PETROBRAS - PETROLEO BRASILEIRO SA
Form 6-K
April 23, 2015

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 April, 2015

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 ___X___ 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___X____

Petróleo Brasileiro S.A. – Petrobras

Consolidated financial statements as of

December 31, 2014, 2013 and 2012 with report of independent registered public accounting firm

Petróleo Brasileiro S.A. – Petrobras

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(Expressed in millions of US Dollars, unless otherwise indicated)

Petróleo Brasileiro S.A. – Petrobras

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of

Petróleo Brasileiro S.A. – Petrobras

In our opinion, the accompanying consolidated statement of financial position and the related consolidated statements of income, comprehensive income, cash flows and changes in shareholders' equity present fairly, in all material respects, the financial position of Petróleo Brasileiro S.A. – Petrobras and its subsidiaries (the "Company") at December 31, 2014 and December 31, 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3 to the financial statements, the Company wrote off US$ 2,527 million of overpayments on the acquisition of property plant and equipment incorrectly capitalized according to testimony obtained from Brazilian criminal investigations.

/s/

PricewaterhouseCoopers

Auditores Independentes

Rio de Janeiro, Brazil

April 22, 2015

Petróleo Brasileiro S.A. – Petrobras

Consolidated Statement of Financial Position

December 31, 2014 and 2013 (In millions of US Dollars)

Assets	**Note**	**12.31.2014**	**12.31.2013**	**Liabilities**	**Note**	**12.31.2014**	**12.31.2013**
Current assets				Current liabilities			
Cash and cash equivalents	7	16,655	15,868	Trade payables	16	9,760	11,919
Marketable securities	7	9,323	3,885	Finance debt	17	11,868	8,001
Trade and other receivables, net	8	7,969	9,670	Finance lease obligations	18	16	16
Inventories	9	11,466	14,225	Income taxes payable	21.1	247	281
Recoverable income taxes	21.1	1,063	1,060	Other taxes payable	21.1	4,064	4,669
Other recoverable taxes	21.1	2,748	3,911	Dividends payable	23.5	−	3,970
Advances to suppliers		423	683	Payroll, profit sharing and related charges		2,066	2,052
Other current assets		1,180	946	Pension and medical benefits	22	796	816
		50,827	50,248	Others		2,301	2,429
						31,118	34,153
Assets classified as held for sale	10.2	5	2,407	Liabilities on assets classified as held for sale	10.2	−	1,073
		50,832	52,655			31,118	35,226
Non-current assets				Non-current liabilities			
Long-term receivables				Finance debt	17	120,218	106,235
Trade and other receivables,	8	5,437	4,532	Finance lease obligations	18	56	73

net							
Marketable securities	7	109	131	Deferred income taxes	21.2	3,031	9,906
Judicial deposits	30.1	2,682	2,504	Pension and medical benefits	22	16,491	11,757
Deferred income taxes	21.2	1,006	1,130	Provisions for legal proceedings	30.1	1,540	1,246
Other tax assets	21.1	4,008	5,380	Provision for decommissioning costs	20	8,267	7,133
Advances to suppliers		2,409	3,230	Others		988	724
Others		3,212	1,875			150,591	137,074
		18,863	18,782				
				Total liabilities		181,709	172,300
				Shareholders' equity	23.1		
Investments	11	5,753	6,666	Share capital (net of share issuance costs)		107,101	107,092
Property, plant and equipment	12	218,730	227,901	Change in interest in subsidiaries		148	674
Intangible assets	13	4,509	15,419	Profit reserves		66,423	73,795
		247,855	268,768	Accumulated other comprehensive (deficit)		(57,400)	(33,034)
				Attributable to the shareholders of Petrobras		116,272	148,527
				Non-controlling interests		706	596
				Total equity		116,978	149,123
Total assets		298,687	321,423	Total liabilities and shareholder's equity		298,687	321,423

The Notes form an integral part of these Financial Statements.

Petróleo Brasileiro S.A. – Petrobras

Consolidated Statement of Income

December 31, 2014, 2013 and 2012 (In millions of US Dollars, unless otherwise indicated)

	Note	**2014**	**2013**	**2012**
Sales revenues	24	143,657	141,462	144,103
Cost of sales		(109,477)	(108,834)	(108,276)
Gross profit		34,180	32,628	35,827
Income (expenses)				
Selling expenses		(6,827)	(4,904)	(4,927)
General and administrative expenses		(4,756)	(4,982)	(5,034)
Exploration costs	15	(3,058)	(2,959)	(3,994)
Research and development expenses		(1,099)	(1,132)	(1,143)
Other taxes		(760)	(780)	(386)
Impairment of assets	14	(16,823)	(544)	(137)
Write-off - overpayments incorrectly capitalized	3	(2,527)	–	–
Other expenses, net	25	(5,293)	(1,113)	(3,306)
		(41,143)	(16,414)	(18,927)
Net income (loss) before finance income (expense), share of earnings in equity-accounted investments, profit sharing and income taxes		(6,963)	16,214	16,900
Finance income		1,949	1,815	3,659
Finance expenses		(3,923)	(2,673)	(2,016)
Foreign exchange and inflation indexation charges		339	(1,933)	(3,569)
Net finance income (expense)	27	(1,635)	(2,791)	(1,926)
Share of earnings in equity-accounted investments	11.2	218	507	43
Profit sharing	22.7	(444)	(520)	(524)
Net income (loss) before income taxes		(8,824)	13,410	14,493
Income taxes	21.3	1,321	(2,578)	(3,562)
Net income (loss)		(7,503)	10,832	10,931

Net income (loss) attributable to:				
Shareholders of Petrobras		(7,367)	11,094	11,034
Non-controlling interests		(136)	(262)	(103)
		(7,503)	10,832	10,931
Basic and diluted earnings (loss) per weighted-average of common and preferred share - in U.S. dollars	23.6	(0.56)	0.85	0.85

The Notes form an integral part of these Financial Statements.

