Caspian Drilling Company LLC

Consolidated financial statements

For the year ended 31 December 2016
with independent auditor's report

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working world

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Independent auditor's report

To the Supervisory Board and Management of Caspian Drilling Company LLC

Qualified opinion

We have audited the consolidated financial statements of Caspian Drilling Company LLC (the Company) and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, except for the possible effects of the matter described in the Basis for qualified opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for qualified opinion

The Company's 5% participating interest in Shemen License, joint operation acquired in 2013, has been carried at the amount of the Group's share of joint operation's intangible assets of USD 8,102 thousand as at 31 December 2015. We were unable to obtain sufficient appropriate audit evidence about the intangible assets of the joint operation as at 31 December 2015 because the Group management was not able to provide supporting information about the financial position and performance of the joint operation. As disclosed in Note 27 to the consolidated financial statements, on 14 February 2016 Shemen License expired. Therefore, the Group derecognized intangible assets related to the joint operation under Shemen License and recognized respective loss in other expenses in the consolidated statement of profit and loss and other comprehensive income for 2016. We were unable to determine whether any adjustments to the intangible assets as at 31 December 2015 and loss from derecognition of intangible assets recognized within other expenses for 2016 were necessary.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

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Responsibilities of management and the Supervisory Board for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidtated financial statements that are free from material misstatement, whether due to fraud or error.

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

The Supervisory Board is responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

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- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

Ernst & Young Holdings (CIS) B.V.

31 July 2017

Baku, Azerbaijan

Consolidated statement of profit or loss and other comprehensive income

for the year ended 31 December 2016

(All amounts are in thousands of US dollars)

	Notes	2016	2015 restated*	2014 restated*
Revenue	6	$ 423,102	$ 500,966	$ 403,513
Revenue		**423,102**	**500,966**	**403,513**
Cost of sales	7	(260,815)	(420,411)	(297,478)
Gross profit		**162,287**	**80,555**	**106,035**
General and administrative expenses	8	(11,992)	(12,307)	(19,236)
Other income	9	2,029	1,599	9,833
Other expenses	10	(85,790)	(386)	(1,486)
Operating profit		**66,534**	**69,461**	**95,146**
Foreign exchange gain/(loss), net		2,686	(1,778)	(491)
Profit before tax		**69,220**	**67,683**	**94,655**
Income tax expense	11	(24,044)	(43,841)	(20,528)
Profit for the year		**45,176**	**23,842**	**74,127**
Other comprehensive income for the year, net of tax – currency translation differences		–	3	8
Total comprehensive income for the year, net of tax		**$ 45,176**	**$ 23,845**	**$ 74,135**

* Certain amounts shown here do not correspond to the 2015 and 2014 financial statements and reflect restatement adjustments, refer to Note 5.

Signed and authorized for release on behalf of management:

Farid Akhundov
General Director

Ziya Hajiyev
Finance Manager

31 July 2017

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of financial position

as at 31 December 2016

(All amounts are in thousands of US dollars)

	Notes	As at 31 December 2016	As at 31 December 2015 restated*	As at 31 December 2014 restated*	As at 1 January 2014
Assets					
Non-current assets					
Property, plant and equipment	12	$ 377,502	$ 391,070	$ 237,074	$ 249,444
Intangible assets	13	1,081	8,584	8,633	8,667
Deposit in bank	16	20,000	20,000	–	–
Prepayments (long-term)	21	4,703	18,311	90,637	82,821
Deferred income tax assets	11	68,855	14,504	6,709	4,634
Other non-current assets	22	–	–	126,008	–
		472,141	**452,469**	**469,061**	**345,566**
Current assets					
Cash and cash equivalents	15	146,887	145,408	158,374	115,491
Deposit in bank	16	–	–	20,000	20,000
Restricted cash	17	10,000	10,000	10,000	10,000
Trade and other receivables	18	74,258	67,517	48,436	28,907
Due from related parties	19	10,373	–	17,850	29,313
Inventories	20	10,574	11,337	8,278	9,772
Prepayments (short-term)	21	3,019	7,627	4,489	4,813
Other current assets	22	61,093	79,437	13	920
		316,204	**321,326**	**267,440**	**219,216**
Total assets		**$ 788,345**	**$ 773,795**	**$ 736,501**	**$ 564,782**
Equity and liabilities					
Equity					
Charter capital	23	$ 285,846	$ 285,846	$ 285,846	$ 285,846
Additional paid-in capital		448	448	448	448
Retained earnings		149,869	153,712	192,590	149,114
Cumulative translation differences		11	11	8	–
Total equity		**436,174**	**440,017**	**478,892**	**435,408**
Non-current liabilities					
Deferred revenue (non-current portion)	6	60,680	5,763	–	799
Advances received (long-term)	25	–	–	45,787	82,794
Other non-current liabilities	22	–	–	126,008	–
		60,680	**5,763**	**171,795**	**83,593**
Current liabilities					
Accounts payable and accrued liabilities	24	25,242	43,486	25,231	28,290
Advances received (short-term)	25	–	115,191	48,401	–
Due to related parties	26	15,091	35,486	5,730	2,670
Deferred revenue	6	145,172	19,712	799	1,598
Income tax payable	11	44,915	34,748	5,653	13,223
Other current liabilities	22	61,071	79,392	–	–
		291,491	**328,015**	**85,814**	**45,781**
Total liabilities		**352,171**	**333,778**	**257,609**	**129,374**
Total equity and liabilities		**$ 788,345**	**$ 773,795**	**$ 736,501**	**$ 564,782**

