

PETROLEOS DEL PERU - PETROPERU S.A.

STATEMENT OF FINANCIAL POSITION

ASSETS	Note	31.12.2017		LIABILITIES AND EQUITY	Note	31.03.2018		31.12.2017
		US\$ 000	US\$ 000			US\$ 000	US\$ 000	
Current assets				Current liabilities				
Cash and cash equivalent	7	576,592	666,141	Other financial liabilities	13	1,527,970	1,319,200	
Trade receivables	8	339,565	293,177	Trade payables	14	562,108	772,247	
Other receivables	9	716,181	711,353	Other payables	15	112,777	115,189	
Inventories	10	642,023	643,611	Other provisions	16	55,458	59,611	
Prepaid expenses		3,220	4,889	Total current liabilities		2,258,313	2,266,247	
Total current assets		2,277,581	2,319,171	Non-current liabilities				
Non-current assets				Other financial liabilities	13	1,985,237	1,985,124	
Other receivables	9	209,143	215,168	Other provisions	16	14,883	14,461	
Other assets		67	67	Deferred income tax liabilities	17	55,283	55,307	
Property, plant and equipment	11	3,421,005	3,291,409	Total non-current liabilities		2,055,403	2,054,892	
Investment properties	12	78,083	79,430	Total liabilities		4,313,716	4,321,139	
Intangible assets		32,749	33,498	EQUITY	18			
Total non-current assets		3,741,047	3,619,572	Share capital		1,171,395	1,171,395	
				Additional capital		0	0	
				Legal reserve		21,650	21,650	
				Other equity reserves		-	(154)	
				Retained earnings		511,867	424,713	
				Total equity		1,704,912	1,617,604	
TOTAL ASSETS				TOTAL LIABILITIES AND EQUITY		6,018,628	5,938,743	

The accompanying notes on the page 8 to 81 are part of the financial statements.


CARLOS A. LINARES PENABAZ
 Gerente Corporativo Financiera
 Ficha: 57960

PETROLEOS DEL PERU - PETROPERU S.A.

Statement of Income and Other Comprehensive Income

	Note	For the three months period ended on March 31, 2018 and 2017	
		2018	2017
		US\$000	US\$000
Income from ordinary activities	19	1,132,598	932,750
Other operational income	20	21,038	15,661
Total income		1,153,636	948,411
Cost of sales	21	(1,007,660)	(829,481)
Gross profit		145,976	118,930
Selling and distribution expenses	22	(34,251)	(31,972)
Administrative expenses	23	(39,473)	(32,082)
Other income	25	46,729	7,241
Other expenses	25	(8)	(52)
Total operating expenses		(27,003)	(56,865)
Profit from operating activities		118,973	62,065
Finance income	26	2,442	530
Finance costs	26	(9,051)	(10,255)
Exchange difference, net	3.1.a.i	3,822	(13,759)
Profit before income tax		116,186	38,581
Income tax expense	27	(29,032)	523
Net result from the financial year		87,154	39,104
Other comprehensive results that could be reclassified to results:			
Results of derivative instruments		154	(395)
Effect of currency translation		-	-
Total other comprehensive results		154	(395)
Total comprehensive results		87,308	38,709
Basic and diluted earnings per share	29	0.026	0.011

The accompanying notes on page 8 through 81 are part of the financial statements.


CARLOS A. LINARES PEÑALOZA
 Gerente Corporativo Finanzas
 Ficha: 57980

PETROLEOS DEL PERU - PETROPERU S.A

Statement of changes in equity

For the three month period ended on March 31, 2018 and de 2017

	Number of shares	Share capital US\$000	Additional capital US\$000	Statutory Reserve US\$000	Other equity reserve US\$000	Accumulated results US\$000	Total equity US\$000
Balance as of January 1, 2017	2,465,047,935	733,645	110,241	16,189	(373)	256,222	1,115,924
Comprehensive results:							
Net result of the financial year	-	-	-	-	-	39,104	39,104
Other comprehensive results:							
Results of derivative instruments	-	-	-	-	(395)	-	(395)
Total comprehensive results	-	-	-	-	(395)	39,104	38,709
Transactions with shareholders:							
Shareholder's cash contribution	-	-	316,357	-	-	-	316,357
Transfer to additional capital and statutory reserve	-	-	11,152	5,461	-	(16,613)	-
Transfer to share capital from cash contribution	1,056,000,000	316,357	(316,357)	-	-	-	-
Transfer 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 as of March 31, 2017	3,927,713,295	1,171,395	-	21,650	(768)	278,713	1,470,990
Balance as of January 1, 2018	3,927,713,295	1,171,395	-	21,650	(154)	424,713	1,617,604
Comprehensive results:							
Net result of the financial year	-	-	-	-	-	87,154	87,154
Other comprehensive results:							
Results of derivative instruments	-	-	-	-	154	-	154
Total comprehensive results	-	-	-	-	154	87,154	87,308
Transactions with shareholders:							
Total transactions with shareholders	3,927,713,295	1,171,395	-	21,650	-	511,867	1,704,912


CARLOS A. LINARES PEÑALOZA
Gerente Corporativo Finanzas
Ficha: 57980

Statement of Cash Flows

Note	For the three month period ended on March 31, 2018 and 2017	
	2018	2017
	US\$000	US\$000
OPERATING ACTIVITIES		
	(24,879)	(31,244)
	(13,056)	(4,546)
	(109)	(62)
	<u>(38,044)</u>	<u>(35,853)</u>
INVESTMENT ACTIVITIES		
	(20,042)	(46,312)
	(138,866)	(124,729)
	(1,631)	(19,340)
	-	(4)
9	(75,000)	-
	<u>(235,539)</u>	<u>(190,385)</u>
FINANCING ACTIVITIES		
12	1,626,239	1,214,385
12	-	-
12	-	-
12	1,442,839	(1,098,911)
17	-	316,357
	<u>183,400</u>	<u>431,831</u>
	(90,183)	205,595
	634	3,323
7	666,141	74,005
	<u>576,592</u>	<u>282,922</u>
TRANSACTIONS OF FINANCING AND INVESTMENT ACTIVITIES THAT DID NOT GENERATE CASH FLOWS		
	32,712	23,886
	117,765	53,228
	-	-

The accompanying notes on page 8 through 81 are part of the financial statements.

CARLOS A. LINARES PEÑALOZA
Gerente Corporativo Finanzas
Ficha: 57980

PETROLEOS DEL PERU - PETROPERU S.A.

STATEMENT OF CASHFLOWS

	Note	For the three-month period ended on March 31	
		2018	2017
		US\$000	US\$000
Net result of the year		87,154	39,105
Adjustments to reconcile the net result of the year with cash			
Estimation of impairment of trade accounts receivable	9	-	4
Estimation of stock depreciation	10	-	41
Provision of retirement pensions	15	8	11
Provision for contingencies	15	195	123
Provision of plugging and environmental remediation	15	(1,519)	(517)
Depreciation	11-12	12,337	10,478
Amortization		682	708
Deferred income tax	17	(24)	(22,331)
Adjustment effect difference unrealized exchange rate		(634)	(3,323)
		<u>98,199</u>	<u>24,299</u>
Net variations in assets and operating liabilities:			
Trade accounts receivable		(46,388)	45,446
Other accounts receivable		1,197	77,435
Inventories		1,588	(118,727)
Expenses hired in advance		1,669	2,012
Commercial accounts payable		(210,139)	(77,797)
Other accounts payable		115,830	11,479
Net cash provided by operating activities		<u>(38,044)</u>	<u>(35,852)</u>

The accompanying notes on page 8 through 81 are part of the financial statements.


CARLOS A. LINARES PEÑALOZA
 Gerente Corporativo Finanzas
 Ficha: 57980

PETROLEOS DEL PERU - PETROPERU S.A.

INTERIM FINANCIAL STATEMENTS

At and for the three-month period ended on March 31, 2018

PETROLEOS DEL PERU - PETROPERU S.A.

INTERIM FINANCIAL STATEMENTS
AT AND FOR THE THREE-MONTH PERIOD ENDED ON MARCH 31, 2018

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S/ = Sol
US\$ = United States dollar
EUR = Euro
JPY = Japanese yen

PETROLEOS DEL PERU - PETROPERU S.A.

STATEMENT OF FINANCIAL POSITION

ASSETS	Note	31.03.2018		31.12.2017		LIABILITIES AND EQUITY	Note	31.03.2018		31.12.2017	
		US\$ 000	US\$ 000	US\$ 000	US\$ 000			US\$ 000	US\$ 000		
Current assets						Current liabilities					
Cash and cash equivalent	7	576,592		666,141		Other financial liabilities	13	1,527,970		1,319,200	
Trade receivables	8	339,565		293,177		Trade payables	14	562,108		772,247	
Other receivables	9	716,181		711,353		Other payables	15	112,777		115,189	
Inventories	10	642,023		643,611		Other provisions	16	55,458		59,611	
Prepaid expenses		3,220		4,889		Total current liabilities		<u>2,258,313</u>		<u>2,266,247</u>	
Total current assets		<u>2,277,581</u>		<u>2,319,171</u>		Non-current liabilities					
Non-current assets						Other financial liabilities	13	1,985,237		1,985,124	
Other receivables	9	209,143		215,168		Other provisions	16	14,883		14,461	
Other assets		67		67		Deferred income tax liabilities	17	55,283		55,307	
Property, plant and equipment	11	3,421,005		3,291,409		Total non-current liabilities		<u>2,055,403</u>		<u>2,054,892</u>	
Investment properties	12	78,083		79,430		Total liabilities		<u>4,313,716</u>		<u>4,321,139</u>	
Intangible assets		32,749		33,498		EQUITY	18				
Total non-current assets		<u>3,741,047</u>		<u>3,619,572</u>		Share capital		1,171,395		1,171,395	
						Additional capital		0		0	
						Legal reserve		21,650		21,650	
						Other equity reserves		-		(154)	
						Retained earnings		511,867		424,713	
						Total equity		<u>1,704,912</u>		<u>1,617,604</u>	
TOTAL ASSETS		<u>6,018,628</u>		<u>5,938,743</u>		TOTAL LIABILITIES AND EQUITY		<u>6,018,628</u>		<u>5,938,743</u>	

The accompanying notes on the page 8 to 81 are part of the financial statements.

PETROLEOS DEL PERU - PETROPERU S.A.

Statement of Income and Other Comprehensive Income

	Note	For the three months period ended on March 31, 2018 and 2017	
		2018	2017
		US\$000	US\$000
Income from ordinary activities	19	1,132,598	932,750
Other operational income	20	21,038	15,661
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Cost of sales	21	(1,007,660)	(829,481)
Gross profit		145,976	118,930
Selling and distribution expenses	22	(34,251)	(31,972)
Administrative expenses	23	(39,473)	(32,082)
Other income	25	46,729	7,241
Other expenses	25	(8)	(52)
Total operating expenses		(27,003)	(56,865)
Profit from operating activities		118,973	62,065
Finance income	26	2,442	530
Finance costs	26	(9,051)	(10,255)
Exchange difference, net	3.1.a.i	3,822	(13,759)
Profit before income tax		116,186	38,581
Income tax expense	27	(29,032)	523
Net result from the financial year		87,154	39,104
Other comprehensive results that could be reclassified to results:			
Results of derivative instruments		154	(395)
Effect of currency translation		-	-
Total other comprehensive results		154	(395)
Total comprehensive results		87,308	38,709
Basic and diluted earnings per share	29	0.026	0.011

The accompanying notes on page 8 through 81 are part of the financial statements.

PETROLEOS DEL PERU - PETROPERU S.A.

Statement of changes in equity

For the three month period ended on March 31, 2018 and de 2017

	<u>Number of shares</u>	<u>Share capital US\$000</u>	<u>Additional capital US\$000</u>	<u>Statutory Reserve US\$000</u>	<u>Other equity reserve US\$000</u>	<u>Accumulated results US\$000</u>	<u>Total equity US\$000</u>
Balance as of January 1, 2017	2,465,047,935	733,645	110,241	16,189	(373)	256,222	1,115,924
Comprehensive results:							
Net result of the financial year	-	-	-	-	-	39,104	39,104
Other comprehensive results:							
Results of derivative instruments	-	-	-	-	(395)	-	(395)
Total comprehensive results	-	-	-	-	(395)	39,104	38,709
Transactions with shareholders:							
Shareholder's cash contribution	-	-	316,357	-	-	-	316,357
Transfer to additional capital and statutory reserve	-	-	11,152	5,461	-	(16,613)	-
Transfer to share capital from cash contribution	1,056,000,000	316,357	(316,357)	-	-	-	-
Transfer 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 as of March 31, 2017	<u>3,927,713,295</u>	<u>1,171,395</u>	<u>-</u>	<u>21,650</u>	<u>(768)</u>	<u>278,713</u>	<u>1,470,990</u>
Balance as of January 1, 2018	3,927,713,295	1,171,395	-	21,650	(154)	424,713	1,617,604
Comprehensive results:							
Net result of the financial year	-	-	-	-	-	87,154	87,154
Other comprehensive results:							
Results of derivative instruments	-	-	-	-	154	-	154
Total comprehensive results	-	-	-	-	154	87,154	87,308
Transactions with shareholders:							
Total transactions with shareholders							-
Balance as of March 31, 2018	<u>3,927,713,295</u>	<u>1,171,395</u>	<u>-</u>	<u>21,650</u>	<u>-</u>	<u>511,867</u>	<u>1,704,912</u>

Statement of Cash Flows

	Note	For the three month period ended on March 31, 2018 and 2017	
		2018	2017
		US\$000	US\$000
OPERATING ACTIVITIES			
Cash generated by operations		(24,879)	(31,244)
Interest payment		(13,056)	(4,546)
Income tax payment		(109)	(62)
Net cash provided by operating activities		<u>(38,044)</u>	<u>(35,853)</u>
INVESTMENT ACTIVITIES			
General sales tax related to investment activities		(20,042)	(46,312)
Payment for property, plant and equipment purchase		(138,866)	(124,729)
Paid capitalized interest		(1,631)	(19,340)
Payment for the purchase of intangible assets		-	(4)
Investment in time deposits	9	<u>(75,000)</u>	-
Net cash used in investment activities		<u>(235,539)</u>	<u>(190,385)</u>
FINANCING ACTIVITIES			
Loans received from financial institutions	12	1,626,239	1,214,385
Bonuses received, net of transaction costs	12	-	-
Payment of transaction costs	12	-	-
Payment of loans to financial institutions	12	1,442,839	(1,098,911)
Shareholder's cash contribution	17	-	316,357
Net cash provided by financing activities		<u>183,400</u>	<u>431,831</u>
Net increase in cash and cash equivalent		(90,183)	205,595
Effect of exchange rate variation on cash		634	3,323
Cash and cash equivalent at the beginning of the year	7	<u>666,141</u>	<u>74,005</u>
Cash and cash equivalent at the end of the year		<u>576,592</u>	<u>282,922</u>
TRANSACTIONS OF FINANCING AND INVESTMENT ACTIVITIES THAT DID NOT GENERATE CASH FLOWS			
- Accrued interest not paid		32,712	23,886
- Works in progress to be paid		117,765	53,228
			-

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PETROLEOS DEL PERU - PETROPERU S.A.

