KUMUL PETROLEUM HOLDINGS LIMITED

2017 ANNUAL REPORT

Aerial view of the PNGLNG liquefaction facilities at Caution Bay.

CONTENTS

HIGHLIGHTS OF 2017

Ground breaking ceremony for POM Power Project.

RECORD PRODUCTION

The PNGLNG project – Kumul Petroleum's most important asset – had another year of excellent performance. The production reached record levels at 8.3 million tonnes, 20% above the nameplate capacity of 6.9 million tonnes per annum (mtpa). With unscheduled downtime of only 0.5%, availability reached 97.2%. August was the record month at 8.63 mtpa equivalent, 26 October was the record day at 8.96 mtpa equivalent. A total of 110 cargoes of LNG were dispatched to customers in the Far East, principally Japan, China and Taiwan. 11.9 million barrels of liquids were produced in 2017.

GOOD PROFITS FOR LOW OIL PRICE ENVIRONMENT

Kumul Petroleum is largely reliant on revenue from the PNGLNG project. Product prices are related to the international price of oil, notably the benchmark of Japan Crude Cocktail (JCC). Following a steep decline in 2014, the price of oil hovered around an average of about US$50/bbl until rising strongly in the 4th quarter 2017, a rally that has been sustained into 2018. The KPHL Group made a consolidated net profit of US$56.69 million in 2017 (2016: US$149.80 million net loss). Even so, Kumul's revenue from the project at an average price in 2017 of US$50 was half that of 2014.

RECOVERING GLOBAL OIL PRICES

Accurate forecasting of the oil price is almost impossible. Kumul Petroleum believes that a likely range is between an average of US$40/bbl as a low price scenario, and an average of US$80/bbl as a high price scenario over the next five-year period. Global LNG supplies increased by 9% in 2017 and much more capacity is due to come on the market in the next five years. However, in 2017 global spare capacity fell by a third and overall demand from China recorded a huge 42% increase.

KPHL actual use of funds 2014–2017

42%	Paid to government
42%	Cost of debt/ debt reduction
10%	Reinvested in oil, gas & energy projects
6%	Corporate costs

NEW POWER PLANT IN PORT MORESBY

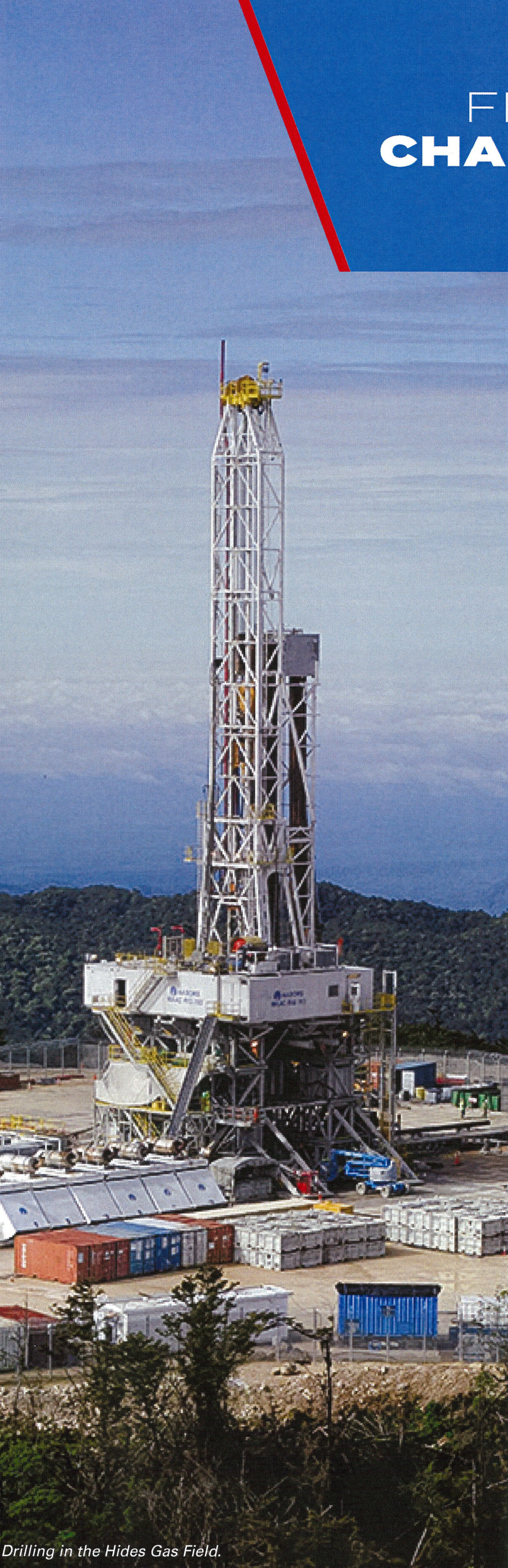
In 2017, Kumul Petroleum officially launched the construction of a US$100 million power plant in Port Moresby. The gas supplied by the PNGLNG project will feed the high-efficiency reciprocating gas engines and generators. It will produce 58MW base load power to the Port Moresby power grid through a new 66kv power line and substation network to be constructed in Gerehu and connected to the new power plant. The power plant remains on track to commence operations in the first quarter of 2019, subject to the timely completion of all required regulatory approval.

FIRST PETROLEUM AND ENERGY SUMMIT

The inaugural PNG Petroleum & Energy Summit (PNGPES) was initiated out of the idea that the country's massive oil, gas and energy potential be well positioned and showcased through an appropriate platform onshore, rather than the traditional ways of being showcased offshore. Hence, the birth of PNG's home-grown summit, PNGPES with the inaugural summit held in February 2017 at the Stanley Hotel, Port Moresby. The summit themed 'Unlocking Papua New Guinea's Energy Potential' was officiated by Prime Minister, Hon Peter O'Neill and brought together over 500 participants, presenters and government representatives.

RETURN OF FUNDS TO PNG GOVERNMENT

By the end of 2017 Kumul Petroleum had remitted a total of US$257 in cash to PNG – over and above dividends and taxes. Taking up the full 22.5% entitlements in the forthcoming LNG projects, Kumul Petroleum will face significant challenges in raising the capital required to fund our equity contribution to these projects. As such we must adopt a very disciplined approach to our capital management moving forward. This will require a change away from delivering all available capital to the government and instead allocating material portions of our capital towards these critical investments.



Drilling in the Hides Gas Field.

FROM THE CHAIRMAN'S DESK

2017 was a year of record production, promising new projects and rewarding nation building initiatives for Kumul Petroleum. We still found time to lay down the foundations for future success in our Strategic Vision.

Clear strategic direction

Following a full strategic review with key staff during 2017, Kumul Petroleum has defined six strategic themes going forward:

- Invest in oil and gas for the nation's benefit
- Enter petroleum infrastructure projects
- Diversify into petroleum products and energy distribution
- Become national champion and industry advisor
- International best practice governance
- Be a good corporate citizen

You can read more about our Strategic Vision and the six strategic themes on page 13 in this report. Other strategies with far reaching implications for Kumul Petroleum are the government of PNG's Three Pillars: Third Party Access, Domestic Gas Obligation and National Content Requirement.

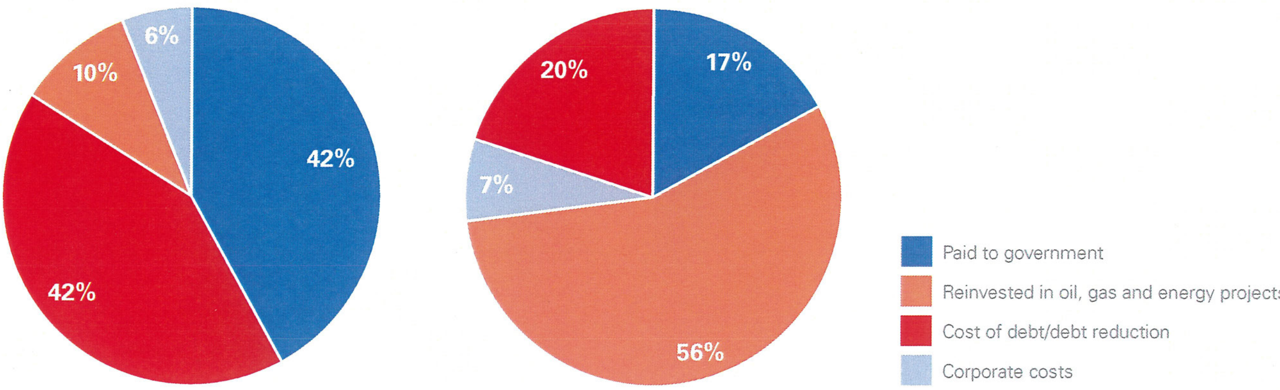
Third Party Access

The Third Party Access scheme is aimed at making sure all developers have access to pipeline infrastructure. It will encourage further competition in upstream and downstream markets, promote exploration & development and improve the economic efficiency of natural gas resources and infrastructure in PNG. In 2017 Kumul Petroleum completed a Pre-FEED study of The Western Pipeline project, a gas pipeline infrastructure connecting the Western and Gulf provinces to be used by all project developers.

Domestic Gas Obligation

The Domestic Gas Obligation requires gas producers to dedicate a percentage of produced gas to domestic electricity generation or other industrial use. Unutilized gas can be exported in return for funding domestic electrification programs. This policy is a backbone in the efforts to increase PNG's rate of household electrification from 14% today to 70% by 2030. Kumul Petroleum has founded NiuEnergy (a 100% owned subsidiary) to

KPHL actual use of funds 2014–2017 | KPHL forecast use of funds 2018–2022



coordinate the domestic distribution of LNG in Papua New Guinea, principally as fuel for electrification.

Kumul Petroleum has also jointly founded NiuPower as a 50% joint venture with Oil Search. NiuPower is currently building a 58MW power station in Port Moresby

National Content Requirement

The National Content Requirement will ensure that oil & gas exporters and producers use the maximum amount of locally available labour and services. It encourages national training & upskilling and promotes the local procurement of goods. Among our initiatives to support this strategy is the Kumul Petroleum Academy – you can read more about it later on in the report.

Changing focus of capital management

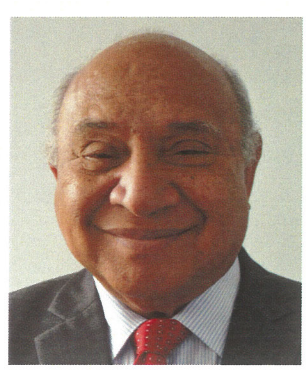
By the end of 2017, Kumul Petroleum had remitted a total of US$257 in cash to the Independent State of Papua New Guinea – over and above dividends and taxes. The Trustee on behalf of the people of PNG has instructed Kumul Petroleum to participate fully in the forthcoming LNG projects and to take up the full 22.5% entitlements. We agree with the strategy and see it delivering the best possible outcome for PNG. However, it must be recognized that Kumul Petroleum will face significant challenges in raising the capital required to fund its equity contribution to these projects and as such we must adopt a very disciplined approach to our capital management moving forwards. This will require a change away from delivering all available capital to the government and instead allocating material portions of our capital towards these critical investments.

Nation building projects

We're committed to maximising the benefit to Papua New Guinea and its people. Numerous projects in 2017 demonstrate this commitment. Below are a few examples but please read more in the Nation Building section of this report:

- Kumul Petroleum Academy
- Global marketing
- Nipa Hospital
- Domestic LNG distribution for power
- Community projects and investments

2017 was a good year for Kumul Petroleum. But we believe the best is still to come and we look forward to playing an important role in the future of Papua New Guinea as a nation.



Sir Moi Avei, KBE
Chairman

MANAGING DIRECTOR'S REPORT

2017 was a very good year for Kumul Petroleum. Production from the PNGLNG project exceeded 8.3 million tonnes, 20% above nameplate capacity. Despite strong production, contingency resources have significantly increased and the current level of production can be upheld for at least another 26 years, probably longer before beginning to decline. Two exciting new LNG projects with the power to shape the future for Kumul Petroleum, P'nyang gas field development and Papua LNG, reached significant milestones in 2017.

Operational and financial highlights

For the year ended 31 December 2017, the KPHL Group made a consolidated net profit of US$56.69 million (2016: US$149.80 million net loss). Kumul Petroleum's substantial participating interest in the PNGLNG project is the company's most important asset and provided the bulk of our income in 2017. 2017 was the third full year of production from the liquefaction plant at Cape Possession near Port Moresby. During the year the operator ran a variety of tests at levels of production in excess of the nameplate capacity of 6.9 mta and achieved an average of 8.3 mtpa for the year. Feed gas into the plant amounted to 406 bcf, principally from the giant Hides gas field in the Hela Province, discovered by BP in 1987.

A total of 110 cargoes of LNG were sold at the average price of US$7.6/mmbtu and were dispatched to customers in the Far East, principally Japan, China and Taiwan. Of these 110 cargoes, 23 were sold on the spot market to buyers apart from the four major long-term buyers.

Company focus 2018–19

Material progress continues to be made on the expansion and development of the PNGLNG project, which is currently producing at levels well above nameplate capacity. Progress has also been made towards petroleum development license award over the P'nyang field, a key resource to underpin a potential new LNG train near the PNGLNG project. In December 2017, P'nyang-South2ST1 appraisal well was successfully drilled and encountered good-quality, gas-bearing Toro and Digimu sands, confirming the presence of gas in the south-eastern part of the P'nyang field. Both the P'nyang development and the Papua LNG project, through their 'Propose Integrated Development Concept' offer attractive returns and remain highly competitive when compared to other possible LNG projects in the South-East Asia region.

Aerial view of the loading facilities at Caution Bay.

P'nyang Development project

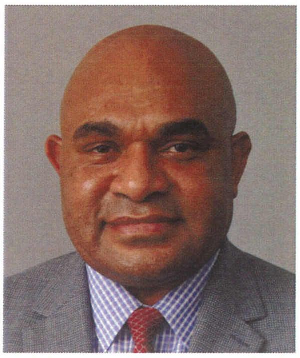
The P'nyang Development project will be operated by Exxon Mobil. The project will fully utilise one of the three additional 2.7 mtpa trains to be located at the PNGLNG project liquefaction site. The initial development plan proposed by ExxonMobil calls for a total of 550 mscf/d of gas to be produced which is enough to produce 4 mtpa of LNG. Kumul Petroleum expects to fully back-in its 22.5% equity interest in the P'nyang Development project, out of which 2.0% is carried for the Project Area Landowners. Recertification of the field's gas resources is likely to be completed in the second quarter of 2018.

Papua LNG project

The Papua LNG project will be operated by Total. The project will include the development and connection of the Elk/Antelope field, the construction of 340 km of onshore and offshore pipelines and the construction of the second and third of three trains built next to the current PNGLNG facility. The final certification shows that the field is good for a 5–6 mtpa development and Kumul Petroleum expects to fully back-in its 22.5% equity interest, out of which 2.0% will be carried for Project Area Landowners.

Signature of both gas agreements is currently expected in Q4 2018, which could allow to move forward with final investment decision in late 2018, early 2019. First gas is envisaged in 2024 (one train) with all 3 trains commissioned before Q4 2025. As mentioned elsewhere, Kumul Petroleum will face significant challenges in raising the capital required to fund our equity contribution to these projects. Short term this will require a change away from delivering all available capital to the government, but long term the government and the people of Papua New Guinea will be the main beneficiaries of these new projects.

The future looks bright for Kumul Petroleum and the people of Papua New Guinea.



Wapu Rodney Sonk
Managing Director

Wapu Rodney Sonk,
Sir Moi Avei KBE,
Dr Ila Temu, Peterson Pipi

BOARD OF **DIRECTORS**

DR BENEDICT YARU

Director

Dr Benedict Yaru is Associate Professor (adjunct), at the Institute of Applied Ecology, University of Canberra, ACT, Australia. He acquired the professorial appointment in the Applied Ecology Institute of the University of Canberra and the Doctor of Philosophy (PhD) in Environmental Biology, Department of Environmental Science, Faculty of Science, University of Technology, Sydney.

Dr Yaru has over 20 years of extensive experience in a variety of challenging responsibilities in operational general management and consultancy roles which include management at senior/executive level, business planning, operational management, budgets and cost control, project management, strategic planning, team building/leadership, purchasing/procurement, financial management, human resources, HSES leadership – minerals and hydrocarbon industries, government and regulatory approvals, management of NGOs, stakeholder engagement, integrated community development and sustainability, research and academic supervision.

WAPU RODNEY SONK

Managing Director

Bachelor in Mining Engineering, University of Technology, Lae, Papua New Guinea.

Diploma of Business – Business Management, Melbourne Business School, Mt Eliza Centre for Executive Education, Australia.

Mr Sonk has two decades of experience as a Papua New Guinean leader in the oil & gas industry as the industry itself matured from being an oil exporting country to now LNG exporter.

He was appointed Managing Director of the National Petroleum Company of PNG in January 2013.

He has occupied numerous leadership roles in the petroleum industry of PNG since beginning his career with Chevron Nuigini Pty Ltd in 1997.

Mr Sonk is also a member of the International Association of Drilling Contractors (IADC), Society of Petroleum Engineers (worldwide), and Institute of Engineers, PNG.

SIR MOI AVEI, KBE

Board Chairman

Sir Moi Avei, KBE was appointed to the board of Kumul Petroleum Holdings on 30th March 2017. He holds a Bachelor of Social Work degree from the University of Queensland, Australia and comes from Boera village in the Central Province of Papua New Guinea.

Sir Moi is currently Chairman of Ok Tedi Mining Limited board and also serves as a Director on the board of Bougainville Copper Limited. In 2015 Sir Moi served as a board member on Pacific Games Authority Board.

Sir Moi was the Member of Parliament for the Kairuku Hiri Electorate for three consecutive terms from 1992 to 2007. During his tenure as a Member of Parliament, Sir Moi held various ministerial portfolios. In 1995 to 1997, he was Minister for National Planning. In 2001 to 2002, he was made Minister for Bougainville Affairs and from 2002 to 2007, he was Minister responsible for Petroleum. His highest achievement in politics was in 2004 to 2006, where he was Deputy Prime Minister in the then Somare led government. He was knighted in 2001 for his leadership in negotiating the Bougainville Peace Agreement when he was Minister responsible for Bougainville Affairs.

DR ILA TEMU

Director

PhD (University of California, Davis, United States of America) Specialising in Development Economics and Econometrics.

Ila Temu brings to the Board considerable experience in executive management and directorship roles in the extractive industry as well as in policy and economic matters of PNG.

He is currently the Country Executive Director of Barrick (Niugini) Ltd, and prior to this he held senior executive roles in Placer Dome both overseas and in PNG, as well as holding senior positions in public organisations including senior lecturer in Economic at the UPNG and as the Director of the National Research Institute. He is also a director of Bank of South Pacific and Kina Petroleum.

Dr Temu acquired his Doctor of Philosophy in Agricultural Economics from the University of California, his Masters in Agricultural Development Economics from the Australian National University and his Bachelor of Economics from UPNG.

PETERSON PIPI

Director

Mr Peterson Pipi was appointed as a Director by the Kumul Petroleum Trustee to the Kumul Petroleum Holdings Limited Board on 22nd February 2017.

Mr Pipi has over 20 years of experience in Mining, Oil and Gas Industries including being the General Manager of Gigira Development Corporation Limited (GDC), a landowner company in Hides Gas Field since 2011. Mr Pipi also serves as a Director on PNG Mining and Petroleum Hospitality Services Limited (PMPHSL).

Mr Pipi attained a Bachelor of Commerce (BCom) from the University of Papua New Guinea in 1994. He further attained a Diploma in Economic Policy analysis of the National Research Institute of Papua New Guinea in 1995. Mr Pipi is also a member of other professional bodies in PNG and abroad including member of PNG Institute of Directors (PNGID) and member of Australian Institute of Company Directors (MAICD).

OUR VISION FOR THE **FUTURE**

Children of Baruni Dump area who are enrolled in Life PNG Care's Mobile Education Program.

VISION

Kumul Petroleum will create value and opportunity for PNG and its people from the nation's petroleum resources.

