at the proposal of OSINERGMIN to approve a regulated rate schedule to be used in the final concession of ONP and Oleoducto Ramal Norte ("Concesión Definitiva para el Transporte de Hidrocarburos Líquidos por el ONP y el Oleoducto Ramal Norte") whenever the parties do not reach a price agreement within a period of 60 days.

c) Regulatory framework governing the Company's selling prices -

In accordance with article 77 of the Organic Hydrocarbon Law, the activities and prices of crude oil and by-products are governed by supply and demand.

The fuel pricing policy of PETROPERÚ S.A approved by the Board establishes that:

- Pricing of liquid and specialty fuels is determined on a supply-and-demand services in compliance with the provisions of the Peruvian Law of Hydrocarbons ("Ley Orgánica de Hidrocarburos").

- The price listing of liquid and specialty fuels will be approved by the Executive Committee of Prices ("Comité Ejecutivo de Precios") presided by the General Management and conformed by Corporate Finance Management, Supply Chain Management, Refining Management and Commercial Management, or those who fulfill those functions.

- The methodology used in setting the prices of liquid and specialty fuels sold by PETROPERÚ in the local market is implemented on a cost-opportunity basis and is approved by the Executive Committee of Prices ("Comité Ejecutivo de Precios").

- PETROPERÚ's price lists should be competitive in relation with other economic agents - manufacturers and importers – at the Sales Plants nationwide in which sales are conducted, provided that economic benefits are obtained.

- In case international market events or circumstances have a significant impact on fuel prices in the local markets, and this, in turn, have an adverse impact on the Company's economic condition and/or reputation, the Price Executive Committee may decide to progressively transfer those events to customers or ignore those price variances specific to a current economic juncture until the local or international market stabilizes.

- Price Stabilization Fund of Petroleum Derived Fuels (hereinafter, Price Stabilization Fund).

  The Price Stabilization Fund was established by the Peruvian Government under Emergency Decree No.010-2004, relevant rules standards and amendments. Pursuant to this piece of legislation the Peruvian Government establishes a contingency fund to prevent the volatility of the hydrocarbon prices being transferred to the final consumers; however, the Ministry of Energy and Mines (MEM, the Spanish acronym) will compensate the Company for the pricing differences that are not transferred to its clients.

  Under the above-mentioned regulations, the National Hydrocarbons Office ("Dirección General de Hidrocarburos - DGH") within the Ministry of Energy and Mines sets a price range per each fuel product sold in Peru. Article 6th, of Supreme Decree No.133-2010-EF (dated June 23, 2010) stipulates that OSINERGMIN shall update and publish every two months in the Peruvian official gazette "El Peruano", the price ranges ("bandas de precios") per each product the last Thursday of the second month, computed from the effective date of the last price update.

  On a weekly basis, OSINERGMIN publishes a reference price per each fuel product sold in Peru known as "Import parity price ("Precio de paridad de importación - PPI"). Whenever the PPI is higher than to the upper range, the difference is the Compensation factor and whenever the PPI is lower than the lower range, the difference is the Contribution factor. See accounting policy in Note 2.23-b.

  In 2018 and 2017, the fuel price stabilization fund was applied to the following fuel items: GLP-E, Diesel B5, Diesel B5 S-50 and industrial petroleum 6. This fund representing 0.8% of the Company's total revenue (0.6% of the Company's total revenue in 2017).

d) Approval of the financial statements -

The financial statements at December 31, 2018 have been issued with the authorization of General Management on March 20, 2019 and will be submitted for approval of their issue by the Board and then for consideration of the General Shareholders' Meeting for final approval. The financial statements at December 31, 2017 were approved at the General Shareholders' Meeting dated June 27, 2018.

2 BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation and presentation -

i) Compliance with IFRS -

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (hereinafter IFRS) issued by the International Accounting Standards Board ("IASB"), effective at the date of the financial statements.

The information contained in these financial statements is the responsibility of the Company's Board of Directors, which expressly states that in preparing them it has applied all accounting principles and criteria required under the IFRS issued by the IASB.

ii) Basis of measurement -

The financial statements of the Company have been prepared under the historical cost convention, except for derivative financial instruments recorded at fair value. The financial statements are presented in thousands of US Dollars, unless a different monetary expression is indicated.

The preparation of the financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires Management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

iii) New standards and interpretations effective at January 1, 2018 adopted by the Company -

IFRS 9, "Financial Instruments" and IFRS 15, "Revenue from contracts with customers" have been effective since January 1, 2018 and have been applied by the Company since that date. The impact of these standards is described in the paragraphs below.

- IFRS 9, "Financial Instruments" -

  IFRS 9 replaces IAS 39 and introduces major changes principally in: classification and measurement of financial instruments, impairment of financial assets and hedge accounting. The new hedge accounting model aligns the accounting treatment with an entity's risk management practices, which are summarized below:

  The Company has applied IFRS 9 from January 1, 2018 and has opted not to restructure the financial statements for the comparative period beginning on January 1, 2017, because there are no additional provision balances that are material to the financial statements.

  Based on an assessment of its major transactions, the Company has concluded that IFRS 9 has not material impact on its financial position, its profit or loss or risk management practices. The Company's adoption of IFRS 9 is summarized as follows:

  Classification and measurement -

  IFRS 9 changes the categories of classification of financial assets, removing the held-to-maturity, loans and receivables and available-for-sale categories. The Company financial assets will now be classified into one of the following categories: measured at amortized cost, measured at fair value through other comprehensive income (FVOCI) or measured at fair value through profit or loss (FVPL). Classification of the financial assets under IFRS 9 is dependent on the business model in which the financial asset is managed and the contractual cash flows characteristics.

  At December 31, 2018 the Company has assets mostly recorded at the amortized cost and immaterial amount derivative financial measured at FVTPL, which means no significant change in relation with the accounting policy in place before adoption of this standard.

  Impairment -

  IFRS 9 replaces the incurred credit losses model under IAS 39 and introduces the expected credit losses model to test impairment of financial assets. The new impairment model is applied to financial assets at amortized costs including trade receivables.

The most significant impact for the Company is impairment of other receivables measured at the amortized cost. The Company opted to apply the simplified approach set under IFRS 9 and determined impairment losses of trade receivables over the lifespan of the financial asset and the use of a matrix of provision for impairment losses, which are not considered material. In the case of other receivables, the Company opted to apply the general approach and determined that they do not have a significant impact due to expected losses, since the counterparties do not have significant risks that could generate defaults.

Hedge accounting -

A hedge arrangement is a transaction by which a counterparty intends to reduce or mitigate its exposure to a particular event or variance in its cash flows. Hedge accounting does not change the yields/gains over time; it only affects the timeliness and presentation in profit or loss. When applying hedge accounting, the gains and losses on the hedged item and the hedging instrument are recognized in profit or loss in the same accounting period. The Company has not assessed the impact of the IFRS 9 requirements regarding hedge accounting because it is not applied hedge accounting to its derivatives.

- IFRS 15, “Revenue from contracts with customers" -

The core principle under IFRS 15, ‘Revenue from contracts with customers’ (IFRS 15) is that an entity should recognize revenue when control over goods or services is transferred to customers, at a carrying amount that reflects the price expected to entitled to collect as a consideration for the transfer of goods or assets. This new standard also extends disclosure requirements and provides guidelines for transactions that were not previously addressed by other standards, including multiple element contracts.

The Company has adopted IFRS 15 from January 1, 2018 using the modified retroactive approach. Under this approach, the cumulative effect at the initial adoption of IFRS 15 should be recognized from January 1, 2018 and the comparative year financial statements are not required to be restated. As a result of the adoption of IFRS 15, no adjustments were identified to be needed to the financial statements at January 1, 2018.

The Company has assessed the changes introduced under IFRS 15 and the nature and effect of these changes on the Company adoption are summarized below:

Identify the separate performance obligations and when these performance obligations are satisfied -

The Company has identified as its main performance obligation the sale of refined products or derivatives of crude oil to its customers. However, other performance obligations were identified, which Management has separated from the main obligation, such as free-of-charge transportation bonus, loaned products and other services related to the main activity, which are recorded in “Revenue from ordinary activities" (Note 19) for US$6,107 thousand and US$4,740 thousand in 2018 and 2017, respectively.

This change in accounting approach has had no impact on the Company’s equity at January 1, 2018 because there are not services promises that have not been satisfied at these dates involving amounts that are material to the financial statements.

Likewise, Management did not identify additional performance obligations that may need to be recognized separately from foreign sales (Note 19) or Other operational income (Note 20).

The Company has concluded that the impact of IFRS 15 on revenue from ordinary activities only impacts the presentation of certain performance obligations, which the Company does not consider significant.

Determine the transaction price and prices allocated to each separate performance obligation.

In determining the transaction price and the amounts assigned to performance obligations, the Company has considered the terms of the contract and its customary business practices. The transaction price is the amount of consideration to which the Company expects to be entitled in exchange for transferring the promised goods or services to its customers. The transaction price is assigned to each performance obligation based on a relative independent selling price including variable consideration.

The Company has concluded that the impact of IFRS 15 with respect to the transaction price and the amounts assigned to performance obligations will only affect the presentation of the Company's financial statements in the periods presented and thereafter. At December 31, 2018 and 2017, revenue from ordinary activities has been identified for US$6,107 thousand and US$4,740 thousand, respectively, which are presented separately in 'Revenue from ordinary activities' (See Note 19).

In addition, based on an assessment of its contracts and the performance obligations identified, the Company has identified that certain expenses shown as selling and distribution expenses of US$74,766 thousand, at December 31, 2017, should be presented as cost of sales in the statement of comprehensive income under the provisions of IFRS 15; because they are expenses that are necessary to bring the sold goods to customers.

The presentation of the statement of comprehensive income for 2017 has been modified by the reclassification of the aforementioned expenses to be consistent with IFRS 15:

	At December 31, 2017 US$000 (Previously reported)	Reclassification US$000	At December 31, 2017 US$000 (Reviewed)
Revenue from ordinary activities	3,979,292	-	3,979,292
Other operating income	72,282	-	72,282
Total revenue	4,051,574	-	4,051,574
Cost of sales	(3,462,327)	(74,766)	(3,537,093)
Gross profit	589,247	(74,766)	514,481
Selling and distribution expenses (a)	(144,972)	74,766	(70,206)
Administrative expenses	(178,984)	-	(178,984)
Other income	68,812	-	68,812
Other expenses	(35,548)	-	(35,548)
Operating profit	298,555	-	298,555
Financial income	3,395	-	3,395
Financial expenses	(51,844)	-	(51,844)
Exchange difference, net	(2,043)	-	(2,043)
Profit before income tax	248,063	-	248,063
Income tax	(62,959)	-	(62,959)
Net profit for the year	185,104	-	185,104

The Company has reclassified its trade receivables from Price Stabilization Fund from other trade receivables to trade receivables, considering the revenue is obtained from the performance obligation of the selling of petroleum-refined products and by-products nationwide and it considers this is a more adequate presentation given their trade nature.

	At December 31, 2017 US$000 (Previously reported)	Reclassification US$000	At December 31, 2017 US$000 (Reviewed)
ASSETS			
Current assets			
Trade receivables	293,177	50,126	343,303
Other receivables	711,353	(50,126)	661,227
Other current assets	1,314,641	-	1,314,641
Total current assets	2,319,171	-	2,319,171
Total non-current assets	3,619,572	-	3,619,572
Total assets	5,938,743	-	5,938,743

In addition, at January 1, 2018 the amendments to standards and interpretations listed below have become into effect:

- Amendments to IFRS 2, "Classification and measurement of Share-based payment transactions"
- Annual improvements 2014 - 2016 cycle
- Amendments to IAS 40, "Transfers to Investment Properties"
- IFRIC 22, "Foreign currency transactions and advance consideration"

The other above-listed standards and interpretations have had no impact on the Company's financial statements for the previous or current year; no material impact is expected on its financial statements for the future years.

iv) New standards, amendments to standards and interpretations that would be effective for annual periods beginning on or after January 1, 2019 and which have not been early adopted -

A number of amendments to standards and interpretations have been released which are of mandatory adoption for the year ended December 31, 2019 and which have not been early adopted by the Company. The impact assessment performed by the Company of these standards and interpretations is described as follows:

- IFRS 16, "Leases" -

  IFRS 16 will affect primarily the accounting by lessees and will result in the recognition of almost all leases on balance sheet. The standard removes the current distinction between operating and financing leases and requires recognition of an asset (the right to use the leased item) and a financial liability to pay rentals for virtually all lease contracts. An optional exemption exists for short-term and low-value leases.

  The income statement will also be affected because the total expense is typically higher in the earlier years of a lease and lower in later years. Additionally, operating expense will be replaced with interest and depreciation, so key metrics like EBITDA will change.

  Operating cash flows will be higher as cash payments for the principal portion of the lease liability are classified within financing activities. Only the part of the payments that reflects interest can continue to be presented as operating cash flows.

  Accounting by lessors will not significantly change.

IFRS 16 is effective for periods beginning on 1 January 2019. The lessee may choose to apply the standard using a comprehensive or modified retrospective approach, in the latter case, the standard allows certain practical applications for the transition.

The Company estimates its liabilities will increase by 1% at January 1, 2019 from recognizing operating lease liabilities, which under current accounting standards are recognized as operating leases over the term of the contract (see Note 30). Also, the Company expects an increase lower than 1% in its non-current assets resulting from the recognition of the right-of-use asset as required under IFRS 16. However, the recognition of these new asset and liability items result in a decrease lower than 1% in retained earnings at that date.

No material impact is expected from the resulting variance in the respective financial indicator on the Company's compliance with its current contractual commitments (covenants).

For the transition to IFRS 16, the Company has decided to apply the option 2, modified retrospective approach.

As a result of the application of the new requirements of IFRS 16, the Company expects to make certain changes in its current business processes, mainly in the contract management.

- IFRIC 23 "Uncertainty over Income Tax Treatments" -

  IFRIC 23 clarifies how the recognition and measurement requirements of IAS 12 Income taxes are applied where there is uncertainty over income tax treatments. The IFRS Interpretation Committee had clarified previously that IAS 12, instead of IAS 37 Provisions, contingent liabilities and contingent assets, applies to accounting for uncertain income tax treatments.

  IFRIC 23 explains how to recognize and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment. An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that treatment will be accepted by the tax authority. IFRIC 23 applies to all aspects of income tax accounting where there is an uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses and credits and tax rates.

  IFRIC 23 is effective for financial periods beginning on or after January 1, 2019. The Company will evaluate the impact of this interpretation in 2019.

v) Other effective modifications for future years that are not relevant for the Company's activities -

- IFRS 17, "Insurance Contracts".
- Amendments to IAS 28 "Investments in Associates and Joint Ventures".
- Amendments to IFRS 9, "Financial Instruments" for instruments that give the possibility of advance payment.
- Annual improvements to the IFRS, cycle 2015 - 2017 - amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23.
- Amendments to IAS 19, Changes, reductions and settlement of plans.
- Amendments to IFRS 10 and IAS 28 - Sale or contribution of assets between an investor and its associate or joint venture.
- Amendments to IFRS 3 – Business Combinations.

The Company does not expect that other IFRS or IFRIC interpretations not yet effective to have a material impact on its financial statements.

2.2 Foreign currency translation -

a) Functional and presentation currency -

Items included in the financial statements are measured using the currency of the primary economic environment in which the Company operates (the functional currency. The financial statements are presented in US Dollars, which is the Company's functional currency and presentation currency since January 1, 2017.

b) Transactions and balances -

Foreign currency transactions (different from the US dollar) are translated into the functional currency using the exchange rates prevailing at the date of the transactions.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of comprehensive income.

2.3 Going concern -

The financial statements have been prepared under the going concern assumption; that is, the Company will be able to continue its activities normally in the foreseeable future.

Under this assumption, the Company will be able to honor its financial obligations disclosed in Note 13.

The Company has reported profits of US$119,552 thousand for 2018. At December 31, 2018, its current assets exceed its current liabilities by US$673,419 thousand, which primarily reflects the liquidity fund and time deposits for US$3,050 thousand and US$1,417,887 thousand, respectively. Time deposits were set up with cash resulting from: (i) bond issuance for a total US$2,000,000 thousand in 2017 and; (ii) reimbursement of expenses in EPC - "Técnicas Reunidas del Financiamiento con Garantía de the Company Española de Seguros de Crédito a la Exportación" (hereinafter, CESCE loan) for US$1,236,717 thousand in 2018; reduced by the liabilities related to the PMRT execution for US$324,578 thousand (US$334,000 thousand at December 2017).

Management recognizes that the crude price uncertainty remains constant; however, a drop in the crude price has no significant impact on the financial performance of the business since the Company obtains its profit based on a net margin on refinery. Furthermore, refined products have, in the short term, a price that is relatively independent of the crude price, since they have their own dynamic; nevertheless, in the long term, the price of those products is influenced by the price of crude oil. The U.S. Energy Information Administration (EIA) considers that the price difference between Brent and WTI (approximately 4 US$/Bl) reflects the competition of the two crude oil products in world export markets. Therefore, there are two components underlying the price difference, the cost to deliver WTI crude from its Cushing price-setting point to the U.S. Gulf coast, for exports and the additional transportation costs incurred in exporting crude from the U.S.A. to Asia as compared to the Brent delivery costs from the North Sea to Asia. As per Management's projections based on PIRA ENERGY GROUP information source, projections for the years from 2019 and 2030, indicate an average crack spread (3:2:1) of 18.10 US$/Bl, reaching levels of 20.2 US$/Bl during the years 2031-2038. Recovery of the crack spread in late 2019 (18.0 US$/Bl) reflects the recovery of crude prices and a proportional increase in the prices of the refined products (gasoline and diesel).

2.4 Segment information -

Segment information is reported in a manner consistent with the internal reporting provided to the chief operating decision-maker of the Company.

The Company's board has designated General Management as the chief operating decision-maker, which assesses the financial performance and position, makes strategic decisions and is responsible for allocating resources to the operating segments.

For management purposes, Management analyzes the performance of PETROPERÚ S.A. on the basis of three operating segments for the purposes of disclosure of financial information (Note 5).

Management evaluates the performance of operating segments based on operating profit. Management determines the segment's assets as the total assets attributable to each segment and the liabilities as the total liabilities attributable to each segment. The accounting policies used in segment reporting are the same as those used in preparing the financial statements. Inter-segment transfer prices are based on market prices.

Revenue by geographical area is determined based on the location of the customer. All of the Company's non-current assets are located in Peru. Accordingly, no other information by geographical area is prepared on non-current assets.

2.5 Financial assets -

Classification -

At January 1, 2018, the Company classifies its financial assets in the following categories:

- Measured at fair value (through profit or loss or other comprehensive income), and
- Measured at amortized cost.

The classification depends on the entity's business model for managing the financial assets and the contractual terms of the cash flows.

For financial assets measured at fair value, any gains or losses will be recognized in results or other comprehensive income. For investments in equity instruments that are not held for trading, measurement will depend on whether the Company irrevocably opts, at initial recognition, to recognize these equity instrument through other comprehensive income.

At December 31, 2018 and 2017, the Company only maintains financial assets in the category of financial assets measured at amortized cost.

Financial assets measured at amortized cost consists of cash and cash equivalents, trade receivables and some items included in other receivables.

Recognition and derecognition -

Purchases or sales of financial assets are recorded on the trading date of the transaction; i.e. the date on which the Group undertakes to buy or sell the asset. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Measurement -

At initial recognition, the Company measures a financial asset at its fair value plus, in the case of a financial asset not at fair value, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

Embedded derivatives are assessed on a comprehensive basis to determine whether their cash flows are solely payments of principal and interest.

For financial assets measured at the amortized cost, these are assets held for the contractual cash flows to be obtained, where these cash flows only relate to payments of principal and interest. Interest income on these financial assets is included in financial income using the effective interest rate method. Impairment losses are presented as separate line item in the statement of comprehensive income.

Impairment -

From 1 January 2018, the Company assesses on a forward-looking basis the expected credit losses associated with its debt instruments carried at amortized cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in the credit risk.

For trade receivables, the Company applies the simplified approach permitted by IFRS 9, which requires that management estimates the expected credit loss over the lifetime of the instrument and recognize it from initial recognition (see Note 3.1-b of Financial Risk Management for more details).

Accounting policy applied until December 31, 2017-

The Company has adopted IFRS 9 - “Financial Instruments” on a retroactive basis from January 1, 2018; however, it has opted not to restate the comparative period. Therefore, the comparative information shown follows the accounting policies previously implemented by the Company as follows.

