

PETROBRAS - PETROLEO BRASILEIRO SA
Form 6-K
March 22, 2017

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of the

Securities Exchange Act of 1934

For the month of March, 2017

Commission File Number 1-15106

PETRÓLEO BRASILEIRO S.A. - PETROBRAS

(Exact name of registrant as specified in its charter)

Brazilian Petroleum Corporation - PETROBRAS

(Translation of Registrant's name into English)

Avenida República do Chile, 65

20031-912 - Rio de Janeiro, RJ

Federative Republic of Brazil

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F Form 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No

FINANCIAL
STATEMENTS

December 31, 2016 and 2015 with
auditor's report

(A free translation of the original in
Portuguese)



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(Expressed in millions of reais, unless otherwise indicated)

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(A free translation of the original in Portuguese)

Independent auditor's report on the financial statements

To the Board of Directors and Stockholders

Petróleo Brasileiro S.A. - Petrobras

Opinion

We have audited the accompanying parent company financial statements of Petróleo Brasileiro S.A. - Petrobras (the "Company"), which comprise the balance sheet as at December 31, 2016 and the statements of income, comprehensive income, changes in equity and cash flows for the year then ended, as well as the accompanying consolidated financial statements of Petróleo Brasileiro S.A. - Petrobras and its subsidiaries ("Consolidated"), which comprise the consolidated balance sheet as at December 31, 2016 and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Petróleo Brasileiro S.A. - Petrobras and of Petróleo Brasileiro S.A. - Petrobras and its subsidiaries as at December 31, 2016, and the financial performance and cash flows for the year then ended, as well as the consolidated financial performance and the cash flows for the year then ended, in accordance with accounting practices adopted in Brazil and with the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

Basis for opinion

We conducted our audit in accordance with Brazilian and International Standards on Auditing. Our responsibilities under those standards are further described in the "Auditor's responsibilities for the audit of the financial statements" section of our report. We are independent of the Company and its subsidiaries in accordance with the ethical requirements established in the Code of Professional Ethics and Professional Standards issued by the Brazilian Federal Accounting Council, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Key Audit Matters

Key Audit Matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Why it is a Key Audit Matter

How the matter was addressed in the audit

1 - "Car Wash Operation" and its effects on the Company (Note 3)

In 2009, the Brazilian Federal Police initiated an investigation called "Car Wash Operation", aiming to investigate money laundering practices by criminal organizations in several Brazilian states. As from 2014, the Federal Public Prosecution Office focused some of its investigations on irregularities committed by Petrobras suppliers and discovered an extensive scheme of undue payments, involving several participants, including former employees of Petrobras. This scheme consisted of a group of companies that, between 2004 and April 2012, were organized in cartel to obtain contracts with Petrobras and impose additional expenditures linked to these contracts, using these amounts to make undue payments.

The amounts paid by the Company under the contracts with the suppliers involved in the scheme were included in the historical costs of the respective property, plant and equipment items. The Company's management understood that the undue payments represent additional expenditures and, consequently, recorded a write-off of R\$ 6,194 million (R\$ 4,788 million in the Parent Company) in prior years.

The "Car Wash Operation" and its effects on the Company were considered as one of the key audit matters due to: (i) the potential effects and inherent limitations that are particularly significant in cases like this; (ii) necessity of monitoring the information related to the investigations in progress conducted by the authorities to confirm the reasonableness of the effects already consigned in the financial statements; and (iii) the need to improve the governance structure and internal controls related to the processes for contracting suppliers of goods and services, which constituted a significant deficiency identified by the Company in its internal control environment in 2015.

Significant aspects of our audit response involved, among others, those described below.

We have enhanced our understanding of the governance structure and how the parties responsible for management perform the general oversight to identify and respond to risks related to the process of contracting suppliers of goods and services, considering the changes introduced by management in its processes and controls in order to address the identified fraud.

We also obtained an understanding of the new internal policies introduced and tested the significant internal controls implemented and transactions related to the process for contracting suppliers of goods and services and corresponding payments. Our objective was to identify and test the transactions selected and the corresponding payments made during the year and evaluate the compliance with the internal policies and applicable laws and regulations. In addition, we analyzed Petrobras Program for Prevention of Corruption ("PPPC"), tested the key controls related to the complaints channel established within the Ombudsman structure, evaluating the integrity of the information, handling of complaints and reporting of the results to the applicable governance bodies.

We followed up the Company's main investigative actions conducted by the Internal Assessment Commissions and independent law firms, which are led by a Special Committee composed of two independent members and the Governance, Risk and Compliance Officer. We discussed the investigations with the Audit Committee, the Board of Directors and the Company's legal advisors and evaluated whether the disclosures in the notes are consistent with the results of those investigations.

According to the Management Report, that significant deficiency was considered as remedied for the year ended December 31, 2016. We consider that the disclosures in the explanatory notes are consistent with the information and representation obtained.

2 - Class action and related proceedings (Note 30.4)

4

Why it is a Key Audit Matter

How the matter was addressed in the audit

During 2015, a class action was filed against the Company before the Federal Court for the Southern District of New York, alleging that the Company, through material facts, communications and other information filed at the U.S. Securities and Exchange Commission (SEC), would allegedly have reported materially false information and made omissions capable of artificially raising the price of the Company's securities and misleading investors.

Significant aspects of our audit response involved the following main procedures:

- understanding of the procedural stage of the class action and individual actions;

In June 2016, the Federal Court of Appeals accepted the Company's request to appeal against the decision on the "class" certification. As a result, the request was accepted by the Federal Court of Appeals and the proceeding is currently suspended up to the judgment of the appeal.

- interviews with the Company's external legal advisors in order to understand the impossibility of producing a reliable estimate of the loss arising from the class action and individual actions not yet provided for;

In addition to the class action, thirty actions (three of them suspended) were filed by individual investors before the same Federal Court for the Southern District of New York with similar claims as those filed in the class action. In addition, a similar action was filed by individual investors in the Eastern District of Pennsylvania.

- confirmation, in writing, of the Company's external legal advisors on: (i) the procedural stage of the class action and individual actions; and (ii) impossibility of producing a reliable estimate of the potential loss and classification of probability of loss between probable, possible and remote;

In 2016, the Company reached agreements to close some of these individual actions. The Company is also negotiating agreements with other authors of individual actions and, based on the agreements already entered into and on the stage of the negotiations in progress with other authors of individual actions, the Company recognized a provision of R\$ 1,215 million in the result for 2016.

- evaluation of the technical ability of the internal and external legal advisors used by the Company; and

- evaluation of the accounting policy adopted for the provision of individual actions and review of the assumptions on which the estimates of the provisioned amounts are based.

As described in Note 30.4, due to the uncertainties inherent to the proceeding, the Company's management is not capable of producing a reliable estimate of the potential loss arising from the class action and individual actions not yet provided for.

We consider that the criteria and assumptions adopted by the Management to determine the provision for the individual actions, as well as the disclosures in the notes in relation to the class action and individual actions are reasonable, in all material respects, within the context of the financial statements.

This matter has been considered one of the key audit matters due to the significant judgments and substantial uncertainties related to the class action and individual actions that affect the amount and timing estimated for a final decision for those actions.

3 - Impairment of property, plant and equipment (Notes 12 and 14)

At December 31, 2016, the assets classified in the property, plant and equipment group amounted to R\$ 571,876 million.

Potential impairment losses on property, plant and equipment are determined based on estimates of the value in use of these assets.

The calculation of value in use requires the exercise of significant judgments on certain assumptions, such as: (i) estimation of the volume of oil and natural gas reserves; (ii) estimation of future oil and natural gas prices; (iii) average foreign exchange rate (Brazilian reais/U.S. dollars); and iv) definition of the discount rate.