Petróleo Brasileiro S.A. – Petrobras

Consolidated Statement of Comprehensive Income

December 31, 2014, 2013 and 2012 (In millions of US Dollars)

	2014	**2013**	**2012**
Net income (loss)	(7,503)	10,832	10,931
Items that will not be reclassified to the statement of income:			
Actuarial gains (losses) on defined benefit pension plans	(5,947)	7,248	(4,693)
Deferred income tax	1,157	(2,153)	1,533
Cumulative translation adjustments	(15,606)	(20,397)	(14,049)
	(20,396)	(15,302)	(17,209)
Items that may be reclassified subsequently to the statement of income:			
Unrealized gains / (losses) on available-for-sale securities			
Recognized in shareholders' equity	−	1	498
Reclassified to the statement of income	−	(44)	(714)
Deferred income tax	−	15	72
	−	(28)	(144)
Unrealized gains / (losses) on cash flow hedge - highly probable future exports			
Recognized in shareholders' equity	(6,443)	(6,226)	−
Reclassified to the statement of income	702	303	−
Deferred income tax	1,953	2,012	−
	(3,788)	(3,911)	−
Unrealized gains / (losses) on cash flow hedge - others			
Recognized in shareholders' equity	6	9	(3)
Reclassified to the statement of income	1	9	7
Deferred income tax	−	−	1
	7	18	5
Share of other comprehensive income (losses) in equity-accounted investments	(263)	(265)	−
Total other comprehensive income (loss):	(24,440)	(19,488)	(17,348)

Total comprehensive income (loss)	(31,943)	(8,656)	(6,417)
Comprehensive income (loss) attributable to:			
Shareholders of Petrobras	(31,729)	(8,263)	(6,136)
Non-controlling interests	(214)	(393)	(281)
Total comprehensive income (loss)	(31,943)	(8,656)	(6,417)

The Notes form an integral part of these Financial Statements.

Petróleo Brasileiro S.A. – Petrobras

Consolidated Statement of Cash Flows

December 31, 2014, 2013 and 2012 (In millions of US Dollars)

	2014	**2013**	**2012**
Cash flows from Operating activities			
Net income (loss) attributable to the shareholders of Petrobras	(7,367)	11,094	11,034
Adjustments for:			
Non-controlling interests	(136)	(262)	(103)
Share of earnings in equity-accounted investments	(218)	(507)	(43)
Depreciation, depletion and amortization	13,023	13,188	11,119
Impairment of assets	16,823	544	137
Inventory write-down to net realizable value	1,015	580	742
Exploration expenditures written off	2,178	1,892	2,847
Write-off - overpayments incorrectly capitalized	2,527	−	−
Allowance for impairment of trade receivables	2,378	73	39
(Gains) losses on disposal of assets / write-offs of non-current assets, E&P areas returned and cancelled projects	481	(1,745)	2
Foreign exchange variation, indexation and finance charges	3,571	3,167	4,308
Deferred income taxes, net	(3,045)	402	1,266
Pension and medical benefits (actuarial expense)	2,022	2,566	2,091
Decrease (Increase) in assets			
Trade and other receivables, net	(2,507)	(1,142)	(1,522)
Inventories	570	(2,128)	(1,864)
Other assets	(2,803)	(303)	(2,028)
Increase (Decrease) in liabilities			
Trade payables	(1,211)	1,108	1,039
Taxes payable	(1,245)	(1,517)	(151)
Pension and medical benefits	(834)	(796)	(735)
Other liabilities	1,410	75	(290)
Net cash provided by operating activities	26,632	26,289	27,888
Cash flows from Investing activities			
Capital expenditures	(34,808)	(45,110)	(40,802)
Investments in investees	(329)	(199)	(146)
	3,744	3,820	276

Proceeds from disposal of assets (divestment)			
Divestment (investment) in marketable securities	(5,469)	5,718	2,051
Dividends received	387	146	241
Net cash (used in) investing activities	(36,475)	(35,625)	(38,379)
Cash flows from Financing activities			
Acquisition of Non-controlling interest	(98)	(70)	255
Financing and loans, net:			
Proceeds from long-term financing	31,050	39,542	25,205
Repayment of principal	(10,031)	(18,455)	(11,347)
Repayment of interest	(5,995)	(5,066)	(4,772)
Dividends paid	(3,918)	(2,656)	(3,272)
Net cash provided by financing activities	11,008	13,295	6,069
Effect of exchange rate changes on cash and cash equivalents	(378)	(1,611)	(1,115)
Net increase (decrease) in cash and cash equivalents	787	2,348	(5,537)
Cash and cash equivalents at the beginning of the year	15,868	13,520	19,057
Cash and cash equivalents at the end of the year	16,655	15,868	13,520

The Notes form an integral part of these Financial Statements.

Petróleo Brasileiro S.A. – Petrobras

Consolidated Statement of Changes in Shareholders' Equity

December 31, 2014, 2013 and 2012 (In millions of US Dollars)

	Share capital (net of share issuance costs)			**Accumulated other comprehensive income (deficit)**			
	Share Capital	**Share issuance costs**	**Change in interest in subsidiaries**	**Cumulative translation adjustment**	**Cash flow hedge - highly probable future exports**	**Actuarial gains (losses) on defined benefit pension plans**	**Other comprehensive income (loss)**
Balance at December 31, 2011	107,355	(279)	595	7,697	–	(4,440)	246
Capital increase with reserves	7						
Realization of deemed cost							(5)
Change in interest in subsidiaries			33				
Net income							
Other comprehensive income				(13,871)		(3,160)	(139)
Appropriations:							
Allocation of net income							
Dividends							
	107,362	(279)	628	(6,174)	–	(7,600)	102
Balance at December 31, 2012		107,083	628				(13,672)
Capital increase with reserves	9						
Realization of deemed cost							(5)

Change in interest in subsidiaries			46				
Net income							
Other comprehensive income				(20,266)	(3,911)	5,095	(275)
Appropriations:							
Allocation of net income							
Dividends							
	107,371	(279)	674	(26,440)	(3,911)	(2,505)	(178)
Balance at December 31, 2013		107,092	674				(33,034)
Capital increase with reserves	9						
Realization of deemed cost							(4)
Change in interest in subsidiaries			(526)				
Net income (loss)							
Other comprehensive income (loss)				(15,528)	(3,788)	(4,790)	(256)
Appropriations:							
Transfer from reserves							
Dividends							
	107,380	(279)	148	(41,968)	(7,699)	(7,295)	(438)
Balance at December 31, 2014		107,101	148				(57,400)

The Notes form an integral part of these Financial Statements.

