

CIECO
Exploration and Production
(UK) Limited

Annual Report and Accounts for the year ended
31 December 2017



Company Registration Number: 02669936

CIECO Exploration and Production (UK) Limited

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CIECO Exploration and Production (UK) Limited

Officers and professional advisers

Directors

Mr. H. Imamura
Mr. T. Mori

Secretary

Mr. A. Gupta

Registered Office

CIECO Exploration and Production (UK) Limited
The Broadgate Tower
20 Primrose Street
London
United Kingdom
EC2A 2EW

Bankers

Sumitomo Mitsui Banking Corporation Europe Limited
Temple Court
99 Queen Victoria Street
London
EC4A 4EH

Mizuho Corporate Bank Limited
London Branch
Bracken House, One Friday Street
London
EC4M 9JA

Solicitor

Baker Botts (UK) LLP
41 Lothbury
London
EC2R 7HF

Auditor

Deloitte LLP
Statutory Auditor
2 New Street Square
London
EC4A 3BZ

CIECO Exploration and Production (UK) Limited

Directors' report

The directors submit their annual report and audited accounts for the year ended 31 December 2017.

Results and dividends

The Company made a loss after tax for the year ended 31 December 2017 of £31,855,000 (2016: £3,572,000). The increase in the loss for the year is significantly due to tax losses not recognised of £52,690,000 offset by an increase in turnover and decline in cost of sales. Further details of the Company's key performance indicators ("KPIs") are presented in the Strategic report.

The directors do not recommend a dividend be paid (2016: £nil).

No significant event since the balance sheet date has occurred.

Details of future developments can be found in the Strategic Report on page 7.

Going concern

The Company's business activities, together with factors likely to affect its future development, performance and position are set out in the Strategic Report. The Strategic Report also outlines the Company's financial risk management policies.

The directors have considered the Company's business activities with the factors likely to affect its future development, performance and liquidity position together with reserves, cash flow and its banking and group facilities in their assessment of going concern. As a consequence, the directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in their operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Directors

The directors, who served during the year and to the date of this report, were as follows:

Mr. S. Hirokawa (resigned on 1 April 2017)
Mr. H. Imamura (appointed on 1 April 2017)
Mr. T. Mori
Mr. S. Ishibashi (resigned on 30 June 2017)

None of the directors held any shares in the Company's ultimate holding company, ITOCHU Corporation, or in any other group company as at 31 December 2017 (2016: none).

CIECO Exploration and Production (UK) Limited

Directors' report (continued)

Financial risk management objectives and policies

The Company is exposed to oil price and currency exchange rate variations over which it has no control. Where the directors deem it appropriate, the Company manages these risks by taking out future contracts to fix the prices for part of its anticipated future production and forward contracts to settle the foreign exchange liability. The Company had no oil hedges outstanding as at 31 December 2017 (2016: none). The Company had no foreign exchange forward contracts outstanding as of 31 December 2017 (2016: £39,825,000) to settle the USD liability for the FPSO on the Western Isles Project. In addition, the Company manages foreign currency risk by converting US Dollars receipts at spot rates periodically and as required for payment in Sterling.

The Company closely monitors and manages its liquidity risk by reviewing cash flow requirements on a regular basis relative to the existing bank and group facilities and the maturity of profile of these facilities. The Company has entered into committed external borrowing facilities to manage development expenditure of the Western Isles project. The Company reviews its cash flow requirements on an ongoing basis to ensure it has suitable resources for its needs. In addition, it has a significant cash balance to carry out its operations smoothly in future.

Variations in interest rates affect the market value of financial liabilities of the Company. The Company works in conjunction with the specialised finance division of the ITOCHU group to mitigate interest rate risk.

The Company currently sells all its production to major oil companies and the directors consider that there is no significant credit risk associated with these sales. Cash balances are invested in short-term bank deposits with a view to minimise counterparty credit risks.

It is Company policy to settle all debts with creditors on a timely basis and in accordance with the terms of credit agreed with each supplier.