In addition, the definition of Cash-Generating Units (CGUs) also requires significant judgments by management, as well as the establishment of controls to review changes in these CGUs. Changes in the aggregation or breakdown of assets that comprise the CGUs may result in reversals or additional impairment losses.

This matter was considered as one of the key audit matters due to: (i) the significance of the Company's property, plant and equipment; (ii) the significant judgments and estimates involved in the calculation of the value in use of the assets; and (iii) the deficiencies in the controls for the review of changes in certain CGUs that constituted a significant deficiency identified by the Company in its internal control environment in 2015.

According to the Management Report, that significant deficiency was considered as remedied for the year ended December 31, 2016.

Significant aspects of our audit response involved, among others, the understanding of the controls related to the processes of impairment and tests of the effectiveness of the controls considered key in these processes. Regarding the testing of detail in operations or transactions, our approach considered the following main procedures:

(i) The evaluation of the definition of CGU by management, based on tests of changes of CGU, and review of the composition of CGU vis-à-vis the criteria established by Technical Pronouncement CPC 01 - Impairment of Assets.

(ii) Support from our team of asset valuation experts in implementing the following key audit procedures:

- comparison of key assumptions with the 2017-2021 Business and Management Plan and sensitivity analysis of these assumptions;

- evaluation of the reasonableness of the key assumptions, including comparisons with benchmarks, understanding of the main variations of the period and retrospective review of the projections;

- evaluation of the criteria used to determine the discount rate and inflation and foreign exchange rate projections;

- review of the internal estimates of oil and gas reserves compared to estimates prepared by independent experts; and

- assessment of the technical ability of the experts responsible for the independent estimate of proven oil and natural gas reserves.

We consider that the criteria and assumptions adopted by the Management to determine the impairment losses, as well as the disclosures in the notes, are reasonable, in all material respects, within the context of the financial statements.

Why it is a Key Audit Matter

How the matter was addressed in the audit

4 - Judicial Proceedings and Contingencies (Note 30)

At December 31, 2016, the Company had provisions of R\$ 11,052 million in connection with judicial provisions whose loss expectation was classified as probable. Additionally, the Company is a party to litigations whose losses are classified as possible, in the amount of R\$ 216,003 million.

Our audit approach considered the understanding of controls related to judicial proceedings and contingencies, and tests on the effectiveness of controls considered as key. Additionally, in our audit strategy, we involved our team of experts in the labor and tax areas, as appropriate, to read and discuss the judicial proceedings, including the classification of the prognosis of loss attributed by the Company's internal and external legal advisors.

Provisions and contingent liabilities have inherent uncertainties regarding their term and settlement value. Also, the recognition and measurement of contingent provisions and liabilities require the Company to exercise significant judgments to estimate the amounts of the obligations and the likelihood of outflow of resources of the judicial and administrative proceedings to which the Company is a party. This evaluation is based on the opinions of internal and external legal advisors and on management's own judgments.

Other significant aspects of our audit approach included evaluating the technical ability of the Company's legal counsel, testing the recalculation of the amount of exposure of judicial and administrative proceedings, testing for financial update in accordance with applicable legislation, obtaining confirmations from external legal advisors and testing of unrecognized contingent liabilities, based on searches on the websites of the relevant courts of law.

This matter was considered as one of the key audit matters due to (i) the significance of the amounts of the litigations provided for (contingent liabilities disclosed) in a Note; (ii) the significant judgments on different doctrinal and jurisprudential interpretations used to estimate the amounts and likelihood of outflow of resources arising from these proceedings; and (iii) deficiencies in the controls on completeness and the evaluation of the probability of loss of contingencies, which constituted a significant deficiency identified by the Company in its internal control environment in 2015.

We consider that the criteria and assumptions adopted by the Management to determine the provision for lawsuits and contingencies, as well as the disclosures on contingent liabilities, are reasonable, in all material respects, within the context of the financial statements.

According to the Management Report, that significant deficiency was maintained for the year ended December 31, 2016.

Why it is a Key Audit Matter

How the matter was addressed in the audit

5 - Benefits granted to employees (Note 22)

At December 31, 2016, the amounts provided for in the balance sheet totaled R\$ 72,668 million.

The amount of the actuarial liability is determined through actuarial calculations prepared by an independent actuary hired by the Company's management, net of guaranteeing assets. The calculation is made based on actuarial assumptions and information recorded of participants of the pension plans and health care.

This matter was considered as one of the key audit matters due to (i) the significance of the balance provided for in the balance sheet referring to benefits granted to employees; (ii) significant judgments regarding the assumptions of the benefit plans; and (iii) the deficiencies in controls over the data generation process to calculate the actuarial liability, which constituted a significant deficiency identified by the Company in its internal control environment in 2015.

According to the Management Report, the internal control deficiencies over the data generation process and assumptions for the calculation of the actuarial liability and valuation of certain guaranteeing assets constituted a significant deficiency for the year ended December 31, 2016.

Our audit approach considered the understanding of key controls related to the process of measuring the actuarial liability and tests on the effectiveness of controls considered as key. In addition, our audit response considered testing of details on the individual information recorded in the databases used to calculate the actuarial liability. The audit evidence deemed necessary was obtained by testing the databases of active and assisted participants in pension and medical care plans.

Other significant aspects of our audit approach included evaluating key assumptions that support the calculation of actuarial liabilities, such as salary growth projections, mortality and disability tables, medical costs and discount rate estimates. These procedures were performed with the support of our team of actuarial calculation experts and included the following key procedures:

- Review of the logical consistency and arithmetic consistency of the model used to estimate the value of the actuarial liability.
- Evaluation of the technical ability of the independent external actuary responsible for preparing the actuarial calculation.
- Review of the reconciliation of the actuarial report with the balances of the Company's financial statements.

In addition, we obtained confirmations from third parties regarding the custody of the plans' guaranteeing assets and tested the fair value of these assets with the support of our team of specialists in the valuation of financial instruments.

We consider that the criteria and assumptions adopted by the Management to determine the value of the actuarial liability, as well as the disclosures in the notes are reasonable, in all material respects, within the context of

the financial statements.

6 - Trade receivables - Electricity sector
(Note 8.4)

At December 31, 2016, the net balance of trade receivables related to the electricity sector totaled R\$ 10,062 million.

A significant portion of the funds used to settle the trade receivables comes from the Fuel Consumption Account (Conta de Consumo de Combustível (CCC). However, amendments to the legislation imposed restrictions that reduced the amounts reimbursed by the CCC, increasing the risk of default of the distributors that operate in this sector and purchase fuel to be used in their thermal plants.

This matter was considered as one of the key audit matters due to those circumstances and the consequent significant judgments in relation to the assumptions used in the determination of the losses on impairment of trade receivables and the significance of the balance of trade receivables.

Our audit approach considered the understanding of the key controls related to the process of measuring impairment losses on trade receivables related to the electricity sector trade receivables and tests of the effectiveness of controls considered as key. As regards the testing of details in operations and transactions, our approach considered the review of the debt acknowledgment agreements entered into between the Company and the companies of the Eletrobras System, understanding of the current stage of the negotiations with the Federal Government and Eletrobras, reading of the official letters and ordinances of the National Electric Energy Agency (ANEEL) and the Ministry of Mines and Energy (MME), as well as the payments received and the reconciliation of the provision for impairment of trade receivables recorded for the total trade receivables of the Electricity sector overdue or without actual guarantees.

We consider that the criteria and assumptions adopted by the Management to determine the impairment losses on trade receivables related to the trade receivables of the electricity sector, as well as the disclosures in the notes, are reasonable, in all material respects, within the context of the financial statements.

