

Taking into account the Internal Audit Department's recommendations, management developed and is implementing a range of measures to improve the effectiveness of the internal control system for business processes and is making amendments to the regulatory and methodological framework.

In addition to audit activities, the Department is developing consulting services that aim to improve the Company's business.

One of the main focuses of the Internal Audit Department's risk management activities in 2016 was methodological support provided to the Company, its subsidiaries and major projects using risk identification and assessment procedures in the form of risk sessions (cross-functional meetings with managers and employees) held in accordance with an approved plan.

As part of efforts to develop the integrated risk management system, Department employees conducted training measures for risk coordinators at subsidiaries and continued work to implement initiatives to integrate the risk management system and business planning processes, manage major investment projects and conduct internal audits (systematisation of information about risks that have been analysed or identified during audits).

EXTERNAL AUDITOR

Each year the Company hires a professional auditing firm that is not associated with the Company through property interests or its shareholders from among the top international auditing companies to audit and confirm the accuracy of its annual financial statements.

The auditor is selected through a tender based on an assessment of the following criteria:

- > The participant's qualification and experience based on the subject for which it is being selected, including experiencing with auditing oil and gas industry companies.
- > Ensuring the protection of the data and requirements of credit agreements (including ratings agencies):
 - Ensuring the protection of the client's information (existence of a Federal Security Service licence)

The Company's auditor is approved by the General Meeting of Shareholders based on a proposal from the Board of Directors. A preliminary assessment of auditor candidates is conducted by the Audit Committee.

- Written endorsement from credit agents on the current credit agreements of Gazprom Neft PJSC confirming that the audit company is an internationally recognised auditor;
- The IFRS statement audited by the audit company was fully used in the prospectus for issuing debt instruments when obtaining a rating from international ratings agencies (Moody's, Fitch, S&P)
- > Financial parameters: cost of services, payment terms.
- > Independence: the auditor's independence is not jeopardised unless revenue per one client exceeds 15% of the auditor's total revenue (according to the requirement of the Russian Ministry of Finance – clause 2.112 'Rules for the independence of auditors and audit organisations' and international requirements – clause 290.219 from the IESBA Code of Ethics).

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In order to assess the quality of work performed by the external auditor, the Audit Committee reviews reports by the external auditor and statements from management and also conducts in-person meetings with representatives of the auditors. The Audit Committee conducted three meetings throughout 2016 with the Company's auditor and considered the following issues:

- > An assessment of the audit report based on the Gazprom Neft PJSC accounting statement for 2015 prepared by PricewaterhouseCoopers Audit JSC.
- > The consideration of the performance results of the external auditor of Gazprom Neft PJSC for 2015.
- > The consideration of the IFRS consolidated statement of Gazprom Neft PJSC for 2015.
- > The candidacy of the external auditor of Gazprom Neft PJSC for 2016.
- > The approaches to the external audit and the plan and procedures for the external audit of Gazprom Neft PJSC for 2016.
- > The determination of the remuneration amount for the auditor's services for 2016.
- > The new form of the audit report for 2016. Key audit issues that will be included in the audit report.
- > The policy for the external auditor's provision of non-audit services to Gazprom Neft PJSC.

PricewaterhouseCoopers Audit JSC (PwC) was re-elected as the Company's auditor at the General Meeting of Shareholders in June 2016.

The Board of Directors set payment for the audit services of the Gazprom Neft PJSC financial (accounting) statements for 2016 at RUB 39,060,000 (excluding VAT), including:

- > RUB 6.06 million – audit services for Gazprom Neft statements according to Russian Accounting Standards (RAS);
- > RUB 33 million – audit services for the consolidated statements according to International Financial Reporting Standards (IFRS), including services involving the audit of interim statements.

The external audit policy of Gazprom Neft PJSC contains a requirement on the management of conflicts of interest (threats of 'self-assessment') regarding an external auditor's non audit-related services. The risk of 'self-assessment' is understood as a situation where the same contractor provides a service (for example, accounting), and then conducts an external audit expressing an opinion on the reliability of the financial statements. Such risks are assessed at Gazprom Neft PJSC and precautionary measures are taken to reduce such risks to an acceptable level. If the risk of self-assessment cannot be reduced, the Company selects another candidate to provide services.

PricewaterhouseCoopers Audit JSC, the company that audits the financial statements of Gazprom Neft PJSC in accordance with international and Russian financial reporting standards, only provides the Company with audit services. PricewaterhouseCoopers Consulting LLC provides the Gazprom Neft Group with consulting services unrelated to accounting and the preparation of the financial statement. In this case, the principles of the auditor's independence are observed: consulting services are provided by an organisation that is not an auditor of Gazprom Neft PJSC; the employees providing audit services are not involved in providing consulting services; and revenue per one client does not exceed the permissible values.

MANAGEMENT OF POTENTIAL CONFLICT OF INTERESTS

The Company strives to maintain a balance of interests between shareholders and management with their cooperation characterised by a high level of trust, strong culture of business relations and ethical standards. The Company's main shareholder has a sufficient number of votes to pass decisions on a significant number of issues that fall within the purview of the General Meeting of Shareholders and also to form the Board of Directors. Despite this, the Company seeks to utilise tools that feature a high concentration of equity to mitigate risks related to the specific nature of management.

The Company has a transparent ownership structure, the rights and duties of shareholders as well as the procedure for administering property rights are clearly defined in the Company's Charter and internal documents, and information about this is publicly available. The Company adheres to the principle of equal shareholder voting rights and has also established mechanisms to protect voting rights in its internal documents.

The main elements for preventing conflicts at the shareholder level are:

- > Compliance with the order and procedure for making decisions on the most significant issues.
- > Compliance with the voting procedure for related party transactions:
- > Hiring reputable and independent appraisers to value the assets in related party transactions.
- > Ensuring maximum transparency and information openness when preparing for and holding meetings of shareholders as well as the prompt disclosure of information about decisions adopted by the Board of Directors.
- > Disclosing information about related party transactions. According to the Company's financial statement for 2016, related party transactions were concluded as part of regular business activities and had a clear economic rationale. The most common types of transactions are those involving the sale and purchase of oil, gas and petroleum products.
- > Hiring companies from the Big Four auditing firms as external auditors.
- > Establishing mechanisms to protect against the dilution of the Company's value. The procedure for organising and selecting counterparties for the procurement of goods, work and services was carried out in accordance with the approved Company standards, which stipulate that open forms of competitive selection procedures for counterparties are preferable.

Gazprom Neft has approved internal documents (the Corporate Conduct Code and Code of Corporate Governance) which enshrine the values and principles that serve as the basis for the establishment and development of the Company's corporate culture.

The Corporate Conduct Code regulates situations that could involve a conflict of interests, the acceptance of gifts, the use of the Company's assets or resources, stakeholder engagement, social responsibility, the handling of confidential information, the activities of the Corporate Culture and Ethics Working Committee and the operation of the fraud and corruption prevention hotline, among other situations.