* Certain amounts shown here do not correspond to the 2015 and 2014 financial statements and reflect restatement adjustments, refer to Note 5.

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

for the year ended 31 December 2016

(All amounts are in thousands of US dollars)

	Notes	Charter capital	Additional paid-in capital	Retained earnings	Cumulative translation differences	Total equity
As at 1 January 2014		**$ 285,846**	**$ 448**	**$ 149,114**	**$ –**	**$ 435,408**
Profit for the period (restated*)		–	–	74,127	–	**74,127**
Other comprehensive income		–	–	–	8	**8**
Total comprehensive income		**–**	**–**	**74,127**	**8**	**74,135**
Dividends declared	23	–	–	(30,651)	–	**(30,651)**
As at 31 December 2014 (restated*)		**$ 285,846**	**$ 448**	**$ 192,590**	**$ 8**	**$ 478,892**
Profit for the period (restated*)		–	–	23,842	–	**23,842**
Other comprehensive income		–	–	–	3	**3**
Total comprehensive income		**–**	**–**	**23,842**	**3**	**23,845**
Dividends declared	23	–	–	(62,720)	–	**(62,720)**
As at 31 December 2015 (restated*)		**285,846**	**448**	**153,712**	**11**	**440,017**
Profit for the period		–	–	45,176	–	**45,176**
Total comprehensive income		**–**	**–**	**45,176**	**–**	**45,176**
Dividends declared	23	–	–	(49,019)	–	**(49,019)**
As at 31 December 2016		**$ 285,846**	**$ 448**	**$ 149,869**	**$ 11**	**$ 436,174**

* Certain amounts shown here do not correspond to the 2015 and 2014 financial statements and reflect restatement adjustments, refer to Note 5.

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

for the year ended 31 December 2016

(All amounts are in thousands of US dollars)

	Notes	2016	2015 restated*	2014 restated*
Operating activities				
Profit before tax		$ 69,220	$ 67,683	$ 94,655
Non-cash adjustments to reconcile profit before tax to net cash flows				
Depreciation and amortization	7, 8	36,796	20,297	23,495
Loss on disposal of property, plant and equipment	12	6	–	–
Impairment of property, plant and equipment	12	77,438	–	–
De-recognition of intangible assets	13	8,102	–	–
Foreign exchange (gain)/loss, net		(7,471)	1,655	524
Working capital adjustments				
Change in trade and other receivables		(6,741)	(19,081)	(19,529)
Change in due from related parties		(373)	–	3,818
Change in prepayments (short-term)		4,608	(3,138)	324
Change in prepayments (long-term)		–	48,869	37,007
Change in inventories		763	(3,059)	1,494
Change in other current assets		–	–	907
Change in accounts payable and accrued liabilities		(9,931)	(1,657)	(4,252)
Change in due to related parties		(3,339)	(1,223)	3,060
Change in advances received (short-term)		(115,191)	66,790	48,401
Change in deferred revenue		125,460	18,913	(1,598)
Change in deferred revenue (non-current portion)		54,917	5,763	–
Change in advances received (long-term)		–	(45,787)	(37,007)
		234,264	**156,025**	**151,299**
Income tax paid		(57,879)	(22,540)	(30,173)
Net cash flows from operating activities		**176,385**	**133,485**	**121,126**
Investing activities				
Loan provided to the parent	19	(12,547)	(35,477)	(17,850)
Purchase of property, plant and equipment		(112,323)	(100,512)	(55,204)
Purchase of intangible assets		(709)	(46)	–
Net cash flows used in investing activities		**(125,579)**	**(136,035)**	**(73,054)**
Financing activities				
Dividends paid	23	(46,472)	(10,539)	(5,156)
Net cash flows used in financing activities		**(46,472)**	**(10,539)**	**(5,156)**
Net increase/(decrease) in cash and cash equivalents		**4,334**	**(13,089)**	**42,916**
Net foreign exchange difference		(2,855)	123	(33)
Cash and cash equivalents as at 1 January	15	145,408	158,374	115,491
Cash and cash equivalents as at 31 December	15	**$ 146,887**	**$ 145,408**	**$ 158,374**