STRATEGIC THEMES

Invest in the development and production of oil and gas reserves for the nation's benefit	**Enter into midstream and downstream petroleum infrastructure projects**	**Diversify into petroleum products and the energy distribution sector**	**Be a national champion and the industry advisor to government and state agencies**	**Govern KPHL in line with international best practice**	**Be a good corporate citizen and maintain our social licence to operate**

STRATEGIC GOALS

Maximise the value of our back-in rights Become an operator of a petroleum license Enter into strategic retention and development licenses Develop strategic alliances with IOCs and other industry partners Facilitate the commercialisation of stranded petroleum resources	Develop and control transportation of gas and LNG throughout PNG Influence major operators to optimize their development options and maximize value Facilitate the development of mid and downstream projects where they are economically and socially viable	Actively pursue domestic and international marketing and trading opportunities in LNG and petroleum Supply gas to power projects and other gas related domestic industries Invest in and/or operate gas fired power stations Encourage investment in petrochemicals using domestic feedstock	Be an expert industry advisor to the state and its instrumentalities Promote programs to develop oil and gas skills and knowledge in country Advocate national content in policy development and implementation Provide a reasonable and sustainable return on investment to KPHL's shareholders Develop a national oil and gas database	Strive for a corporate culture with the highest levels of compliance and social responsibilities Ensure that KPHL and its contractors adhere to the values outlined in the KPHL Code of Conduct All company activities will have risk safeguards Manage HSES in line with international best practice Implement a transparent and measurable human resource development program for all levels in the company An engaged and inclusive workplace with high levels of knowledge and talent, a culture of learning and accountability, and a focus on career development	Fulfil KPHL's social inclusion policy Contribute to PNG's social development through targeted investments and sponsorships High public awareness of KPHL's activities to build KPHL's positive corporate image Ensure KPHL is recognised as the nation's NOC Ensure effective engagement with landowners

Loading an LNG tanker at Caution Bay.

HELPING BUILD **A NATION**

Trainees at Kumul Petroleum Academy.

Our most important value is to benefit Papua New Guinea. During 2017 we had numerous examples of projects that demonstrate our wish to operate in a manner that maximises the outcome for PNG and its people...

KUMUL PETROLEUM ACADEMY

The success of the PNGLNG project and promising new projects taking off in the next few years, will drive a demand for semi-skilled and skilled technicians in the operations and maintenance fields.

Kumul Petroleum Academy is the first training facility in PNG preparing Papua New Guineans to meet that demand. The main aim of the academy is to accelerate human capital development to support the growth of the industry in PNG and elsewhere in the region. The 12 month competency based technical development programme is designed to ensure the graduates are 'job ready'.

The success has been confirmed by the significant recruitment rate by employers from the first batches of students. Longer term the aim is to become a preferred training provider in the region, attracting trainees from the Pacific, including Australia, New Zealand and East Timor.

> The success has been confirmed by the significant take up rate by employers from the first batches of students.

GLOBAL MARKETING

Management reached preliminary agreement with Total to explore the possibility of jointly marketing their LNG and condensate production from the Elk/Antelope field. Importantly for Kumul, Total has already agreed that any such marketing company should be jointly staffed by both Kumul and Total employees, and the companies have developed a series of milestones to incorporate the marketing company in 2018 after finalising the prerequisite HOA and Share Holders Agreement.

Nipa Hospital

NIPA HOSPITAL

The Nipa District Hospital was completed in December 2017. The original submitted cost was K10M but the scope continued to grow, and in the end Kumul Petroleum made a significant contribution to ensure the best possible hospital for Nipa District. Kumul Petroleum's K4M contribution covered:

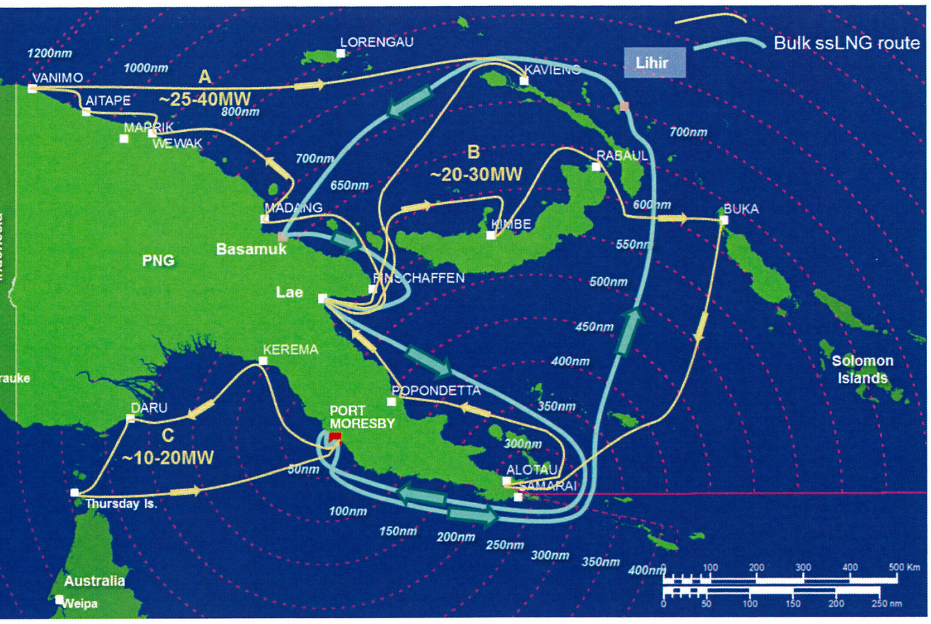
- Step down accommodation (outpatient facilities)
- Water treatment facilities and tank
- Incinerator house and incinerator
- 2 x 3 bedroom duplex staff houses
- 1 x 12 bedroom staff dormitory

DOMESTIC LNG DISTRIBUTION FOR POWER

Kumul Petroleum is committed to playing a key role in the efforts to increase PNG's rate of household electrification from 14% today to 70% by 2030.

We have founded NiuEnergy as a 50% joint venture with Oil Search. NiuEnergy's construction of a 58MW power station in Port Moresby commenced in October and completion is expected early 2019.

NiuEnergy is planning for domestic distribution of LNG in Papua New Guinea, principally as fuel for electrification. Apart from addressing the low rate of household electrification, the aim is to encourage industrial growth around the country.



Potential domestic LNG routes and facilities.

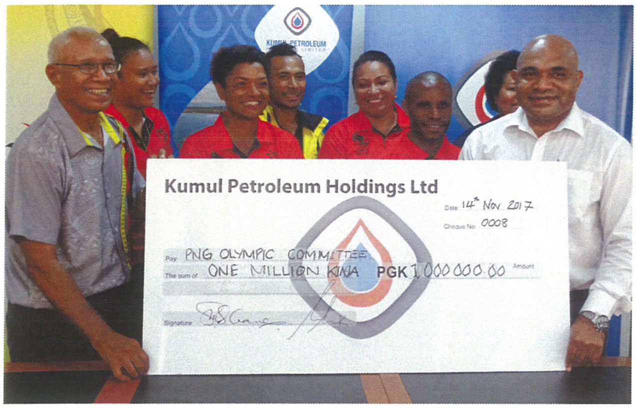
> Kumul Petroleum is committed to playing a key role in the efforts to increase PNG's rate of household electrification from 14% today to 70% by 2030.

COMMUNITY PROJECTS AND INVESTMENTS

On another note, Kumul Petroleum has implemented its Social Inclusion Policy to giving a helping hand to activities that promote law and order, health, sports and sporting codes that promote healthy living, including at the highest level like the Commonwealth Games and Mini Pacific Games.

Kumul Petroleum has also partnered with Life PNG Care, a local NGO that provides shelter and education to underprivileged children from the streets of Port Moresby. This initiative has not only given the opportunity for the NGO to carry out its good work, but for Kumul Petroleum staff to be involved and gain opportunity to visit mobile education sites and give back to the community through volunteerism. Below is a list of some of the community projects undertaken this year:

- Hela Wigman Naming Rights sponsorship (K1.2M)
- 2017 Kimbe PNG Games Platinum sponsorship (K1M)
- PNG Olympic Committee sponsorship (K1M)
- PNG Olympic Committee – Mini Pacific Games, Vanuatu (K500,000)
- PNG Amateur Boxing Union (K100,000)
- Life PNG Care Annual Charity Dinner (K58,000)
- PNG Defense Force Golf Club sponsorship to Jakarta (K30,000)
- Hanuabada Fire Disaster Relief (K20,000)
- PNG Medical Symposium (K20,000)
- Independent Consumer Commission Regulatory Workshop (K20,000)
- Crocodile Prizing – Major sponsor for short stories (K10,000)
- Christ the King Papitalai Secondary School Manus (K10,000)
- Bougainville Magazine (capturing human rehabilitation during crisis and peace negotiations) (K10,000)
- Funding of Library Building in Siwai – Bougainville



Managing Director Wapu Sonk presenting the K1M sponsorship cheque to the PNG Olympic Committee.

KUMUL PETROLEUM VALUES

To benefit Papua New Guinea

To only operate in a manner that will enable Kumul Petroleum to maximise the benefits it delivers to PNG and its people.

Accountability and transparency

To act with integrity and honesty so Kumul Petroleum can always be relied on as a trusted, valuable, and attractive business partner.

Team value and diversity

We will value our team and respect their diversity as we strive to provide opportunities for their future within an inclusive workplace.

Protect and conserve the environment

Kumul Petroleum will always seek to minimise the social and environmental impact of our operations so that the short and long-term interests of the countries in which we operate, and the people with whom we work, are protected for their future.

Maintain appropriate standards in safety, health, and wellbeing

Kumul Petroleum will provide everyone with a safe, secure and healthy working environment.

Promote innovation and excellence in the workplace

Encourage critical thinking, collaboration and communication that provide innovative solutions to challenges and problems.

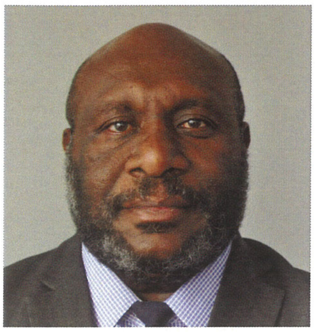
MEMBERS OF THE **EXECUTIVE COMMITTEE**

Supporting culture preservation in east Sepik Province – EGM External Affairs, Ian Marru (L) with Strategic Advisor, Rodney Berapu (R) at the Boem-Sata Cultural Centre.

ROGEN WATO

General Counsel

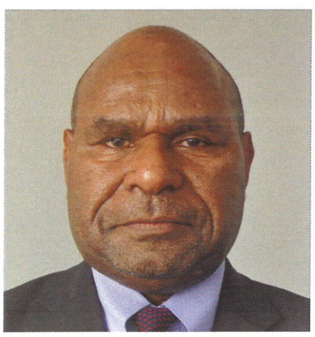
Rogen joined Kumul Petroleum in October 2010 as legal counsel, and has since then been instrumental with reforming relevant government policy and law which has transformed the company from an investment vehicle to the NOC of PNG and major LNG exporter. He was appointed Company Secretary in February 2013 and made General Counsel in July 2016. He holds a Bachelor of Laws and attained a Master of Laws (with High Distinction) from the University of PNG and has been admitted to practice law in PNG. He previously practised law in the commercial and natural resources space.



IAN MARRU

Executive GM External Affairs

Ian Marru is the General Manager for Stakeholder Relations. Ian has just over 21 years of petroleum industry experience, having worked in both the public and private sectors. Prior to joining Kumul Petroleum Holdings Limited, he spent four years as the Community Affairs Manager for ExxonMobil PNG in the PNGLNG Project during the construction phase and during transition into production phase. Ian has a degree in Land Studies, which he obtained in 1995 from the PNG University of Technology and a Master of Philosophy from the University of Cambridge in the United Kingdom in 2004.



LUKE LIRA

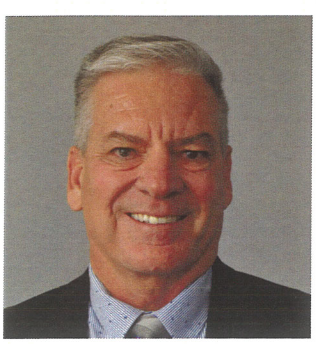
Executive General Manager Projects and Planning

General Manager Shared Services at the Kumul Petroleum Holdings Limited since Q3, 2013. Appointed Chief Executive Officer of Kumul Petroleum Foundation Inc. mid-2016 and currently Interim Chief Operating Officer of Kumul Petroleum Academy. Additional roles as General Manager in Kumul Petroleum. Several years' board level experiences with Not-For-Profit organizations. Creator and founder of Papua New Guinea Leadership Network, an organization that focuses on the teaching, coaching, and speaking on leadership in Papua New Guinea.

JOHN BENNETT

Chief Operating Officer

Based in Port Moresby, John is the COO of Kumul Petroleum and was appointed to the role in March 2018. John holds Chartered Professional engineering status and is Fellow and EngExec member of Engineers Australia, a management background coupled with over 30 years experience building and developing technical teams for delivery of complex multidisciplinary downstream projects in the oil and gas, power and hydrocarbon industries. John is a chartered professional engineer and worked on both the client and contractor sides on a number of mega LNG projects.



GREG HEANEY BCOM, FCPA, FAICD, CFTP, CPA (PNG)

Chief Financial Officer

Greg is an experienced MD, CEO, CFO and Company Director who has more than 35 years of experience in financial and general management for large publicly listed companies in Australia and overseas. Greg's experience in the resource sector includes ten years with the LASMO Group, which at the time was one of the world's largest independent oil and gas exploration and production companies, working in Australia, Great Britain, USA and Indonesia. Greg was the Chief Financial Officer of Queensland Cotton Holdings Limited and of Roche Mining.

PETROLEUM OPERATIONS **IN 2017**

PNGLNG PROJECT

Kumul Petroleum's substantial participating interest in the PNGLNG Project is the company's most important asset and provided the bulk of the company's income in 2017. 2017 was the third full year of production from the liquefaction plant at Caution Bay near Port Moresby. During the year the operator ran a variety of tests at levels of production in excess of the nameplate capacity of 6.9 mta and achieved an average of 8.3 mtpa for the year. Feed gas into the plant amounted to 406 bcf, principally from the giant Hides gas field in the Hela Province, discovered by BP in 1987.

A total of 110 cargoes of LNG were sold at the average price of US$7.6/mmbtu and were dispatched to customers in the Far East, principally Japan, China and Taiwan. Of these 110 cargoes, 23 were sold on the spot market to buyers apart from the four major long-term buyers.

Condensate produced from PNGLNG Project gas fields is blended with crude oil produced by Oil Search at its Kutubu processing facility, which are then transported via pipeline to the offshore Kumul Loading Terminal. In 2017, PNGLNG project sold 10.9 million barrels of condensate in 22 cargoes sold at an average price of US$53.53/bbl.

Kumul Petroleum's net share of production in 2017 was 68 bcf of gas and 1.83 million barrels.

A magnitude 7.5 earthquake hit the Highlands region on 26th February 2018, with a series of intense 'aftershocks' experienced in the following weeks. A controlled shut-down of plant and facilities was initiated by the operator ExxonMobil as a precautionary measure. Force majeure was declared on 27th February 2018. Production resumed in early May 2018.

For the Angore gas field tie-in project, a landowners' incursion & crew kidnapping incident occurred in November 2017 in the Angore field camp. While the operator contemplate whether to demobilise the site construction crew, then we have the 26th February 2018 earthquake incident. The Angore site construction crew was then utilised in the post earthquake emergency response and recovery efforts, to make safe all field operating sites and performed initial assessment on the damage.

The tie-in of the Angore Gasfield to the PNGLNG infrastructure will continue through 2018 and is expected to be completed in 2019H2. Angore is expected to produce at 300 mmscfd and help to sustain the production plateau of the project.

PDL3

Post the acquisition of JX Nippon's interest in June 2017, Kumul Petroleum now holds a substantial non-operated participating interest in PDL3, a producing licence that includes a part-share in the Southeast Gobe Field. SE Gobe Field is operated by Oil Search and is unitised between PDL3 (46.8%) and PDL4 (53.2%).

SE Gobe is a mature field that has produced 45.2 mbbls of oil since 1998. For several years, natural gas in the reservoir was produced and reinjected to enhance the recovery of oil from the field. As part of a planned and prudent management of the reservoir, in March 2015 the operator began to produce and sell the gas. Though the production of oil will decline more rapidly without gas lift, the loss is more than offset by the increase in net revenue earned from the sale of gas. As a result of the operational changes, SE Gobe became a gas field for the purpose of taxation, and therefore the rate of income tax switched from 50% to 30%.

SE Gobe produced a gross 259 mbbls of oil in 2017, together with a gross sales gas volume of 12.1 bcf. The gross revenue generated amounted to US$10.4 million.

SE Gobe was also hit by the February 2018 earthquake with production resumed in April 2018.

PDL5

Moran is unitised across three licences, namely PDL5, PDL2 and PDL6. KPHL's 20.5% interest in PDL5 constitutes an 11.275% share of the Moran Unit.

Moran is a mature oilfield that began production in 1998. Production peaked at about 21,000 bopd gross in 2007 and the field produced at an average of about 7,000 bopd gross in 2017. Production of associated gas is increasing year-on-year as the field matures, and the gas is captured by the PNGLNG Project. The field remains profitable, despite the declining production and reduced price of oil and gas, and provides a net income to KPHL.

A workover on the Moran-4 gas injection well commenced in December 2017. Like the PNGLNG Project and SE Gobe, Moran was also hit by the February 2018 earthquake. Partial production is expected to resume in Q3 2018.

PDL10

Stanley 10% participating interest was acquired in May 2017 as a part of the former Mitsubishi Corporation's PNG assets.

PRL8

Kimu 17% participating interest was acquired in May 2017 as a part of the former Mitsubishi Corporation's PNG assets.

The Kimu gas field was first discovered in 1999. Additional seismic data was acquired in 2016. Works performed in 2017 were mainly to firm up the drilling location of the Kimu-2 appraisal well. In Q2 2018, Kimu-2 well successfully encountered gas in the target Alene reservoir. The provisional interpretation of the Alene sandstone at the Kimu-2 location is that it has similar reservoir properties as the Kimu-1 discovery well and a slightly greater reservoir thickness. In addition, the reservoir appears to be in pressure communication with the Kimu-1 discovery well.

Cores and logs were acquired and a Drill Stem Test undertaken over the Alene sandstone interval, which flowed at a continuous rate of 34.5 mmscf/day over a 72-hour period through a 1" choke.

These results were significant as it underpinned a possible original gas volume in place in the 400 – 900 Bcf range subjected to further independent certification. Kimu could potentially form another hub for gas aggregation in the Western and Gulf provinces and it is located in the corridor of the Kumul Petroleum's proposed Western Pipeline route.

PRL9

The company is engaged in appraising discovered gas resources in two retention licences that straddle the PNGLNG trunk gas pipeline, namely PRL9 and PRL14 near the southern coast of PNG.

PRL9 contains the Barikewa discovery. Operator Oil Search is gearing up for a firm drilling of the Barikewa-3 appraisal well in H2 2018.

PRL14

PRL14 is another retention licence that straddles the PNGLNG trunk gas pipeline near the southern coast of PNG.

PRL14 contains the Lehi, Cobra and Bilip discoveries. Operator Oil Search plans to acquire an additional seismic line data over Lehi in H2 2018.

POWERING THE NATION: POM GAS TO ELECTRICITY

In 2015, the PNGLNG Project operator ExxonMobil announced its intention to provide gas for a power plant in Port Moresby. As at the end of 2016, Kumul Petroleum had secured a plot of land suitable for the construction of the power plant. In November, 2017 Kumul Petroleum officially launch the construction of the US$120 million project, which will use natural gas from the PNGLNG plant, is being developed by NiuPower, a 50/50 partnership between Kumul Petroleum Holdings Limited (KPHL) and Oil Search Limited.

Development of the gas-fired power station has been progressing steadily since the beginning of September 2017. The power station site is located adjacent to the liquefaction plant site.

The gas supply pipeline, being constructed separately by the PNGLNG project team, will also commence construction in 2018.

The gas supplied by the PNGLNG project will feed the high-efficiency reciprocating gas engines and generators. It will produce 58MW base load power to the Port Moresby power grid through a new 66kv power line and substation network to be constructed in Gerehu and connected to the new power plant.

The power plant remains on track to commence operations in the first quarter of 2019 subject to the timely completion of all required regulatory approval.

Members of the Board inspecting progress on the construction of the new Port Moresby power plant.

BUSINESS DEVELOPMENT

Monetising the Domestic Gas Resource

Western Pipeline Project

Kumul Petroleum embarked on the Western Pipeline Project in 2016, with the focus to facilitate development of most of the stranded gas resources in the Western and Gulf Provinces. The project strategy is for KPHL to build a common gas pipeline infrastructure, starting from the northwest part of the Western Province, somewhere close to the Elevala-Ketu discoveries, southwards to the coastline somewhere near Kopi. The Pre-FEED study was completed in 2017.

The pipeline infrastructure will be a common facility used by all project developers engaging in developing different gas fields in the two provinces. Kumul Petroleum believes that as the National Oil Company it should take this step to enable the development of the stranded gas fields, as well as to encourage more exploration activities in the two provinces.