Classification

Until December 31, 2017, the Company classifies its financial assets in the following categories: (i) financial assets at fair value through profit or loss, (ii) financial assets held-to-maturity, (iii) loans and receivables and (iv) financial assets available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and reassesses this classification on the date of each closing of financial statements.

At December 31, 2017, the Company only has financial assets in the category of (i) cash and cash equivalent, (ii) trade receivables and (iii) some items included in other receivables.

Subsequent measurement

Measurement at initial recognition have not changed from the adoption of IFRS 9, that is, all financial assets are to be recognized at fair value at initial recognition.

Subsequently, loans and receivable are measured at the amortized cost under the effective interest method.

Impairment

The Company assessed at the end of each reporting period whether there was objective evidence that a financial asset or group of financial assets was impaired. A financial asset or a group of financial assets was impaired and impairment losses were incurred only if there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a ‘loss event’) and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or group of financial assets that could be reliably estimated.

Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulties; such as: default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization, and where observable data indicate that there is a measurable decrease in the estimated future cash flows expected from the asset, such as changes in arrears or economic conditions that correlate with defaults.

For the loans and receivables category, the amount of the impairment loss was measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset was reduced and the amount of the loss was recognized in the statement of comprehensive income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the reversal of the previously recognized impairment loss was recognized in the statement of comprehensive income.

2.6 Cash and cash equivalents -

For purposes of the statement of cash flows, cash and cash equivalents includes cash in hand in checking accounts and time deposits with maturity of less than three months, highly liquid investments with original maturities of three months or less that are easily convertible into cash and are subject to an insignificant risk of changes in value and fixed funds. Time deposits that will not be used within the following three months were classified as other receivables.

2.7 Trade receivables -

Trade receivables are amounts owed to the Company by customers for items sold or services rendered in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are initially recognized at their fair value and are subsequently measured at their amortized cost using the effective interest method, less the provision for impairment.

2.8 Inventories -

Inventories are stated at the lower of cost and net realizable value. The cost includes direct material costs and, where applicable, direct labor related production overheads (based on normal operating capacity). It excludes borrowing costs and exchange differences and includes costs incurred in transferring inventories to their actual location and conditions. The cost of crude oil and acquired by-products/derived products is determined using the first-in / first-out method. Refined products in process and finished products are determined at average production cost. Material and supplies at weighted average cost. In-transit inventories are stated at specific cost of acquisition. The volume of crude oil acquired and kept in the oil pipeline ("ONP") is accounted for at the initial cost of acquisition.

The provision for impairment of inventories of in-process refined products, finished products and by-products acquired is applied directly to the carrying amount of inventories, with a charge to cost of sales; the carrying amount of these inventories is reduced to their net realizable value in the same year. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

With respect to supplies, Management makes a periodic provision for obsolescence based on a technical study or considering those items with no movement for more than two years; said estimated provision is recognized with a charge to results of the period they relate to.

2.9 Property, plant and equipment -

Property, plant and equipment are recorded at acquisition cost, less their accumulated depreciation and accumulated amount of any impairment loss. The cost of an element of property, plant and equipment comprises its purchase price or construction or manufacturing cost, including customs duties and non-reimbursable purchase taxes, as well as any necessary cost, the initial estimate of the obligation to dismantle the asset and, for qualifying assets, the finance costs. The purchase price or construction cost comprises the total amount paid and the fair value of any other consideration given to purchase the asset. The elements of property, plant and equipment are recognized at a major component level.

Costs incurred to replace a component of an item or element of property, plant and equipment are capitalized separately if the qualifying criterion is met and the carrying amount of the component being replaced is written down.

Subsequent costs attributable to an item of fixed assets are capitalized, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably, otherwise they are accounted for as expenses.

Assets under construction are capitalized as a separate component. Recognition of costs will cease when the item is ready for use as expected by Management and from that date, those items are depreciated. When the items are ready for their intended use, they are transferred to their final category.

The cost of the items of property, plant and equipment, net of their residual value is depreciated over their estimated useful lives. Depreciation of assets is recognized as cost or expense depending on their function.

Land is not depreciated. Depreciation is calculated using the straight-line method over the estimated useful life of each asset, as follows:

	Years
Buildings and other constructions	Between 25 and 50
Machinery and equipment	Between 10 and 12
Containers and returnable containers	20
Vehicles	Between 5 and 10
Other equipment	10
Computer equipment	3
Furniture and fixtures	5

The assets' residual values, useful lives and depreciation method applied are reviewed, and adjusted if appropriate, at the date of each statement of financial position. Any change in these estimates is prospectively adjusted. At December 31, 2018, there were no significant changes as a result of its review.

Items of property, plant and equipment are written off when they are disposed of or when economic benefits are no longer expected from their use or subsequent sale.

Gains or losses on disposal are determined considering the difference between the proceeds and carrying amount of the assets. These are included in statement of comprehensive income.

The accounting treatment of the capitalization of interest on qualifying assets is described in Note 2.16.

The income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

2.10 Intangible assets -

Software -

Intangible assets include acquired computer software licenses and software, which are capitalized based on costs incurred to acquire and put the specific software to use. These costs are amortized over their estimated useful lives (between three and ten years).

Costs associated with maintaining computer software programs are recognized as an expense as incurred.

Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Company are recognized as intangible assets when the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- Management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- it can be demonstrated that the software product will generate probable future economic benefits;
- adequate technical, financial and other resources are available to complete the development and to use or sell the software product; and
- the expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalized as part of the software product include the software development employee costs and an appropriate portion of the corresponding overheads.

Hydrocarbons exploration activities -

Exploration costs such as seismic lines and exploratory drilling of wells are capitalized until the technical and commercial feasibility of extracting the resources in the area is demonstrated.

If the exploration and evaluation activities are not expected to be successful, such assets are charged to profit or loss recognizing an impairment loss in the statement of comprehensive income. In the event feasible reserves are identified, exploration and evaluation assets are re-classified from said category as development costs after evaluating their recoverability. Depreciation is not recognized during the exploration and evaluation phase.

If events or circumstances indicate a possible impairment of resource exploration and evaluation assets has occurred, their recoverability is assessed by grouping assets at the lowest levels for which there are separately identifiable cash flows, cash-generating units (hereinafter, CGU), based on considerations such as geographical and geological features, common use of facilities and contractual terms and conditions. Such events and circumstances include the interpretation of seismic data, return requirements of areas, drilling results, remaining period to comply with the exploration commitment period, remaining capital investment plans and political and market conditions.

The hydrocarbons exploration activity comprises the Project for the Exploration and Exploitation of Hydrocarbons in Block 64 ("Proyecto de Exploración y Explotación de Hidrocarburos en el Lote 64), which consists of the implementation of the project called "Desarrollo y explotación del yacimiento Situche Central Lote 64", to bring to production the crude oil reserves discovered in Block 64.

Costs associated at December 31, 2018 amounted to US$21,578 thousand (US$19,634 thousand at December 31, 2017).

2.11 Investment properties -

Investment properties consists of land, buildings, and production infrastructure owned by the Company that are held to obtain cash from terms over a long terms and are not used by the Company. Investment properties are shown at cost less accumulated depreciation and impairment losses, if any. Subsequent costs attributable to investment properties are capitalized only if it is probable that future economic benefits associated with the asset will flow to the Company and the cost of these assets can be measured reliably; if not, they are recognized as expenses when incurred.

Repair and maintenance expenses are recognized in profit and loss when they are incurred. A property's carrying amount is written down immediately to its recoverable amount when the property's carrying amount is greater than its estimated recoverable amount.

Cost and accumulated depreciation of properties sold or retired are eliminated from their respective accounts and any profit or loss is recognized in the income statement. Depreciation of these assets is determined under the straight-line method at a rate considered sufficient to absorb the carrying amount of assets at the end of their useful lives and considering their major components with substantially different useful lives (each component is accounted for separately for depreciation purposes over its individual useful life).

2.12 Impairment of non-financial assets of indefinite useful lives -

The Company conducts an assessment of impairment under the provisions of International Accounting Standard 36 "Impairment of assets" and performs annual tests of impairment of its items of property, plant and equipment, intangible assets and investment properties to determine whether there are indications that said items are impaired. If there is any indication of impairment, Management calculates the recoverable amount in order to determine the extent of the impairment loss (if any). If the recoverable amount of an individual asset item cannot be determined, the Company calculates the recoverable amount of the respective CGU to which the asset belongs. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (CGUs). Provided that consistent and reasonable criteria of asset allocation are used, common assets are also allocated to individual CGUs; or otherwise to the smallest groups of CGUs identified on a consistent and reasonable basis.

The recoverable amount is the higher of the asset's value in use or fair value less costs of disposal. Value in use corresponds to the present value of the estimated future cash flows discounted to current value using a pre-tax discount rate that reflects the current market conditions and the specific risks associated with each asset or CGU.

Impairment losses, calculated with reference to the value in use of the assets, recognized in previous years, are reversed if there is a change in the estimates used when an impairment loss was last recognized.

Impairment losses of assets related to ongoing operations are recognized in the statement of comprehensive income in the categories of expenses corresponding to the nature of the impaired asset.

The Company evaluates annually if there is evidence that indicates that previously recognized impairment losses have been partially or totally reversed.

2.13 Financial liabilities -

The Company classifies its financial liabilities into the following categories: i) financial liabilities at fair value through profit or loss and ii) other financial liabilities. The classification depends on the purpose for which the liabilities were assumed and the way in which they are managed. The Company determines the classification of its financial liabilities at the date of initial recognition. At December 31, 2018 and 2017, the Company only holds liabilities in "other financial liabilities", which correspond to (i) corporate bonds, (ii) unsecured bank loans, which includes the CESCE loan, (iii) trade payables (iv) provisions and other provisions, and, (v) other payables.

In addition, the Company has liabilities for derivative financial instruments that are measured and classified at fair value with changes in profit or loss.

In the case of financial liabilities measured at fair value through profit or loss, changes in the fair value of these liabilities is recognized as gains or losses through profit or loss and shown net within "Other financial income (expenses)" in the period in which changes occur.

2.14 Trade payables -

Trade payables are payment obligations for goods or services acquired from suppliers in the normal course of business. Payables are classified as current liabilities if payment must be made within one year or less (or in the normal operating cycle of the business if it is greater), otherwise, they are presented as non-current liabilities.

Payables are initially recognized at their fair value and subsequently, if the time value of money is relevant, they are remeasured at amortized cost using the effective interest method, otherwise they are shown at their nominal value.

2.15 Borrowings -

Borrowings consist of loans obtained from financial institutions, including unsecured short-term, which are used for working capital and capital expenditures in the PMRT, corporate bonds and CESCE loan. Borrowings are classified based on the terms and conditions of the agreements signed and considering the economic substance of the agreement.

Loans maintained by the Company are initially recognized at their fair value, net of transactional costs incurred. These loans are subsequently recorded at amortized cost. Any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of comprehensive income over the period of the loan using the effective interest method. The Company presents borrowings within other financial liabilities.

Fees and commissions paid on the establishment of loan facilities are recognized as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, transaction costs are deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalized as payments for services to obtain liquidity and amortized over the period of the facility to which it relates.

Borrowings are derecognized from the statement of financial position when the obligation specified in the contract is settled or expires. The difference between the carrying amount of a financial liability that has been extinguished or transferred to another party and the paid consideration, including non-cash transferred or the liabilities assumed are recognized in profit or loss within other finance income or finance cost.

Borrowings are classified as current liabilities unless the Company obtains the unconditional right to defer the payment of the obligation by no less than 12 months from the statement of financial position date.

2.16 Borrowing costs -

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets. Capitalization starts when activities are being carried out to bring the qualifying asset to its expected condition for use and costs are being incurred, as well as borrowing costs; capitalization ends when all the activities required to prepare the asset for its expected use have been completed.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. Other borrowing costs are recognized in the statement of comprehensive income in the period in which they are incurred.

2.17 Leases -

a) Leases in which the Company is the lessee -

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

The Company leases buildings, equipment and vehicles. Leases of buildings, equipment and vehicles in which the Company has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Lease payments are apportioned between the liability and finance expenses so as to achieve a constant rate of interest on the remaining balance of the liability. The obligation for the corresponding leasing minimum payments, net of finance charges, is included in other long-term payables. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Equipment and vehicles acquired through finance leases are depreciated over their useful lives.

b) Leases in which the Company is the lessor -

Property and land leased under operating lease agreements are included in the investment property category in the statement of financial position.

Property assets under operating leases are stated within property, plant and equipment.

Revenues related to operating leases are recognized in the statement of income on the basis of the straight-line method over the period of the lease.

2.18 Employee benefits -

a) Statutory bonuses -

The Company recognizes an expense for statutory bonuses and related liability in accordance with laws and regulations currently in force. Statutory bonuses consist of two one-month salaries per year paid every July and December, respectively. Statutory bonuses are recognized proportionally to the time during which a worker has provided the services that entitle him/her to said benefit.

b) Employees' severance indemnities -

Employees' severance indemnities for time of service of the Company's personnel correspond to their indemnification rights, calculated in accordance with the regulations in force in Peru, which has to be credited to the banks accounts designated by the workers in May and November every year. Personnel severance indemnity is equivalent to one-half of a one-month salary prevailing at the date of deposit, which is recognized in profit or loss as accrued. The Company does not have additional payment obligations once the annual deposits of the funds that the worker is entitled to are made.

c) Vacation leave -

Personnel's annual vacation leave is recognized on an accrual basis. The provision for the estimated obligation for annual vacations of personnel resulting from services provided by the employees is recognized at the date of the statement of financial position.

d) Workers' profit sharing -

The Company recognizes a liability and an expense for the workers' profit sharing in accordance with laws and regulations currently in force. Workers' profit sharing is calculated applying the rate of 10% to the taxable income determined by the Company in accordance with current income tax legislation.

2.19 Provisions -

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

Provisions are reviewed at each period-end. When the effect of the time value of money is significant, provisions are discounted using a pre-tax rate that reflects, when appropriate, the risks specific to the obligation. The reversal of the discount due to the passage of time gives rise to an increase of the obligation recognized with a charge to the statement of comprehensive income as finance cost. Provisions are not recognized for future operating losses.

Provision for environmental remediation and plugging wells of privatized units -

The obligation to be incurred in environment remediation and plugging wells arises from the operating units transferred by the Peruvian Government to the private sector and from a specific mandate, respectively. The Peruvian Government, through the Company assumed these obligations. In this respect, the Peruvian Government will refund all expenses incurred by the Company in meeting these obligations. The obligation assumed by the Peruvian Government was recognized with a charge to prior-year profit or loss. The amount of the provision at that date is adjusted at each year-end.

The Company recognizers a provision for environmental remediation and plugging of wells as part of its legal obligations to remediate the environment at the end of operation of these wells and in adherence to a specific legal mandate. At the date of initial recognition of the liability arising from this obligation, as measured at its fair value discounted to its present value, the same amount is simultaneously charged to the statement of comprehensive income. Subsequently, the liability amount is reviewed and increased in each period, if applicable. In settling this liability, the Company recognizes any resulting profit or loss. Changes in the estimated fair value of the initial obligation and in the interest rates are recognized in the statement of comprehensive income.

2.20 Contingent liabilities and assets -

Contingent liabilities are recognized in the financial statements to the extent that cash outflows are probable; and they are only disclosed in a note to the financial statements when cash outflows are possible.

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

2.21 Current and deferred income tax -

The income tax expense for the period comprises current and deferred tax. Tax is recognized in the statement of comprehensive income, except to the extent that it relates to items recognized directly in the statement of other comprehensive income or in equity. In this case, tax is also recognized in the statement of other comprehensive income or directly in equity, respectively. The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the date of the statement of financial position. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. Management establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using the tax rates (and tax laws) enacted at the date of the statement of financial position and expected to be applicable when the deferred income tax is realized or settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available, against which the temporary differences can be utilized.

Deferred income tax liabilities are provided on taxable temporary differences arising from investments in subsidiaries, associates and joint arrangements, except for deferred income tax liability where the Company controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority.

2.22 Capital -

Subscribed and paid-in common shares are classified as capital share in equity. Shareholder cash capital contributions and profit capitalization for which shares remain to be subscribed and issued are recognized as additional capital when they occur and are approved by shareholders.

2.23 Revenue recognition -

a) Revenue from sales of refined products -

The Company sells refined products principally in the local market but a smaller portion is exported. Revenue from sales of products are recognized when control of goods is transferred, which occurs, when the product is delivered to the customer, the Company has the discretion to decide the sales price and there are no performance obligations to be satisfied that may make customer not to accept the goods. A product is considered to be delivered, for products sold in the local market, when the goods are delivered; for exported goods, it all depends on the export contractual conditions, which mainly occurs when the goods are delivered to the port of shipment.

In certain cases, products are sold applying discounts by retroactive volumes, based on cumulative sales for a period of 12 months. Revenue from these sales are recognized based on the list of prices referred to in the agreement, net of the estimated volume discounts. Historical information is used to estimate and record discounts recognizing revenue only to the extent it is highly probable that no significant reversal will occur in the future. Discounts are stated net of the balance of trade receivables at the estimated volume discounts that are expected to be offset against customer sales billings. There was no need to separate any financing component because sales are agreed at a term no exceeding 45 days, which is consistent with the practice in the market.

b) Revenue from the fuel price stabilization fund (Note 1-c) -

Revenue derived from the fuel price stabilization fund are recognized simultaneously with the revenue from sales to customers of the refined products comprising the Fuel Price Stabilization Fund, for which the General Direction of Hydrocarbons (DGH) of the Ministry of Energy and Mines sets a price range. The Company's price-setting policy is using as a reference the Import Price Parity (PPI); nevertheless, the price billed to customers must be within the price ranges set for the products within the scope of the Fund.

In accordance with the provisions of Emergency Decree No. 010-2004, whenever the Company's price is above the upper price range threshold, the Company records revenue and the respective receivable from the Ministry of Energy and Mines (MEM), for the amount equivalent to the difference between the price billed to customers and the upper price range threshold, since this is a compensating factor; whenever the Company's price is below the lower price range threshold, the Company recognizes a reduction in revenue and the receivables from MEM, for the amount equivalent to the difference between the price billed to customers and the lower price range threshold, since this is a contribution factor.

Balances receivable from the Ministry of Energy and Mines are accounted for as described in 2.5.

c) Revenue from sales of services -

The Company provides services at fixed prices in accordance with contractual terms.

Revenue from services rendered are recognized when control over service is transferred to the customer. For the services of operating terminals, freight, supply, and use of hydrocarbons, the transfer of control occurs when the service is completed and there are no other performance obligations remaing to be satisfied that may affect the customer's acceptance of the service (revenue recognized at a point in time). For the services of rent, transport of crude oil and other services, transfer of control occurs over time, because the relevant performance obligations are satisfied to the extent the service is being rendered given that there is no possibility for the customer not to accept the service already completed.

d) Interest income -

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

2.24 Earnings per share -

Earnings per share are calculated by dividing the net profit attributable to the Company's stockholders by the weighted average number of shares outstanding during the year.

3 FINANCIAL RISK MANAGEMENT

Management is responsible for establishing and supervising the risk management structure. Corporate Finance Management is responsible for risk management. This department identifies, evaluates and manages financial risks.

The Company's risk management policies are established to identify and assess the risks to which the Company is exposed and set adequate risk limits and controls and monitor risks and compliance of limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and entity-specific operations.

The Company seeks to develop a disciplined and constructive control environment through its risk management standards and procedures in which all personnel fully understands their functions and duties.

3.1 Financial risk factors -

The Company's activities expose it to a variety of financial risks: market risk (principally foreign exchange risk, interest rate risk and price risk of crude oil or commodities), credit risk and liquidity risk.

a) Market risk -

The most significant market risks for the Company's activities are explained below:

i) Foreign exchange risk -

Transactions in foreign currency are mainly agreed in soles and euros. The Company is exposed to the risk of severe fluctuations in the exchange rate of said currencies.

Management manages the foreign exchange risk using forward exchange contracts to mitigate its exposure to fluctuations in foreign exchange rates in the short term, mainly resulting from billing of sales in the local market and working capital financing. For other transaction such as purchases from suppliers in Peruvian soles and Euros and obligations with suppliers, the Company takes the Exchange rate risk.