* Certain amounts shown here do not correspond to the 2015 and 2014 financial statements and reflect restatement adjustments, refer to Note 5.

Non-cash transactions performed by the Group during 2016 are represented by settlement of declared dividends with loan receivable from shareholder in the amount of USD 2,547 (2015: USD 52,181; 2014: USD 25,495).

The accompanying notes are an integral part of these consolidated financial statements.

(All amounts are in thousands of US dollars)

1. Corporate information

Caspian Drilling Company LLC (the "Company") is a limited liability company registered under the laws of the Republic of Azerbaijan by the State Oil Company of the Azerbaijan Republic ("SOCAR") and Union Grand Energy PTE LTD ("UGE") holding 92.44% and 7.56% of ownership interest, respectively.

The Company is providing drilling services in the Caspian Sea by means of "Dada-Gorgud" and "Istiglal" mobile offshore drilling units operated at ACG (oil) and Shah Deniz (gas) fields, respectively.

Caspian Drilling International Ltd., Caspian Drilling Company USA LLC and Caspian Drilling Company (Israel) Ltd. incorporated by the Company are jointly referred to as "subsidiaries" within these consolidated financial statements.

The registered address of the Company is 86, Nasibbey Yusifbeyli street, Baku AZ1007, the Republic of Azerbaijan.

2.1 Basis of preparation

The consolidated financial statements of the Company and its subsidiaries (jointly referred to as "the Group") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements have been prepared on a historical cost basis, unless described otherwise in the accounting policy below. The consolidated financial statements are presented in United State dollars ("USD") and all values are rounded to the nearest thousands, except when otherwise indicated.

2.2 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at 31 December 2016. Subsidiaries are fully consolidated from the date of incorporation or acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. All intra-group balances, transactions, unrealised gains and losses resulting from intra-group transactions and dividends are eliminated in full.

2.3 Summary of significant accounting policies

a) Foreign currency translation

The official currency of the Republic of Azerbaijan is Azerbaijani Manat ("AZN"). However, according to International Accounting Standard ("IAS") No. 21 *The Effects of Changes in Foreign Exchange Rates*, and its interpretations, the Company's measurement currency, which reflects the economic substance of the underlying events and circumstances of the Company is the USD, as the majority of the Company's property, plant and equipment purchased, sales, purchases, trade receivables and payables are either priced, incurred, payable or otherwise measured in USD.

The functional currency of the Group's Israeli subsidiary is Israeli Shekel ("ILS"), the currency of the primary economic environment in which the Israeli subsidiary operates.

The transactions executed in foreign currencies are initially recorded in the functional currencies of respective Group's subsidiary by applying the appropriate rates of exchanges prevailing at the date of transaction.

Monetary assets and liabilities not already measured in the functional currencies of the respective Group's subsidiary are translated into the functional currency of that entity at the appropriate exchange rates prevailing at the statement of financial position date.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

a) Foreign currency translation (continued)

Foreign exchange gains and losses resulting from the re-measurement into the functional currencies of respective Group's subsidiaries are recognized in consolidated statement of profit or loss and other comprehensive income.

On consolidation, the assets and liabilities of Group's subsidiaries are translated into USD at the rate of exchange prevailing at the reporting date and their income statements are translated at average exchange rates determined for the year. The exchange differences arising on translation for consolidation are recognized in other comprehensive income.