STATEMENT OF CASHFLOWS

	Note	For the three-month period ended on March 31	
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Provision of retirement pensions	15	8	11
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Deferred income tax	17	(24)	(22,331)
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		<u>98,199</u>	<u>24,299</u>
Net variations in assets and operating liabilities:			
Trade accounts receivable		(46,388)	45,446
Other accounts receivable		1,197	77,435
Inventories		1,588	(118,727)
Expenses hired in advance		1,669	2,012
Commercial accounts payable		(210,139)	(77,797)
Other accounts payable		115,830	11,479
Net cash provided by operating activities		<u>(38,044)</u>	<u>(35,852)</u>

The accompanying notes on page 8 through 81 are part of the financial statements.

(Free translation from the original in Spanish)

PETROLEOS DEL PERU - PETROPERU S.A.

NOTES TO THE FINANCIAL STATEMENTS
AT AND FOR THE THREE MONTH PERIOD ENDED ON MARCH 31, 2018

1 BACKGROUND AND ECONOMIC ACTIVITY

a) Background -

Petróleos del Perú - PETROPERU 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 - PETROPERU 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 PETROPERU 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 Petróleos del Perú – Petroperú S.A.", for the modernization of Petroperu, 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, PETROPERU 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.

Also, 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 - PETROPERU 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 PETROPERU 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, 2017 and 2016 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” and stipulating the re-organization and improvement of the corporate governance of PETROPERU S.A.

b) Economic activity -

By means of Law No.28244 enacted on June 2, 2004, PETROPERU 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 PETROPERUS.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 Perú (“Ley que afianza la Seguridad Energética y promueve el desarrollo del Polo Petroquímico en el Sur del País”) PETROPERU S.A. shall take part, individually or jointly, in the petrochemical development described in the above-mentioned law.

Pursuant to Law No.30130 PETROPERU 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. Also, PETROPERU 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 PETROPERU 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 PETROPERU S.A. to GEOPARK PERU 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 (“Oleoducto Norperuano”) 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 PETROPERU 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.

Legislative Decree No 1292 under the above regulation, once the reorganization and modernization mentioned in subsection 3.1, article 3th is completed, PETROPERU 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). In this respect, in March 2017 a commission in the Peruvian Congress approved the amendment of Legislative Decree No. 1292; one of these amendments stipulated that the provision by which PETROPERU S.A was made part of the scope of FONAFE was revoked.

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 Oleoducto Norperuano and Oleoducto Ramal Norte (“Concesión Definitiva para el Transporte de Hidrocarburos Líquidos por el Oleoducto Norperuano 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 PETROPERU S.A approved by the Board establishes that:

- The prices of products will follow the international market trend reflected in the Import Parity Prices calculated by PETROPERU S.A.
- The net prices of certain products of the listing of PETROPERU S.A., including the factors of contribution/offsetting of the Fuel Price Stabilization Fund are allowed to fluctuate within a range of prices set by policy. These products include GLP-E, Diesel B5, Diesel B5 S-50 and industrial petroleum 6.
- In the event that prices exceed the ranges set for each product or product basket during a given period of time (taking into account the Fund Factors) a proposal of price re-adjustment will be put forward to the Pricing Executive Committee (“Comité Ejecutivo de Precios”) for approval.

- For gasolines, gasohols, middle distillates and industrial petroleum, the comparison of net prices is made against the Import Parity price effective in Callao; for Liquefied Petroleum Gas (LPG) the export Parity price effective in Callao will be used and the cost of acquisition of LPG in the local market.
- The analysis of the net prices of the product listing of PETROPERU S.A. will consider the reference prices published by OSINERGMIN plus a differentiated trade margin for each type of fuel, Exchange rate, local competitors' prices and any other relevant circumstances or event having an impact on the fundamentals of the global hydrocarbons market.
- Price Stabilization Fund -

The Fuel Price Stabilization fund ("Fondo de Estabilización de Precios de los Combustibles") 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 Perú. 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 Perú 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 2.24-b.

As of March 31st 2018, the fuel price stabilization fund was applied to the following fuel items: GLP-E, Diesel B5, Diesel B5 S-50 and industrial petroleum 6, representing 1% of the Company's total revenue.

d) Approval of the financial statements -

The interim financial statements at and for the period of three months ended on March 31st, 2018 and approved by the general management of the company on May 29th, 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 amendments applicable from January 1, 2017 -

The following standards and interpretations are effective for the first time for periods beginning on or after January 2017:

- Disclosure Initiative - Amendments to IAS 7 "Statement of Cash Flows" -

This amendment requires an entity to disclose in the financial statements a numerical explanation of the changes in the year in the liabilities related to financing activities. This explanation applies to the changes arising from operations which generate cash flows, such as disbursements and payments of loans; as well as changes arising from operations that do not generate cash flow, such as the incorporation of liabilities assumed from a business acquisition, debt extinction, interest accrual and unrealized exchange gains and losses. An entity should also include changes related to financial assets to the extent that their cash flows are, or will be, included in the cash flows related to financing activities; such as, for example, assets that cover liabilities arising from financing liabilities.

The Company has applied the requirements of this amendment in preparing its 2017 financial statements, which has resulted in the incorporation of the disclosure set out in Note 13.

- Recognition of deferred tax assets for unrealized losses - Amendment to IAS 12 "Income tax" -

Amendments to IAS 12 substantially clarify the accounting treatment of deferred tax assets for unrealized losses when an asset is measured at fair value and this fair value is below the tax base of the instrument. Also, the estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this and tax deductions resulting from the reversal of the deferred tax assets must be excluded.

This amendment had no impact on the preparation of the Company's financial statements.

- Annual improvements, 2014-2016 cycle: Amendments to IFRS 12 "Disclosure of interests in other entities".

Amendments to IFRS 12 clarify that the disclosure requirements also apply to interests in entities that are classified as held for sale, except for summarized financial information.

This amendment has had no impact on the preparation of the Company's financial statements.

iv) New standards and interpretations effective on or after January 1, 2018.

New IFRSs and amendments to certain IFRSs, the application of which is not required for 2017 and which have not been early adopted by the Company, have been issued. The impact assessment of these new standards and amendments applicable to the activities of the Company is summarized below:

- IFRS 9, “Financial Instruments” -

IFRS 9 replaces IAS 39, “*Financial instruments: Recognition and measurement*” mainly in the following areas:

- (a) Classification and measurement of financial assets. Classification of financial assets into debt instruments will be driven by the entity’s business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. A debt instrument is measured at amortized cost if: a) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows, and b) the contractual cash flows under the instrument solely represent payments of principal and interest. All other debt and equity instruments, including certain debt instruments, must be recognized at fair value through profit or loss, except for equity investments that are not held for trading, which may be recorded in the statement of profit or loss or in other comprehensive income (without subsequent recycling to profit or loss) and certain debt instruments whose business model is mixed (collect and sell), in which case changes in fair value are recognized in other comprehensive income (and subsequently reclassified to profit or loss).
- (b) For financial liabilities that are measured under the fair value, entities will need to recognize the part of the fair value change that is due to changes in their own credit risk in other comprehensive income.
- (c) New standards are established to apply hedge accounting that aim to align the accounting treatment to the entity’s risk management practices. The new standard also introduces expanded disclosure requirements and changes in presentation.
- (d) IFRS 9 also establishes a new model for the recognition of impairment losses on financial assets, based on a new expected credit loss (ECL) model. Two models of application are introduced depending on the type of financial asset: “the general model”, by which impairment of financial assets is measured over a three-stage lifespan of the instruments; and the “simplified model” applicable to short-term trade receivables. When applying the simplified model, a provision matrix is required to be used.
- (e) The treatment of renegotiations of financial liabilities measured at amortized cost that do not qualify to be written-off is modified. In these cases, a gain or loss should be immediately recognized in profit or loss. The gain or loss is calculated as the difference between the original contractual cash flows and the modified contractual cash flows discounted at the original effective interest rate. Under the IAS 39 rules, the resulting difference was allocated over the remaining life of the instrument.

In relation to the classification of financial instruments, the Company does not have any relevant impact from the application of the new requirements of IFRS 9. In general, financial assets held (trade receivables and other receivables) will continue to be measured at amortized cost. The Company does not hold financial assets in equity instruments.

In relation to derivative financial instruments, the Company does not have a relevant impact from the application of the new requirements of IFRS 9.

In relation to the impairment of trade receivables, considering the credit quality of its customers, the Company does not have a significant impact resulting from the application of the PCE concept. The new approach did not modify the current levels of recognized provisions.

For loans outstanding, the Company applies the general model prescribed by IFRS 9; based on a credit risk analysis, the conclusion is reached that no relevant ECL are to be recognized.

In relation to the application of the IFRS 9 requirements on renegotiation of liabilities, Management determinate that does not have an impact since the Company has had no financial liabilities that have been renegotiated.

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

This will replace IAS 18, IAS 11 and various interpretations associated with revenue recognition. The new standard is based on the principle that revenue is recognized when control of a good or service transfers to a customer - so the notion of control replaces the existing notion of risks and rewards. A new five-step process must be applied before revenue can be recognized: (i) identify contracts with customers, (ii) identify the separate performance obligation, (iii) determine the transaction price of the contract, (iv) allocate the transaction price to each of the separate performance obligations, and (v) recognize the revenue as each performance obligation is satisfied.

Key changes to current practice are:

- Any bundled goods or services that are individually distinct must be separately recognized.
- Revenue may be recognized earlier than under current standards if the consideration varies for any reason (for example, incentives, rebates, performance fees, royalties, success of an outcome etc.) - a minimum amount of variable income must be recognized if it is not at significant risk of reversal.
- The point at which revenue is able to be recognized may change: some revenue which is currently recognized at a given point in time at the end of a contract may have to be recognized over the term of the contract and vice versa.
- There are also increased disclosures.

IFRS 15 is effective for financial periods beginning on or after January 1, 2018. For the transition, entities will have the choice of applying the full retrospective method, the full retroactive method with practical applications or the modified retroactive method with changes recognized in retained earnings at January 1, 2018 with additional disclosures.

The Company is in the process of implanting the standard. As a result of the application of the new concepts set forth in IFRS 15, changes may be required in the internal financial reporting processes currently in place.

- IFRS 16, “Leases” -

This standard replaces IAS 17 “Leases” and IFRIC 4 “Contracts that may contain a lease” and other related interpretations.

IFRS 16, ‘Leases’ (IFRS 16) will have far-reaching consequences for lessees since it requires the recognition of almost all leases in the statement of financial position. The standard removes the distinction between finance and operating leases and requires lessees to recognize an asset representing their right of use of the leased asset and a liability for the obligation of future contractual payments, except for lease contracts of less than 12 months (considering in this determination the likelihood of contract extension) and low-value asset lease contracts.

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 expenses will be replaced with interest and depreciation expenses, so financial metrics like EBITDA will also be affected.

In the cash flow statement, financing cash flows will be higher because of cash payments for the principal portion of the lease liability. Only the part of the payments that reflects interest may continue to be presented as operating cash flows.

Accounting for lessors will not significantly change. Some differences may arise as a result of the new guidance on the definition of a lease. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

IFRS 16 is effective for financial periods beginning on or after January 1, 2019; early application is permitted. The Company does not expect the changes introduced by IFRS 16 to have a significant impact on the financial statements.

- IFRIC 22, 'Foreign currency transactions and advance consideration' -

IFRIC 22 clarifies the exchange rate to be used on the transaction date when a foreign currency transaction involves an advance payment or receipt. The interpretation provides additional guidance for the definition of "date of transaction" under two circumstances: i) a single payment or receipt of cash: for the purpose of determining the exchange rate to be used on initial recognition of the related item, the date on which an entity initially recognizes the asset or liability arising from the advance consideration must be identified; ii) multiple payments or cash receipts: for the purpose of determining the exchange rate to be used, the entity must assess the dates for each payment or cash receipt.

This interpretation will impact all entities that enter into foreign currency transactions for which consideration is paid or received in advance.

This interpretation is effective for financial periods beginning on or after January 1, 2018; early application is permitted. As part of the impact assessment of this standard, the Company considers that the changes introduced by IFRIC 22 will not have an impact on its financial statements, since it already applied the definition criteria of "transaction date".

- 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 IFRIC had previously clarified that IAS 12, not 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. For example, a decision to claim a deduction for a specific expense or not to include a specific item of income in a tax return is an uncertain tax treatment if its acceptability is uncertain under tax law. 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 conduct an impact assessment of this IFRIC during the course of 2018.

v) Other amendments to standards to become effective in future years that are not relevant to the Company's operations -

- Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts
- IAS 40 - Transfers of investment property
- Annual improvements - 2014 - 2016 cycle: IFRS 1 and IAS 28 were amended in respect of an investment held by an entity that is a venture capital organization.
- Amendments to IAS 28 Long-term Interests in Associates and Joint Ventures
- Amendment to IFRS 9 "Financial instruments" for instruments that give the possibility of advance payment
- Annual improvements - 2015 - 2017 cycle- amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23
- IFRS 17, "Insurance Contracts."

There are no other NIIF or IFRIC Interpretations that are not yet effective that would be expected to have a material impact on the Company's 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 with effect from January 1, 2017.

Determination of the Company's functional currency requires Management to exercise professional judgment to the extent to which its revenue and costs are influenced by factors associated with a number of different economic environments. Until 2016, Management defined the sol as the Company's functional currency; and therefore, the financial statements were prepared and presented in said currency. During the course of 2017 the intensification of the activities relating to the Talara Refinery Modernization Project (PMRT) resulted in a significant increase in the Company's US Dollar cash flows, comprising both investment cash outflows as well as financing required.