Kumul LNG

In August 2017, Kellogg Brown and Root (KBR) was awarded a contract by Kumul Petroleum for the conceptual development and feasibility study services for an energy hub in the Kikori region of the Gulf Province of PNG. In addition, a PNG dedicated alliance was formed between KBR and Wison in November 2017 to provide a seamless and integrated relationship to Kumul Petroleum in reducing the project execution risk. Should the business case for the project prove to be viable and in the interest of the people of PNG, this alliance between KBR and Wison will give Kumul Petroleum an experienced and very capable development option.

Kumul Petroleum is leading a strategic and transformational liquefied natural gas (LNG) project that will create a sustainable economic oil and gas business economy, and subsequent long term supporting economies, for the country. In analysing the potential In Country Value (ICV) created and maximising the contribution to the PNG economy, further consideration has been given to expanding the downstream commercialisation options that have been considered for the Western Pipeline beyond either exporting to another major project or a standalone LNG liquefaction facility.

The expanded options include a regional LNG export facility to encourage future gas fired power generation in remote locations of PNG via shallow water LNG import and re-gasification, a 180MW gas fired power generation facility to provide up to 100MW power transmission to the Western and Gulf provinces via future grid connection, methanol and other petrochemical bi-product (such as urea, fertiliser, ammonia, etc) process facilities and a liquid/condensate stabilisation and export facility for local export. Collectively, these downstream facilities form the Kikori Energy Hub (KEH) concept.

With the upstream and midstream facilities located in the Western province, initial analysis suggests the downstream facilities would create considerable ICV if located in the Kikori region of Gulf province.

Methanol Project

In 2015, Kumul Petroleum signed an MoU with a major Japanese trading company named Sojitz in regard to their proposal to establish a methanol plant in Port Moresby. Kumul Petroleum and Sojitz subsequently incorporated a Joint Venture Company named Port Moresby Methanol Industry (PMI) to be the structured entity to progress the petrochemical opportunity.

With the Department of Petroleum and Energy and the Gas Project Coordination office leading the policy development on Domestic Market Obligation (DMO), Kumul Petroleum sees a window of opportunity for the petrochemical industry to be developed as the next wave of PNG major gas development projects are under consideration.

Mayur Resources Memorandum of Understanding

Kumul signed a MoU with Mayur Iron PNG Limited, a subsidiary of Mayur Resources in January 2018. Under this proposed business, KPHL will be supplying gas to Mayur via a 6–7inch pipeline from KPHL Power Plant at Caution Bay to Mayur's location, which is about 10km north of PNGLNG liquefaction plant for cement production.

Diversifying Internationally

LNG Marketing

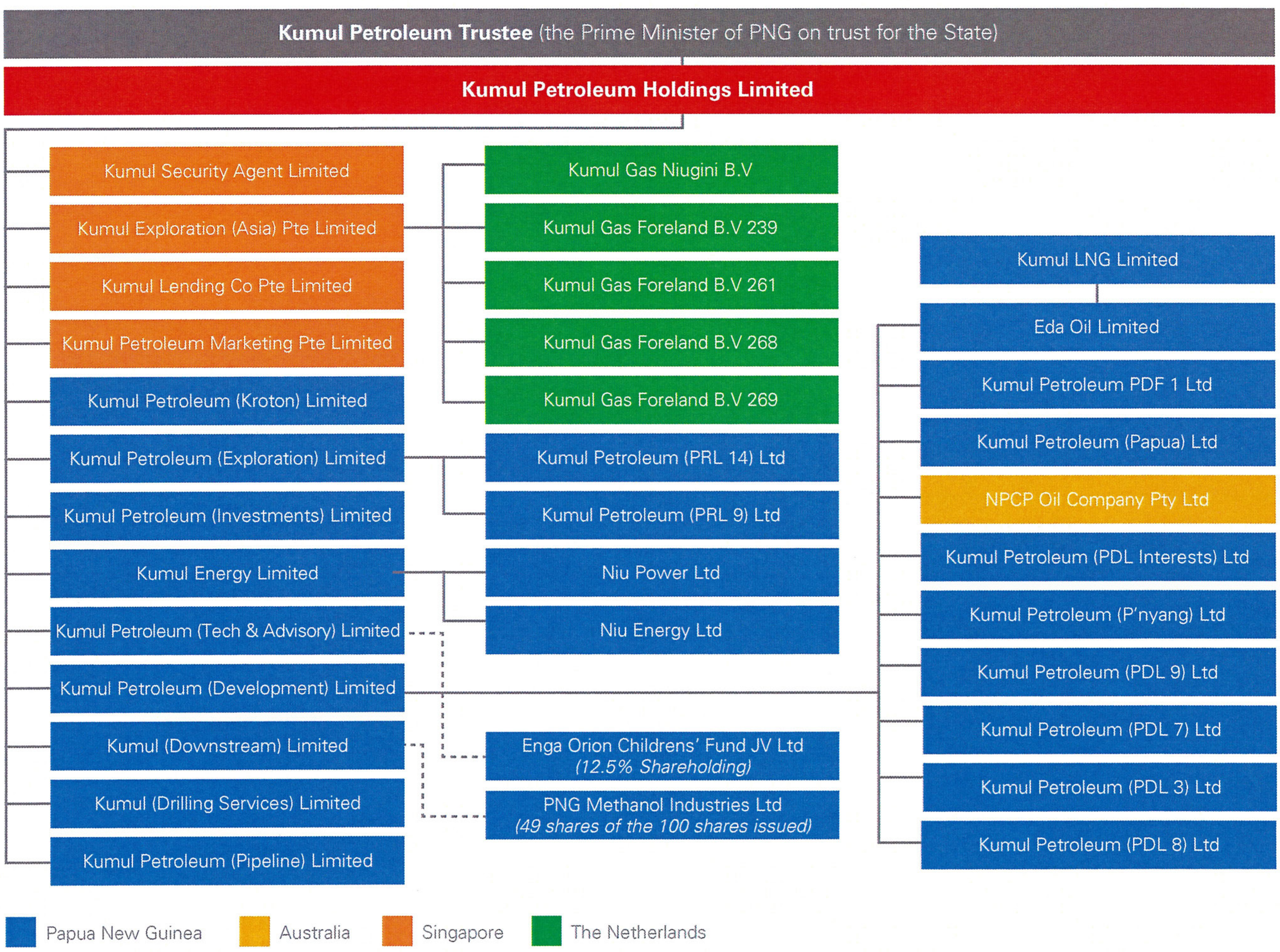
In February 2018, Kumul Petroleum has signed a binding Heads of Agreement (HoA) with Total for the joint marketing and sale of their shares of LNG and condensates to be produced from the Papua LNG Project.

Under the HoA, KPHL and Total will negotiate a Shareholders' Agreement for an Incorporated Joint Venture (IJV) to be set up as the corporate vehicle to commercialize their combined production share of LNG and condensates from Papua LNG and jointly staffed by Total and KPHL. The IJV will engage potential buyers of LNG in the Asia Pacific region for the long term sale and purchase of their respective entitlements of LNG in Papua LNG.

CORPORATE STRUCTURE AND **GOVERNANCE**

CORPORATE STRUCTURE

KPHL has nine (9) wholly owned subsidiaries and eight specific purpose subsidiaries incorporated under two of its subsidiaries. The chart below shows its operating subsidiaries as at 31st December 2017.



Share Holder Information

The *Kumul Petroleum Holdings Limited Authorisation Act 2015* ***('Kumul Petroleum Act')*** which commenced in September 2015 provides for a change in the shareholding structure of Kumul Petroleum Holdings Limited. Section 5 (1) of the Kumul Petroleum Act provides that all the issued shares in Kumul Petroleum Holdings Limited of which IPBC, now Kumul Consolidated Holdings Limited, is the registered holder shall be transferred to the Kumul Petroleum Trustee when the Kumul Petroleum Act comes into operation.

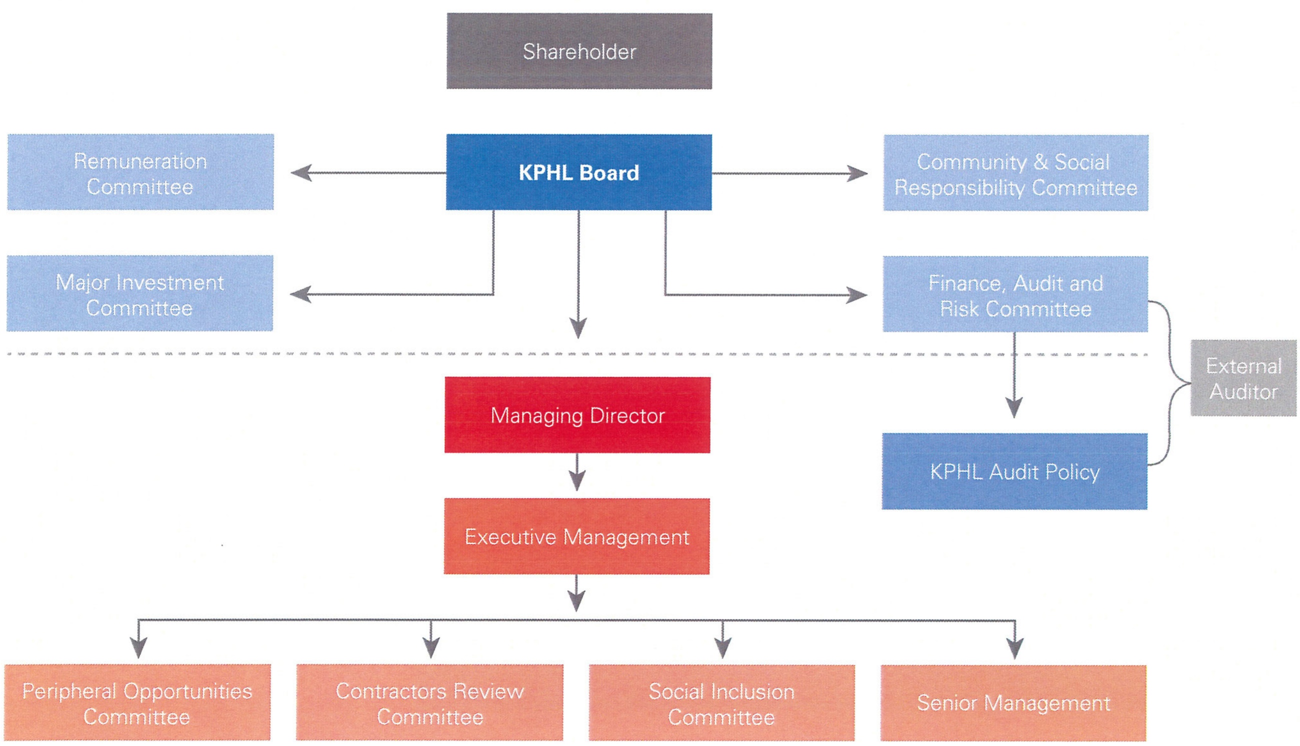
The Kumul Petroleum Trustee as per section 4 (2) of the Kumul Petroleum Act is the office of the Prime Minister established by section 142 *(The Prime Minister)* of the ***Constitution***. The Kumul Petroleum Trustee will hold the shares in Kumul Petroleum Holdings Limited for and on behalf of the Independent State of Papua New Guinea ***('the State')*** under a Trust Deed to be executed by Kumul Petroleum Holdings Limited, the Prime Minister and the State. The Trust Deed and necessary arrangements are underway to effect the transfer of shares from Kumul Consolidated Holdings Limited to the Prime Minister as the Trustee.

CORPORATE GOVERNANCE

Corporate Governance is the system of rules, practices and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of the many stakeholders in a company - these include its shareholders, management, suppliers, financiers, government and the community. Since corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.

As part of the company's objectives, KPHL must be managed with the highest standards of governance, responsibility and transparency. The company is required to:

- maintain a corporate culture with the highest levels of accountability, transparency and independence; and
- implement a transparent and measurable human resource development program for all levels in the company.



LICENCE INTERESTS AND **PETROLEUM RESOURCES**

In February 2017, Kumul Petroleum acquired from Mitsubishi Corporation and its subsidiaries their PNG assets in PDL10, PRL8 and PRL40.

A swap deal was made with Horizon Oil (Papua) Ltd. in 2017Q4 to exchange 20% interest of PRL40 from Kumul Petroleum for 20% interest in PRL28 Ubuntu. At the time of writing this report, the transfer/swap deal is still pending regulatory approval.

In June 2017, Kumul Petroleum also acquired from JX Nippon its interest in PDL3.

KPHL's Upstream Assets

Petroleum licences	Project	Kumul Petroleum Interest (%)	
		2016	2017
PDL1	Hides gas field	20.5	20.5
PDL3	Development licence	5.57	45.72
	Unitised SE Gobe gas field	2.61	21.40
PDL 5	Development licence	20.5	20.5
	Unitised Moran oil field	11.3	11.3
PDL7	South Hides gas field	20.5	20.5
PDL8	Angore gas field	20.5	20.5
PDL9	Juha gas field	20.5	20.5
PDL10	Stanley gas field	0.0	10.0
PRL8	Kimu gas field	0.0	17.0
PRL9	Barikewa gas field	14.89	14.89
PRL14	Cobra, Lehi and Bilip gas field	37.44	37.44
PRL28	Ubuntu gas field	0.0	20.0
PRL40	Puk Puk, Douglas gas field	0.0	40.0

Infrastructure licences	Project	Kumul Petroleum Interest (%)	
		2016	2017
PL4	PNGLNG Project	20.5	20.5
PL5	PNGLNG Project	5.57	5.57
PL6	PNGLNG Project	3.29	2.61
PL7	PNGLNG Project	20.5	20.5
PL8	PNGLNG Project	20.5	20.5
PNGLNG	PNGLNG Global Company LDC	20.5	20.5
PNGLNG	PNGLNG Project	20.5	20.5
PPFL2	PNGLNG Project	14.89	14.89
PL3	SE Gobe	37.44	37.44

Petroleum reserves and resources net to Kumul Petroleum are predominantly gas and principally contained in the PNGLNG asset. The company's 1P reserves are in excess of 1.5 tcf and 25 million barrels of liquids and the company's 2C contingent resources amount to 193 bcf and 220 million barrels of liquid.

Kumul Petroleum's Proved 1P Reserve/Production Ratio at the end of 2017 was 26 years, meaning that at the current level of production, Kumul Petroleum's Proved 1P reserves would last 26 years.

Oil, Condensate and Gas Reserves Net to Kumul Petroleum

		Oil & Condensate	Gas	Oil & Condensate	Gas
		mmbbl	bscf	mmbbl	bscf
Reserves Category		Proved (1P)		Proved and Probable (2P)	
PNGLNG Project	Project fields[1]	20.23	1,514	22.99	1,677
PDL1	Hides GTE[2]	–	2.719	–	6.150
PDL3	South East Gobe[3]	0.10	8.19	0.20	11.52
PDL5	Moran[4]	1.29	25.70	2.12	32.12
Total		**21.62**	**1,551**	**25.31**	**1,727**

Contingent Oil, Condensate and Gas Resources Net to Kumul Petroleum

		Oil & Condensate	Gas	Oil & Condensate	Gas
		mmbbl	bscf	mmbbl	bscf
Reserves Category		1C		2C	
PRL10	Stanley[5]	1.01	31.50	1.27	39.90
PRL8	Kimu[6]	–	6.46	–	15.98
PRL9	Barikewa[7]	–	29.78	–	67.45
PRL14	Cobra, Bilip,lehi[7]	0.07	29.95	0.22	69.64
PRL40	Puk Puk, Douglas[8]	–	155.56	218.76	69.64
Total		**1.08**	**253.25**	**220.25**	**192.97**

Notes:

1. PNGLNG project includes Hides, Juha, Angore, and OSL operated fields of Kutubu, Agogo, Moran, SE Gobe and Gobe Main, and SE Hedinia. The reserves are as per NSAi Reserves Recertification of June 2016.
2. Hides GTE reserves are as stated on OSL 2016 Reserves and Resources Statement.
3. NSAi Reserves Assessment as of December 2015. PDL3 additional interest acquired from JX Nippon in 2017.
4. NSAi Reserves assessment of 2014 for oil; Moran gas reserves are part of the PNGLNG Project.
5. PDL10 added in 2017 as acquisition from Mitsubishi Corporation.
6. PRL8 added in 2017 as acquisition from Mitsubishi Corporation.
7. PRL9 and PRL14 Reserves are taken from the Operator, Oil Search Limited; net to KPH.
8. PRL40 added in 2017 as acquisition from Mitsubishi Corporation.

ECONOMY AND **MARKET OVERVIEW**

INTERNATIONAL PRODUCT PRICES

Kumul Petroleum is largely reliant on revenue from the sale of LNG, condensate and naphtha from the PNGLNG Project. Product prices are related to the international price of oil, notably the benchmark of Japan Crude Cocktail.

Following a steep decline in 2014, the price of oil hovered around an average of about US$50/bbl until rising strongly in the 4th Quarter 2017, a rally that has been sustained into 2018. Even so, Kumul's revenue from the project at an average price in 2017 of US$50 was half that of 2014.

Five-Year Monthly Japan Imported Oil Price 2013–2017 (US$)

OUTLOOK FOR PRODUCT PRICES

For planning purposes, accurate forecasting of the oil price is almost impossible. Kumul Petroleum believes that a likely range is between an average of US$40/bbl as a low price scenario, and an average of US$80/bbl as a high price scenario over the next five-year period.

Global LNG supplies increased by 9 per cent in 2017, and much more capacity is due to come on the market in the next five years. Buyers reacted to this perceived oversupply by reducing LNG prices on term contracts negotiated in 2017. However, in 2017 global spare capacity fell by a third and this is likely to feed into price volatility across the international regions in the future, with patches of local shortage and local oversupply dictating prices.

Demand for LNG in Asia is seasonal and therefore affects the price of spot cargoes sold by PNGLNG. Chinese winter demand notably caused Asian spot prices to spike in 2017–18 with prices rising from $6/mmbtu in September to touch $12/mmbtu in January 2018 before declining. Remarkably, overall demand from China recorded a huge 42 per cent increase in 2017. The market is unsure how this will play out, perhaps drawing in competing supplies of LNG from North America, where prices are low.

Three of PNGLNG's four long-term contracts are facing a price review in 2018 and already experiencing pressure from key buyers to reduce prices by up to 15 per cent.

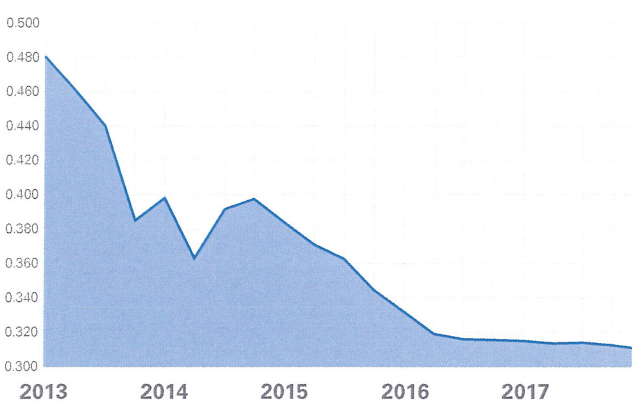
Further out, beginning in 2022, prices are expected to harden as demand outstrips supply, and this is the period when contracts for LNG produced by two new projects will be negotiated. Kumul Petroleum expects to participate with a 20.5 per cent share in both projects.

DOMESTIC ECONOMY

Kumul Petroleum's revenue and the majority of its expenditure commitments are in US Dollars, a situation that puts the company at risk of changes to the Kina/USD exchange rate in relation to domestic expenditure on salaries, local contracts and office overheads and utilities. The weakening of the Kina between 2013 and early 2016 benefited the company.

In 2017, the Kina continued its steady run against the US Dollar, begun in second quarter 2016, depreciating by only 1.5% from 0.315 to 0.310 during the year. However, the position is expected to reverse within two years because the Kina will appreciate and inflation will rise due to the new LNG and mining projects to be developed.

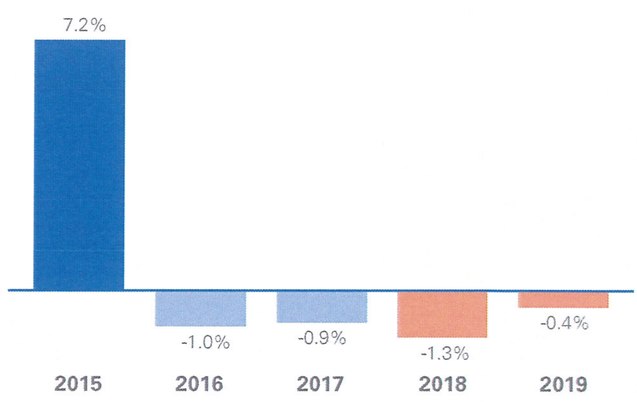
Five-Year PGK/US$ Exchange Rate
2013–2017



Papua New Guinea's economy was set to see a recovery in 2017. A shortage of US Dollars slowed imports and led to pockets of strength. Robust activity at the small and medium-sized enterprise level and in the informal sector took place, while key statistics, such as the current account, indicated a return to balance. The recent drought ended, and two major mines were back on-line and ramped up production. Importantly, commodity prices seemed to have stabilised.