AZN is not a fully convertible currency outside the territory of the Republic of Azerbaijan. Within the Republic of Azerbaijan, the official exchange rates are determined principally by the Central Bank of the Republic of Azerbaijan and are generally considered to be a reasonable approximation of market rates.

At 31 December 2016 the principal rate of exchange used for translating foreign currency balances were AZN 1 = USD 0.5647, ILS 1 = USD 0.2605 (31 December 2015: AZN 1 = USD 0.6413, ILS 1 = USD 0.2565; 31 December 2014: AZN 1 = USD 1.2748, ILS 1 = USD 0.2261).

b) Revenue recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty. The Group assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent.

Drilling services

Revenue from the provision of drilling services is recognized based on agreed day rates for works performed on a monthly basis.

Sale of goods

Revenue from the sale of goods is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer, usually on delivery of the goods.

Revenue from reimbursable items

Revenue from reimbursable items represents mark-ups on certain equipment, materials and supplies, third-party services and other expenses acquired at request of the customer. Revenue from reimbursable items is recognized on net basis and included into "Other income" in the consolidated statement of profit or loss and other comprehensive income.

Mobilization revenue

Fees received prior to the commencement of the drilling service agreement related directly to mobilization of drilling units, equipment and personnel are deferred over the primary contract term of the drilling project using the straight-line method.

c) Construction contract activities

Construction contracts are represented by a fixed price contract with Azerbaijan Rigs LLC for management of drilling unit construction.

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract shall be recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

c) Construction contract activities (continued)

For fixed price contract, the outcome of a construction contract can be estimated reliably when: (i) the total contract revenue can be measured reliably; (ii) it is probable that the economic benefits associated with the contract will flow to the entity; (iii) the costs to complete the contract and the stage of completion can be measured reliably; and (iv) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

For cost plus contract, the outcome of a construction contract can be estimated reliably when: (i) it is probable that the economic benefits associated with the contract will flow to the entity; and (ii) the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

When the outcome of a construction cannot be estimated reliably (principally during early stages of a contract), contract revenue is recognized only to the extent of costs incurred that are expected to be recoverable.

In applying the percentage of completion method, revenue recognized corresponds to the total contract revenue (as defined below) multiplied by the actual completion rate based on the proportion of total contract costs (as defined below) incurred to date and the estimated costs to complete.

Contract revenue − contract revenue corresponds to the initial amount of revenue agreed in the contract and any variations in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue; and they are capable of being reliably measured.

Contract costs − contract costs include costs that relate directly to the specific contract and costs that are attributable to contract activity in general and can be allocated to the contract. Costs that relate directly to a specific contract comprise: site labor costs (including site supervision); costs of materials used in construction; depreciation of equipment used under a contract; costs of design, and technical assistance that is directly related to the contract and are recognized as expenses in the period in which they are incurred.

Contract costs incurred that relate to future activity on the contract are recognized as an asset provided it is probable that they will be recovered.

When the outcome of a construction contract cannot be estimated reliably: (i) revenue shall be recognized only to the extent of contract costs incurred that it is probable will be recoverable; and (ii) contract costs shall be recognized as an expense in the period in which they are incurred.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized in full as an expense immediately.

The Group presents amounts prepaid to subcontractors for estimated works under the construction contract as prepayment and other current assets.

The Group presents amounts received in advance from customer for estimated works under the construction contract as advances received and other current liabilities.

d) Joint operations

Joint arrangement is an arrangement over which two or more parties have joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities (being those that significantly affect the returns of the arrangement) require unanimous consent of the parties sharing control.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

d) Joint operations (continued)

A joint operation is a type of 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. In relation to its interests in joint operations, the Group recognizes its:

- Assets, including its share of any assets held jointly;
- Liabilities, including its share of any liabilities incurred jointly;
- Revenue from the sale of its share of the output arising from the joint operation;
- Share of the revenue from the sale of the output by the joint operation;
- Expenses, including its share of any expenses incurred jointly.

e) Income taxes

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date.