CIECO Exploration and Production (UK) Limited

Directors' report (continued)

Auditor

Each of the persons who is a director at the date of approval of this report confirms that:

- i) so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- ii) the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Elective resolutions are in force to dispense with the obligations of laying the Annual Report before the Company in a general meeting and holding Annual General Meetings. The Company is therefore not obliged to reappoint the auditor annually and Deloitte LLP will continue in office.

By order of the Board



H. Imamura
Director
23 March 2018

CIECO Exploration and Production (UK) Limited

Strategic report

The directors submit their strategic report for the year ended 31 December 2017.

Principal activities

The principal activities of the Company are oil and gas exploration, development and production on the UK Continental Shelf.

The Company has equity interests in the Hudson (25.77%) and Western Isles (23.08%), together with associated interests in pipelines, and terminal facilities and attendant acreage. During the year, the Company has disposed 12% equity interest in Licence P2170 block 20/5b & 21/1d to fellow subsidiary company, CIECO V&C (UK) Limited at book value.

The Company also provides technical, commercial, financial and legal advisory services to other members of the ITOCHU Corporation group.

Business review

Details of the Company's results for the year are provided in the Directors' report. The Company's key performance indicators for the year are net production, average sales price and cost of production.

The Company's net production for 2017 from the Hudson and Western Isles oilfields amounted to 0.265 million stock tank barrels (2016: from Hudson 0.118 million). The company KPI's are average sales price realised and cost of production. The average sales price realised in the year was £44.76 a barrel (2016: £29.80). The cost of production in the year was £47.59 a barrel (2016: £32.16).

During November 2017, first oil was achieved on Western Isles and the Company has disposed an interest in Licence P2170 block 20/5b & 21/1d to fellow subsidiary company, CIECO V&C (UK) Limited.

Outlook for 2018

It is anticipated that production will continue from the Hudson oilfield. The Company has commenced a sales process to divest Western Isles. A financial adviser has been appointed and divestment plan has been agreed, which is expected to complete in the 4th quarter of 2018.

The Company will continue to provide technical, commercial and financial and legal advisory services to other Group companies.

By order of the Board



H. Imamura

Director

23 March 2018

CIECO Exploration and Production (UK) Limited

Directors' responsibilities statement

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including [FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"]. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- applicable UK Accounting Standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CIECO EXPLORATION AND PRODUCTION (UK) LIMITED

Report on the audit of the financial statements

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of CIECO Exploration and Production (UK) Limited (the 'company') which comprise:

- the statement of income and retained earnings;
- the balance sheet;
- the cash flow statement;
- the statement of accounting policies; and
- the related notes 1 to 22.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs(UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CIECO EXPLORATION AND PRODUCTION (UK) LIMITED (continued)

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CIECO EXPLORATION AND PRODUCTION (UK) LIMITED (continued)

Auditor's responsibilities for the audit of the financial statements

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

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

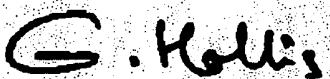
**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF CIECO
EXPLORATION AND PRODUCTION (UK) LIMITED (continued)**

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.



Graham Hollis ACA (Senior statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

23 March 2018

CIECO Exploration and Production (UK) Limited

Statement of income and retained earnings for the year ended 31 December 2017

	Notes	2017 £000	2016 £000
Turnover	1, 2	8,909	4,654
Cost of sales		(2,310)	(12,379)
Depletion and depreciation	4, 11	(4,950)	(1,581)
Gross profit/(loss)		<u>1,649</u>	<u>(9,306)</u>
Administrative expenses		(2,186)	(2,216)
Operating loss	4	<u>(537)</u>	<u>(11,522)</u>
Interest receivable and similar income	7	128	193
Interest payable and similar charges	8	(2,757)	(1,504)
Loss on ordinary activities before taxation		<u>(3,166)</u>	<u>(12,833)</u>
Tax on loss on ordinary activities	9	(28,689)	9,261
Loss for the financial year		<u>(31,855)</u>	<u>(3,572)</u>
Retained losses at 1 January		(82,451)	(78,879)
Loss for the year		(31,855)	(3,572)
Retained losses at 31 December		<u>(114,306)</u>	<u>(82,451)</u>

All income and expenditure relates to continuing activities.