At December 31, assets and liabilities related to transactions in foreign currency, as well as the net position exposed to exchange risk, are summarized as follows:

	2018		2017	
	S/000	**EUR000**	**S/000**	**EUR000**
Assets:				
Cash and cash equivalent	229,620	8,942	321,312	-
Trade receivables	1,320,427	-	864,011	-
Other receivables	2,352,590	-	2,067,971	-
	3,902,637	8,942	3,253,294	-
Liabilities				
Other liabilities	(2,942,995)	-	(2,125,000)	-
Trade payables	(120,377)	(2,223)	(119,887)	(7,933)
Other payables	(396,082)	-	(297,282)	-
Environmental remediation	(49,448)	-	(87,536)	-
	(3,508,902)	(2,223)	(2,629,705)	(7,933)
Net asset (liability) exposition	393,735	6,719	623,589	(7,933)

The Company's assets and liabilities denominated in foreign currencies were translated into its functional currency using the exchange rates published by the Peruvian banking, insurance and pension plan regulator ("Superintendencia de Banca y Seguros y AFP- SBS"). The following exchange rates were used per each foreign currency:

	Exchange rate at December 31	
	2018	**2017**
S/	0.296	0.308
EUR	1.228	1.216

For the year ended December 31, 2018 the Company recognized a net exchange loss of US$6,661 thousand (net exchange loss of US$2,043 thousand at December 31, 2017) as stated in "Exchange difference, net" in the statement of comprehensive income.

Sensitivity analysis -

If the U.S. dollar had strengthened/weakened against the soles and euros by 5% and 10%, respectively (a variation considered reasonable) in 2018 (soles against the US dollars and euros in 2017) it would have affected profit before income tax.

	Movement of	Effect on profit and loss before taxes Revaluation US$000	Devaluation US$000
Year 2018			
S/	5%	5,826	(5,826)
EUR	10%	825	(825)
Year 2017			
S/	5%	9,603	(9,603)
EUR	10%	971	(971)

ii) Interest rate risk -

The Company does not have significant assets, which bear interest; income and operating cash flows are not impacted by the changes in market interest rates.

The Company's interest rate risk arises from long-term borrowings. Borrowings at variable rates expose the Company to cash flow interest rate risk. Borrowings at fixed rates expose the Company to fair value interest rate risk on t its borrowings. Management's policy is to maintain financing mainly at fixed interest rates. Management considers that the fair value interest rate risk is not material because the interest rates of its financing contracts are similar to those available to the Company in the market for similar financial instruments.

At December 31, 2018 and 2017 the Company maintains all of its debt to finance its operations and construction in PMRT at fixed rates according to the following: i) bullet bonds, interest are paid on a semi-annual basis from December 2017 at rates of 4.750% and 5.625% and maturity in s 2032 and 2047, respectively; ii) CESCE loan at a rate of 3.285%, interest is payable on a semi-annual basis from May 2019 and maturity in 2031 and (iii) bank loans without short-term guarantees at rates between 0.8% and 3.45%.

iii) Price risk of crude oil or commodities -

Selling prices of the products traded by the Company are exposed to commercial risks inherent to the volatility of international prices. Prices invoiced by the Company are modified according to the variations in international prices (Note 1-c).

As explained in Note 1-c, prices in the local market are determined considering the international prices of crude oil and by-products. Prices are expressed in soles at the effective exchange rate, taking into consideration, the legal requirements issued in prior years, according to which, under the regime established for the "Price Stabilization Fund" the Peruvian Government can make compensating payments or receive contributions to stabilize the price of certain products for final consumers. This mechanism mitigates the effect of changes in the prices of some products, which are not transferred to the final consumer.

Note 9-a) shows the net balance of compensations and contributions made by the Peruvian Government at December 31, 2018 and 2017.

The Company seeks to enter into agreements with crude oil suppliers and manufacturers in Peru in order to mitigate the price risk by signing long-term purchase agreements at referential basket prices of crude oil or WTI pricing formulas, taking into account the expected margins in the international market. In addition, in purchasing crude oil and imported products, the best price quotes are obtained based on international public bidding processes.

b) Credit risk -

Credit risk arises from the cash and cash equivalents, time deposits with banks as well as the exposure to wholesale and retail credit customers that is reflected by the balances of trade receivables. For banks and financial institutions, only independently rated parties with a minimum rating of "A" are accepted.

i) Risk management -

Credit risk is the risk that a counterparty is unable not meet its borrowings in relation to a financial instrument or sales contract, generating a financial loss. The Company's financial assets potentially exposed to credit risk concentrations, mainly comprise bank deposits, trade receivables and some items included in other receivables.

With respect to bank deposits, the Company reduces the probability of significant concentrations of credit risk by distributing its excess funds in prestigious financial institutions and sets limits on the amounts of credit risk exposure with any of these financial institutions.

For trade receivables, credit risk concentration mostly relates to wholesale customers, which are nation-wide prestigious prime-rated companies. Management has policies in place to make sure that sales of goods are made to wholesale customers with an adequate credit history and guarantees. Such policies comprise, among others, approving credit limits on a customer-by-customer basis, monitoring procedures and continuous follow-up of payment behavior. With respect to agreements signed with Government entities (Peruvian Armed Forces and National Police Force), a due date for payment has been set at 45 days. The Company does not foresee significant losses arising from its counterparties.

ii) Impairment of financial assets -

The Company has the following types of financial assets that are subject to models to determine the expected credit loss:

- Cash and cash equivalents and time deposits and certain items of other receivables,
- Receivables for sales of products and services.

For cash and cash equivalents, time deposits and certain items of other receivables, the Company considers any credit loss as immaterial.

For trade receivables, the Company applies the simplified approach according to IFRS 9 to measure expected credit losses, which uses expected losses over the life of the asset for trade receivables.

To measure the expected credit losses, trade receivables are grouped based on common risk characteristics that reflect the payment capacity of each segment of customers for the amounts owed and the number of days past due. The Company has grouped its customers into (i) Trade, (ii) Armed Forces, (iii) Industrial and (iv) Wholesale.

The rates of expected credit losses are based on the payment profiles of over a 12-month period before December 31, 2018 or January 1, 2018, respectively, and the historical credit losses are adjusted to reflect the current and prospective information about macroeconomic factors that affect customers' ability to settle the Company's trade accounts receivable. The expected credit loss is shown in Note 8.

c) Liquidity risk -

Prudent liquidity risk management involves maintaining sufficient cash and cash equivalents, the availability of financing through an adequate number of sources of committed credit facilities and the capacity to close positions in the market. In this sense, the Company does not have significant liquidity risks since the cash flows from its operations have enabled it to maintain sufficient cash to meet its obligations.

Management manages its liquidity risk by ensuring that sufficient committed lines of credit are available at all times, and meeting its working capital needs with the cash flows obtained from operating activities.

At December 31, 2018, the Company maintains short-term revolving credit lines with local and foreign banks for a total of US$2,914,000 thousand, of which US$1,184,077 thousand are available at that date, a sufficient amount to meet its purchase operations in the local territory and in foreign markets and other obligations related to working capital. These credit limits involve no maintenance costs or collateral requirements.

The Company's Corporate Finance Management supervises the cash flow projections carried out based on its liquidity requirements to ensure that there is sufficient cash to cover the operating needs while maintaining sufficient headroom on its undrawn committed borrowing facilities, so that the Company does not breach borrowing limits or covenants, where applicable, on any of its borrowing facilities. Cash surpluses and balances above what is required for the administration of working capital are invested in interest-bearing instruments and time deposits, choosing instruments with appropriate due dates or sufficient liquidity.

The table below analyzes the Company's financial liabilities into relevant maturity groupings based on the period remaining at the date of the statement of financial position to the contractual maturity date. The amounts disclosed in the table are the undiscounted cash flows:

	Carrying amount	Cash flows non-discounted	Less than 1 year	More than 1 year	More than 2 years
	US$000	US$000	US$000	US$000	US$000
2018					
Other financial liabilities	4,820,722	7,733,274	1,820,292	144,376	5,808,606
Trade payables	529,801	529,801	529,801	-	-
Other payables (*)	21,590	21,590	21,590	-	-
	5,372,113	8,284,665	2,371,683	144,376	5,808,606
2017					
Other financial liabilities	3,304,324	5,669,871	1,425,496	103,750	4,140,625
Trade payables	772,247	772,247	772,247	-	-
Other payables (*)	13,489	13,489	13,489	-	-
	4,090,060	6,455,607	2,211,232	103,750	4,140,625

(*) Other payables do not include liabilities for taxes, advances, or labor liabilities. Liabilities for derivative financial instruments are included.

3.2 Capital risk management -

The Company monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including current and non-current borrowings), less cash and cash equivalent. Total capital is calculated as 'equity' as shown in the statement of financial position plus net debt.

The Company maintains the investment grade given by credit rating agencies: Standard & Poor's (BBB- on the long-term debt) and Fitch Ratings (BBB+ on the foreign currency long-term debt), as well as the AA- rating issued by local agency Apoyo & Asociados Internacionales S.A.C. (AA-(pe).

At December 31, gearing ratios were as follows:

	2018 US$000	2017 US$000
Other financial liabilities	4,820,722	3,304,324
Less: Cash and cash equivalents and time deposits	(1,565,565)	(942,381)
Net debt (A)	3,255,157	2,361,943
Total equity (B)	1,737,310	1,617,604
Total capital (A+B)	4,992,467	3,979,547
Ratio (A/(A+B))	0.65	0.59

At December 31, 2018, the increase in the gearing ratio was mainly due to the effect of the increase in net debt for financing with the CESCE loan, decrease in cash and cash equivalents, increase in time deposits and increase in equity derived from profit or loss for the year.

3.3 Estimation of fair value -

The information used by the Company to estimate the fair value is classified as follows:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).
- Level 3: Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs generally based on the Company's internal estimates and assumptions).

At December 31, 2018 and 2017, the Company has only measured at fair value its forward foreign exchange contracts. The fair value of forward foreign exchange contracts is estimated discounting the future contractual cash flows, net, comparing the contractually agreed foreign exchange rate against a forward foreign exchange rate applicable at the date of measurement. Discounting is performed using a market interest rate that is available to the Company for similar financial instruments, and the inputs of which used in fair value measurement have been classified in Level 2.

In determining the fair value of bonds (measured at the amortized cost), Management uses observable market inputs (Bloomberg), that are classified in Level 1. In determining the fair value of other borrowings (measured at amortized cost) with long-term maturity for disclosure purposes, in the case of borrowings, the expected future cash flows are discounted using a current market interest rate that is available to the Company for similar financial instruments and the inputs of which have been classified in Level 2; while for the CESCE loan, Management has discounted the contractual cash flows at the Company's average borrowing rate at mid- and long-term plus a spread, information that is classified in level 3.

In determining the fair value of investment properties (measured at cost less accumulated depreciation) for disclosure purposes, Management has used appraisals conducted internally; of which the respective inputs used for measurement have been classified in Level 3.

The carrying amount of cash and cash equivalents corresponds to their fair value. The Company considers that the carrying amount of receivables and payables (including borrowings) are similar to their fair values due to their short-term maturity and the impact of the discount is not significant.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgments used are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4.1 Estimates and critical accounting criteria

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of the reported assets and liabilities are addressed below:

- Useful life of property, furniture and equipment -

Depreciation is calculated under the straight-line method over the estimated useful life of the asset. This results in depreciation charges that are proportional to the estimated wear and tear of the assets as measured in number of years. The useful life of the assets is assessed on the basis of: i) the physical wear and tear of the asset and ii) expected use of the asset. These calculations require estimates and assumptions to be made regarding the market demand for the Company's production and the capital disbursements that will be required in the future.

- Provisions and contingencies -

The Company is subject to a number of laws and regulations as well as business practices effective in Peru. In this sense, Management makes judgement and estimates in recording environmental matters and seeking to meet the technical standards issued by the local regulatory authorities. Actual costs may differ from estimates for a number of reasons, such as changes in the assumptions and differing interpretations of laws, opinions and assessments in determining the amount of losses.

The Company updates the provision for remediation of privatized and own units as well as the provision of plug-back costs to reflect new events, changes in circumstances and any other relevant information available to determine the costs that it will incur to cover these items. Changes in the variables used to establish the amount of the environmental obligation and plugging wells costs may give rise to major adjustments to the balance of the obligation. Also, the Company determines the provisions required for the environmental remediation obligation arising from oil spills derived from the events that occurred on the Northern Peruvian Oil Pipeline ("ONP"), considering the contracts remaining to be implemented and currently in the contracting process.

Furthermore, in the ordinary course of business, the Company is exposed to certain contingent liabilities relating to existing or potential claims, litigation and other actions brought against it, including some involving taxes.

A provision is recorded for contingencies when it is probable that a liability has been incurred and the amount of the loss can be estimated reliably. The Company's estimates are based on projections that are updated considering the results of the above-mentioned litigation or other actions and the previous experience of its technical staff and legal counsel both internal and external to address and resolve legal, labor-related and tax claims. To the extent the amount of obligations is being more clearly defined or further information become available, the Company may change its future cost estimates, which may have a significant effect on the results of its operations and its financial position or liquidity.

- Taxes -

Determination of tax expenses and obligations requires interpretation of the Peruvian tax laws. The Company seeks professional advice in tax matters before making tax-related decisions. Management considers that these estimates are reasonable and appropriate at the reporting date; however, it considers that a particular interpretation of a point of tax laws by the Peruvian tax authorities may eventually result in additional taxes payable in the future. The Company recognizes liabilities for the observations resulting from tax audits when additional taxes become payable; any differences have an impact on the balances of current and deferred income tax for the fiscal period in which those observations are determined.

Deferred income tax asset is reviewed at each reporting date to determine the recoverable amount.

The current income tax determination is performed by the Company following applicable laws and regulations and it does not include any estimated provisions that may eventually give rise to differences against tax audit results. Accordingly, no sensitivity analysis has been considered necessary to be included to simulate variances in calculation, because Management considers that no significant differences will arise that may have a material impact on its financial statements.

- Review of carrying amounts and impairment provision -

The Company performs an assessment of whether a provision for impairment is required following the accounting policy described in Note 2. This determination requires Management to exercise judgment in analyzing evidence of impairment and determining the recoverable amount. In determining the latter, judgment is required to calculate the expected future cash flows, including Management's projections of the Company operations in the future, projections of economic factors that may affect the Company's expected revenue and costs as well as determining the discount rate to be applied to those cash flows.

Estimates used in determining the recoverable amount of assets consider prior-year events, current operations, future expectations as well as changes in the Company's business strategy. These considerations were relevant in estimating the expected future cash flows and are taken into account in the coming years.

- Assets subject to depreciation or amortization -

Assets that are subject to depreciation and amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount of an asset comprise the higher of its fair value less cost of disposal or its value in use. For purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (CGUs).

The Company groups its assets into three CGUs: (i) Production and trading; (ii) Oil Pipeline operations and iii) Leased and privatized Units.

Company's Management did not identify impairment indicators of the Leased and privatized units CGU; therefore, no impairment test was performed on the assets of this CGU.

The Company, based on internal and external information, considers that there are certain indications that the assets of the Production and trading and Oil Pipeline operations CGUs may be impaired in 2018 and 2017 by calculating the value in use of these CGUs, disclosure and sensitivity analysis of which are provided in Note 11.

- PMRT assets in process of construction -

PMRT assets in the process of construction are reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. Impairment losses are recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount of assets under construction is their fair value less costs of disposal. The Company has calculated the recoverable amount of the PMRT; disclosure and sensitivity analysis is provided in Note 11.

- Provision for doubtful account -

The Company has recognized a correction in the amount of the provision based on the expected credit losses on its financial assets. Under IFRS 9, impairment of a financial asset has to be estimated based on the expected credit losses rather than incurred losses (as stated in the predecessor IAS 39).

4.2 Critical judgments in the application of accounting policies -

Determination of functional currency - Note 2.2 - a) -

Under IAS 21, "The Effects of Changes in Foreign Exchange Rates", an entity must define its functional currency as the currency of the primary economic environment in which the Company operates. As part of its assessment, an entity analyzes primary indicators (those associated with the economic forces that mainly influence sales prices and costs); when the primary indicators are not conclusive, it analyzes secondary indicators (those associated with the currency in which funds from financing activities are generated and in which cash surpluses are maintained). After this evaluation, the determination of the functional currency may not be evident, in which case, Management should exercise judgment to determine its functional currency as the currency that most faithfully reflects the economic effects of the Company's underlying transactions.

The Company sells its products and services mostly in the Peruvian market; selling prices of crude are influenced by the international market and by the local market and regulations. Most of the costs correspond to the import of crude, this cost is denominated in U.S. dollars and is mainly influenced by the international markets, most notably the United States market.

In 2017 and 2018, Management has not observed any relevant change in the circumstances prevailing until 2016. However, from 2017, borrowings are mostly held in U.S. dollars as a result of the issuance of bonds in foreign markets for US$2,000,000 thousand; this circumstance gave rise to a change in the financing structure existing until previous years. In addition, in 2018 the Company obtained a long-term loan with CESCE for US$1,236,717 thousand.

Until 2016, since the results of the assessment of the primary indicators set forth in IAS 21 were not conclusive, the Company defined the sol as its functional currency on the grounds that this is the currency in which most borrowings are denominated. From 2017, the change in the financing structure and the notable prevalence of the U.S. dollar, have led the Company to re-assess its functional currency determination and define the United States dollar as its functional currency; accordingly, the financial statements are to be expressed in the currency in which most of the underlying transactions are denominated.

At December 31, 2018 according to Management's critical judgment, the functional currency is the US dollar.

5 SEGMENT INFORMATION

a) Description of business segments and core activities -

The Company's chief operating decision-maker (General Management) evaluates the Company's performance in its three divisions that are considered reportable segments. These divisions offer different products and services and are managed separately since they required different sales and financial business strategies.

The Company's operating segments are assessed by the activities of the following business units: (i) Production and trading, (ii) Oil Pipeline operations y (iii) Leased and privatized units.

As set forth under IFRS 8, the reportable operating segment based on its level of revenue is: 'Production and trading'. However, the Company has voluntarily decided to report on all its operating segments as detailed in this Note.

The following summary describes the operations of each reportable segment:

Reportable segment	Operations
Production and trading	Refining and commercialization of petroleum products.
Oil Pipeline operations	Service of transfer and custody of crudes from the Northern jungle of Peru.
Leased and privatized units	Assets that originate cash inflows derived from rentals.

The Company's General Management reviews the internal management reports of each segment on a quarterly basis.

There are several levels of transactions between the Production and trading segments and Oil Pipeline operations. These transactions include oil transfers or some transportation products and services, respectively.

b) Statement of financial position by segments -

	Production and trading (*)	Oil Pipeline operations	Leased and privatized units	Total
	US$000	US$000	US$000	US$000
At December 31, 2018				
Assets				
Current	2,745,057	267,563	3,466	3,016,086
Non-current	3,888,085	200,991	238,841	4,327,917
Total assets	6,633,142	468,554	242,307	7,334,003
Liabilities				
Current	2,273,861	43,653	25,153	2,342,667
Non-current	3,263,908	118	-	3,264,026
Total liabilities	5,537,769	43,771	25,153	5,606,693
At December 31, 2017				
Assets				
Current	2,285,586	28,504	5,081	2,319,171
Non-current	3,248,310	178,298	192,964	3,619,572
Total assets	5,533,896	206,802	198,045	5,938,743
Liabilities				
Current	2,166,106	91,597	8,544	2,266,247
Non-current	2,045,450	9,442	-	2,054,892
Total liabilities	4,211,556	101,039	8,544	4,321,139

(*) Include refineries, a gas station, commercial area and main office.

c) Statement of comprehensive income by segments -

	Production and trading (*) US$000	Oil Pipeline operations US$000	Leased and privatized units US$000	Total US$000
For the year ended December 31, 2018				
Income from ordinary activities:				
Net sale of good	4,800,258	83,748	-	4,884,006
Provision of services	14,205	22,109	44,750	81,064
Total income from ordinary activities	4,814,463	105,857	44,750	4,965,070
Cost of sales	(4,546,234)	(65,977)	(5,389)	(4,617,600)
Transfers	(7,108)	7,108	-	-
Gross profit	261,121	46,988	39,361	347,470
Selling and distribution expenses	(69,887)	(51)	(7,471)	(77,409)
Administrative expenses	(138,247)	(17,970)	(8)	(156,225)
Other income and expenses, net	109,149	(7,140)	(2)	102,007
Operating profit	162,136	21,827	31,880	215,843
Financial, net	(36,419)	(2,135)	(14)	(38,568)
Profit before income tax	125,717	19,692	31,866	177,275
Income tax	(40,935)	(6,412)	(10,376)	(57,723)
Net profit for the year	84,782	13,280	21,490	119,552
For the year ended December 31, 2017				
Income from ordinary activities:				
Net sale of good	3,974,111	5,181	-	3,979,292
Provision of services	22,888	3,390	46,004	72,282
Total income from ordinary activities	3,996,999	8,571	46,004	4,051,574
Cost of sales	(3,492,930)	(38,774)	(5,389)	(3,537,093)
Transfers	(191)	191	-	-
Gross profit (loss)	503,878	(30,012)	40,615	514,481
Selling and distribution expenses	(65,168)	-	(5,038)	(70,206)
Administrative expenses	(156,641)	(22,319)	(24)	(178,984)
Other income and expenses, net	57,417)	(31,675)	7,522	33,264
Operating profit (loss)	339,486	(84,006)	43,075	298,555
Financial, net	(49,483)	(1,118)	109	(50,492)
Profit (loss) before income tax	290,003	(85,124)	43,184	248,063
Income tax	(71,110)	19,329	(11,178)	(62,959)
Net profit (loss) for the year	218,893	(65,795)	32,006	185,104

(*) Include refineries, a gas station, commercial area and main office.

d) Revenue by geographical area -

At December 31, revenue by geographical segment is based on the customers' geographical location:

	2018 US$000	2017 US$000
Peru	4,450,327	3,657,830
Other countries	514,743	393,744
	4,965,070	4,051,574

6 FINANCIAL INSTRUMENTS

6.1 Financial instruments per category -

The classification of financial assets and liabilities per category is as follows:

	At December 31,	
	2018 US$000	2017 US$000
Financial assets as per the statement of financial position		
Financial assets at amortized cost:		
- Cash and cash equivalents	528,700	666,141
- Trade receivables	438,698	343,303
- Other receivables (*)	1,088,206	413,480
	2,055,604	1,422,924
Financial liabilities as per the statement of financial position		
Other financial liabilities at amortized cost:		
- Other financial liabilities	4,820,722	3,304,324
- Trade payables	529,801	772,247
- Other payables (*)	7,106	9,687
	5,357,629	4,086,258
Derivative financial instruments:		
- Other liabilities at fair value (Note 15)	14,484	3,802

(*) Not including taxes, labor liabilities nor advances.

