Public Joint Stock Company
"National Joint Stock Company
"NAFTOGAZ OF UKRAINE"

Unaudited Condensed Consolidated Interim Financial Statements as at and for the Six Months Ended 30 June 2017

PUBLIC JOINT STOCK COMPANY "NATIONAL JOINT STOCK COMPANY "NAFTOGAZ OF UKRAINE"

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PUBLIC JOINT STOCK COMPANY "NATIONAL JOINT STOCK COMPANY "NAFTOGAZ OF UKRAINE"

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2017

In millions of Ukrainian hryvnias	Note	30 June 2017	31 December 2016
ASSETS			
Non-current assets			
Property, plant and equipment		542,047	551,661
Investments in associates and joint ventures		1,170	1,328
Prepaid corporate income tax		847	1,317
Deferred tax assets		6,415	6,415
Other non-current assets	5	9,073	9,326
Total non-current assets		**559,552**	**570,047**
Current assets			
Inventories	6	46,136	50,244
Trade accounts receivable	7	59,326	49,209
Prepayments made and other current assets	8	12,103	12,051
Prepaid corporate income tax		2,410	22
Cash and bank balances	9	23,571	22,336
Restricted cash		674	680
Total current assets		**144,220**	**134,542**
TOTAL ASSETS		**703,772**	**704,589**
EQUITY			
Share capital	10	194,307	164,607
Revaluation reserve		435,339	437,510
Unregistered contributed capital	10	-	29,700
Cumulative exchange difference		3,405	3,164
Accumulated deficit		(152,409)	(175,873)
Equity attributable to owners of the Parent		**480,642**	**459,108**
Non-controlling interest in equity		**1,070**	**1,164**
TOTAL EQUITY		**481,712**	**460,272**
LIABILITIES			
Non-current liabilities			
Borrowings	11	13,926	23,100
Provisions	12	12,620	12,416
Deferred tax liabilities		81,236	82,088
Other long-term liabilities		1	4
Total non-current liabilities		**107,783**	**117,608**
Current liabilities			
Borrowings	11	53,659	47,744
Provisions	12	19,579	31,116
Trade accounts payable		16,789	16,234
Advances received and other current liabilities	13	19,645	28,328
Corporate income tax payable		4,605	3,287
Total current liabilities		**114,277**	**126,709**
TOTAL LIABILITIES		**222,060**	**244,317**
TOTAL LIABIITIES AND EQUITY		**703,772**	**704,589**

Andriy Kobolyev
Chairman of the Executive Board

Sergiy Konovets
Deputy Chairman of the Executive Board

The accompanying notes are integral part of these unaudited condensed consolidated interim financial statements

PUBLIC JOINT STOCK COMPANY "NATIONAL JOINT STOCK COMPANY "NAFTOGAZ OF UKRAINE"

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF PROFIT OR LOSS FOR THE SIX MONTHS ENDED 30 JUNE 2017

In millions of Ukrainian hryvnias	Note	Six months ended 30 June 2017	Six months ended 30 June 2016
Revenue	3	122,767	86,546
Cost of sales	14	(81,326)	(53,533)
Gross profit		**41,441**	**33,013**
Other operating income		358	1,415
Other operating expenses	15	(10,435)	(6,585)
Operating profit		**31,364**	**27,843**
Finance costs	16	(4,061)	(4,765)
Finance income		1,134	1,544
Share of after-tax results of associates and joint-ventures		(63)	91
Net foreign exchange gain/(loss)		902	(2,734)
Profit before income tax		**29,276**	**21,979**
Income tax expense		(5,939)	(2,635)
Net profit		**23,337**	**19,344**
Net profit/(loss) is attributable to:			
Equity holders of the Company		23,404	19,341
Non-controlling interest		(67)	3
Net profit		**23,337**	**19,344**

The accompanying notes are integral part of these unaudited condensed consolidated interim financial statements

PUBLIC JOINT STOCK COMPANY "NATIONAL JOINT STOCK COMPANY "NAFTOGAZ OF UKRAINE"

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF COMPREHENSIVE INCOME FOR THE SIX MONTHS ENDED 30 JUNE 2017

In millions of Ukrainian hryvnias	Note	Six months ended 30 June 2017	Six months ended 30 June 2016
Net profit		**23,337**	**19,344**
Other comprehensive income/(loss)			
Items that will not be reclassified subsequently to profit or loss, net of income tax:			
Loss on revaluation of property, plant and equipment (net of income tax of UAH 464 million (2016: UAH 3,125 million)		(2,116)	(14,237)
Items that may be reclassified subsequently to profit or loss, net of income tax:			
Cumulative exchange difference		241	657
Other comprehensive loss		(1,875)	(13,580)
Total comprehensive income		**21,462**	**5,764**
Total comprehensive income/(loss) is attributable to:			
Equity holder of the Company		21,545	5,761
Non-controlling interests		(83)	3
Total comprehensive income		**21,462**	**5,764**

The accompanying notes are integral part of these unaudited condensed consolidated interim financial statements

PUBLIC JOINT STOCK COMPANY "NATIONAL JOINT STOCK COMPANY "NAFTOGAZ OF UKRAINE"

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF PROFIT OR LOSS FOR THE THREE MONTHS ENDED 30 JUNE 2017

In millions of Ukrainian hryvnias	**Three months ended 30 June 2017**	**Three months ended 30 June 2016**
Revenue	40,409	31,551
Cost of sales	(24,338)	(21,150)
Gross profit	**16,071**	**10,401**
Other operating income	108	(864)
Other operating expenses	(806)	(3,859)
Operating profit	**15,373**	**5,678**
Finance costs	(1,925)	(2,275)
Finance income	669	913
Share of after-tax results of associates and joint-ventures	1	10
Net foreign exchange gain	500	1,798
Profit before income tax	**14,618**	**6,124**
Income tax expense	(2,860)	(1,204)
Net profit	**11,758**	**4,920**
Net profit/(loss) is attributable to:		
Equity holders of the Company	11,884	4,683
Non-controlling interest	(126)	237
Net profit	**11,758**	**4,920**

PUBLIC JOINT STOCK COMPANY "NATIONAL JOINT STOCK COMPANY "NAFTOGAZ OF UKRAINE"

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF COMPREHENSIVE INCOME FOR THE THREE MONTHS ENDED 30 JUNE 2017

In millions of Ukrainian hryvnias	**Three months ended 30 June 2017**	**Three months ended 30 June 2016**
Net profit	**11,758**	**4,920**
Other comprehensive loss		
Items that will not be reclassified subsequently to profit or loss, net of income tax:		
Loss on revaluation of property, plant and equipment (net of income tax of UAH 3,010 million (2016: UAH 2,338 million)	(13,713)	(10,653)
Items that may be reclassified subsequently to profit or loss, net of income tax:		
Cumulative exchange difference	(411)	(155)
Other comprehensive loss	(14,124)	(10,808)
Total comprehensive loss	**(2,366)**	**(5,888)**
Total comprehensive income/(loss) is attributable to:		
Equity holder of the Company	(2,224)	(6,125)
Non-controlling interests	(142)	237
Total comprehensive loss	**(2,366)**	**(5,888)**

PUBLIC JOINT STOCK COMPANY "NATIONAL JOINT STOCK COMPANY "NAFTOGAZ OF UKRAINE"

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED 30 JUNE 2017

	Equity attributable to owners of the Parent							
In millions of Ukrainian hryvnias	Share capital	Revaluation reserve	Unregistered contributed capital	Cumulative exchange difference	Accumulated deficit	Total	Non-controlling interest	Total equity
Balance at 31 December 2016	**164,607**	**437,510**	**29,700**	**3,164**	**(175,873)**	**459,108**	**1,164**	**460,272**
Net profit/(loss)	-	-	-	-	23,404	23,404	(67)	23,337
Other comprehensive income/(loss)	-	(2,100)	-	241	-	(1,859)	(16)	(1,875)
Total comprehensive income/(loss)	**-**	**(2,100)**	**-**	**241**	**23,404**	**21,545**	**(83)**	**21,462**
Transfer of revaluation reserve	-	(71)	-	-	71	-	-	-
Change in investments in joint operations	-	-	-	-	(11)	(11)	(11)	(22)
Registration of share capital	29,700	-	(29,700)	-	-	-	-	-
Balance at 30 June 2017	**194,307**	**435,339**	**-**	**3,405**	**(152,409)**	**480,642**	**1,070**	**481,712**

