

Notes to the Consolidated Financial Statements

1. General information

Neste Corporation (the Company) is a Finnish public limited liability company domiciled in Espoo, Finland. The company is listed on the NASDAQ OMX Helsinki. The address of its registered office is Keilaranta 21, P.O. Box 95, 00095 Neste, Finland.

Neste Corporation and its subsidiaries (together referred to as the Group) is a fore-runner in oil refining and renewable solutions. Neste offers its customers cleaner traffic solutions and industrial products based on cutting-edge research. The Group's refineries and other production facilities, together with its network of service stations and other retail outlets in Finland and the Baltic Rim area, supply both domestic and export markets with gasoline, diesel fuel, aviation fuel, marine fuel, heating oil, heavy fuel oil, base oil, lubricant, traffic fuel components, solvent, liquefied petroleum gas, and bitumen as well as renewable diesel and other renewable products based on Neste's proprietary technology. Neste's customers benefit not only from the high quality products, but also from the comprehensive supply and logistics services that Neste can provide. As an oil refiner, Neste is a leading manufacturer of high-quality fuels for cleaner traffic.

The Board of Directors has approved these consolidated financial statements for issue on 6 February 2017.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRS IC) interpretations applicable to companies reporting under IFRS as adopted by the European Union. The notes to the consolidated financial statements also include compliance with Finnish accounting and corporate legislation. The consolidated financial statements have been prepared under the historic cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative financial instruments) at fair value through the comprehensive income statement.

The consolidated financial statements are presented in millions of euros unless otherwise stated. The figures in the tables are exact figures and consequently the sum of individual figures may deviate from the sum presented.

New standards, significant amendments and interpretations adopted by the Group

There have been no new standards, significant amendments or interpretations to existing standards in year 2016, which would have had a material impact on Neste's consolidated financial statements.

New standards, amendments and interpretations not yet adopted

Certain new interpretations, amendments to existing standards or new standards have been published. The Group intends to adopt these standards when they become effective.

IFRS 9 Financial instruments

IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains, but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through other comprehensive income and fair value through an income statement. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through an income statement with the irrevocable option at inception to present changes in fair value in other comprehensive income not to be recycled. A new expected credit loss model replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income for liabilities designated at fair value through income statement. IFRS 9 relaxes the requirements for hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the hedged ratio to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39.

IFRS 9 has been endorsed and approved by the EU in November 2016. The standard is effective from 1 January 2018 onwards. Early adoption is permitted. The Group will start applying IFRS 9 from 1.1.2018. Classification and measurement changes or impairment requirements for financial instruments do not have major effects for Neste.

Application of hedge accounting within existing hedge accounting relationships (cash flow and fair value hedges within foreign exchange and interest rate derivatives) will continue under IFRS 9 as earlier.

IFRS 9 will allow the application of hedge accounting in separate commodity risk components, but the Group does not expect to be applying hedge accounting in commodity derivatives. The Group hedges its commodity risk in line with its risk management policy and these derivatives will continue to be presented at fair value through income statement.

IFRS 15 Revenue from contracts with customers

IFRS 15 was issued in May 2014. The standard deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces all existing requirements (IAS 18 Revenue and IAS 11 Construction contracts and related interpretations).

IFRS 15 has been endorsed by the EU in September 2016. The standard is effective for annual periods beginning on or after 1 January 2018. Early adoption is permitted. The Group will start applying IFRS 15 from 1.1.2018, and will apply the modified retrospective model.

Based on the Groups' interpretations, it has been assessed that the implementation of IFRS 15 is not likely to have a significant impact on the consolidated financial statements. Management has assessed the IFRS 15 impact on the different agreement types that are used in Neste's business areas. The majority of the Group's net sales comprise of fuel and other product sales. These sales contracts are mostly standard in nature, and the delivery terms have been investigated, with no major impact compared to the current revenue recognition. Certain storage service contracts, rebates, bonuses, penalties, warranties and other special terms and conditions that deviate from the basic agreement types have also been analyzed in more detail, and these are unlikely to have an impact on Neste's revenue recognition compared to the current accounting policy.