In this context, as required under IAS 21, "Effect of changes in foreign exchange rates" resulting from changes in circumstances and events that affect the business of an entity, the Company re-assessed the factors originally supporting the determination of its functional currency and arrived at the conclusion that a change in functional currency from the Sol to the US dollar responds to these new characteristics of the operations. This change has been implemented prospectively with effect from January 1, 2017. The Company has performed a prospective translation of all its items into the new functional currency (US dollar) using the Exchange rate prevailing at the date of the change. The resulting converted amounts, for non-monetary items, are considered as their respective historical costs. From January 1, 2017 the foreign currency transactions and balances are accounted as described in 2.2.b).

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\$87,154 thousand in the first quarter of 2018. At March 31, 2018 its current assets exceed its current liabilities by US\$19,268 thousand, which primarily reflects the balance of cash and cash equivalents kept in deposits of US\$716,173 thousand (US\$294,000 thousand in liquidity funding, US\$72,173 thousand in checking accounts and US\$350,000 in time deposits shown within other receivables), resulting from bond issuance for a total US\$2,000,000 thousand in 2017.

The Company has access to revolving short-term credit lines granted by local and foreign banks for up to US\$2,461,000 thousand; of which, US\$909,501 thousand are available at March 31, 2018.

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\$/BI) 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 2017 to 2023 indicate an average crack spread (3:2:1) of 17.90 US\$/BI, reaching levels of 17.85 US\$/BI during the years 2024-2035. Recovery of the crack spread in late 2017 (17.5 US\$/BI) 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 Perú. Accordingly, no other information by geographical area is prepared on non-current assets.

2.5 Financial assets -

Classification -

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 the date of initial recognition and reassesses this classification on the date of each closing of individual financial statements.

At March 31, 2018 and 2017 the Company only holds financial assets in the category of loans and receivables which corresponds to (i) cash and cash equivalents, (ii) trade receivables and (iii) certain items included in other receivables, which are described as follows:

Loans and receivables -

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Company provides money, goods or services directly to a debtor with no intention of negotiating the receivable. They are included in current assets, except for those with maturities greater than 12 months after the date of the statement of financial position. They are classified as non-current assets. Receivables are included in trade receivables and certain items in other receivables in the statement of financial position.

Recognition and measurement -

Receivables are initially recognized at fair value and are subsequently measured at amortized cost less the provision for impairment. The Company assesses at each date of the statement of financial position if there is objective evidence of impairment or impairment in the value of a financial asset or group of financial assets. The impairment policy on receivables is described in Note 2.6.

Derecognition of financial assets -

Financial assets are derecognition when the contractual rights to receive cash from the asset have expired or have been transferred and the Company has transferred substantially all risks and benefits inherent to its ownership.

2.6 Impairment of financial assets recorded at amortized cost -

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

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 is 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 is reduced and the amount of the loss is recognized in the statement of income and other comprehensive income.

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

2.7 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.

2.8 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.

2.9 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 ("Oleoducto") 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.

2.10 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:

	<u>Years</u>
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 March 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 income and other comprehensive income.

The accounting treatment of the capitalization of interest on qualifying assets is described in Note 2.17.

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.

2.11 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) 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.

2.12 Investment properties -

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).

2.13 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 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 cash-generating unit 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 (cash-generating units - CGU). Provided that consistent and reasonable criteria of asset allocation are used, common assets are also allocated to individual cash-generating units; or otherwise to the smallest groups of cash generating units 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 income and other 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.

2.14 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 March 31, 2018 and December 31, 2017, the Company only holds liabilities in "other financial liabilities", which correspond to (i) trade payables, (ii) certain items included in other payables; and, (iii) borrowings.

2.15 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.

2.16 Borrowings -

Borrowings consist of loans obtained from financial institutions, including loans for working capital and corporate bonds. 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 transaction 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.

2.17 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.

2.18 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.

2.19 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 Perú, 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 5% to the taxable income determined by the Company in accordance with current income tax legislation.

2.20 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 recognizes 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.

2.21 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.

2.22 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 timing of the reversal of the temporary difference is controlled by the Company 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.

2.23 Capital -

Subscribed and paid-in common shares are classified as equity. Shareholder cash capital contributions, profit capitalization, transfer of retirement liabilities to the Peruvian pension fund (ONP) by the Peruvian Government (shareholder) (Note 18-a) for which shares remain to be subscribed and issued are recognized as additional capital when they occur and are approved by shareholders.

2.24 Revenue recognition -

Revenue comprises the fair value of the consideration received or receivable for the sale of goods in the ordinary course of the Company's activities. Revenue is shown net of sales taxes, rebates and discounts. The Company recognizes revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Company's activities as described below.

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 all the risks and rewards inherent to the ownership of the assets have been transferred to the buyer, collection of the consideration is probable; the associated costs and eventual returns of assets can be estimated reliably and there is no longer ongoing involvement in the management of the assets. For products sold in the local market, the transfer of the risks and rewards occurs 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.

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 -

Revenue from services rendered (terminal operations fee, rentals, crude transportation and other services) are recognized in the accounting period in which they are rendered, with reference to the entire specific service, calculated on the basis of the service actually rendered as a portion of the total services to be provided.

d) Interest income -

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

2.25 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.

2.26 Reclassification of items -

During the first quarter of 2017 the Company reviewed the presentation of certain items in its financial statements. As a result of this process, certain changes were made in the presentation of profit or loss and cash flows. The financial statements at March 31, 2017 were restated so as to be consistent with this revised presentation:

Statement of comprehensive income -	For the year ended on March 31, 2017	For the year ended March 31, 2017	Reclassification	For the year ended March 31, 2017
	S/000 (Previously Reported)	US\$000	US\$000	US\$000 (Reviewed)
Income from ordinary activities	3,068,287	932,750	-	932,750
Other operating income	51,202	15,661	-	15,661
Total income	3,119,489	948,411	-	948,411
Sales cost	- 2,740,134	- 828,135	- 1,346	(a) - 829,481
Gross profit	379,355	120,276		118,930
Sales and distribution expense	- 104,503	- 31,972		- 31,972
Administration expense	- 109,611	- 33,428	1,346	(a) - 32,082
Other income	22,051	7,241		7,241
Other expenses	- 170	- 52		- 52
Operating profit	187,122	62,065		62,065
Financial income	1,738	530		530
Financial expenses	- 33,242	- 10,255		- 10,255
Exchange difference, net	151,630	- 13,759		- 13,759
Result before tax	307,248	38,581		38,581
Income tax	- 95,727	523		523
Net result for the year	211,521	39,104		39,104

(a) Reclassification of depreciation of investment properties.

Statement of cashflows	At March	At March	Reclassification	At March
	31	31		31
	2017	2017		2017
	S/0	US\$000	US\$000	US\$000
	(Previously reported)			(Reviewed)
Operation activities				
- Net cash generated by operation	160,334	35,676	- 61,235 (b) -	31,244
- Interest payment	- 33,242	- 10,231	- 5,685 (c) -	4,546
- Income tax payment	- 349,619	- 107,608	61,235 (b) -	46,373
Net cash provided by operating activities	<u>- 222,527</u>	<u>- 82,164</u>	<u>-</u>	<u>- 82,164</u>
Investment				
- Payment due to property, plant and equipment purchases	- 868,224	- 144,069	19,340 (d) -	124,729
- Paid capitalized interest	-	-	- 19,340 (d) -	19,340
- Payment for the purchase of intangibles	- 14	- 4	-	4
Net cash applied in Investment activities	<u>- 868,238</u>	<u>- 144,073</u>	<u>-</u>	<u>- 144,073</u>
financing activities				
- Loans from financial institutions	3,945,538	1,214,385	-	1,214,385
- Payment of loans to financial institutions	- 3,945,460	- 1,098,911	-	- 1,098,911
- Public treasure contribution	1,056,000	316,357	-	316,357
Net cash applied in financing activities	<u>1,056,078</u>	<u>431,831</u>	<u>-</u>	<u>431,831</u>
Net increase in cash	- 34,687	205,595	-	205,595
Variation exchange rate effect in cash	- 143,630	3,323	-	3,323
Variation exchange rate effect in other accounts	306,836	-	-	-
Cash and cash equivalent at year beginning	248,656	74,005	-	74,005
Cash and cash equivalent at year end	<u>377,175</u>	<u>282,922</u>		<u>282,922</u>

(b) Reclassification from exchange difference of other items to net cash from operating activities.

(c) Reclassification of payments of derivatives to net cash from operating activities

(d) Capitalized interest paid are separated from purchases of property, plant and equipment.

2.27 Change in accounting policy -

Over 2017, as a result of the significant increase in cash flows derived from the investing activities relating to the PMRT development, the Company revised the presentation in the statement cash flows of the Value Added Tax - VAT (IGV in Perú) cash flows that is charged in the invoices issued by the suppliers of capital goods required for that Project; until fiscal 2016 these cash flows were presented as operating activities. As a result of this review, the Company changed its accounting policy to present said cash outflows as part of investment activities.

Management considers that this accounting change is intended to reflect more faithfully the economic substance of these cash outflows.

This modification represents a change in accounting policy, which, in accordance with IAS 8 – Accounting policies, Changes in accounting estimates and errors, the Company applied retrospectively, restating its cash flow statement for fiscal 2016:

This change had the following impact on the statement cash flows:

	<u>At March 31, 2017</u> <u>S/000</u>		<u>At March 31, 2017</u> <u>US\$000</u>		<u>Reclassification</u> <u>US\$000</u>		<u>At March 31, 2017</u> <u>US\$000</u>
	(Previously reported) (*)						(Reviewed)
Statement of cash flow							
Operation activities	- 222,527	-	82,164	-	46,312	-	35,852
Investment activities	- 868,238	-	144,073	-	46,312	-	190,385

(*) Amounts after the reclassifications described in Note 2.26.

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, euros and yen. 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 (forwards) to mitigate its exposure to fluctuations in foreign exchange rates in the short term.

At March 31, 2018 assets and liabilities related to transactions in foreign currency, as well as the net position exposed to exchange risk, are summarized as follows:

	At March 2018			At December 2017	
	S/000	EUR000	JPY000	S/000	EUR000
Assets:					
Cash and cash equivalent	261,216	-	-	321,312	-
Trade accounts receivable	1,084,773	-	-	864,011	-
Other accounts receivable	541,636	-	-	694,908	-
	1,887,626	-	-	1,880,231	-
Liabilities:					
Other financial liabilities	- 2,683,486	-	-	-2,125,000	-
Trade payable accounts	- 62,234	- 6,658	- 2,535	- 119,887	- 7,933
Other payable accounts	- 224,361	-	-	- 233,142	-
	- 2,970,082	- 6,658	- 2,535	-2,478,029	- 7,933
Net liabilities position	- 1,082,456	- 6,658	- 2,535	- 597,798	- 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 closing	
	31.03.2018	31.12.2017
S/	0.310	0.308
EUR	1.258	1.216
JPY	0.00991	0.00924

For the year ended on March 31, 2018 the Company recognized a net exchange gain of US\$3,822 thousand (net exchange loss of US\$13,759 thousand at March 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 10% (a variation considered reasonable) at March 31, 2018 (soles against the US dollars, euros and yen in 2017), it would have affected profit before income tax.

	Operations	Effect on results before taxes	
		Revaluation US\$000	Devaluation US\$000
At March 31, 2018			
S/	5%	16,761	(16,761)
EUR	10%	838	(838)
JPY	5%	3	(3)
At December 31, 2017			
S/	5%	9,211	(9,211)
EUR	10%	964	(964)

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 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, 2017 the Company has fully repaid the syndicated loan contracted at a variable interest rate (LIBOR plus 1.75% for the first two years; LIBOR plus 2.00% subsequently) to finance part of the PMRT.

At March 31, 2018 the Company has recognized fixed-interest-rate bullet bonds issued to finance part of the PMRT; interest is payable on a semi-annual basis from December 2017, at rates of 4.750% and 5.625% and maturity in 2032 and 2047, respectively, the next coupon payment is in June 2018.

At March 31, 2018 and December 31, 2017, the interest rate position of financial instruments is as follows:

	<u>31.03.2018</u>	<u>31.12.2017</u>
	US\$000	US\$000
Instruments at a fixed rate (*)		
Financial Obligations (Note 13)	3,495,258	3,311,971

(*) Comprising the principal of the debt, excluding US\$32,712 thousand of interest and US\$-14,763 thousand of amortized cost for March 2018. For 2017; US\$7,229 thousand of interest and US\$-14,876 thousand of amortized cost.

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 "*Fondo para la Estabilización de los Precios de los Combustibles*", 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 March 31, 2018 and December 31, 2017.

The Company seeks to enter into agreements with crude oil suppliers and manufacturers in Perú 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 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 nationwide 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.

As of March 31, 2018, the Company distributed the surplus of its funds in short-term instruments, in first class financial institutions, both local and foreign, managing to reduce its exposure to credit risk.

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 March 31, 2018 the Company maintains revolving credit lines with local and foreign banks for a total of US\$2,461,000 thousand, of which US\$909,511 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.

	<u>Book value</u>	<u>Undiscounted cash flows</u>	<u>Less than 1 year</u>	<u>More than 1 year</u>	<u>More than 2 years</u>
31.03.2018					
Other financial liabilities	3,513,207	5,853,746	1,609,371	103,750	4,140,625
Trade payable accounts	562,108	562,108	562,108		
Other accounts payable (*)	24,146	24,146	24,146		
	<u>4,099,461</u>	<u>6,440,000</u>	<u>2,195,625</u>	<u>103,750</u>	<u>4,140,625</u>
31.12.2017					
Other financial liabilities	3,304,324	5,669,871	1,425,496	103,750	4,140,625
Trade payable accounts	772,247	772,247	772,247		
Other accounts payable (*)	13,489	13,489	13,489		
	<u>4,090,060</u>	<u>6,455,607</u>	<u>2,211,232</u>	<u>103,750</u>	<u>4,140,625</u>

(*) Other payables do not include liabilities for taxes, advances, or labor liabilities.

3.2 Capital risk management -

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders, benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

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.

PETROPERU S.A. re-confirmed 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.