There have been no recognised gains or losses for the current or previous financial year other than the loss of £31,855,000 (2016: £3,572,000) shown above. Consequently no separate statement of comprehensive income is presented with these financial statements.

The result as shown in the profit and loss account is not materially different from the result on an unmodified historical cost basis.

The notes on pages 16 to 36 form part of these financial statements.

CIECO Exploration and Production (UK) Limited

Balance sheet as at 31 December 2017

	Notes	2017 £000	2016 £000
Non-current assets			
Intangible fixed assets	10	-	1,863
Tangible oil and gas assets	11	221,380	178,540
Other tangible assets	11	85	115
Deferred tax asset	16	18,955	51,648
		<u>240,420</u>	<u>232,166</u>
Current assets			
Stocks	12	48	30
Debtors	13	16,990	7,058
Cash at bank and cash equivalents		32,591	31,055
		<u>49,629</u>	<u>38,143</u>
Creditors: amounts falling due within one year	14	(34,424)	(64,781)
Net current assets/(liabilities)		<u>15,205</u>	<u>(26,638)</u>
Total assets less current liabilities		255,625	205,528
Creditor: amounts falling due after one year	15	(297,753)	(224,681)
Provisions for liabilities	16	(47,652)	(38,772)
Net liabilities		<u>(89,780)</u>	<u>(57,925)</u>
Capital and reserves			
Called up share capital	17	24,526	24,526
Retained losses		(114,306)	(82,451)
Shareholders' deficit	18	<u>(89,780)</u>	<u>(57,925)</u>

These financial statements were approved by the Board of Directors on 23 March 2018.

The notes on pages 16 to 36 form part of these financial statements.

Signed on behalf of the Board of Directors



H. Imamura
Director

Company Registration Number: 02669936

CIECO Exploration and Production (UK) Limited

Cash flow statement for the year ended 31 December 2017

	Notes	2017 £000	2016 £000
Net cash outflow from operating activities	19	(1,631)	(12,319)
Cash flows from investing activities			
Payments to acquire tangible fixed assets		(84,187)	(26,737)
Payments to acquire intangible fixed assets		(155)	(563)
Proceeds from sale of intangible fixed assets		2,018	616
Decommissioning expenditure		(3)	(2,215)
Interest received		128	147
Net cash outflows from investing activities		<u>(82,199)</u>	<u>(28,752)</u>
Cash flows from financing activities			
Proceeds from borrowings		85,410	39,945
Interest paid		(28)	(4)
Net cash inflows from financing activities		<u>85,382</u>	<u>39,941</u>
Net increase/(decrease) in cash and cash equivalents		1,552	(1,130)
Cash and cash equivalents at the beginning of year		31,055	32,139
Effect of foreign exchange rate changes		(16)	46
Cash and cash equivalents at end of year		<u>32,591</u>	<u>31,055</u>
Reconciliation to cash at bank			
Cash at bank and in hand at end of year		17	51
Short-term deposits at end of year		22,968	21,423
Short-term deposits held in a trust		9,606	9,581
Cash and cash equivalents at end of year		<u>32,591</u>	<u>31,055</u>

The notes on pages 16 to 36 form part of these financial statements.

CIECO Exploration and Production (UK) Limited

Notes to the financial statements for the year ended 31 December 2017

Note 1. Statement of accounting policies

CIECO Exploration and Production (UK) Limited (the Company) is a private limited company limited by shares incorporated in the United Kingdom under the Companies Act 2006 and is registered in England and Wales. The address of the Company's registered office is shown on page 3.

i) Accounting convention

The financial statements have been prepared under the historical cost convention, and in accordance with Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council.