6.2 Credit quality of financial assets -

The credit quality of financial assets is shown in Note 3.1.b).

According to the information provided by Apoyo & Asociados Internacionales S.A.C., the credit quality of the financial institutions in which cash is maintained in checking accounts, liquidity funds and time deposits is broken down as follows:

	At December 31,	
	2018 US$000	2017 US$000
Cash and cash equivalent -		
Checking accounts:		
A+	45,698	60,358
A	479,922	109,749
	525,620	170,107
Liquidity funds:		
A	3,050	496,000

	At December 31,	
	2018	2017
	US$000	US$000
Other receivables -		
Time deposits:		
A+	130,000	126,008
A	132,865	232
A-	774,000	150,000
	1,036,865	276,240

Risk ratings "A" and "A+" in the above table represent high quality ratings. For banks in Peru, risk ratings are obtained from the credit rating agencies authorized by the Peruvian banking regulator, (Superintendencia de Banca, Seguros y AFP - SBS).

Customers' credit quality is assessed in three category (internal ranking):

A: new customers / related parties (less than six months).
B: existing customers / related parties (more than six months) with no history of default.
C: existing customers / related parties (more than six months) with some history of default in the past.

	At December 31,	
	2018	2017
	US$000	US$000
Trade receivables (Note 8)		
Counterparties without external credit rating		
A	65	171
B	426,783	83,554
C	11,850	259,578
	438,698	343,303

Other receivables (Note 9)

Counterparties without external credit rating (excludes time deposits, tax credit, advances, payments on account, other taxes and impaired accounts).

	At December 31,	
	2018	2017
	US$000	US$000
A	11,955	130
B	23,861	20,706
C	282,748	194,307
	318,564	215,143

The total balance of trade receivables and receivables from related parties is in compliance with contract terms and conditions; none of them have been re-negotiated.

7 CASH AND CASH EQUIVALENTS

This item comprises:

	At December 31,	
	2018	2017
	US$000	US$000
Checking accounts (a)	525,620	170,107
Liquidity funds (b)	3,050	496,000
Fixed funds	30	34
	528,700	666,141

(a) The Company maintains cash in checking accounts in local and foreign currency with financial institutions. These funds are freely available earning preferred interest rates between 0.25% and 2.46%.

(b) At December 31, 2018, liquidity funds are short-term instruments in foreign institutions with variable returns between 2.29% and 2.45% and are immediately available without a defined maturity date, which will be used in PMRT investment activities in the subsequent months.

8 TRADE RECEIVABLES

This item comprises:

	At December 31,	
	2018	2017
	US$000	US$000
Wholesalers	239,987	203,314
Price Stabilization Fund - Ministry of Energy and Mines (Note 1-c)	82,472	50,126
Mining industry	32,108	24,914
External market	26,887	341
Fuel traders	19,315	20,273
Armed Forces and National Police Force	11,555	19,776
Aviation business	7,451	7,007
Construction industry	5,511	5,895
Oil companies	3,687	5,681
Fishing industry	2,513	-
Maritime businesses	2,429	3,149
Transport industry	2,373	1,364
Electric power industry	1,063	300
Sector industrial	926	579
Other customers	421	584
Doubtful accounts	5,019	4,996
	443,717	348,299
Less - doubtful account estimate	(5,019)	(4,996)
	438,698	343,303

Accounts receivable -

The balances of trade receivables are invoices in soles and U.S. dollars mainly originated by sales of refined products. For the Armed Forces and National Police Force, receivables fall due after 45 days; for wholesalers and other customers, from 7 to 45 days. Following internal policies, receivables are mostly secured by a letter of guarantee and other instruments of the Peruvian financial system in accordance with the credit policy approved by the Board of Directors.

Price Stabilization Fund - Ministry of Energy and Mines -

At December 31, 2018 and 2017 the total amount receivable from the General Hydrocarbons Agency (DGH) amounted to US$102,379 thousand and US$68,008 thousand, respectively, generated from compensations and contributions transactions (Note 2.24-b); at December 31, 2018 this includes a legal recourse ("Demanda de Amparo") recorded in a Claims account for US$17,173 thousand (US$17,882 thousand at December 31, 2017), classified as other long-term receivables (Note 9) and the amount receivable of US$82,472 thousand (US$50,126 thousand at December 31, 2017).

At December 31, the movement of the total balance of the item Price Stabilization Fund is explained as follows:

	2018 US$000	2017 US$000
Opening balance	50,126	23,696
Price compensation	60,170	47,406
Price contribution	(21,405)	(22,515)
Net credited to revenue from ordinary activities (Note 19)	38,765	24,891
Contribution generated by import of products	(2,734)	-
Exchange difference	(3,685)	1,539
Closing balance	82,472	50,126

Expected loss of trade receivables -

To measure the expected credit losses, the Company has classified its customers based on common risk characteristics that reflect the payment capacity of each segment of customers considering the amounts owed. This classification was performed considering the segments that represent specific risks: wholesale, industrial, trade and armed forces segments.

The Company considered appropriate to exclude trade receivable from wholesale and trade segments considering their high liquidity and because no historical losses have been incurred.

The rates of expected credit losses are based on the payment profiles of sales over a 12-month period before December 31, 2018 and the historical credit losses are adjusted to reflect the current and prospective information about macroeconomic factors that affect customers' ability to settle the Company's trade accounts receivable.

Based on that information, the provision for losses at December 31, 2018 and January 1, 2018 (after the adoption of IFRS 9) was determined as follows:

	2018			2017		
	Expected loss rate %	Gross carrying amount US$000	Expected loss US$000	Expected loss rate %	Gross carrying amount US$000	Expected loss US$000
Current	0.01	354,397	32	0.01	220,675	24
From 1 to 30 days	0.48	831	4	0.27	12,870	35
From 31 to 60 days	0.54	373	2	0.29	2,101	6
From 61 to 90 days	0.68	147	1	0.30	5,312	16
From 91 to 120 days	-	43	-	0.52	33,837	176
From 121 to 150 days	-	-	-	0.56	1,963	11
From 151 to 180 days	-	1	-	0.65	1,681	11
From 181 to 210 days	1.69	59	1	0.97	8,106	79
From 211 to 240 days	5.88	17	1	1.72	582	10
From 241 to 270 days	-	-	-	2.08	5,915	123
From 271 to 300 days	-	-	-	14.75	644	95
From 301 to 330 days	67.31	52	35	56.98	179	102
From 331 to 360 days	92.44	119	110	100.00	43	43
More than 360 days	92.84	5,206	4,833	100.00	4,265	4,265
Total (*)		361,245	5,019		298,173	4,996

(*) Does not include the Price Stabilization Fund.

The movement in the provision for expected loss of trade receivables is as follows:

	2018 US$000	2017 US$000
Opening balance	4,996	6,063
Expected loss for the year (Note 22)	382	126
Exchange difference	(229)	234
Recoveries	(130)	(1,427)
Closing balance	5,019	4,996

Management considers that the estimate for the expected loss recognized in the financial statements and guarantees required are sufficient to cover any eventual risk of collection of trade receivables at the date of the statement of financial position.

Trade receivables that have reached maturity, on which no losses are expected are related to independent customers maintaining letters of guarantee and/or whose debt is reconciled and is expected to be collected in the short term; therefore, Management has not estimated an expected loss for these accounts.

The provision for expected loss for trade receivables is included in selling and administrative expenses in the statement of comprehensive income (Note 22 - 23).

9 OTHER RECEIVABLES

This item comprise:

	At December 31,	
	2018 US$000	2017 US$000
Current		
Claims against tax authorities - SUNAT (a)	-	96,430
Tax credit - VAT (c)	385,735	259,822
Fixed time deposits (e)	1,036,865	276,240
Loans to personnel	4,356	5,364
Advances granted to suppliers	9,279	6,622
Payments for return of association investment with GeoPark	9,149	9,819
Others	10,373	6,930
Doubtful accounts (f)	35,495	36,483
	1,491,252	697,710
Less - Doubtful accounts estimate	(35,495)	(36,483)
	1,455,757	661,227
Non-current		
Claims against tax authorities - SUNAT (a)	9,613	27,777
Price Stability Fund Claims - Ministry of Energy and Mines (Note 1-c) (b)	17,173	17,882
Tax credit - VAT, long-term (d)	209,563	163,310
Long-term third parties claims	677	815
Other long-term taxes	4,725	5,384
Non-current portion	241,751	215,168

(a) Claims to the Peruvian Tax and Customs regulator (Superintendencia Nacional de Aduanas y de Administración Tributaria - SUNAT) -

This item consists of claims against tax assessments involving the Turbo A-1 (fuel intended only for aviation activities) resulting from the provisions of DS 186-2002-EF, which stipulated the sales of Turbo A1 intended for general aviation activities were not subject to Excise Tax (ISC in Peru). In this respect, the Company considers it illegal to restrict the tax to sales conducted by profit-making entities since they were finally directed to aviation entities by virtue of private contracts.

At December 31, this item comprises:

	2018 US$000	2017 US$000
File No.02529-2010-2-1801-JR-CA-14(i)	-	36,984
File No.07873-2012-0-1801-JR-CA-13 (ii)	-	59,446
File No.00114-2012-1801-JR-CA-07 (iii)	-	18,316
File No.03490-2012-0-1801-JR-CA-08 (iv)	972	810
File No.17806-2012 (v)	8,641	8,651
	9,613	124,207

(i) In April 2011, SUNAT conducted a preventive seizure of US$36,656 thousand (equivalent to S/120,012 thousand) for Excise tax (hereinafter, ISC) unpaid by the Company on the import of a type of fuel called Turbo A-1, in 2003. On May 31, 2017, a notice was served with the Final Decision No. 626-2017-MP-FN-FSCA by which the Supreme Tax Judge found groundless the appeal recourse submitted by the Peruvian Tax Authorities.

As per Supreme Court decision dated October 5, 2017 the appeal actions filed by the Peruvian tax authorities were declared groundless ("Casación N° 0397-2016"). The Company and its legal counsel consider that the claim will have a favorable outcome in the short term.

By means of Division Resolution No. 000 323300/2018-000110 dated July 25, 2018 SUNAT approved the refund of the excise tax (ISC, in Peru) unduly paid by the Company for a total US$74,989 thousand (equivalent to S/245,439 thousand), including interest for US$38,333 thousand (equivalent to S/125,427 thousand), recognized in other income in the statement of comprehensive income (Note 25).

(ii) In February 2013 the Company paid a total US$55,693 thousand (S/180,723 thousand) of excise tax (ISC) and tax penalties for fiscal 2004; in July 2013 it paid a total US$3,753 thousand (S/12,179 thousand) of excise tax (ISC) for October 2004, regarding coercive collection resolutions issued by the Peruvian tax authorities. As per Supreme Court decision dated September 27, 2017 the appeal actions filed by the Peruvian tax authorities were declared groundless and the Company was served notice on November 21, 2017 ("Casación N° 3644-2016"). In December 2017, the Company applied for a refund of the amounts already paid to the Peruvian tax authorities.

By means of resolutions ("Resoluciones de Intendencia") No. 012-180-0015915/SUNAT and N° 012-180-0015914/SUNAT dated February 14, 2018 refunding of US$101,967 thousand (equivalent to S/332,044 thousand) were approved, relating to a refunding claim under case file ("Expediente N° 07873-2012-0-1801-JR-CA-13"). Returns obtained include interest of US$42,813 thousand (equivalent to S/139,142 thousand), recognized in other income in the statement of comprehensive income (Note 25).

(iii) In July and August 2013, the Company paid a total US$18,000 thousand (S/59,434 thousand) of VAT (IGV) and excise tax (ISC) for fiscal 2005. As per Supreme Court decision dated November 30, 2017 the appeal actions filed by the Peruvian tax authorities were declared groundless ("Casación N°3791-2016").

By means of resolutions ("Resoluciones de Intendencia") No. 012-180-0017743/SUNAT, 012-180-0017751/SUNAT, 012-180-0017742/SUNAT and 012-180-0017752/SUNAT dated November 12, 2018 SUNAT approved the refund of US$31,251 thousand (equivalent to S/105,077 thousand) regarding VAT (IGV) and excise tax (ISC) that inadequately levied sales of fuel Turbo A-1 made in 2005. Refunds include interest for US$13,678 thousand (equivalent to S/45,642 thousand), recognized in other income in the statement of comprehensive income (Note 25).

(iv) In February 2013, the Company paid a total of US$777 thousand (S/2,627 thousand) on the tax assessments relating to allegedly unpaid Excise Tax (ISC) for fiscal 2002. By means of resolution ("Resolución de Intendencia") No. 012-180-0017009/SUNAT date July 16, 2018, SUNAT approved the refund of US$195 thousand (equivalent to S/656 thousand) comprising the excise tax (ISC) of November for 2002, approving a total refund of S/1,199 thousand.

On August 13, 2018, SUNAT issued Resolution 012-180-0017018 stating that the refund of S/2,627 thousand was groundless. Subsequently, a claim against said Resolution was filed with SUNAT and the outcome was adverse for the Company under Resolution 0150140014459 dated October 31, 2018. At December 31, 2018, an Appeal against this last resolution remains to be filed.

(v) In November 2012, the Company paid a total US$8,651 thousand (S/29,197 thousand) in respect of a number of tax determination and tax penalty resolutions involving allegedly unpaid excise tax (ISC) and VAT (IGV) for fiscal 2007. At December 31, 2018, this action remains to be resolved by Courtroom 4 of the Peruvian Tax Tribunal, under File No. 17806-2012. The Company and its legal counsel have high expectations of obtaining a favorable outcome. The expected refund is equivalent to US$8,641 thousand at the closing exchange rate.

(b) Price Stabilization Fund Claims - Ministry of Energy and Mines -

In April 2010, the General Hydrocarbons Agency (DGH) issued Resolution 075-2010-EM/DG, by which the producers and importers of fuel are required to amend the weekly statements presented since August 2008 and apply, on a retroactive basis, the reference values established in said Resolution. The Company, based on the opinion of Management and legal counsel, has filed an Action seeking constitutional protection with the second constitutional court in Lima, on the grounds that this resolution was unconstitutional. This action was assigned with the File N°21022-2010-0-1801-JR-CI-02.

On November 28, 2018, a Sentence was issued as contained in Resolution No16 by which a constitutional court in Lima ("Segundo Juzgado Especializado Constitucional de Lima") decided the claim was groundless. At December 31, 2018 notice with that sentence remains to be served to PETROPERÚ S.A. for the Company to be able to file an appeal.

Management considers that, based on the reports of its external legal counsel, once the court proceedings are completed, the outcome will be favorable to the Company and it will enable it to recover the whole account receivable recorded that amounts to US$17,173 thousand at December 31, 2018 (US$17,882 thousand at December 31, 2017).

(c) Tax credit - Value added tax and income tax, short-term -

At December 31, 2018 corresponds to the Value Added Tax credit (IGV in Peru) of operations for US$244,768 thousand (equivalent to S/827,070 thousand), Value Added Tax of the PMRT for an amount of US$53,547 thousand (equivalent to S/180,936 thousand) and tax credit for payments on account of income tax for US$87,195 thousand (equivalent to S/294,631 thousand), which will be recovered in the short term from operations and under the VAT anticipated recovery regime.

During 2018, SUNAT approved the return of VAT for US$44,002 thousand, which was requested by the Company through the anticipated recovery regime ("Régimen de Recuperación Anticipada"). At December 31, 2017 it mainly corresponds to the Value Added Tax credit (IGV in Peru) for US$162,133 thousand (equivalent to S/526,126 thousand), Value Added Tax of the PMRT for an amount of US$91,614 thousand (equivalent to S/297,288 thousand) and Excise Tax (ISC in Peru) for US$6,074 thousand (equivalent to S/19,711 thousand).

(d) Tax credit - Value added tax, long-term -

Corresponds to the Value Added Tax credit (IGV in Peru) paid for the acquisition of goods and services mainly related to the Talara Refinery Modernization Project amounting to US$157,028 thousand (equivalent to S/530,599 thousand) and the VAT for operations amounting to US$52,535 thousand (equivalent to S/177,513 thousand). This credit balance of tax credit has no expiry date. The Company expects to recover this tax credit through the anticipated recovery regime ("Régimen de Recuperación Anticipada").

(e) Fixed time deposits -

At December 31, 2018 and 2017 the Company maintains fixed time deposits with maturity less than 90 days in foreign banks. However, Management expects to renew the term of said deposits for a period greater than 90 days.

(f) Expected loss of other receivables -

Based on that information, the provision for losses at December 31, 2018 and January 1, 2018 (after the adoption of IFRS 9) was determined as follows:

	2018			2017		
	Expected loss rate	Gross carrying amount	Expected loss	Expected loss rate	Gross carrying amount	Expected loss
	%	US$000	US$000	%	US$000	US$000
Current	2.15	9,821	10	1.13	6,571	74
From 1 to 30 days	19.75	562	111	7.48	254	19
From 31 to 60 days	28.00	75	21	14.29	28	4
From 61 to 90 days	40.00	45	18	16.67	6	1
From 91 to 120 days	50.00	22	11	21.88	128	28
From 121 to 150 days	50.00	4	17	50.00	2	1
From 151 to 180 days	60.71	28	2	76.47	17	13
From 181 to 210 days	66.67	3	2	80.00	15	12
From 211 to 240 days	81.82	11	19	90.91	11	10
From 241 to 270 days	88.89	9	8	91.49	646	591
From 271 to 300 days	90.48	21	9	93.15	73	68
From 331 to 360 days	100.00	654	654	100.00	26	26
More than 360 days	100.00	34,613	34,613	100.00	35,636	35,636
Total (*)		45,868	35,495		43,413	36,483

(*) It only includes other receivables.

The expected loss is mainly related to claims submitted to municipalities involving property taxes and municipal taxes; the probability of a favorable outcome is low. At December 31, the movement of the provision for expected loss is as follows:

	2018 US$000	2017 US$000
Opening balance	36,483	33,259
Expected losses (Note 23)	553	3,218
Exchange difference	(723)	627
Recoveries	(620)	(573)
Write-offs	(198)	(48)
Final balance	35,495	36,483

10 INVENTORIES

This item comprises:

	At December 31, 2018 US$000	2017 US$000
Crude oil	54,878	118,317
Refined products:		
In-process	220,811	219,701
Finished	187,464	203,432
Acquired refined products	93,173	63,844
In-transit inventories	18,075	22,314
Supplies	17,199	17,518
	591,600	645,126
Less - Provision for impairment of supplies	(1,063)	(1,515)
	590,537	643,611

In 2018, the cost of inventories recognized as expenses and included in the cost of sales amounted to US$4,304,606 thousand (US$3,241,227 thousand in 2017) which are equivalent to cost of sales less operating expenses of production (Note 21).

At December 31, 2018 the crude oil price had a rising trend, with a closing price of US$45.33 per barrel (US$60.42 per barrel at December 31, 2017). The average price during December 2018 was US$49.53 per barrel (US$57.94 per barrel in December 2017).