The accompanying notes are integral part of these unaudited condensed consolidated interim financial statements

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED 30 JUNE 2016

	Equity attributable to owners of the Parent							
In millions of Ukrainian hryvnias	**Share capital**	**Revaluation reserve**	**Unregistered contributed capital**	**Cumulative exchange difference**	**Accumulated deficit**	**Total**	**Non-controlling interest**	**Total equity**
Balance at 31 December 2015	**164,607**	**430,503**	**29,700**	**2,086**	**(188,421)**	**438,475**	**5,287**	**443,762**
Net profit	-	-	-	-	19,341	19,341	3	19,344
Other comprehensive income/(loss)	-	(14,237)	-	657	-	(13,580)	-	(13,580)
Total comprehensive income/(loss)	**-**	**(14,237)**	**-**	**657**	**19,341**	**5,761**	**3**	**5,764**
Transfer of revaluation reserve	-	(5)	-	-	5	-	-	-
Profit share payable to the State Budget and dividends	-	-	-	-	(1,092)	(1,092)	(72)	(1,164)
Balance at 30 June 2016	**164,607**	**416,261**	**29,700**	**2,743**	**(170,167)**	**443,144**	**5,218**	**448,362**

The accompanying notes are integral part of these unaudited condensed consolidated interim financial statements

PUBLIC JOINT STOCK COMPANY "NATIONAL JOINT STOCK COMPANY "NAFTOGAZ OF UKRAINE"

UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS FOR THE SIX MONTHS ENDED 30 JUNE 2017

In millions of Ukrainian hryvnias	Note	Six months ended 30 June 2017	Six months ended 30 June 2016
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before income tax		**29,276**	**21,979**
Adjustments for:			
Depreciation of property, plant and equipment and amortisation of intangible assets		11,623	11,909
Loss on disposal of property, plant and equipment		66	3
Impairment of property, plant and equipment	15	41	-
Write down of inventories	6	291	(4,451)
Net movement in provision for trade accounts receivable and prepayments made, other current assets, financial investments and VAT balances	15	2,822	1,236
Change in provisions	12	2,555	2,366
Write off of accounts payable and other current liabilities		(41)	(84)
Share of after-tax results of associates and joint-ventures		63	(91)
Foreign exchange (gain)/loss		(902)	2,734
Finance costs, net		2,927	3,221
Operating cash flows before working capital changes		**48,721**	**38,822**
Decrease in other non-current assets		411	575
Decrease in inventories		3,817	8,085
Increase in trade accounts receivable		(12,570)	(4,642)
(Increase)/decrease in prepayments made and other current assets		(155)	4,698
Decrease in other long-term liabilities		(3)	(40)
Provisions paid or used	12	(864)	(333)
Increase/(decrease) in trade accounts payable		14,119	(4,142)
Decrease in advances received and other current liabilities		(8,836)	(1,827)
Cash generated from operations		**44,640**	**41,196**
Income taxes paid		(6,934)	(1,837)
Interest received		691	540
Net cash generated by operating activities		**38,397**	**39,899**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment and intangible assets		(5,093)	(2,357)
Withdrawal of bank deposits		483	2,535
Dividends received		84	1
Net cash (used in)/generated from investing activities		**(4,526)**	**179**

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UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS FOR THE SIX MONTHS ENDED 30 JUNE 2017 (CONTINUED)

In millions of Ukrainian hryvnias	Note	Six months ended 30 June 2017	Six months ended 30 June 2016
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from borrowings		4,766	6,302
Repayment of borrowings		(19,597)	(23,374)
Interest paid		(3,773)	(4,566)
Profit share and dividends paid	10, 12	(13,264)	(1,020)
Net cash used in financing activities		**(31,868)**	**(22,658)**
Net increase in cash and cash equivalents		**2,003**	**17,420**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		**21,853**	**9,256**
Effect of exchange rates change on cash and cash equivalents		(285)	(291)
CASH AND CASH EQUIVALENTS AT THE END OF THE REPORTING PERIOD	9	**23,571**	**26,385**

Significant Non-Cash Transactions

In millions of Ukrainian hryvnias	Six months ended 30 June 2017	Six months ended 30 June 2016
Direct payment by a lending bank for gas purchased by the Group	12,958	6,302

1. THE ORGANISATION AND ITS OPERATIONS

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

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

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

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

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

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

	% Interest held		
Name/Segment	**30 June 2017**	**31 December 2016**	**Country of registration**
Production of gas, oil and refinery products			
Ukrgasvydobyvannia, PJSC	100.00	100.00	Ukraine
Ukrnafta, PJSC	50.00+1 share	50.00+1 share	Ukraine
Petrosannan Company, Joint operations with the Arab Republic of Egypt and Egyptian General Petroleum Corporation	50.00	50.00	Egypt
Zakordonnaftogaz, Subsidiary Enterprise	100.00	100.00	Ukraine
Carpatygaz LLC, Joint operations with Misen Enterprises AB	49.99	49.99	Ukraine
Oil and gas transportation			
Ukrtransgaz, PJSC	100.00	100.00	Ukraine
Ukrtransnafta, PJSC	100.00	100.00	Ukraine
Ukrspetstransgaz, PJSC	100.00	100.00	Ukraine
Wholesale and retail distribution of oil, gas and refinery products			
Gaz Ukraiiny, Subsidiary Enterprise	100.00	100.00	Ukraine
Naftogaz Trading Europe S.A. (former Naftogaz Overseas S.A.)	100.00	100.00	Switzerland
Kirovogradgaz, Open JSC	51.00	51.00	Ukraine
Ukravtogaz, Subsidiary Enterprise	100.00	100.00	Ukraine
Other			
Vuglesyntezgaz Ukraiiny, Subsidiary Enterprise	100.00	100.00	Ukraine
Ukrnaftogazkomplekt, Subsidiary Enterprise	100.00	100.00	Ukraine

2. OPERATING ENVIRONMENT

During recent years Ukraine has been in a political and economic turmoil. Autonomous Republic of Crimea within Ukraine was unlawfully annexed by the Russian Federation. Certain areas in Luhansk and Donetsk regions continue to experience military actions. These actions led to rapid inflation, national currency devaluation against major foreign currencies, drop in GDP, illiquidity and volatility at the financial markets.

Economic situation stabilisation started in 2016 with GDP growth of 1% and Ukrainian hryvnia devaluation slowdown. These events allowed the National Bank of Ukraine to ease certain restrictions implemented in 2014-2015, including decrease of compulsory conversion level down to 65% and permission of dividend distribution abroad. Nevertheless, certain restrictions were further prolonged.

Significant external financing is needed to support the economy. During 2015 and 2016 Ukraine received first tranches within the Extended Fund Facility programme, agreed with the International Monetary Fund ("IMF"). Further economic and political progress depends essentially from the Ukrainian Government actions, however, further development in the economic and political areas remains uncertain.

The Government and the Group are undertaking significant measures in the open European natural gas market development that is required by the Memorandum on Economic and Financial Policy agreed with the IMF, provisions of the Coalition Agreement, the "Ukraine-2020" Sustainable Development Strategy, the Corporate Governance Action Plan, and the Plan for Implementation of the Gas Sector Reform. These measures introduce conceptual changes to the legal framework and functioning of the natural gas market and have significant impact on the performance of the Company and the Group as a whole.

State regulation of gas market in Ukraine

Gas trading and supply

Starting from 1 October 2015 model of the gas market has switched to the principles of free, fair competition and ensuring a high level of protection of customer rights and interests from the regulated tariffs market model.