Why it is a Key Audit Matter

How the matter was addressed in the audit

7 - Mutual rescissions and advances to suppliers - Shipbuilders (Note 14.4)

In 2016, the Company recognized provisions and write-offs totaling R\$ 5,263 million, as follows: (i) provision for impairment of R\$ 1,925 million, due to uncertainties on the continuity of the construction of the hulls of platforms P 71, P 72 and P 73; (ii) provision for losses of R\$ 2,353 million, referring to the remaining balance of the advances to the suppliers Ecovix and Enseada; (iii) write-off of investments made in the Rio Grande shipbuilder, in the amount of R\$505 million, and (iv) write-offs of other investments related to the construction of the hulls of platforms P-71, P72 and P73, in the amount of R\$480 million.

Due to the strategic importance of certain assets and the financial difficulties faced by the suppliers contracted for their construction, the Company implemented, in 2015, a blocked account system to make feasible the development of the execution of the work. In the third quarter of 2016, the Company revalued whether the blocked accounts should be kept, which resulted in the recognition of those provisions and write-offs.

This matter was considered as one of the key audit matters due to the significance of the amounts involved and of the deficiencies in the controls related to the necessity of writing off the advances to suppliers that would not result in future economic benefits and recognizing expenses related to the mutual rescission of related agreements, which constituted a significant deficiency identified by the Company in its internal control environment in 2015.

According to the Management Report, that significant deficiency was maintained for the year ended December 31, 2016.

Our audit approach considered the understanding of the main controls related to the process of advances to suppliers and mutual rescissions, as well as tests on the effectiveness of controls considered as key. Additionally, our audit response considered tests on details of transfers made to the blocked accounts, provision for losses referring to advances to the suppliers Ecovix and Enseada and write-offs of investments related to the shipbuilder Rio Grande and the construction of the hulls of platforms P-71, P72 and P73.

Other significant aspects of our audit approach included review of the main contracts and mutual rescissions related to the subject-matter, inspection of subrogation of debt agreements and testing of details in relation to the subsequent financial settlement of the liabilities recorded, as well as the impairment test for the remaining assets.

We consider that the criteria and assumptions adopted by the Management to determine the provisions and write-offs related to the construction of platforms hulls by the suppliers Ecovix and Enseada, as well as the disclosures in the notes, are reasonable, in all material respects, within the context of the financial statements.

Why it is a Key Audit Matter

How the matter was addressed in the audit

8 - Cash flow hedge accounting (Notes 4.3.6 and 33.2)

At December 31, 2016, the Company presented R\$ 25,119 million, net of the tax effects, recognized in other comprehensive income, in equity.

The Company designates hedging relationships, in which highly probable future exports are defined as hedged items, and liabilities denominated in foreign currency are used as hedging instruments. The purpose of this accounting practice is to recognize the foreign exchange effects of both the hedged item and the hedging instrument at the same time in the statement of income.

The estimate of highly probable future exports requires the use of significant judgments by the Company's management. Such an estimate can be significantly influenced by changes in the price projections for oil and its byproducts and the future production curve.

This matter was considered as one of the key audit matters in view of the critical estimates and significant judgments used by management to estimate the "highly probable" future exports and the significance of the accumulated balance of foreign exchange variation recognized in Equity arising from the application of the cash flow hedge accounting.

Our audit approach considered the understanding of key controls related to the process of hedge accounting and tests on the effectiveness of controls considered as key. Regarding the testing of detail in operations or transactions, our approach involved evaluating the reasonableness of the main assumptions used by management to estimate future exports. This work was carried out with the support of our team of asset valuation experts.

The audit procedures also included reviewing the criteria used by management to define the portion of future exports deemed "highly probable", in accordance with the criteria established by Technical Pronouncement CPC 38 - Financial Instruments: Recognition and Measurement (CPC 38). In this regard, we reviewed historical export data used by Management to define the highly probable portion, as well as sensitivity analysis of key assumptions and evaluation of potential impacts within a range of possible outcomes.

Other significant aspects of our audit approach included: (i) analysis of the application of hedge accounting by the Company vis a vis the requirements established by CPC 38; (ii) review of the documentation of hedge designations; (iii) test for the recalculation of the foreign exchange variation; and (iv) recalculation of prospective and retrospective effectiveness tests.

We consider that the application of the hedge accounting by the Company, which can be made by the management under the terms of CPC 38, meets the requirements established by that technical pronouncement. Additionally, we consider that the assumptions adopted by the Management to determine the highly probable future exports and foreign exchange losses and gains recorded in other comprehensive income are reasonable, and the disclosures in the notes are appropriate.

Supplementary information

Statements of Value Added

The parent company and consolidated Statement of Value Added for the year ended December 31, 2016, prepared under the responsibility of the Company's management and presented as supplementary information for IFRS purposes, was submitted to the same audit procedures performed in conjunction with the audit of the Company's financial statements. For the purposes of forming our opinion, we evaluated whether these statements are reconciled with the financial statements and accounting records, as applicable, and if their form and content are in accordance with the criteria defined in Technical Pronouncement CPC 09 - "Statement of Value Added". In our opinion, these Statements of Value Added are prepared in all material respects, in accordance with the criteria established in the Technical Pronouncement and are consistent with the parent company and consolidated financial statements taken as a whole.

Other information accompanying the financial statements and the independent auditor's report

The Company's management is responsible for the other information that comprises the Management Report and the Financial Market Report ("RMF").

Our opinion on the financial statements does not cover the Management Report and the Financial Market Report, and we do not express any form of audit conclusion thereon.

In connection with the audit of the financial statements, our responsibility is to read the Management Report and the Financial Market Report and, in doing so, consider whether these reports are materially inconsistent with the financial statements or with our knowledge obtained in the audit or otherwise appear to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement in the Management Report and the Financial Market Report, we are required to communicate the matter to those charged with governance. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting practices adopted in Brazil and with the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Brazilian and International Standards on Auditing will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Brazilian and International Standards on Auditing, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

Identify and assess the risks of material misstatement of the parent company and consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control of the Company and its subsidiaries.

Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the ability of the Company to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Rio de Janeiro, March 21, 2017

PricewaterhouseCoopers

Auditores Independentes

CRC 2SP000160/O-5 "F" RJ

Marcos Donizete Panassol

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Advances to suppliers		3,742	6,395	510	1,017	Others		1,790	1,989	1,122	1,334
Others		10,378	9,550	9,106	8,216			471,035	530,633	318,427	338,668
		66,551	75,853	46,098	50,059	Total liabilities		552,202	642,205	431,858	443,915
						Shareholders' equity					
						Share capital (net of share issuance costs)	23.1	205,432	205,432	205,432	205,432
Investments	11	9,948	13,772	121,191	115,536	Capital transactions	23.2	1,035	21	1,251	237
Property, plant and equipment	12	571,876	629,831	424,771	442,439	Profit reserves	23.3	77,800	92,612	77,584	92,396
Intangible assets	13	10,663	12,072	8,764	9,133	Accumulated other comprehensive (deficit)	23.4	(34,037)	(43,334)	(34,037)	(43,334)
						Attributable to the shareholders of Petrobras		250,230	254,731	250,230	254,731
		659,038	731,528	600,824	617,167	Non-controlling interests	11.5	2,513	3,199	-	-
						Total equity		252,743	257,930	250,230	254,731
Total assets		804,945	900,135	682,088	698,646	Total liabilities and shareholder's equity		804,945	900,135	682,088	698,646

The Notes form an integral part of these Financial Statements.