The movement of the provision for impairment of supplies is explained as follows

	2018 US$000	2017 US$000
Opening balance	(1,515)	(1,507)
Impairment of supplies	(591)	(8)
Recovery	1,043	-
Closing balance	(1,063)	(1,515)

This provision was recognized as a result of analyzing the net realizable value of inventories, taking into account the expectations of obtaining net cash flows from sales or consumption and considering their physical condition. At December 31, 2018 and 2017, Management considers that the amount of the provision adequately reflects the risk of impairment of all its inventories both by physical obsolescence and net realizable value.

11 PROPERTY, PLANT AND EQUIPMENT

This item comprises:

	Land US$000	Buildings and others constructions US$000	Machinery and equipment US$000	Vehicles US$000	Furniture and fixtures US$000	Other and computer equipment US$000	Equipment not in use US$000	In-transit units US$000	Work in progress US$000	Additional Investments US$000	Total US$000
At January 1, 2017:											
Cost	198,607	135,497	592,715	21,570	3,871	39,550	13,674	122	2,100,342	15,554	3,121,502
Accumulated depreciation	-	(81,327)	(274,666)	(16,341)	(3,184)	(23,698)	(13,674)	-	-	-	(412,890)
Accumulated impairment	-	-	(43,331)	-	-	-	-	-	-	-	(43,331)
Net cost	198,607	54,170	274,718	5,229	687	15,852	-	122	2,100,342	15,554	2,665,281
Year 2017											
Opening balance of net book cost	198,607	54,170	274,718	5,229	687	15,852	-	122	2,100,342	15,554	2,665,281
Additions	-	534	4,788	-	-	1,551	-	-	609,112	22,135	638,120
Disposals	(549)	(1)	(4,709)	(152)	-	(38)	(1,710)	-	-	-	(7,159)
Transfers	858	47,043	54,049	2,690	338	7,429	1,903	-	(108,532)	(5,778)	-
Reclassifications	(2)	-	(121)	3	-	15	-	-	(23)	-	(128)
Reversal of impairment	-	-	31,790	-	-	-	-	-	-	-	31,790
Depreciation for the year	-	(5,959)	(30,306)	(1,863)	(307)	(2,949)	(468)	-	-	-	(41,852)
Depreciation of disposals	-	1	3,505	104	-	37	1,710	-	-	-	5,357
Transfer depreciation	-	4	558	108	12	753	(1,435)	-	-	-	-
At December 31, 2017	198,914	95,792	334,272	6,119	730	22,650	-	122	2,600,899	31,911	3,291,409
Cost	198,914	183,073	646,722	29,111	4,209	48,507	13,867	122	2,600,899	31,911	3,752,335
Accumulated depreciation	-	(87,281)	(300,909)	(22,992)	(3,479)	(25,857)	(13,867)	-	-	-	(449,385)
Accumulated impairment	-	-	(11,541)	-	-	-	-	-	-	-	(11,541)
At December 31, 2017	198,914	95,792	334,272	6,119	730	22,650	-	122	2,600,899	31,911	3,291,409
Year 2018											
Opening balance of net book cost	198,914	95,792	334,272	6,119	730	22,650	-	122	2,600,899	31,911	3,291,409
Additions	3,900	-	-	-	-	-	-	-	694,117	26,280	724,297
Capitalizations	962	12,850	53,680	647	511	10,048		(96)	(42,666)	(35,936)	-
Disposals	(661)	(3,505)	(1,383)	(1,564)	(60)	(3)	(3,892)	-	-	-	(11,068)
Transfers	-	-	(1,136)	(4,732)	(107)	(1,442)	7,417	-	-	-	-
Reclassifications to assets held for sale	(1,963)	90	(90)	-	-	-	-	-	-	-	(1,963)
Reversal of impairment	-	-	11,536	-	-	-	-	-	-	-	11,536
Depreciation for the year		(6,578)	(30,472)	(1,646)	(395)	(3,485)	(414)	-	-	-	(42,990)
Depreciation of disposals	-	-	1,292	1,557	57	2	3,892	-	-	-	6,800
Transfer depreciation	-	-	1,014	4,488	105	1,397	(7,004)	-	-	-	-
Impairment of loaned assets	-	-	(304)	-	-	-	-	-	-	-	(304)
Adjustments	124	(810)	429	25	163	(156)	1	(26)	989	-	739
At December 31, 2018	201,276	97,839	368,838	4,894	1,004	29,011	-	-	3,253,339	22,255	3,978,456
Cost	201,276	191,725	696,018	18,459	4,506	56,891	17,463	-	3,253,339	22,255	4,461,932
Accumulated depreciation	-	(93,886)	(326,871)	(13,565)	(3,502)	(27,880)	(17,463)	-	-	-	(483,167)
Accumulated impairment	-	-	(309)	-	-	-	-	-	-	-	(309)
At December 31, 2018	201,276	97,839	368,838	4,894	1,004	29,011	-	-	3,253,339	22,255	3,978,456

(i) Major projects -

a) Talara Refinery Modernization Project - PMRT -

Its objective is the technological development involving building new manufacturing facilities, modernizing and extending current facilities to:

i) Manufacture Diesel and Gasoline with less than 50 ppm (part per million) of sulphur.
ii) Enlarge the production capacity of the refinery from 65 to 95 thousand bpd (barrels per day)
iii) Process heavy and more economic crudes to be used in manufacturing light fuels of higher commercial value.

The status of the Project at December 31, 2018 is described as follows:

- Overall progress

  - Overall physical progress of PMRT: 71.15% Real vs 96.04% Scheduled.

  - The baseline of the reported progress was Project completion in June 2019; however, it will be updated once the new Project overall timetable ("Cronograma Integral del Proyecto") is approved; this new timetable will include the Auxiliary Unit and Complementary Work Timetable already approved as well as the new baseline of EPC Contracts with Técnicas Reunidas.

The table below shows a breakdown of the estimated total cost of project compared to the disbursements incurred:

	December 31, 2018		**Total Budget**	
	Disbursements	**Progress percentage**	**Planned**	**Total percentage**
	US$000	**%**	**US$000**	**%**
Técnicas Reunidas (TR) -				
Processing unit	2,212,893	82.40	2,685,400	53,71
Consorcio Cobra SCL -				
Auxiliary units	70,774	9.20	765,300	15.30
Complementary work	92,519	31.80	290,600	5.81
Others -				
Supervising	175,158	63,90	274,000	5.48
Management	102,538	43.70	234,500	4.69
Contingencies	-	-	55,000	1.10
Interest on financing	235,706	33.90	695,000	13.90
	2,889,588		4,999,800	100

	December 31, 2017		Total Budget	
	Disbursements	Progress percentage	Planned	Total percentage
	US$000	%	US$000	%
Técnicas Reunidas (TR) -				
Processing unit	2,009,800	73.61	2,730,300	50.53
Approved change orders	610	43.46	1,400	0.03
Consorcio Cobra SCL -				
Auxiliary units	-	-	891,100	16.49
Complementary work	67,740	30.04	225,500	4.17
Others -				
Management	199,700	44.08	453,000	8.38
Provision for change orders	-	-	74,400	1.38
Interest on financing	139,860	13.60	1,028,000	19.02
	2,417,710		5,403,700	100

- Progress of EPC Unidades Auxiliares y Trabajos Complementarios - Contract with Consorcio Cobra SCL UA&TC

  - The overall progress of the EPC contract with Consorcio Cobra SCL UA&TC is 9.92% Real vs 12.70% Scheduled.
  - On October 29, 2018 the first invoice Cobra SCL for US$24,500 thousand was paid.
  - Cobra SCL continues performing detail engineering work and preparation contruction work.
  - Progress of engineering was 38.22% Real vs 52.32% Scheduled.
  - Progress of Procurement was 8.73% Real vs 14.95% Scheduled.
  - Progress of construction was 1.67% Real vs 6.93% Scheduled.

- Progress of "EPC Unidades de Proceso" - Contract withTécnicas Reunidas (TR)

  - TR continues to implement detail engineering, procurement and construction (EPC) work, with a progress of 89% Real vs 92.76% Scheduled.
  - Progress of engineering totaled 100% Real vs 100% Scheduled.
  - Procurement of equipment totaled 99.81% Real vs 100% Scheduled.
  - Procurement of construction totaled 83.98% Real vs 93.68% Scheduled.

- Management

  Financial structure of the PMRT:

  - International bond placement of up to US$2,000,000 thousand, placed in June 2017.
  - CESCE loan US$1,300,000 thousand. In January 2018 CESCE loan was signed. In November 2018 a drawdown of US$1,236,717 thousand was completed
  - International bond placement of up to S$600,000 thousand expected for 2019.
  - Own resources for US$775 thousand.
  - Capital contribution for US$325 thousand.

  PMC (Project Management Consultancy):

  - The service of Project monitoring continues to be provided by Consorcio PMC Talara (CPT).

PMO (Project Management Office):

- The service of Project management office continues to be provided by Consorcio Deloitte Talara.

- Social Management and Communications

Colegio Federico Villarreal:

- On September 29, 2018, construction of a school named Colegio Federico Villarreal was completed and it began operating in November 2018.

Communications plan:

- On November 26, 2018, a Public Hearing was conducted reinforcing key messages of the commitments contained in the PRC as part of the MEIA under the PMRT.

Local labor program ("Programa de Mano de Obra Loca"):

- At December 31, 2018, the total work force consisted of 3,394 job positions. The share of local unqualified labor was 86%, above the limit set in the EIA (70%), while the share of local qualified labor was 39%.

Operations are expected to begin in 2021.

b) Project to set up and operate the New Ilo Terminal -

This project consists of the construction, installation and startup of a new Supply Terminal in Ilo for receiving, storing and shipping of fuel (Diesel, Gasoline and Gasohol) to meet demand in the surrounding area.

At December 31, 2018 the status of this Project is described as follows:

- The estimated investment in this Project is estimated to be US$48,100 thousand, of which 22% has been disbursed. The overall physical progress of the project amounted to 52.3% 52.3% Real vs 53.3% Scheduled.

- The engineering, procurement and construction (EPC) service is provided by an entity called Felguera and supervision has been assigned to "Consorcio Supervisor Ilo" has a physical advance of 38% Real vs 53.3% Scheduled.

- Detailed Engineering and Procurement amounts to 74% and 39%, respectively. At the reporting date, a contract was awarded for plant automatization (MAC), construction of fences, civil works, geomembranes and assembly of tanks.

- The service of monitoring construction work conducted by Consorcio Supervisor Ilo showed a 75% progress; this monitoring service agreement was extended to January 2019, consistent with the EPC implementation.

- With respect of social reach, the Av. Mariano Lino Urquieta road was completed at the satisfaction of the Province Municipality of Ilo.

- At December 31, 2018 activated costs amount to US$10,677 thousand (US$2,254 thousand at December 31, 2017).

c) Puerto Maldonado Plant and Selling Point (1st stage) -

Comprising the construction of a Plant and selling point in Puerto Maldonado to sell Diesel B5 and Gasolines.

At December 31, 2018, the status of this Project is described as follows:

- Under a Board Agreement No. 120-2018-PP dated December 20, 2018 the decision was made to re-assess the amount of the Project to US$19,300 thousand (S/65,200 thousand).

- Detail engineering work was completed by contractor called NOOVI S.A.C. For construction, the technical conditions and MER are being prepared to contract earth movement.

(ii) Concession of port terminals -

The purpose of the Terminal Operation Contract is to contract operators to operate, under their sole responsibility, cost and risk, North, Central and South Terminals; additionally, for the effective period of the concession agreement, making investments as committed as well as additional investments. Terminal operation consists of receiving, storing and shipping hydrocarbons, including maintenance and compliance with the work safety and environmental technical standards.

Maintenance of concession assets is contained in the respective operation agreements, by which, at the termination of those agreements, the concession assets must be returned to grantor in the same conditions in which they were originally provided, except for regular wear and tear from use.

During 2014 a public tender was organized to select Operators for the North, Central and South Terminals; awards for the North and Central Terminals were granted to the companies Graña y Montero Petrolera S.A. and Oiltanking Perú S.A.C; the relevant operating contracts were signed for an effective period of 20 years, which are effective until October 31, 2034 (Terminales Norte) and September 1, 2034 (Terminales del Centro).

The conditions of the agreements include executing additional investments for the approximate amount of US$83,116 thousand (Terminales Norte) and US$102,842 thousand (Terminales Centro) and investments committed by US$18,390 thousand (Terminales Norte) and US$18,766 thousand (Terminales Centro).

Bearing in mind that the Public Tender to select the Operator for the South Terminals had no bids, an addendum to the South Terminals Operation Contract was signed with Consorcio Terminales, conformed by Graña and Montero Petrolera S.A. and Oiltanking Perú S.A.C. on September 5, 2014 in order to extend the effective period of the contract for the period from August 2, 2014 to August 1, 2015 and setting forth the conditions for a time extension necessary to call a new tender. On July 31, 2015 an additional addendum was signed to extend the South Terminals Operation Contract for the period from August 2, 2015 to August 1, 2017. The conditions negotiated in this document include an amount to be paid by the operator to the contractor of US$1 million (recognized as other income in the statement of comprehensive income for 2015) for time extension; as well as implementing additional investments for an approximate amount of US$25,000 thousand under the Additional Investment Program.

On June 28, 2017, an additional addendum was signed to extend the South Terminal Operation Contract for the period from August 2, 2017 to August 1, 2018. The conditions agreed under this addendum include a payment to be made by the Operator to the Contractor of US$625 thousand for this time extension; also included are additional investments amounting to approximately US$10,000 thousand under the Additional Investment Program. The execution of committed investments was not included.

On July 23, 2018, an additional addendum was signed to extend the South Terminal Operation Contract for the period from August 2, 2018 to August 1, 2019. The conditions agreed under this addendum include a payment to be made by the Operator to the Contractor of US$625 thousand for this time extension; also included are additional investments amounting to approximately US$10,000 thousand under the Additional Investment Program. The execution of committed investments was not included.

At December 31, 2018, the public tender to select the new Terminales del Sur Operator was in progress.

At December 31, 2018 the net carrying amounts of the terminal concession assets totaled US$133,423 thousand (US$80,446 thousand at December 31, 2017), included mainly in the item of land, machinery and equipment.

(iii) Insurance -

The assets and operations of PETROPERÚ S.A. are covered with an integral insurance policy against:

a) Property and loss of profits policy for up to US$650,000 thousand with declared values of US$6,503,000 thousand.
b) Sabotage and terrorism policy for up to US$650,000 thousand with declared value of assets of US$6,586,000 thousand.
c) Public general liability insurance ("Póliza de responsabilidad civil general comprensiva") for up to US$100,000 thousand.
d) Air carrier's liability and insurance ("responsabilidad civil de aviación") for up to US$500,000 thousand.

(iv) Depreciation -

The annual depreciation charge to profit or loss on property, plant and equipment is allocated to the following cost centers:

	2018 US$000	2017 US$000
Cost of sales (Note 21)	28,520	29,343
Selling and distribution expenses (Note 22)	8,824	7,291
Administrative expenses (Note 23)	5,646	5,218
	42,990	41,852

At December 31, 2018 and 2017, the Company has not pledged any item of fixed assets to secure borrowings obtained.

The gross cost of totally depreciated assets still in use at December 31, 2018 was US$142,776 thousand (US$91,009 thousand at December 31, 2017).

(v) Major additions related to work in progress -

During 2018, additions of work in progress mostly relate to PMRT's EPC contract, PMC, PMO and Auxiliary services amounting to US$390,997 thousand equivalent to S/1,293,436 thousand (US$426,656 thousand equivalent to S/1,380,000 thousand in 2017); advances granted to Consorcio Cobra SCL UA&TC for US$87,403 thousand and other additions of other works in progress that individually are less than US$1,000 thousand, for US$111,381 thousand (equivalent to S/368,520 thousand).

Additionally, borrowing costs that were capitalized during 2018 related to PMRT, amounted to US$102,204 thousand equivalent to S/335,258 thousand (US$74,663 thousand equivalent to S/242,314 thousand during 2017).

(vi) Asset retirement -

At December 31, 2018 the balance of asset retirement mainly includes the cost of construction of former school named "Federico Villareal" by US$3,505 thousand equivalent to S/11,670 thousand and the cost of land "Sub Lote 1-B / Ex Campo Ferial Municipal" of Talara by US$661 thousand equivalent to S/2,220 thousand, as per approval under Board Decision No. 096-2016-PP dated November 30, 2016.

(vii) Impairment of assets -

a) Cash-generating units (CGUs) -

At December 31, 2018, the Company has performed the impairment test of the CGUs: (i) Production and trading and (ii) Oil Pipeline operations ("Operaciones ONP").

The impairment test was performed by comparing the recoverable amount of the CGUs against the carrying amount of the assets of those CGUs. The CGU is the smallest group of identifiable assets capable of generating cash flows for the Company. Management has determined the recoverable amount of the CGUs using their value in use. Key assumptions used in determining the value in use were as follows:

Production and trading -

- Operating cash flows from refineries Talara, Iquitos and Conchán. Cash flow projections comprise all the cash flows that are expected to be obtained in the ordinary course of business. All relevant assets have been allocated to the respective CGU.
- These refineries have created significant synergies between them, by which in-process products are transferred between them when there is no active market for those products so that higher revenue is obtained and significant savings are achieved.
- A 10-year projection horizon and perpetuity. The perpetuity cash flow projection considers no growth rate in the long term. As per projections, considerer that the Primary Distillation Unit, the Vacuum Distillation Unit and the Catalytic Cracking Unit of Talara refinery work until November 2019, month in which interconnection work will be begun to enable the beginning of operatons of the new Talara Refinery in 2021. Management considers it appropriate to use a projection period of 10 years since it has the support information for these purposes.
- Projections do not include cash inflows or outflows from financing activities.
- Pre-tax discount rate affected by the risks associated with a specific CGU and market assessments of the time value of money.
- The forecast costs and expenses are based on expense budgets for 2019 prepared by Management.
- Forecast selling prices: Management estimates the selling prices of oil by-products at import parity prices of PETROPERÚ S.A., based on the movement of prices of WTI crude oil and spreads of by-products in time, considering inputs obtained from a specialized international prices source IHS Global Consulting Services.
- Forecast crude product volume purchases: Refinery loads are estimated by the Management of Refinery and Pipelines ("Gerencia Refinación y Ductos") using the mathematical model of Refining.
- Forecast of costs of acquisition of crude and products: Management has prepared, based on projections released by IHS Global Consulting Services, a forecast of costs of acquisition of crude and products, based on the movement of prices of crude oil and by-products in time.

Oil Pipeline operations -

- Operating cash flows from the service of transportation and custody of crude from the Northern jungle in Peru.
- Forecast crude volumes: Based on crude production volume projections released by Perupetro S.A., Management has prepared forecast of crude volumes expected to be carried through the Oil Pipeline (ONP).
- Forecast transportation rate: Management estimates the transportation rate based on the current rate schedule as established under the contracts and negotiations for the service of liquid hydrocarbon transport via Nor Peruano pipeline.
- Operating cash flows from the service of crude unloading and use.
- Operating cash flows from exports of Loreto crudes in 2019.
- Operating cash flows from sales in 2024 of crude held in the oil pipeline.
- Cash flows from services rendered to the Production and trading CGU of transport and selling of residual products from the Iquitos Refinery.
- All relevant assets have been allocated to the respective CGU.
- A 10-year projection horizon and perpetuity. The perpetuity cash flows projection considers no growth rate in the long term. Management considers it appropriate to use a projection of 10 years since it has the support information for these purpose.
- Projections do not include cash inflows or outflows from financing activities.
- Pre-tax discount rate affected by the risks associated with a specific CGU and market assessments of the time value of money.
- Projected costs and expenses are based on the expense budgets for 2019 prepared by Management.

Key assumptions used in calculating the value in use are as follows:

	Production and trading	**Oil Pipeline operations**
Annual growth rate (%)	6%	14%
Budgeted gross margin (%)	30%	39%
Prices ($)	99	9
Discount rate (%)	17.08%	13.63%

The annual growth rate corresponds to annual growth rate compound income during the period 2019 - 2028. The average growth rates used are consistent with the actual performance of the CGU and with Management's forecasts. Growth in the projections of Production and trading is constant for the following 10 years but no significant growth is forecasted subsequently. For Oil Pipeline operations ("Operaciones Oleoducto") revenue growth is generated according to the forecasts prepared by Perupetro S.A.

The budgeted gross margin is the average gross margin for 10-year projections.