Petróleo Brasileiro S.A. – Petrobras

Notes to the financial statements

(Expressed in millions of US Dollars, unless otherwise indicated)

1. The Company and its operations

Petróleo Brasileiro S.A. - Petrobras is dedicated, directly or through its subsidiaries (referred to jointly as "Petrobras" or "the Company") 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

2.1. Statement of compliance and authorization of financial statements

These consolidated financial statements have been prepared and are being presented in accordance with the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The information is presented in U.S. dollars.

These financial statements have been prepared under the historical cost convention, as modified by available-for-sale financial assets, financial assets and financial 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 consolidated financial statements were approved and authorized for issue by the Company's Board of Directors in a meeting held on April 22, 2015.

2.2. Functional and presentation currency

The functional currency of Petrobras and all of its Brazilian subsidiaries is the Brazilian Real. The functional currency of most of the Petrobras entities that operate outside Brazil is the U.S. dollar. The functional currency of Petrobras Argentina is the Argentine Peso.

Petrobras has selected the U.S. Dollar as its presentation currency. The financial statements have been translated from the functional currency (Brazilian Real) into the presentation currency (U.S. Dollar) in accordance with IAS 21 – "The effects of changes in foreign exchange rates". All assets and liabilities are translated into U.S. dollars at the closing exchange rate at the date of the financial statements; income and expenses, as well as the cash flows are translated into U.S. dollars using the average exchange rates prevailing during the year. Equity items are translated using the exchange rates prevailing at the dates of the transactions. All exchange differences arising from the translation of the consolidated financial statements from the functional currency into the presentation currency are recognized as cumulative translation adjustments (CTA) within accumulated other comprehensive income (loss) in the consolidated statements of changes in shareholders' equity.

Brazilian Real x U.S. Dollar	**Mar 2014**	**Jun 2014**	**Sep 2014**	**Dec 2014**	**Mar 2013**	**Jun 2013**	**Sep 2013**	**Dec 2013**
Quarterly average exchange rate	2.36	2.23	2.28	2.55	2.00	2.07	2.29	2.28
Period-end exchange rate	2.26	2.20	2.45	2.66	2.01	2.22	2.23	2.34

The Brazilian *real* x U.S. dollar exchange rate at April 15, 2015 was R$ 3.07 per U.S. dollar.

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

In the third quarter of 2014, the Company wrote off US$2,527 of capitalized costs representing amounts that Petrobras overpaid for the acquisition of property, plant and equipment in prior years.

Petróleo Brasileiro S.A. – Petrobras

Notes to the financial statements

(Expressed in millions of US Dollars, unless otherwise indicated)

According to testimony from Brazilian criminal investigations that became available beginning October 2014, senior Petrobras personnel conspired with contractors, suppliers and others from 2004 through April 2012 to establish and implement an illegal cartel that systematically overcharged the Company in connection with the acquisition of property, plant and equipment. Two Petrobras executive officers (*diretores*) and one executive manager were involved in this payment scheme, none of whom has been affiliated with the Company since April 2012; they are referred to below as the “former Petrobras personnel.” The overpayments were used to fund improper payments to political parties, elected officials or other public officials, individual contractor personnel, the former Petrobras personnel and other individuals involved in the payment scheme. The Company itself did not make the improper payments, which were made by the contractors and suppliers and by intermediaries acting on behalf of the contractors and suppliers.

Petrobras believes that under IAS 16, the amounts it overpaid pursuant to this payment scheme should not have been included in historical costs of its property, plant and equipment. However, Petrobras cannot specifically identify either the individual contractual payments that include overcharges or the reporting periods in which overpayments occurred. As a result, 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. The circumstances and the methodology are described below.

Background

In 2009, the Brazilian federal police began an investigation called “Lava Jato” (Car Wash) aimed at criminal organizations engaged in money laundering in several Brazilian states. The Lava Jato Operation 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.

Over the course of 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 the former Petrobras personnel. Based on the information available to Petrobras, the payment scheme involved a group of 27 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 contractor personnel, the 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.”

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

In connection with the investigation of the payment scheme, Paulo Roberto Costa, a former Chief Downstream Officer of Petrobras, was arrested in March 2014 and subsequently charged for money-laundering and passive corruption. Other former executives of Petrobras, including Renato de Souza Duque (a former Chief Services Officer), Nestor Cerveró (a former Chief International Officer) and Pedro José Barusco Filho (a former executive manager of the Services area), as well as former executives of Petrobras contractors and suppliers, have been or are expected to be charged as a result of the investigation.

Petróleo Brasileiro S.A. – Petrobras

Notes to the financial statements

(Expressed in millions of US Dollars, unless otherwise indicated)

When the Company issued its 2013 audited financial statements on February 27, 2014, when it filed its 2013 Form 20-F on April 30, 2014, and when it issued its interim financial statements for the six months ended June 30, 2014 on August 8, 2014, there was no evidence available to Petrobras related to the Lava Jato investigation that would have affected the conclusions of the Company regarding the fact that its financial statements fairly presented its financial position, and the extent of the payment scheme had not been made public.

Information and sources available to Petrobras

On October 8, 2014, Costa and Alberto Youssef testified in the 13th Criminal District Court of Curitiba (Vara Federal Criminal de Curitiba) ("Paraná Court"), publicly describing the payment scheme. Since then, extensive testimony of participants in the payment scheme who have entered into plea agreements has been made public. The Company's understanding of the payment scheme, and its methodology for measuring its impact on the Company, are based on this testimony, which includes the complete testimony of two of the former Petrobras personnel (Costa and Barusco), the complete testimony of two individuals who acted as intermediaries in the payment scheme (Youssef and Julio Gerin de Almeida Camargo), partial testimony of another individual who acted as an intermediary in the payment scheme (Shinko Nakandakari), and the complete testimony of one representative of a construction company (Augusto Ribeiro de Mendonça Neto).

The Brazilian Federal Prosecutor's Office, which is in possession of the full record of the investigation to date, filed administrative misconduct complaints (ações de improbidade administrativa) on February 20, 2015 against five cartel members based on the payment scheme and relied on the same approach used by the Company to measure the actual damages attributable to the payment scheme, as set out below.