Statement of Income

December 31, 2016 and 2015 (In millions of reais, unless otherwise indicated)

	Consolidated		Parent Company		
	Note	2016	2015	2016	2015
Sales revenues	24	282,589	321,638	223,067	251,023
Cost of sales		(192,611)	(223,062)	(153,725)	(174,717)
Gross profit		89,978	98,576	69,342	76,306
Income (expenses)					
Selling expenses		(13,825)	(15,893)	(17,023)	(15,130)
General and administrative expenses		(11,482)	(11,031)	(8,242)	(7,561)
Exploration costs	15	(6,056)	(6,467)	(5,533)	(5,261)
Research and development expenses		(1,826)	(2,024)	(1,823)	(2,011)
Other taxes		(2,456)	(9,238)	(1,305)	(7,730)
Impairment of assets	14	(20,297)	(47,676)	(11,119)	(33,468)
Other expenses, net	25	(16,925)	(18,638)	(9,707)	(17,547)
		(72,867)	(110,967)	(54,752)	(88,708)
Income (loss) before finance income (expense), results in equity-accounted investments and income taxes		17,111	(12,391)	14,590	(12,402)
Net finance income (expenses):	27	(27,185)	(28,041)	(25,704)	(26,187)
Finance income		3,638	4,867	2,418	3,303
Finance expense		(24,176)	(21,545)	(18,967)	(18,951)
Foreign exchange gains (losses) and inflation indexation charges		(6,647)	(11,363)	(9,155)	(10,539)
Results in equity-accounted investments	11	(629)	(797)	(4,576)	(4,294)
Loss before income taxes		(10,703)	(41,229)	(15,690)	(42,883)
Income taxes	21.7	(2,342)	6,058	866	8,047
Loss		(13,045)	(35,171)	(14,824)	(34,836)
Net income (loss) attributable to:					
Shareholders of Petrobras		(14,824)	(34,836)	(14,824)	(34,836)
Non-controlling interests		1,779	(335)	—	—
Loss		(13,045)	(35,171)	(14,824)	(34,836)
Basic and diluted loss per common and preferred share (in R\$)	23.6	(1.14)	(2.67)	(1.14)	(2.67)

The Notes form an integral part of these Financial Statements.

13

Statement of Comprehensive Income

December 31, 2016 and 2015 (in millions of reais, unless otherwise indicated)

	Consolidated		Parent Company	
	2016	2015	2016	2015
Loss for the period	(13,045)	(35,171)	(14,824)	(34,836)
Other comprehensive income				
Items that will not be reclassified to the statement of income:				
Actuarial losses on defined benefit pension plans	(17,449)	(202)	(15,510)	(208)
Deferred Income tax and social contribution	3,485	(53)	3,219	(2)
	(13,964)	(255)	(12,291)	(210)
Share of other comprehensive income in equity-accounted investments	(12)	(1)	(1,679)	45
Items that may be reclassified subsequently to the statement of income:				
Unrealized gains / (losses) on cash flow hedge - exports				
Recognized in shareholders' equity	40,327	(68,739)	36,607	(60,712)
Reclassified to the statement of income	9,935	7,088	8,994	6,200
Deferred Income tax and social contribution	(17,089)	20,961	(15,504)	18,534
	33,173	(40,690)	30,097	(35,978)
Unrealized gains / (losses) on cash flow hedge - others				
Recognized in shareholders' equity	30	35		–
Cumulative translation adjustments in investees (*)				
Recognized in shareholders' equity	(15,585)	24,545	(11,209)	23,826
Reclassified to the statement of income	3,693		–	
	(11,892)	24,545	(11,209)	23,826
Share of other comprehensive income in equity-accounted investments	1,285	(2,863)	4,391	(7,631)
Total other comprehensive income (loss)	8,620	(19,229)	9,309	(19,948)
Total comprehensive income (loss)	(4,425)	(54,400)	(5,515)	(54,784)
Comprehensive income (loss) attributable to:				
Shareholders of Petrobras	(5,520)	(54,785)	(5,515)	(54,784)
Non-controlling interests	1,095	385		
Total comprehensive income (loss)	(4,425)	(54,400)	(5,515)	(54,784)

(*) Includes, in the consolidated, a debit of R\$ 1,063 (a credit of R\$ 2,825 in 2015) relating to cumulative translation adjustments in associates and joint ventures.

The Notes form an integral part of these Financial Statements.

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Statement of Cash Flows

December 31, 2016 and 2015 (in millions of reais, unless otherwise indicated)

	Consolidated		Parent Company	
	2016	2015	2016	2015
Cash flows from Operating activities				
Loss	(13,045)	(35,171)	(14,824)	(34,836)
Adjustments for:				
Pension and medical benefits (actuarial expense)	8,001	6,388	7,409	5,872
Results in equity-accounted investments	629	797	4,576	4,294
Depreciation, depletion and amortization	48,543	38,574	37,150	28,039
Impairment assets	20,297	47,676	11,119	33,468
Inventory write-down to net realizable value	1,320	1,547	–	14
Allowance for impairment of trade receivables	3,843	3,641	1,072	669
Exploratory expenditures written off	4,364	4,921	3,940	3,784
(Gains) losses on disposal / write-offs of assets	(951)	2,893	(1,399)	3,075
Foreign exchange, indexation and finance charges	27,854	30,752	25,604	26,094
Deferred income taxes, net	(3,280)	(8,911)	(1,010)	(8,047)
Reclassification of cumulative translation adjustment - CTA	3,693	–	–	–
Review and unwinding of discount on the provision for decommissioning costs	(2,591)	1,307	(2,601)	1,274
Decrease (Increase) in assets				
Trade and other receivables, net	397	(1,496)	(22,470)	1,485
Inventories	(2,010)	1,730	515	546
Judicial deposits	(3,357)	(2,526)	(3,145)	(2,640)
Other assets	(1,214)	(2,474)	(2,961)	(3,191)
Increase (Decrease) in liabilities				
Trade payables	(4,154)	(3,890)	(3,302)	(11,896)
Other taxes payable	3,216	4,510	539	3,740
Income taxes paid	(1,284)	(1,794)	–	–
Pension and medical benefits	(2,634)	(2,367)	(2,465)	(2,232)
Other liabilities	2,072	563	(486)	528
Net cash provided by operating activities	89,709	86,670	37,261	50,040
Cash flows from Investing activities				
Capital expenditures	(49,289)	(71,311)	(33,512)	(50,589)
Increase in investments in investees	(455)	(344)	(26,782)	(29,229)
Proceeds from disposal of assets - Divestment	7,231	658	4,304	223
Divestment (Investment) in marketable securities (*)	842	25,971	(1,652)	6,054

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Dividends received	1,607	874	3,859	4,699
Net cash used in investing activities	(40,064)	(44,152)	(53,783)	(68,842)
Cash flows from Financing activities				
Investments by non-controlling interest	122	243	–	–
Proceeds from financing	64,786	56,158	105,886	117,844
Repayment of principal	(105,832)	(49,741)	(91,877)	(82,544)
Repayment of interest	(25,563)	(20,851)	(7,773)	(6,973)
Dividends paid to non-controlling interests	(239)	(263)	–	–
Proceeds from sale of interest without loss of control (**)	–	1,934	–	1,934
Net cash used in financing activities	(66,726)	(12,520)	6,236	30,261
Effect of exchange rate changes on cash and cash equivalents	(11,656)	23,608	–	–
Net increase / (decrease) in cash and cash equivalents	(28,737)	53,606	(10,286)	11,459
Cash and cash equivalents at the beginning of the year	97,845	44,239	16,553	5,094
Cash and cash equivalents at the end of the period	69,108	97,845	6,267	16,553

(*) In the Parent Company, includes amounts relating to changes in the investment in FIDC-NP (receivables investment fund).

(**) Reclassified from Investing activities.

The Notes form an integral part of these Financial Statements.