Prices are the average included in projections. Management determines the prices based on the international long-term benchmarks and markers of IHS Global Inc., the international consultant

Risk-adjusted rates are pre-tax and reflect the specific risks associated with the business of each CGU.

At December 31, 2018, the Company tested its assets for impairment and based on the results obtained the impairment loss on the Oil Pipeline CGU assets of US$11,536 thousand was reversed (US$31,790 thousand at December 31, 2017), in the case of the Production and trading CGU, Management has determined that it is not necessary to record an impairment provision.

Provisions for impairment and reversals of impairment of property, plant and equipment were recognized in cost of sales (Note 21).

Sensitivity analysis -

Management performs a sensitivity analysis to determine the effect of eventual changes in the assumptions used in the valuation model. In this respect, the pre-tax discount rate used by the Company was 17.08% for the Production and trading CGU and 13.63% for the Oil Pipeline CGU (Operaciones Oleoducto).

If the discount rate on the Oil Pipeline CGU had been higher by 1%, no impairment would have arisen and neither would have impact on the amount of the impairment reversal that was recorded at December 31, 2018.

If the discount rate on Production and trading CGU had been higher by 1%, it would not give rise to impairment in the carrying amount.

Management has conducted a sensitivity analysis of the key assumptions used in determining the recoverable amount:

Key assumption	**Variation**	**Impairment US$000**
Production and trading:		
Budgeted annual growth	-5%	-
Prices	-5%	-
Budgeted gross margin	-5%	-
Production	-5%	-
Oil Pipeline operations (Oleoducto):		
Budgeted annual growth	-5%	-
Prices	-5%	-
Budgeted gross margin	-5%	-

b) Talara Refinery Modernization Project (PMRT, the Spanish acronym) -

At December 31, 2018, the Company has performed the impairment test of the PMRT, hereinafter the Project for impairment.

The impairment test was performed by comparing the recoverable amount of this Project against the carrying amount of the Project assets. Management has determined the recoverable amount by estimating their fair value less cost of disposal. Key assumptions used in determining the fair value are as follows:

- Operational cash flows from the Project activities. Cash flow projections comprise all cash flows that are expected to be generated in the normal course of the Project.
- The forecast cash flows consider an investment to be made to complete construction of PMRT.
- 27-year including construction period projection horizon and a perpetuity. The perpetuity cash flow projections consider no growth rate in the long term. Management considers it appropriate to use a projection period of 27 years since it has the support information for these purposes.
- Projections do not include cash inflows or outflows from financing activities.
- Post-tax discount rate affected by specific risk of the industry and market and a risk premium since this is under construction.
- Projections considered in valuation were operating cash flows from purchases, refinery and sales of crude by-products.
- Fixed and variable costs were defined by Management.

- Forecast selling prices: Management estimates the selling prices of oil by-products at import parity prices of PETROPERÚ S.A., based on the movement of prices of WTI crude oil and spreads of by-products in time, considering inputs obtained from a specialized international prices source IHS Consulting Services.
- Selling prices used in valuation are prices at the plant site.
- Forecast crude product volume purchases: Refinery loads are estimated by the Management of Refinery and Pipelines ("Gerencia Refinación y Ductos") using the mathematical model of Refining.
- Forecast of costs of acquisition: Management has prepared, based on projections released by IHS Consulting Services, a forecast of costs of acquisition of crude and products, based on the movement of prices of WTI crude oil and spreads of by-products in time.
- Inputs used to determine the fair value correspond to Level 3 of the fair value measurement hierarchy described in Note 3.3.

Key assumptions used in determining the fair value less costs of sales are as follows:

Annual growth rate (%)	2%
Budgeted gross margin (%)	16%
Prices ($)	113
Discount rates (%)	7.83%

The annual growth rate corresponds to annual growth rate compound of income during the period 2021 - 2045. The average growth rates used are consistent with the actual performance of the asset and with Management's forecasts.

The budgeted gross margin is the average gross margin for operating 25-year projections.

Prices are the average included in projections. Management determines the budgeted prices based on past performance, current trends in the industry, established rates and market development expectations.

Risk-adjusted rates are post-tax and reflect the risks associated with the relevant business.

As a result of this assessment, Management has determined that it is not necessary to record an impairment provision for PMRT at the date of the statement of financial position.

Sensitivity analysis -

Management performs a sensitivity analysis to determine the effect of changes in the assumptions used in the valuation model. The post-tax discount rate used by the Company was 7.83% in determining the recoverable amount. When changing the discount rate to 9.86%, the recoverable amounts would be equal to the carrying amounts.

Management has conducted a sensitivity analysis of the key assumptions used in determining the recoverable amount:

Key assumption	**Variation**	**Impairment US$000**
Budgeted annual growth	-5%	-
Prices per year	-5%	-
Budgeted annual growth	-5%	-
Production	-5%	-

12 INVESTMENT PROPERTY

	Land US$000	Buildings and other constructions US$000	Total US$000
Year 2017			
Opening carrying amount	9,339	75,520	84,859
Additions	2	15	17
Depreciation	-	(57)	(57)
Depreciation for the year	-	(5,389)	(5,389)
Closing carrying amount	9,341	70,089	79,430
At December 31, 2017			
Cost	9,341	117,906	127,247
Accumulated depreciation	-	(47,817)	(47,817)
Net cost	9,341	70,089	79,430
Year 2018			
Opening carrying amount	9,341	70,089	79,430
Adjustments	-	130	130
Depreciation	-	(15)	(15)
Depreciation for the year	-	(5,389)	(5,389)
Closing carrying amount	9,341	64,815	74,156
At December 31, 2018			
Cost	9,341	117,585	126,926
Accumulated depreciation	-	(52,770)	(52,770)
Net cost	9,341	64,815	74,156

At December 31, 2018 and 2017, this item comprises:

(a) PETROPERÚ S.A. signed a lease contract of the assets of Block Z-2B with Savia Perú S.A. (ex Petro-Tech Peruana S.A.) for a period of 10 years, which expired on November 15, 2013. The lease contract continues to be effective under the provisions of article 1700 of the Peruvian Civil Code, by which, if at the contract termination date the lessee continues using the leased asset, it should not be understood as a tacit renewal, but the continuation of the lease under the same terms and conditions, until lessor requests the return of the asset, which can occur at any time. By virtue of this lease, Savia Perú S.A. pays the Company US$10,000 thousand annually.

(b) The Company signed in March 2014 a lease contract of the assets the Pucallpa Refinery and Sales plant, Residences and Administrative Offices with Maple Gas Corporation Del Perú S.R.L. (hereinafter, MAPLE), for a period of 10 years, which expires on March 28, 2024. MAPLE pays the Company US$1,200 thousand annually on a quarterly basis.

    During 2018, the Corporate Legal Management has informed Maple that the contract has been duly terminated for breach of contract, default in rents and failure to provide the service of Receiving, Warehousing, and Dispatch; as a result, an arbitration process is undergoing.

    The Company has the intention to call a public tender in 2019 involving those assets.
    The annual depreciation charge on investment properties was allocated to the cost of sales (Note 21).

The fair value of investment properties at December 31, 2018 is US$206,234 thousand (U$206,000 thousand at December 31, 2017). Fair value measurement has been classified as Level 3 as explained in Note 3.3.

13 OTHER FINANCIAL LIABILITIES

This item comprises:

	At December 31,	
	2018	2017
	US$000	US$000
Current liabilities		
Bank loans without guarantee	1,650,893	1,311,971
Accrued interest	22,219	7,229
	1,673,112	1,319,200
Non-current liabilities		
Corporate bonds (i)	1,985,589	1,985,124
CESCE loan (ii)	1,162,021	-
	3,147,610	1,985,124

i) On June 12, 2017, the Company issued bonds in the international market for a total of US$2,000,000 thousand under the U.S. Rule 144A and S Regulation, which are exceptions ("Safe-harbors") to the U.S. regulatory framework (US Securities Act - 1933 and US Securities Exchange Act -1934) by which foreign issuers are allowed to offer, place and/or resell securities without the requirement to register those securities with the relevant New York Stock Exchange agency (SEC). The funds received are allocated to the Talara Refinery Modernization Project.

The bonds issued are as follows:

- 2032 Notes, a principal of US$1,000,000 thousand, with coupons paid semi-annually at a fixed rate of 4.750% per year, with a maturity of 15 years. Coupons are due from December 2017 and repayment of principal fall due on the bond maturity date. Transactional costs totaled US$7,009 thousand, which are presented net of the liability.

- 2047 Notes, a principal of US$1,000,000 thousand with coupons paid semi-annually at a fixed rate of 5.625% per year with maturity of 30 years. Coupons are due from December 2017 and repayment of principal will take place on the bond maturity date. Transactional costs totaled US$7,402 thousand, which are presented net of the liability.

Under the bond issue agreement, there is no covenants that need to be met apart from the financial reporting requirement.

Bonds issued are not secured with specific guarantees; nevertheless, under Law No. 30130 guarantees are approved to be given by the Government for up to US$1,000 million (Note 1-a).

ii) On January 31, 2018 a loan agreement was signed with Compañía Española de Seguros de Crédito a la Exportación (CESCE), with Deutsche Bank SAE, acting as administrative agent, for up to US$1,300,000 thousand. At December 31, 2018 a drawdown of US$1,236,717 thousand was obtained, which was used to settle other sources of financing used in settling PMRT invoices, relating to the EPC with Técnicas Reunidas. Transactional costs consists of the drawdown commission of US$61,880 thousand and other structuring costs of US$12,815 thousand. Interest will be paid on a semi-annual basis starting May 2019 with maturity in 2031 and bearing an annual fixed interest rate of 3.285%.

The remaining drawdown at December 31, 2018 is US$63,283 thousand, which is expected to occur on the second half of 2019.

The CESCE loan does not have specific contractual guarantees given by the Company or by the Peruvian Government; nevertheless, it is 99% secured by the Government of Spain through the CESCE.

Under the terms of this loan agreement, the Company has to meet the following financial covenants, which are measured on a quarterly basis:

- Debt ratio
- Service coverage ratio
- Direct financing for investment in the PMRT

At December 31, 2018 the Company did not comply with the service coverage ratio required under the loan agreement; however, on November 26, 2018 the Company obtained the required waivers to show those requirements as required by the timetables provided by the financial institution.

a) Debt repayment terms and timetable -

The terms and conditions of the outstanding loans are as follows:

				December 31, 2018		December 31, 2017	
	Original currency	Nominal interest rate	Maturity	Nominal value US$000	Carrying amount US$000	Nominal value US$000	Carrying amount US$000
Bank loans without guarantee	Soles	2.40%-2.95%	2018	-	-	654,858	654,858
Bank loans without guarantee	Dollars	0.80%-2.20%	2018	-	-	657,113	657,113
Bank loans without guarantee	Soles	3.10%-3.45%	2018	870,980	870,980	-	-
Bank loans without guarantee	Dollars	2.20%-3.36%	2018	779,713	779,913	-	-
CESCE loan	Dollars	3.29%	2031	1,236,717	1,162,021	-	-
Corporate bonds	Dollars	4.75%	2032	1,000,000	992,991	1,000,000	992,629
Corporate bonds	Dollars	5.63%	2047	1,000,000	992,598	1,000,000	992,495
Accrued interest				-	22,219	-	7,229
Total interest-bearing liabilities				4,887,410	4,820,722	3,311,971	3,304,324

The carrying amount is the amortized cost of borrowings, discounting at the effective rate.

b) Classification of loans by type of use (*) -

The Company allocated or will allocate the funds obtained by financing, as follows:

	2018 US$000	2017 US$000
Working capital	1,326,315	977,971
PMRT	3,472,188	2,319,124
	4,798,503	3,297,095

(*) Does not include accrued interest payable

c) Movement of financial liabilities

The movement of these balances was as follows:

	Bank loans without guarantee US$000	Corporate bonds US$000	Syndicated loans US$000	Total US$000
Balance at January 1, 2017	1,564,814	-	417,552	1,982,366
New loans	3,968,753	2,000,000	-	5,968,753
Payment of transactional costs	-	(14,876)	-	(14,876)
Amortizations	(4,200,853)	-	(416,667)	(4,617,520)
Accrued interest	45,132	55,295	5,777	106,204
Interest paid	(62,066)	(51,875)	(6,662)	(120,603)
Balance at December 31, 2017	1,315,780	1,998,544	-	3,304,324

	Bank loans without guarantee	Corporate bonds	Syndicated loans	Total
	US$000	US$000	US$000	US$000
Balance at January 1, 2018	1,315,780	1,988,544	-	3,304,324
New loans	4,452,234	-	1,236,717	5,688,951
Payment of transactional costs	-	465	(74,695)	(74,230)
Amortizations	(4,113,312)	-	-	(4,113,312)
Accrued interest	38,626	103,750	3,703	146,079
Interest paid	(27,340)	(103,750)	-	(131,090)
Balance at December 31, 2018	1,665,988	1,989,009	1,165,725	4,820,722

The Company has earmarked in 2018 a total US$107,425 thousand of the interest paid on investing activities since they are related to the PMRT project (US$85,792 thousand in 2017).

d) Fair value estimation -

At December 31, the carrying amount and fair value of borrowings are as follows:

	Carrying amount		Fair value	
	2018	2017	2018	2017
	US$000	US$000	US$000	US$000
Unsecured loans	1,650,893	1,311,971	1,650,893	1,311,971
Bonds	1,985,589	1,985,124	1,952,383	2,002,970
CESCE loan	1,162,021	-	1,092,868	-
	4,798,503	3,297,095	4,696,144	3,314,941

At December 31, 2018 and 2017 the information used to determine the fair value of the bonds corresponds to level 1, unsecured loans at level 2 and CESCE loan at level 3 according to the hierarchy defined in Note 3.3. There were no transfers between the levels during the year. This item does not include accrued interest.

14 TRADE PAYABLES

This item comprises:

	At December 31,	
	2018	2017
	US$000	US$000
Foreign suppliers of crude and refined products	278,194	536,177
Suppliers of goods and services	128,275	117,933
National suppliers of crude and refined products	92,180	103,018
Shipping companies and terminal operators and sales plants	31,152	15,119
	529,801	772,247

At December 31, 2018 the main local supplier of crude is Savia Perú S.A. with a balance of US$25,481 thousand (US$27,668 thousand at December 31, 2017). The main international supplier is Exxon Mobil Sales and Suppy LLC. to which US$178,847 thousand is owed (US$210,630 thousand at December 31, 2017). Major service providers are Consorcio Cobra SCL UA&TC with a balance of US$36,392 thousand, which began trade relations with the Company in 2018 and Técnicas Reunidas de Talara S.A.C. with a balance of US$17,814 thousand (US$57,512 thousand at December 31, 2017).

This account reflects the Company's obligations related to the acquisition of crude oil and refined products, transportation and plant operators, supplies and spare parts; and project construction services. The invoices are issued in U.S. dollars, are of current maturity, are non-interest bearing and have no specific guarantees.

15 OTHER PAYABLES

This item comprises:

	At December 31,	
	2018	2017
	US$000	US$000
Taxes (a)	36,313	34,480
Advances from customers (b)	24,050	14,979
Remunerations	20,384	21,393
Financial instruments liability (e)	14,484	3,802
Guarantee deposits (c)	3,699	4,405
Workers' profit sharing (d)	2,755	30,848
Others	3,407	5,282
	105,092	115,189

(a) Taxes payable at December 31, 2018 mainly include Excise Tax (ISC in Peru), tax on gasoline vehicles and the Fund for the mass use of gas (FISE) for US$19,555 thousand, US$7,265 thousand and US$3,320 thousand, respectively (third-category (corporate) and fifth-category (dependent employee) income tax, tax on gasoline vehicles and FISE for US$19,223 thousand, US$6,908 thousand and US$3,320 thousand, respectively in 2017).

(b) Advances received from local and foreign customers mainly comprise the amounts received for US$5,296 thousand and US$18,754 thousand, respectively at December 31, 2018 (US$4,448 thousand y US$10,531 thousand, respectively at December 31, 2017), to secure the supply of fuel that is pending delivery.

(c) Comprising security deposits received by third parties to transport fuel to cover possible loss occurrences. If no such event occurs, the security deposit is returned at the end of the contract.

(d) As established under current legislation, workers' profit sharing is 10% of the net income of the Company. This profit sharing is deductible for income tax calculation purposes, provided that it is paid before the annual income tax returns are filed.

In 2018, the Company determined profit sharing for US$2,754 thousand (US$30,848 thousand in 2017) recorded with a charge to the results of the year under the following items:

	At December 31,	
	2018	2017
	US$000	US$000
Cost of sales (Note 21)	1,110	12,659
Selling and distribution expenses (Note 22)	467	5,432
Administrative expenses (Note 23)	1,177	12,757
	2,754	30,848

(e) Comprising 23 forward foreign exchange contracts to be settled from January to June 2019, which are stated at fair value and the inputs used in determining the fair value qualify as Level 2 of the fair value hierarchy, as described in Note 3.3.

16 OTHER PROVISIONS

This item comprises:

	At December 31,	
	2018	2017
	US$000	US$000
Current -		
Provision for environmental improvements (a)	29,864	38,454
Provision for civil lawsuit (b)	2,229	17,809
Provision for labor-related court actions	1,801	2,547
Provision for plugging of wells (a)	570	594
Provision for retirement pensions	42	45
Other provisions	156	162
	34,662	59,611
Non-current -		
Provision for environmental improvements (a)	7,011	14,396
Provision for retirement pensions	56	65
	7,067	14,461
	41,729	74,072

The movement of other provisions is as follows:

	Provision for environmental improvements US$000	Provision for civil lawsuits US$000	Provision for labor-related court actions US$000	Provision for plugging of wells US$000	Provision retirement pensions US$000	Other provisions US$000	Total US$000
Balances at January 1, 2017	95,790	22,537	2,242	574	120	157	121,420
Provision for the year	33,706	5,384	857	-	32	-	39,979
Update	1,247	-	-	-	-	-	1,247
Payments	(80,114)	(113)	(603)	-	(46)	-	(80,876)
Reversal of unused provisions	-	(10,474)	(27)	-	-	-	(10,501)
Exchange difference	2,221	475	78	20	4	5	2,803
Balances at December 31, 2017	52,850	17,809	2,547	594	110	162	74,072
Provision for the year	10,806	23,728	937	-	33	-	35,504
Update	60	-	-	-	-	-	60
Payments	(25,872)	(23,438)	(448)	-	(41)	-	(49,799)
Reversal of unused provisions	-	(15,619)	(1,229)	-	-	-	(16,848)
Exchange difference	(969)	(251)	(6)	(24)	(4)	(6)	(1,260)
Balances at December 31, 2018	36,875	2,229	1,801	570	98	156	41,729

a) Provision for environmental improvements and plugging wells costs -

The Peruvian Government promotes the conservation of the environment and responsible use of natural resources in hydrocarbon activities in accordance with the Political Constitution of Peru, Law No. 26221, Organic Law of Hydrocarbons in the National Territory; Law No. 26821, Organic Law for the Sustainable Use of Natural Resources; Law No. 27446, Law of the National System of Evaluation of the Environmental Impact; Law No. 28245, Framework Law for Environmental Management; Law No. 28611, General Law of the Environment and Law No. 29134, Law Regulating the Environmental Liabilities of the Hydrocarbons Sub-Sector, among others.

The Ministry of Energy and Mines, by means of Supreme Decree No.039-2014-EM, published on November 12, 2014, approved the new Rules for the Environmental protection of Hydrocarbon 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 life cycle, as a way to prevent, control, mitigate and remediate the adverse environmental impact of such activities.

Also, within the framework of Legislative Decree No. 674, "Ley de Promoción de la Inversión Privada en las Empresas del Estado", the Company assumed contractual obligations of environmental remediation of its privatized units, guaranteed by the Peruvian Government. Therefore, as per the applicable laws and regulations, the signed contracts and management policies, at December 31, 2018, PETROPERÚ S.A. continues to implement environmental remediation activities in its own operating units and privatized units.

Own operating units consist of: Operaciones Talara, Operaciones Oleoducto, Refinería Conchán, Refinería Selva, Planta de Ventas Aeropuerto and Block 64.

During 2018 and 2017, no significant environmental remediation work was performed in the privatized units.

Of a total 230 of projects of which the environmental management programs ("Programas de Adecuación y Manejo Ambiental - PAMA") were implemented and met by the Company from 1995 to adapt its operations to the first regulations to protect the environment - "Reglamento para la Protección Ambiental en las Actividades de Hidrocarburos" (D.S. No.046-93-EM). At December 31, 2018 the respective supplementary environmental program (PAC) for the Talara Refinery is pending approval by a governmental agency: "Dirección General de Asuntos Ambientales y Energéticos - DGAAE").