At March 31, 2018 and December 31, 2017, gearing ratios were as follows:

	31.03.2018	31.12.2017
	US\$000	US\$000
Other financial liabilities	3,513,207	3,304,324
Less: Cash and cash equivalents and time deposits	<u>- 872,284</u>	<u>- 942,381</u>
Net debt (A)	2,640,923	2,361,943
Total equity(B)	<u>1,704,913</u>	<u>1,617,604</u>
Total capital (A+B)	<u>4,345,836</u>	<u>3,979,547</u>
Ratio (A/(A+B))	<u>0.61</u>	<u>0.59</u>

At March 31, 2018 the increase in the gearing ratio was mainly due to the greater proportion of profit generated in the January - March 2018 period with respect to financial obligations.

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 March 31, 2018 and December 31, 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, 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.

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 Perú. 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 (“Oleoducto Norperuano”), 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.

- 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 (cash-generating units).

The Company groups its assets into three cash-generating units: (i) Production and trading; (ii) Oil Pipeline operations and (iii) Leased Units.

Company's Management did not identify impairment indicators of the Leased 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 2017 and 2016 by calculating the value in use of these CGUs; disclosure of which is 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 is provided in Note 11.

- Provision for doubtful collection -

The Company estimates its provision for uncollectable receivables based on a specific analysis of those unsecured invoices, which is carried out periodically, taking into account the aging of the maturities, start of the legal process and the uncollectability of the debtor.

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 view of the above, 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 2016.

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.

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 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 Perú.
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	Units rented and privatized	Total
	US\$000	US\$000	US\$000	US\$000
As of March 31, 2018				
Assets:				
Current	2,245,370	26,822	5,389	2,277,581
Non-current	3,184,569	362,065	194,414	3,741,048
Total assets	<u>5,429,939</u>	<u>388,887</u>	<u>199,803</u>	<u>6,018,629</u>
Liabilities				
Current	2,146,463	100,325	11,525	2,258,313
Non current	2,055,343	60	-	2,055,403
Total assets	<u>4,201,806</u>	<u>100,385</u>	<u>11,525</u>	<u>4,313,716</u>
As of 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	<u>5,533,896</u>	<u>206,802</u>	<u>198,045</u>	<u>5,938,743</u>
Liabilities				
Current	2,166,106	91,597	8,544	2,266,247
Non-current	2,045,450	9,442	-	2,054,892
Total liabilities	<u>4,211,556</u>	<u>101,039</u>	<u>8,544</u>	<u>4,321,139</u>

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

c) Statement of comprehensive income by segments -

	Production and trading(*)	Oil pipeline operations	Units rented and privatized	Total
	US\$000	US\$000	US\$000	US\$000
As of March 31, 2018				
Ordinary activities income				
Net Sales of Goods	1,120,158	12,440		1,132,598
Provision of Services	3,937	5,774	11,327	21,038
Total Revenue from Ordinary Activities	<u>1,124,095</u>	<u>18,214</u>	<u>11,327</u>	<u>1,153,636</u>
Sales cost	(992,605)	(13,707)	(1,348)	(1,007,660)
Transfers	(4,085)	4,085	0	-
Gross Profit (Loss)	<u>127,405</u>	<u>8,592</u>	<u>9,979</u>	<u>145,976</u>
Sales and Distribution Expenses	(32,767)	-	(1,484)	(34,251)
Administration Expenses	(36,024)	(3,440)	(9)	(39,473)
Other income and expenses	45,533	1,188	0	46,721
Operating Profit (Loss)	<u>104,147</u>	<u>6,340</u>	<u>8,486</u>	<u>118,973</u>
Financial Net	13,010	(14,580)	(1,217)	(2,787)
Profit before Income Tax	<u>117,157</u>	<u>(8,240)</u>	<u>7,269</u>	<u>116,186</u>
Income tax	(29,275)	2,059	(1,816)	(29,032)
Net Profit (Loss) for the Year	<u>87,882</u>	<u>(6,181)</u>	<u>5,453</u>	<u>87,154</u>

	Production and trading(*)	Oil pipeline operations	Units rented and privatized	Total
	US\$000	US\$000	US\$000	US\$000
As of March 31, 2017				
Ordinary activities income				
Net Sales of Goods	932,750	-		932,750
Provision of Services	4,737	99	10,825	15,661
Total Revenue from Ordinary Activities	<u>937,487</u>	<u>99</u>	<u>10,825</u>	<u>948,411</u>
Sales cost	(818,967)	(10,514)	0	(829,481)
Transfers	862	(862)	0	-
Gross Profit (Loss)	<u>119,382</u>	<u>(11,277)</u>	<u>10,825</u>	<u>118,930</u>
Sales and Distribution Expenses	(30,873)	-	(1,099)	(31,972)
Administration Expenses	(27,574)	(4,501)	(7)	(32,082)
Other income and expenses	6,029	1,160	0	7,189
Operating Profit (Loss)	<u>66,964</u>	<u>(14,619)</u>	<u>9,719</u>	<u>62,065</u>
Financial Net	(22,027)	(1,394)	(63)	(23,484)
Profit before Income Tax	<u>44,937</u>	<u>(16,013)</u>	<u>9,656</u>	<u>38,581</u>
Income tax	(1,352)	4,724	(2,848)	523
Net Profit (Loss) for the Year	<u>43,585</u>	<u>(11,289)</u>	<u>6,808</u>	<u>39,104</u>

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

d) Revenue by geographical area -

Revenue by geographical segment is based on the customers' geographical location:

	For the three-month period ended March 31	
	2018	2017
	US\$000	US\$000
Peru	1,018,316	857,823
Other countries	135,320	90,588
	<u>1,153,636</u>	<u>948,411</u>

6 FINANCIAL INSTRUMENTS

6.1 Financial instruments per category -

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

	<u>31.03.2018</u>	<u>31.12.2017</u>
	<u>US\$000</u>	<u>US\$000</u>
Financial assets according to the statement of financial position		
Loans and accounts receivable:		
cash and cash equivalent	576,592	666,141
Trade accounts receivable	339,565	293,177
Other accounts receivable (*)	464,457	491,383
	<u>1,380,614</u>	<u>1,450,701</u>
Financial liabilities according to the statement of financial position		
Other financial liabilities		
Other financial liabilities	3,513,207	3,304,324
Trade accounts payable	562,108	772,247
Other accounts payable (*)	22,736	9,687
	<u>4,098,051</u>	<u>4,086,258</u>
Derivative financial instruments:		
Other liabilities at fair value	1,410	3,802
(*) Not including taxes, labor liabilities nor advances.		

6.2 Credit quality of financial assets -

The credit quality of financial assets that are neither past-due nor impaired can be evaluated on the basis of external credit ratings (if any) or historical information of the counterparty default ratios:

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:

	<u>31.03.2018</u>	<u>31.12.2017</u>
	<u>US\$000</u>	<u>US\$000</u>
Cash and cash equivalent -		
Current accounts:		
A+	133,066	60,358
A	93,494	109,749
	<u>226,560</u>	<u>170,107</u>
Current accounts:		
A	294,000	496,000
	<u>294,000</u>	<u>496,000</u>

	<u>31.03.2018</u>	<u>31.12.2017</u>
	US\$000	US\$000
Other payable accounts:		
Time deposits:		
A+	145,397	126,008
A	295	232
A-	150,000	150,000
	<u>295,692</u>	<u>276,240</u>

Risk ratings "A" and "A+" in the above table represent high quality ratings. For banks in Perú, 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.

	<u>31.03.2018</u>	<u>31.12.2017</u>
	US\$000	US\$000
Cuentas por cobrar comerciales (Nota 8)		
Contrapartes sin calificaciones de riesgo externa		
A	444	171
B	307,175	33,428
C	31,946	259,578
	<u>339,565</u>	<u>293,177</u>
	<u>31.03.2018</u>	<u>31.12.2017</u>
	US\$000	US\$000

Otras cuentas por cobrar (Nota 9)

Contrapartes sin calificaciones de riesgo externa (excluye depósitos a plazo, crédito fiscal, anticipos, otros tributos y cuenas deterioradas)

A	102	130
B	16,242	20,706
C	152,421	194,307
	<u>168,765</u>	<u>215,143</u>

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:

	<u>31.03.2018</u>	<u>31.12.2017</u>
	US\$000	US\$000
Liquidity funds (a)	350,000	496,000
Current accounts (b)	226,560	170,107
Fixed funds	32	34
	<u>576,592</u>	<u>666,141</u>

(a) At March 31st 2018, liquidity funds are short term instruments, characterized by liquidity and a stable price of participation with average monthly performance of 1.68% and are immediately available without a defined maturity date, which will be used in PMRT investment activities in the subsequent months.

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

8 TRADE RECEIVABLES

This item comprises:

	<u>31.03.2018</u>	<u>31.12.2017</u>
	US\$000	US\$000
Wholesale distributors	228,894	203,314
Fuel distributors	20,296	20,273
Mining sector	23,632	24,914
Armed Forces and National Police of Peru	15,553	19,776
Aviation business	10,565	7,007
Construction sector	5,707	5,895
Oil companies	8,428	5,681
Maritime business	3,788	3,149
Transport sector	1,643	1,364
Industrial sector	657	579
External market	19,169	341
Electric sector	200	300
Fishing sector	632	-
Various customers	401	584
Doubtful collection accounts	4,933	4,996
	<u>344,498</u>	<u>298,173</u>
Less - estimate of doubtful collection	- 4,933	- 4,996
	<u>339,565</u>	<u>293,177</u>

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.

Receivables from oil companies are mainly related to hydrocarbon transport services along sections I and II of the North Peruvian oil pipeline in accordance with the contracts entered into between the Company and PLUSPETROL and for operations of terminals with the companies Consorcios Terminales and Terminales Perú.

The aging detail of trade receivables is as follows:

	31.03.2018		31.12.2017	
	Impaired US\$000	Not impaired US\$000	Impaired US\$000	Not impaired US\$000
In force	-	307,770	-	269,152
From 1 to 90 days	-	30,648	-	21,056
From 91 to 360 days	-	306	-	1,614
More than 1 year	4,933	841	4,996	1,355
	<u>4,933</u>	<u>339,565</u>	<u>4,996</u>	<u>293,177</u>

The movement in the provision for doubtful accounts is as follows:

	31.03.2018 US\$000	31.03.2017 US\$000
Opening balance	4,996	6,063
Additions	-	-
Exchange rate difference	23	199
Recoveries	- 86	- 15
Write-off	-	-
	<u>4,933</u>	<u>6,247</u>

Management considers that the estimated provision for doubtful accounts 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 but are not impaired 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.

The provision for impairment of trade receivables is included in selling and administrative expenses in the statement of comprehensive income (Note 22 - 23). The amounts charged to results are generally written off when there are no expectations of cash recovery.

9 OTHER RECEIVABLES

This item comprise:

	<u>31.03.2018</u>	<u>31.12.2017</u>
	US\$000	US\$000
Fuel Price Stabilization Fund - Ministry of Energy and Mines (Note 1-c) (a)	63,562	50,126
Claims for Fuel Price Stabilization Fund - Ministry of Energy and Mines (Note 1-c) (17,970	17,882
Claims to the Superintendency of Tax Administration (c.1)	37,167	96,430
Claims to the Superintendency of Tax Administration (c.2)	27,915	27,777
Tax credit - General Sales Tax (d)	289,725	259,822
Tax credit - General Sales Tax, long term (e)	157,042	163,310
Time deposits (f)	295,692	276,240
Claims to third parties	-	-
Claims to long-term third parties (h)	806	815
Loans to staff	4,626	5,364
Advances granted to suppliers	8,690	6,622
Payments for return of association investment with GeoPark	9,341	9,819
Other tributary, long term (i)	5,410	5,384
Sundry	7,378	6,930
Doubtful collection accounts (g)	36,560	36,483
	961,884	963,004
Less - Estimate for doubtful accounts	- 36,560	- 36,483
	925,324	926,521
Current portion (a), (c.1), (d), (f)	716,181	711,353
Non-current portion (b),(c.2),(e) ,(h) y (i)	209,143	215,168

(a) Price Stability Fund - Ministry of Energy and Mines -

At March 31, 2018 and December 31, 2017, the total amount receivable from the General Hydrocarbons Agency (DGH) amounted to US\$81,532 thousand and US\$68,008 thousand, respectively, generated from compensations and contributions transactions (Note 2.24-b); at March 31, 2018 this includes a legal recourse (“Demanda de Amparo”) recorded in a Claims account for US\$17,970 thousand and the amount receivable of US\$63,562 thousand.

(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.

Since the above-mentioned Action was deemed groundless by the first lower court, the Company filed an appeal; this appeal was admitted and subsequently sent to the Third Civil Court of Lima.

By means of a notice received on November 7, 2017, the Civil Court ordered that the matter be seen on January 10, 2018, which was completed; the pronouncement of the second lower court has yet to be released.

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.

The movement of the total balance of the item Price Stabilization Fund is explained as follows:

	31.03.2018	31.03.2017
	US\$000	US\$000
Opening balance	68,008	41,578
Compensation of prices	13,177	6,046
Price contribution	-	2,780
Net (charged) credited to income from ordinary activities (Note 19)	13,177	3,266
Exchange rate difference	347	1,559
Collection of compensation and / or contribution payments	-	-
Final balance	81,532	46,403

(c) 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 Perú). 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.

This item comprises:

	31.03.2018	31.12.2017
	US\$000	US\$000
File No. 02529-2011-2-1801-JR-CA-14 (i) (c.1)	37,167	36,984
File No. 6002-2011-0-1801-JR-CA-17 (ii) (c.1)	-	-
File No. 07873-2012-0-1801-JR-CA-13 (iii) (c.1)	-	59,446
File No. 00114-2012-1801-JR-CA-07 (iv) (c.2)	18,406	18,316
File No. 03490-2012-0-1801-JR-CA-08 (v) (c.2)	814	810
File No. 17806-2012 (vi) (c.2)	8,492	8,450
Sunat-Res Determination Fine ISC and Income tax 2002 (c.2)	203	202
	65,082	124,207

- (i) In April 2011, SUNAT conducted a preventive seizure of S/120,012 thousand (equivalent to US\$37,167 thousand) for the Excise tax (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. On October 5, 2017 the file of the matter was acknowledged. The Company and its legal counsel consider that the claim will have a favorable outcome in the short term.
- (ii) On June 6, 2017 SUNAT issued Resolutions No. 012-180-0013877/SUNAT, No. 012-180-0013878/SUNAT, No. 012-180-0013879/SUNAT and N° 012-180-0013880/SUNAT 012, for the amounts of S/119,887 thousand (US\$36,674 thousand), S/ 31,791 thousand (US\$9,725 thousand), S/90,366 thousand (US\$27,643 thousand) and S/19,245 thousand (US\$5,887 thousand), respectively relating to the returns of the File No. 6002-2011-0-1801-JR-CA-17 involving the inapplicability of the Excise Tax (ISC) on the aviation fuel (Turbo A-1) sales for fiscal years 2003 and 2006. Refunds obtained at December 31, 2017 included interest for S/101,816 thousand, equivalent to US\$31,146 thousand, recorded in the statement of comprehensive income (Note 25).