A significant portion of the information mentioned above was made public after January 28, 2015, when the Company issued its interim financial statements as of and for the nine months ended September 30, 2014 not reviewed by independent auditors, amplifying and corroborating the information that was previously available, namely the testimony of Barusco, Costa, Youssef and Nakandakari.

The information available to the Company is generally consistent with respect to the existence of the payment scheme, the companies involved in the payment scheme, the former Petrobras personnel involved in the payment scheme, the period during which the payment scheme was in effect, and the maximum amounts involved in the payment scheme relative to the contract values of affected contracts.

Petrobras will 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. However, the Company has no expectation that additional information bearing on these matters is or will be available from internal sources.

Other information obtained in the course of the Lava Jato investigation, including portions of Nakandakari’s testimony, has not been made public. However, the Company believes that, at this point, the risk that new information emerges causing material changes to the known facts and materially affecting the adjustment described below is low. This belief is largely based on the fact that a significant amount of information has become public, it is unlikely that the Brazilian authorities (in possession of the full record of the investigation to date) would withhold information that is inconsistent with what they have publicly released (they have relied on the same approach to measure the actual damages attributable to the payment scheme in the civil and criminal proceedings they have already filed) and the public information is consistent even though it comes from a range of individuals with different positions and motivations, including two of the former Petrobras personnel, alleged intermediaries in the payment scheme and representatives of contractors and suppliers.

Petróleo Brasileiro S.A. – Petrobras

Notes to the financial statements

(Expressed in millions of US Dollars, unless otherwise indicated)

The Company's response to the facts uncovered in the Lava Jato investigation, a description of the payment scheme and the accounting issue regarding the payment scheme, as well as the approach adopted by the Company to account for the impact of the payment scheme are set out below.

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

While the internal and external investigations are ongoing, the Company is taking the necessary procedural steps with Brazilian authorities to seek compensation for the damages it has suffered, including those related to its reputation. 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, Petrobras may be entitled to receive a portion of such funds.

The proceedings will also include civil proceedings against cartel members, which Petrobras would have the right to join as a plaintiff, and it expects to do so. The civil proceedings typically result in three types of relief: effective damages, civil fines and moral damages. Petrobras would be entitled to any effective damages and possibly civil fines. Moral damages would typically be contributed to a federal fund, although Petrobras may seek to obtain moral damages once it joins the proceedings as a plaintiff.

Petrobras does not tolerate corruption or any illegal business practices of its contractors or suppliers or the involvement of its employees in such practices, and it has therefore undertaken the following initiatives in furtherance of the investigation of irregularities involving its business activities and to improve its corporate governance system:

- The Company has established several Internal Investigative Committees (Comissões Internas de Apuração – CIA) to investigate instances of non-compliance with corporate rules, procedures or regulations. We have provided the findings of the internal commissions that have been concluded to Brazilian authorities.

- On October 24 and 25, 2014, the Company engaged two independent law firms, U.S. firm Gibson, Dunn & Crutcher LLP and Brazilian firm Trench, Rossi e Watanabe Advogados, to conduct an independent internal investigation.

- The Company has been cooperating fully with the Brazilian Federal Police (Polícia Federal), the Brazilian Public Prosecutor's Office (Ministério Público Federal), the Brazilian Judiciary, and other Brazilian authorities (the Federal Audit Court – Tribunal de Contas da União – TCU, and the Federal General Controller – Controladoria Geral da União – CGU).

- The Company has established committees to analyze the application of sanctions against contractors and suppliers, and imposed a provisional ban on contracting with the cartel members (and entities related to them) mentioned in the testimony that has been made public.

- The Company has developed and implemented measures to improve corporate governance, risk management and control, which are documented in standards and minutes of management meetings that establish procedures, methods, responsibilities and other guidelines to integrate such measures into the Company’s practices.

- The Company has created a position of Governance, Risk and Compliance Officer, with the aim of supporting the Company’s compliance programs and mitigating risks in its activities, including fraud and corruption. The new Officer participates in the decisions of the Executive Board, and any matter submitted to the Executive Board for approval must previously be approved by this Officer as they relate to governance, risk and compliance.

Petróleo Brasileiro S.A. – Petrobras

Notes to the financial statements

(Expressed in millions of US Dollars, unless otherwise indicated)

- On January 13, 2015 the Board of Directors appointed Mr. João Adalberto Elek Junior to the position of Governance, Risk and Compliance Officer. Mr. João Adalberto Elek Junior took office on January 19, 2015. He will serve a three-year term, which may be renewable, and may only be removed by a vote of the Board of Directors, including the vote of at least one Board Member elected by the non-controlling shareholders or by the preferred shareholders.

- A Special Committee was formed to act independently and to serve as a reporting line to the Board of Directors for the firms conducting the independent internal investigation. The Special Committee is composed of Ellen Gracie Northfleet, retired Chief Justice of the Brazilian Supreme Court (as chair of the Committee), Andreas Pohlmann, Chief Compliance Officer of Siemens AG from 2007 to 2010, and the executive officer of Governance, Risk and Compliance, João Adalberto Elek Junior.

3.2. Description of the payment scheme and its impact on the Company’s financial statements

The following items discuss the need to correct the carrying amount of specified property, plant and equipment due to the impact of the payment scheme, as well as the impracticability of identifying actual improper payments, tying the overpayments to specific contract payments, or measuring the exact amount of the overpayments to be corrected. They also discuss the approach adopted by the Company to write off capitalized costs representing amounts that Petrobras overpaid for property, plant and equipment. Note 5.8 below discusses the two alternative approaches considered and rejected by the Company as surrogates for measuring the exact amounts.

3.2.1. The payment scheme and the need to correct the carrying amount of specified property, plant and equipment

According to the information available to the Company described above, under the payment scheme, a large number of contractors and suppliers colluded with the former Petrobras personnel to overcharge Petrobras under construction contracts and contracts to provide Petrobras with goods and services, and used the overpayments to make improper payments to political parties, elected officials or public officials, individual contractor personnel, or the former Petrobras personnel.

In particular, the former Chief Downstream Officer, the former Chief Services Officer and the former executive manager of the Services area of Petrobras were involved in the payment scheme. Those individuals, who were all in positions of authority at Petrobras, not only failed to report the existence of the cartel, but they also used their influence to further the objectives of the payment scheme, primarily by ensuring that the cartel members would be selected to participate in bidding rounds for goods and services contracts with Petrobras so that the cartel members would secure contracts with the Company. However, there is no available information indicating that these individuals controlled or directed the use of the overpayments once the funds left Petrobras.