In compliance with these provisions, the Company has made provisions for the remediation of negative environment impacts caused in its privatized units for US$80,228 thousand and in its own operating units for US$6,656 thousand. At December 31, 2018, the amount implemented by the privatized units and operating units was US$617 thousand and US$159 thousand, respectively.

With respect to the privatized units (La Pampilla Refinery, Lubricant Plant, Block X, Block 8, Terminales, Selling Plants, Planta de Generación Eléctrica y Gas Natural), the estimates made were based on the environmental studies ruled favorable by the general hydrocarbons agency (Dirección General de Hidrocarburos - DGH) or the general environmental office (Dirección General de Asuntos Ambientales Energéticos - DGAAE). The provision is updated annually depending on the costs of the work completed or in progress and the estimates of work remaining to be implemented corresponding to the Environmental Remediation Agreements.

With respect to its own operating units (Talara operations, Oil Pipeline operations, Refinería Conchán, Refinería Selva, Planta de Ventas Aeropuerto and Block 64), estimates were made on the basis of the Company's ISO 14001 Environmental Management System and available data of the costs of the privatized units; this information is also updated on an annual basis considering its own operational needs, the cost of work performed, actually performed or in the process of implementation, of market prices and estimates of work remaining to be completed based on information sourced from the own operating units.

With respect to its own operating units, there are new environmental obligations in place, specifically involving compliance of certain standards: "Normas de los Estándares de Calidad Ambiental para Suelo - ECA Suelo (D.S. No. 002-2013-MINAM, D.S. No. 002-2014-MINAM, R.M. No. 085-2014-MINAM, R.M. No. 034-2015-MINAM and D.S. No. 013-2015-MINAM)" that will require other expenses to be incurred by the Company to conduct a number of different technical studies as required under said new regulations. In addition, for the year 2018 the Operational Environmental Remediation Program was executed for US$430 thousand (equivalent to S/1,395 thousand), Conchán for US$215 thousand (equivalent to S/698 thousand), Oleoducto for US$263 thousand (equivalent to S/853 thousand), Selva for US$175 thousand (equivalent to S/567 thousand), Commercial Management for US$209 thousand (equivalent to S/677 thousand) and Explotación for US$329 thousand (equivalent to S/1,068 thousand).

During 2017 the "Service of identification of possibly polluted places was completed (identifying sampling) that are over the environmental quality standards for soil in the operations of PETROPERÚ S.A." for a total budgeted amount of US$2,670 thousand (equivalent to S/9,347 thousand), representing 99.94% of the contractual amount. With regard to the 0.06% reduction in the unimplemented amount; this resulted from lower consumption than budgeted for field work implementation as part of the service rendering, based on the approved monthly valuations and the sign-off of those responsible for managing the contract.

At December 31, 2018 the submission of 38 Reports Identifying Possibly Contaminated Sites (IISC) was completed, which were presented to the governmental agency "Dirección General de Asuntos Ambientales Energéticos" of the MINEM for review and approval, by means of Letters No. SAMB-JAAM-585-2017, SAMB-JAAM-661-2017, SAMB-JEDA-837-2017, SAMB-JEDA-856-2017, SAMB-JEDA-869-2017, SAMB-JEDA-906-2017, SAMB-JEDA-936-2017 and SAMB-JEDA-951-2017. In addition, approvals were obtained of the IISC for Iquitos Refinery, Yurimaguas Plant Sales point, Iquitos Plant and Sales point, Tarapoto Plant and Sales point, Petrocentro Río Amazonas and Morona Station.

From 2014 to December 2018 a total number of 23 oil spills have occurred at ONP, of which, 18 have been completely served and are waiting for approval of the relevant agency ("Organismo de Evaluación y Fiscalización Ambiental" (hereinafter, OEFA); and 6 are still active, with progress from 56.89% to 97.25%, under the oversight and monitoring of the staff of the corporate environmental management ("Gerencia Corporativa Ambiente, Salud y Seguridad Ocupacional" (GCAS), which is committed to making sure PETROPERÚ S.A. will continue operating, on a sustainable basis, and reducing the potential impact on the environment. At the reporting date, expenses incurred in environmental cleaning and remediation, supervision and disposal of solid waste totals US$48,421 thousand; and there is a fund of US$14,117 thousand that remains to be used in activities expected to last until the end of 2019.

Also, as a result of the contingencies that occurred in the ONP, the OEFA, under Director's Resolution No 012-2016-OEFA/DS, ordered PETROPERÚ S.A., among others, to submit a Project to update the IGA of ONP with the MINEM; in this context, PETROPERÚ S.A. presented its proposal to the DGAAE-MINEM containing its Terms of Reference for Updating Pama of the ONP, which were approved under Report No022-2018-MEM-DGAAH/DEAH dated September 7, 2018.

The purpose is updating the Environmental Adequacy and Management Program ("Programa de Adecuación y Manejo Ambiental - PAMA") for the ONP and will involve identifying and characterizing the different alternatives, impact assessment, preliminary management measures, comparing, selection and justification of management alternatives; contingency plan, etc.; the estimated referential amount is S/3,641 thousand (equivalent to US$1,078 thousand) and US$1,040 thousand.

Environmental and Social Assessments, conducted in the framework of industry best practices and which have resulted in, among others, obtaining actual data on the dimension of the impact on the environment of the contingent events. It should be noted that this information is useful for the Company to defend itself against potential allegations of negligence and /or environmental and health risk; based on the results of these assessments, the environmental impacts have been determined to be temporary, restricted and reversible. In addition, risk assessments relating to health and environment are conducted; monitoring activities completed at the closure stages enable the Company to verify and support that the environmental remediation objectives in the involved areas are met. The total amount implemented in environmental and social assessments until the reporting date is US$6,545 thousand; and there is a balance of US$733 thousand that remains to be used in activities expected to last until the end of 2019.

During 2018, the Company reported 3 significant oil spills (6 in 2017) mainly resulting from undue acts by third-parties against the Northern Peru Oil Pipeline (ONP); these acts resulted in the total stoppage of oil pumping from the Peruvian jungle to the coast. For those oil spills the Company recorded a provision of US$10,806 thousand and disbursements were made of US$23,640 thousand.

As part of its contingency plan, the Company contracted specialized companies to halt and contain the oil spills and begin the environmental remediation of the affected areas.

At December 31, 2018 the provision for environmental remediation related to the above-mentioned oil spills in the ONP totals US$16,584 thousand (US$29,359 thousand at December 31, 2017).

The movement of the provision for environmental remediation is as follows:

	Balances at January 1 US$000	Provision Payments US$000	Balances at and update US$000	December 31 US$000
Year 2018				
Block 8	2,598	(533)	25	2,090
Block X	4,841	(1)		4,840
Pampilla	(8)	(1)	14	5
Lubricants	117	(1)	-	116
Northern terminals	263	-	-	263
Southern terminals	204		-	204
Mid-country terminals	1,734	(111)	2	1,625
Natural Gas Electric system	20	-	-	20
Total privatized units	9,769	(647)	41	9,163
Operations in Talara	7,625	(1,566)	(22)	6,037
Operations in Conchán	919	(12)	(2)	905
Operations in Oleoducto	29,359	(23,640)	10,865	16,584
Operations in Iquitos Refinery	1,402	(7)	(4)	1,391
Commercial operations	602	-	(5)	597
Management Exploration and Exploitation	956	-	(8)	948
Total own units	40,863	(25,225)	10,824	26,462
Total	50,632	(25,872)	10,865	35,625
Exchange difference	2,218			1,250
Total	52,850			36,875

	Balances at January 1	Provision Payments	Balances at and update	December 31
	US$000	US$000	US$000	US$000
Year 2017				
Block 8	3,473	(574)	(301)	2,598
Block X	5,260	(1)	(418)	4,841
Pampilla	10	(2)	(16)	(8)
Lubricants	127	-	(10)	117
Northern terminals	274	-	(11)	263
Southern terminals	218	(1)	(13)	204
Mid-country terminals	1,879	(1)	(143)	1,735
Natural Gas Electric system	19	-	-	19
Total privatized units	11,260	(579)	(912)	9,769
Operations in Talara	9,046	(1,140)	(281)	7,625
Operations in Conchán	1,094	(143)	(32)	919
Operations in Oleoducto	71,075	(77,967)	36,251)	29,359
Operations in Iquitos Refinery	1,569	(120)	(47)	1,402
Commercial operations	729	(116)	(11)	602
Management Exploration and Exploitation	1,020	(49)	(15)	956
Total own units	84,533	(79,535)	35,865	40,863
Total	95,793	(80,114)	34,953	50,632
Exchange difference	(3)			2,218
Total	95,790			52,850

Disbursements required in the environmental remediation activities conducted by PETROPERÚ S.A. in the privatized units are recorded with a charge to profit or loss. As stated in Article 6 of Law No. 28840, "Ley de Fortalecimiento y Modernización de la Empresa de Petróleos del Perú - PETROPERÚ S.A.", the government treasury agency "Dirección General del Tesoro Público" shall transfer PETROPERÚ S.A, the total resources needed to cover the expenses to be incurred in environmental remediation activities of the respective privatized units.

The mandate under Article 6 of Law No. 28840 by which the Peruvian Government shall compensate the Company for the environmental remediation work to be performed in its privatized units was re-confirmed by another piece of legislation ("Vigésima Sexta Disposición Complementaria Final de la Ley No. 30114, Ley de Presupuesto del Sector Público") for fiscal 2014, which authorizes the Ministry of Energy and Mines to transfer financial resources to the Company so that it can complete environmental remediation activities in the privatized units that belonged to it. At December 31, 2018 a total of US$11,000 thousand (equivalent to S/34,000 thousand) remained to be transferred for future expenditures, which was recognized by the MINEM in 2014.

Continuing with the procedures begun in 2006, PETROPERÚ S.A. presented to the Ministry of Energy and Mines invoices and similar documentation supporting the expenses incurred in environmental remediation for the period from January 2007 to October 2014. Based on this process, a total US$1,377 thousand (equivalent to S/4,116 thousand).

The Company has sent communications to MINEM requesting financial remittances intended for environmental remediation, which resulted in contributions of S/62,600 thousand (equivalent to US$20,900 thousand) during 2015; these resources covered the total expenses incurred by the Company at December 31, 2017 in environmental remediation of its privatized units. At December 31, 2018 and 2017 Management considers that the amounts of those provisions are sufficient to cover the environmental remediation liabilities which the Company has to fulfill.

Article No.3 of Supreme Decree No.002-2006-EM, the supplementary environmental plan (*"Disposiciones para la presentación del Plan Ambiental Complementario - PAC")* enacted on January 5, 2006 establishes that the energy and mining regulator (*Organismo Supervisor de la Inversión en Energía y Minas - OSINERGMIN)* (competence transferred to the "Organismo de Evaluación y Fiscalización Ambiental - OEFA" under Board Resolution No. 001-2011-OEFA/CD dated March 2, 2011) will communicate to the Company the list of activities not complied in the respective PAMA requirements so as to coordinate with the *Dirección General de Asuntos Ambientales Energéticos* of the Ministry of Energy and Mines, the PAC execution schedule over a period not exceeding four (4) years.

The Supplementary Environmental Plan (*PAC)* for Operations in Talara is currently undergoing the approval process with *DGAAE*; once approval is obtained, of the term of execution will be four (4) years and it will be become a medium-term project.

b) Provision for civil claims -

At December 31, 2018 the Company has estimated a provision of US$2,229 thousand (equivalent to S/7,533 thousand), of which US$1,476 thousand (equivalent to S/4,885 thousand) correspond to eight (8) administrative proceeding contingencies with the energy and mining regulator "Organismo Superior de la Inversión en Energía y Minería - OSINERGMIN".

During 2018, the Company reversed a total US$15,619 thousand (equivalent to S/50,978 thousand) involving a change in the degree of probability of the contingencies from probable to remote for the administrative proceeding with the government environmental agency "Organismo de Evaluación y Fiscalización Ambiental - OEFA".

At December 31, 2017 the Company estimated a provision of US$17,809 thousand (equivalent to S/57,791 thousand), which comprises: (i) US$15,710 thousand (equivalent to S/50,978 thousand) for administrative proceeding contingencies with the government environmental agency "Organismo de Evaluación y Fiscalización Ambiental - OEFA" and (ii) US$1,505 thousand (equivalent to S/4,883 thousand) for administrative proceedings with the energy and mining regulator "Organismo Superior de la Inversión en Energía y Minería - OSINERGMIN", related to the oil spills in the ONP.

During 2017, the Company reversed a total US$10,474 thousand of unused provisions, mainly relating to the Ventanilla Municipality for a total of US$7,133 thousand.

17 DEFERRED INCOME TAX LIABILITIES

The movement on the deferred income tax for the years ended December 31, 2018 and 2017 is as follows:

	Balances at January 1, 2017 US$000	Credit (charge) to profit and loss US$000	Balances at December 31, 2017 US$000	Credit (charge) to profit and loss US$000	Balances at December 31, 2018 US$000
Deferred assets:					
Provision for retirement pension	35	(3)	32	(3)	29
Provision for environmental remediation	28,258	(12,667)	15,591	(4,734)	10,857
Other provisions	7,881	(2,337)	5,544	(904)	4,640
Provision for impairment of fixed assets	12,782	(9,287)	3,495	(3,495)	-
Unpaid labor liabilities	-	3,784	3,784	(3,784)	-
	48,956	(20,510)	28,446	(12,920)	15,526
Deferred liabilities:					
Attributed cost of property, plant and equipment	(122,075)	12,549	(109,526)	3,946	(105,580)
Translation effect of non-monetary items (a)	-	25,773	25,773	(45,068)	(19,295)
Interest on PMRT financing	(4,916)	4,916	-	-	-
	(126,991)	43,238	(83,753)	(41,122)	(124,875)
Net deferred liabilities	(78,035)	22,728	(55,307)	(54,042)	(109,349)

(a) Comprising the deferred income tax arising from the exchange rate affecting non-monetary items (mainly fixed assets) given the fact the Company is levied with income tax in a currency (Peruvian Soles) other than its functional currency (US$). During the course of 2018 the U.S. dollar strengthened significantly in relation with the Peruvian sol, giving rise to deferred income tax liabilities of US$45,068 thousand; during the course of 2017 the U.S. dollar weakened in relation with the Peruvian sol giving rise to deferred income tax asset of US$25,773 thousand.

18 EQUITY

a) Share capital -

At December 31, 2018 the authorized, subscribed and paid-in share capital comprises 4,448,416,995 common shares (3,927,713,295 at December 31, 2017) at S/1 par value each. At December 31, 2018 the share capital structure of the Company is as follows:

Class	Number of shares	Percentage %
A	3,558,733,596	80
B	889,683,399	20
	4,448,416,995	100

Class- "A" shares have voting rights but are indivisible, non-transferable and non-seizable shares and cannot be pledged, loaned or affected in any way.

Class- "B" shares have voting right and are transferable via centralized trading mechanisms in the securities market.

The movements of the share capital in 2018 and 2017 were as follows:

At the General Shareholders' Meeting held on January 14, 2017 an increase in capital of US$316,357 thousand (equivalent to S/1,056,000 thousand) was approved, contributed in cash in 2017 which was transferred from additional capital. Also, at the General Shareholders' Meeting held on April 18, 2017 a capital increase by US$121,393 thousand (equivalent to S/406,665 thousand) was approved; this increase in share capital was made through an additional capital contribution. On August 7, 2017 registration with the Lima Public Records was reported.

At the General Shareholders' Meeting held on June 27, 2018 an increase in capital of US$166,594 thousand (equivalent to S/520,704 thousand) was approved; this increase in share capital was made through an additional capital contribution. On October 29, registration with the Lima Public Records was reported.

b) Additional capital -

During 2017 a cash contribution of US$316,357 thousand (equivalent to S/1,056,000 thousand) was made by the Ministry of Energy and Mines in accordance with the provisions of Legislative Decree No. 1292 "Legislative Decree that declares the adequate operation of the ONP of public need and national interest and sets forth the reorganization and improvement of the corporate governance of PETROPERÚ S.A." This contribution increased the additional capital.

At the General Shareholders' Meeting held on April 18, 2017, an increase in additional capital by US$11,152 thousand (equivalent to S/36,254 thousand) was approved, as a result of the capitalization of distributable profits reported for 2016.

At the General Shareholders' Meeting held on June 27, 2018 an increase in share capital by US$166,594 thousand (equivalent to S/520,704 thousand) was approved, as a result of the capitalization of distributable profits reported for 2017.

c) Legal reserve -

In accordance with Peruvian Corporate Law in Article No.229, a legal reserve must be formed by the transfer of 10% of the annual net profits until it reaches a 20% of the paid-in capital. In the absence of non-distributed profits or freely available reserves, the legal reserve may be applied to offset losses, and must be replenished with profit from subsequent periods.

In the context of this regulation, the legal reserve recorded at December 31, 2018 totaled US$40,160 thousand (equivalent to S/135,703 thousand); the legal reserve constituted in 2018 totaled US$18,510 thousand (equivalent to S/65,445 thousand); which corresponds to 10% of the distributable profits for 2017. At December 31, 2017 the legal reserve was US$21,650 thousand (equivalent to S/72,144 thousand); the legal reserve constituted in 2017 totaled S/17,749 thousand (equivalent to US$5,461 thousand), which corresponds to 10% of the distributable net profits for 2016.

d) Retained earnings -

The General Shareholders' Meeting approved the dividends policy, which states that: "The distributable profits and after the deduction of workers' profit sharing, the Legal taxes and legal reserve that may be applicable, will be destined to the 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 No.28840- Law for the Strengthening and Modernization of the Company Petróleos del Perú - PETROPERÚ S.A.", which is concordant with Article Twenty Nine subsection F) of the current Corporate by-laws.

19 REVENUE FROM ORDINARY ACTIVITIES

This item comprises:

	2018 US$000	2017 US$000
Local sales	4,324,391	3,555,916
Price Stabilization Fund (*)	38,765	24,892
Revenue from ordinary activities	6,107	4,740
	4,369,263	3,585,548
Foreign sales	514,743	393,744
	4,884,006	3,979,292

(*) The Price Stabilization Fund is applied to some products such as GLP-E, Diesel B5, Diesel B5 S-50 and industrial oil 6.

Revenues from ordinary activities are recognized according to what is defined by IFRS 15, at one point in time.

In 2018 and 2017, sales are broken down as follows:

	2018 US$000	2017 US$000
Local sales:		
Diesel - others	2,418,171	2,091,494
Gasoline	1,132,185	961,031
Industrial oil	380,162	165,021
GLP	189,177	206,284
Turbo	125,841	101,571
Asphalt	65,884	45,450
Loreto Crude	40,266	-
Solvent	16,810	14,697
Primary Naphtha	767	-
Total local sales	4,369,263	3,585,548

	2018 US$000	2017 US$000
Foreign sales:		
Diesel - others	125,775	100,637
Industrial oil	166,871	152,279
Virgin Naphtha	98,922	90,865
Loreto Crude	43,155	5,181
Turbo	38,409	31,611
Primary residual/crude	27,239	4,039
Asphalt	6,215	5,569
Gasoline	2,513	3,563
Naphtha Cracked	2,453	-
USLD	2,349	-
HOGBS	842	-
Total foreign sales	514,743	393,744
	4,884,006	3,979,292

20 OTHER OPERATING INCOME

This item comprises:

	2018 US$000	2017 US$000
Income recognized at a point in time:		
Terminal operating fees (a)	34,124	34,778
Recoverable freight (b)	7,545	15,011
PNP supply operations	2,452	1,331
Revenue from cost of use of hydrocarbons	1,043	267
Income recognized over time:		
Crude transport via oil pipeline (c)	19,243	3,032
Savia Perú S.A. lease (Note 12)	10,000	10,000
Leases (d)	5,464	6,850
Other service revenue	1,193	1,013
	81,064	72,282

(a) Comprises revenue from operating agreements of the terminals of the Company signed with Consorcio Terminales regarding the terminals and southern plant of Peru and with "Terminales del Perú" for the terminals and northern and central plants.

(b) Comprising revenue from billing of transportation expenses incurred by customers. The Company considers a handling margin when billing this type of expenses.

(c) Comprising the revenue obtained from the transport of crude through the oil pipeline (ONP). At the reporting date, Section I ("Tramo I") is shutdown.

(d) PETROPERÚ S.A. as a private-law government-owned entity has signed agreements with private sector entities to lease a number of floors in its headquarters building, refinery exploitation machinery and equipment as well as productive facilities such as the refinery and sales plant in Pucallpa.