Statement of Changes in Shareholders' Equity

December 31, 2016 and 2015 (in millions of reais, unless otherwise indicated)

	Share capital (net of share issuance costs)	Capital transactions	Accumulated other comprehensive income				Profit reserves			Profit retention	Retained earnings
			Cumulative translation adjustment	Losses on pension plans	Cash flow hedge - highly probable future exports	Other comprehensive income (loss) and deemed cost	Legal	Statutory	Tax incentives		
Balance at January 1, 2015	205,432	(430)	9,959	(14,545)	(17,601)	(1,189)	16,524	4,503	1,393	104,802	–
Realization of deemed cost of associates						(10)					10
Change in interest in subsidiaries		667									
Loss Other comprehensive income (loss)			23,826	(255)	(40,690)	(2,829)					(34,826)
Distributions: Offsetting of loss against reserves										(34,826)	34,826
Dividends											
Balance at December 31, 2015	205,432	237	33,785	(14,800)	(58,291)	(4,028)	16,524	4,503	1,393	69,976	–
Realization of deemed cost of associates	205,432	237				(43,334)				92,396	
Capital transactions		1,014									
Loss Other comprehensive income (loss)			(11,209)	(13,958)	33,173	1,303					(14,812)
Distributions: Offsetting of loss against reserves										(14,812)	14,812

reserves

Dividends

Balance at

December 31,

2016	205,432	1,251	22,576	(28,758)	(25,118)	(2,737)	16,524	4,503	1,393	55,164	–
	205,432	1,251				(34,037)				77,584	–

The Notes form an integral part of these Financial Statements.

Statement of Added Value

December 31, 2016 and 2015 (in millions of reais, unless otherwise indicated)

	Consolidated		Parent Company	
	2016	2015	2016	2015
Income				
Sales of products, services provided and other revenues	373,081	414,859	307,808	338,059
Gains and losses on impairment of trade receivables	(3,843)	(3,641)	(1,072)	(669)
Revenues related to construction of assets for own use	49,476	68,703	36,710	53,634
	418,714	479,921	343,446	391,024
Inputs acquired from third parties				
Materials consumed and products for resale	(65,864)	(94,453)	(42,210)	(67,401)
Materials, power, third-party services and other operating expenses	(72,846)	(109,876)	(56,412)	(88,143)
Tax credits on inputs acquired from third parties	(19,766)	(22,311)	(17,880)	(19,753)
Impairment of property, plant and equipment, intangible and other assets	(20,297)	(47,676)	(11,119)	(33,468)
Inventory write-down to net realizable value (market value)	(1,320)	(1,547)	–	(14)
	(180,093)	(275,863)	(127,621)	(208,779)
Gross added value	238,621	204,058	215,825	182,245
Depreciation, depletion and amortization	(48,543)	(38,574)	(37,150)	(28,039)
Net added value produced by the Company	190,078	165,484	178,675	154,206
Transferred added value				
Share of profit of equity-accounted investments	(629)	(797)	(4,576)	(4,294)
Finance income	3,638	4,867	2,418	6,208
Rents, royalties and others	358	377	860	420
	3,367	4,447	(1,298)	2,334
Total added value to be distributed	193,445	169,931	177,377	156,540
Distribution of added value				
Personnel and officers				
Direct compensation				
Salaries	18,685	19,068	14,445	14,219
	18,685	19,068	14,445	14,219
Benefits (**)				
Short-term benefits	4,629	1,452	4,313	1,110
Pension plan	5,069	4,133	4,304	3,705

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Medical plan	4,821	3,778	4,359	3,433
	14,519	9,363	12,976	8,248
FGTS	1,273	1,301	1,118	1,151
	34,477	29,732	28,539	23,618
Taxes				
Federal (*)	50,141	50,297	44,449	45,198
State	49,565	51,888	31,352	33,074
Municipal	690	725	301	377
Abroad (*)	5,351	6,879	–	–
	105,747	109,789	76,102	78,649
Financial institutions and suppliers				
Interest, and exchange and indexation charges	36,819	38,768	32,605	37,180
Rental and affreightment expenses	29,447	26,813	54,955	51,929
	66,266	65,581	87,560	89,109
Shareholders				
Non-controlling interests	1,779	(335)	–	–
Absorbed losses	(14,824)	(34,836)	(14,824)	(34,836)
	(13,045)	(35,171)	(14,824)	(34,836)
Added value distributed	193,445	169,931	177,377	156,540

(*) Includes government holdings.

(**) In 2016, include R\$ 4,082 in the Consolidated (R\$ 418 in 2015), relating to spending on Voluntary Separation Incentive Plan - PIDV (R\$ 3,647 in 2016 and R\$ 326 in 2015 in the Parent Company).

The Notes form an integral part of these Financial Statements.

Notes to the financial statements

(Expressed in millions of Reais, unless otherwise indicated)

1. The Company and its operations

Petróleo Brasileiro S.A. - Petrobras is a company controlled by the Brazilian government dedicated, directly or through its subsidiaries (referred to jointly as “Petrobras”, “the Company”, or “Petrobras Group”), either independently or through joint ventures or similar arrangements with third parties, to prospecting, drilling, refining, processing, trading and transporting crude oil from producing onshore and offshore oil fields and from shale or other rocks, as well as oil products, natural gas and other liquid hydrocarbons. In addition, Petrobras carries out energy related activities, such as research, development, production, transport, distribution and trading of all forms of energy, as well as other related or similar activities. The Company’s head office is located in Rio de Janeiro – RJ, Brazil.

2. Basis of preparation of financial statements

The financial statements include:

Consolidated financial statements

The consolidated financial statements are being presented in accordance with accounting practices adopted in Brazil, including the pronouncements issued by the Accounting Pronouncements Committee (Comitê de Pronunciamentos Contábeis - CPC) and with the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and present all relevant information related to financial statements, and only them, corresponding to the information used by the Company’s management.

Individual financial statements

The individual financial statements had been prepared in accordance with accounting practices adopted in Brazil, issued by the CPC. These accounting practices do not differ from IFRS standard to separate financial statement, since 2014, when it permitted investments in associates, subsidiaries and joint ventures to be accounted for by the equity method. Therefore, the individual financial statements are in accordance with the IFRS issued by the IASB. Both individual and consolidated financial statements are disclosed together.

The standards, interpretations and orientations of CPC converge with the International Accounting Standards issued by IASB.

The financial statements have been prepared under the historical cost convention, except for available-for-sale financial assets, financial assets and liabilities measured at fair value and certain current and non-current assets and liabilities, as set out in the summary of significant accounting policies.

The annual financial statements were approved and authorized for issue by the Company's Board of Directors in a meeting held on March 21, 2017.

2.1. Statement of added value

The statement of added value present information related to the value added by the Company (wealth created) and how it has been distributed. This statement is presented as supplementary information under IFRS and was prepared in accordance with CPC 09 – Statement of Added Value, approved by CVM Deliberation 557/08.

2.2. Functional currency

The functional currency of Petrobras and all of its Brazilian subsidiaries is the Brazilian Real, which is the currency of its primary economic environment of operation. The functional currency of most of the entities that operate in the international economic environment is the U.S. dollar.

The income statements and statement of cash flows of non-Brazilian Real functional currency subsidiaries, joint ventures and associates in stable economies are translated into Brazilian Real using the monthly average exchange rates prevailing during the year. Assets and liabilities are translated into Brazilian Real at the closing rate at the date of the financial statements and the equity items are translated using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured.

All exchange differences arising from the translation of the financial statements of non-Brazilian Real subsidiaries, joint ventures and associates are recognized as cumulative translation adjustments (CTA) within accumulated other comprehensive income in the shareholders' equity and transferred to profit or loss in the periods when the disposal of the investments affects profit or loss.