At the same time, the Cabinet of Ministers of Ukraine has issued Resolution #758 dated 1 October 2015, imposing public service obligations on the Company during the transitional period from 1 October 2015 to 31 March 2017 in respect of gas purchase of domestic production from "Ukrgasvydobyvannia" PJSC and gas supply for the needs of households, district heating companies and religious organisations, and starting from 23 December 2016 – for the needs of budget financed entities and PJSC "Odessa Port Plant".

2. OPERATING ENVIRONMENT (Continued)

Public service obligations imposed on the Company were prolonged up to 1 April 2018 according to the Resolution of the Cabinet of Ministers of Ukraine #187 dated 22 March 2017. This Resolution contains, amongst others, a series of differences from the previous one, in particular:

- Both "Ukrgasvydobyvannia" PJSC and "Chornomornftogas" PJSC are obliged to sell gas to the Company for the needs of households, heat generating entities and religious organisations.
- The Company is obliged to sell gas to district heating companies for all groups of customers, as well as for producing electricity by these companies.
- Starting from 1 April 2017 the Company will sell gas for the needs of households, religious organisations and district heating companies at the price of UAH 4,942 for 1,000 cubic meters. (excluding VAT, transportation and distribution tariffs and trade mark-up). In setting wholesale price for religious organisations and district heating companies for the needs of religious organisations a ratio of 0.5 is applied to the price defined above; in setting wholesale price for gas for district heating companies for all customers, except for the needs of religious organisations and households, and for electricity production by district heating companies a ratio of 1.6 is applied.
- In case gas wholesale price calculated at 100% import parity before 1 July 2017 is more than 10% higher than currently effective price, selling price should be calculated at 100% import parity for the period from 1 October 2017 up to 1 April 2018 for gas sales to households, religious organisations and district heating companies. Concurrently with resolution on Company's gas sales price change for specified categories, gas purchase price from PJSC "Ukrgasvydobyvannia" and PJSC "Chornomornftogas" should be revised.

Other customers outside the Resolution buy imported natural gas under the prices set discretionary by the gas market participants, including the Company.

2. OPERATING ENVIRONMENT (Continued)

The following tariffs and prices were set:

	30 June 2017	30 June 2016
Prior to 1 May 2016 **retail prices for natural gas for households** were differentiated depending on the type and volume of consumption (UAH per cubic meter), including VAT, duties in the form of additional levy to the existing tariffs, and tariffs for gas transmission and distribution. Effective from 1 May 2016 single retail price for households was set at the level of import parity, with possibility of quarterly review up to 31 March 2017 as set up in the Resolution of the Cabinet of Ministers of Ukraine # 315 dated 27 April 2016.	**UAH 6.88** per cubic meter	From 1 October 2015 to 30 April 2016: **UAH 7.19** per cubic meter; **UAH 3.6** per cubic meter within the range of 1,200 cubic meters (on the basis of 200 cubic meters per month) for customers using gas in a single package From 1 May 2016 to 31 March 2017: **UAH 6.88** per cubic meter
Natural gas prices for entities generating heat for household needs, UAH per cubic meter, net of VAT and other taxes and duties. Effective from 1 April 2015, regulated prices are applied, net of VAT, duties in the form of additional levy to the existing tariffs, and tariffs for gas transmission and distribution.	**UAH 4.94** per cubic meter	From 1 October 2015 to 30 April 2016: **UAH 1.84** for the entities directly connected to gas transmission system, and **UAH 1.77** for other entities From 1 May 2016 to 31 March 2017: **UAH 4.94** per cubic meter
Selling prices for gas sold to industrial and other customers, net of VAT, duties in the form of additional levy to the existing tariffs, and tariffs for gas transmission and distribution. Effective from 1 October 2015, the said prices are determined by the Company on a monthly basis individually and are differentiated based on the monthly volumes of gas consumption and terms and conditions of payment for it by a customer.	From **UAH 6,192** to **UAH 6,875** per 1,000 cubic meter	From **UAH 4,996** to **UAH 5,604** per 1,000 cubic meter
General tariff for gas storage (storage, injection, and withdrawal), net of VAT, UAH per thousand cubic meters for one season of storage.	**UAH 112.00**	**UAH 112.0 0**
General gas transportation tariff via transmission and distribution pipelines within Ukraine, net of VAT, UAH per thousand cubic meters.	**UAH 732.70**	**UAH 732.70**
Tariff for entry and exit points of Ukrainian gas transmission network, net of VAT, USD per thousand cubic meters	**USD 12.47**	**USD 12.47**

2. OPERATING ENVIRONMENT (Continued)

Households settle their debts on natural gas consumed via special purpose bank accounts. The list of banks creating such accounts is approved by the Cabinet of Ministers of Ukraine. According to the current procedure, gas suppliers with public service obligations open special purpose bank accounts to receive payments for natural gas consumed. Amounts accumulated on the special purpose bank accounts were allocated to current accounts of the transmission system operator, distribution system operators and gas supplier with public service obligations according to ratios calculated by the gas suppliers with specific obligations and approved by the National Commission for Regulation of Energy and Utilities ("NCREU"). Balances on the special purpose accounts cannot be arrested or blocked.

District heating companies also open special purpose banks accounts for the settlement of debts for heat supplied with similar allocation principles according to ratios approved by NCREU monthly. The special purpose bank accounts of district heating companies also cannot be blocked or arrested.

In November 2016 the Law of Ukraine "On measures to settle the debts for the natural gas consumed by district heat generating and distribution and water supplying companies" #1730 was adopted. The principles of district heat generating and distribution and water supply companies' payables for gas settling are set in this Law. Among other, the Law assumes writing off penalties and fines implied for overdue debts for gas supplied, and restructuring of payables to the Company on gas consumed.

The list of companies entitled for debt settling procedures should be approved by the central body of the government executive authority responsible for pursuing the State policy in housing and utilities. This list should be approved as a separate register of companies. Additionally, gas debts restructuring should be performed according to a standard pro forma contract approved by the Resolution of the Cabinet of Ministers of Ukraine #222 dated 29 March 2017.

Gas transmission and distribution

Before 1 January 2016 tariffs for gas transit were set by negotiations between two parties, and gas transmission and distribution tariffs were set by NCREU.

Starting from 1 January 2016, Ukraine has changed its gas transmission pricing policy to harmonise Ukrainian legislation with the European energy regulations, introducing a new system regulating tariffs for gas transmission. According to the Law of Ukraine "On Natural Gas Market", gas transmission tariffs are set by NCREU for entry/exit points. New tariffs are set using regulatory asset base ("RAB") methodology that assumes setting appropriate return on assets to stimulate gas operators to invest in infrastructure development. The new tariffs allow compensating for acceptable return on RAB, depreciation and operating expenses. Depreciation included in the tariff was calculated based on the assumption that there would not be any transit flows starting from 1 January 2020 ("accelerated depreciation").

Currently JSC "Gazprom" ("Gazprom") still pays gas transmission tariffs as set in the current agreement on gas transit. Following disagreement of Gazprom to book entry capacities starting from 1 January 2016 based on the new tariffs, NCREU temporarily suspended the application of new tariffs for gas transit pending the award of the Arbitral Tribunal under the auspices of the Arbitration Institute of the Stockholm Chamber of Commerce (Note 17). Naftogaz expects that the NCREU following the award will apply the new tariffs for gas transit with retroactive effect from 1 January 2016.

2. OPERATING ENVIRONMENT (Continued)

Had new tariffs been enforced starting from 1 January 2016, and assuming that Gazprom would not book any transit capacities beyond 2019, the Group would have applied the revenue from gas transmission based on the new tariffs and accelerated depreciation.

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

In accordance with Para 7, Article 11 of the Law of Ukraine "On Natural Gas Market", a gas market player with public service obligations is eligible for compensation of economically justified expenditures incurred by such player, less any income obtained in the course of fulfilling such obligations plus adequate margin. The level of margin should be calculated following the relevant resolution by the Cabinet of Ministers of Ukraine. As at the date of these consolidated financial statements such resolution has not been adopted.