Current income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statement of profit or loss and other comprehensive income. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Deferred income tax

Deferred income tax is provided using the liability method on all temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

- Where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss;
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilized, except:

- Where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss;
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred income tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

The carrying amount of deferred income tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

e) Income taxes (continued)

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

f) Property, plant and equipment

Property, plant and equipment is stated at cost, net of accumulated depreciation and/or accumulated impairment losses, if any. Such cost includes the cost of replacing part of the property, plant and equipment and borrowing costs for long-term construction projects if the recognition criteria are met. When significant parts of property, plant and equipment are required to be replaced at intervals, the Group recognizes such parts as individual assets with specific useful lives and depreciation, respectively. All other repair and maintenance costs are recognized in the consolidated statement of comprehensive income as incurred.

Depreciation is calculated on a straight-line basis over estimated useful lives of asset as follows:

Drilling units, buildings and installations	10 to 50 years
Machinery and equipment	5 to 10 years
Vehicles, furniture and tools	3 to 5 years
Other	up to 3 years

An item of property, plant and equipment and any significant part initially recognized is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of profit or loss and other comprehensive income when the asset is derecognized.

The assets' residual values, useful lives and methods of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate.

Spare parts and emergency stock necessary to support the Group's continuous operations and expected to be utilised during more than one-year period are classified as property, plant and equipment less an accumulated depreciation.

g) Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date, whether fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset, even if that right is not explicitly specified in an arrangement.

Group as a lessee

Operating lease payments are recognized as an operating expense in the consolidated statement of profit or loss and other comprehensive income on a straight-line basis over the lease term.

h) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the respective assets. All other borrowing costs are expensed in the period they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

i) Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses, if any.

The useful lives of intangible assets are assessed as either finite or indefinite.

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and are treated as changes in accounting estimates.

The amortisation expense on intangible assets with finite lives is recognized in the consolidated statement of profit or loss and other comprehensive income in the expense category consistent with the function of the intangible asset.

Intangible assets with indefinite useful lives are not amortised, but are tested for impairment annually, either individually or at the cash-generating unit level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the consolidated statement of profit or loss and other comprehensive income when the asset is derecognized.

j) Financial instruments − initial recognition and subsequent measurement

(i) Financial assets

Initial recognition and measurement

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives, as appropriate. The Group determines the classification of its financial assets at initial recognition.

All financial assets are recognized initially at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the marketplace (regular way trades) are recognized on the trade date, i.e., the date that the Company commits to purchase or sell the asset.

The Group's financial assets include cash and cash equivalents, restricted cash, trade and other receivables, deposit in bank and due from related party.

Subsequent measurement

The subsequent measurement of financial assets depends on their classification.

Cash and cash equivalents

Cash and cash equivalents in the statement of financial position comprise cash at banks and at hand and other short-term highly liquid investments with original maturities of three months or less.

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

j) Financial instruments − initial recognition and subsequent measurement (continued)

Restricted cash

Restricted cash is presented separately from cash and cash equivalents. Restricted balances are excluded from cash and cash equivalents for the purposes of consolidated statement of cash flows.

Trade and other receivables

Trade and other receivables are recognized and carried at the original invoice amount less provision for any uncollectible amounts. An allowance for doubtful debts is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Change in the provision during the year is recognized through the profit or loss.

Derecognition

A financial asset is derecognized when:

- The rights to receive cash flows from the asset have expired;
- The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a "pass-through" arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset.

In that case, the Group also recognizes an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

(ii) Impairment of financial assets

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

j) Financial instruments − initial recognition and subsequent measurement (continued)

(iii) Financial liabilities

Initial recognition and measurement

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss. The Group determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognized initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The Group's financial liabilities include trade payables, accrued liabilities and due to related parties.

Subsequent measurement

The measurement of financial liabilities depends on their classification.

Accounts payable and accrued liabilities

Accounts payable and accrued liabilities are carried at cost, which is the fair value of the consideration to be paid in the future for goods or services received, whether or not billed to the Group.

Derecognition

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated statement of profit or loss and other comprehensive income.

(iv) Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

(v) Fair value of financial instruments

The fair value of financial instruments that are traded in active markets at each reporting date is determined by reference to quoted market prices or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques. Such techniques may include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; a discounted cash flow analysis or other valuation models.