- (iii) In February 2013 the Company paid a total S/180,723 thousand of excise tax (ISC) and tax penalties for fiscal 2004 and in July 2013 paid a total 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 15, 2017, the Company applied for a refund of the amounts already paid, which was approved by SUNAT through Resolutions No. 012-180-0015915/SUNAT and No. 012-180-0015914/SUNAT for the amounts of S/ 225,054 thousand (US\$ 79,403) and S/ 106,990 thousand (US\$ 37,748 thousand), respectively, corresponding to the refunds of File No. 07873-2012-0-1801-JR-CA-13. The refunds obtained include interest for S/ 139,142 thousand (equivalent to US\$ 42,813 thousand), recorded in the statement of comprehensive income (Note 25).
- (iv) In July and August 2013, the Company paid a total S/59,434 thousand of VAT (IGV) and excise tax (ISC) for fiscal 2005. By means of Resolution No. 29 dated December 17, 2015, issued by the Superior Court of Lima (“Sexta Sala Especializada en lo Contencioso-Administrativo de la Corte Superior de Justicia de Lima”), Resolution No. 15 dated December 19, 2014 was revoked; that resolution stated that the action filed by the Company against the Tax Tribunal Resolution No. 15320-3-2011 was groundless and confirmed the tax assessments on the inapplicability of the ISC on Turbo A-1 fuel sales for fiscal 2005. On November 30, 2017, the file was acknowledged and seen; the Supreme Court’s decision is still pending; the Company and its legal counsel have high expectations of obtaining a favorable outcome. This amount is equivalent to US\$18,406 thousand at the closing exchange rate.
- (v) In February 2013, the Company paid a total of S/2,627 thousand on the tax assessments relating to allegedly unpaid Excise Tax (ISC) for fiscal 2002. By means of a Supreme Court decision dated September 22, 2017, the appeal actions submitted by Peruvian tax authorities were found groundless; notice was served to the Company on December 15, 2017 (“Casación No. 17984-2015”). Management and legal counsel have high expectations of obtaining a refund in the short term from the tax authorities. The expected refund is equivalent to US\$814 thousand at the closing exchange rate.
- (vi) In November 2012, the Company paid a total S/27,426 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, 2017, 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\$8,492 thousand at the closing exchange rate.

Management expects that, considering the favorable pronouncement obtained by the Company regarding F 6002-2011-0-1801-JR-CA-17 (a court action described in (ii)), similar criteria would be followed at the time of deciding on the remaining case files involving the inapplicability of the excise tax (ISC) on imports and/or sales of Turbo A-1 aviation fuel.

Therefore, the Company and its legal counsel consider that the outcome of the claim processes involving the Turbo A-1 that remain to be decided by the Supreme Court will be favorable based on the above-mentioned precedents, which are indicative of the soundness of the unconstitutional nature of the tax levied on sales of the Turbo A-1 fuel.

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

Corresponds to the Value Added Tax credit (IGV in Perú) of operations for S/605,876 thousand (equivalent to US\$187,636 thousand), Value Added Tax of the PMRT for an amount of S/329,646 thousand (equivalent to US\$102,089 thousand).

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

Corresponds to the Value Added Tax credit (IGV in Perú) paid for the acquisition of goods and services mainly related to the Talara Refinery Modernization Project amounting to S/329,646 thousand (equivalent to US\$102,089 thousand) and the VAT for operations amounting to S/177,442 thousand (equivalent to US\$54,953 thousand). This credit balance of tax credit has no expiry date.

(f) Fixed time deposits -

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

(g) Doubtful accounts -

This item reflects claims submitted to municipalities involving property taxes and municipal taxes; the probability of a favorable outcome is low. The movement of the provision for doubtful accounts is as follows:

	31.03.2018	31.03.2017
	<u>US\$000</u>	<u>US\$000</u>
Opening balance	36,483	33,259
Additions	-	4
Exchange rate difference	88	538
Recoveries	-11	-134
Write-offs	0	0
	<u>36,560</u>	<u>33,667</u>

The aging detail of other receivables is as follows:

	31.03.2018		31.12.2017	
	<u>Impaired</u>	<u>Not Impaired</u>	<u>Impaired</u>	<u>Not Impaired</u>
	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>	<u>US\$000</u>
In force	-	329,099	-	300,032
From 1 to 90 days	-	19,139	-	17,449
From 91 to 360 days	-	18,116	-	16,516
More than 1 year	36,560	15,556	36,483	14,182
	<u>36,560</u>	<u>381,911</u>	<u>36,483</u>	<u>348,179</u>

10 INVENTORIES

This item comprises:

	<u>31.03.2018</u>	<u>31.12.2017</u>
	<u>US\$000</u>	<u>US\$000</u>
Raw oil	87,120	118,317
Refined products:		
Products in process	219,179	219,701
Finished products	198,371	203,432
Acquired refined products	58,289	63,844
Products to be received	62,394	22,314
Supplies and materials	18,185	17,518
Less - Estimate for depreciation of supplies	(1,515)	(1,515)
	<u>642,023</u>	<u>643,611</u>

At March 31st 2018, the cost of inventories recognized as expenses and included in the cost of sales amounted to US\$946,704 thousand (US\$3,241,277 thousand in 2017) that equals the cost of sales less operating manufacturing costs (Nota 21).

At March 31, 2018 the crude oil price had a rising trend, with a closing price of US\$64.94 per barrel (US\$50.60 per barrel at March 31, 2017). The average price during March 2018 was US\$62.78 per barrel (US\$49.58 per barrel in March 31, 2017).

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

	<u>31.03.2018</u>	<u>31.03.2017</u>
	<u>US\$000</u>	<u>US\$000</u>
Opening balance	- 1,515	- 1,507
Impairment of supplies	-	41
Reversals	-	-
Exchange rate difference	-	-
	<u>(1,515)</u>	<u>(1,548)</u>

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, 2017 and 2016 Management considers that the amount of the provision adequately reflects the risk of impairment of all its inventories.

11 PROPERTY, PLANT AND EQUIPMENT

This item comprises:

	Lands	Buildings and other constructions	Machinery and equipment	Transportation unit	Furniture and fixtures	Miscellaneous and computer equipment	Equipment out of use	Units to be received	Work in progress	Additional investments	Total
	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000	US\$000
As of January 1, 2017:											
Cost	198,607	135,497	592,715	21,270	3,871	39,550	13,674	122	2,100,342	15,554	3,121,202
Accumulated depreciation	-	81,327	274,666	16,341	3,184	23,698	13,674	-	-	-	412,890
Accumulated impairment	-	-	43,331	-	-	-	-	-	-	-	43,331
Net cost	<u>198,607</u>	<u>54,170</u>	<u>274,718</u>	<u>4,929</u>	<u>687</u>	<u>15,852</u>	<u>-</u>	<u>122</u>	<u>2,100,342</u>	<u>15,554</u>	<u>2,664,981</u>
Opening balance of net book cost	198,607	54,170	274,718	4,929	687	15,852	-	122	2,100,342	15,554	2,664,981
Additions	855	175	2,936	473	12	42	-	-	136,906	2,429	143,828
Withdrawals	-	1	2,856	-	-	-	-	-	-	-	2,857
Transfers	-	-	306	3	7	211	527	-	-	-	-
Reclassifications	-	-	-	-	-	-	-	-	82	-	82
Depreciation for the period	-	1,123	6,986	365	60	586	12	-	-	-	9,132
Depreciation of withdrawals	-	1	2,856	-	-	-	-	-	-	-	2,857
Depreciation transfers	-	-	303	3	7	203	515	-	-	-	1
Balance as of March 31, 2017	<u>199,462</u>	<u>53,222</u>	<u>270,665</u>	<u>5,037</u>	<u>639</u>	<u>15,300</u>	<u>-</u>	<u>122</u>	<u>2,237,166</u>	<u>17,983</u>	<u>2,799,596</u>
Cost	199,462	135,671	592,489	21,740	3,876	39,381	14,201	122	2,237,166	17,983	3,262,091
Accumulated depreciation	-	82,449	278,493	16,703	3,237	24,081	14,201	-	-	-	419,164
Accumulated impairment	-	-	43,331	-	-	-	-	-	-	-	43,331
Net cost	<u>199,462</u>	<u>53,222</u>	<u>270,665</u>	<u>5,037</u>	<u>639</u>	<u>15,300</u>	<u>-</u>	<u>122</u>	<u>2,237,166</u>	<u>17,983</u>	<u>2,799,596</u>
As of January 1, 2018:											
Cost	198,914	183,073	646,722	29,111	4,209	48,507	13,867	122	2,600,899	31,911	3,757,335
Accumulated depreciation	-	87,281	300,909	22,992	3,479	25,857	13,867	-	-	-	454,385
Accumulated impairment	-	-	11,541	-	-	-	-	-	-	-	11,541
Net cost	<u>198,914</u>	<u>95,792</u>	<u>334,272</u>	<u>6,119</u>	<u>730</u>	<u>22,650</u>	<u>-</u>	<u>122</u>	<u>2,600,899</u>	<u>31,911</u>	<u>3,291,409</u>
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	-	1,009	14,323	176	1	1,737	-	-	119,323	3,871	140,440
Withdrawals	-	-	99	-	-	-	17	-	-	-	116
Transfers	-	-	360	4,446	11	619	5,436	-	-	-	-
Reclassifications	-	-	-	-	-	-	-	27	172	-	145
Depreciation for the period	-	1,616	7,602	415	68	952	336	-	-	-	10,989
Withdrawal depreciation	-	-	99	-	-	-	17	-	-	-	116
Depreciation of transfers	-	-	272	4,210	11	607	5,100	-	-	-	-
Balance as of March 31, 2018	<u>198,914</u>	<u>95,185</u>	<u>340,905</u>	<u>5,644</u>	<u>663</u>	<u>23,423</u>	<u>-</u>	<u>95</u>	<u>2,720,394</u>	<u>35,782</u>	<u>3,421,005</u>
Cost	198,914	184,082	660,586	24,841	4,199	49,625	19,286	95	2,720,394	35,782	3,897,804
Accumulated depreciation	-	88,897	308,140	19,197	3,536	26,202	19,286	-	-	-	465,258
Accumulated impairment	-	-	11,541	-	-	-	-	-	-	-	11,541
Net cost	<u>198,914</u>	<u>95,185</u>	<u>340,905</u>	<u>5,644</u>	<u>663</u>	<u>23,423</u>	<u>-</u>	<u>95</u>	<u>2,720,394</u>	<u>35,782</u>	<u>3,421,005</u>

(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 March 31, 2018 is described as follows:

Setting up new units to enlarge the processing capacity and produce fuels under new specifications.

- Overall physical progress of PMRT: 67.89% Actual vs. 82.22% Scheduled. Construction of Auxiliary Units still pending together with Supplementary Work.

The estimated investment in this Project is estimated to be US\$4,999.8 million; of which, 48% has been executed at December 31, 2017.

- Técnicas Reunidas (TR) continues to implement detail engineering, procurement and construction (EPC) work.

- Progress of engineering totaled 99.99% Actual vs. 99.63% Scheduled.
- Procurement of equipment totaled 99.09% Actual vs. 99.90% Scheduled.
- Procurement of construction totaled 74.53% Actual vs. 84.38% Scheduled.

- Auxiliary Units: Terms and conditions required to build the Auxiliary Units and Supplementary Works are set under an EPC contract.

- On January 30, 2018 a contract was signed between Petroperú S.A and Consorcio Cobra SCL.
- On February 08, 2018 the Start of Contract meeting was held.
- Regarding the construction of Colegio Federico Villareal, the placement of concrete, filling with borrow material and enabling of the structural steel for foundations, continues. A physical advance of 12.65% vs. 10.09% scheduled
- In relation to the Cerro El Faro cutting works, the cutting, loading and disposal of dump material authorized in 02 shifts (day and night) continue.

- Regarding Project financing:

On June 12, 2017 the placement of bonds for an amount of US\$2,000,000 thousand was completed successfully in the international markets of debt instruments. The transaction was completed in two tranches:

- US\$1,000,000 thousand at 15 years and at a 4.750% annual interest rate.
- US\$1,000,000 thousand at 30 years and at a 5.625% annual interest rate, in both cases with one single payment upon maturity.
- Bank loan secured by Compañía Española de Crédito a la Exportación - CESCE: the approval of the loan facility and external authorizations are currently in progress. The loan deal and drawdown are expected during the first half of 2018.
- On January 15, 2018 through MR No. 017-2018-EF/52, PETROPERÚ S.A. was authorized to arrange the operation of external indebtedness without the guarantee of the National Government, destined to partially finance the PMRT.