Accordingly, the Company did not receive any compensation as a gas market player with public service obligations during the six months of 2017.

Assets located at temporarily occupied areas

In early 2014, Ukraine suffered from the military aggression of the Russian Federation which resulted in the occupation of the Autonomous Republic of Crimea ("Crimea") and unlawful military take-over of certain areas in Luhanska and Donetska regions by armed terrorist groups that are controlled, directed, and financed by the Russian Federation, as well as a result of the unconcealed intrusion of regular armed forces of the Russian Federation.

Additionally, Ukraine suffered from the separatist movements and the collapse of law enforcement in Luhansk and Donetsk regions in 2014. As a result, before 1 January 2016 the Group recognised provision for impairment for assets located on anti-terrorist operation area (ATO) as stipulated by the Law of Ukraine „On Provisional Measures during ATO" # 1669 dated 2 September 2014.

Management of the Group continues to undertake all possible legal and diplomatic measures to reimburse for losses and recover control of the Group's assets in Crimea.

3. SEGMENT INFORMATION

The Executive Board is the Group's chief operating decision maker. Management has determined the operating segments used for disclosure by the Group based on reports reviewed by the Executive Board for assessing the Group's financial performance.

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

- *Gas upstream.* Natural gas production is mainly performed in Poltava, Kharkiv, Sumy, Dnipropetrovsk, Lviv and Zakarpattya regions. Exploration works are mainly performed in Carpathian and Dniprovs'ko-Donetsk regions. The Group controls about 70% of all natural gas produced in Ukraine.
- *Oil and gas condensate upstream.* Oil exploration is performed by "Ukrnafta" PJSC and "Ukrgasvydobyvannia" PJSC. Production of gas condensate is performed in the area of natural gas exploration.
- *Gas transmission and distribution.* This segment is presented by the gas transmission and distribution pipelines operated by the Group. Ukrainian gas transportation system is one of the largest in the world in terms of its transportation capacities. The total length of gas transmission pipelines in Ukraine is 38.5 thousand km. Over 46% of natural gas supplied from the Russian Federation to European countries in 2016 was transported through Ukrainian transmission gas pipelines. This segment also includes result of market-based gas balancing operations introduced by the Code of the gas transmission system. Market-based gas balancing operations is an activity to balance gas volumes entered the gas transmission system at entry point and volumes taken out at exit point. Gas balancing services are provided to consumers of gas transmission services based on respective allocation. Currently this type of activities is provided by "Ukrtransgas" PJSC.
- *Gas storage.* Ukrainian gas transportation system includes 12 underground gas storage facilities located in mainland Ukraine. The total capacity of the underground gas storage system located in Ukraine is 31 billion cubic meters of gas.
- *Crude oil transportation.* This segment is presented by the transmission oil pipelines operated by the Group. Total length of oil transmission pipelines in Ukraine is 4.7 thousand km. Segment also includes oil storage, presented by 11 oil reservoirs with total capacity of 1.1 million tonnes of oil.
- *Crude oil and gas condensate refinery and petroleum products trading.* This segment is presented by 8 oil and gas refineries. The refinery products mainly include gasoline and diesel fuel, and LPG.
- *Gas trading and supply.* The Government has imposed public service obligations on the Company in respect of gas supplies for the needs of households, district heating companies and religious organisations at regulated prices (Note 2). Other customers are supplied with gas under the prices set discretionary by gas market participants, including the Company.
- *Other.* Revenues of this segment include revenues from sales of materials and services.

The accounting policies of the reportable segments are the same as the Group's accounting policies described in Note 21.

3. SEGMENT INFORMATION (Continued)

Segment information for the reportable business segments of the Group for the six months ended 30 June 2017 is as follows:

In millions of Ukrainian hryvnias	Gas upstream	Oil and gas condensate upstream	Gas transmission and distribution	Gas storage	Crude oil transportation	Crude oil and gas condensate refinery and petroleum products trading	Gas trading and supply	Other	Elimination	Total
Sales – external	401	6,812	50,622	100	1,744	10,211	52,385	492	-	122,767
Sales to other segments	32,864	-	1,695	377	-	19	13,805	-	(48,760)	-
Total revenue	**33,265**	**6,812**	**52,317**	**477**	**1,744**	**10,230**	**66,190**	**492**	**(48,760)**	**122,767**
Segment result	**18,141**	**339**	**15,546**	**(1,001)**	**646**	**2,547**	**(3,771)**	**(1,185)**	**(2,917)**	**28,345**
Share of after-tax results of associates										(63)
Unallocated income/ (expense), net										994
Profit before income tax										**29,276**

3. SEGMENT INFORMATION (Continued)

In millions of Ukrainian hryvnias	Gas upstream	Oil and gas condensate upstream	Gas transmission and distribution	Gas storage	Crude oil transportation	Crude oil and gas condensate refinery and petroleum products trading	Gas trading and supply	Other	Elimination	Total
Material non-cash items included in segment results:										
Depreciation, depletion and amortisation	(2,732)	(191)	(6,460)	(970)	(348)	(560)	(27)	(335)	-	(11,623)
Net movement in provision for trade and other receivables and prepayments made and other current assets	(17)	11	(4,208)	(54)	(93)	(19)	267	-	-	(4,113)
Net foreign exchange (loss)/gain	-	5	(172)	-	78	12	1,165	(1,100)	-	(12)
Capital expenditure	4,155	366	700	62	70	11	-	155	-	5,519
Segment assets	70,154	16,732	295,698	165,838	17,827	15,544	72,233	9,474	-	663,500
Investments in associates and joint ventures										1,170
Cash and bank balances										23,571
Unallocated assets										15,531
Total assets										**703,772**

3. SEGMENT INFORMATION (Continued)

Segment information for the reportable business segments of the Group for the six months ended 30 June 2016 is as follows:

In millions of Ukrainian hryvnias	Gas upstream	Oil and gas condensate upstream	Gas transmission and distribution	Gas storage	Crude oil transportation	Crude oil and gas condensate refinery and petroleum products trading	Gas trading and supply	Other	Elimination	Total
Sales – external	1,557	5,011	34,749	60	1,623	5,664	37,251	631	-	86,546
Sales to other segments	17,152	-	659	408	11	18	6,641	-	(24,889)	-
Total revenue	**18,709**	**5,011**	**35,408**	**468**	**1,634**	**5,682**	**43,892**	**631**	**(24,889)**	**86,546**
Segment result	**4,609**	**856**	**11,691**	**(926)**	**546**	**1,056**	**7,137**	**(99)**	**(1,820)**	**23,050**
Share of after-tax results of associates and joint ventures										91
Unallocated income/ (expense), net										(1,162)
Profit before income tax										**21,979**

3. SEGMENT INFORMATION (Continued)

In millions of Ukrainian hryvnias	Gas upstream	Oil and gas condensate upstream	Gas transmission and distribution	Gas storage	Crude oil transportation	Crude oil and gas condensate refinery and petroleum products trading	Gas trading and supply	Other	Elimination	Total
Material non-cash items included in segment results:										
Depreciation, depletion and amortisation	(2,793)	(211)	(7,057)	(915)	(354)	(312)	-	(23)	-	(11,665)
Net movement in provision for trade and other receivables and prepayments made and other current assets	(62)	-	(187)	-	-	(25)	(71)	-	-	(345)
Net foreign exchange (loss)/gain	(81)	-	153	-	123	-	(2,726)	115	-	(2,416)
Capital expenditure	2,201	250	477	10	169	27	-	137	-	3,271
Segment assets	76,108	17,039	284,631	169,939	20,324	8,464	23,217	20,243	-	619,965
Investments in associates and joint ventures										1,457
Cash and bank balances										26,385
Unallocated assets										3,307
Total assets										**651,114**

3. SEGMENT INFORMATION (Continued)

External customers concentration, exceeding 10% of total revenues

During the six months ended 30 June 2017 and 2016, the only external customer with concentration of revenue exceeding 10% of total revenues was Gazprom. Amount of revenue from Gazprom related to gas transmission during the six months ended 30 June 2017 amounted to UAH 35,737 million (2016: UAH 27,574 million).