An analysis of fair value of financial instruments and further details as to how they are measured are provided in Note 28.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

k) Inventories

Inventories are valued at the lower of cost and net realisable value. Cost of inventories is determined on the weighted average basis. The cost of inventories comprises costs of purchase and other costs incurred in bringing each inventory to its present location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

l) Impairment of non-financial assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's (CGU) fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, recent market transactions are taken into account, if available. If no such transactions can be identified, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

Impairment losses of operations, including impairment on inventories, are recognized in the consolidated statement of profit or loss and other comprehensive income in those expense categories consistent with the function of the impaired asset, except for property previously revalued where the revaluation was taken to other comprehensive income. In this case, the impairment is also recognized in other comprehensive income up to the amount of any previous revaluation.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of profit or loss and other comprehensive income unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase.

m) Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of profit or loss and other comprehensive income net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

n) Prepayments

Prepayments are recognized and carried at the original amount of payment less provision for any amount at risk of non-performance by the counterparty. Prepayments made for non-current assets as well as prepayments which will be settled during more than one-year period are non-current prepayments.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

o) Value added tax

The tax authorities permit the settlement of sales and purchases value added tax ("VAT") on a net basis.

VAT payable

VAT is payable to tax authorities upon collection of receivables from customers. VAT on purchases, which have been settled at the date of the statement of financial position, is deducted from the amount payable. In addition, VAT related to sales which have not been settled at the date of the statements of financial position (VAT deferred) is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

VAT receivable

VAT receivable relates to purchases which have not been settled at the date of the statement of financial position. VAT receivable is reclaimable against sales VAT upon payment for the purchases.

p) Social and pension contributions

In accordance with the *Law on Social Insurance of the Republic of Azerbaijan*, as amended, the Company is obligated to contribute to the State Social Protection Fund of the Republic of Azerbaijan (the "State Fund") on behalf of its employees that are citizens of the Republic of Azerbaijan.

The Company's contributions represented 22% of the employees' salaries reflected in the statutory records in 2016, 2015 and 2014. Additionally, employees are obligated to pay 3% of their salaries to the State Fund.

The Group is not obligated to pay any retirement or post-retirement benefits to its employees.

q) Equity

Charter capital

The charter capital represents contributions made by the shareholders according to the ownership structure.

Additional paid-in capital

Additional paid-in capital represents the excess of the shareholder's contribution over the charter capital.

Dividends

Dividends are recognized as a liability and deducted from equity at the date of the consolidated statement of financial position only if they are declared before or on the date of the consolidated statement of financial position. Dividends are disclosed when they are proposed before the date of the consolidated statement of financial position or proposed or declared after the date of the consolidated statement of financial position but before the financial statements are authorised for issue.

r) Transactions with related parties

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties. It is the nature of transactions with related parties that they cannot be presumed to be carried out on an arms' length basis.

(All amounts are in thousands of US dollars)

2.3 Summary of significant accounting policies (continued)

s) Carried interest arrangements

A carried interest arrangements where the Group participates as carried party is an agreement under which the carrying party agrees to pay for a portion or all of the pre-production costs of the carried party on a project in which both parties own participating interest. The carrying party will not be reimbursed for the pre-production costs that it has incurred on behalf of the carried party.

The Group does not recognize any carry related transactions and balances in the consolidated financial statements.

3. Significant accounting judgments, estimates and assumptions

The preparation of the Group's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the end of the reporting period.

However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Group based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments however, may change due to market changes or circumstances arising beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

Impairment of non-financial assets

Management assesses whether there are any indicators of possible impairment of all non-financial assets at each reporting date based on events or circumstances that indicate the carrying value of assets may not be recoverable. Such indicators include changes in the Group's business plans, changes in commodity prices leading to unprofitable performances and changes in product mixes. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable.

The carrying value of "Dada Gorgud" drilling unit at 31 December 2016 has been tested for impairment through comparison with its recoverable amount, since the drilling unit was expected to remain idle for an uncertain period after April 2017, upon expiration of the rental contract with BP Exploration (Caspian Sea) Limited. The recoverable amount of USD 25,739 as at 31 December 2016 was derived under income and market approaches and was determined at the level of the respective CGU. As a result of the test performed, an impairment loss USD 76,700 has been identified and charged to Other expenses in the consolidated statement of profit or loss and other comprehensive income.

The following key assumptions were used for impairment test of the fixed assets:

<u>Discount rate</u>

The pre-tax discount rate applied to the cash flow projections was 12.6 % and is the Group's weighted average cost of capital (WACC). In calculating WACC the cost of equity was estimated using peer group data and the cost of debt is based on market rates for interest bearing borrowings in the Republic of Azerbaijan. The beta factors are evaluated annually based on publicly available market data. If the estimated WACC used in the calculation had been 1% higher/lower than management's estimate, no change to the recognized impairment loss would be required.