The functional currency of the Company is considered to be pounds sterling because that is the currency of the primary economic environment in which the Company operates.

ii) Joint arrangements

The Company's exploration, development and production activities are generally conducted in joint arrangements with other companies. The accounts reflect the relevant proportions of production, capital expenditure and operating costs applicable to the Company's interests. The effects of re-determinations of equity interests in joint arrangements are accounted for when the outcome of the re-determination is known. In the case of producing fields, adjustments to past production entitlements arising therefrom are accounted for in the manner agreed with other companies participating in the arrangements, usually by means of adjustments to future production entitlements.

iii) Oil and gas exploration and development activities

Exploration, appraisal and development costs are accounted for under the full cost method.

Exploration and appraisal costs except pre-license costs are initially capitalised to intangible fixed assets until the determination or cessation of exploration and appraisal (see policy (iv) below). Upon determination and cessation of exploration and appraisal, all associated costs are capitalised as tangible oil and gas assets, irrespective of the success or failure of exploration activity. Such costs include the net present value at inception of the expected cost of decommissioning in accordance with accounting policy (vi).

CIECO Exploration and Production (UK) Limited

Note 1. Statement of accounting policies (continued)

iii) Oil and gas exploration and development activities (continued)

Costs capitalised to tangible oil and gas assets are depreciated on the "unit-of-production" basis in accordance with accounting policy (vii). Costs recognised in the calculation are the undepleted balance, including capitalised interest on financing for development purposes during the period prior to commencement of production, together with estimated future development costs required to access the commercial reserves. Costs capitalised to intangible assets are not depleted until these costs are transferred to tangible oil and gas assets.

Interest on borrowings to finance fixed asset expenditure is capitalised during the development period prior to commencement of production from those facilities, except to the extent that such capitalisation would necessitate a provision under an impairment test calculation (see policy (ix) below).

iv) Intangible fixed assets

All the exploration and appraisal costs, except pre-licence costs are capitalised as intangible assets. Pre-licence costs are expensed to operating expenditure in the period in which they are incurred. Intangible exploration and appraisal costs are not depleted.

Exploration and appraisal costs are transferred to tangible fixed assets and treated as depletable interests from the date development consent is received or upon determination of non-commerciality or cessation of exploration on each licence.

v) Commercial reserves

Commercial reserves are proven and probable reserves that are the estimated quantities of crude oil, natural gas and gas liquids which geological, geophysical and engineering data demonstrate to be recoverable from known reservoirs in future years and which can be commercially produced.

vi) Decommissioning

Production licences are generally required to restore oil and gas field sites at the end of the producing lives of the fields to a condition acceptable to the relevant authorities. The expected cost of decommissioning, discounted to its net present value, is recorded as a provision with a corresponding addition within oil and gas assets when the installation of facilities has had an environmental impact. The capitalised cost is amortised over the life of the operation on a unit-of-production basis. Any adjustment arising from reassessment of the estimated cost of decommissioning is capitalised within tangible fixed assets with a corresponding amount being recognised as provision whilst the adjustment arising from the unwinding of the discount is taken to the profit and loss account in finance costs.

CIECO Exploration and Production (UK) Limited

Note 1. Statement of accounting policies (continued)

vii) Depletion and depreciation

Those costs that have been capitalised to tangible oil and gas assets, together with anticipated future development costs required to access commercial reserves, are depleted on a unit-of-production basis. Depletion is calculated on a field-by-field basis by reference to the proportion that production for the year bears to the total of the estimated remaining commercial reserves as at the end of the period plus production in the period.

Intangible assets are not depleted until such time as they are transferred to oil and gas assets, at which point those costs not relating to commercially viable activities are maintained separately from other field assets and are depleted on a unit-of-production basis, using the combined production and commercial reserves of the total cost pool. The Company has one cost pool, being UKCS, which therefore includes all the Company's interests.

Depreciation on all other, non-oil and gas, tangible fixed assets are provided on a 25% reducing balance basis.

viii) Effect of changing estimates

Changes in estimates affecting unit-of-production calculations for depletion are accounted for prospectively over the estimated remaining commercial reserves of the pool.

ix) Impairment

Tangible oil and gas assets which represent successful exploration costs transferred from intangible assets together with development costs and capitalised interest are assessed for impairment on a field-by-field basis.