In addition to the payment scheme, the investigations identified several other specific instances in which Petrobras was overcharged in connection with the acquisition of property, plant and equipment. The amount that Petrobras was overcharged was used to make unrelated payments to Petrobras personnel.

3.2.2. Impracticability of determining the actual amount of overpayment and the periods to be corrected

It is impracticable to identify the exact date and amount of each overpayment by the Company to the contractors and suppliers because of the limitations described below:

The information available to the Company in the testimony identifies the companies involved in the payment scheme and the period of time it was in effect, but the testimony does not identify all the affected contracts, the individual contractual payments that include overcharges or the reporting periods in which overpayments occurred.

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Petrobras itself did not make or receive any improper payments. They were made by outside contractors and suppliers, so the exact amounts that the Company overpaid to fund these payments cannot be identified. The information to determine the amount by which the Company was overcharged by the cartel members is not contained within the Company's accounting records. These records reflect the terms of the contract entered into by the Company, which entailed payments that were inflated because of the conspiracy among the cartel members and the former Petrobras personnel to overcharge Petrobras. Since the Company cannot identify the amount of overpayments for specific contractual payments or in specific accounting periods, it cannot determine the period in which to adjust property, plant and equipment.

Two independent law firms are conducting an independent internal investigation, under the direction of the Special Committee mentioned above. The independent internal investigation is not expected to provide additional quantitative information of a kind to support an adjustment to the Company's financial statements. The information available to the investigators is limited to internal information of Petrobras, so it will not be able to produce specific identified information on the amount by which the Company was overcharged. The money-laundering activities alleged to have occurred were designed to hide the origins and amounts of the funds involved, so a specific accounting should not be expected.

The ongoing investigations by Brazilian authorities will focus on the criminal liability of individuals, and not on establishing a full accounting of the amounts that Petrobras was overcharged by the cartel members or all improper payments made by contractors and suppliers from the Company's contract payments. These investigations may take several years before all the evidence and allegations are evaluated.

The Brazilian authorities have filed actions against contractors and suppliers and their respective representatives. In these actions, the prosecutors have sought judicial remedies for administrative misconduct (ação de improbidade administrativa) using 3% of the contract prices paid to the contractors and suppliers to measure the actual damages attributable to the payment scheme, which is consistent with the methodology used by the Company to account for the effects of the payment scheme. The scope of this process is not expected to produce a full accounting of all improper payments, even after the significant amount of time the investigations by Brazilian authorities may take. Brazilian law does not provide for discovery in civil proceedings, so the information that is produced in these proceedings would not be expected to exceed the information produced in the investigation and the criminal proceedings.

As previously discussed, despite the limitations described above, the information available to the Company is, in general, consistent in terms of the individuals and companies involved in the payment scheme, the period during which the payment scheme was in effect, and the percentage of overcharging applied over the total contract values under affected contracts and used to fund the improper payments made by contractors and suppliers.

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

As it is impracticable to identify specific periods and amounts for the overpayments by the Company, the Company considered all the information available (as described above) to quantify the impact of the payment scheme.

The Company included in its historical cost for property, plant and equipment all of the amounts paid under the affected contracts. However, the Company believes that the amount of its contract payments representing overpayments to contractors and suppliers pursuant to the payment scheme should not have been capitalized as property, plant and equipment.

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The testimony identified 27 cartel members (Brazilian contractors and suppliers involved in the payment scheme) and several additional instances where a contractor or supplier acting individually overcharged to make improper payments unrelated to the payment scheme.

The testimony states that the cartel and the payment scheme were active from 2004 through April 2012. The Company also evaluated whether the payment scheme affected periods before 2004. However, the testimony does not indicate that the payment scheme was in effect before 2004 and even if it were, the impact of contractors and suppliers overcharging the Company prior to 2004 is not material, as most of the Company's property, plant and equipment assets were built between 2004 and 2014 (the balance of property, plant and equipment was US$30.8 billion as of December 31, 2003) and the assets existing as of December 31, 2003 were substantially depreciated by 2014.

Based on the available information described above, the Company concluded that the portion of the costs incurred to build its property, plant and equipment that resulted from contractors and suppliers in the cartel overcharging the Company to make improper payments should not have been capitalized. In order to account for the impact of overpayments, the Company developed an estimation methodology to serve as a proxy for the adjustment that should be made to property plant and equipment using the five steps described below:

(1) Identify contractual counterparties: the Company listed all the companies identified in public testimony, 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 identified 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.

The calculation considered all the recorded amounts in the Company's books and records from 2004 through September 2014 with respect to contracts initially entered into between 2004 and April 2012, and any related supplemental contracts, between the companies of the Petrobras group and the cartel members (individually or in a consortium). This broad scope was used to produce the best estimate for quantifying the aggregate amount of the overpayment, even if there was no specific evidence of overcharging or improper payments under every affected contract. The Company also identified amounts recorded in its books and records concerning specific contracts and projects with the non-cartel members to account for the amounts those companies overcharged Petrobras to fund improper payments they made, unrelated to the payment scheme and the cartel.

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.

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The Company has a number of ongoing projects in which the original contract was entered into between 2004 and April 2012. The approach adopted by the Company considers that the overcharge was applied over total contract values. These include contract payments to be incurred by Petrobras in future periods, because it is impracticable to allocate the aggregate overpayments to specific periods and the portion of the overcharge that relates to future contract payments may have been charged to the Company in prior periods. Therefore, the write-off of overpayments incorrectly capitalized takes into account the total contract values and not only contract payments already incurred. However, as mentioned above, based on the available information, the Company believes that the cartel and the payment scheme were dismantled after April 2012 and that, considering all the developments in the ongoing criminal investigation, the improper payments related to the payment scheme have stopped.

Petrobras believes that this methodology produces the best estimate for the aggregate overstatement of its property, plant and equipment resulting from the payment scheme, in the sense that it represents the upper bound of the range of reasonable estimates. The estimate assumes that all contracts with the identified counterparties were affected and that 3% represents the amount by which the Company overpaid on those contracts. Both assumptions are supported by the testimony, even though some testimony indicated lower percentages with respect to certain contracts, a shorter period (2006 to 2011), or fewer contractors involved.