(All amounts are in thousands of US dollars)

3. Significant accounting judgments, estimates and assumptions (continued)

Estimates and assumptions (continued)

Useful life of property, plant and equipment

The Group assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

Assessment of the percentage of completion on services or construction contracts

The percentage of completion and the revenue to recognize are determined on the basis of a large number of estimates.

In particular, the Group reviews each reporting period the estimates of contract revenue and contract costs as the contract progress.

Deferred income tax

Management judgment is required for the calculation of current and deferred income taxes. Deferred income tax assets are recognized to the extent that their utilization is probable. The utilization of deferred income tax assets will depend on whether it is possible to generate sufficient taxable income in respective tax type and jurisdiction. Various factors are used to assess the probability of the future utilization of deferred income tax assets, including past operating results, operational plan, expiration of tax losses carried forward, and tax planning strategies.

Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. If actual results differ from that estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that the assessment of future utilization of deferred income tax assets must be reduced this reduction is recognized through profit or loss.

Current taxes

Azerbaijani tax, currency and customs legislation is subject to varying interpretations and changes occurring frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group may be assessed additional taxes, penalties and interest, which can be significant. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2016 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained.

Contingencies

By their nature, contingencies will only be resolved when one or more future events will occur. The assessment of contingencies inherently involves the exercise of significant judgement and estimates of the outcomes of future events.

Provision for impaired or obsolete inventory

The Group reviews and if required reduces the carrying value of inventories for the amount of obsolete, impaired and slow-moving inventories at each reporting date. Such amount is estimated individually and in aggregate based on the percentage thresholds applied to obsolete or slow-moving inventories depending on the level of damage and frequency of use.

(All amounts are in thousands of US dollars)

3. Significant accounting judgments, estimates and assumptions (continued)

Estimates and assumptions (continued)

Allowance for doubtful accounts

Management maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts, management bases its estimates on the aging of accounts receivable balances and historical write-off experience, customer credit worthiness and changes in customer payment terms. If the financial condition of customers were to deteriorate, actual write-offs might be higher than expected.

Litigations

The Group exercises considerable judgment in measuring and recognizing provisions and the exposure to contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as environmental liabilities or other contingent liabilities. Judgement is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and to quantify the possible range of the final settlement. Because of the inherent uncertainties in this evaluation process, actual losses may be different from the originally estimated provision. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists, if available, or with the support of outside consultants, such as actuaries or legal counsel. Revisions to the estimates may significantly affect future operating results.

Long-term debt

In assessment of the fair value of the long-term debt the management uses the market borrowing rate to discount the amount of future cash outflows. Management uses its judgment in respect of the duration, timing and amounts of future payments.

4. Adoption of new or revised standards and interpretations

The Group applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after 1 January 2016. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

The nature and the effect of these changes are disclosed below. Although these new standards and amendments applied for the first time in 2016, they did not have a material impact on the annual consolidated financial statements of the Group. The nature and the impact of each new standard or amendment is described below:

Amendments to IFRS 11 Joint Arrangements: Accounting for Acquisitions of Interests

The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business, must apply the relevant IFRS 3 *Business Combinations* principles for business combination accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation if joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party.

The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are applied prospectively. These amendments do not have any impact on the Group as there has been no interest acquired in a joint operation during the period.

(All amounts are in thousands of US dollars)

4. Adoption of new or revised standards and interpretations (continued)

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation

The amendments clarify the principle in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is a part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are applied prospectively and do not have any impact on the Group, given that it has not used a revenue-based method to depreciate its non-current assets.

Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants

The amendments change the accounting requirements for biological assets that meet the definition of bearer plants. Under the amendments, biological assets that meet the definition of bearer plants will no longer be within the scope of IAS 41 *Agriculture*. Instead, IAS 16 will apply. After initial recognition, bearer plants will be measured under IAS 16 at accumulated cost (before maturity) and using either the cost model or revaluation model (after maturity). The amendments also require that produce that grows on bearer plants will remain in the scope of IAS 41 measured at fair value less costs to sell. For government grants related to bearer plants, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* will apply. The amendments are applied retrospectively and do not have any impact on the Group as it does not have any bearer plants.