If the events or changes in circumstances indicate that the carrying amount of expenditure within the field may not be recoverable from the fair market value of asset committed to sell and future net revenues from the commercial reserves attributable to the field, a comparison between the net book value of the field and the fair market value of the asset and the discounted future cash flows from that field is undertaken. To the extent that the carrying amount exceeds the recoverable amount, the field net book value is written down to its recoverable amount and charged as additional depreciation shown in depletion and impairment line.

Other tangible oil and gas assets, which have been transferred from intangible assets and represent costs that do not relate to commercially viable activities, are assessed for impairment on a pool-wide basis.

CIECO Exploration and Production (UK) Limited

Note 1. Statement of accounting policies (continued)

ix) Impairment (continued)

The aggregate carrying value of the pool, including the field costs that fall within the pool, is compared against the expected recoverable amount of the pool. To the extent that the carrying amount exceeds the recoverable amount, the net book value is written down to its recoverable amount and charged as additional depreciation shown in depletion and impairment line.

x) Financial assets and liabilities

All financial assets and liabilities are initially measured at transaction price (including transaction costs) unless the arrangement constitutes a financing transaction. If an arrangement constitutes a financing transaction, the financial asset or financial liability is measured at present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Non-current debt instruments which meet the following conditions, are subsequently measured at amortised cost using the effective interest method:

- a) Returns to the holders are (i) a fixed amount; or (ii) a fixed rate of return over the life of the instrument; or (iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quote or observable interest rate; or (iv) some combination of such fixed rate and variable rates, providing that both rates are positive.
- b) There is no contractual provision that could, by its terms, result in the holder losing the principal amount or interest attributable to the current period or prior periods.
- c) Contractual provisions that permit the issuer to prepay a debt instrument or permit the holder to put it back to the issue before maturity are not contingent on future events, other than to protect the holder against the credit deterioration of the issuer or a change in control of the issuer, or to protect the holder or issuer against changes in relevant taxation or law.
- d) There are no conditional returns or repayment provisions except for the variable rate return described in a) and prepayment provisions described in c).

Debt instruments that are classified as payable or receivable within one year and which meet the above conditions are measured at the undiscounted amount of the cash or other consideration expected to be paid or received, net of impairment.

CIECO Exploration and Production (UK) Limited

Note 1. Statement of accounting policies (continued)

xi) Derivative financial instruments

The Company uses derivative financial instruments to reduce exposure to foreign exchange risk. The Company does not hold or issue derivative financial instruments for speculative purposes.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at each reporting date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedge instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

xii) Turnover

Turnover represents the invoiced value of petroleum products and services sold during the year. Turnover also includes consultancy costs recharged to other group entities.

xiii) Interest income

Interest income is recognised on a time proportion basis.

xiv) Overlift and underlift

Lifting or offtake arrangements are frequently such that an imbalance between cumulative production entitlement and cumulative sales at the reporting date occur. This short-term imbalance is underlift or overlift. Where material, adjustments in respect of overlift or underlift are recorded at market value against cost of sales. The equivalent balance sheet entry is recorded to creditors or debtors as applicable.

xv) Stocks

The Company's share of material and supplies, such as drill-pipe, well casing, stock of oil within the Brent System pipelines and field production and maintenance material, are included in current assets at the lower of cost and net realisable value. Cost is calculated using the FIFO (first in, first out) method. Provision is made for obsolete, slow moving or defective items where appropriate.

CIECO Exploration and Production (UK) Limited

Note 1. Statement of accounting policies (continued)

xvi) Taxation

Corporation tax is provided on the relevant taxable profits at the current rates.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where the transactions or events that result in an obligation to pay more tax in the future or a right to pay less in the future have occurred at the balance sheet date. The timing differences are differences between the taxable (loss)/ profit and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in period different from those in which they are recognised in the financial statements. Deferred corporation tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred corporation tax assets and liabilities are not discounted.