A part of the Group's product sales are under CIF Incoterm conditions, where the total sales price is allocated to the separate performance obligations; the first being the product and the second being the other costs, insurance and freight. The sales price allocated to the product is recognized upon shipment. The sales price for the

costs, insurance and freight will be recognized when the latter performance obligation has been fulfilled. However, the allocated sales price for these is a minor part of the total revenue from contracts with customers, and thus the estimated impact of IFRS 15 on the Group's net sales and operating profit is estimated to be minor.

Subsidiary Neste Jacobs' current revenue recognition based on the percentage of completion method is also consistent with IFRS 15, as the revenue is already recognized over time.

Renewable products' RINs (Renewable Identification Number), LCFS (Low Carbon Fuels Standard) credits, and BTCs (Blender's Tax Credits) and other similar separate performance obligations have also been assessed, with no changes to the current revenue recognition.

At the moment there is no industry guidance for the Oil and Gas Industry. Should there be any industry guidance published, the Group will follow that guidance and the impact on the Group's net sales might differ from the current assessment described above.

IFRS 16 Leases

IFRS 16 Leases, issued in January 2016, sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the entity. IFRS 16 supersedes IAS 17 Leases and IFRIC 4 Determining whether an Arrangement contains a Lease. The standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. In lessor accounting IFRS 16 substantially carries forward requirements in IAS 17. IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial application of IFRS 16 after EU endorsement. The Group has preliminary reviewed leasing, service and some utility purchase contracts to assess the effects of IFRS 16. The Group's assessment of the standard impact is under further investigation.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Group.

Estimates and judgements requiring management estimation

The preparation of Consolidated Financial Statements in conformity with the International Accounting Standard requires the Group's management to make estimates and assumptions which have an impact on reported assets and liabilities, the disclosure of contingent assets and liabilities at the dates of the consolidated financial statements, and the reported amounts of income and expenses during the reporting period. In addition, management judgement may be required in applying the accounting principles, for example, classifying assets as held for sale.

These estimates, assumptions and judgements are based on management's historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The actual amounts may differ significantly from the estimates used in the financial statements.

The Group follows the changes in estimates, assumptions and the factors affecting them by using multiple internal and external sources of information. Possible changes in estimates and assumptions are recognized in the financial period the estimate or assumption is changed. The most significant estimates relate to the following:

Inventories

Inventories are measured at the lower value of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period. More information regarding inventories is presented in [Note 22](#).

Impairment testing

Intangible assets and property, plant and equipment are always tested for impairment, when there is any indication that an asset may be impaired. When the recoverable amount of an asset is less than the carrying amount, an impairment loss is recognized as an expense immediately and the carrying amount is reduced to the asset's recoverable amount.

The amounts recoverable from cash generating units' operating activities are determined based on value in use calculations. These calculations are based on estimated future cash flows approved by the Group's management, covering a period of three years. Preparation of these estimates requires management to make assumptions relating to future expectations. The main assumptions used relate to the

estimated future operating cash flows and discount rates. More information regarding impairment testing is presented in [Note 18](#).

Taxes

Determination of income taxes and deferred tax assets and liabilities and the amount of deferred tax asset to be recognized requires management judgement.

The Group has deferred tax assets and liabilities which are expected to be realized through the income statement over extended periods of time in the future. In calculating the deferred tax items, the Group is required to make certain assumptions and estimates regarding the future tax consequences attributable to differences between the carrying amounts of assets, and liabilities as recorded in the financial statements and their tax basis.

More information regarding taxes is presented in [Note 14](#), Income tax expense and in [Note 28](#), Deferred income taxes.

Employee benefits

Pension calculations under defined benefit plans in compliance with IAS 19 include the factors that rely on management estimates: the discount rate used in calculating pension expenses and obligations for the period, the rate of salary increase and the rate of future discretionary bonuses decided by the insurance company. Changes in these assumptions can significantly impact the amounts of pension liability and future pension expenses. The assumptions used are presented in [Note 30](#), Employee benefit obligations.