2.3. Corrections

For the preparation of the financial statements for the year ended December 31, 2016, the Company has corrected certain amounts from prior periods to conform to current period presentations. The Company concluded that these corrections are not material and they did not affect the income statement and the shareholders' equity, as described below:

- Receivables from the electricity sector, in the Parent Company and Consolidated, in the amount of R\$ 974, previously accounted for as current assets, were reclassified to trade and other receivables, net within non-current assets;
- Finance lease installments, in the Consolidated, amounting to R\$ 25 were reclassified from trade payables to finance lease obligations within current liabilities, as well as finance lease installments amounting to R\$ 149 were reclassified from other non-current liabilities to finance lease obligations within non-current liabilities;
- Proceeds from disposal of interests in subsidiaries without loss of control, in the Parent Company and Consolidated, in the amount of R\$ 1,934, previously presented in the Statement of Cash Flows as investing activities, were reclassified to financing activities;
- The investment, in the Parent Company, in the receivables investment fund (FIDC-NP), in the amount of R\$ 7,812, was reclassified from Marketable Securities – Held-to-maturity to Trade receivables;
- Fair value of finance debt changed from R\$ 385,017 to R\$ 426,282 due to changes in the finance debts fair value approach based on inputs other than quoted prices (level 2), as set out in note 17.1.

3. The “Lava Jato (Car Wash) Operation” and its effects on the Company

In 2009, the Brazilian Federal Police (Polícia Federal) began an investigation called “Lava Jato” (Car Wash) aimed at criminal organizations engaged in money laundering in several Brazilian states. The Lava Jato investigation is extremely broad and involves numerous investigations into several criminal practices focusing on crimes committed by individuals in different parts of the country and sectors of the Brazilian economy.

Beginning in 2014, the Brazilian Federal Prosecutor's Office focused part of its investigation on irregularities involving Petrobras's contractors and suppliers and uncovered a broad payment scheme that involved a wide range of participants, including former Petrobras personnel. Based on the information available to Petrobras, the payment scheme involved a group of companies that, between 2004 and April 2012, colluded to obtain contracts with Petrobras, overcharge the Company under those contracts and use the overpayment received under the contracts to fund improper payments to political parties, elected officials or other public officials, individual contractors and suppliers personnel, former Petrobras personnel and other individuals involved in the scheme. Petrobras refers to this scheme as the “payment scheme” and to the companies involved in the scheme as “cartel members”. The Company did not make any improper payment.

In addition to the payment scheme, the investigations identified specific instances of other contractors and suppliers that overcharged Petrobras and allegedly used the overpayment received from their contracts with the Company to fund improper payments, unrelated to the payment scheme, to certain former Petrobras personnel. Those contractors and suppliers are not cartel members and acted individually. Petrobras refers to these specific cases as the “unrelated payments.”

Certain former executives of Petrobras were arrested and/or charged for certain crimes such as money-laundering and passive corruption. Other former executives of the Company as well as executives of Petrobras contractors and suppliers were or may be charged as a result of the investigation.

The amounts paid by Petrobras related to contracts with contractors and suppliers involved in the payment scheme were included in historical costs of its property, plant and equipment. However, the Company believes that, under International Accounting Standard IAS 16 – Property, Plant and Equipment, the portion of the payments made to these companies and used by them to make improper payments, which represents additional charges incurred as a result of the payments scheme, should not have been capitalized. Thus, in the third quarter of 2014, the Company wrote off R\$ 6,194 (R\$ 4,788 in the parent company) of capitalized costs representing amounts that Petrobras overpaid for the acquisition of property, plant and equipment in prior years.

The Company has continuously monitored the investigations for additional information and to assess any potential impact on the adjustments made. No additional information has been identified that impacted the adopted calculation methodology and the recorded adjustment in 2014 for the preparation of the financial statements for the year ended December 31, 2016.

Notes to the financial statements

(Expressed in millions of reais, unless otherwise indicated)

Petrobras will continue to monitor the results of the investigations and the availability of other information concerning the payment scheme. If information becomes available that indicates with sufficient precision that the estimate described above should be adjusted, Petrobras will evaluate whether the adjustment is material and, if so, recognize it.

3.1. The Company's response to the facts uncovered in the investigation

The Company has been closely monitoring the investigations and cooperating fully with the Brazilian Federal Police (Policia Federal), the Brazilian Public Prosecutor's Office (Ministério Público Federal), Federal Auditor's Office (Tribunal de Contas da União – TCU), and the Ministry of Transparency, Supervision and Control (Ministério da Transparência, Fiscalização e Controle) in the investigation of all crimes and irregularities. We have responded to numerous requests for documents and information from these authorities.

The Company has also cooperated with the U.S. Securities and Exchange Commission (SEC) and the United States Department of Justice (DOJ), which, since November 2014, have been investigating potential violations of U.S. law based on information disclosed as a result of the Lava Jato investigation.

We have been formally recognized as a victim of the crimes identified under the Lava Jato investigation by the Brazilian Federal Prosecutor's Office, the lower court hearing the case and also by the Brazilian Supreme Court. As a result, we have entered into 29 criminal proceedings as an assistant to the prosecutor. In addition, we have entered into five criminal proceedings as an interested party. We have also renewed our commitment to continue cooperating with authorities to clarify the issues and report them regularly to our investors and to the public in general.

We do not tolerate corrupt practices and illegal acts perpetuated by any of our employees. Accordingly, in 2016, the Company continued to implement several measures as a response to the facts uncovered in the "Lava Jato" investigation and to improve its corporate governance and compliance systems as described below.

As part of the process of strengthening the internal control structure, among the measures taken in 2016, the Company approved its new Corporate Compliance Policy, performed training programs with personnel and executives focused on the prevention of corruption, reviewed the "Compliance Agents" initiative and adapted its findings to the new organization structure, conducted nearly 12,000 integrity due diligence procedures, and performed background checks as part of the decision making for appointing personnel to key positions.

Internal investigations are still in progress and are being carried out by two independent firms hired in October 2014, which report directly to a Special Committee that serves as a reporting line to the Board of Directors. The Special Committee is composed of our Governance and Compliance Officer, João Adalberto Elek Junior and two other independent and recognized experts: Ellen Gracie Northfleet, former Chief Justice of the Brazilian Supreme Court, who is recognized internationally as a jurist with great experience in analyzing complex legal issues; and Andreas Pohlmann from Germany, former Chief Compliance Officer of Siemens AG (2007-2010), who has broad experience in compliance and corporate governance matters.

We established Internal Investigative Committees (Comissões Internas de Apuração) to investigate instances of non-compliance with corporate rules, procedures or regulations. The Committees' investigation results are shared with the Brazilian authorities as they progress.

In addition, the Company has been taking the necessary procedural steps to seek compensation for damages suffered from the improper payments scheme, including those related to its reputation.

Accordingly, the Company joined 12 public civil suits addressing acts of administrative misconduct filed by the Brazilian Public Prosecutor's Office and the Federal Government, including demands for compensation for reputation damages.

In order to secure future compensation to Petrobras for each civil action related to misconduct, the courts granted cautionary orders in certain actions to impound defendants' property.

To the extent that any of the proceedings resulting from the Lava Jato investigation involve leniency agreements with cartel members or plea agreements with individuals pursuant to which they agree to return funds, the Company may be entitled to receive a portion of such funds. Nevertheless, the Company is unable to reliably estimate further recoverable amounts at this moment. Any recoverable amount will be recognized as income when received or when their economic benefits become virtually certain.

So far, the Company recognized the accumulated amount of R\$ 661 as compensations for damages relating to the "Lava Jato" Operation (R\$ 432 in 2016) pursuant to leniency and cooperation agreements.

Notes to the financial statements

(Expressed in millions of reais, unless otherwise indicated)

3.2. Approach adopted by the Company to adjust its property, plant and equipment for overpayments

As it is not possible to specifically identify the amounts of each overpayment to contractors and suppliers, or periods over which such payments occurred, Petrobras developed a methodology to estimate the aggregate amount that it overpaid under the payment scheme, in order to determine the amount of the write off representing the overstatement of its assets resulting from overpayments used to fund improper payments.