Revenues, gross profit and receivables of the segment "Gas transmission and distribution" by main types of transportation services are as follows:

30 June 2017

In millions of Ukrainian hryvnias	Revenue	Gross profit	Trade accounts receivable gross amount	Trade accounts receivable provision for impairment	Trade accounts receivable carrying amount
International transit	35,739	17,375	5,827	-	5,827
Domestic transmission and distribution	4,816	1,506	3,050	(1,125)	1,925
Gas balancing operations	10,067	1,770	15,087	(6,536)	8,551
Total	**50,622**	**20,651**	**23,964**	**(7,661)**	**16,303**

30 June 2016

In millions of Ukrainian hryvnias	Revenue	Gross profit	Trade accounts receivable gross amount	Trade accounts receivable provision for impairment	Trade accounts receivable carrying amount
International transit	27,710	13,153	4,412	-	4,412
Domestic transmission and distribution	4,662	43	1,429	(914)	515
Gas balancing operations	2,377	(18)	2,860	(925)	1,935
Total	**34,749**	**13,178**	**8,701**	**(1,839)**	**6,862**

3. SEGMENT INFORMATION (Continued)

Revenues, gross (loss)/profit, (loss)/profit before income tax and accounts receivable of gas trading and supply segment by main groups of customers are as follows:

30 June 2017

In millions of Ukrainian hryvnias	Revenue	Gross (loss)/ profit	(Loss) / profit before income tax	Trade accounts receivable: gross amount	Trade accounts receivable: provision for impairment	Trade accounts receivable: carrying amount
District heating companies for the needs of households	12,984	(3,764)	(4,274)	11,611	(2,943)	8,668
Regional gas distribution companies for resale to households	34,360	(72)	(1,922)	29,279	(182)	29,097
District heating companies for the needs of budget entities	2,447	(576)	(700)	125	-	125
Odessa Port Plant				1,375	(1,375)	-
Total public service obligations performance (Note 2)	*49,791*	*(4,411)*	*(6,896)*	*42,390*	*(4,500)*	*37,890*
District heating companies for the needs of other customers	-	-	-	7,929	(6,607)	1,322
Regional gas distribution companies for resale to other customers	172	65	5	213	(207)	6
Industrial and other customers	2,422	346	302	10,427	(10,016)	411
Total performance of gas trading at non-regulated prices for the needs of other customers	*2,594*	*411*	*307*	*18,569*	*(16,830)*	*1,739*
Effect of elimination of intersegment transactions		*2,818*	*2,818*			
Total for gas trading and supply segment	**52,385**	**(1,182)**	**(3,771)**	**60,959**	**(21,330)**	**39,629**

Effect of elimination of intersegment transactions include results from natural gas sales to other segments.

3. SEGMENT INFORMATION (Continued)

30 June 2016

In millions of Ukrainian hryvnias	Revenue	Gross profit	(Loss) / profit before income tax	Trade accounts receivable gross amount	Trade accounts receivable provision for impairment	Trade accounts receivable carrying amount
District heating companies for the needs of households	6,234	634	(1,359)	5,596	(2,736)	2,860
Regional gas distribution companies for resale to households	24,198	12,249	8,693	13,103	(100)	13,003
Total public service obligations performance (Note 2)	*30,432*	*12,883*	*7,332*	*18,699*	*(2,836)*	*15,863*
District heating companies for the needs of other customers	4,233	288	(217)	7,840	(5,919)	1,921
Regional gas distribution companies for resale to other customers	392	44	(9)	314	(172)	142
Industrial and other customers	2,194	128	(716)	10,695	(7,955)	2,740
Total performance of gas trading at non-regulated prices for the needs of other customers	*6,819*	*460*	*(942)*	*18,849*	*(14,046)*	*4,803*
Effect of elimination of intersegment transactions		*747*	*747*			
Total for gas trading and supply segment	**37,251**	**14,090**	**7,137**	**37,548**	**(16,882)**	**20,666**

Effect of elimination of intersegment transactions include results from natural gas sales to other segments.

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

4. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

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

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

Transactions with state-controlled entities. The Group performs significant transactions with entities controlled, jointly controlled or significantly influenced by the Government of Ukraine. These entities include State Savings Bank of Ukraine, Ukreximbank, Ukrgazbank, district heating companies, regional gas distribution entities and other entities.

For the six months ended 30 June 2017, about 26% of Group's revenue (2016: 21%) were earned from transactions with the entities controlled, jointly controlled or influenced by the Government of Ukraine. Outstanding trade accounts receivable related to these transactions as at 30 June 2017 and 31 December 2016 are about 48% and 44%, respectively, of total trade accounts receivable balance.

Outstanding accounts payable, advances and other current liabilities as at 30 June 2017 and 31 December 2016 are about 38% and 60%, respectively, of total balance of these liabilities.

Provisions in respect of the entities controlled by the Government of Ukraine as at 30 June 2017 and 31 December 2016 are about 71% and 80%, respectively, of total provisions.

As at 30 June 2017 and 31 December 2016, about 95% of cash and bank balances were placed in banks controlled, jointly controlled or influenced by the Government of Ukraine and about 57% and 54%, respectively, of borrowings were provided by these banks. About 59% of finance income in six months of year 2017 relate to balances in these banks (2016: 8%) and about 68% of finance costs for the six months ended 30 June 2017 (2016: 66%) relate to borrowings from these banks.

During 2016 the Group has prolonged maturity of its bonds amounting to UAH 4,800 million for one year without changes in interest rate.

Pledges. As at 30 June 2017 and 31 December 2016, borrowings from related parties (state-owned banks) were secured by property, plant and equipment, inventories and proceeds from future sales.

Guarantees. Amount of guarantees, provided by the Government of Ukraine, as at 30 June 2017 and 31 December 2016 equalled to UAH 32,623 million and UAH 28,912 million, respectively (Note 11).

Transactions with the State are further disclosed in Note 10.

5. OTHER NON-CURRENT ASSETS

The Group's other non-current assets were as follows:

In millions of Ukrainian hryvnias	**30 June 2017**	**31 December 2016**
Accounts receivable on product sharing agreement	4,049	4,204
Restructured accounts receivable of gas consumers	1,218	1,340
Intangible assets	1,028	977
Other	2,778	2,805
Total	**9,073**	**9,326**

As at 30 June 2017 and 31 December 2016, included in other non-current assets are research and development expenditures amounting to UAH 1,493 million and UAH 1,443 million, respectively, that were incurred within the concession agreement for oil exploration and development with the EGPC on 13 December 2006, but not yet claimed for recovery (Note 21).

6. INVENTORIES

The Group's inventories were as follows:

In millions of Ukrainian hryvnias	**30 June 2017**	**31 December 2016**
Natural gas	34,798	38,792
Spare parts	2,976	2,843
Crude oil and petroleum products	2,666	3,378
Technological oil	1,976	1,976
Raw materials	1,974	1,760
Other	1,746	1,495
Total	**46,136**	**50,244**

Management estimates the necessity of write-down of inventories to their net realisable value taking into consideration indicators of economical and physical obsolescence. During the six months ended 30 June 2017 write-down adjustment amounted to UAH 282 million was included in cost of sales and UAH 9 million was included in other operating expense (2016: UAH 4,538 million included in cost of sales and UAH 87 million included in other operating expense).

As at 30 June 2017 and 31 December 2016, inventories with carrying amount of UAH 15,940 million and UAH 37,698 million, respectively, were pledged as collateral for borrowings (Note 11).

7. TRADE ACCOUNTS RECEIVABLE

The Group's trade accounts receivable were as follows:

In millions of Ukrainian hryvnias	**30 June 2017**	**31 December 2016**
Trade accounts receivable	99,252	86,438
Less: provision for impairment	(39,926)	(37,229)
Total	**59,326**	**49,209**

Out of total carrying amount of trade accounts receivable as at 30 June 2017 there are UAH 39,629 million of accounts receivable for gas supply (31 December 2016: UAH 35,652 million) (Note 3).