Deferred tax is measured using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

xvii) Foreign currencies

Transactions denominated in foreign currencies are translated into sterling and recorded at the relevant rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are restated into sterling at the rates of exchange ruling at the balance sheet date.

Foreign exchange gains and losses are recognised in the profit and loss account for the year.

xviii) Pension costs

For defined benefit schemes and defined contribution schemes the amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

xix) Leases

Operating lease rentals are charged to the profit and loss account in equal annual amounts over the lease term.

CIECO Exploration and Production (UK) Limited

Note 1. Statement of accounting policies (continued)

xx) Cash equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.

xxi) Critical accounting estimates and judgements

The Company assess critical accounting judgements and estimates when preparing the financial statements. Uncertainties in the estimates and judgements could have an impact on the carrying amount of assets and liabilities and the Company's result. The key estimates and judgements are discussed below.

Impairment methodology

The Company makes a judgement in relation to the methodology to be applied to development and production assets. The recoverable amount is determined applying a value in use basis with the exception of circumstances where the business has committed to the sale of an asset, in which case a fair value approach is taken to determine the recoverable value.

Estimates in oil and gas reserves

Estimates of oil and gas reserves are used in the calculations for impairment tests and accounting for depletion and decommissioning. Changes in estimates of oil and gas reserves resulting in different future production profiles will affect the discounted cash flows used in impairment testing, the anticipated date of decommissioning and the depletion charges in accordance with the unit-of-production method.

Estimates in impairment of assets

For details of the policy see Impairment (above).

The Company uses commodity prices that are based on forward curves for three years and the long-term corporate economic assumptions thereafter, pre-tax discount rate of 10% (2016: 10%). The costs have been extrapolated using a range from 2.70% to 2.5% till 2019 and 2.25% thereafter by annual inflation rates.

As above, the Company uses fair market value approach where there is a commitment to sell.

CIECO Exploration and Production (UK) Limited

Note 1. Statement of accounting policies (continued)

Decommissioning provision

Amounts used in recording a provision for decommissioning are estimates based on current legal and constructive requirements, current technology and price levels for the removal of facilities and plugging and abandoning of wells. Due to changes in relation to these items, the future actual cash outflows in relation to decommissioning are likely to differ in practice. The estimated decommissioning costs are reviewed on a regular basis.

The effects of changes in estimates do not give rise to prior year adjustments and are dealt with prospectively. In estimating decommissioning provisions, the Company applies a range of annual inflation rates of 2.70% to 2.50% till 2019 and 2.25% thereafter and an annual nominal discount rate of 4% (2016: 4%). The discount rate used is a pre-tax rate reflects current market assessments of the time value of money and the risks specific to the asset. See note 16(b) for further details.

Recoverability of deferred tax assets

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that future taxable profits will be available against which the losses can be utilised. This requires management to make judgements and assumptions regarding the amount of deferred tax that can be recognised, as well as the likelihood of future taxable profits. See note 16 for further detail.

Note 2. Revenue

An analysis of the Company's revenue is as follows:

	2017 £000	2016 £000
Sale of crude	7,259	3,249
Service income	1,650	1,405
Revenue	<u>8,909</u>	<u>4,654</u>

The Company's major activities are currently within the United Kingdom and consequently no segmental analysis is required.

Note 3. Impairment of fixed assets

As at 31 December 2017, the directors performed an impairment test on the carrying value of the Company's tangible oil and gas assets. The test indicated that fair market value of Western Isles and forecast future cash flows of other assets are sufficient to cover the carrying value. The other assets held, including Hudson, SVT & Brent System continued to be assessed on a value in use basis and forecast future cash flows of these assets are sufficient to recover the carrying value. As such no impairment charge has been recognised in the year (2016: £nil).