As it is impracticable to identify the periods and amounts of overpayments incurred, the Company developed a methodology to estimate the adjustment incurred in property, plant and equipment in the third quarter of 2014 using the five steps described below:

(1) Identify contractual counterparties: the Company listed all the companies identified as cartel members, and using that information the Company identified all of the contractors and suppliers that were either so identified or were consortia including entities so identified.

(2) Identify the period: the Company concluded from the testimony that the payment scheme was operating from 2004 through April 2012.

(3) Identify contracts: the Company identified all contracts entered into with the counterparties identified in step 1 during the period identified in step 2, which included supplemental contracts when the original contract was entered into between 2004 and April 2012. It has identified all of the property, plant and equipment related to those contracts.

(4) Identify payments: the Company calculated the total contract values under the contracts mentioned in step 3.

(5) Apply a fixed percentage to the amount determined in Step 4: the Company estimated the aggregate overpayment by applying a percentage indicated in the depositions (3%) to the total amounts for identified contracts.

For overpayments attributable to non-cartel members, unrelated to the payment scheme, the Company included in the write-off for incorrectly capitalized overpayments the specific amounts of improper payments or percentages of contract values, as described in the testimony, which were used by those suppliers and contractors to fund improper payments.

For more information on the approach adopted by the Company to estimate the write-off for overpayments incorrectly capitalized, see note 3 to the Company's audited consolidated financial statements for 2014.

The Company considered all available information for purposes of the preparation of the financial statements for the year ended December 31, 2016 and did not identify any additional information that would impact the adopted calculation methodology and consequently require additional write-offs. Information available to the Company included:

Petrobras has closely monitored the progress of both the investigation by Brazilian authorities and the independent law firms and no new facts that could impact the Company's previously recorded adjustments or change the methodology adopted were discovered. The Company will continuously monitor the investigations for additional information and will review its potential impact on the adjustment made.

3.3. Investigation involving the Company

Petrobras is not a target of the Lava Jato investigation and is formally recognized as a victim of the improper payments scheme by the Brazilian Authorities.

On November 21, 2014, Petrobras received a subpoena from the U.S. Securities and Exchange Commission (SEC) requesting certain documents and information about the Company. The Company has been complying with the subpoena and intends to continue to do so, working with the independent Brazilian and U.S. law firms that were hired to conduct an independent internal investigation.

On December 15, 2015, the State of São Paulo Public Prosecutor's Office issued the Order of Civil Inquiry 01/2015, establishing a civil proceeding to investigate the existence of potential damages caused by Petrobras to investors in the stock market. The Company has provided all relevant information required by the authorities.

3.4. Legal proceedings involving the Company

Note 30 provides information about class actions and other material legal proceedings.

Notes to the financial statements

(Expressed in millions of reais, unless otherwise indicated)

4. Summary of significant accounting policies

The accounting policies set out below have been consistently applied to all periods presented in these consolidated financial statements.

4.1. Basis of consolidation

The consolidated financial statements include the financial information of Petrobras and the entities it controls (its subsidiaries), joint operations and consolidated structured entities.

Control is achieved when Petrobras: i) has power over the investee; ii) is exposed, or has rights, to variable returns from involvement with the investee; and iii) has the ability to use its power to affect its returns.

Subsidiaries are consolidated from the date on which control is obtained until the date that such control no longer exists. Accounting policies of subsidiaries have been changed, where necessary, to ensure consistency with the policies adopted by Petrobras.

Note 11 sets out the consolidated entities and other direct investees.

Petrobras has no equity interest in certain structured entities and control is not determined by voting rights, but by the power the Company has over the relevant activities of such entities. Consolidated structured entities are set out below:

Consolidated structured entities	Country	Main segment
Charter Development LLC – CDC	U.S.A	E&P
Companhia de Desenvolvimento e Modernização de Plantas Industriais – CDMPI	Brazil	RT&M
PDET Offshore S.A.	Brazil	E&P
Fundo de Investimento em Direitos Creditórios Não-padronizados do Sistema Petrobras	Brazil	Corporate
Fundo de Investimento em Direitos Creditórios Padronizados do Sistema Petrobras	Brazil	Corporate

The consolidation procedures involve combining assets, liabilities, income and expenses, according to their function and eliminating all intragroup balances and transactions, including unrealized profits arising from intragroup transactions.

4.2. Business segment reporting

The information related to the Company's operating segments (business areas) is prepared based on items directly attributable to each segment, as well as items that can be allocated to each segment on a reasonable basis. This information reflects the views of the Company's Board of Executive Officers (Chief Operating Decision Maker – CODM).

The measurement of segment results includes transactions carried out with third parties and transactions between business areas, which are charged at internal transfer prices defined by the relevant areas using methods based on market parameters.

The information of operating segments comprises the following business areas:

a) Exploration and Production (E&P): this segment covers the activities of exploration, development and production of crude oil, NGL (natural gas liquid) and natural gas in Brazil and abroad, for the primary purpose of supplying its domestic refineries and the sale of surplus crude oil and oil products produced in the natural gas processing plants to the domestic and foreign markets. The E&P segment also operates through partnerships with other companies.

b) Refining, Transportation and Marketing (RT&M): this segment covers the refining, logistics, transport and trading of crude oil and oil products activities in Brazil and abroad, exports of ethanol, extraction and processing of shale, as well as holding interests in petrochemical companies in Brazil;

c) Gas and Power: this segment covers the activities of transportation and trading of natural gas produced in Brazil and abroad, imported natural gas, transportation and trading of LNG (liquid natural gas), generation and trading of electricity, as well as holding interests in transporters and distributors of natural gas and in thermoelectric power plants in Brazil, in addition to being responsible for the fertilizer business;

d) Biofuels: this segment covers the activities of production of biodiesel and its co-products, as well as the ethanol-related activities: equity investments, production and trading of ethanol, sugar and the surplus electric power generated from sugarcane bagasse; and

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e) Distribution: this segment covers the activities of Petrobras Distribuidora S.A, which operates selling oil products, ethanol and vehicle natural gas in Brazil. This segment also includes distribution of oil products operations abroad (South America).

The corporate segment comprises the items that cannot be attributed to the other segments, notably those related to corporate financial management, corporate overhead and other expenses, including actuarial expenses related to the pension and medical benefits for retired employees and their dependents.

Assets and the statement of income by business area are presented in note 29.

4.3. Financial instruments

4.3.1. Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, term deposits with banks and short-term highly liquid financial investments that are readily convertible to known amounts of cash, are subject to insignificant risk of changes in value and have a maturity of three months or less from the date of acquisition.

4.3.2. Marketable securities

Marketable securities comprise investments in debt or equity securities. These instruments are initially measured at fair value, classified and subsequently measured as set out below:

- Fair value through profit or loss – includes financial instruments purchased and held for trading in the short term. These instruments are measured at fair value with changes recognized in the statement of income in finance income (expenses).
- Held-to-maturity – includes non-derivative financial instruments with fixed or determinable payments and fixed maturity, for which Management has the clear intention and ability to hold to maturity. These instruments are measured at amortized cost using the effective interest rate method.
- Available-for-sale – includes non-derivative financial instruments that are designated as available for sale or are not classified as financial assets at fair value through profit or loss or held-to-maturity investments. These instruments are measured at fair value and changes are recognized in other comprehensive income, in the shareholders' equity and recycled to the statement of income when the instruments are derecognized or realized.

Subsequent changes attributable to interest income or changes in foreign exchange rates or inflation indexation (price indexes) are recognized in the statement of income for all categories, when applicable.

4.3.3. Trade receivables

Trade receivables are initially measured at the fair value of the consideration to be received and, subsequently, at amortized cost using the effective interest rate method and adjusted for allowances for impairment or uncollectible receivables.