Provisions

The existence of criteria for recognizing provisions and the amounts of provisions are determined based on estimates. The amount to be recorded is the best estimate of the cost required to settle the obligation at the reporting date. The estimate of the financial impact of the past event requires management judgement, which is based on similar events occurred in the past, and where applicable, the opinion of external experts. Estimates may differ from the actual future amount of the obligation and with respect to the existence of the obligation.

The most significant provisions in the statement of financial position relate to environmental liabilities. Environmental provisions are based on management's best estimate of remediation costs. The restructuring provision is recognized when the Group has prepared a detailed restructuring plan and published it. More information regarding provisions is presented in [Note 29](#), Provisions.

Structured entities

Management uses judgement when determining the accounting treatment of the structured entities. In addition to the voting rights or similar rights the management considers other factors such as the nature of the arrangement, contractual arrangements and level of influence with the structured entities.

Consolidation

Subsidiaries

The consolidated financial statements cover the parent company, Nestle Corporation, and all those companies in which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group, and are no longer consolidated when this control ceases.

Acquired or established subsidiaries are accounted for by using the acquisition method. The consideration transferred and the identifiable asset acquired and liabilities assumed in the acquired company are measured at the fair value at acquisition date. The consideration transferred includes any assets transferred by the acquirer, liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. Any contingent consideration related to the business combination is measured at fair value at the acquisition date and it is classified as either liability or equity. Contingent consideration classified as liability is re-measured at its fair value at the end of each reporting period and the subsequent changes to fair value are recognized in profit or loss. Contingent consideration classified as equity is not subsequently re-measured. The consideration transferred does not include any transactions accounted for separately from the acquisition. Acquisition-related costs are expensed as incurred.

All intra-group transactions, receivables, liabilities and unrealized margins, as well as distribution of profits within the Group, are eliminated in the preparation of consolidated financial statements.

The result for the period and items recognized in other comprehensive income are allocated to the equity holders of the company and non-controlling interests and presented in the statement of income and statement of other comprehensive income. Non-controlling interests are presented separately from the equity allocated to the equity holders of the company. Comprehensive income is allocated to the equity holders of the company and to non-controlling interests even in situations where the allocation would result in the non-controlling interests' share being negative, unless

non-controlling interests have an exemption not to meet obligations which exceed the non-controlling interests' investment in the company.

When the Group ceases to have control any retained interest in the entity is re-measured to its fair value at the date when control is lost, with the change in the carrying amount recognized in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognized in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities.

Joint arrangements

A joint arrangement is an arrangement in which two or more parties have joint control. Joint arrangements are arrangements in which the sharing of control has been contractually agreed between two or more parties. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. Joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations of each investor, rather than the legal structure of the joint arrangement. The Group has assessed the nature of its joint arrangements and determined them to be either joint ventures or joint operations.

Joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities relating to the arrangement. Joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Joint ventures are accounted for using the equity method. Joint operations are consolidated for its share of the assets, liabilities, revenues, expenses and cash flow on a line-by-line basis. Under the equity method of accounting, interests in joint ventures are initially recognized at cost and adjusted thereafter to recognize the Group's share of the post-acquisition profits or losses and movements in other comprehensive income. When the Group's share of losses in a joint venture equals or exceeds its interests in the joint ventures (which includes any long-term interests that, in substance, form part of the Group's net investment in the joint ventures), the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the joint ventures.

Unrealized gains on transactions between the Group and its joint arrangements are eliminated to the extent of the Group's interest in the joint ventures. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Associates

Associated companies are entities over which the Group has significant influence but not control, and generally involve a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for by using the equity method as described above in the 'Joint arrangements' paragraph.

Structured entities

The Group engages in business activities with structured entities which are designed to achieve a specific business purpose. A structured entity is one that has been set up so that voting rights or similar rights are not the dominant factor in deciding who controls the entity. An example is when voting rights relate only to administrative tasks and the relevant activities are directed by contractual arrangements.