Along with the write-off to reduce the carrying amount of specified property, plant and equipment, the impact in the current period includes write-offs of tax credits (VAT and correlated taxes) and a provision for credits applied in prior periods with respect to property, plant and equipment that has been written-down, as well as the reversal of depreciation of affected assets beginning on the date they started operating.

As previously discussed, the testimony does not provide sufficient information to allow the Company to determine the specific period during which the Company made specific overpayments. Accordingly, the write-off of overpayments incorrectly capitalized was recognized in the third quarter of 2014, because it is impracticable to determine the period-specific effect in each prior period. The Company believes this approach is the most appropriate pursuant to the requirements of IFRS for the correction of an error.

In addition, the Company has evaluated the materiality of the impact of the payment scheme on prior periods presented in its financial statements for comparative purposes using two different analyses: it estimated the allocation of the overpayments to specific prior periods if all overpayments were made on a pro rata basis out of each of the actual contract payments and capitalized correspondingly; and it also estimated the materiality of improper payments to prior periods if the improper payments had been made at inception (on the date the contracts were entered into). Both allocation exercises indicated writing off the overpayment that was improperly capitalized would not have been material to any of the prior periods presented for comparative purposes.

The Company has not recovered and cannot reliably estimate any recoverable amounts at this point. Any amounts ultimately recovered would be recorded as income when received (or when their realization becomes virtually certain).

As previously mentioned, Petrobras believes that under IAS 16, the amounts it overpaid pursuant to the payment scheme should not have been included in the historical cost of the property, plant and equipment. Therefore, under Brazilian tax legislation, this write-off is considered a loss resulting from unlawful activity and subject to the evolution of the investigations in order to establish the actual extent of the losses before they can be deducted from an income tax perspective.

As a result, at September 30, 2014, it is not possible for the Company to estimate the amounts that will ultimately be considered deductible or the timing for the deduction. Accordingly no deferred tax assets were recognized for the write-off of overpayments incorrectly capitalized.

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The Company carefully considered all available information and, as discussed above, does not expect that new developments in the investigations by the Brazilian authorities, by the independent law firms conducting an internal investigation, or by new internal commissions set up (or a review of the results of previous internal investigations) could materially impact or change the methodology described above. Notwithstanding this expectation, the Company will continuously monitor the investigations for additional information and will review its potential impact on the adjustment.

The total impact of the adjustments described above by business area is set out below.

"Write-off – overpayments incorrectly capitalized"	**E&P**	**RTM**	**GAS & POWER**	**DISTRIB.**	**INTER.**	**CORP.**	**TOTAL**
Payment scheme:							
Total contract amounts (*)	25,573	45,233	8,663	309	307	1,355	81,440
Estimated aggregate overpayments (3%)	767	1,358	260	9	9	41	2,444
Unrelated payments (outside the cartel)	57	−	4	−	−	−	61
	824	1,358	264	9	9	41	2,505
Reversal of depreciation of the affected assets	(35)	(81)	(21)	−	−	(4)	(141)
Impact on property, plant and equipment	789	1,277	243	9	9	37	2,364
Write-down of tax credits related to affected assets (**)	15	121	23	−	−	4	163
Write-off – overpayments incorrectly capitalized	804	1,398	266	9	9	41	2,527

(*) Of this amount, US$ 17,999 represents amounts scheduled to be paid after September 30, 2014.
(**) Write-down of tax credits that will not be applicable in the future.

The Company has conducted a sensitivity analysis taking into account that approximately 26% of the write-off of overpayments incorrectly capitalized relates to assets that were charged for impairment in the fourth quarter of 2014. Excluding these assets, an increase or decrease of 1% in the applicable percentage of the overcharge applied over total contract values would result in an increase or decrease of US$ 603 in the write-off of overpayments incorrectly capitalized. However, as discussed above, the Company believes it has used the most appropriate methodology and assumptions to determine the impact of the payment scheme and there is no evidence that would indicate the possibility of a material change in the amounts that were written off.

3.3. Changes in the current business context

Changes in the Company’s business context and the impact of the Lava Jato investigation prompted a review of the Company’s future prospects and ultimately led to the reduction in the pace of the Company’s capital expenditures.

Petrobras’s ability to invest its available funds has been limited as a result of a decrease in expected future operating revenues following the decline of oil prices, along with the devaluation of the Brazilian real, which has increased the Company’s cash outflows to service debt in the near term, most of which is denominated in foreign currencies. For a variety of reasons, including the economic and political environment in Brazil, Petrobras is currently unable to access the capital markets. Other sources of available financing are limited, and in any event would be insufficient to meet Petrobras’s investment needs. Petrobras also faces a shortage of qualified contractors and suppliers as a result of the difficulties created for suppliers by the Lava Jato investigation.

As a result, Petrobras has recently determined to delay or suspend the completion of some of the assets and projects included in Petrobras’s capital expenditure plan that are expected to contribute little to its cash generation from its operations or that present complications due to contractor insolvency or to a lack of availability of qualified suppliers (as a result of the Lava Jato investigation or otherwise). Those changes had a material impact in the Company’s impairment tests, as described in note 14.

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3.4. Investigations involving the Company

Petrobras is not a target of the Lava Jato investigation. 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.

3.5. Legal proceedings involving the Company

See note 30 for information about class actions and the Company's other material legal proceedings.

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 its consolidated structured entities and control is not determined by voting rights, but by the power the Company has over the relevant operating activities of such entities. Consolidated structured entities are set out below:

Consolidated structured entities	**Country**	**Main segment**
Charter Development LLC – CDC (i)	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

(i) Companies abroad with financial statements prepared in foreign currencies.

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.

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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 Company operates under 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 for the purpose of supplying, primarily, its domestic refineries; and also selling the crude oil surplus and oil products produced in the natural gas processing plants to the domestic and foreign markets. The exploration and production segment also operates through partnerships with other companies.

b) Refining, Transportation and Marketing (RTM): this segment covers the refining, logistics, transport and trading of crude oil and oil products activities, exporting 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 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.

e) Distribution: this segment includes the activities of Petrobras Distribuidora S.A., which operates through its own retail network and wholesale channels to sell oil products, ethanol and vehicle natural gas in Brazil to retail, commercial and industrial customers, as well as other fuel wholesalers.

f) International: this segment covers the activities of exploration and production of oil and gas, refining, transportation and marketing, gas and power, and distribution, carried out outside of Brazil in a number of countries in the Americas, Africa, Europe and Asia.