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

In millions of Ukrainian hryvnias	**Six months ended 30 June 2017**	**Six months ended 30 June 2016**
Balance at 1 January	**37,229**	**20,553**
Recognised provision for impairment	3,845	2,341
Reversal of provision for impairment	(1,135)	(1,044)
Amounts written off as uncollectible	(13)	(1)
Balance at 30 June	**39,926**	**21,849**

8. PREPAYMENTS MADE AND OTHER CURRENT ASSETS

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

In millions of Ukrainian hryvnias	**30 June 2017**	**31 December 2016**
Prepayments to suppliers for materials, works and services	9,977	9,984
Taxes prepaid, other than income tax	3,783	84
VAT recoverable	2,689	2,242
Receivables under assignation agreements in respect of natural gas sales	1,661	1,690
Promissory notes receivable	1,471	1,471
Prepayments for pipelines construction	1,310	1,412
Prepayments to suppliers for natural gas	882	5,731
Amounts receivable under legal claims	633	609
Other	4,794	3,997
Less: Provision for impairment	(15,097)	(15,169)
Total	**12,103**	**12,051**

As at 30 June 2017, included in taxes prepaid, other than income tax are prepayments for subsoil royalty amounting to UAH 1,828 million (31 December 2016: UAH 15 million).

8. PREPAYMENTS MADE AND OTHER CURRENT ASSETS (Continued)

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

In millions of Ukrainian hryvnias	Six months ended 30 June 2017	Six months ended 30 June 2016
Balance at 1 January	**15,169**	**11,514**
Recognised provision for impairment	22	160
Reversal of provision for impairment	(43)	(318)
Amounts written off as uncollectible	(51)	(20)
Balance at 30 June	**15,097**	**11,336**

9. CASH AND BANK BALANCES

The Group's cash and bank balances were as follows:

In millions of Ukrainian hryvnias	30 June 2017	31 December 2016
Cash in banks	21,125	20,024
Term deposits	2,268	2,163
Other	178	149
Total	**23,571**	**22,336**

As at 30 June 2016 and 31 December 2016, included in term deposits are bank deposits amounting to UAH 483 million with original maturity of more than three months and less than one year, which are excluded from cash and cash equivalents for the purpose of cash flow statement.

10. SHARE CAPITAL

As at 30 June 2017 and 31 December 2016, the registered, issued and fully paid share capital of the Company was UAH 194,307 million and UAH 164,607 million, respectively, comprising 190,150,481 and 160,450,481 ordinary shares, respectively, with a par value of UAH 1,000 per share.

As at 30 June 2017 and 31 December 2016, share capital of the Company has been adjusted for the effect of hyperinflation in accordance with IAS 29 "Financial Reporting in Hyperinflationary Economies" by UAH 4,156 million.

Unregistered contributed capital

In April 2017 the Securities and Stock Market State Commission registered the report of share placement of the Company and registered a certificate of new share issue of the Company. As a result, registered share capital was increased to UAH 190,151 million (net of effect of hyperinflation).

Distribution of profits

According to the Resolution of the Cabinet of Ministers of Ukraine #282-p dated 26 April 2017, portion of net profit of the Company amounting to UAH 13,264 million was paid to the State Budget of Ukraine in June 2017.

11. BORROWINGS

The Group's borrowings were as follows:

In millions of Ukrainian hryvnias	30 June 2017	31 December 2016
Non-current		
Bank borrowings	14,105	23,275
Unamortised discount	(179)	(175)
Total non-current portion	*13,926*	*23,100*
Current		
Bank borrowings	53,115	47,099
Interest accrued	544	645
Total current portion	*53,659*	*47,744*
Total	**67,585**	**70,844**

The weighted average effective interest rates by currency denomination of borrowings were as follows:

In millions of Ukrainian hryvnias	30 June 2017		31 December 2016	
	Balance	**% per annum**	**Balance**	**% per annum**
UAH	29,388	19%	27,315	19%
US Dollars	25,574	9%	43,316	8%
EUR	12,623	1%	213	7%
Total	**67,585**		**70,844**	

Pledges

All the Group's borrowings were secured as at 30 June 2017 and 31 December 2016.

The Group's borrowings were secured by the following pledges:

	30 June 2017	31 December 2016
Proceeds from future sales	110,382	143,965
Property, plant and equipment	35,946	10,536
Inventories (Note 6)	15,940	37,698
Total	**152,200**	**192,199**

Guarantees. As at 30 June 2017, the Group's borrowings were guaranteed by the State in the amount of UAH 32,623 million (31 December 2016: UAH 28,912 million).

12. PROVISIONS

Movements in provisions for the six months ended 30 June 2017 were as follows:

In millions of Ukrainian hryvnias	Provisions for litigations	Employee benefit obligations	Decommissio-ning provision	Provision for fines and penalties	Portion of net profit attributable to the State Budget of Ukraine (Note 10)	Other provisions	Total
Balance at 31 December 2016	**11,844**	**4,510**	**1,771**	**11,154**	**13,264**	**989**	**43,532**
Non-current	*7,670*	*3,447*	*1,299*	-	-	-	*12,416*
Current	*4,174*	*1,063*	*472*	*11,154*	*13,264*	*989*	*31,116*
Charge for the reporting period	12	704	7	1,743	-	96	2,562
Unwinding of discount (Note 16)	-	161	73	-	-	-	234
Used or paid during the reporting period	(58)	(789)	-	(16)	(13,264)	(1)	(14,128)
Foreign exchange rate changes	(23)	-	-	-	-	-	(23)
Other movements	-	-	-	22	-	-	22
Balance at 30 June 2017	**11,775**	**4,586**	**1,851**	**12,903**	**-**	**1,084**	**32,199**
Non-current	*7,670*	*3,588*	*1,362*	-	-	-	*12,620*
Current	*4,105*	*998*	*489*	*12,903*	-	*1,084*	*19,579*

Other movements in provision for fines and penalties relate to difference in proportion of assets and profits consolidation related to joint ventures of one of the Group's subsidiaries, recognised in equity movement.

12. PROVISIONS (Continued)

Movements in provisions for the six months ended 30 June 2016 were as follows:

In millions of Ukrainian hryvnias	Provisions for litigations	Employee benefit obligations	Decommissioning provision	Provision for fines and penalties	Other provisions	Total
Balance at 31 December 2015	**5,180**	**3,616**	**1,423**	**7,078**	**973**	**18,270**
Non-current	*3,042*	*3,034*	*1,311*	-	-	*7,387*
Current	*2,138*	*582*	*112*	*7,078*	*973*	*10,883*
Charge for the reporting period	130	723	227	1,214	72	2,366
Unwinding of discount (Note 16)	-	156	57	-	-	213
Used or paid during the reporting period	-	(265)	(39)	-	(29)	(333)
Balance at 30 June 2016	**5,310**	**4,230**	**1,668**	**8,292**	**1,016**	**20,516**
Non-current	*3,080*	*3,346*	*1,439*	-	-	*7,865*
Current	*2,230*	*884*	*229*	*8,292*	*1,016*	*12,651*

13. ADVANCES RECEIVED AND OTHER CURRENT LIABILITIES

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

In millions of Ukrainian hryvnias	30 June 2017	31 December 2016
Advances from customers for natural gas	1,290	1,130
Advances for natural gas transportation	340	316
Advances for oil transportation	286	303
Advances received for geophysical surveys	238	240
Advances for petroleum products	230	205
Other advances received	134	132
Total advances received	*2,518*	*2,326*
Taxes payable other than income tax	10,663	13,768
VAT payable	2,428	6,195
Liabilities for purchase of property, plant and equipment	1,166	1,050
Dividends payable to non-controlling shareholders of "Ukrnafta" PJSC	476	2,781
Recognised liabilities for litigations	454	482
Wages, salaries and related social charges payable	451	343
Other current liabilities	1,489	1,383
Total other current liabilities	*17,127*	*26,002*
Total	**19,645**	**28,328**

As at 30 June 2017, taxes payable other than income tax include UAH 10,465 million of subsoil royalty payable (31 December 2016: UAH 13,450 million). Subsoil royalty is calculated with reference to the volume of crude oil, gas condensate or natural gas produced, and volume of crude oil transportation.