Structured entities are consolidated when the substance of the relationship between the Group and the structured entities indicate that the structured entities are controlled by the Group. The extent of the Group's interests to unconsolidated structured entities will vary depending on the type of structured entities. Entities are not consolidated because the Group does not control them through voting rights, contract, funding agreements, or other means.

Segment reporting

The Group's operations are divided into four operating segments: Oil Products, Renewable Products, Oil Retail and Others. The performance of the reporting segments is reviewed regularly by the chief operating decision maker, Neste President & CEO, to assess performance and to decide on allocation resources.

The accounting policies applicable to the segment reporting are the same as those used for establishing the Group consolidated financial statements.

Non-current assets and disposal groups held for sale

Non-current assets (or disposal groups) are classified as held for sale and stated at the lower of their carrying amount and fair value, less costs to sell, if their carrying amount is recovered principally through a sale transaction rather than through continuing use and sale is considered highly probable.

The assets are not depreciated after being classified as held for sale.

Foreign currency translation

(a) Presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in euros, which is the company's presentation currency.

(b) Transactions in foreign currencies

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognized in the income statement, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

(c) Group companies

The results and financial position of all the Group entities (none of which uses a hyperinflationary economy currency) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities are translated at the closing rate quoted on the relevant balance sheet date;
- Income and expenses are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions);
- All resulting exchange differences are recognized as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities and currency instruments designated as hedges of such investments, are booked to shareholders' equity. When a foreign operation is sold, exchange differences are recognized in the income statement as part of the gain or loss on the sale. Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the entity in question and translated at the closing rate.

Revenue recognition

Revenue from the sale of goods is recorded in the consolidated statement of income when the significant risks and rewards related to the ownership of the goods have been transferred to the buyer. Revenue from services is recorded when services have been provided. Revenue is recorded for the exchange of goods only when dissimilar goods are exchanged. Sales under fixed price engineering and construction contracts are recorded on a percentage-of-completion basis by recognizing the revenue according to the work hours incurred. Provisions for losses are made when identified and the amounts can be reliably estimated. Sales of technology licenses are recognized when the risks and rewards are transferred to the buyer.

Revenue will be recognized as gross method when an entity is acting as a principal and it has exposure to the significant risks and rewards associated with the sale of goods. The amounts collected on behalf of the principal are not revenue; instead, revenue is the amount of commission.

Revenue includes sales from actual operations, less discounts, indirect taxes such as value added tax and excise tax payable by the manufacturer, and statutory stockpiling fees. Excise taxes included in the retail price of petroleum products according to prevailing legislation in some countries are included in product sales. The corresponding amount is included in the purchase price of petroleum products and included in 'Materials and services' in the income statement.

Blender's tax credit (BTC) is recognized in revenue if the Government of the United States will make decision to grant it. It is made annually. Blender's tax credit is an incentive given to fuel blenders to use more renewable fuel by making the bio mandates less costly to achieve.

Revenue from activities outside normal operations is reported in other income. This includes items such as capital gains on disposal of other non-current assets and rental income.

Government grants

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and that the Group will comply with all attached conditions. Government grants relating to costs are deferred and recognized in the consolidated statement of income in 'Other income' over the period necessary to match them with the costs that they are intended to compensate. Investment grants related to acquisitions of property, plant and equipment and intangible assets are deducted from the cost of the asset in question in the statement of financial position and recognized as income on a systematic basis over the useful life of the asset in the form of reduced depreciation expense.

Borrowing costs

Borrowing costs are recognized as expenses in the period in which they are incurred, except if they are directly attributable to the construction of an asset that meets the determined criteria, in which case they are capitalized as part of the cost of that asset. These criteria are that the borrowing costs incurred for the construction of a major initial investment, such as a new production facility.

Income taxes

The Group's income tax expenses include taxes of Group companies calculated on the basis of the taxable profit for the period, with adjustments for previous periods, as well as the change in deferred income taxes. In respect of the deferred tax liability on undistributed foreign earnings, the amount recorded is based on expected circumstances and management expectations regarding the profit distribution. For items recognized directly in equity or other comprehensive income, the income tax effect is similarly recognized. Management judgment is required in determining the income tax expense and deferred tax assets.