21 COST OF SALES

This item comprises:

	2018 US$000	2017 US$000
Opening inventory of goods	605,294	475,381
Purchase of crude oil, refined products and supplies	4,255,126	3,371,140
Operating expenses of production (a)	313,506	295,866
Closing inventory of goods	(556,326)	(605,294)
	4,617,600	3,537,093

(a) The composition of operating expenses of production is as follows:

	2018 US$000	2017 US$000
Third-party services (*)	216,974	209,130
Personnel charges (Note 24)	54,063	55,345
Depreciation (Note 11 and 12)	33,909	34,732
Other materials and production supplies	9,059	7,385
Insurance	7,352	6,363
Workers' profit sharing (Note 15-b and Note 24)	1,110	12,659
Other management charges	772	584
Amortization	8	42
Reversal for impairment of assets (Note 11)	(11,536)	(31,790)
Others	1,795	1,416
	313,506	295,866

(*) Includes the following:

Ground transport freight and expenses	51,439	59,392
Maintenance and repair services	24,968	21,195
Maritime transport freight and expenses	24,016	21,755
Other freights	21,875	17,465
Energy and water	19,724	20,922
Industrial protection and safety	5,504	3,568
Food and lodging	3,260	3,226
Others	66,188	61,607
	216,974	209,130

22 SELLING AND DISTRIBUTION EXPENSES

This item comprises:

	2018 US$000	2017 US$000
Personnel charges (Note 24)	27,464	25,983
Taxes (b)	20,156	18,076
Third-party services (a)	15,309	9,134
Depreciation (Note 11)	8,824	7,291
Materials and supplies	2,813	2,566
Insurance	1,331	1,000
Other management charges	663	577
Workers' profit sharing (Note 15-b and Note 24)	467	5,432
Expected loss of receivables (Note 8)	382	147
	77,409	70,206

(a) Includes the following:

	2018 US$000	2017 US$000
Other third-party services	5,093	2,048
Maintenance and repair services	4,471	2,877
Industrial protection and safety	3,684	1,702
Rentals	1,077	1,194
Travel and transfer expenses	524	512
Energy and water	316	476
Other freight	134	325
Advertising	10	-
	15,309	9,134

(b) The item of taxes mainly reflects the aliquots payable to OSINERGMIN for a total US$15,882 thousand (US$13,960 thousand in 2017) as well as contributions to OEFA for a total US$3,954 thousand (US$3,737 thousand in 2017).

23 ADMINISTRATIVE EXPENSES

This item comprises:

	2018 US$000	2017 US$000
Personnel charges (Note 24)	87,734	83,258
Third-party services (a)	45,980	38,803
Depreciation (Note 11)	5,646	5,420
Other management charges	5,291	12,294
Taxes	3,349	12,674
Contingencies	2,191	6,241
Amortization	2,165	2,323
Materials and supplies	1,369	1,427
Workers' profit sharing (Note 15-b and Note 24)	1,177	12,757
Expected loss of receivables (Note 9)	553	3,218
Insurance	770	569
	156,225	178,984

(a) Includes the following:

	2018 US$000	2017 US$000
Advisory, appraisal and audits	9,055	4,700
Maintenance and repair services	9,026	6,712
IBM outsourcing services	8,977	8,534
Industrial protection and safety	3,733	7,017
Temporary services	2,581	1,707
Advertising	1,967	2,427
Freight and other freight	1,712	712
Bank expenses	1,303	1,090
Travel and transfer expenses	1,731	1,472
Other	5,895	4,432
	45,980	38,803

24 PERSONNEL CHARGES

This item comprises:

	2018 US$000	2017 US$000
Wages and salaries	62,246	60,529
Bonuses	43,212	43,590
Social contributions	22,775	23,555
Statutory bonuses	13,187	13,486
Employees' severance indemnities	9,294	8,908
Vacations	4,740	4,225
Feeding	3,752	3,635
Mutual disagreement and other	3,830	810
Workers' profit sharing (Note 21, 22 and 23)	2,754	30,848
Overtime	1,433	1,460
Transportation	1,263	1,163
Others	3,529	3,225
	172,015	195,434

Personnel charges and workers' profit sharing expenses were recorded with charges to profit and loss of the year as follows:

	2018 US$000	2017 US$000
Cost of sales (Note 21)	55,173	68,004
Selling expenses and distribution (Note 22)	27,931	31,415
Administrative expenses (Note 23)	88,911	96,015
	172,015	195,434

25 OTHER INCOME AND EXPENSES

This item comprises:

	2018 US$000	2017 US$000
Other income		
Interest - SUNAT refund (a)	94,824	31,146
Recovery of provision for civil claim	15,621	10,474
Claims and/or indemnities (insurance/ non-compliance)	10,397	4,001
Maritime operations services	4,017	3,501
Labor provision recovery	1,230	27
Doubtful trade accounts provision recovery	668	1,427
Committed investments received	-	6,437
Others	8,730	11,799
	135,487	68,812
Other expenses		
Environmental Remediation (Block 8) (b)	(22,474)	-
Provision for losses in oil pipeline (Note 16-b) (c)	(10,806)	(33,706)
Net cost of disposal	(102)	(1,802)
Provision for retirement pension	(34)	(32)
Right of equity	(64)	-
Impairment of supplies	-	(8)
	(33,480)	(35,548)

(a) During 2018, SUNAT issued three Resolutions ordering a refund in connection with Case Files No. 07873-2012-0-1801-JR-CA-13, No.02529-2010-2-1801-JR-CA-14 and No.00114-2012-1801-JR-CA-07. Refunds obtained included interest for a total US$42,813 thousand, US$38,333 and US$13,678 thousand, respectively (Note 9).

(b) This is a provision for arbitration proceedings involving environmental remediation in Block 8 brought by Pluspetrol Norte S.A. for US$22,474 thousand.

(c) Comprising the expenses incurred by the Company in cleaning activities, environmental monitoring, recovery and collection of materials, among others, related to losses in oil pipeline ONP. The Company expects to recover these expenses with the insurance indemnities.

26 FINANCIAL INCOME AND EXPENSES

Financial income and expenses comprises:

	2018 US$000	2017 US$000
Interest on bank deposits	4,226	1,707
Interest on receivables	707	1,212
Gains from derivative financial instruments	12,088	476
	17,021	3,395
Interest on working capital loans	(31,888)	(31,541)
Loss on derivative financial instruments	(17,040)	(20,210)
Others	-	(93)
	(48,928)	(51,844)

27 TAX SITUATION

a) Tax rates -

In accordance with current legislation, the Company is individually subject to applicable taxes. Management considers that it has determined taxable income in accordance with the Peruvian income tax general regime, by adding to and deducting from the results shown in the financial statements, those items that are considered as taxable and non-taxable, respectively. The applicable Income tax rate ha has been 29.5% since 2017 onwards, by means of Legislative Decree N° 1261 published on December 10, 2016.

It should be noted that under current Peruvian laws, non-domiciled parties are only subject to income tax on their Peruvian-source income. In general, income obtained by non-domiciled parties that provide services in Peru will be subject to a 30% income tax rate on gross income; this is as long as no double taxation agreement (CDI) is applicable. In respect of technical assistance services or digital services rendered by non-domiciled parties to legally resident taxpayers; the place where the services are rendered will not be relevant; in all cases, will be subject to income tax of 15% and 30%, respectively on a gross basis. The income tax rate on technical assistance services is 15% as long as the qualifying requirements under the Peruvian income tax law are met.

b) Income tax determination -

The Company, in calculating its taxable income for the years ended December 31, 2018 and 2017, has determined current income tax for US$3,906 thousand and US$85,687 thousand, respectively.

The income tax expense shown in the statement of comprehensive income comprises:

	2018 US$000		2017 US$000
Current	3,681		85,687
Deferred	54,042	(	22,728)
	57,723		62,959

Reconciliation between the effective income tax rate to the tax rate is as follows:

		2018 US$000		%		2017 US$000		%
Pre-tax profit		177,275		100.00		248,063		100.00
Theoretical income tax 29.5%		52,296		29.50		73,179		29.50
Permanent non-deductible expenses		18,035		10.17		18,563		7.13
Permanent non-taxable income	(	32,328)	(	18.24)	(	9,256)	(	3.73)
Effect of exchange difference on tax fixed assets		45,068		25.42	(	25,773)	(	10.39)
Effect of (lower) higher current tax resulting from exchange difference	(	27,296)	(	15.40)		16,182		6.52
Others		1,948		1.10	(	9,936)	(	4.00)
Current and deferred income tax		57,723		32.55		62,959		25.38

Permanent non-taxable revenue for 2018 mainly consisted of interest collected from SUNAT in the form of tax refunds on sales of Turbo A-1 fuel that is tax-exempt.

The Peruvian tax authorities have the right to review and, if necessary, amend the income tax determined by the Company in the last four years from January 1 of the year following the date of filing of the corresponding tax return (years subject to examination). Years 2013 to 2018 are subject to examination. Since discrepancies may arise over the interpretation of the tax laws applicable to the Company by tax authorities, it is not possible at present to anticipate whether any additional liabilities will arise as a result of eventual tax examinations. Any additional tax, penalties and interest, if arising, will be recognized in the results of the period when such differences of opinion with the Tax Authority are resolved. Management considers that no significant liabilities will arise as a result of these eventual tax examinations.

Under current legislation, for purposes of determining Income Tax and VAT (IGV in Perú), transfer prices agreed between related parties and/or tax havens must have documentation and information supporting the valuation methods and criteria applied in their determination. Tax Authorities are authorized to request this information from the taxpayer. Based on an analysis of the Company's business, Management and its legal advisers consider that no significant contingencies will arise as a result of this legislation for the Company at December 31, 2018.

c) Temporary Tax on Net Assets -

The Company is subject to the Temporary Tax on Net Assets (ITAN, from its Spanish acronym). The taxable base is the prior period adjusted net asset value less depreciation, amortization admitted by the Income Tax Law, as shown in the respective standard (Law 28424 and its Regulation). The ITAN rate is 0.4% for 2018 and 2017 applied to the amount of net assets that exceed S/1,000,000. It may be paid in cash or in nine consecutive monthly installments. The amount paid may be used as a credit against payments of the general income tax regime 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 regularization of income tax payments for the related fiscal year.

d) Tax on financial transactions -

For fiscal 2018 and 2017, the rate of the Tax on Financial Transactions was set at 0.005% and is applicable to bank debits and credits or cash movements through the formal financial system, unless the transaction is exempt. This tax is accounted for as tax expenses within administrative expenses.

e) Tax Regime of Value Added Tax -

The VAT rate (including Wholesale Price Index) currently in force is 18%.

The Company opted to take advantage of the VAT anticipated recovery regime ("Régimen de Recuperación Anticipada del Impuesto General a las Ventas - IGV") by which it will be able to obtain a refund of the VAT levied on imports and local purchases of new goods or inputs, as well as construction services and contracts, carried out in the pre-operating phase to be used in implementing the PMRT project.

On October 21, 2016 PETROPERÚ S.A. filed with PROINVERSION an application for anticipated recovery of VAT (IGV). As part of the paperwork, the application was sent by PROINVERSION to the Ministry of Energy and Mines (MEM) and the Ministry of Economy and Finance (MEF). In this respect, Technical Report No. 0125-2017-MEM-DGH-DPTC-DNH was issued, by which the Ministry of Energy and Mines approved the investment schedule presented by PETROPERÚ S.A. for a total of US$2,958,000 thousand.

Said report was sent to MEF on December 29, 2017, which issued Report No.117-2018-EF/61.01 stating a favorable opinion on the listing of goods, services and construction contracts relating to the PMRT project subject to the benefit of anticipated recovery of VAT ("Régimen de Recuperación Anticipada del IGV")

By means of Ministry Resolution No 212-2018-MEM/DM published in the Peruvian gazette "El Peruano" dated June 8, 2018, the MEM authorized the Company to apply for the anticipated recovery of VAT (IGV) and approved respective listing of goods, services and construction contracts relating to the PMRT project subject to the benefit of anticipated recovery of VAT (IGV).

On July 31, 2018 the Company apply for a refund of the VAT paid in the months from October 2016 to March 2017 on the purchases related to the PMRT Project subject to the anticipated VAT recovery benefit for a total US$25,133 thousand (equivalent to S/84,924 thousand). By means of Resolution No 012-180-0017401 SUNAT approved and refunded a balance of S/83,015 thousand.

Subsequently, on October 19, 2018 the Company applied for a refund of the VAT (IGV) paid in the months from April to September 2017 on the purchases related to the PMRT Project for a total US$34,293 thousand (equivalent to S/115,465 thousand). By means of Resolution No 012-180-0017799 SUNAT approved and refunded a balance of US$18,869 thousand (equivalent to S/63,760 thousand).

Finally, on December 12, 2018 the Company requested for a refund of the VAT (IGV) paid in the months from April to October 2017 through March 2018 on the purchases related to the PMRT Project for a total US$23,584 thousand (equivalent to S/79,692 thousand) that remains to refunded by the Peruvian tax authorities.

f) Main tax changes in force at January 1, 2019.

On September 13, 2018 Legislative Decree No. 1422 was enacted setting certain changes in tax laws and regulations with effect from 2019. Changes that are considered most significant by the Company are as follows:

- Final beneficiaries: The mandatory requirement is set for legal entities and/or "entes jurídicos" in Peru to inform about the identity of their final beneficiaries.

- Transfer pricing: The scope of Transfer Pricing regulations is extended to transactions entered into to/from and through no-cooperating countries or territories or involving parties whose revenue or earnings benefit from a preferred tax treatment. Also, the requirement is established that the market value of transaction of export and import of goods, with a known market quoted price,, including derivative financial instruments; or goods with prices that are set based on those quoted prices.

- Accrual: A legal definition of accrual is established for the recognition of income and expenses for income tax purposes. As per this definition, Peruvian third-category (corporate) income is considered accrued whenever the underlying income-generating events have substantially occurred and the right to that income is not restricted by any suspensive condition. Income is accrued regardless of the timing of settlement and even if the payment conditions have not been set. When the consideration or a portion thereof is set based on an event or fact that is expected to occur in the future, income will be accrued when such a future event or fact occurs. Apart from the above-explained general rule, specific rules have been introduced that should be adhered to considering the kind of transactions that is required for the accrual to be triggered.

- Deductibility of financial expenses: New rules are established on interest deductibility effective from 2021 that are based on the EBITDA determined by entities.

- General Anti-Tax Avoidance Clause (Peruvian Tax Standard XVI): A special procedure has been set up for the enforcement of Peruvian Tax Standard XVI, by which SUNAT will be entitled to enforce paragraphs second to fifth of Tax Standard XVI in the framework of a final tax examination, provided that a favorable opinion is obtained from a Reviewing Committee, comprising three (3) SUNAT auditors. In addition, boards of directors are now required to approve, ratify or amend the events, situations or economic relations to be implemented (or already implemented) as part of "tax planning". Ultimately, a new assumption of joint and several liability is established for the legal representatives of a tax debtor; whenever, the latter is subject to the provisions of Tax Standard XVI, provided that those legal representatives had demonstrably helped design, approve or implement initiatives, acts or economic relations intended for tax avoidance.

g) Examination by the tax authorities -

As a result of the income tax review by the tax authorities for fiscal 2011, the Company paid a total of US$2,940 thousand (equivalent to S/9,540 thousand) in respect of unpaid taxes, interest and tax penalties. However, given the difference between the tax loss determined by SUNAT and the tax loss filed by the Company for fiscal 2008, under Resolution No. 0150140009896 dated July 27, 2011, SUNAT issued a Tax Determination Resolution No. 012-003-0090872 for the amount of US$2,667 thousand (equivalent to S/8,653 thousand) An appeal against said resolution was presented by the Corporate and Legal Management ("Gerencia Corporativa Legal, Sub Gerencia Tributaria, Cumplimiento Regulatorio y ambiental") within the term set by law with an outcome adverse for the Company as per Resolution No 0150150014244 dated July 16, 2018. The Company has filed an appeal against that Resolution; and the final decisions remains to be issued by the Tax Tribunal, (Case File No 11632-2018).

The above-mentioned Resolution No 0150140009896, involving Income Tax for fiscal 2008 was subject to appeal with the Tax Tribunal (Case File No 10758-2011) that remained to be resolved at that date.

With respect to fiscal 2007, an appeal filed with the Tax Tribunal remains to be resolved involving tax assessments determined by SUNAT on the VAT (IGV) and excise tax (ISC) (Case File No 17806-2012 as described in subsection vi above).

With respect to fiscal 2006, an appeal filed with the Tax Tribunal remains to be resolved involving prepaid Income Tax (Case File No 10971-2011). In August 2018, a notice was served to the Company with the Tax Tribunal Resolution No 06573-1-2018 containing a pronouncement that was favorable to the Company revoking the VAT tax assessments for the period from January to December 2006.

Finally, with respect to fiscal 2005, an appeal filed with the Tax Tribunal remains to be resolved involving tax assessments detemined by SUNAT on the Income Tax (Case File No 164-2011).

At December 31, 2018 SUNAT's tax examination on the Company's income tax for the period from January to December 2012 remains to be resolved.

28 CONTINGENCIES

The Company has the following labor-related court actions, civil lawsuits, tax and customs claims pending resolution, which are considered possible contingencies:

	At December 31,	
	2018	2017
	US$000	US$000
Civil (a)	141,219	40,839
Tax and customs claims (b)	39,274	61,817
Labor-related	3,803	6,628
	184,296	109,284

The movement of contingencies is detailed below:

	Balance at January 1	Additions	Deductions	Balance at December 31
	US$000	US$000	US$000	US$000
Civil (a)	40,839	130,023	(29,643)	141,219
Tax and customs claims (b)	61,817	3,374	(25,917)	39,274
Labor-related	6,628	1,691	(4,516)	3,803
	109,284	135,088	(60,076)	184,296

(a) During 2018, the Company added to its disclosures the arbitration process brought by Savia Perú S.A. for US$100,000 thousand in 2018, involving a claim against the rent agreement signed by the Company and an administrative and challenging actions brought by the OEFA for alleged violations of the environmental standards for a total US$24,238 thousand. Also, the arbitration proceedings brought by Pluspetrol Norte S.A. and Refinería La Pampilla S.A. for US$22,474 thousand and US$5,180 thousand, respectively.

(b) During 2018, the Company obtained favorable outcome in the tax challenging action of Files Nos. 8616-2016 and 11967-2017 for US$9,295 thousand and US$14,563 thousand, respectively.

29 BASIC AND DILUTED EARNINGS PER SHARE

The calculation at December 31, 2018 and 2017 of earnings per basic and diluted share shows the same value as there are no shares with dilutive effect is as follows:

	Profit	Weighted average number of	Earnings
	US$000	shares used	per share
2018:			
Basic and diluted earnings per share	119,552	4,019,014	0.030
2017:			
Basic and diluted earnings per share	185,104	3,415,046	0.054

30 GUARANTEES AND COMMITMENTS

(a) Guarantees and performance bonds -

At December 31, 2018 the Company has given performance bonds backed by local financial institutions to suppliers for a total US$31,377 thousand (equivalent to S/106,203 thousand) and US$33,518 thousand.

Guarantees related to borrowings are disclosed in Note 13.

At December 31, 2018 and 2017 the Company maintains no long-term operating lease commitments.

(b) Commitments -

The contracted investment expense comprising commitments at the date of the statement of financial position is recognized as follows:

	2018 US$000	2017 U$000
Property, plant and equipment	23,298	50,639

The expense for the periods 2018 and 2017 amounted to US$26,861 thousand and US$22,933 thousand, respectively, and was recorded in selling expenses and cost of sales in the statement of comprehensive income.

Future minimum non-cancellable operating lease payments at December 31, 2018 and 2017 are as follows:

	2018 US$000	2017 US$000
Less than 1 year	17,701	26,861
Between 1 year and less than 3 years	4,594	21,884
More than 3 years	1,003	1,894
Total	23,298	50,639

Beginning in 2019, the Company will adopt IFRS 16 Leasing (Note 2.1)

31 RELATED PARTIES

The Peruvian Government owns the Company's share capital and it is represented by each member of the General Shareholders' Meeting. As per the twenty-third article of the Bylaws of PETROPERÚ S.A., the General Shareholders' Meeting consists of five members representing the class " A" and " B " shares owned by the Peruvian Government: the Ministry of Energy and Mines, which chairs the Meetings and four members on behalf of the Peruvian Government, appointed by Supreme Decree. Transactions between the Company and the Peruvian Government and the Ministry of Energy and Mines are shareholder transactions.

32 SUBSEQUENT EVENTS

Between December 31, 2018 and the date of approval of the financial statements, there have been no significant subsequent events that Management considers that required any additional disclosure or any adjustment to the balances stated in the financial statements.