Medium-term conditions are favourable for GDP to increase above the rate of population growth and therefore lead to improved living conditions. Major gas/LNG and mining projects are expected to contribute substantially, and reforms currently being put into place are likely to add to the sustainability of the economy.

Per Capita GDP Growth
2015–2017 Actual and 2018–2019 Forecast



were dispatched in 2017.

Kumul Petroleum Holdings Limited and its subsidiaries

CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

CONTENTS

ANNUAL REPORT OF THE DIRECTORS TO THE SHAREHOLDER

FOR THE YEAR ENDED 31 DECEMBER 2017

The directors take pleasure in presenting their report on the consolidated financial statements of the Kumul Petroleum Holdings Limited (the 'Parent entity') and its subsidiaries (together referred to as 'the Group') for the year ended 31 December 2017. The Parent entity was incorporated on 04 March 2014.

Principal Activity

The principal activity of the Parent entity is to be the State's nominee to hold interests in all oil and gas projects and grow its oil and gas portfolio in the country. The principal activities of the Group are:

- to hold the State's interest in the existing Papua New Guinea Liquefied Natural Gas (PNGLNG) Project;
- to hold interest in marketable securities;
- to hold pipeline and midstream related services;
- to hold interest in and venture into potential power generation projects;
- to hold interest in and or venture into potential exploration activities in the oil and gas sector;
- to hold interest in and or venture into potential drilling and related activities in the oil and gas sector;
- provide academic, technical and any other up-skilling and training ventures locally to benefit the industry; and
- to hold interest in and or venture into potential downstream and petrochemical related activities

Results

For the year ended 31 December 2017, the Group made a consolidated net profit for the year of US$56.69 million (2016: US$149.80 million net loss).

Production of LNG from Train 1 and Train 2 commenced in April and May 2014, respectively. In late 2014, the PNGLNG Project reached full operating capacity. Material progress continues to be made on the expansion and development of PNGLNG Project. The PNGLNG Project is currently producing at levels well above nameplate capacity. Progress has also been made towards petroleum development license award over the P'nyang field, a key resource to underpin potential PNGLNG Project expansion. In December 2017, P'nyang-South2ST1 appraisal well was successfully drilled and encountered good-quality, gas-bearing Toro and Digimu sands, confirming the presence of gas in the south-eastern part of the P'nyang field. Recertification of the field's gas resources is likely to be completed in the second quarter of 2018 and is expected to result in the addition of 1C contingent resources that can be used to underpin marketing and financing discussions for PNGLNG expansion. Both PNGLNG Project expansion and the Papua LNG Project, through their 'Propose Integrated Development Concept' offer attractive returns and remain highly competitive when compared to other possible LNG Projects in the South – East Asia region.

Directors

The directors as at the date of this report are:

Moi Avei	Non executive / Chairman	Appointed 30 March 2017
Frank Kramer	Non executive / Chairman	Appointed 4 March 2014 (ceased 30 March 2017
Mark Soipang	Non executive	Appointed 2 September 2014 (ceased 31 March 2017)
Wapu Sonk	Executive / Managing Director	Appointed 4 March 2014
Ila Temu	Non executive	Appointed 2 September 2014
Benedict Yaru	Non executive	Appointed 2 September 2014
Peterson Pipi	Non executive	Appointed 22 February 2017

Secretary

The Group secretary is Rogen Wato (Appointed 4 March 2014).

Directors' Interests

As at 31 December 2017, the directors did not have any interests in the Group warranting disclosure (2016: Nil).

AUDITOR-GENERAL'S OFFICE

Directors' Remuneration

The Directors remuneration for the year ended 31 December 2017 is shown below:

	Remuneration	Sitting allowance	Total
	US$	US$	US$
Moi Avei – Chairman	30,400	2,129	**32,529**
Dr. Ila Temu – Director	19,608	3,178	**22,786**
Dr. Benedict Yaru – Director	19,608	3,175	**22,783**
Peterson Pipi – Director	19,608	2,199	**21,807**
Total	89,224	10,681	99,905

Remuneration above US$31,111 (K100, 000) per annum

The number of employees not being directors whose total remuneration and other benefits received above US$31,111 (K100,000) per annum from the Group during the year was 43.

Remuneration and other benefits paid to employees during the year, in excess of US$31,111 (K100,000) in brackets of US$31,111 (K100,000) were:

Salary bands		No. of employees
K'000	US$'000	
100 to 199	31 to 61	33
200 to 299	62 to 93	8
300 to 399	94 to 124	1
400 to 499	125 to 155	1
Over 500	Over 156	9

Dividends

A total of US$93.40 million (PGK309 million) was paid as dividend to the State for the year ended 31 December 2017 (2016: US$30.75 million (PGK100 million)).

Employees

As of 31 December 2017, the Group had 74 employees (2016: 73).

AUDITOR-GENERAL'S OFFICE

ANNUAL REPORT OF THE DIRECTORS TO THE SHAREHOLDER

FOR THE YEAR ENDED 31 DECEMBER 2017

Donations and community sponsorships

Donations and community sponsorship made by the Group as part of corporate standing in the community for the year ended 31 December 2017 is US$ 5.41 million (2016: US$2.57 million).

Auditors

Auditor's fees for the service rendered during the 2017 year are disclosed in Note 9 to the consolidated financial statements.

Accounting Policies

The accounting policies and any changes to the accounting policies are stated in Note 2 to the consolidated financial statements.

Subsequent Events

Subsequent events that can have impact on the consolidated financial statements have been disclosed in Note 26 of the financial statements.

Preparation of accounts in US Dollars

The Group received approval from Investment Promotion Authority (IPA) through the Office of Registrar of Companies on 25 February 2015 to use United States Dollars ('US$') as it's functional and presentation currency. The numbers in the consolidated financial statements are rounded to the nearest thousands (US$ '000), except where otherwise indicated.

Signed for, and on behalf of the Board,

Moi Avei
Chairman
Port Moresby

11 September 2018

Wapu Sonk
Managing Director/Executive Director
Port Moresby

11 September 2018

AUDITOR-GENERAL'S OFFICE

DIRECTORS' DECLARATION

FOR THE YEAR ENDED 31 DECEMBER 2017

The directors declare that:

(a) in the directors' opinion, there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable; and

(b) in the directors' opinion, the attached consolidated financial statements and notes thereto are in accordance with the Companies Act 1997, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the Group.

Signed in accordance with a resolution of the directors.

On behalf of the Directors,

Moi Avei
Chairman
Port Moresby

11 September 2018

Wapu Sonk
Managing Director/Executive Director
Port Moresby

11 September 2018

AUDITOR-GENERAL'S OFFICE

AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

PAPUA NEW GUINEA

Phone: (+675) 3012200 Fax: (+675) 325 2872 Email: agopng@ago.gov.pg Website: www.ago.gov.pg

To the Shareholders

I have audited the accompanying financial statements of **Kumul Petroleum Holdings Limited and Its Subsidiaries** for the year ended **31 December, 2017**.

The financial statements comprise:

- Consolidated Statement of Financial Position;
- Consolidated Statement of Comprehensive Income;
- Consolidated Statement of Changes In Equity;
- Consolidated Statement of Cash Flows; and
- Summary of Significant Accounting Policies and Other Explanatory Notes.

Responsibility for the Financial Statements

The Directors of the Company are responsible for preparing financial statements that give a true and fair presentation of the financial position and performance of the Company. The financial statements should comply with the *Companies Act 1997* and other mandatory financial reporting requirements in accordance with the *International Financial Reporting Standards*, which have been approved by the *Accounting Standards Board* as the financial reporting standards for use in Papua New Guinea. The Directors are also responsible for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial statements.

Responsibility of the Auditor-General

I have conducted an independent audit in order to express an opinion to the shareholders. My audit has been planned and performed in accordance with *International Standards on Auditing* as promulgated by the *International Federation of Accountants* to obtain reasonable assurance as to whether the financial statements are free of material misstatement. The audit involved performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements.

AUDITOR-GENERAL'S OFFICE

Level 6
TISA Investment Haus
Kumul Avenue, NCD

PO Box 423
WAIGANI, NCD
Papua New Guinea

The nature of an audit is influenced by factors such as the use of professional judgment, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. I have considered the risks, based on those assessments, on the internal controls relevant to the preparation and fair presentation of the financial statements in designing audit procedures considered appropriate in the circumstances.

Procedures were performed to assess whether, in all material respects, the financial statements present fairly, in accordance with the *Companies Act, 1997*, the *International Financial Reporting Accounting Standards* and other mandatory financial reporting requirements, a view which is consistent with my understanding of the Company's financial position, and of its performance as represented by the results of their operations and cash flows.

I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for this report.

AUDIT OPINION

In my opinion:

(a) the financial statements of Kumul Petroleum Holdings Limited and Its Subsidiaries for the year ended 31 December, 2017:

 (i) give a true and fair view of the financial position and the results of its operation and cash flows for the year ended on that date; and

 (ii) the financial statements have been presented in accordance with the *Companies Act 1997, International Financial Reporting Standards* and other generally accepted accounting practice in Papua New Guinea;

(b) Proper accounting records have been kept by the Company, as far as appears from my examination of those records; and

(c) I have obtained all the information and explanation required.

GORDON KEGA, CPA
Acting Auditor-General

AUDITOR-GENERAL'S OFFICE

18 September 2018

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 US$'000	2016 US$'000
Revenue	6	678,960	547,326
Cost of sales	7	(267,748)	(257,772)
Gross profit		**411,212**	**289,554**
Other Income	8	10,610	12,435
Consultancy and professional service	9b	(4,703)	(6,845)
Depreciation charges		(7,029)	(5,174)
Employee benefits expense	9c	(8,478)	(8,396)
Other operating expenses	9a	(13,532)	(9,410)
Operating profit		**388,080**	**272,164**
Interest income		2,953	1,380
Finance costs	9d	(161,526)	(167,246)
Foreign exchange gain (loss)		(81,005)	6,403
Impairment loss		(26,416)	–
Changes in fair value of other financial liabilities		62,933	–
Net gain from disposal of AFS investments		54,888	–
Gain (loss) on valuation of derivatives	17	40,755	(55,643)
Expense recognized for Kroton Equity Option	25	(167,239)	(166,654)
Profit (loss) before income tax		**113,423**	**(109,596)**
Income tax expense	10	(56,738)	(40,203)
Net Profit (loss) for the year		**56,685**	**(149,799)**
Other comprehensive income			
Item that may be reclassified to profit or loss in subsequent period:			
Fair value adjustment on AFS financial assets	16	28,939	47,979
Total comprehensive income (loss) for the year		**85,624**	**(101,820)**
Attributable to:			
Equity holder of the parent		70,788	(101,820)
Non-controlling interest		14,836	–
		85,624	**(101,820)**

This consolidated statement of comprehensive income should be read in conjunction with the accompanying notes to the consolidated financial statements.

AUDITOR-GENERAL'S OFFICE

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 US$'000	2016 US$'000
ASSETS			
Current Assets			
Cash and cash equivalents	11	177,148	126,068
Receivables and other current assets	10 & 12	216,584	206,499
Inventories		25,081	25,638
Advances to the State	22b	–	50,000
Total Current Assets		**418,813**	**408,205**
Non-current Assets			
Advances to the State	**22b**	–	137,960
Oil and gas assets	13	3,709,686	3,832,159
Property, plant and equipment	14	27,350	13,516
Rehabilitation and restoration assets	15	24,815	26,167
Derivative financial assets	17	–	48,407
AFS financial assets	16	3,803	778,347
Deferred tax assets	10b	13,955	14,655
Total Non-current Assets		**3,779,609**	**4,851,211**
Total Assets		**4,198,422**	**5,259,416**
LIABILITIES AND EQUITY			
Current Liabilities			
Trade and other payable	18	52,477	44,887
Income tax payable	10	12,186	-
Provisions	19	501	495
Loans and borrowings	20	318,624	309,471
Other financial liabilities	25	7,750	4,320
Total Current Liabilities		**391,538**	**359,173**
Non-current Liabilities			
Deferred tax liabilities	10	224,505	188,674
Provisions	19	73,790	42,711
Loans and borrowings	20	1,925,510	2,843,999
Other financial liabilities	25	130,775	62,420
Total Non-current Liabilities		**2,354,580**	**3,137,804**
Total Liabilities		**2,746,118**	**3,496,977**
Equity			
Share/contributed capital	21a	1,170,725	1,428,685
Retained earnings		124,863	176,414
Reserves	21c	24,949	118,600
Equity attributable to equity holders of the parent		**1,320,537**	**1,723,699**
Non-controlling interest		131,767	38,740
Total Equity		**1,452,304**	**1,762,439**
Total Liabilities and Equity		**4,198,422**	**5,259,416**

This consolidated statement of financial position should be read in conjunction with the accompanying notes to the consolidated financial statements.

AUDITOR-GENERAL'S OFFICE

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2017

		Attributable to the equity holder of the Parent					
		Share/ Contributed Capital	Retained Earnings	Reserves	Total	Non-controlling interest	Total
		US$'000	US$'000	US$'000	US$'000	US$'000	US$'000
	Notes	Note 21a		Note 21c			
Balance at 1 January 2016		1,428,685	356,963	–	1,785,648	–	1,785,648
Net loss for the year		–	(149,799)	–	(149,799)	–	(149,799)
Other comprehensive income		–		47,979	47,979	–	47,979
Total comprehensive loss		–	(149,799)	47,979	(101,820)	–	(101,820)
Reserve from common control acquisition	21	–	–	9,446	9,446	–	9,446
Kroton Equity Option reserve	21	–	–	61,175	61,175	–	61,175
Exercise of Kroton Equity Option		–	–	–	–	38,740	38,740
Dividends paid	21	–	(30,750)	–	(30,750)	–	(30,750)
Balance at 31 December 2016		1,428,685	176,414	118,600	1,723,699	38,740	1,762,439
Net profit for the year		–	41,849	–	41,849	14,836	56,685
Other comprehensive income		–	–	28,939	28,939	–	28,939
Total comprehensive income		–	41,849	28,939	70,788	14,836	85,624
Kroton Equity Option reserve		–	–	(45,671)	(45,671)	–	(45,671)
Exercise of Kroton Equity Option		–	–	–	–	78,191	78,191
Disposal of AFS		–	–	(76,919)	(76,919)	–	(76,919)
Return of capital		(257,960)	–	–	(257,960)	–	(257,960)
Dividends paid		–	(93,400)	–	(93,400)	–	(93,400)
Balance at 31 December 2017		**1,170,725**	**124,863**	**24,949**	**1,320,537**	**131,767**	**1,452,304**

This consolidated statement of changes in equity should be read in conjunction with the accompanying notes to the consolidated financial statements.

AUDITOR-GENERAL'S OFFICE

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2017

	Notes	2017 US$'000	2016 US$'000
Cash flows from operating activities			
Receipts from customers		**676,413**	543,121
Payments to suppliers and employees		**(149,716)**	(183,823)
Income tax paid	10c	**(8,021)**	(4,826)
Interest received		**2,953**	1,380
Dividend received		**489**	822
Net cash flow from operating activities		**522,118**	**356,674**
Cash flows from investing activities			
Purchase of property, plant and equipment		**(15,786)**	(7,745)
Acquisition of oil and gas assets		**(26,169)**	(12,463)
Net proceeds from disposal of AFS investments		**28,191**	–
Other investing activities		**11,652**	1,052
Net cash flow used in investing activities		**(2,112)**	**(19,156)**
Cash flows from financing activities			
Payment of loans and borrowings		**(305,526)**	(353,154)
Cash provided to the State	22b	**(70,000)**	(62,400)
Dividends paid to the equity holder of the parent	21b	**(93,400)**	(30,750)
Net cash flow used in financing activities		**(468,926)**	**(446,304)**
Net increase (decrease) in cash and cash equivalents		**51,080**	(108,786)
Opening cash and cash equivalents		**126,068**	234,854
Closing cash and cash equivalents	11	**177,148**	126,068

This consolidated statement of cash flows should be read in conjunction with the accompanying notes to the consolidated financial statements.

AUDITOR-GENERAL'S OFFICE

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

1. General Information

Kumul Petroleum Holdings Limited ('the Parent entity') is an unlisted company, incorporated in Papua New Guinea on 4 March 2014. The Parent entity is the immediate shareholder and holding Parent entity of the Kumul Petroleum Group (together referred to as 'the Group'). The Parent entity is the State's nominee in all oil and gas projects in the country. As a result of the enactment of the Kumul Petroleum Holdings Ltd Authorisation Act 2015, the issued shares of the Parent entity previously owned by Independent Public Business Corporation ('IPBC'), were transferred to the Kumul Petroleum Trustee.

The registered office is located at Level 7, Kina Haus, Douglas Street, Port Moresby, National Capital District, Papua New Guinea.

The consolidated financial statements were authorised for issue in accordance with a resolution of the directors on 11 September 2018.

2. Significant Accounting Policies

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

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ('IFRS') and interpretations of the International Financial Reporting Interpretations Committee 'IFRIC' as issued by the International Accounting Standard Board (IASB) and the requirements of Companies Act 1997. The consolidated financial statements have been prepared under the historical cost convention and on a going concern basis except for the fair value of derivatives and available for sale investments.

The consolidated financial statement are presented in US$, and all values are rounded to the nearest thousands (US$'000'), except when otherwise indicated.

2.2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Parent and entities (including structured entities) controlled by it and its subsidiaries. Control is achieved when the Group:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- Has the ability to use its power to affect its returns.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above. When the Group has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Group entity considers all relevant facts and circumstances in assessing whether or not the Group's voting rights in an investee are sufficient to give it power, including:

- the size of the Group's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- potential voting rights held by the Group, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- Any additional facts and circumstances that indicate that the Parent entity has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

AUDITOR-GENERAL'S OFFICE

2. Significant Accounting Policies continued

Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the date the Group gains control until the date when the Group ceases to control the subsidiary.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

(i) Business combinations
The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment. Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if related to the issue of debt or equity securities.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss. Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

(ii) Business combinations between entities under common control
Business combinations between entities under common control are accounted for by applying the pooling of interest method.

Under the pooling of interest method, the acquirer accounts for the combination as follows:

- the assets and liabilities of the acquiree are consolidated using the existing carrying values instead of fair values;
- intangible assets and contingent liabilities are recognized only to the extent that they were recognized by the acquiree in accordance with applicable IFRS;
- no amount is recognized as goodwill;
- The difference between the acquirer's cost of investment and the acquiree's equity is presented in equity as 'Reserves' in the consolidated statement of financial position and any subsequent changes are presented within statement of changes in equity under 'Changes in equity reserves';
- any NCI is measured as a proportionate share of the book values of the related assets and liabilities;
- the income statement reflects the results of the combining entities for the full year, irrespective of when the combination took place. and
- no restatement of financial information in the consolidated financial statements for the periods prior to the combination under common control.

(iii) Subsidiaries
Subsidiaries are entities controlled by the Group. The Group controls an entity when it 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. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases. The financial statements of subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies.

AUDITOR-GENERAL'S OFFICE

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. Significant Accounting Policies continued

(iv) Joint arrangements

Exploration, development and production activities of the Group are primarily carried on through joint arrangements with other parties. Joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations each investor has, rather than the legal structure of the joint arrangement. The Group has assessed the nature of its joint arrangements and determined that they comprise investments in joint operations.

Joint operations

The Group has accounted for its direct rights and obligations by recognising its share of jointly held assets, liabilities, revenues and expenses of each joint operation. These have been incorporated in the financial statements under the appropriate headings.

2.3 Changes in accounting policies and disclosures

The Company applied for the first time certain pronouncements, which are effective for annual periods beginning on or after 1 January 2017. The Company has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each amendment is described below. The adoption of these standards did not have any effect on the financial performance or position of the Company.

- Amendments to IFRS 12, *Disclosure of Interests in Other Entities, Clarification of the Scope of the Standard (Part of Annual Improvements to IFRSs* 2014 – 2016 Cycle)
- Amendments to IAS 7, *Statement of Cash Flows, Disclosure Initiative*
- Amendments to IAS 12, *Income Taxes, Recognition of Deferred Tax Assets for Unrealized Losses*

Standards issued but not yet effective

Pronouncements issued but not yet effective are listed below. Unless otherwise indicated, the Company does not expect that the future adoption of the said pronouncements will have a significant impact on its financial statements. The Company intends to adopt the following pronouncements when they become effective.