Deferred income taxes are stated using the balance sheet liability method, to reflect the net tax effect of temporary differences between the financial reporting and tax bases of assets and liabilities. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Deferred income tax is determined using tax rates that are in force at the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Research and development

Research expenditure is recognized as an expense as incurred and included in other operating expenses in the consolidated statement of income. Expenditure on development activities is capitalized only when it fulfills strict criteria e.g. development relates to new products that are technically and commercially feasible. The majority of the Group's development expenditure does not meet the criteria for capitalization and are recognized as expenses as incurred.

Property, plant and equipment

Property, plant, and equipment mainly comprise oil refineries and other production plants and storage tanks, marine fleet, and retail station network infrastructure and equipment. The Group owns station network infrastructure with the exception of dealer stations. Property, plant, and equipment are stated at historical cost in the balance sheet, less depreciation and any accumulated impairment losses. Historical

cost includes expenditure that is directly attributable to the acquisition of the items in question. Cost may also include transfers from equity of any gains/losses on qualifying cash flow hedges related to foreign currency purchases of property, plant, and equipment. Assets acquired through the acquisition of a new subsidiary are stated at their fair value on the date of acquisition.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Costs for major periodic overhauls at oil refineries and other production plants on a 3–5 year cycle are capitalized when they occur and then depreciated during the shutdown cycle, i.e. the time between shutdowns. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land areas are not depreciated. The bottom of crude oil rock inventory is included in other tangible assets and is depreciated according to possible usage of the crude oil. Depreciation on tangible assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives as follows:

Buildings and structures, including terminals	20–40	years
Production machinery and equipment, including special spare parts	15–20	years
Marine fleet	15–20	years
Retail station network infrastructure and equipment	5–15	years
Other equipment and vehicles	3–15	years
Other tangible assets	20–40	years

The residual values and useful lives of assets are reviewed and adjusted where appropriate at each balance sheet date. The carrying amount of an asset is written down immediately to its recoverable amount if the former amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing proceeds with carrying amounts. These are included in 'Other income' or 'Other expenses' in the consolidated statement of income.

Intangible assets

Intangible assets, except goodwill, are stated at historical cost and amortized in a straight-line method over expected useful lives. Intangible assets comprise the following:

Computer software

Computer software licenses are capitalized on the basis of the costs incurred to acquire and introduce the software in question. The costs include the software development employee costs and professional fees arising directly bringing the asset to its working condition. Capitalization depends also on the technology used e.g. cloud services are not capitalized. Costs are amortized over their estimated useful lives (three to five years). Costs associated with updates or maintaining computer software programs are recognized as an expense.

Trademarks and licenses

Trademarks and licenses have a definite useful life and are carried at cost less accumulated amortization. They are amortized over their estimated useful lives (three to ten years).

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary, associate or joint venture at the date of acquisition. Goodwill on acquisition of subsidiaries is included in 'intangible assets'. Separately recognized goodwill is tested annually for impairment and carried at cost, less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill is allocated to cash-generating units for the purpose of impairment testing, using those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Emission allowances

Emission allowances, which are purchased to cover future periods deficit are recorded in intangible assets and measured at cost, and emission allowances received free of charge are recorded in their nominal value, i.e. at zero.

A provision is recognized to cover the obligation to buy emission allowances if emission allowances received free of charge and purchased emission allowances intended to cover the deficit do not cover actual emissions. The provision is measured at its probable settlement amount. The difference between emissions made and emission allowances received, as well as any change in the probable amount of the provision, are reflected in the operating profit.

Impairment of non-financial assets

Intangible assets that have an indefinite useful life or intangible assets not ready to use are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized in the income statement to the extent that the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

Financial assets

The Group classifies financial assets in the following categories: financial assets at fair value through income statement, loans and receivables, and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired.