- On February 21, 2018 by Official Letter No. 00199-2018-CG / DC of February 21, 2018, the Office of the Comptroller General forwarded the Preliminary Report No. 00015-2018-CG / PREV, "Report on transactions that pose a threat to the credit or the financial capacity of the State". The report was sent to DEUTSCHE BANK (Administrative Agent of the Line of Credit of CESCE) on February 22, 2018.
 - To date the submission of the necessary documentation specified in point 3.01 Conditions Precedent to Effectiveness, of the contract with the CESCE Facility Agreement, which is a requirement for the start of disbursements, is being made.
 - International bond placement of up to US\$1,000,000 thousand expected for 2019.
- 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 responsibility and Community Relations.
 - Field visits with the Local Committee were scheduled for the month of April to monitor the working conditions of contractors and subcontractors. Also, trainings are carried out to increase the possibilities of employability of Talara personnel. Also, trainings in tree planting and medical campaigns.
 - As of March, labor totaled 7,230 jobs. The unskilled local labor had a participation of 87%, surpassing the minimum established in the EIA (70%), while the local skilled labor had a participation of 31%

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

- The estimated investment in this Project is estimated to be US\$48.1 million, of which, 17.2% has been implemented at March 31, 2018
- The engineering, procurement and construction(EPC) service is provided by an entity called Felguera and supervision has been assigned to "Consorcio Supervisor Ilo".
- Progress of detailed Engineering and Procurement is reported to be 86.93% and 33.55%, respectively. Regarding Construction, the progress was 7.99%, mainly due to earthworks and excavation works, and the assembly and emptying of the concrete of the perimeter fence. Also, the excavation work and the foundation of the tank bottom were started.
- With regard to the service of power supply and electric power, the contracting process continues under the modality of abbreviated adjudication. On 03.13.18, the bidder submitted his comments and observations to the contract pro forma.
- It has: Environmental Impact Study, Risk Study, Urban Authorization, Archaeological Remains Certificate (CIRA), Favorable Technical Report (ITF), Temporary Use of Aquatic Area, Building License and Port Authorization.

(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 (hereinafter, Terminales del Perú); the relevant operating contracts were signed for an effective period of 20 years. The tender for the South Terminal was declared deserted.

Bearing in mind the results of the Public Tender to select the Operator for the South Terminals, an addendum to the South Terminals Operation Contract was signed with Consorcio Terminales 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.

At December 31, 2017, the South Terminal Operation Contract signed with Consorcio Terminales is effective until August 1, 2018; also, the Operations Contracts for the North and Central Terminals signed with Terminales del Perú continue to be effective until October 31, 2034 (North Terminals) and September 1, 2034 (Central Terminals).

(iii) Insurance -

The assets and operations of PETROPERÚ S.A. are covered with an integral insurance policy against damages to property, loss of profits, sabotage and terrorism for up to US\$650,000 thousand and with declared values of US\$6,703,000 thousand. The insurance policy includes third party liability coverage for up to US\$100,000 thousand.

Supply and re-supply operations of aviation products are also covered with an insurance policy against aviation third party liability of 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:

	31.03.2018	31.12.2017
	US\$000	US\$000
Cost of sales (Note 21)	7372	6811
Selling and distribution expenses (Note 22)	2276	1512
Administration expenses (Note 23)	1341	809
	10989	9132

At March 31, 2018 and December 31, 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 March 31, 2018 was US\$111,245 thousand (US\$91,009 thousand at December 31, 2017).

(v) Major expenditures related to work in progress -

During 2018 additions of work in progress mostly relate to the Talara Refinery Modernization Project EPC amounting to US\$74.0 million, equivalent to S/239 million (S/ 1,380 million in 2017 equivalent to US\$ 427 million).

Additionally, borrowing costs that were capitalized over the period ended on March 31, 2018, related to Talara Refinery Modernization Project, amounted to S/ 108.988 equivalent to US\$ 33.8 thousand (S/242,314 thousand in 2017, equivalent to US\$ 74.663 thousand).

(vi) Asset retirement -

As of March 31, 2018, the retirement of assets amounted to US\$ 121 thousand (S/ 392 thousand).

At December 31, 2017 the balance of asset retirement mainly includes the cost of the distillery unit inspection ("XII Inspección General de la Unidad de Destilación en Refinería Talara") for US\$2,886 thousand, equivalent to S/9,595 thousand, the cost of Major Maintenance in the Iquitos Refinery for US\$1,556 thousand, equivalent to S/5,228 thousand and the cost of land in Callao Terminal of US\$548 thousand, equivalent to S/1,184 thousand, assigned to the Regional Government of Callao and authorized by Board Decision No. 014-2014-PP.

(vii) Impairment of assets -

a) Cash-generating units (CGUs) -

At December 31, 2017 the Company has performed the impairment test of the CGUs: (i) Production and trading and (ii) Oil Pipeline operations ("Operaciones Oleoducto").

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 year 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 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 source prices, the consulting entity PIRA Energy Group.
- 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 PIRA Energy Group, 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.

Oil Pipeline operations -

- Operating cash flows from the service of transportation and custody of crude from the Northern jungle in Perú.
- 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 (Oleoducto Nor Peruano).
- Forecast transportation rate: Management estimates the transportation rate based on the carried volume, route of transportation, and the current rate Schedule as set forth under Supreme Decree No. 025-94-EM.
- Operating cash flows from the service of crude unloading and use
- Operating cash flows from exports of Piraña Gran Tierra crudes in 2018.
- Operating cash flows from sales in 2024 of crude held in the oil pipeline.
- Cash flows from the crude transportation services rendered to the Production and trading CGU.
- 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 prepared by Management.

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

	<u>Production and trading</u>	<u>Oil Pipeline operations</u>
Annual growth rate (%)	5%	10%
Budgeted gross margin (%)	15%	42%
Prices (\$)	97	10
Discount rate (%)	9.45%	9.32%

The annual growth rate corresponds to annual growth rate compound income during the period 2017 - 2027. 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 Oleoductos") revenue growth is mainly generated in the first 4 years 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 budgeted prices based on past performance, current trends in the industry, established rates and market development expectations.

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

At December 31, 2016, the Company tested its assets for impairment and obtained the following results: i) reversal of the impairment loss on the assets of the Production and trading CGU of US\$6,148 thousand and ii) impairment of assets of the Oil Pipeline CGU of US\$43,331 thousand, mainly resulting from the activity shutdown as a result of the losses that occurred in 2016 and the environmental remediation expenses that were incurred as a result of those loss events.

At December 31, 2017 the Company tested its assets for impairment and based on the results obtained the impairment loss on the Oil Pipeline CGU assets of US\$31,790 thousand was reversed. 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. The discount rate used by the Company was 9.45% for the Production and trading CGU and 9.32% for the Oil Pipeline CGU (Operaciones Oleoducto).

If the discount rate on the Oil Pipeline CGU had been higher by 1%, the Company would have not reversed impairment by US\$27,361 thousand and no impairment would have recognized.

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:

<u>Key assumption</u>	<u>Variation</u>	<u>Impairment</u> <u>US\$000</u>
<u>Production and trading:</u>		
Budgeted annual growth	-5%	-
Prices	-5%	-
Budgeted gross margin	-5%	-
Production	-5%	-
<u>Oil Pipeline operations (Oleoducto):</u>		
Budgeted annual growth	-5%	18,965
Prices	-5%	13,015
Budgeted gross margin	-5%	-

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

At December 31, 2017 the Company tested 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. If a 5-year horizon and a perpetuity had been used, there would have been no significant difference in the recoverable amount.
- 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 under the EPC contracts.
- Forecast selling prices: Management estimates the selling prices of oil by-products at import parity prices of PETROPERU 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 (PIRA Energy Group in 2017) 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 (%)	3%
Budgeted gross margin (%)	13%
Prices (\$)	121
Discount rates (%)	7.38%

The annual growth rate corresponds to annual growth rate compound of income during the period 2021 - 2015.

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

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 7.38% in determining the recoverable amount. When changing the discount rate to 8.82%, 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:

<u>Key assumption</u>	<u>Variation</u>	<u>Impairment</u> <u>US\$000</u>
Budgeted annual growth	-5%	-
Prices per year	-5%	-
Budgeted annual growth	-5%	-
Production	-5%	-

12 INVESTMENT PROPERTY

	<u>Lands</u> <u>US\$000</u>	<u>Buildings and other constructions</u> <u>US\$000</u>	<u>Total</u> <u>US\$000</u>
At January 1, 2017			
Cost	9,339	117,948	127,287
Depreciation	-	- 42,428	- 42,428
Net cost	<u>9,339</u>	<u>75,520</u>	<u>84,859</u>
Opening balance net cost in books	9,339	75,520	84,859
Additions	-	27	27
Year depreciation	-	- 1,346	- 1,346
Final balance net cost in books	<u>9,339</u>	<u>74,201</u>	<u>83,540</u>
At March 31, 2017			
Cost	9,339	117,975	127,314
Accumulated depreciation	-	- 43,774	- 43,774
Net cost	<u>9,339</u>	<u>74,201</u>	<u>83,540</u>
At January 1, 2018			
Cost	9,341	117,906	127,247
Depreciation	-	- 47,817	- 47,817
Net cost	<u>9,341</u>	<u>70,089</u>	<u>79,430</u>
At January 1, 2018			
Initial balance net cost in books	9,341	70,089	79,430
Additions	-	-	-
Depreciation of the year	0	- 1348	- 1,348
Final balance net cost in books	<u>9,341</u>	<u>68,741</u>	<u>78,082</u>
At March 31, 2018			
Cost	9,341	117,906	127,247
Accumulated depreciation	-	- 49,165	- 49,165
Net cost	<u>9,341</u>	<u>68,741</u>	<u>78,082</u>

- (a) The Company 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 PERU S.A. pays the Company US\$10,000 thousand annually; this

amount will remain unchanged until the contract termination date. At December 31, 2017 the Company is in the process of negotiating the lease contract of the assets of Block Z-2B to be signed with SAVIA PERU S.A.

- (b) PETROPERU S.A signed in March 2014 a lease contract of the assets the Pucallpa Refinery and Sales plant with Maple Gas Corporation del Perú S.R.L, for a period of 10 years. By virtue of this lease, MAPLE S.R.L pays the Company US\$361 thousand on a quarterly basis.

The annual depreciation charge on investment properties was allocated to the cost of sales (Note 23).

13 OTHER FINANCIAL LIABILITIES

	31.03.2018	31.12.2017
	US\$000	US\$000
Current liabilities		
Bank loans without guarantee	1,495,258	1,311,971
Interest	32,712	7,229
	<u>1,527,970</u>	<u>1,319,200</u>
Non-current liabilities		
Corporate bonds (i)	1,985,237	1,985,124
	<u>1,985,237</u>	<u>1,985,124</u>

- 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 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. Transaction expenses at March 31, 2018 totaled US\$7,283 thousand, 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. Transaction expenses at March 31, 2018 totaled US\$7,480 thousand, thousand, 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).

a) **Debt repayment terms and timetable**

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

Original currency	Nominal interest rate	Maturity date	March 31, 2018		December 31, 2017		
			Nominal value	Amount in Book	Nominal value	Amount in Book	
			US\$000	US\$000	US\$000	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	2.00% - 2.40%	2018	435,123	435,123		
Bank loans without guarantee	Dollars	2.42% - 1.10%	2018	1,060,135	1,060,135		
Corporate bonds	Dollars	4.75%	2032	1,000,000	992,717	1,000,000	992,629
Corporate bonds	Dollars	5.63%	2047	1,000,000	992,520	1,000,000	992,495
Accrued interest					32,712		7,229
Total Interest-bearing Liabilities				3,495,258	3,513,207	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:

	31.03.2018	31.12.2017
	US\$000	US\$000
Working capital	1,161,258	977,971
PMRT	2,319,237	2,319,124
	3,480,495	3,297,095

(*) Does not include accrued interest payable

c) **Movement of financial liabilities**

The movement of these balances was as follows:

	Banking Loans US\$000	Union Loans US\$000	Corporate Bonds US\$000	Total US\$000
Balance as of January 1, 2017	1,564,814	417,552	-	1,982,366
New loans	1,214,385	-	-	1,214,385
Depreciations	-1,098,911	-	-	-1,098,911
Accrued interest	8,688	12,164	-	20,851
Paid interest	-4,546	-19,340	-	-23,886
Balance as of March 31, 2017	1,684,429	410,376	-	2,094,805
Balance as of January 1, 2018	1,315,780	-	1,988,544	3,304,324
New loans	1,626,239	-	-	1,626,239
Transaction costs	-	-	-	-
Amortizations	-1,442,839	-	-	-1,442,839
Accrued interest	6,511	-	33,657	40,168
Paid interest	-14,687	-	-	-14,689
Balance as of March 31, 2018	1,491,005	-	2,022,202	3,513,207

d) **Fair value estimation**

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

	<u>Book value</u>		<u>Fair value</u>	
	31.03.2018	31.12.2017	31.03.2018	31.12.2017
	US\$000	US\$000	US\$000	US\$000
Loans without guarantee	1,495,258	1,311,971	1,495,258	1,311,971
Bonds	1,985,237	1,985,124	2,028,908	2,002,970
	<u>3,480,495</u>	<u>3,297,095</u>	<u>3,524,166</u>	<u>3,314,941</u>

At March 31, 2018 and December 31, 2017, the information used to determine the fair value of the bonds corresponds to level 1 and of other borrowings to level 2 of the fair value hierarchy described 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:

	<u>31.03.2018</u>	<u>31.12.2017</u>
	US\$000	US\$000
National suppliers of crude and refined products	86,769	103,018
Foreign suppliers of crude and refined products	371,213	536,177
Goods and service suppliers	85,850	117,933
Shipping companies and operators of terminals and plant	18,276	15,119
	<u>562,108</u>	<u>772,247</u>

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. 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:

	<u>31.03.2018</u>	<u>31.12.2017</u>
	US\$000	US\$000
Taxes	50,526	34,480
Participation of workers (a)	10,944	30,848
Remuneration (b)	19,612	21,393
Advances received from clients (c)	7,549	14,979
Financial instruments payable	1,410	3,802
Deposits under guarantee (d)	4,559	4,405
Others	18,177	5,282
	<u>112,777</u>	<u>115,189</u>

(a) Taxes payable at March 31, 2018 mainly include net income tax payable and ITAN (temporary tax on net assets) for US\$20,851 thousand (US\$15,991 thousand in 2017) and excise tax for US\$ 14,680 thousand.

- (b) Workers' profit sharing is equivalent to 10% of taxable income, as determined according to current income tax legislation. This profit sharing is a deductible expense for income tax calculation purposes, provided that it is paid before the annual income tax returns are filed.

As of March 31, 2018, the Company determined profit sharing for US\$10.944 thousand (US\$8.214 thousand in March 31, 2017) recorded with a charge to the results of the year under the following items:

	<u>31.03.2018</u>	<u>31.03.2017</u>
	<u>US\$000</u>	<u>US\$000</u>
Cost of sale (Note 21)	4,491	3,212
Sales and distribution expenses (Note 22)	1,927	1,441
Administration expenses (Note 23)	4,526	3,561
	<u>10,944</u>	<u>8,214</u>

- (c) Advances received from local and foreign customers mainly comprise the amounts received for US\$5,538 thousand and US\$2,010 thousand respectively, to secure the supply of fuel that is pending delivery.
- (d) 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.