Effective beginning on or after January 1, 2018

- Amendments to IFRS 2, *Share-based Payment, Classification and Measurement of Share-based Payment Transactions*
- IFRS 9, *Financial Instruments*
- Amendments to IFRS 4, *Insurance Contracts, Applying IFRS 9, Financial Instruments, with IFRS 4*
- IFRS 15, *Revenue from Contracts with Customers*
- Amendments to IAS 28, *Measuring an Associate or Joint Venture at Fair Value* (Part of *Annual Improvements to IFRSs* 2014 – 2016 Cycle)
- Amendments to IAS 40, *Investment Property, Transfers of Investment Property*
- IFRIC Interpretation 22, *Foreign Currency Transactions and Advance Consideration*

Effective beginning on or after January 1, 2019

- Amendments to IFRS 9, *Prepayment Features with Negative Compensation*
- IFRS 16, *Leases*
- Amendments to IAS 28, *Long-term Interests in Associates and Joint Ventures*
- IFRIC Interpretation 23, *Uncertainty over Income Tax Treatments*

Deferred effectivity

- Amendments to IFRS 10 and IAS 28, *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

The Company continues to assess the impact of the foregoing new and amended accounting standards and interpretations effective subsequent to 2017 on the Company's financial statements in the period of initial application. Additional disclosures required by these amendments will be included in the Company's financial statements when these amendments are adopted.

AUDITOR-GENERAL'S OFFICE

2. Significant Accounting Policies continued

2.4 Summary of significant accounting policies

(a) Foreign currency translation

(i) Functional and presentation currency

The consolidated financial statements are presented in US$ as opposed to the currency of the economic environment in which the Group operates, the Papua New Guinea Kina ('PNG Kina'). Items included in the financial statements of the Group are measured using United States Dollars ('US$') as the functional currency ('the functional currency') of the Parent and its subsidiaries. The decision to use US$ as the Parent and its subsidiaries' functional currency is considered more beneficial for the market and that the balances and transactions are significantly denominated in US$ when operating in the oil and gas industry.

Below is the supplementary disclosure as required for reporting purposes with the PNG Registrar of Companies per approval notice dated 25 February 2015 (ref: asbd2 1-100045/rm)

	As translated	
	2017	2016
	PGK'000	PGK'000
TOTAL ASSETS*	13,902,060	17,103,792
TOTAL LIABILITIES*	(9,093,106)	(11,372,283)
NET ASSETS	**4,808,954**	**5,731,509**
NET PROFIT (LOSS)**	**185,245**	**(481,205)**

*Translated using reporting date exchange rate of 0.3020 in 2017 (2016: 0.3075)
**Translated using average exchange rate of 0.3060 in 2017 (2016: 0.3113)

(ii) Transactions and balances

Transactions in foreign currencies are initially recorded by the Group's entities at their respective functional currency spot rates at the date the transaction first qualifies for recognition.

Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency spot rates of exchange at the reporting date.

Differences arising on settlement or translation of monetary items are recognised in profit or loss with the exception of monetary items that are designated as part of the hedge of the Group's net investment in a foreign operation. These are recognised in OCI until the net investment is disposed of, at which time, the cumulative amount is reclassified to profit or loss. Tax charges and credits attributable to exchange differences on those monetary items are also recorded in OCI.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

The gain or loss arising on translation of non-monetary items measured at fair value is treated in line with the recognition of the gain or loss on the change in fair value of the item (i.e., translation differences on items whose fair value gain or loss is recognised in OCI or profit or loss are also recognised in OCI or profit or loss, respectively).

AUDITOR-GENERAL'S OFFICE

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. Significant Accounting Policies continued

(iii) Group companies

The results and financial position of operations that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- Income and expenses for each statement of comprehensive income are translated at average exchange rates (unless this 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); and
- All resulting exchange differences are recognised in other comprehensive income ('OCI').

(b) Oil and natural gas exploration, evaluation and development expenditure

Oil and natural gas exploration, evaluation and development expenditure is accounted for using the successful efforts method of accounting.

Oil and gas assets are usually single oil or gas fields being developed for future production or which are in the production phase. Where several individual oil or gas fields are to be produced through common facilities, the individual oil or gas field and the associated production facilities are managed and reported as a single oil and gas asset.

(i) Pre-permit costs

Pre-permit costs are expensed in the period in which they are incurred.

(ii) Exploration and evaluation costs

All such capitalised costs are subject to technical, commercial and management review, as well as review for indicators of impairment at least once a year. This is to confirm the continued intent to develop or otherwise extract value from the discovery. When this is no longer the case, the costs are written off through profit or loss.

When proved reserves of oil and natural gas are identified and development is sanctioned by management, the relevant capitalised expenditure is first assessed for impairment and (if required) any impairment loss is recognised, then the remaining balance is transferred to assets in development.

Exploration and evaluation activity involves the search for mineral resources, the determination of technical feasibility and the assessment of commercial viability of an identified resource.

Once the legal right to explore has been acquired, costs directly associated with an exploration well are capitalised as exploration and evaluation intangible assets until the drilling of the well is complete and the results have been evaluated. These costs include directly attributable employee remuneration, materials and fuel used, rig costs and payment made to contractors.

(iii) Development and producing costs

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells, including unsuccessful development or delineation wells, is capitalised within oil and gas properties.

The costs of oil and gas assets in development are separately accounted for and include past exploration and evaluation costs, development drilling and other subsurface expenditure, surface plant and equipment and any associated land and buildings. Development expenditure is subject to amortisation once production commences. Once commercial operation commences the accumulated costs are transferred to oil and gas assets – producing assets.

AUDITOR-GENERAL'S OFFICE

2. Significant Accounting Policies continued

(c) Oil and gas assets and other property, plant and equipment

(i) Initial recognition

Oil and gas assets and other property, plant and equipment are stated at cost, less accumulated depreciation and accumulated impairment losses.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the decommissioning obligation and, for qualifying assets (where relevant), borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalised value of a finance lease is also included within oil and gas properties.

When a development project moves into the production stage, the capitalisation of certain construction/ development costs ceases, and costs are either regarded as part of the cost of inventory or expensed, except for costs which qualify for capitalisation relating to oil and gas property asset additions, improvements or new developments.

(ii) Depreciation / amortisation

Producing oil and gas assets are depreciated /amortised over the life of the assets which is 32 years (until 2046) on a straight line basis, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the shorter period is applied.

Other property, plant and equipment are generally depreciated on a straight-line basis over their estimated useful lives as follows:

- Vehicles — 3–5 years
- Furniture, fittings, software and equipment — 3–8 years

Property, plant and equipment held under finance leases are depreciated over the shorter of lease term and estimated useful life. An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss when the asset is derecognised. The asset's residual values, useful lives and methods of depreciation/amortisation are reviewed at each reporting period and adjusted prospectively, if appropriate.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

(iii) Major maintenance, inspection and repairs

Expenditure on major maintenance refits, inspections or repairs comprises the cost of replacement assets or parts of assets, inspection costs and overhaul costs. Where an asset, or part of an asset that was separately depreciated and is now written off is replaced and it is probable that future economic benefits associated with the item will flow to the Group, the expenditure is capitalised. Where part of the asset replaced was not separately considered as a component and therefore not depreciated separately, the replacement value is used to estimate the carrying amount of the replaced asset and is immediately written off. Inspection costs associated with major maintenance programmes are capitalised and amortised over the period to the next inspection. All other day-to-day repairs and maintenance costs are expensed as incurred.

AUDITOR-GENERAL'S OFFICE

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. Significant Accounting Policies continued

(d) Other intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets with definite lives are carried at cost less any accumulated amortisation (calculated on a straight-line basis over their useful lives) and accumulated impairment losses, if any. Indefinite lived intangibles are not amortised, instead they are tested for impairment as at annually.

Internally generated intangible assets, excluding capitalised development costs, are not capitalised. Instead, the related expenditure is recognised in profit or loss in the period in which the expenditure is incurred.

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 are 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 are considered to modify 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 recognised in profit or loss in the expense category that is consistent with the function of the intangible assets.

Gains or losses arising from de-recognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in profit or loss when the asset is derecognised.

(e) Impairment of non-financial assets

Intangible assets, for example goodwill and software licenses, that are internally generated are not subject to amortisation and are tested annually for impairment. Off the shelf assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable. An impairment loss is recognised for the amount by which 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. For the purposes of assessing impairment, assets are carried at the lowest levels for which there are separately identifiable cash flows (cash generating units).

(f) Financial instruments – initial recognition and subsequent measurement

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

(i) Financial assets

Initial recognition and measurement

Financial assets are classified, at initial recognition, as financial assets at fair value through profit or loss, loans and receivables, held to-maturity investments, available-for-sale (AFS) financial assets, or derivatives designated as hedging instruments in an effective hedge, as appropriate. All financial assets are recognised initially at fair value plus, in the case of financial assets not recorded at fair value through profit or loss, transaction costs that are attributable to the acquisition of the financial asset.

AUDITOR-GENERAL'S OFFICE

2. Significant Accounting Policies continued

Purchases or sales of financial assets that require delivery of assets in a timeframe established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date at which the Group commits to purchase or sell the asset.

The Group financial assets include cash and cash equivalents, trade and other receivables and derivative financial assets.

Subsequent measurement
For purposes of subsequent measurement financial assets are classified into four categories:

- Financial assets at fair value through profit or loss
- Loans and receivables
- Held-to-maturity investments – the Parent entity has no held-to-maturity investments
- AFS financial investments

Financial assets at fair value through profit or loss
Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments, as defined by IAS 39. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as finance costs (negative changes in fair value) or finance revenue (positive net changes in fair value) in the statement of profit or loss and other comprehensive income. The Group has not designated any financial assets at fair value through profit or loss.

Derivatives embedded in host contracts are accounted for as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contracts and the host contracts are not held for trading or designated at fair value though profit or loss. These embedded derivatives are measured at fair value, with changes in fair value recognised in the statement of profit or loss. Reassessment occurs only if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required or there is a reclassification of a financial asset out of the fair value through profit or loss category.

Loans and receivables
This category is the most relevant to the Group. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate method, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included in finance income in the statement of profit or loss and other comprehensive income. The losses arising from impairment are recognised in the statement of profit or loss and other comprehensive income in finance costs for loans and in cost of sales or other operating expenses for receivables.

This category generally applies to trade and other receivables.

AFS financial assets
AFS financial assets include equity investments. Equity investments classified as AFS are those that are neither classified as held for trading nor designated at fair value through profit or loss.

After initial measurement, AFS financial assets are subsequently measured at fair value with unrealised gains or losses recognised in OCI and credited in the AFS reserve until the investment is derecognised, at which time the cumulative gain or loss is recognised in other operating income, or the investment is determined to be impaired, when the cumulative loss is reclassified from the AFS reserve to profit or loss.

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2. Significant accounting policies continued

The Group evaluates whether the ability and intention to sell its AFS financial assets in the near term is still appropriate. When, in rare circumstances, the Group is unable to trade these financial assets due to inactive markets, the Group may elect to reclassify these financial assets if the management has the ability and intention to hold the assets for foreseeable future or until maturity.

For a financial asset reclassified from the AFS category, the fair value carrying amount at the date of reclassification becomes its new amortised cost and any previous gain or loss on the asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the effective interest rate ('EIR'). Any difference between the new amortised cost and the maturity amount is also amortised over the remaining life of the asset using the EIR. If the asset is subsequently determined to be impaired, then the amount recorded in equity is reclassified to profit or loss.

Impairment of financial assets

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. An impairment exists if one or more events that has occurred since the initial recognition of the asset (an incurred '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 debtor or a Parent entity 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 observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets carried at amortised cost

For financial assets carried at amortised cost, the Group first assesses whether impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a Group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment Joss is, or continues to be, recognised are not included in a collective assessment of impairment.

The amount of any impairment loss identified is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account, and the loss is recognised in profit or loss. Interest income (recorded as finance income in the statement of profit or loss and other comprehensive income) continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account, if a write-off is later recovered, the recovery is credited to finance costs in the statement of profit or loss and other comprehensive income.

Available-for-sale (AFS) financial assets

For AFS financial assets, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

AUDITOR-GENERAL'S OFFICE

2. Significant accounting policies continued

In the case of equity investments classified as AFS, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. 'Significant' is evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. When there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in profit or loss – is removed from OCI and recognised in profit or loss. Impairment losses on equity investments are not reversed through profit or loss; increases in their fair value after impairment are recognised in OCI.

The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Group evaluates, among other factors, the duration or extent to which the fair value of an investment is less than its cost.

(ii) Financial liabilities

Initial recognition and measurement

Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, payables, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

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

The Group financial liabilities include trade and other payables, loans and borrowings including bank overdrafts and derivative financial liabilities.

Subsequent measurement

The measurement of financial liabilities depends on their classification, as described below:

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities designated upon initial recognition at fair value through profit or loss are designated at the initial recognition date and only if the conditions in IAS 39 are satisfied, The Group has not designated any financial liabilities as at fair value through profit or loss.

Held for trading

Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. This category includes derivative financial instruments entered into by the Group that are not designated as hedging instruments in hedge relationships as defined by IAS 39. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments.

Gains or losses on liabilities held for trading are recognised in profit or loss.

Loans and borrowings

This is the category most relevant to the Group. Loans and borrowings are recognised initially at fair value net of transaction cost incurred. After initial recognition, interest-bearing loans and borrowings are subsequently measured at interest rate method (amortised cost). Gains and losses are recognised in profit or loss when the liabilities are derecognised, as well as through the effective interest rate amortisation process.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

2. Significant accounting policies continued

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included as finance costs in the statement of profit or loss and other comprehensive income.

This category generally applies to interest-bearing loans and borrowings.

(h) Cash and short-term deposits

Cash and short-term deposits in the statement of financial position comprise cash at banks and on hand and short-term deposits with a maturity of three months or less.

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and short-term deposits, as defined above, net of outstanding bank overdrafts, but exclude any restricted cash.

(i) Inventories

Inventories are stated at the lower of cost and net realisable value. The cost of materials and supplies is the purchase cost, determined on a weighted average basis. The cost of liquefied natural gas and gas in tanks and pipelines is the purchase cost, the cost of refining, including the appropriate proportion of depreciation, depletion and amortisation and overheads based on normal operating capacity, determined on a weighted average basis. The value of extracted by-products is stated at net realisable value.

The net realisable value of inventories is based on 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.

(j) Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

(k) Borrowing cost

Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalised as a pre-payment for liquidity services and amortised over the period of the facility to which it relates.

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 (a qualifying asset) are capitalised as part of the cost of the respective assets. Borrowings costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

Where funds are borrowed specifically to fund a project, the amount capitalised represents the actual borrowing costs incurred. Where surplus funds are available for a short term out of money borrowed specifically to finance a project, the income generated from the temporary investment of amounts is also capitalised and deducted from the total capitalised borrowing cost. Where the funds used to finance a project form part of general borrowings, the amount capitalised is calculated using a weighted average of rates applicable to relevant general borrowings of the Parent entity during the period. All other borrowing costs are recognised in the profit or loss in the period in which they are incurred.

Even though exploration and evaluation assets can be qualifying assets, they generally do not meet the 'probable economic benefits' test and also are rarely debt funded. Any related borrowing costs are therefore generally recognised in profit or loss in the period they are incurred.

AUDITOR-GENERAL'S OFFICE

2. Significant accounting policies continued

(l) Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the taxation authority and there is an intention to settle the balances on a net basis.

(m) Royalties and development levies

In addition to corporate income taxes, the Group's consolidated financial statements also include and recognise as income taxes, other types on net income such as royalties and development levies.

Royalties and development levies are accounted for under IAS12 when they have the characteristics of an income tax. This is considered to be the case when they are imposed under government authority and the amount payable is based on taxable income – rather than physical quantities produced or as a percentage of revenue – after adjustment for temporary differences. For such arrangements, current and deferred tax is provided on the same basis as described above for other forms of taxation. Obligations arising from royalty arrangements and other types of taxes that do not satisfy these criteria are recognised as current provisions and included in cost of sales. The revenue taxes payable by the Group are considered to meet the criteria to be treated as part of income taxes.

(n) 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 profit or loss on a straight-line basis over the period of the lease.

The Group leases certain property, plant and equipment. Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset and the lease term.

AUDITOR-GENERAL'S OFFICE ★

2. Significant accounting policies continued

(o) Provisions

(i) General
Provisions are recognised 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 recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is recognised in the profit or loss 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 recognised as part of finance costs in profit or loss.

(ii) Decommissioning liability – rehabilitation and restoration
The Group recognises a decommissioning liability where it has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made.

The obligation generally arises when the asset is installed or the ground/environment is disturbed at the field location. When the liability is initially recognised, the present value of the estimated costs is capitalised by increasing the carrying amount of the related oil and gas assets to the extent that it was incurred by the development/construction of the field. Any decommissioning obligations that arise through the production of inventory are expensed when the inventory item is recognised in cost of goods sold.

Changes in the estimated timing or cost of decommissioning are dealt with prospectively by recording an adjustment to the provision and a corresponding adjustment to oil and gas assets.

Any reduction in the decommissioning liability and, therefore, any deduction from the asset to which it relates, may not exceed the carrying amount of that asset. If it does, any excess over the carrying value is taken immediately to profit or loss.

If the change in estimate results in an increase in the decommissioning liability and, therefore, an addition to the carrying value of the asset, the Parent entity considers whether this is an indication of impairment of the asset as a whole, and if so, tests for impairment. If, for mature fields, the estimate for the revised value of oil and gas assets net of decommissioning provisions exceeds the recoverable value, that portion of the increase is charged directly to expense.

Over time, the discounted liability is increased for the change in present value based on the discount rate that reflects current market assessments and the risks specific to the liability. The periodic unwinding of the discount is recognised in the statement of profit or loss and other comprehensive income as a finance cost.

The Group recognises neither the deferred tax asset in respect of the temporary difference on the decommissioning liability nor the corresponding deferred tax liability in respect of the temporary difference on a decommissioning asset.

(iii) Employee benefits
A liability is recognised for benefits accruing to employees in respect of salaries and wages, annual leave, long service leave and staff incentives when it is probable that settlement will be required and they are capable of being measured reliably.

Liabilities recognised in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Liabilities recognised in respect of employee benefits which are not expected to be settled within 12 months are measured as the present value of the estimated future cash outflows to be made by the Group in respect of services provided by employees up to reporting date. Contributions to defined contribution superannuation plans are expensed when incurred.

AUDITOR-GENERAL'S OFFICE

2. Significant accounting policies continued

(p) Revenue Recognition

Revenue is recognised to the extent it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable, excluding discounts, sales taxes, excise duties and similar levies. The Group has concluded that it is the principal in all of its revenue arrangements since it is the primary obligor, has pricing latitude and is also exposed to inventory and credit risks.

Revenue from the sale of oil and petroleum products is recognised when the significant risks and rewards of ownership have been transferred, which is considered to occur when title passes to the customer. This generally occurs when the product is physically transferred into a vessel, pipe or other delivery mechanism.

Revenue from the production of oil, in which the Group has an interest with other producers, is recognised based on the Group's working interest and the terms of the relevant production sharing contracts. Differences between oil lifted and sold and the Group's share of production are not significant. Where forward sale and purchase contracts for oil or natural gas have been determined to be for trading purposes, the associated sales and purchases are reported net.

Dividend income is also recognised when the Group's right to receive the payment is established, which is generally when shareholders or board of directors approve the dividend. For all financial instruments measured at amortised cost and interest bearing financial assets classified as available for sale, interest income or expense is recorded using the effective interest rate, which is the rate that discounts the estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. Interest revenue is included in finance income in the profit or loss.

(q) Current versus non-current classification

The Group presents assets and liabilities in the statement of financial position based on current/non-current classification. An asset is current when it is either:

- Expected to be realised or intended to be sold or consumed in the normal operating cycle
- Held primarily for the purpose of trading
- Expected to be realised within 12 months after the reporting period
- Cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period

All other assets are classified as non-current.

A liability is current when either:

- It is expected to be settled in the normal operating cycle
- It is held primarily for the purpose of trading
- It is due to be settled within 12 months after the reporting period
- There is no unconditional right to defer the settlement of the liability for at least 12 months after the reporting period

The Group classifies all other liabilities as non-current.

Deferred tax assets and liabilities are classified as non-current assets and liabilities.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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2. Significant accounting policies continued

(r) Derivative financial instruments

The Group has entered into a collar loan arrangement. The collar loans include a borrowing element under which the Group obtained financing from the bank collateralized by available-for-sale investments (Oil Search Limited (OSL) shares) with an obligation to repay it in the future and an option (collar) element comprised of a number of put and call options over OSL shares. From accounting point of view (IAS 39) this is a hybrid contract containing a host and debt instrument (loan) and embedded derivative (collar over OSH shares).