Derivatives are recognized on the trade date at fair value. Purchases and sales of other financial assets are recognized on the settlement date. Financial assets are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through income statement. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

Available-for-sale financial assets and financial assets at fair value through income statement are subsequently carried at fair value. Unlisted equity securities, for which fair value cannot be measured reliably, are recognized at cost less impairment. Loans and receivables are carried at amortized cost, using the effective interest method. Realized and unrealized gains and losses arising from changes in the fair value of assets in 'financial assets at fair value through income statement' category are included in the income statement in the period in which they arise. The Group assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired at each balance sheet date.

Financial assets at Fair value through income statement

The assets in this category are financial assets held for trading, and include derivative financial instruments, if they are held for trading or do not meet the criteria for hedge accounting as defined under IAS 39. Assets in this category are classified as current assets if they are held for trading or are expected to be realized within 12 months of the balance sheet date.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date, which are classified as non-current assets. The Group's loans and receivables comprise 'trade and other receivables' and 'cash and cash equivalents' in the balance sheet.

Available-for-sale Financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any other category and consist of shares in unlisted companies. They are included in non-current assets unless management intends to dispose of the asset within 12 months of the balance sheet date. Gains or losses on the sale of available-for-sale financial assets are included in 'Other income' or 'Other expenses'.

Leases

Finance leases

Lease arrangements that transfer substantially all the risks and rewards related to a leased asset to the lessee are classified as finance lease. Finance leases are capitalized at the commencement of the lease term at the lower of the fair value of the leased property or the present value of the minimum lease payments, as determined at the inception of the lease. Lease payments are allocated between the reduction of the outstanding liability and finance charges. The corresponding rental obligations, net of finance charges, are included in interest-bearing liabilities according to their maturities. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. Assets acquired under finance leases are depreciated over the useful life of the asset or the lease term, whichever is the shortest.

An arrangement that does not take the legal form of a lease but conveys a right to use an asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. Determining whether an arrangement is, or contains, a lease is based on IFRIC interpretation 4.

Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Inventories

Inventories are stated at either cost or net realizable value, whichever is the lowest. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labor, other direct costs, and related production overheads (based on normal operating capacity). Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Inventories held for trading purposes are measured at fair value less selling expenses. Standard spare parts are carried as inventory and recognized in profit or loss as consumed.

Trade receivables

Trade receivables are recognized initially at fair value. A provision for impairment of trade receivables is established for receivables over 90 days overdue, or when there is objective evidence that the Group will not be able to collect amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default in payments are considered as indicators that a trade receivable is impaired. Impairment for doubtful trade receivables are based on a periodic review of outstanding amounts, including an analysis of historical bad debt, customer creditworthiness, past due amounts and changes in customer payment terms. The amount of provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the loss is recognized in the consolidated statement of income within 'Other expenses'. When the trade receivables are sold to a third party, the Group receives the purchase price, less a discount for commission and fees. These fees are booked to financial expenses. The Group derecognizes a trade receivable when the contractual rights to the cash flows from the asset expire, or when it transfers the asset and substantially all the related risks and rewards to the third party.

Cash and cash equivalents

Cash and cash equivalents are carried in the consolidated statement of financial position at cost. Cash and cash equivalents includes cash in hand, deposits held at call with banks, and other short-term, highly liquid investments with original maturities of three months or less.

Provisions

A provision is recognized in the consolidated statement of financial position when the Group has a present legal or constructive obligation as a result of a past event, and

it is probable that the obligation will result in payment, and the amount of payment can be estimated reliably. Provisions can arise from environmental risks, litigation, restructuring plans or onerous contracts. Environmental provisions are recorded based on current interpretations of environmental laws and regulations when the conditions referred to above are met. The Group has asset retirement obligations recorded in the consolidated statement of financial position.

Where there are a number of similar obligations, the likelihood that an outflow of resources will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as an interest expense.

Financial liabilities

Financial liabilities are recognized initially at fair value, net of transaction costs, and subsequently measured at amortized cost. Any difference between net proceeds and nominal amount is recognized as interest cost over the period of the borrowing, using the effective interest method. Bank overdrafts are shown in current liabilities on the balance sheet. Derivative financial instruments are recorded at fair value through profit and loss when hedge accounting is not applied.