CIECO Exploration and Production (UK) Limited

Note 4. Operating loss

Operating loss is stated after charging:

	2017 £000	2016 £000
Office rental	171	141
Depletion of Oil and Gas assets (note 11)	4,921	1,543
Depreciation of other tangible fixed assets (note 11)	29	38
Fees for the audit of the Company's annual accounts	50	48

Note 5. Related Party Transactions

- ◆ Included within turnover is income of £557,137 (2016: £710,922) from ITOCHU Oil Exploration (Azerbaijan) Inc. (IOEA) for consultancy services provided by the Company. £557,137 (2016: £710,922) is included within amounts due from fellow subsidiary companies at the year end.
- ◆ Included within turnover is income of £2,408 (2016: £11,564) from Itochu Oil Exploration (BTC) Inc (IOEB) for consultancy services provided by the Company. £2,408 (2016: £11,564) is included within amounts due from fellow subsidiary companies at the year end.
- ◆ Included within turnover is income of £230,606 (2016: £35,161) from CIECO BTC (UK) Limited for consultancy services provided by the Company. £233,896 (2016: £38,179) is included within amounts due to fellow subsidiary companies at the year end.
- ◆ Included within turnover is income of £14,183 (2016: £54,318) from ITOCHU Corporation for consultancy services provided by the Company. £14,183 (2016: £54,318) is included within amounts due to parent company at the year end.
- ◆ Included within turnover is income of £490,320 (2016: £Nil) to CIECO V&C (UK) Limited for consultancy services provided by the Company. £630,107 (2016: £Nil) is included within amounts due to fellow subsidiary companies at the year end.
- ◆ Included within turnover is income of £74,629 (2016: £Nil) to CIECO West Qurna Limited for consultancy services provided by the Company. £89,398 (2016: £Nil) is included within amounts due to fellow subsidiary companies at the year end.
- ◆ Included within interest receivable is interest income of £45,892 (2016: £73,477) from ITOCHU Treasury Centre Europe Plc (ITCE).
- ◆ Included within administrative expenses are charges of £40,075 (2016: £113,563) to ITOCHU Europe PLC. (ITCE) for treasury payroll and management services. £40,075 (2016: £46,062) is included within amounts due from fellow subsidiary companies at the year end.

CIECO Exploration and Production (UK) Limited

Note 5. Related Party Transactions (continued)

- ◆ Included within administrative expenses are charges of £222,107 (2016: £306,314) to ITOCHU Oil Exploration Co. Limited, for support services primarily of a technical and administrative nature. £479,979 (2016: £722,496) is included within amounts due to fellow subsidiary companies at the year end.
- ◆ Included within administrative expenses are charges of £116,239 (2016: £113,563) to ITOCHU Corporation, for support services primarily of a legal, financial, commercial and administrative nature. £392,561 (2016: £283,712) is included within amounts due to parent company at the year end.
- ◆ Included within cost of sales are charges of £8,947 (2016: £11,804) from IPC Europe Limited for services provided.
- ◆ During the year £2,094,813, CAPEX £1,770,182, OPEX £324,631 (2016: £1,812,078) was recognised in respect of interest and commitment fees payable relating to amounts due to fellow subsidiary. £233,950 (2016: £1,744,906) is included within amounts due from fellow subsidiary companies at the year end.
- ◆ During the year £157,538 (2016: £109,409) was recognised in respect of guarantee fees payable relating to amounts due to fellow subsidiary. £233,590 (2016: £109,409) is included within amounts due to parent company at the year end.

IOEA, IOEB, CIECO BTC (UK) Ltd, ITCE, IPC, CIECO V&C (UK) Ltd, CIECO West Qurna Ltd and ITOCHU Oil Exploration Co. Ltd. are all subsidiaries of ITOCHU Corporation.

All of the directors of the Company are employees of ITOCHU Corporation.

Note 6. Directors and employees

During the year the average monthly number of employees in the Company was 17 (2016: 18).