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.

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, are classified according to the Company's intention and are subsequently measured as set out below:

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- Fair value through profit or loss – includes financial instruments purchased and held for trading in the short term. These instruments are subsequently 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 positive intention and ability to hold to maturity. These instruments are subsequently measured at amortized cost using the effective interest rate method.

- Available-for-sale – includes non-derivative financial instruments that are either 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 subsequently measured at fair value. Subsequent changes in fair value are recognized in other comprehensive income, in the shareholders' equity and recycled to the statement of income when the instruments are derecognized.

Subsequent value changes attributable to interest income or changes in foreign exchange rates or inflation indexation (price indices) 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 uncollectibility.

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, after initial recognition, are 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.

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. Hedge accounting

Hedge accounting is formally documented at inception in terms of the hedging relationship and the Company's risk management objective and strategy for undertaking the hedge.

Hedging relationships that qualify for hedge accounting are classified as: (i) fair value hedge, when they involve a hedge of the exposure to changes in fair value of a recognized asset or liability, unrecognized firm commitments, or an identifiable portion of such assets, liabilities or firm commitments; and (ii) cash flow hedges when they involve a 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 forecast transaction.

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In hedging relationships that qualify for fair value hedge accounting, the gain or loss from remeasuring the hedging instrument and the hedged item at fair value is recognized in the statement of income.

In hedging relationships that qualify for cash flow hedge accounting, the Company designates derivative financial instruments and long-term debt (non-derivative financial instruments) as hedging instruments. 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 recognized in the statement of income.

When, the hedging instrument expires or is sold, terminated or exercised or 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 remains separate 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 flow 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.

Maintenance materials, supplies, and others are mainly comprised of production supplies and operating and consumption 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 the identified cost.

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, relating to the arrangement and in a joint venture, the parties have rights to the net assets of the arrangement.

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Profit or loss, assets and liabilities related to joint ventures and associates are accounted for by the equity method. In a joint operation the Company recognizes the amount of its share of assets, liabilities and related income and expenses.

Accounting policies of joint ventures and associates have been modified, 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, development and production of crude oil and natural gas 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.

- Costs directly attributable to exploratory wells pending determination of proved reserves are capitalized within property, plant and equipment. Unsuccessful exploratory wells are charged to expense when they are considered dry holes, uneconomic (did not encounter potentially economic oil and gas quantities) or were abandoned due to mechanical accidents. Exploratory wells that have found oil and gas reserves, but those reserves 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.

- 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.

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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, including the present value of 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 performing regular major inspections and maintenance. Those expenditures are capitalized if the recognition criteria are met or otherwise expensed when incurred. The capitalized costs are depreciated over the period through the next major maintenance.

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.

General and specific 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. The Company suspends capitalization of borrowing costs during extended periods in which it suspends active development of a qualifying asset.

Except for assets with useful lives shorter than the life of the field, which are depreciated based on the straight line method, depreciation, depletion and amortization of proved oil and gas producing properties are accounted for pursuant to the unit-of-production method.

Assets with useful lives shorter than the life of the field, floating platforms and assets that are unrelated to oil and gas production are depreciated based on the straight line method.

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) and the acquisition costs with respect to the Assignment Agreement, referring to the right to carry out prospection and drilling activities for oil, natural gas and other liquid hydrocarbons located in blocks in the pre-salt area (“*Cessão Onerosa*”) is recognized using the unit-of-production method, computed based on the units of production over the total proved oil and gas reserves, applied on a field by field basis.

Except for land, which is not depreciated, other property, plant and equipment are depreciated on a straight line basis. See note 12 for further information about the estimated useful life by class of assets.

4.9. Intangible assets

Intangible assets are measured at the acquisition cost, less accumulated amortization and impairment losses and comprise rights and concessions, including the signature bonus paid for obtaining concessions for exploration of oil and natural gas (capitalized acquisition costs); public service concessions; trademarks; patents; software and goodwill.

Signature bonuses paid for obtaining concessions for exploration of oil and natural gas are initially capitalized within intangible assets and are transferred to property, plant and equipment upon the declaration of commerciality. The acquisition costs with respect to the Assignment Agreement were reclassified to property, plant and equipment during 2013 and 2014. On December 29, 2014 the Company submitted the declaration of commerciality of the last area of the agreement to the Brazilian Agency of Petroleum, Natural Gas and Biofuels (*Agência Nacional de Petróleo, Gás Natural e Biocombustíveis*) - *ANP*. Signature bonuses are not amortized until they are transferred to property, plant and equipment.

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Intangible assets with a finite useful life, other than amounts paid for obtaining concessions for exploration of oil and natural gas of producing properties, are amortized over the useful life of the asset on a straight-line basis.

Internally-generated intangible assets are not capitalized and are expensed as incurred, except for development costs that meet the recognition criteria related to completion and use of assets, probable future economic benefits, and others.

Intangible assets with an indefinite useful life are not amortized but are tested annually for impairment considering individual assets or cash-generating units. Their useful lives are reviewed annually to determine whether events and circumstances continue to support an indefinite useful life assessment for those assets. If they do not, the change in the useful life assessment from indefinite to finite is accounted for on a prospective basis.

4.10. Impairment

Property, plant and equipment and intangible assets with definite useful lives are tested for impairment when there is an indication that the carrying amount may not be recoverable. Assets related to exploration and development of oil and gas and assets that have indefinite useful lives, such as goodwill acquired in business combinations are tested for impairment annually, irrespective of whether there is any indication of impairment.

The impairment test is performed by a comparison of the carrying amount of an individual asset or a cash-generating unit (CGU) with its recoverable amount. Whenever the recoverable amount is less than the carrying amount, an impairment loss is recognized to reduce the carrying amount to the recoverable amount. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use. Considering the specificity of the Company’s assets, value in use is generally used by the Company for impairment testing purposes, except when specifically indicated.