Liabilities are included in non-current liabilities, except for items with maturities less than 12 months after the balance sheet date. Fees of revolving credit facility are capitalized and amortized over the period of the facility.

Employee benefits

Pension obligations

The Group has pension arrangements in different countries, which are generally funded through insurance companies. Pension schemes consist of both defined benefit and defined contribution plans.

Contributions to the defined contribution plans are charged directly to the statement of income in the year to which these contributions relate. In defined contribution plans, the Group has no legal or contractive obligations to pay further contributions in case the payment recipient is unable to pay the retirement benefits. All arrangements that do not fulfill these conditions are considered defined benefit plans.

In defined benefit plans, after the Group has paid the amount for the period, an excess or deficit may result. The defined benefit obligation represents the present value of future cash flows from payable benefits, which are calculated for by using the projected unit credit method. The discount rate assumed in calculating the present value of the pension obligation is based on the market yield of high-quality corporate bonds (AA-rated) with appropriate maturities. Pension costs are recognized in the consolidated statement of income so as to spread the current service cost over the service lives of employees based on actuarial calculations. The net interest is included as part of the finance cost component in the consolidated statement of income.

The liability (or asset) recognized in the consolidated financial statement of financial position is the pension obligation at the closing date less the fair value of plan assets. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Actuarial valuations for the Group's defined benefit pension plans are performed annually.

Share-based payments

The share-based incentive plans are accounted for as a share-based transaction. The portion of the earned reward (approximately 50%) for which the participants will receive shares is accounted for as an equity settled transaction, and the portion of the earned reward to be settled in cash to cover tax and other charges payable by the participants (approximately 50%), is accounted for as a cash settled transaction. The earned reward is entered into the income statement spread over the earnings period and restriction period. In respect of the equity settled portion, the amounts recognized in the consolidated statement of income are accumulated in equity; and in respect of the cash settled portion, a respective liability is entered into the balance sheet. The liability is measured at fair value at each reporting date, and the respective change in the fair value is reflected in operating profit in the consolidated statement of income.

Derivative Financial Instruments and hedging activities

Derivative financial instruments are initially recognized at fair value on the date a contract is entered into and are subsequently re-measured at their fair value. The method of recognizing any resulting gain or loss depends on whether the derivative financial instrument is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivative financial instruments as either:

1. hedges of highly probable forecast transactions (cash flow hedges);
2. hedges of the fair value of recognized assets or liabilities or a firm commitment (fair value hedge); or
3. hedges of net investments in foreign operations.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Hedge accounting for each type of hedge is described in more detail in [Note 3](#).

The effective portion of changes in the fair value of derivative financial instruments that are designated and qualify as cash flow hedges are recognized in equity/other comprehensive income. Any gain or loss relating to the ineffective portion is recognized immediately in the income statement. Amounts accumulated in equity are reclassified in the income statement in the periods when the hedged item affects the income statement, e.g. when a forecast sale that is being hedged takes place. The gain or loss relating to the effective portion of the foreign exchange derivative contracts hedging of the future USD-sales are recorded within revenue. Interest element of interest rate swaps hedging variable rate interest-bearing liabilities is recognized in the income statement within 'financial expenses', and the change in fair value of the hedging instrument is accumulated in equity/other comprehensive income. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the consolidated statement of income.

Changes in the fair value of derivative financial instruments that are designated and qualify as fair value hedges are recorded in the consolidated statement of income in 'financial income and expenses', together with any changes in the fair value of the hedged asset or liability attributable to the hedged risk compensating the effect.

Derivative Financial Instruments that do not qualify For hedge accounting

Some commodity and currency derivative contracts do not qualify for hedge accounting, although these instruments are largely held for economic hedging purposes. Any movements in the fair value of these contracts are recognized in the income statement in operating profit for commodity derivative contracts and in 'financial income and expenses' concerning financial instruments related to financing activities.