For these contracts and the host part of the contracts containing embedded derivatives, they are accounted for as executor contracts. The Group recognises such contracts in its statement of financial position only when one of the parties meets its obligation under the contract to deliver either cash or a non-financial asset.

The contracts are not accounted for as designated hedges. Derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. Any gains or losses arising from changes in the fair value of derivatives are taken directly to the profit or loss, and presented separately.

(s) Share/contributed capital

Share capital is measured at value for all shares issued. Incremental costs incurred directly attributable to the issuance of new shares are shown in equity as a deduction from proceeds, net of tax. Contributed capital relates to the value of contribution received from shareholders in which future shares will be issued. The contributed capital will be transferred to share capital once shares are issued.

(t) Fair value measurement

The Group measures AFS investment and derivatives at fair value at each reporting date and for the purposes of impairment testing, uses fair value less cost of disposals to determine the recoverable amount of some of its non-financial assets.

Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumptions that the transaction to sell the asset or transfer the liability takes place either:
- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that the market participants act in their economic best interest.

A fair value measurement of a nonfinancial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:
- Level 1 – Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

2. Significant accounting policies continued

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by reassessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

At each reporting date, the Group analyses the movements in the values of assets and liabilities which are required to be re-measured or reassessed as per the Group's accounting policies. For this analysis, the Group verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents.

For purpose of fair value disclosures, the Group has determined classes of assets and liabilities based on the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

3. Significant accounting judgements, estimates and assumptions

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures, and the disclosure of contingent liabilities at the date of the financial statements. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

In particular, the Group has identified the following areas where significant judgements, estimates and assumptions are required. Further information on each of these areas and how they impact the various accounting policies are described below and also in the relevant notes to the financial statements.

(a) Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, which have the most significant effect on the amounts recognised in the financial statements.

Joint arrangements
Judgement is required to determine when the Group has joint control over an arrangement, which requires an assessment of the relevant activities and when the decisions in relation to those activities require unanimous consent. The Group has determined that the relevant activities for its joint arrangements are those relating to the operating and capital decisions of the arrangement such as approval of the capital expenditure program for each year or terminating the service providers of the arrangement. The considerations made in determining joint control are similar to those necessary to determine control over subsidiaries.

Judgement is also required to classify a joint arrangement. Classifying the arrangement requires the Group to assess its rights and obligations arising from the arrangement. Specifically, the Group considers:

- The structure of the joint arrangement – whether its structured through a separate vehicle
- When the arrangement is structure through a separate vehicle, the Group also considers the rights and obligations arising from:
    - The legal form of the separate vehicle
    - The terms of the contractual arrangement
    - Other facts and circumstances (when relevant)

This assessment often requires significant judgement, and a different conclusion on joint control and also whether the arrangement is a joint operation or a joint venture, may materially impact the accounting.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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3. Significant accounting judgements, estimates and assumptions continued

(b) 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 describe below. The Group based its assumptions and estimates on parameters available when the financial statements were prepared and existing circumstances arising beyond the control of the Group. Such changes are reflected in the assumption when they occur.

(i) Hydrocarbon reserve and resource estimates

Hydrocarbon reserves are estimates of the amount of hydrocarbons that can be economically and legally extracted from the Group's oil and gas properties. The Group estimates its commercial reserves and resources based on information compiled by appropriately qualified persons relating to the geological and technical data on the size, depth, shape and grade of the hydrocarbon body and suitable production techniques and recovery rates. Commercial reserves are determined using estimates of oil and gas in place, recovery factors and future commodity prices, the latter having an impact on the total amount of recoverable reserves and the proportion of the gross reserves which are attributable to the host government under the terms of the Production-Sharing Agreements. Future development costs are estimated using assumptions as to the number of wells required to produce the commercial reserves, the cost of such wells and associated production facilities, and other capital costs.

The Group estimates and reports hydrocarbon reserves in line with the principles contained in the SPE Petroleum Resources Management Reporting System (PRMS) framework. As the economy assumptions used may change and as additional geological information is obtained during the operation of a field, estimates of recoverable reserves may change. Such changes may impact the Group's reported financial position and results, which includes:

- The carrying value of exploration and evaluation assets; oil and gas properties and property, plant and equipment; may be affected due to changes in estimated future cash flows.
- Depreciation and amortisation changes in the statement of profit or loss and other comprehensive income may change where the useful life of the related assets change.
- Provisions for decommissioning may change – where changes to the reserve estimates affect expectations about when such activities will occur and the associated cost of these activities.
- The recognition and carrying value of deferred tax assets may change due to changes in the judgements regarding the existence of such assets and in estimates of the likely recovery of such assets

(ii) Exploration and evaluation expenditures

The application of the Group's accounting policy for exploration and evaluation expenditure requires judgement to determine whether future economic benefits are likely, from future either exploration or sales, or whether activities have not reached a stage which permits a reasonable assessment of the existence of reserves. The determination of reserves and resources is itself and estimation process that requires varying degrees of uncertainty depending on how the resources are classified. These estimates directly impact when the Group defers exploration and evaluation expenditure. The deferral policy requires management to make certain estimates and assumptions about future events and circumstances, in particular, whether an economically viable extraction operation can be established. Any such estimates and assumptions may change as new information becomes available. If, after expenditure is capitalised, information becomes available suggesting that the recovery of the expenditure is unlikely, the relevant capitalised, information becomes available suggesting that the recovery of the expenditure is unlikely, the relevant capitalised amount is written off in the statement of profit or loss and other comprehensive income in the period when the new information becomes available.

AUDITOR-GENERAL'S OFFICE

3. Significant accounting judgements, estimates and assumptions continued

(iii) Recoverability of oil and gas assets
The Group through the project operator assesses each significant asset that make up the oil and gas asset each reporting period to determine whether any indication of impairment exists. Where an indicator of impairment exists, a formal estimates of the recoverable amount is made, which is considered to be the higher of the fair value less costs of disposal (FVLCD) and value in use (VIU). The assessments require the use of estimates and assumptions such as long term oil prices (considering current and historical prices, price trends and related factors), discount rates, operating costs, future capital requirements, decommissioning operating performance (which includes production and sales volumes). These estimates and assumptions are subject to risks and uncertainty. Therefore, there is a possibility that changes in circumstances will impact this project, which may impact the recoverable amount of the asset.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

(iv) Decommissioning costs
Decommissioning cost will be incurred by the Group at the end of the operating life of the oil and gas facilities and properties. The Group assesses its decommissioning provision at each reporting date. The ultimate decommissioning costs are uncertain and cost estimates can vary in response to many factors, including changes to relevant legal requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing, extent and amount of expenditure may also change – for example, in response to changes in reserves or changes in laws and regulations or their interpretation. Therefore, significant estimates and assumptions are made in determining the provision for decommissioning. As a result, there could be significant adjustments to the provisions established which would affect future financial results. The provision at reporting date represents management's best estimate of the present value of the future decommissioning costs required.

(v) Recovery of deferred tax assets
Judgment is required to determine which arrangements are considered to be a tax on income as opposed to an operating cost. Judgment is also required to determine whether deferred tax assets are recognized in the statement of financial position. Deferred tax assets, including those arising from unutilized tax losses, require management to assess the likelihood that the Group will generate sufficient taxable earnings in future periods, in order to utilize recognized deferred tax assets. Assumptions about the generation of future taxable profits depend on management's estimates of future cash flows.

These estimates of future taxable income are based on forecast cash flows from operations (which are impacted by production and sales volumes, oil and natural gas prices, reserves, operating costs, decommissioning costs, capital expenditure, dividends and other capital management transactions) and judgment about the application of existing tax laws in each jurisdiction to the extent that future cash flows and taxable income differ significantly from estimates. Hence, the ability of the Group to realise the net deferred tax assets recorded at the reporting date could be impacted.

In addition, future changes in tax laws in the jurisdictions in which the Group operates could limit the ability of the Group to obtain tax deductions in future periods.

(vi) Impairment of available for sale financial assets
For AFS financial assets, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired. In the case of equity investments classified as AFS, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. 'Significant' is evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. When there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in profit or loss – is removed from OCI and recognised in profit or loss.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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3. Significant accounting judgements, estimates and assumptions continued

(vii) Kroton equity option and conversion

As disclosed in Note 25 of this financial report, in the current period, management accounted for the Kroton Equity Option and Conversion. Given the nature of the transaction, it is considered to be a complex, unusual transaction which has occurred outside of the normal course of business. The accounting for the transaction includes a number of significant judgments, assumptions and estimates involved. The following assumptions are considered to be the key material assumptions adopted in the recognition and measurement of the transaction:

- Modification date of 20 December 2016 – Management considers the Option to first have 'intrinsic value' on this date as this was when MRDC, on behalf of the BG's accepted the revised terms offered by the State (including KPHL's vendor financing package).
- Option Valuation – Management determined the option valuation with consideration to an external independent valuation performed on the PNGLNG project on 30 June 2016. Management considers that no material matters have occurred since date of valuation until modification date.
- Compound financial instrument liability component – With the assistance of external independent specialists, management determined the liability component by discounting the expected future cash flows in accordance with the vendor financing arrangement (derived from a financial model) using a cost of debt discount rate of 5% which management considers appropriate in the determination of the value.

4. Fair value measurement

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1)
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2)
- Inputs for asset or liability that are not based on observable market data (unobservable inputs) (Level 3)

The following table presents assets and liabilities that are measured at fair value:

	Level 1	Level 2	Level 3	Total
As at 31 December 2017:	US$ '000	US$ '000	US$ '000	US$ '000
Assets				
Derivatives	–	–	–	–
AFS financial assets (Quoted)	3,803	–	–	3,803
Liabilities				
Other financial liabilities	–	–	(138,525)	(138,525)
	3,803	–	(138,525)	(134,722)

	Level 1	Level 2	Level 3	Total
As at 31 December 2016:	US$ '000	US$ '000	US$ '000	US$ '000
Assets				
Derivatives	–	48,407	–	48,407
AFS financial assets (Quoted)	778,347	–	–	778,347
Liabilities				
Other financial liabilities	–	–	(66,740)	(66,740)
	778,347	48,407	(66,740)	760,014

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4. Fair value measurement continued

The fair value of the financial instruments is included at the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Other than noted above, the carrying value of all other financial assets and liabilities approximates fair value.

The following methods and assumptions were used to estimate the fair values:

- Fair value of the quoted shares is based on price quotations at the reporting date.
- The liability component is determined as the net present value of all potential contractually determined future cash flows under the instrument, discounted at the rate of interest applied by the market at the time of issue to instruments.

5. Financial risk management policies and objectives

Financial risk factors

The Group activities expose it to a variety of financial risks: market risk (including currency risk, equity price risk and cash flow interest rate risk), liquidity risk and credit risk. The Group overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. Risk management is carried out under policies approved by the board of directors.

(a) Market risk

(i) Foreign exchange risk

The Group major transactions are denominated in US$ which is the Group functional and reporting currency. The Group's residual foreign exchange risk arises on administrative expenditure incurred at the corporate level in the PNG Kina and loan transactions in AUD. In addition, the Group may be exposed to one off transactions which occur on an ad hoc basis for purchases in currencies other than the US$. The Group is not exposed to major translation exposures as the majority of the Group's assets and liabilities are denoted in US Dollars.

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5. Financial risk management policies and objectives continued

The balance of financial instruments denominated in foreign currencies are as follows:

	2017	2016
	US$'000	US$'000
Denominated in PNG KINA		
Cash and cash equivalent	9,860	10,008
Borrowings	(136,202)	(138,908)
	(126,342)	(128,900)
Denominated in AUD		
Cash and cash equivalents	–	3
Derivative financial assets	–	101,498
Available for sale financial assets	–	774,543
Borrowings	–	(735,223)
	–	**140,821**
Total	126,342)	**11,922**

The following table demonstrates the sensitivity to a reasonably possible change on the foreign exchange rate, with all other variables held constant, of the Group's profit before tax due to changes on the carrying value of monetary assets and liabilities.

Increase/decrease in foreign exchange rate	Effect on profit before tax for the year ended 31 December 2017 Increase/(Decrease)	Effect on profit before tax for the year ended 31 December 2016 Increase/(Decrease)
	US$'000	US$'000
+5%	(6,317)	596
-5%	6,317	(596)

(ii) Interest rate risk

The Group manages its interest rate risk by entering its syndicated loans with available best options for project financing. The Group interest rate risk arises from long term borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. The Group does not hedge its exposure to interest rate risk.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates with all other variables held constant the impact to the Group's profit before tax:

Increase/decrease in basis points	Effect on profit before tax for the year ended 31 December 2017 Increase/(Decrease)	Effect on profit before tax for the year ended 31 December 2016 Increase/(Decrease)
	US$'000	US$'000
+50	(10,674)	(15,180)
-50	10,674	15,180

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5. Financial risk management policies and objectives continued

(iii) Equity price risk

The Group's listed equity securities are susceptible to market price risk arising from uncertainties about future values of the investment securities. The Group manages the equity price risk by placing limits on individual and total equity instruments.

	Effect on equityfor the year ended 31 December 2017 Increase/(Decrease)	Effect on equityfor the year ended 31 December 2016 Increase/(Decrease)
Increase/decrease in percentage	US$'000	US$'000
10%	–	77,454
-10%	–	(77,454)

(b) Liquidity risk

Cash flow forecasting is performed by the Group and monitors rolling forecasts of its liquidity requirements to ensure it has sufficient cash to meet its operational needs.

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted payments.

	On demand	<1 year	1–5 years	>5 years	Total
As at 31 December 2017:	US$ '000	US$ '000	US$ '000	US$ '000	US$ '000
Trade creditors and other liabilities	–	52,477	–	–	52,477
Finance lease obligation	–	12,541	38,125	179,550	230,216
Borrowings including future interest	–	343,125	891,325	1,029,659	2,264,109
Other financial liabilities	–	7,750	38,291	92,484	138,525
	–	415,893	967,741	1,301,693	2,685,327

	On demand	<1 year	1–5 years	>5 years	Total
As at 31 December 2016:	US$ '000	US$ '000	US$ '000	US$ '000	US$ '000
Trade creditors and other liabilities	–	44,887	–	–	44,887
Finance lease obligation	–	11,145	44,551	148,162	203,858
Borrowings including future interest	–	432,937	2,257,498	1,126,682	3,817,117
Other financial liabilities	–	4,320	14,740	47,680	66,740
	–	493,289	2,316,789	1,322,524	4,132,602

(c) Credit risk

The Group is exposed to credit risk from its operating activities and from its financing activities, including deposits with banks and financial institutions. The Group's maximum exposure to credit risk at reporting date in the event other parties fail to perform their obligations is as follows:

	2017	2016
	US$'000	US$'000
Cash at bank	168,704	126,068
Trade receivables	210,710	194,943
Derivative financial assets	-	48,407
Advances to the state	-	187,960
AFS financial assets	3,803	778,347
Total	**383,217**	1,335,725

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5. Financial risk management policies and objectives continued

The Group reduces its risk on cash at bank by dealing only with reputed major banks. The Group's trade receivables credit risk is managed by entering into sales contracts with investment grade counter parties. Credit limit has been established with counter parties. For derivatives, refer to Note 17.

Capital management

The Group manages its capital to ensure that entities in the consolidated group will be able to continue as a going concern while maximizing the return to its stakeholders through optimization of the debt and equity balances.

This involves the use of corporate forecasting models which facilitate analysis of the Group's financial position including cash flow forecasts to determine future capital management requirements. Capital management is undertaken to ensure a secure cost effective and flexible supply of funds is available to meet the Group's operating and capital expenditure requirements.

6. Revenue

	2017	2016
	US$'000	US$'000
Revenue from sale of:		
Liquefied natural gas	548,193	449,971
Condensates	100,799	73,661
Naphtha	10,650	5,919
Crude Oil	18,552	16,991
Power and other sales	766	784
Total	**678,960**	547,326

7. Cost of sales

	2017	2016
	US$'000	US$'000
Production cost	126,030	122,816
Depreciation of oil and gas assets	133,582	132,999
Royalty and development levy charges	7,233	1,563
Movement in product inventories	903	394
Total	**267,748**	257,772

8. Other income

		2017	2016
	Notes	US$'000	US$'000
Hides Gas to Electricity (HGTE) income	(i)	4,197	3,120
Gain from write-off of payables	(ii)	–	4,067
Power sales		4,259	2,518
Dividend income	16	489	822
Miscellaneous income		1,665	1,908
Total		**10,610**	12,435

(i). HGTE income represents 20.5% share of net revenue recognised from the facility operated by Oil Search Limited in the PDL 1 area.

(ii). Gain from write-off of payables relates to write-off of amounts owed by the Group to Petromin PNG Holdings Limited prior to acquisition of Eda Oil Limited in 2016.

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9. Cost and expenses

(a) Other operating expenses

	2017	2016
	US$'000	US$'000
Donations and community sponsorship	5,408	2,573
Rental expense	1,558	854
Travel and accommodation	1,521	2,417
Communication and information technology	733	550
Security and safety	643	584
Insurance expense	505	244
Directors fees and other expenses	451	147
Meeting and conferences	345	212
Recruitment and training expense	295	223
Subscriptions	235	563
Stationery and supplies	234	242
Advertising and media	215	163
Motor vehicle expenses	148	41
Utilities, repairs and maintenance	79	201
Other costs	1,162	396
	13,532	9,410

(b) Consultancy and professional services

	2017	2016
	US$'000	US$'000
Consultancy fees	4,091	6,533
Audit fees	347	227
Legal fees	265	85
	4,703	6,845

(c) Employee benefits expense

	2017	2016
	US$'000	US$'000
Salaries and wages	5,635	5,265
Short term and long term incentive	1,010	1,533
Housing benefits	717	760
Annual and long service leave	541	236
Other benefits	575	602
	8,478	8,396

(d) Finance costs

	2017	2016
	US$'000	US$'000
Loans and borrowings	150,489	157,654
Finance lease obligation	9,856	8,311
Accretion on rehabilitation provision	1,181	1,281
	161,526	167,246

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10. Current and deferred income tax

(a) Income tax expense

	2017 US$'000	2016 US$'000
Current income tax (benefits)/expense	20,207	(7,028)
Deferred tax expense	36,531	47,231
Income tax expense reported in profit or loss	56,738	40,203
Prima facie tax expense is presented as follow:		
Profit before tax expense	113,423	(109,596)
Prima facie tax @ 30%	34,027	(32,879)
Non-deductible expenses	50,189	124,808
Movement in DTA previously not recognized	27,478	(51,726)
Income tax expense as reported in profit or loss	**56,738**	**40,203**

(b) Net deferred tax liabilities

Deferred tax asset		
Balance at beginning of year	14,655	12,550
Common control business combination	(1,171)	1,229
Timing differences and tax losses to profit or loss	471	876
Balance at end of year	**13,955**	**14,655**
Deferred tax liability		
Balance at beginning of year	(188,674)	(140,187)
Common control business combination	851	(322)
Timing differences to profit or loss	(36,862)	(48,165)
Balance at end of year	**(224,505)**	**(188,674)**
Net deferred tax liabilities	**(210,550)**	**(174,019)**

The net deferred tax liabilities comprises the tax effect of:

Rehabilitation and restoration liability	4,500	3,903
Leased assets	2,127	1,125
Tax losses	–	926
Oil and gas / plant and equipment	(217,178)	(151,429)
Unrealised exchange loss/(gain)	1	(28,839)
Provisions	72	337
Prepayments	(72)	(42)
Net deferred tax liabilities	**(210,550)**	**(174,019)**

(c) Refund (Provision) for income tax refund

Opening balance for provision for income tax	7,597	698
Current tax expense	(20,253)	6,612
Common control business combination	46	(4,539)
Payments made during the year	424	4,826
Closing balance of refund (provision) for income tax refund	**(12,186)**	**7,597**

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11. Cash and cash equivalents

	2017	2016
	US$'000	US$'000
Cash in bank	177,131	126,051
Share of joint venture cash at bank	17	17
	177,148	**126,068**

The cash at bank includes US$2.87million as at 31 December 2017 (2016: US$3.56million) representing restricted cash held by the bank for interest payment and letters of credit.