The Company recognizes an allowance for impairment of trade receivables when there is objective evidence that a loss event occurred after the initial recognition of the receivable and has an impact on the estimated future cash flows, which can be reliably estimated. Impairment losses on trade receivables are recognized in the statement of income in selling expenses.

4.3.4. Loans and financing (Debt)

Loans and financing are initially recognized at fair value less transaction costs incurred and subsequently measured at amortized cost using the effective interest rate method.

4.3.5. Derivative financial instruments

Derivative financial instruments are recognized in the statement of financial position as assets or liabilities and are initially and subsequently measured at fair value.

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Gains or losses arising from changes in fair value are recognized in the statement of income in finance income (finance expense), unless the derivative is qualified and designated for hedge accounting.

4.3.6. Cash flow hedge accounting

The Company qualifies certain transactions for cash flow hedge accounting.

Hedging relationships qualify for cash flow hedges when they involve the hedging of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a highly probable forecasted transaction that may impact the statement of income.

Gains or losses relating to the effective portion of the hedge are recognized in other comprehensive income, in the shareholders' equity and recycled to the statement of income in finance income (expense) in the periods when the hedged item affects the statement of income. The gains or losses relating to the ineffective portion are immediately recognized in the statement of income.

When the hedging instrument expires or settled in advance, no longer meets the criteria for hedge accounting or the Company revokes the designation, the cumulative gain or loss on the hedging instrument that has been recognized in other comprehensive income from the period when the hedge was effective is recorded separately in equity until the forecast transaction occurs. When the forecast transaction is no longer expected to occur, the cumulative gain or loss on the hedging instrument that has been recognized in other comprehensive income is immediately reclassified from equity to the statement of income.

4.4. Inventories

Inventories are determined by the weighted average cost method and mainly comprise crude oil, intermediate products and oil products, as well as natural gas, LNG, fertilizers and biofuels, stated at the lower of the average cost, and their net realizable value.

Crude oil and LNG inventories can be traded or used for production of oil products and/or electricity generation, respectively.

Intermediate products are those product streams that have been through at least one of the refining processes, but still need further treatment, processing or converting to be available for sale.

Biofuels mainly include ethanol and biodiesel inventories.

Materials, supplies and others mainly comprise production supplies and operating materials used in the operations of the Company, stated at the average purchase cost, not exceeding replacement cost.

Net realizable value is the estimated selling price of inventory in the ordinary course of business, less estimated cost of completion and estimated expenses to complete its sale.

The amounts presented in the categories above include imports in transit, which are stated at their cost of purchase.

4.5. Investments in other companies

An associate is an entity over which the Company has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but not the ability to exercise control or joint

control over those polices. The definition of control is set out in note 4.1.

A joint arrangement is an arrangement over which two or more parties have joint control (pursuant to contractual provisions). A joint arrangement is classified either as a joint operation or as a joint venture depending on the rights and obligations of the parties to the arrangement.

In a joint operation, the parties have rights to the assets and obligations for the liabilities related to the arrangement, while in a joint venture the parties have rights to the net assets of the arrangement.

In the parent company's financial statements, investments in associates, subsidiaries and joint ventures are accounted for by the equity method from the date on which they become an associate, a joint venture or a subsidiary. In the parent company's financial statements, only joint operations structured through separate vehicles are accounted for by the equity method. For other joint operations the Company recognizes the amount of its share of assets, liabilities and related income and expenses.

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Accounting policies of joint ventures and associates have been adjusted, where necessary, to ensure consistency with the policies adopted by Petrobras. Distributions received from an investee reduce the carrying amount of the investment.

4.6. Business combinations and goodwill

Acquisitions of businesses are accounted for using the acquisition method when control is obtained. Combinations of entities under common control are not accounted for as business combinations.

The acquisition method requires that the identifiable assets acquired and the liabilities assumed be measured at the acquisition-date fair value. Amounts paid in excess of the fair value are recognized as goodwill. In the case of a bargain purchase, a gain is recognized in the statement of income when the acquisition cost is lower than the acquisition-date fair value of the net assets acquired.

Changes in ownership interest in subsidiaries that do not result in loss of control of the subsidiary are equity transactions. Any excess of the amounts paid/received over the carrying value of the ownership interest acquired/disposed is recognized in shareholders' equity as changes in interest in subsidiaries.

4.7. Oil and Gas exploration and development expenditures

The costs incurred in connection with the exploration, appraisal and development of crude oil and natural gas production are accounted for using the successful efforts method of accounting, as set out below:

- Costs related to geological and geophysical activities are expensed when incurred.
- Amounts paid for obtaining concessions for exploration of crude oil and natural gas (capitalized acquisition costs) are initially capitalized as intangible assets and are transferred to property, plant and equipment upon the declaration of commerciality.
- Costs directly attributable to exploratory wells pending determination of proved reserves are capitalized within property, plant and equipment. Exploratory wells that have discovered oil and gas reserves, which cannot be classified as proved when drilling is completed, continue to be capitalized if the well has found a sufficient quantity of reserves to justify its completion as a producing well and progress on assessing the reserves and the economic and operating viability of the project is under way. An internal commission of technical executives of Petrobras reviews these conditions monthly for each well, by analysis of geoscience and engineering data, existing economic conditions, operating methods and government regulations.
- Costs related to exploratory wells drilled in areas of unproved reserves are charged to expense when determined to be dry or uneconomic by an expert commission of the Company.
- Costs related to the construction, installation and completion of infrastructure facilities, such as drilling of development wells, construction of platforms and natural gas processing units, construction of equipment and facilities for the extraction, handling, storing, processing or treating crude oil and natural gas, pipelines, storage facilities, waste disposal facilities and other related costs incurred in connection with the development of proved reserve areas are capitalized within property, plant and equipment.

4.8. Property, plant and equipment

Property, plant and equipment are measured at the cost to acquire or construct, including all costs necessary to bring the asset to working condition for its intended use and the estimated cost of dismantling and removing the asset and restoring the site, reduced by accumulated depreciation and impairment losses.

A condition of continuing to operate certain items of property, plant and equipment, such as industrial plants, offshore plants and vessels is the performance of regular major inspections and maintenance. Those expenditures are capitalized if a maintenance campaign is expected occur, at least, 12 months later. Otherwise, they are expensed when incurred. The capitalized costs are depreciated over the period through the next major maintenance date.

Spare parts are capitalized when they are expected to be used during more than one period and can only be used in connection with an item of property, plant and equipment. These are depreciated over the useful life of the item of property, plant and equipment to which they relate.

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Borrowing costs directly attributable to the acquisition or construction of qualifying assets are capitalized as part of the costs of these assets. General borrowing costs are capitalized based on the Company's weighted average of the cost of borrowings outstanding applied over the balance of assets under construction. Borrowing costs are amortized during the useful lives of the assets or by applying the unit-of-production method to the related assets. In general, the Company suspends capitalization of borrowing to the extent investments in a qualifying asset hibernates during a period greater than one year or whenever the asset is prepared for its intended use.

Whenever an asset is directly associated to oil and gas production and its estimated lifecycle is equal or greater than the estimated length of reserves depletion, the depreciation of this asset will be accounted for pursuant to the unit-of-production method.

Assets depreciated based on the straight line method include: (i) assets related to oil and gas production with useful lives shorter than the life of the field; (ii) floating platforms; and (iii) assets that are unrelated to oil and gas production.

The unit-of-production method of depreciation (amortization) is computed based on a unit-of-production basis (monthly production) over the proved developed oil and gas reserves, applied on a field-by-field basis.

Amortization of amounts paid for obtaining concessions for exploration of oil and natural gas of producing properties, such as signature bonuses (capitalized acquisition costs) is recogni