Value in use is estimated based on the present value of the risk-adjusted (for specific risks) future cash flows expected to arise from the continuing use of an asset or cash-generating unit (based on assumptions that represent the Company’s best estimates), discounted at a pre-tax discount rate. This rate is obtained from the Company’s post-tax weighted average cost of capital (WACC). Cash flow projections are mainly based on the following assumptions: prices based on the Company’s most recent strategic plan; production curves associated with existing projects in the Company's portfolio, operating costs reflecting current market conditions, and investments required for carrying out the projects.

For purposes of the impairment test, assets are grouped at the smallest identifiable group that generates largely independent cash inflows from other assets or groups of assets (the cash-generating unit). Assets related to exploration and development of oil and gas are tested annually for impairment or when there is an indication that the carrying amount may not be recoverable, on a field by field basis.

Reversal of previously recognized impairment losses is permitted for assets other than goodwill.

4.11. Leases

Leases that transfer substantially all the risks and rewards incidental to ownership of the leased item are recognized as finance leases.

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For finance leases, when the Company is the lessee, assets and liabilities are recognized at the lower of the fair value of the leased property or the present value of the minimum lease payments, both determined at the inception of the lease.

Capitalized lease assets are depreciated on a systematic basis consistent with the depreciation policy the Company adopts for property, plant and equipment that are owned. Where there is no reasonable certainty that the Company will obtain ownership by the end of the lease term, capitalized lease assets are depreciated over the shorter of the lease term or the estimated useful life of the asset.

When the Company is the lessor, a receivable is recognized at the amount of the net investment in the lease.

If a lease does not transfer substantially all the risks and rewards incidental to ownership of the leased item, it is classified as an operating lease. Operating leases are recognized as expenses over the period of the lease.

Contingent rents are recognized as expenses when incurred.

4.12. Assets classified as held for sale

Assets, disposal groups and liabilities directly associated with those assets are classified as held for sale if their carrying amounts will principally be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is approved by the Company's Board of Directors and the asset or disposal group is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification as held for sale.

However, events or circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the Company's control and there is sufficient evidence that it remains committed to its plan to sell the assets (or disposal groups).

Assets (or disposal groups) classified as held for sale and the associated liabilities are measured at the lower of their carrying amount and fair value less costs to sell. Assets and liabilities are presented separately in the statement of financial position.

4.13. Decommissioning costs

Decommissioning costs are future obligations to perform environmental restoration, dismantle and remove a facility when it terminates its operations due to the exhaustion of the area or economic conditions.

Costs related to the abandonment and dismantling of areas are recognized as part of the cost of an asset (with a corresponding liability) based on the present value of the expected future cash outflows, discounted at a risk-adjusted rate when a future legal obligation exists and can be reliably measured. Unwinding of the discount of the corresponding liability is recognized as a finance expense, when incurred. The asset is depreciated similarly to property, plant and equipment, based on the class of the asset.

Future decommissioning costs for oil and natural gas producing properties are initially recognized after a field is declared to be commercially viable, on a field by field basis, and are revised annually. Decommissioning costs related to proved developed oil and gas reserves are depreciated by applying the unit-of-production method, computed based on a unit-of-production basis over the proved developed oil and gas reserves, applied on a field by field basis.

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4.14. Provisions, contingent assets and contingent liabilities

Provisions are recognized when there is a present obligation (legal or constructive) that arises from past events and for which it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, which must be reasonably estimable.

Contingent assets are not recognized.

Contingent liabilities for which the likelihood of loss is considered to be possible or which are not reasonably estimable are not recognized in the financial statements but are disclosed unless the expected outflow of resources embodying economic benefits is considered remote.

4.15. Income taxes

Income tax expense for the period comprises current and deferred tax.

a) Current income taxes

The Company has adopted the Transition Tax Regime in Brazil (RTT) in order to exclude potential tax impacts from the adoption of IFRS in the determination of taxable profit. RTT is based on Brazilian tax/corporate regulations and accounting principles as of December 31, 2007. Therefore, taxable profit differs from accounting profit due to certain adjustments required by tax regulations.

Law 12,973, dated as of May 13, 2014, terminated the RTT and established a new tax regime. The new tax regime is mandatory for 2015 and optional for 2014. The Company has not adopted the new tax regime for 2014 and, therefore, its taxable profit was determined based on the RTT.

The Company does not expect the adoption of the new tax regime to result in material impacts in its tax expense or in its financial statements.

The tax currently payable is computed based on taxable profit for the year, calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

b) Deferred income taxes

Deferred income taxes are recognized on temporary differences between the tax base of an asset or liability and its carrying amount. Deferred income tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences and carryforward of unused tax losses or credits to the extent that it is probable that taxable profit will be available against which those deductible temporary differences can be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Current and deferred tax assets and current and deferred tax liabilities are offset when they relate to income taxes levied on the same taxable entity.

4.16. Employee benefits (Post-Employment)

Actuarial commitments related to post-employment defined benefit plans and health-care plans are recognized as liabilities in the statement of financial position based on actuarial calculations which are revised annually by an independent qualified actuary (to update for material changes in actuarial assumptions and estimates of expected future benefits), using the projected unit credit method, net of the fair value of plan assets, when applicable, out of which the obligations are to be directly settled.

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Actuarial assumptions include: demographic assumptions; financial assumptions; medical costs estimates, historical data related to benefits paid and employee contributions.

Under the projected credit unit method, each period of service gives rise to an additional unit of benefit entitlement and each unit is measured separately to determine the final obligation.

Changes in the net defined benefit liability (asset) are recognized when they occur, as follows: i) service cost and net interest cost in the statement of income; and ii) remeasurements in other comprehensive income.

Service cost comprises: (i) current service cost, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period; (ii) past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction, modification, or withdrawal of a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan); and (iii) any gain or loss on settlement.

Net interest on the net defined benefit liability (asset) is the change during the period in the net defined benefit liability (asset) that arises from the passage of time.

Remeasurement of the net defined benefit liability (asset) is recognized in other comprehensive income and comprises: (i) actuarial gains and losses; (ii) the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and (iii) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

The Company also contributes amounts to defined contribution plans, that are expensed when incurred and are computed based on a percentage over salaries.

4.17. Share capital and distributions to shareholders