14. COST OF SALES

In millions of Ukrainian hryvnias	Six months ended 30 June 2017	Six months ended 30 June 2016
Cost of gas supplied	36,722	14,136
Subsoil royalty and other taxes other than on income	13,753	13,846
Depreciation, depletion and amortisation	11,291	11,417
Non-reimbursable VAT on gas transit	7,148	5,515
Cost of purchased oil and petroleum products	4,090	1,315
Staff costs and related social charges	3,275	2,067
Repair and maintenance costs	292	507
Oil and gas transportation costs	197	378
Other	4,558	4,352
Total	**81,326**	**53,533**

15. OTHER OPERATING EXPENSES

In millions of Ukrainian hryvnias	Six months ended 30 June 2017	Six months ended 30 June 2016
Net movement in provision for trade accounts receivable, prepayments made and other assets and direct write-offs	2,768	1,136
Staff costs and related social charges	2,302	1,459
Change in provisions for litigations and other provisions (Note 12)	1,851	1,643
Fines and penalties	1,036	298
Professional fees	474	242
Depreciation and amortisation	332	492
Research, development and exploration costs	152	124
Transportation costs	135	119
VAT liabilities written off	54	100
Impairment of property, plant and equipment	41	-
Other	1,290	972
Total	**10,435**	**6,585**

16. FINANCE COSTS

In millions of Ukrainian hryvnias	Six months ended 30 June 2017	Six months ended 30 June 2016
Interest expense on bank borrowings	3,676	4,483
Unwinding of discount on employee benefit obligations	161	156
Unwinding of discount of decommissioning provision	72	57
Other	152	69
Total	**4,061**	**4,765**

17. CONTINGENCIES, COMMITMENTS AND OPERATING RISKS

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

Management believes that the Group has been in compliance with all requirements of the effective tax legislation. In the ordinary course of business the Group is engaged in transactions that may be interpreted differently by the Group and tax authorities. Where the risk of outflow of financial resources associated with this is deemed to be probable and the amount is measured with sufficient reliability, the Group provides for those liabilities. Where management of the Group estimates the risk of financial resources outflow as possible, the Group makes a disclosure of these contingent liabilities.

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

The Group exports refinery products and transportation services, performs intercompany transactions and is involved in transactions with related parties, which may potentially be in the scope of the new Ukrainian transfer pricing ("TP") regulations. The Group's companies have submitted the controlled transaction report for the year ended 31 December 2015 within the required deadline. The report on controlled transactions for the year ended 31 December 2016 shall be prepared by the Group's companies by 1 October 2017.

Management believes that the Group is in compliance with TP requirements. As the practice of implementation of the new transfer pricing rules has not yet developed and wording of some clauses of the rules may be subject to various interpretations, the impact of challenge of the Group's companies transfer pricing positions by the tax authorities cannot be reliably estimated.

Arbitral Tribunal requests. Naftogaz and Gazprom have initiated the Gas Sales Arbitration and the Gas Transit Arbitration ("the Arbitrations") under the auspices of the Arbitration Institute of the Stockholm Chamber of Commerce. The Gas Sales Arbitration was initiated by both Naftogaz and Gazprom on 16 June 2014. In its Request for Arbitration, Gazprom claimed payment of unpaid invoices in an amount of approximately USD 4.5 billion for gas delivered under the Gas Sales Contract from November 2013 to May 2014, while Naftogaz claimed a retroactive revision of the price under the Gas Sales Contract, resulting in a claim for payment by Gazprom to Naftogaz of more than USD 12.0 billion as compensation for previous overpayments. Gazprom has subsequently updated its payment claims, which as at 30 May 2017 stood at approximately USD 3.0 billion including interest (USD 2.2 billion excluding interest).

17. CONTINGENCIES, COMMITMENTS AND OPERATING RISKS (Continued)

In addition, Gazprom has later added a claim for payment of gas which Gazprom did not deliver, but which Naftogaz allegedly nevertheless was obliged to pay for under the Contract (the "take or pay" claim), which as at 30 May 2017 stood at approximately USD 44.1 billion including interest (up to USD 34.5 billion excluding interest). Naftogaz has subsequently updated its claim for overpayments to approximately USD 18.0 billion including interest (approximately USD 14.1 billion excluding interest) as at 30 May 2017.

On 31 May 2017 The Arbitral Tribunal rendered a separate award in the Gas Sales Arbitration. The separate award sets all legal and factual issues required to resolve the parties' claims except for certain elements and/or values of a numeric or quantifiable nature, and is final and legally binding. All remaining issues and any resulting monetary claims will be left for the final award to be rendered at a later stage.

The Tribunal has required the parties to determine gas price formula to be used for gas supplies starting from 27 April 2014 through negotiations. The Tribunal has also requested the assistance of the parties and their experts to provide the relevant input and calculations in this respect. In case of failure of agreement between the parties, the Tribunal will decide on such issues on its own. There are three main pillars in this award of 31 May, which are final and binding: (a) the award totally rejected Gazprom`s "take or pay" claim; (b) the award declared "take or pay" claim invalid from the date of the Contract; (c) the award decided that Naftogaz is entitled to a market-reflective reduction of the sales price and to gas market indexation of the price formula, with effect from April 2014.

Naftogaz initiated the Gas Transit Arbitration on 13 October 2014. In its Statement of Claim, Naftogaz claimed a revision of the transit tariff with retroactive effect, compensation for underdeliveries and other adjustments of the Gas Transit Contract. Naftogaz's monetary claim stands at approximately USD 12.2 billion including interest (up to USD 10.6 billion excluding interest). Gazprom has submitted a counterclaim in amount of approximately USD 7.0 million including interest (up to USD 5.3 million excluding interest), but has reserved the right to make additional counterclaims after receiving the award in the Gas Sales Arbitration.

Both the Gas Sales Arbitration and the Gas Transit Arbitration were initiated by Naftogaz following unsuccessful efforts to reach agreement with Gazprom in negotiations. The monetary claims in the Arbitrations are being updated on a continuous basis until the awards, inter alia in respect of interest calculations.

Naftogaz's main objectives in both Arbitrations are to (i) revise or interpret both contracts in line with European standards and requirements for gas sales and gas transit agreements; (ii) achieve competitive pricing for the gas purchased from Gazprom; and (iii) achieve a cost-reflective tariff for the transit of Russian gas through Ukraine. These objectives are in line with the stated purpose of both parties when the Contracts were negotiated and concluded in January 2009, namely in price revision and tariff revision clauses. At the same time, both Contracts contain clauses which deviate from European standards. Notably, the volume and "take or pay" provisions in the Gas Sales Contract are in breach of European and Ukrainian competition law, lack important standard features, and combine with an illegal destination clause to amount to an abuse of dominant position.

Gazprom has taken the same approach in both cases, which is essentially that the Contracts shall be "untouchable", and shall be enforced based on Gazprom's construction.

17. CONTINGENCIES, COMMITMENTS AND OPERATING RISKS (Continued)

The deadline for final award in the Gas Sales Arbitration and the Gas Transit Arbitration is currently 30 November 2017. This date may be subject to adjustment by the Arbitration Institute of the Stockholm Chamber of Commerce at the request of the Tribunal. The awards taken by the Tribunal are final and enforceable even if challenged, although enforceability in case of challenge depends on the legislation in the jurisdiction where enforcement is sought. The awards may be challenged on very limited grounds, essentially on the basis of grave procedural errors, or breach of public policy. The possibility of challenge proceedings can obviously not be properly assessed before the awards have been rendered.