16 OTHER PROVISIONS

This item comprises:

	<u>31.03.2018</u>	<u>31.12.2017</u>
	<u>US\$000</u>	<u>US\$000</u>
Current		
Provision for environmental improvements (b)	34,023.00	38,454.00
Provisions for civil claims (c)	17,956.00	17,809.00
Provisions for labor claims	2,675.00	2,547.00
Provision for wells plugging (b)	597.00	594.00
Provision for retirement pensions (a)	44.00	45.00
Other provisions	163.00	162.00
	<u>55,458</u>	<u>59,611</u>
Non-current		
Provision for environmental improvements (b)	14,823.00	14,396.00
Provision for retirement pensions (a)	60.00	65.00
	<u>14,883</u>	<u>14,461</u>
	<u>70,341</u>	<u>74,072</u>

The movement of other provisions is as follows:

	Provision for retirement pension US\$000	Provision for environment improvement US\$000	Provision para reclamos laborales US\$000	Provision for civil claims US\$000	Provision for well plugging US\$000	Other provision s US\$000	Total US\$000
Balances as of January 1, 2017	120	95,790	2,242	22,537	574	157	121,420
Provision of the year	11	-	123	-	-	-	134
Update	-	517	-	-	-	-	(517)
Payments	(12)	26,373	(24)	(64)	-	-	(26,473)
Reversion of unused provisions	-	-	-	-	-	-	-
Exchange rate difference	4	2,239	76	482	19	249	3,069
Balances as of March 31, 2017	123	71,139	2,417	22,955	593	406	97,633
Balances as of January 31, 2018	110	52,850	2,547	17,809	594	162	73,846
Provision of the year	8	-	128	67	-	-	203
Present value	-	(1,519)	-	-	-	-	(1,519)
Payments	(13)	(2,625)	(13)	(7)	-	-	(2,658)
Recovery of provision	-	-	-	-	-	-	-
Exchange rate difference	(1)	140	13	87	3	1	243
Balances as of March 31, 2018	104	48,846	2,675	17,956	597	163	70,341

a) Provision for pension plans -

Law No. 30372 "Ley del Presupuesto del Sector Público para el Año Fiscal 2016", sixty-fourth article of the final supplementary provisions states that from the effective date of the Law, the government-run pension plan office ("Oficina de Normalización Previsional - ONP") will be responsible for managing and paying pensions under Decree Law No.20530 and complementary standards and amendments, concerning pensioners of PETROPERU S.A., including the contingencies that may arise from management and payment. In paying out pension plans, the ONP will take as reference the amount of pensions credited for the last month before the effective date of this Law. Also, pursuant to Supreme Decree countersigned by the Ministry of Economy and Finance, complementary standards will be issued as they are deemed necessary for a more adequate application of this regulation.

From January 2016 the Company recorded the transfer of the provision for retirement pensions to the ONP, as additional capital of US\$150,735 thousand, and considering the following:

Law No.30372 "Ley de Presupuesto del Sector Público para el año fiscal 2016" was prepared by the Ministry of Economy and Finance and approved by the Peruvian Government. The Peruvian Government approved the transfer of the pension liabilities from PETROPERU S.A. to the ONP in order to contribute to the financial capacity of the Company that is acting as a single shareholder rather than as the Government. The Peruvian Government does not require compliance of any specific requirement by PETROPERU S.A. in respect of the exploitation activities for the Company to be eligible for this benefit, since this benefit was specifically established for the Company. This Law that results in the transfer of obligations with third parties to the ONP, given that was enacted by the Peruvian Government, which is the shareholder of the Company, being a direct benefit, qualifies as a transaction with the shareholder; this was reflected as an increase in equity in additional capital.

In accordance with the provisions of IAS 19 - Employee Benefits, at December 31, 2017 the Company maintained a defined benefit plan which obliges it to provide the benefits agreed in Decree Law No.20530 and its supplementary provisions. These benefits correspond exclusively to ex – employees (in respect of termination, disability, widowhood and orphanhood) who acquired the right to a pension upon completing 15 years of actual and remunerated service in the case of men and 12.5 years in the case of women (Article 4 of Section I of Decree Law No.20530). The financing of these obligations was covered from own resources.

At December 31, 2017 and 2016 the amount of the provision corresponds to the present value of the future payments to be made by the Company in favor of its pensioners and it is updated annually on the basis of an actuarial calculation performed by an independent actuary following the projected credit method, which is validated by the National Pension Office - ONP (the Spanish acronym).

b) Provision for environmental remediation 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 Perú, Law No. 26221, Organic Law of Hydrocarbons, 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, 2017, 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.

Privatized units consist of: Refinería La Pampilla, Planta de Lubricantes, Block X, Block 8, Terminales y Plantas de Ventas, and Planta de Generación Eléctrica y Gas Natural.

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).

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 and in its own operating units.

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, expenses have been estimated to be incurred over 2018 of S/5,258 thousand (equivalent to US\$1,620 thousand) by the Company in conducting start-up assessments of environmental quality standards- soil (ECA Suelo), involving exploratory sampling and identifying polluted soil through a “Service of identification of possibly polluted places (identifying sampling) that are over the environmental quality standards for soil in the operations of PETROPERÚ”; all these expected expenses have been included in the provision for the Operational Environmental Remediation Program for Talara, Conchán, Oleoducto, Selva and “Gerencias Comercial y Exploración y Explotación for US\$430 thousand (equivalent to S/1,395 thousand), US\$215 thousand (equivalent to S/698 thousand), US\$263 thousand (equivalent to S/853 thousand), US\$175 thousand (equivalent to S/567 thousand), US\$209 thousand (equivalent to S/677 thousand) and US\$329 thousand (equivalent to S/1,068 thousand), respectively. This tender for this service: “Service of identification of possibly polluted places (identifying sampling) that are over the environmental quality standards for soil in the operations of PETROPERÚ”, was

awarded through a second bidding call on May 2, 2016, the winner being Consorcio TEMA/LITOCLEAN with US\$2,610 thousand (equivalent to S/8,468 thousand). At December 31, 2017, Consorcio TEMA has submitted 38 Reports identifying possibly polluted sites (IISC). On the other hand, considering the importance of the events that occurred in 2014 (oil spills in km 41+833 and km 20+190), the approval was obtained, through GCAS, for an additional 10,4% over the contractual amount so as to assess those events and verify current conditions.

The above-mentioned reports (38 IISC and 02 contingency assessments) have been approved by PETROPERÚ and presented in final draft to the governmental agency "Dirección General de Asuntos Ambientales Energéticos" of the MINEM, 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 y SAMB-JEDA-951-2017.

The total amount executed for "Service of identification of possibly polluted places (identifying sampling) that are over the environmental quality standards for soil in the operations of PETROPERU", totaled S/9,352 thousand (after IGV) (equivalent to US\$2,882 thousand), representing 99.94% of the contractual amount adjudicated. 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.

During 2017 the Company reported 6 significant oil spills (13 in 2016) mainly resulting from undue acts by third-parties against the Northern Perú Oil Pipeline ("Oleoducto Norperuano"); these acts resulted in the total stoppage of oil pumping from the Peruvian jungle to the coast

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 March 31, 2018 the provision for environmental remediation related to the above-mentioned oil spills in the "Oleoducto Norperuano" totals US\$26,894 thousand (US\$45,618 thousand at March 31, 2017).

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

	Balances at January			Balances at March 31,			
	1, 2018	Payments	Provision and update	2018			
	US\$000	US\$000	US\$000	US\$000			
Lot 8	2,598	-	308	-	166	2,124	
Lot X	4,841	-	0	-	203	4,638	
Pampilla	-	8	-	25	29	-	4
Lubricants	117	-	-	-	5	-	112
Norht Terminals	263	-	-	-	-	-	263
South Terminals	204	-	0	-	5	-	198
Central Terminals	1,735	-	0	-	82	-	1,653
Natural Gas Electric System	19	-	-	-	-	-	19
Total Privatized Units	<u>9,769</u>	<u>-</u>	<u>334</u>	<u>-</u>	<u>432</u>	<u>-</u>	<u>9,003</u>
Talara Operations	7,625	-	537	-	244	-	6,844
Conchán Operations	919	-	-	-	28	-	891
Oil Pipeline Operations	29,359	-	1,747	-	718	-	26,894
Iquitos Refinery operations	1,402	-	7	-	38	-	1,357
Commercial operations	602	-	-	-	22	-	580
Exploration and Exploitation Management	956	-	-	-	36	-	920
Total of Own Units	<u>40,863</u>	<u>-</u>	<u>2,291</u>	<u>-</u>	<u>1,087</u>	<u>-</u>	<u>37,485</u>
Total	<u>50,632</u>	<u>-</u>	<u>2,625</u>	<u>-</u>	<u>1,519</u>	<u>-</u>	<u>46,488</u>
Exchange rate difference	2,218	-	-	-	-	-	2,358
Total	<u>52,850</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>48,846</u>

	Balances at January			Balances at March 31,
	1, 2017	Payments	Provision and update	2017
	US\$000	US\$000	US\$000	US\$000
Lot 8	3,473	- 495	- 92	2,886
Lot X	5,260	-	126	5,134
Pampilla	10	- 1	4	5
Lubricants	127	-	3	124
Norht Terminals	274	-	-	274
South Terminals	218	-	3	215
Central Terminals	1,879	-	44	1,835
Natural Gas Electric System	19	-	-	19
Total Privatized Units	<u>11,260</u>	<u>- 496</u>	<u>- 272</u>	<u>10,492</u>
Talara Operations	9,046	- 269	- 165	8,612
Conchán Operations	1,094	-	14	1,080
Oil Pipeline Operations	71,075	- 25,441	- 16	45,618
Iquitos Refinery operations	1,569	- 41	- 29	1,499
Commercial operations	729	- 88	- 5	636
Exploration and Exploitation Managem€	1,020	- 38	- 16	966
Total of Own Units	<u>84,533</u>	<u>- 25,877</u>	<u>- 245</u>	<u>58,411</u>
Total	<u>95,793</u>	<u>- 26,373</u>	<u>- 517</u>	<u>68,903</u>
Exchange rate difference	-	3	-	2,236
Total	<u>95,790</u>			<u>71,139</u>

Cash outflows required in the environmental remediation activities conducted by PETROPERU 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 PETROPERU S.A.", the government treasury agency "Dirección General del Tesoro Público" shall transfer PETROPERU 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 March 31, 2018 a total of S/34,016 thousand (equivalent to US\$11,338 thousand) remained to be transferred for future expenditures, which was recognized by the MINEM in 2014.

Continuing with the procedures begun in 2006, PETROPERU 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 S/4,116 thousand (equivalent to US\$1,377 thousand) was credited by the Ministry of Energy and Mines to the Company's accounts on December 31, 2014.

The Company has sent communications to MINEM requesting financial remittances intended for environmental remediation, which resulted in contributions of S/62,679 thousand (equivalent to US\$20,893 thousand) during 2015; these resources covered the total expenses incurred by the Company at March 31, 2018 in environmental remediation of its privatized units. 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 become a medium-term project.

c) Provision for civil claims -

As of March 31, 2018, the Company has estimated a provision for US\$ 17,956 thousand equivalent to S/ 57,977 thousand, of which S/ 51 million correspond to contingencies for administrative processes with the “Organismo de Evaluación y Fiscalización Ambiental – OEFA” and S/ 5 million for administrative processes with the “Organismo Superior de la Inversión en Energía y Minería – OSINERGMIN”.

At December 31, 2017 the Company has 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”; (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 related to the oil spills in the “Oleoducto Nor Peruano.”

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

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

	Balances at December 31, 2016	Charge (Payment) to Results	Balances at December 31, 2017	Charge (Payment) to Results	Balances at March 31, 2018
	US\$ 000	US\$ 000	US\$ 000	US\$ 000	US\$ 000
Deferred assets:					
Provision for retirement pensions (a)	35	-	3	-	31
Provision for environmental remediation	28,258	-	12,667	-	14,414
Other provisions	7,881	-	2,337	-	5,272
Provision for impairment of fixed assets	12,782	-	3,495	-	3,495
Participation of unpaid workers	-	3,784	3,784	19	3,803
	48,956	-	28,446	-	27,015
Deferred liabilities:					
Fixed asset allocated cost	-	122,075	12,549	-	107,947
Exchange effect for tax assets	-	-	25,773	-	25,649
PMRT financing interests	-	4,916	-	-	-
	-	126,991	43,238	-	82,298
Net deferred liabilities	-	78,035	55,307	24	55,283

(a) Deferred income tax assets were recognized with a credit to equity (additional capital), since the accounting treatment of the underlying transaction (assignments and transfers of retirement pension liabilities to ONP) was recorded in that category.

18 EQUITY

a) Share capital -

At March 31, 2018 the authorized, subscribed and paid-in share capital comprises 3,927,713,295 common shares, at S/1 par value each.

The share capital structure of the Company is as follows:

<u>Class</u>	<u>Number of shares</u>	<u>%</u>
A	3,142,170,636	80
B	<u>785,542,659</u>	<u>20</u>
	<u>3,927,713,295</u>	<u>100</u>

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.

As of March 2018, there were no changes in share capital. The movements of the share capital as to December 31st 2017 were as follows:

At the General Shareholders' Meeting held on January 14, 2017, an increase in capital of S/1,056,000 thousand (equivalent to US\$316,357 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 S/406,665 thousand (equivalent to US\$121,393 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.

b) Additional capital -

During 2017 a cash contribution of S/1,056,000 thousand (equivalent to US\$316,357 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 Oleoducto Norperuano 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 S/36,254 thousand (equivalent to US\$11,152 thousand) was approved, as a result of the capitalization of distributable profits reported for 2016.

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 March 31, 2018 totaled S/72,144 thousand (equivalent to US\$21,650 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 profits for 2016. At December 31, 2016 the legal reserve was S/54,395 thousand (equivalent to US\$16,189 thousand); the legal reserve constituted in 2017 totaled S/50,267 thousand (equivalent to US\$15,104 thousand); which corresponds to 10% of the distributable net profits for 2015.