Amendments to IAS 27: Equity Method in Separate Financial Statements

The amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in their separate financial statements have to apply that change retrospectively. These amendments do not have any impact on the Group’s consolidated financial statements.

Annual improvements 2012-2014 cycle

These improvements include:

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Assets (or disposal groups) are generally disposed of either through sale or distribution to the owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. This amendment is applied prospectively.

IFRS 7 Financial Instruments: Disclosures

(i) Servicing contracts

The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and the arrangement against the guidance for continuing involvement in IFRS 7 in order to assess whether the disclosures are required. The assessment of which servicing contracts constitute continuing involvement must be done retrospectively. However, the required disclosures need not be provided for any period beginning before the annual period in which the entity first applies the amendments.

(ii) Applicability of the amendments to IFRS 7 to condensed interim financial statements

The amendment clarifies that the offsetting disclosure requirements do not apply to condensed interim financial statements, unless such disclosures provide a significant update to the information reported in the most recent annual report. This amendment is applied retrospectively.

(All amounts are in thousands of US dollars)

4. Adoption of new or revised standards and interpretations (continued)

Annual improvements 2012-2014 cycle (continued)

IAS 19 Employee Benefits

The amendment clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used. This amendment is applied prospectively.

IAS 34 Interim Financial Reporting

The amendment clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the interim financial report (e.g., in the management commentary or risk report). The other information within the interim financial report must be available to users on the same terms as the interim financial statements and at the same time. This amendment is applied retrospectively.

These amendments do not have any impact on the Group.

Amendments to IAS 1 Disclosure Initiative

The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify:

- The materiality requirements in IAS 1;
- That specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated;
- That entities have flexibility as to the order in which they present the notes to financial statements;
- That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement of profit or loss and other comprehensive income. These amendments do not have any impact on the Group.

Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception

The amendments address issues that have arisen in applying the investment entities exception under IFRS 10 *Consolidated Financial Statements*. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value.

Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 *Investments in Associates and Joint Ventures* allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries.

These amendments are applied retrospectively and do not have any impact on the Group as the Group does not apply the consolidation exception.

(All amounts are in thousands of US dollars)

4. Adoption of new or revised standards and interpretations (continued)

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which reflects all phases of the financial instruments project and replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

The Group plans to adopt the new standard on the required effective date. The Group will quantify the effect of adoption of IFRS 9 on the Group's consolidated financial statements.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018, when the IASB finalizes their amendments to defer the effective date of IFRS 15 by one year. Early adoption is permitted. The Group is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

IAS 7 Disclosure Initiative − Amendments to IAS 7

The amendments to IAS 7 *Statement of Cash Flows* are part of the IASB's *Disclosure Initiative* and require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. On initial application of the amendment, entities are not required to provide comparative information for preceding periods. These amendments are effective for annual periods beginning on or after 1 January 2017, with early application permitted. Application of amendments will result in additional disclosure provided by the Group.

IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses − Amendments to IAS 12

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount.

Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognized in opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact.

These amendments are effective for annual periods beginning on or after 1 January 2017 with early application permitted. If an entity applies the amendments for an earlier period, it must disclose that fact. The Group plans to adopt the new standard on the required effective date. These amendments are not expected to have material impact on the Group's consolidated financial statements.

(All amounts are in thousands of US dollars)

4. Adoption of new or revised standards and interpretations (continued)

Standards issued but not yet effective (continued)

IFRS 2 Classification and Measurement of Share-based Payment Transactions − Amendments to IFRS 2

The IASB issued amendments to IFRS 2 *Share-based Payment* that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. The amendments are effective for annual periods beginning on or after 1 January 2018, with early application permitted. These amendments are not expected to have any impact on the Group.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement Contains a Lease*, SIC-15 *Operating Leases-Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees − leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less).

At the commencement date of a lease, a lessee will recognize a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset).

Lessees will be required to separately recognize the interest expense on the lease liability and the depreciation expense on the right-of-use asset. Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs. These amendments are not expected to have any impact on the Group.

5. Changes in comparative information

During the preparation of the consolidated financial statements for the year ended 31 December 2016 the Group identified errors related to the comparative financial information as follows:

In 2014 and 2015 the Group entered into operating lease agreements with BP Exploration (Caspian Sea) Limited ("BP"). Under these agreements, the Group should upgrade leased out drilling units "Istiglal" and "Dada-Gorgud" and BP should compensate the respective expenditure.