12. Receivables and other current assets

	2017	2016
	US$'000	US$'000
Trade receivables	41,891	43,281
Undistributed cash from PNGLNG Project	168,819	151,662
Prepayments in joint operations	1,158	2,257
General prepayments	596	208
GST receivables	281	536
Tax credit scheme	279	279
Income tax credits and receivables	–	7,597
Others	3,560	679
	216,584	**206,499**

In accordance with the terms of the PNGLNG project financing, cash relating to the Group's interest in undistributed cash flows of the PNGLNG project is required to be held in secured bank accounts. As these are not readily available to the Group within 90 days, these are classified as other current assets.

Project and other receivables are due within 45 days and current. No receivable balances are past due nor impaired in 2017 (2016: nil).

The fair value of receivable approximates the carrying value as they are largely due to the short term of maturities.

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13. Oil and gas assets

31 December 2017	Assets in production US$ '000	Assets in evaluation and exploration US$ '000	Finance lease tugs and vessels US$ '000	Total US$ '000
Cost				
Balance at 1 January 2017	4,149,420	50,906	81,716	4,282,042
Additions for the year	21,240	20,327	–	41,567
Common control acquisition	–	–	–	–
Balance at 31 December 2017	**4,170,660**	**71,233**	**81,716**	**4,323,609**
Accumulated Depreciation				
Balance at 1 January 2017	444,021	–	5,862	449,883
Additions for the year	133,451	–	4,173	137,624
Impairment loss	–	26,416	–	**26,416**
Common control acquisition	–	–	–	–
Balance at 31 December 2017	**577,472**	**26,416**	**10,035**	**613,923**
Net Book Value at 31 December 2017	**3,593,188**	**44,817**	**71,681**	**3,709,686**

31 December 2016	Assets in production US$ '000	Assets in evaluation and exploration US$ '000	Finance lease tugs and vessels US$ '000	Total US$ '000
Cost				
Balance at 1 January 2016	3,974,482	48,866	43,134	4,066,48
Additions for the year	10,423	2,040	38,582	51,045
Common control acquisition	164,515	–	–	164,515
Balance at 31 December 2016	**4,149,420**	**50,906**	**81,716**	**4,282,042**
Accumulated Depreciation				
Balance at 1 January 2016	205,340	–	2,475	207,815
Additions for the year	130,801	–	3,387	134,188
Common control acquisition	107,880	–	–	107,880
Balance at 31 December 2016	**444,021**	**–**	**5,862**	**449,883**
Net Book Value at 31 December 2016	**3,705,399**	**50,906**	**75,854**	**3,832,159**

Impairment assessment

The entire PNGLNG operation is considered as one cash generating unit (CGU) for impairment testing. The calculation of value in use for the CGU assets (comprising of oil and gas assets and property, plant and equipment) is most sensitive to the following assumptions:

- Production volumes
- Discount rates
- LNG sale price

Estimated production volumes are based on detailed data for the fields and take into account development plans for the fields agreed by management as part of the long-term planning process for the PNGLNG project until 2049.

The Group generally estimates value in use for the CGU using a discounted cash flow model (Model). The future cash flows are discounted to their present value using a post-tax discount rate of 10% that reflects current market assessments of the time value of money and the risks specific to the asset.

The model assumes a USD denominated nominal crude oil price desk as the basis for forecast LNG and condensate sales price.

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13. Oil and gas assets continued

Management believes that, currently, there is no reasonably possible change in above key assumptions which would reduce the Group's excess of recoverable amount over the carrying amounts of the CGU to zero. There were no existing impairment indicators based on Group's assessment.

14. Property, plant and equipment

2017	Software	Motor Vehicles	Leasehold Improvement	Furniture & Fittings	Plant & Equipment	Capital Work in Progress	Total
	US$ '000	US$ '000	US$ '000	US$ '000			
COST							
Balance at 1 January 2017	**3,240**	**764**	**1,551**	**407**	**1068**	**9,182**	**16,212**
Additions	83	376	309	53	79	14,885	**15,785**
Transfers	–	–	–	–	–	–	–
Disposals	–	–	–	–	–	–	–
Balance at 31 December 2017	**3,323**	**1,140**	**1,860**	**460**	**1,147**	**24,067**	**31,997**
ACCUMULATED DEPRECIATION							
Balance at 1 January 2017	**607**	**228**	**1,037**	**309**	**515**	–	**2,696**
Depreciation	–	–	–	–	–	–	–
Disposal	953	142	565	46	245	–	**1,951**
Balance at 31 December 2017	**1,560**	**370**	**1,602**	**355**	**760**	–	**4,647**
Net book value at 31 December 2017	**1,763**	**770**	**258**	**105**	**387**	**24,067**	**27,350**

2016	Software	Motor Vehicles	Leasehold Improvement	Furniture & Fittings	Plant & Equipment	Capital Work in Progress	Total
	US$ '000	US$ '000	US$ '000	US$ '000			
COST							
Opening balance	**567**	**1,009**	**1,531**	**407**	**511**	**4,379**	**8,404**
Additions	315	46	20	–	557	7,161	**8,099**
Transfers	2,358	–	–	–	–	(2,358)	–
Disposals	–	(291)	–	–	–	–	**(291)**
Closing Balance	**3,240**	**764**	**1,551**	**407**	**1068**	**9,182**	**16,212**
ACCUMULATED DEPRECIATION							
Opening balance	**532**	**165**	**667**	**276**	**386**	–	**2,026**
Depreciation	75	354	370	33	129	–	**961**
Disposal	–	(291)	–	–	–	–	**(291)**
Closing Balance	**607**	**228**	**1,037**	**309**	**515**	–	**2,696**
Closing NBV	**2,633**	**536**	**514**	**98**	**553**	**9,182**	**13,516**

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15. Rehabilitation and restoration assets

	2017 US$'000	2016 US$'000
COST		
Opening balance	**35,923**	**33,458**
Common control acquisition	–	5,060
Adjustment*	(462)	(2,595)
Closing Balance	**35,461**	**35,923**
ACCUMULATED DEPRECIATION		
Opening balance	**9,756**	**4,982**
Common control acquisition	–	3,800
Depreciation charge	**890**	974
Closing Balance	**10,646**	**9,756**
Closing net book value	**24,815**	**26,167**

*Adjustment relates to change in discount rate used on the assumptions.

16. AFS financial assets

	Note	2017 US$'000	2016 US$'000
Quoted equity shares	(i)	–	774,543
Non-quoted equity shares	(ii)	3,803	3,804
		3,803	**778,347**

(i) AFS in quoted equity shares represents 149,390,244 shares or a 10.01% shareholding in Oil Search Limited (OSL). Reconciliation of fair value measurement of AFS financial assets in quoted equity shares is presented below:

	2017 US$'000	2016 US$'000
Opening balance	774,543	726,564
Fair value adjustment through OCI	28,939	47,979
Disposal	(803,482)	–
Closing balance	**–**	**774,543**

The Group received dividends amounting to US$0.49 million from the AFS financial assets held from Oil Search for the year ended 31 December 2017 (2016: US$0.82 million). In 2017, the Group disposed the AFS by way of exercising the call and put options.

(ii) Non-quoted equity shares represent 12.5% investment to Orion Enga Children's Fund JV Ltd. which has been recognised at cost less provision for impairment as fair value cannot be determined reliably. No impairment is recognised on AFS non-quoted equity shares.

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17. Derivative financial assets

The UBS collar loans (Note 20) include a borrowing element under which the Group obtained financing from the bank collateralised by AFS equity shares (OSL shares) with an obligation to repay it in the future and an option (collar) element comprised of a number of put and call options over OSL shares. This is a hybrid contract containing a host debt instrument (loan) and embedded derivative (collar over OSL shares).

In 2017, the options were exercised as presented in note 16.

As at 31 December 2016, the Group had the following collar arrangements attached to its collar loans for acquisition of OSL shares:

- Collar consists of 148,144,885 call options and 148,144,855 put options with expiry dates ranges from 26 February 2018 to 1 August 2019. Options relate to 148,144,885 OSL shares; and
- Collar consists of 1,245,359 call options and 1,245,359 put options with expiry date on 2 August 2019. Options relate to 1,245,359 OSH shares.

In 2016, these options are carried at fair value through profit or loss and are fair valued using the Black-Scholes Option Pricing Model. The following key assumptions are used in valuing options:

	2016
Reference price	AU$7.17 per OSL share
Dividend yield	AU$0.0541 to AU$0.1062 per share
Risk free rate	1.87% to 2.13%
UBS credit spread	32.51bps to 32.55bps
Average volatilities (call)	21–68% – 30.24%
Average volatilities (put)	21–68% – 30.24%

The reconciliation of fair value is summarised below:

	2017 US$'000	2016 US$'000
Opening balance	48,407	104,050
Changes in assumptions	40,755	(55,243)
Disposal/exercise/Exchange difference	(89,162)	(400)
Closing balance	–	**48,407**

18. Trade and other payables

	2017 US$'000	2016 US$'000
Trade creditors	4,943	4,358
Cash call advance	19,826	19,223
Accrued interest	5,340	4,632
Royalty and development levy	4,029	362
Other liabilities and accrual	18,339	16,312
	52,477	**44,887**

Trade creditors and other liabilities are non-interest bearing and are normally settled on a 30 day terms. Due to the short term nature of these balances, the fair value approximates their carrying value.

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19. Provisions

	2017	2016
	US$'000	US$'000
Current:		
Employee benefits	**501**	**495**
Noncurrent:		
Employee benefits	735	524
Rehabilitation and restoration liability	73,055	42,187
	73,790	**42,711**
	74,291	**43,206**

The reconciliation of rehabilitation and restoration liability is summarized below:

	2017	2016
	US$'000	US$'000
Opening balance	42,187	39,898
Accretion of interest	1,262	1,244
Common control business acquisition	30,150	4,055
Adjustment*	(544)	(3,010)
Closing Balance	**73,055**	**42,187**

*Adjustment relates to change in discount rates used on the assumptions.

20. Loans and borrowings

	Note	2017	2016
		US$'000	US$'000
The balance is made up as follows:			
Secured loan from joint operation	20a	2,023,160	2,188,403
BSP Loan	20b	136,202	138,908
UBS Collar loans	20c	–	735,223
ANZ Loan	20d	6,000	11,333
Finance lease obligation	20e	78,772	79,603
		2,244,134	**3,153,470**

Presented in the statement of financial position:

	Note	2017	2016
Current:			
Secured loan from joint operation	20a	175,646	163,939
BSP loan	20b	136,202	138,908
UBS Collar loan	20c	–	–
ANZ loan	20d	5,334	5,334
Finance lease obligation	20e	1,442	1,290
		318,624	309,471
Noncurrent:			
Secured loan from joint operation	20a	1,847,514	2,024,464
BSP loan	20b	–	–
UBS Collar loan	20c	–	735,223
ANZ loan	20d	666	5,999
Finance lease obligation	20e	77,330	78,313
		1,925,510	**2,843,999**
		2,244,134	**3,153,470**

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20. Loans and borrowings continued

(a) Secured loan from joint operation

The Group has an existing loan through Papua New Guinea Liquefied Natural Gas Global Company LDC ('GloCo'), a limited duration company incorporated under the laws of the Commonwealth of the Bahamas (the 'Borrower') that was organised to conduct certain activities of the PNGLNG Project outside of PNG, including the borrowing and on-lending to the Participants of Senior Debt, and the purchase and re-sale of Project LNG and Project Liquids. The Borrower is owned by each participant in a percentage equal to its Project Interest. The Group's interest in the project as at 31 December 2017 is 16.78% (2016: 16.78%).

The PNGLNG Project achieved financial close on 12 March 2010. The maximum committed debt facility available to the PNGLNG Project at the date of signing was US$14 billion under nine loan facility agreements. On 4 October 2014, a supplemental debt facility of US$1.5 billion was secured by the PNGLNG Project.

Interest and principal on the loan is payable on specified semi-annual dates, which commenced in June 2015 with principal being repayable over 11.5 years based on a customised repayment profile.

Following completion, the LNG sales proceeds are received into a sales escrow account from which agreed expenditure obligations are firstly made and, subject to meeting certain debt service cover ratio tests, surpluses are distributed to the project participants. The Borrower grants to the security trustee:

- A first-ranking security interest in all of the Borrower's assets, with a few limited exceptions;
- A fixed and floating charge over existing and future funds in the offshore accounts; a deed of charge (and assignment) over the sales contracts, LNG charter party agreements, rights under insurance policies, LNG supply and sales commitment agreements, on-loan agreements and the sales, shipping and finance administration agreements, collectively known as 'Borrower Material Agreements'; and
- A mortgage of contractual rights over Borrower Material Agreements.

The loan facility is subject to various covenants and a negative pledge restricting future secured borrowings, subject to a number of permitted lien exceptions. Neither the covenants nor the negative pledge have been breached at any time during the reporting period.

The Group, as a completion guarantor, has guaranteed payment by the Borrower of the Groups' share (16.57%) of the senior debt obligations up until practical completion is achieved. The Group, as a completion guarantor, is subject to certain covenants and undertakings. Neither the covenants nor the undertakings have been breached at any time during the reporting period or have unduly restricted the Group's planned activities.

The Group has also granted security over:

- The shares in each of its project participants; and
- The participants' project interests and gas field licences.

Financial completion for the PNGLNG Project was achieved on 5 February 2015. From that date, the completion guarantee that was provided by the Company for its share of the Project Finance Debt Facility was released. The Company has not provided any other security.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

20. Loans and borrowings continued

The breakdown of loan balance is as follows:

	2017	2016
	US$'000	US$'000
Current loan		
Loan – principal	192,002	181,599
Unamortized finance fees	(16,356)	(17,660)
	175,646	**163,939**
Noncurrent loan		
Loan – principal	1,905,295	2,097,297
Unamortized finance fees	(57,781)	(72,833)
	1,847,514	**2,024,464**
Total	**2,023,160**	**2,188,403**

(b) BSP Loan

The Group has outstanding loan with principal amount of PGK451 million (2017:$136 million; 2016:$139 million) from Bank of South Pacific to fund the dividend payment to the shareholder, fund the interest reserve accounts, payment of fees and cost related to this loan and to fund the working capital and general corporate purposes of the Group.

In 2015, the loan agreement was amended and the principal repayment term was changed from 8 equal quarterly instalments to one lump sum payment on 30 September 2017. The effective interest rate is % in 2016 (2016: 6.40 %).

(c) UBS Collar Loans

The movement in the loan balances are as follows:

	2017	2016
	US$'000	US$'000
Opening balance	735,223	775,643
Additional principal	–	3,225
Amortisation of interest	26,227	33,117
Additional unamortised finance fees	–	(73,695)
Exchange difference	80,973	(3,067)
Extinguishment	(842,423)	–
Closing balance	**–**	**735,223**

In 2014, the Group acquired a 10.01% shareholding in Oil Search Limited (OSL) (149,390,244 shares) at a price of AUD8.20 per share. The funding for the purchase of the OSL shares was provided by UBS in the form collar loans. As at 31 December 2015, the collar loans has principal amount of AU$1,098 million collateralized by approximately 149 million OSL shares with interest rate of 4.95% per annum.

In February 2016, the Group refinanced the original collar loans with following changes:

- The original loan that was to be repaid in tranches effective from March 2016 through to July 2016 is extended out to 2019 financial year. Payments will start in 2018;
- The original interest rate of 4.95% per annum was renegotiated down to 3% per annum; and
- Continued to limit any security for the financing to the Oil Search shares only.

In 2017, the loan was settled through the exercise of call and put options and the AFS was used to settle the loan (note 16).

AUDITOR-GENERAL'S OFFICE

20. Loans and borrowings continued

(d) ANZ Loan

In 2016, the net assets of Eda Oil Limited including the loan with ANZ Bank was transferred to the Parent entity in accordance with the Kumul Petroleum Holdings Limited Authorisation Bill of 2015. The loan was acquired by Eda Oil Limited for the purposes of paying the cash calls directly to the Moran Field Operator under the PDL 5 joint venture agreement, for payment of taxes directly to the relevant PNG tax authority in relation to PDL 5 and for general corporate purposes. The principal is payable in equal quarterly instalments and the interest is payable on a quarterly basis. The last payment is due on 29 March 2019.

(e) Finance lease obligation

The Group leases LNG carriers and tug facilities under finance lease. Two LNG carrier finance leases started in 2015 and additional one carrier started in 2016. The leases have terms of between 10 and 20 years with varying renewal options. Title does not pass to the Group on expiration of the relevant lease period. Please refer to Note 23 for the finance lease commitment disclosure.

21. Equity

(a) Share/contributed capital

Share capital represents the consideration for shares issued by the Group. Contributed capital represents the equity contribution of the Group in which shares are still to be issued by the Group.

	2017	2016
	US$'000	US$'000
Share capital and contributed capital		
Share capital	1,292,478	1,292,478
Contributed capital	136,207	136,207
Additions during the year	–	–
Return of capital	(257,960)	–
Total share/contributed capital	**1,170,725**	**1,428,685**

Number of Ordinary Shares	**2017**	**2016**
Number of issued and paid up ordinary shares:		
Balance at beginning of the period	100	100
Ordinary shares issued and paid during the year	–	–
Ordinary shares disposed-off during the year	–	–
Balance at 31 December	**100**	**100**
Authorised ordinary shares	**100**	**100**

*Contributed capital represents additional contribution made by the equity holder in which shares will be issued in the future.

AUDITOR-GENERAL'S OFFICE

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

21. Equity continued

(b) Dividends

The Board has declared and paid a dividend of US$93.40 million (PGK300 million) for the year ended 31 December 2017 (2016: US$30.75 million (PGK100 million).

(c) Reserves

	Note	2017 US$'000	2016 US$'000
Balance at the beginning of the year		118,600	–
Reserve from common control acquisition		–	9,446
AFS reserve	16	(47,979)	47,979
Kroton Equity:	25		
Share-based payment reserve		(45,672)	61,175
		24,949	**118,600**

22. Related party transactions

(a) Transactions with Key management personnel

Key management includes directors and executive management. The compensation paid or payable to key management for services rendered is taken up in operating expenses. The key management remuneration and other benefits paid during the year are shown below:

	2017 US$'000	2016 US$'000
Remuneration	2,884	2,140
Sitting allowance	11	5
Short term incentive	775	681
Long term retention	564	380
	4,234	**3,206**

(b) Advances to the State

In 2015, the Parent entity advanced an amount of US$125.56 million to ISPNG. In 2017 and 2016, the Parent entity made additional advance to the ISPNG amounting to US$70.00 million and US$62.40 million, respectively. The total advance to the ISPNG amounting to US$257.96 million and US$187.96 million as at 31 December 2017 and 2016, respectively.

As at 31 December 2016, management determined that the advances to the State is at call. Further, US$50 million classified as a current receivable and US$137.8 million as non-current. This classification reflects the best estimate of when likely the economic benefit of the receivable would realise. Realisation of the receivable balance will occur through KPHL's ability to offset future dividend payments to the ISPNG, with the outstanding Advance to State amount. Until such time as when further information from the State becomes available as to the annual quantum and timing of repayments, the classification and subsequent measurement would be reassessed at each reporting date. As this receivable is determined to be at call there is no material fair value adjustment that may be required to the balance outstanding.

As at 31 December 2017, Management has determined that the entire amount of the advances to State be treated as return of capital. This is subsequently ratified on 22 March 2018 by the National Executive Council.