Legal proceedings. From time to time and in the normal course of business, claims against the Group arise. Where the risk of outflow of financial resources associated with such claims is assumed as probable, a respective liability is recognised as a component of provision for litigations (Note 12). Where management estimates the risk of outflow of financial resources associated with such claims as possible, or amount of outflow cannot be measured reliably, no provision is recognised, and respective amount is disclosed in the consolidated financial statements. Management believes that it has provided for all material losses in these consolidated financial statements.

The Group and certain natural gas suppliers have disputes in respect of volumes and/or prices for natural gas supplied to the Group and other disputes. Management assesses its contingent liabilities under such disputes as at 30 June 2017 and as at 31 December 2016 at the level of UAH 4,678 million. Management cannot reliably estimate amount of potential losses on these obligations, if any.

Uncertainty as to the ability of "Ukrnafta" PJSC to continue as a going concern. Following recent decline in oil prices, accumulated debts to the State Budget since 2014 of UAH 26,092 million as at 30 June 2017 (31 December 2016: UAH 24,379 million), limited ability to collect accounts receivable and settle prepayments made to suppliers with gross amount of UAH 23,122 million as at 30 June 2017 (31 December 2016: UAH 22,680 million), Ukrnafta had insufficient funds to satisfy its working capital needs and settle its tax payments as they fall due. Consequently, as at 30 June 2017 and 31 December 2016 Ukrnafta had a negative working capital.

Despite the material uncertainties described above, and taking into account Ukrnafta's management actions in improving its liquidity, production and sales activities, management of the Group believes that application of the going concern assumption in respect of Ukrnafta is appropriate for the purpose of these condensed consolidated interim financial statements.

18. FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks: market risk (including currency risk and interest rate risk), concentration risk, credit risk and liquidity risk. These condensed consolidated interim financial statements do not include a complete set of financial risk management information and disclosures required in the annual financial statements and should be read in conjunction with the Group's annual consolidated financial statements as at 31 December 2016.

There have been no changes in the risk management function and risk management policies since 31 December 2016.

The Group reviews and agrees risk management policies to minimise the potential adverse effects on the Group's financial performance for those risks.

Major categories of financial instruments:

In millions of Ukrainian hryvnias	Note	30 June 2017	31 December 2016
Other non-current assets	5	5,560	5,832
Trade accounts receivable	7	59,327	49,209
Prepayments made and other current assets	8	4,770	4,150
Cash and bank balances	9	23,571	22,336
Restricted cash		674	680
Total financial assets		**93,902**	**82,207**

In millions of Ukrainian hryvnias	Note	30 June 2017	31 December 2016
Borrowings	11	(67,585)	(70,844)
Trade accounts payable		(16,789)	(16,234)
Advances received and other current liabilities	13	(3,051)	(2,777)
Other long-term liabilities		(1)	(4)
Total financial liabilities		**(87,426)**	**(89,859)**

Credit risk. The maximum exposure to credit risk as at 30 June 2017 is UAH 93,902 million (31 December 2016: UAH 82,207 million).

Liquidity risk. There were no significant changes in the contractual undiscounted cash outflows for financial liabilities.

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

In millions of Ukrainian hryvnias	30 June 2017	31 December 2016
Total borrowings (Note 11)	67,585	70,844
Less: cash and cash equivalents (Note 9)	(23,571)	(21,853)
Total Net Debt	**44,014**	**48,991**
Total Equity	**481,712**	**460,272**
Gearing ratio	**0.09**	**0.11**

19. FAIR VALUE

There were no changes in valuation techniques during the period. There were no transfers between Level 2 and Level 3 during the period. During the six months ended 30 June 2017 there were no significant changes in the business and economic environment that affect the fair value of the Group's financial assets and liabilities.

20. SUBSEQUENT EVENTS

Legal claims. In July 2017 Kiev Regional Court decided claim against the Cabinet of Ministers of Ukraine in favour of the Group and admitted illegal an inactivity of the Cabinet of Ministers of Ukraine and ordered to define the procedure and sources of compensation of losses incurred because of fulfilment of public service obligations.

Loans repayment and refinancing. During July-August 2017 the Group repaid UAH 5,789 million of bank loans. Additionally, in August 2017 the Company agreed refinancing of loan agreement with one of the state-owned banks in amount of UAH 3,500 million through signing new nonrevolving credit line for UAH 3,500 million under lower interest rate UAH 17.5% (previously 19-20%). Subsequent to 30 June 2017, the Group obtained USD 178 million (equivalent to UAH 4,615 million) tranche from the European Bank for Reconstruction and Development for gas purchase at the western border of Ukraine.

21. BASIS OF PREPARATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These condensed consolidated interim financial statements for the six months ended 30 June 2017 have been prepared in accordance with IAS 34 *Interim Financial Reporting*. They do not include all disclosures and information required for complete set of the annual consolidated financial statements, and should be read in conjunction with the latest annual consolidated financial statements as at and for the year ended 31 December 2016, which have been prepared in accordance with IFRS.

The accounting policies applied during the six months ended 30 June 2017 are consistent with those described in the Group's consolidated financial statements referred above.

22. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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

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

Investment in "Ukrnafta" PJSC. The Group holds 50% + 1 share of voting rights in "Ukrnafta" PJSC. The rest is owned by limited number of investors. In March 2015, according to changes in the Law of Ukraine "On Joint-Stock Companies", quorum of the General meetings of shareholders was lowered from 60%+1 share down to 50%+1 share. Following those changes and changes in the Supervisory Board of "Ukrnafta" PJSC in July 2015, the Company has regained control over "Ukrnafta" PJSC starting from 22 July 2015. Accordingly, the investment in "Ukrnafta" PJSC is accounted for as investment in subsidiary starting from that date. The Company considers this change as a business combination and applied acquisition method of accounting, respectively.

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

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

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

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

22. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

Decommissioning costs. The decommissioning provision represents the present value of the decommissioning costs relating to oil and gas properties, which are expected to be incurred in the future (Note 12). These provisions were recognised, based on Group’s internal estimates.

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

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

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

The Group currently depreciates gas transit assets using a straight line method. After the award of the Arbitral Tribunal under the auspices of the Arbitration Institute of the Stockholm Chamber of Commerce (see Note 17) and assuming enforcement of the new tariffs, and that Gazprom would not book any transit capacities beyond 2019, the Group will revise its depreciation method or shorten useful lives of its transit assets. However, should the assumption of no transit flows from 1 January 2020 change, this may provide a basis for a reduction of the tariff due to an extension of the useful life of gas transit assets, and the straight line method could continue to apply.

Estimation of oil and gas reserves. Reserves are the quantities of oil and gas which are anticipated to be commercially recovered from known accumulations from a given date forward under defined conditions. Proved and probable reserves used in depletion rate calculation are determined using estimates of known oil and gas reservoirs, recovery factors, operating conditions, future oil and gas prices and government regulations. Latest assessment of gas reserves was performed as at 31 December 2014, and major part of oil reserves was estimated as at 30 June 2016. Reserves estimates involve some degree of uncertainty, and their estimates are revised as additional geologic and engineering data becomes available or as economic conditions change. Accordingly, depletion rates and discounted cash flows for revaluation and impairment of property, plant and equipment may be also revised.

Revaluation and impairment of property, plant and equipment. Management performs assessment whether carrying amounts of property, plant and equipment accounted under the revaluation model, differ materially from their fair values. Such assessment is performed on an annual basis, and was performed as at 31 December 2016.

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

22. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

The Group reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period. The review is based on the current condition of the assets and the estimated period during which they will continue to bring economic benefit to the Group. Any change in estimated useful life or residual value is recorded on a prospective basis from the date of the change.

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

Inventory valuation. Inventory are stated at lower of cost or net realisable value. In assessing the net realisable value of its inventories, management bases its estimates on various assumptions including current market prices. At each reporting date, the Group evaluates its inventories for excess quantities and obsolescence and, if necessary, records an allowance to reduce inventories for obsolete and slow-moving goods. This allowance requires assumptions related to future inventories use. These assumptions are based on inventories ageing and forecasted demand. Any changes in the estimates may impact the amount of the allowances for inventory that may be required.