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 PETROPERU 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:

	For the three-month period ended	
	March 31	
	2018	2017
	US\$000	US\$000
National sales	984,101	838,896
Derivative fuel price stabilization fund (*)	13,177	3,266
	997,278	842,162
Sales abroad	135,320	90,588
	1,132,598	932,750

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

At March 31, 2018 and December 31, 2017, sales are broken down as follows:

	For the three-month period ended	
	March 31	
	2018	2017
	US\$000	US\$000
National sales:		
GLP	48,236	49,747
Turbo	32,181	22,913
Gasolines	270,271	230,409
Sundry diesel	537,676	484,799
Industrial oils	77,233	39,752
Asphalts	14,325	7,391
Solvents	4,179	3,885
Stabilization Fund	13,177	3,266
Total national sales	997,278	842,162
Ventas al exterior:		
Virgin naphtha	27,884	25,621
Turbo	9,183	5,624
Gasolines	-	2,650
Sundry diesel	31,751	23,378
Industrial oils	48,958	27,971
Reduced crude	-	4,039
Raw loreto exp	12,440	-
Asphalts	2,232	1,305
Hogbs (Expo)	419	-
Naphtha Cracked Adq.	2,453	-
Total sales abroad	135,320	90,588
	1,132,598	932,750

20 OTHER OPERATING INCOME

This item comprises:

	For the three-month period ended	
	March 31	
	2018	2017
	US\$000	US\$000
Terminal operating rates (a)	8,521	8,024
Recoverable freights (b)	1,639	3,869
Leases SAVIA PERU S.A (Note 12)	2,500	2,500
Rental (c)	1,697	1,751
Crude transport by oil pipeline (d)	5,424	85
PNP supply operation	669	-829
Income by hydrocarbon use cost	349	0
Other income from services	239	262
	21,038	15,661

- (a) Comprises revenue from operating agreements of the terminals of PETROPERU S.A. signed with Consorcio Terminales regarding the terminals and southern plant of Perú and with Terminales del Perú for the terminals and northern and central plants.

At March 31, 2018, the South Terminal Operation Contract signed with Consorcio Terminales is effective until August 1, 2018; also, the Operations Contracts for the North and Central Terminals signed with Terminales del Perú continue to be effective until October 31, 2034 (North Terminals) and September 1, 2034 (Central Terminals).

- (b) Comprising revenue from billing of transportation expenses incurred by customers. The Company considers a handling margin when billing this type of expenses.
- (c) 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.
- (d) Comprising the revenue obtained from the transport of crude through the oil pipeline (Oleoducto Nor Peruano). At the reporting date, Section I ("Tramo I") is shutdown.

21 COST OF SALES

This item comprises:

	For the three-month period ended	
	March 31	
	2018	2017
	US\$000	US\$000
Initial stock inventory	607,139	475,381
Purchase of crude oil, refined products and sup	904,368	788,462
Operating expenses of production (a)	60,956	55,868
Final stock inventory	- 564,803	- 490,230
	1,007,660	829,481

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

	For the three-month period ended	
	March 31	
	2018	2017
	US\$000	US\$000
Personnel burdens	12,048	12,733
Participation of workers (Note 15-b)	4,491	3,212
Other materials and production supplies	2,660	2,112
Thirdparty services (*)	31,018	27,652
Insurances	1,541	1,581
Miscellaneous management charges	68	16
Depreciation (Note 11)	8,720	8,157
Amortization	2	4
Others	408	401
	60,956	55,868

(*) Includes the following:

	For the three-month period ended	
	March 31	
	2018	2017
	US\$000	US\$000
Freight and gtp tpte - Terrestrial	8,275	8,870
Freights and gtp tpte - Maritime	6,116	5,337
Freight and other freight	4,190	3,485
Maintenance services and repair	4,924	2,621
Energy and water	4,784	5,245
Industrial protection and safety	1,706	702
Food and lodging	649	520
Third-party services - Miscellaneous	374	872
	31,018	27,652

22 SELLING AND DISTRIBUTION EXPENSES

This item comprises:

	For the three-month period ended March 31, 2017	
	2018	2017
	US\$000	US\$000
Personnel burdens	6,056	5,614
Participation of workers (Note 15-b)	1,927	1,441
Materials and supplies	743	734
Miscellaneous management charges	23	62
Insurance	201	255
Third party services (a)	18,358	17,699
Doubtful collection account	-	4
Depreciation (Note 11)	2,276	1,512
Amortization	-	-
Taxes (b)	4,667	4,651
	<u>34,251</u>	<u>31,972</u>

(a) Includes the following:

	For the three-month period ended March 31	
	2018	2017
	US\$000	US\$000
Product storage	5,833	5,091
Product dispatch	7,098	6,831
Advertising	664	-102
Maintenance and repair services	464	447
Freight and other freight charges	1,833	3,995
Protection and industrial safety	1,072	169
Third party services	1,299	1,202
Travel expenses and transfers	95	65
	<u>18,358</u>	<u>17,699</u>

(a) The item of taxes mainly reflects the aliquots payable to OSINERGMIN for a total US\$3,597 thousand (US\$3,267 thousand in March 31, 2017) as well as contributions to OEFA for a total US\$795 thousand (US\$1,065 thousand in March 31, 2017).

23 ADMINISTRATIVE EXPENSES

This item comprises:

	For the three-month period ended March 31, 2017	
	2018	2017
	US\$000	US\$000
Personnel burdens	20,790	17,035
Participation of workers (Note 15-b)	4,526	3,561
Materials and supplies	415	290
Third party services (a)	8,757	6,923
Insurances	158	147
Miscellaneous management charges	1,411	1,491
Depreciation (Note 11)	1,341	809
Amortization	680	704
Taxes	1,395	1,122
	<u>39,473</u>	<u>32,082</u>

(a) Includes the following:

	For the three-month period ended March 31	
	2018	2017
	US\$000	US\$000
Medical services	211	43
IBM Outsourcing Services	1,226	1,336
Maintenance and repair services	1,420	993
Industrial protection and safety	1,356	1,243
Temporary services	442	304
Consulting, expertise and audits	1,263	994
Advertising	349	463
Bank costs	256	252
Third-party services - Miscellaneous	1,155	839
Freight and other freight	616	150
Travel expenses and transfers	464	306
	<u>8,757</u>	<u>6,923</u>

24 PERSONNEL CHARGES

This item comprises:

	For the three-month period ended March 31, 2017	
	2018	2017
	US\$000	US\$000
Wages and salaries	14,296	13,386
Social contributions	5,616	5,364
Gratifications	3,019	2,955
Compensation for length of service	2,387	2,323
Participation of the workers	10,944	8,214
Vacations	1,186	1,159
Bonuses	7,628	7,497
Movility	306	298
Feeding	934	903
Overtime	304	445
Others	3,218	1,052
	<u>49,838</u>	<u>43,596</u>

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

	For the three-month period ended March 31	
	2018	2017
	US\$000	US\$000
Sales cost (Note 21)	16,539	15,945
Sales and distribution expenses (Note 22)	7,983	7,055
Administration expenses (Note 23)	25,316	20,596
	<u>49,838</u>	<u>43,596</u>

25 OTHER INCOME AND EXPENSES

Other income and expenses comprises:

	For the three month period ended March 31	
	2018	2017
	US\$000	US\$000
Other income		
Interests - SUNAT return (a)	42,813	-
Claims and / or indemnities (insurance / default)	975	1,074
Marine Operations Services	771	790
Recover provision commercial doubtful collection	86	15
Present value environmental remediation	1,519	517
Other income	565	4,845
	46,729	7,241
Other expenses		
Provision for retirement pension	-	11
Supply impairment	-	41
	- 8	- 52

(a) SUNAT issued Resolutions ordering a refund in connection with Case File No. 07873-2012-0-1801-JR-CA 13. Refunds obtained included interest for a total US\$42,813 thousand.

26 FINANCE INCOME AND COST

Finance income and costs comprises:

	For the three month period ended March 31	
	2018	2017
	US\$000	US\$000
Interest on bank deposits	886	263
Interest on accounts receivable	142	234
Profit from derivative financial instruments	1,414	33
	2,442	530

	For the three month period ended March 31	
	2018	2017
	US\$000	US\$000
Interest on working capital loans	(6,512)	(8,688)
Loss on derivative financial instruments	(2,539)	(1,475)
Others	-	(92)
	(9,051)	(10,255)

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 for fiscal years 2018 and 2017 is 29.5%.

By means of Legislative Decree No.1261, enacted on December 10, 2016, amendments to Income Tax Law have been made, which are applicable from fiscal year 2017 onwards.

Among these amendments, should be noted the increase in the corporate income tax rate (on the Peruvian third-category income tax) to 29.5% from 2017 onwards. Tax on dividends and other forms of profit distribution, agreed on by legal entities to non-domiciled individuals and legal entities is to be reduced to 5%, for distributions agreed on or made available in cash or in kind during fiscal year 2017 onwards. The distribution of retained earnings until December 31, 2014, will continue to be subject to a rate of 4.1% and 6.8% in 2015 and 2016, even when the distribution is made in subsequent years.

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 Perú 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 determination -

The Company, in calculating its taxable income for the years ended on March 31, 2018 and March 31, 2017, has determined current income tax for US\$29,056 thousand and US\$21.808 thousand, respectively.

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

	For the three month period ended	
	March 31	
	<u>2018</u>	<u>2017</u>
	US\$000	US\$000
Current	29,056	21,808
Deferred	(24)	(22,331)
	<u>29,032</u>	<u>(523)</u>

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

	For the three month period ended March 31			
	2018		2017	
	US\$000	%	US\$000	%
Result before income tax	116,186	100%	38,581	100%
Theoretical income tax 29.5%	34,275	30	11,382	29.50
Permanent non-deductible expenses	6,286	5	3,021	7.83
Permanent non-taxable income	(12,712)	(11)	-	0.00
Effect of exchange rate difference on tax assets	124	0	(20,387)	(52.84)
Effect of higher current tax for difference in tax exchange	5,668	5	9,709	25.16
Others	(4,609)	(4)	(4,248)	(11.01)
Current and deferred income tax	29,032	24.99	(523)	(1.36)

Permanent non-deductible expenses for 2016 are mainly related to penalties and administrative and tax fines paid.

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.

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 2014 to 2017 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, 2017.

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 -

By means of Legislative Decree No. 1347, published on January 7, 2017 the VAT (IGV in Perú) rate was reduced by one percentage point, effective July 1, 2017, as long as the VAT annual fiscal collection target is accomplished at May 31, 2017 net of internal refunds of 7.2% of GDP. This means that as long as said condition is met, the VAT rate (including the Wholesale Price Index) will be reduced from 18 to 17%.

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

The Company opted to take advantage of the VAT early 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 PETROPERU S.A. filed with PROINVERSION an application for early 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 PETROPERU S.A. for a total of US\$2,958,000 thousand.

Said report was sent to MEF on December 29, 2017, which shall issue a report on the listing of goods, services and construction contracts relating to the PMRT project. The report was also sent to PROINVERSION so that, after its evaluation, it will prepare a draft investment contract to be signed with PETROPERU S.A.

If the PETROPERU S.A. application is approved, the MEF will have to issue a favorable report addressed to the MEM for the latter to issue the respective Ministerial Resolution after PETROPERU S.A. signs the investment agreement with PROINVERSION and the MEM to be eligible for early recovery of VAT (“Régimen de Recuperación Anticipada del IGV”).

f) 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 S/9,540 thousand (equivalent to US\$2,940 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, dated December 11, 2017 amounting to S/8,653 thousand (equivalent to US\$2,667 thousand). An appeal against said resolution will be presented by the Corporate and Legal Management (“Gerencia Corporativa Legal, Sub Gerencia Tributaria, Cumplimiento Regulatorio y ambiental”).

With respect to fiscal 2007 the Company has filed an appeal against SUNAT for an estimated total of S/56,060 thousand (equivalent to US\$17,276 thousand) comprising VAT (IGV), excise tax and income tax. For fiscal 2008 the Company has also filed an appeal for an estimated total S/9,846 thousand (equivalent to US\$3,034 thousand) comprising income tax and VAT.

At December 31, 2017 PETROPERU S.A. has the following tax examinations:

- FISE collection, from January to December 2014 and 2015, by OSINERGMIN.
- Contribution to Regulator (aliquot), from January to December 2014, by OSINERGMIN.
- Income Tax, from January to December 2011, by SUNAT.

28 CONTINGENCIES

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

	<u>31.03.2018</u>	<u>31.12.2017</u>
	<u>US\$000</u>	<u>US\$000</u>
Labor proceedings (a)	6,832	6,628
Civil proceedings (b)	41,096	40,839
Tax and customs proceedings	41,080	61,817
	<u>89,008</u>	<u>109,284</u>

- (a) Labor-related lawsuits are principally actions involving claims for social benefits for a total S/18,000 thousand (equivalent to US\$6,000 thousand), retirement related claims for a total S/1,000 thousand (equivalent to US\$308 thousand) and other labor-related actions involving the Oil Pipeline operating Unit for a total S/3,000 thousand (equivalent to US\$924 thousand).
- (b) This balance mainly consists of: i) an arbitration process brought by Pluspetrol Norte S.A. (International) for US\$20,000 thousand relating to the Company's alleged failure to reimburse expenses incurred in remediation work in Block 8, in connection with the Contractual Position Assignment Agreement; ii) a civil court action brought by the Regional Government of Lambayeque for US\$7,000 thousand; iii) arbitration process brought by RELAPASA for a total US\$5,000 thousand; iv) arbitration process brought by INTTCORP for US\$2,000 thousand; and v) civil court action brought by an entity called COVISE for S/10,000 thousand (equivalent to US\$3,081 thousand).

Management and its legal counsel consider that the outcome of this contingencies will be favorable to the Company.

29 BASIC AND DILUTED EARNINGS PER SHARE

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

	<u>Utility US \$</u>	<u>Weighted average</u>	<u>Earnings per share</u>
	<u>000</u>	<u>of outstanding</u>	
		<u>shares</u>	
As of March 31, 2018			
Profit per diluted share	87,154	3,415,046	0.026
As of March 31, 2017			
Profit per diluted share	39,104	3,521,048	0.011

30 GUARANTEES AND COMMITMENTS

Guarantees and performance bonds -

At March 31, 2018 the Company has given performance bonds backed by local financial institutions to suppliers for a total S/75 million (equivalent to US\$23.2 million) and US\$34 million.

Guarantees related to borrowings are disclosed in Note 13.

At December 31, 2017 and 2016 the Company maintains no long-term operating lease commitments.

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.