AUDITOR GENERAL'S OFFICE

22. Related party transactions continued

c) The Group includes following wholly-owned subsidiaries at reporting date:

Name	Principal activities	Country of incorporation	Date of incorporation/ acquisition	Status	% Equity interest	
					2017	2016
Kumul Petroleum (Kroton) Limited	Holds the State's interest in the PNGLNG Project	PNG	20 June 2008	Operational	100%	100%
Kumul Petroleum (Investments) Limited	Holds interest in marketable securities	PNG	15 October 2015	Operational	100%	100%
Kumul Petroleum (Development) Limited	Holds interest in pipeline and midstream related services.	PNG	19 September 2015	Operational	100%	100%
Eda Oil Limited*	Investment in development and production of hydrocarbons directly by participation in the Moran Joint Venture	PNG	11 February 2003	Operational	100%	100%
Kumul LNG Limited*	Established as a special purpose entity to hold interests in the PNGLNG project	PNG	19 May 2009	Operational	100%	100%
NPCP Oil Company Pty Ltd*	Exploration and production activities in oil and gas	Australia	20 November 2015	Operational	100%	100%
Kumul Petroleum (Pipeline) Limited	Incorporated to the interest in the Western Pipeline (Strategic Pipeline) project.	PNG	30 October 2015	Operational	100%	100%
Kumul Petroleum (Tech & Advisory) Limited	To participate in the Kumul Academy and any other up-skilling and training ventures that the Group undertakes	PNG	8 September 2015	Operational	100%	100%
Kumul Security Agent Ltd	Fund management activities	Singapore	31 August 2016	Operational	100%	100%
Kumul Lending Co Pte Ltd	Fund management activities	Singapore	8 August 2016	Operational	100%	100%
Kumul Exploration (Asia) Pte Limited	Service activities incidental to oil and gas extraction and crude petroleum and natural gas production.	Singapore	2 March 2017	Operational	100%	100%
Kumul Petroleum Marketing Pte Limited	Marketing of liquefied natural gas, condensate and other related products	Singapore	28 April 2017	Operational	100%	100%
Kumul Energy Limited	Holds interest in all future power generation projects	PNG	19 September 2015	Inactive	100%	100%
Kumul Petroleum Exploration Limited	To hold interest in new exploration activities	PNG	8 September 2015	Inactive	100%	100%
Kumul Petroleum Drilling Services Limited	To hold interest in drilling and related services	PNG	19 September 2015	Inactive	100%	100%
Kumul Petroleum Downstream Limited	To hold interest in downstream & petrochemical related activities	PNG	8 September 2015	Inactive	100%	100%

Indirectly owned through its wholly owned subsidiary – Kumul Petroleum Development Limited

AUDITOR-GENERAL'S OFFICE

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

22. Related party transactions continued

d) The Group's interest in joint operations are as follows:

Name	Principal activities	Principal place of business	% Equity interest	
			2017	2016
PDL1	Hides gas field	PNG	20.5	20.5
PDL7	South Hides gas field	PNG	20.5	20.5
PDL8	Angore gas field	PNG	20.5	20.5
PDL9	Juha gas field	PNG	20.5	20.5
PNGLNG	PNGLNG Project	PNG	16.79	16.79
PPFL2	PNGLNG Project	PNG	16.57	16.57
PL4	PNGLNG Project	PNG	16.57	16.57
PL5	PNGLNG Project	PNG	16.57	16.57
PL6	PNGLNG Project	PNG	16.57	16.57
PL7	PNGLNG Project	PNG	16.57	16.57
PL8	PNGLNG Project	PNG	16.57t	16.57
PDL3	South East Gobe oil field	PNG	3.29	3.29
PL2 LE	South East Gobe oil field	PNG	0.0198	0.0198
PRL9	Barikewa gas field	PNG	14.89	14.89
PRL14	Cobra, Iehi, Bilip gas field	PNG	10.94	10.94
PNGLNG	PNGLNG Global Company LDC	Bahamas	16.79	16.79
PDL 5	Moran oil field	PNG	11.75	11.75
PDL 10	Stanley	PNG	10%	–
PL 10	Stanley	PNG	10%	–
PRL 8	Kimu	PNG	17%	–
PRL 40	Pukpuk, Douglas, Langia, NW Koko and Weimang	PNG	40%	–

AUDITOR-GENERAL'S OFFICE

22. Related party transactions continued

e) Share in joint operation's financial information

This disclosure represents the Group's share of interest in the PNGLNG project, the four non PDL 'projects' (PDL 1, 7, 8 and 9) and PNGLNG Global Company LDC (Gloco).

Share in net assets

2017	PDLs (1,7,8,9) US$'000	PNGLNG Project US$'000	Gloco US$'000	Moran (PDL 5) US$'000	Balance US$'000
Current assets					
Cash and cash equivalents	–	–	116,932	–	**116,932**
Receivables	–	746	37,921	39	**38,706**
Prepayments and other receivables	53	3,007	–	–	**3,060**
Inventory	–	16,539	–	1,030	**17,569**
Noncurrent assets					
Oil and gas assets	17,459	3,649,666	–	15,264	**3,682,389**
Receivable from participants	–	–	2,105,913	(2,754)	**2,103,159**
Current liabilities					
Trade and other payables	(215)	(8,954)	(46,539)	–	**(55,708)**
Other liabilities	–	(1,867,332)	(74,134)	–	**(1,941,466)**
Borrowings	–	(8,533)	(2,023,160)	–	**(2,031,693)**
Payable to Participants	–	–	(116,916)	–	**(116,916)**
Net Assets	**17,297**	**1,785,139**	**17**	**13,579**	**1,639,765**

2016	PDLs (1,7,8,9) US$'000	PNGLNG Project US$'000	Gloco US$'000	Moran (PDL 5) US$'000	Balance US$'000
Current assets					
Cash and cash equivalents	–	–	103,922	–	**103,922**
Receivables	–	998	34,840	39	**35,877**
Prepayments and other receivables	55	2,218	–	–	**2,273**
Inventory	–	24,907	–	730	**25,637**
Noncurrent assets					
Oil and gas assets	41,235	3,759,354	–	24,448	**3,825,037**
Receivable from participants	–	–	2,268,571	–	**2,268,571**
Current liabilities					
Trade and other payables	–	(6,355)	(40,852)	(1,328)	**(48,535)**
Other liabilities	(124)	(2,047,533)	(74,156)	(846)	**(2,122,659)**
Borrowings	–	(8,470)	(2,188,403)	–	**(2,196,873)**
Payable to Participants	–	–	(103,905)	–	**(103,905)**
Net Assets	**41,166**	**1,725,119**	**17**	**23,043**	**1,789,345**

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

22. Related party transactions continued

Share in revenue and expense

2017	PDLs (1,7,8,9) US$'000	PNGLNG Project US$'000	Gloco US$'000	Moran (PDL 5) US$'000	Balance US$'000
Revenue	–	–	659,643	–	**659,643**
Cost of sales	(26,416)	(124,361)	(6,750)	(9,552)	**(167,079)**
Gross Profit	(26,416)	(124,361)	652,893	(9,552)	**492,564**
Other income	–	4,311	265	–	**4,576**
Consultancy and professional service	–	–	(120)	–	**(120)**
Operating profit	(26,416)	(120,050)	653,038	(9,552)	**497,020**
Interest income	–	–	2,923	–	**2,923**
Finance costs	–	(9,856)	(114,981)	–	**(124,837)**
Net profit/(loss)	**(26,416)**	**(129,906)**	**540,980**	**(9,552)**	**375,106**

2016	PDLs (1,7,8,9) US$'000	PNGLNG Project US$'000	Gloco US$'000	Moran (PDL 5) US$'000	Balance US$'000
Revenue	–	–	529,458	–	**529,458**
Cost of sales	–	(123,704)	(857)	(8,891)	**(133,452)**
Gross Profit	–	(123,704)	528,601	(8,891)	**396,006**
Other income	–	3,907	106	–	**4,013**
Consultancy and professional service	–	–	(135)	–	**(135)**
Operating profit	–	(119,797)	528,572	(8,891)	**399,884**
Interest income	–	–	1,323	–	**1,323**
Finance costs	–	(8,311)	(114,020)	–	**(122,331)**
Net profit/(loss)	**–**	**(128,108)**	**415,875**	**(8,891)**	**278,876**

AUDITOR-GENERAL'S OFFICE

23. Commitments

(a) Capital expenditure commitments

The Group does not have any other capital commitments other than its joint venture commitments as disclosed below:

	2017	2016
	US$'000	US$'000
Capital expenditure commitments	**113,092**	**194,222**

(b) Finance lease commitments

	2017	2016
	US$'000	US$'000
Not later than 1 year	12,559	11,145
Later than 1 year but less than 5 years	38,046	44,551
More than 5 years	180,758	148,162
Future finance charges	(74,137)	(123,762)
	157,226	**80,096**

(c) Operating lease commitments – Lease of PNGLNG marine vessels and tugs

	2017	2016
	US$'000	US$'000
Not later than 1 year	8,623	6,651
Later than 1 year but not more than 5 years	25,771	26,621
More than 5 years	66,294	94,549
	100,688	**127,821**

(d) Office space operating lease commitments

	2017	2016
	US$'000	US$'000
Not later than 1 year	323	526
Later than 1 year but not more than 5 years	495	130
More than 5 years	–	–
	818	**656**

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2017

24. Acquisition of Mitsubishi's PNG Oil and Gas Interests

On 7th February 2017, Mitsubishi Corporation, a Company organised and existing under the laws of Japan and having its principal place of business in Tokyo, Japan, has entered into an agreement with Kumul Exploration (Asia) Pte Limited ('KEAPL'), for the sale of all its shares on Diamond Gas Niugini B.V. ('DGN'). The Parent entity has agreed to guarantee the performance by KEAPL of its obligations in respect of the sale on the terms set-out in the agreement.

At completion date on 31 May 2017 or such later date as agreed by the Seller and Purchaser, the title and risk in DGN to pass on to KEAPL. The total assets at the date of completion amounted to US$26.12 million, while assumed liabilities amounted to US$30.15 million. KEAPL has received the net amount of US$4.03 million and transferred US$4.00 million to the Parent entity during the year.

As at the completion date, the carrying values of the assets and liabilities acquired from the asset acquisition are as follows:

	US$'000
Assets	
Cash and cash equivalents	8,444
Receivables and other assets	3,099
Oil and gas assets	14,580
Liabilities	
Rehabilitation and restoration liability	(30,149)
Net liabilities acquired	**(4,026)**

The sum of the continuing participation license interest values of US$14.58 million composed of the following:

License Number	Percentage Interest	License Values US$
PDL 10	10%	7,800,000
PL 10	10%	1
PRL 8	17%	3,500,000
PPL 235	40%	3,280,000
		14,580,001

25. Kroton Equity Option and Conversion under the Umbrella Benefit Sharing Agreement (UBSA)

KPHL and related parties recognise that Project Area Landowners, affected provincial governments ('PGs'), local-level governments ('LLGs') (collectively referred to as 'Beneficiary Group' or 'BG') are important stakeholders for the success and stability of the Project. On 23 May 2009, the State signed an Umbrella Benefits Sharing Agreement ('UBSA') with the Beneficiary Group. The Beneficiary Group is entitled to certain benefits under the existing policies, laws and agreements. Also Beneficiary Group recognises this is an integrated project for the nation and sharing benefits in order for the Project to get access to the area falls/affected.

Among others, the UBSA sets out the principles of sharing of benefits between the parties, accordingly, the Beneficiary Group will be entitled to a benefit of an estimated 4.22% equity participating interest in the project by virtue of commercial option for an undivided and fixed 25.75% shareholding in KROTON (Kroton Equity).

AUDITOR-GENERAL'S OFFICE

25. Kroton equity option and Conversion under the Umbrella Benefit Sharing Agreement (UBSA) continued

At 31 December 2015, the options were determined not to have any intrinsic value as the exercise price was assessed to be higher than the fair value of the project.

Timeline of the option exercise date:

- The options were originally exercisable between 1 January 2016 and 30 Jun 2016 at the price of US$240m per percentage point of the project interest (equivalent to total price of US$1,013m).
- On 6 June 2016 the NEC issued Decision # 137/2016 to extend the option expiry from 30 June 2016 to 30 September 2016.
- The State then by a NEC Decision # 239/2016, on 28 September 2016 revised the terms by extending the option period to the 31st of December 2016, discounting the option exercise price to US$150m per PNGLNG Project percentage point (totalling US$640.5m), and offered vendor financing through KPHL to enable the timely exercise of the Equity Option.

Leading up to the 31st of December 2016, the Beneficiary groups had not organised themselves in time to be able to execute the option transaction documents to meet the option deadline. To bridge this problem, the Beneficiary Groups, represented by Mineral Resources Development Company Limited, MRDC, on 20 December 2016 wrote to KPHL and expressed their interest in exercising the option on behalf of all those beneficiary groups that may not be able to exercise the option by 31 December 2016. In their expression of interest, the Beneficiary Groups accepted the Kroton Equity Option on the revised terms offered by the State (including KPHL's offer of vendor financing). This date of 20 December 2016 is viewed as the modification date in accordance with IFRS2 and also the date when the incremental value of the options are to be determined. Consequently management determined the valuation of the option on this date as US$83.8m.

Following on from the expression of interest by MRDC, BG are required to execute the Unit Application Forms to secure their respective allocation of the Kroton Equity. 27% of the Kroton Equity Options were converted to Share based payment reserve – Kroton Equity as the Kroton Equity Option holders executed the Unit Application Forms prior to 31 December 2016. As the offer to the Beneficiary Groups to participate in the equity sharing benefits in the Kroton was agreed under the UBSA, the option to acquire shares under the arrangement remains available at 31 December 2017. However the option to acquire the shares under the vendor financing arrangement has lapsed at 31 December 2016 and remains at the discretion of KPHL.

Accounting policy and treatment adopted for the option exercise and conversion:
Based on the financing structure and repayment arrangement which provides the BG's with the right to partial dividends over the initial 20 year period as long as certain factors are satisfied (e.g. availability of profits and oil price), management are of the view that the substance of the transaction from Kroton's perspective is that of a compound financial instrument in accordance with IAS 32 Financial Instruments: Presentation. The liability component represents the obligations to make payments if profits are available and other factors are satisfied; management will not have discretion to restrict the payment of dividends if the factors, which are outside of their control, are satisfied. The total value of the arrangement, received by the beneficiaries from KPHL, represents the nature and substance of a hybrid instrument (i.e. the right to receive a distribution over 20 years, and then discretionary ordinary dividends thereafter). From an accounting perspective this substance takes the form of a compound financial instrument in accordance with IAS 32.

IAS 32 Financial Instruments: Presentation requires the issuer of a non-derivative financial instrument to evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. This evaluation is based on the contractual terms of the financial instrument, the substance of the arrangement and the definition of a financial liability, and an equity instrument. If such components are identified, they must be accounted for separately as financial liabilities, or equity, and the liability and equity components shown separately in the statement of financial position. This treatment, commonly referred to as 'split accounting' is to be applicable to Kumul Petroleum (Kroton) Ltd as the issuer of a compound financial instrument.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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25. Kroton equity option and Conversion under the Umbrella Benefit Sharing Agreement (UBSA) continued

In the issuer's financial statements, under IAS 32:

- on initial recognition of the instrument, the fair value of the liability component is calculated first and the equity component is treated as a residual; and
- the equity component is never remeasured after initial recognition.

The liability component is determined as the net present value of all potential contractually determined future cash flows under the instrument, discounted at the rate of interest applied by the market at the time of issue to instruments.

In accordance with the general definition of equity as a residual, the equity component of the instrument is the difference between the fair value of the compound instrument and the liability component as determined above.

In accordance with the principles in IFRS2 Share based payments, as the financial instrument has a positive value/benefit to the BGs, it is considered that there are unidentifiable services provided by the BGs in exchange for the financial instrument. However, the unidentifiable services to be received by Kroton do not meet the definition of an asset, hence the fair value of the total compound financial instrument is expensed through the Statement of Profit or Loss.

As noted above, on modification date, the entity recorded an incremental expense for unidentifiable services provided by the BG's and a resulting Kroton equity option share based payment reserve in accordance with IFRS2 Share based payment.

Subsequently, within the 31 December 2016 financial report, for those BG's that exercised their options on 27 December 2016, management recorded the option exercise and equity conversion as a compound financial instrument in accordance with accounting standards.

In accordance with the accounting standard IAS32 Financial Instruments: Presentation, management recorded the relevant BG's full value of the compound financial instrument as an expense for the period.

The equity component has been valued using an assumed cash flow stream after expiry of the vendor financing arrangement period. Management recognised a financial liability for the present value of future net cash flows under the arrangement. The residual balance has been recorded in Kroton equity option share based payment reserve.

During 2017, a further 55% of the BGs having signed the Unit Application Forms have acquired the compound financial instrument under the vendor financing arrangement. At 31 December 2017 18% of the shares on offer are outstanding to be acquired by the BGs.

AUDITOR-GENERAL'S OFFICE

25. Kroton equity option and Conversion under the Umbrella Benefit Sharing Agreement (UBSA) continued

As at date of this report, the following BG's are entitled to the Kroton equity in their respective percentages as follows:

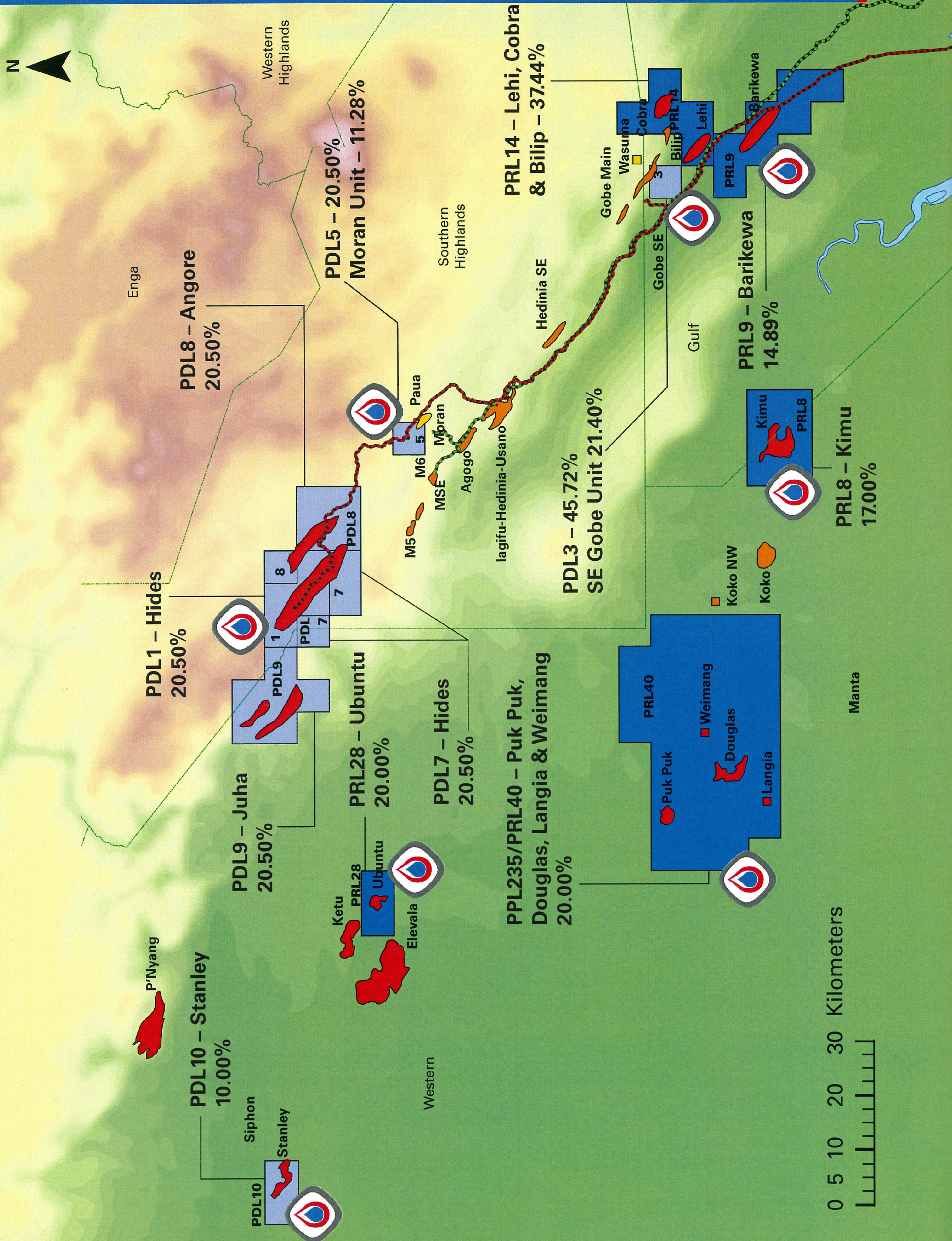
Beneficiary Groups	% Shareholding in Kroton
Southern Highlands & Hela Provincial Governments	4.89%
PDL 1 (Hides) Landowners	4.89%
PDL 7 (Hides 4) Landowners	2.32%
PDL 2 (Kutubu) Landowners	3.09%
PDL 5 (Moran) Landowners PDL 6 (Moran) Landowners	0.77%
PDL 4 (Gobe) Landowners	0.77%
PDL 9 (Juha) Landowners	0.90%
PDL 8 (Angore) Landowners	1.67%
Fly River Provincial Government	0.26%
Gulf Provincial Government	0.64%
Central Provincial Government	0.64%
PL Landowners	2.06%
PPFL Landowners	2.83%
	25.75%

26. Subsequent events

We evaluated subsequent events through the date of issuance of the financial statements. There have been no subsequent events that occurred during such period that would require adjustment to or disclosure in the financial statements as of and for the year ended December 31, 2017.

AUDITOR-GENERAL'S OFFICE

KUMUL PETROLEUM HOLDINGS
ASSETS IN PAPUA NEW GUINEA



Legend

- Kumul interest
- Coastal outline
- PNGLNG pipeline
- Oil pipeline
- Gas fields
- Oil fields
- Oil & gas fields
- Kumul assets – petroleum retention licence
- Kumul assets – petroleum development licence

Supporting PNG Scouts Association with Trukai Fun Run shirts (2016)

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