Amounts paid by the Company in respect of these employees were as follows:

	2017	2016
	£000	£000
Wages and salaries	2,800	2,754
Social security costs	110	103
Pension contributions (note 21)	124	122
Total	<u>3,034</u>	<u>2,979</u>

CIECO Exploration and Production (UK) Limited

Note 6. Directors and employees (continued)

Staff costs include remuneration in respect of directors as follows:

	2017 £000	2016 £000
Directors' emoluments (excluding pension contributions)	517	715

The emolument of the highest paid director was £190,000 (2016: £339,000).

None of the directors made contributions to either the defined benefit scheme or the defined contribution pension scheme during the year (2016: none).

Note 7. Interest receivable and similar income

	2017 £000	2016 £000
Bank interest receivable	20	62
Interest receivable from fellow subsidiary	46	73
Other interest receivable	62	12
Effect of foreign exchange rate changes	-	46
Total	128	193

Note 8. Interest payable and similar charges

	2017 £000	2016 £000
Finance charges	10	4
Interest paid	548	-
Interest paid to fellow subsidiary	346	-
Unwinding of discount on decommissioning provision (note 16(b))	1,837	1,500
Effect of foreign exchange rate changes	16	-
Total	2,757	1,504

CIECO Exploration and Production (UK) Limited

Note 9. Tax on loss on ordinary activities

i) Analysis of tax charge/(credit) in the year

	2017 £000	2016 £000
<i>Current tax:</i>		
Corporation tax at 40% (2016: 50%)	-	-
Corporation tax adjustment to prior year	(4,004)	(2,053)
Total current tax credit	<u>(4,004)</u>	<u>(2,053)</u>
<i>Deferred tax:</i>		
Timing difference origination and reversal	31,808	(6,863)
Deferred tax adjustment to prior year	885	(345)
Total deferred tax charge/(credit) (note 16(a))	<u>32,693</u>	<u>(7,208)</u>
Tax charge/(credit) on loss in the year	<u>28,689</u>	<u>(9,261)</u>

ii) Factors affecting the tax charge/(credit) for the year

	2017 £000	2016 £000
Loss on ordinary activities before tax	(3,166)	(12,833)
Corporation tax at the UK ring-fence rate of 40% (2016: 40%)	<u>(1,266)</u>	<u>(5,133)</u>
Effects of:		
Non-deductible expenses	17	17
Expenses deductible at lower rates	121	(22)
Ring fence expenditure supplement	(13,657)	(11,500)
Decrease in tax rate	-	6,615
Changes in tax rate applied to decommissioning provision	(2,628)	-
Tax losses not recognised	49,221	3,160
Prior period adjustment	(3,119)	(2,398)
Total tax charge/(credit) for the year	<u>28,689</u>	<u>(9,261)</u>

The rate of corporation tax charged on the Company of 40% (2016: 40%) comprises the ring fence corporation tax rate of 30% (2016: 30%) plus a 10% (2016: 10%) supplementary charge in respect of ring-fenced trades in the North Sea. The standard corporation tax rate has been 19.25% (2016: 20%) and will subsequently be reduced to 17% from 1 April 2020.

iii) Factors that may affect the future tax charge

A deferred tax asset of £13,143,000 (2016: £9,453,000) has been recognised in respect of timing differences relating to the decommissioning provision where they are expected to reverse in the future as tax relief is gained on decommissioning expenditures.

CIECO Exploration and Production (UK) Limited

Note 10. Intangible fixed assets

	Oil & gas interests £000
Balance as at 1 January 2017	1,863
Additions	155
Disposal	(2,018)
Balance as at 31 December 2017	<u>-</u>
Balance as at 31 December 2016	<u>1,863</u>

The Company's exploration costs incurred during 2017 comprise £155,000 (2016: £563,000) incurred on exploration licences in the UKCS. The disposal relates to the transfer of an interest in Licence P2170 block 20/5b & 21/1d to fellow subsidiary company, CIECO V&C (UK) Limited.

CIECO Exploration and Production (UK) Limited

Note 11. Tangible fixed assets

	Oil and Gas Assets	Short Leasehold	Fixtures and Fittings	Total
	£000	£000	£000	£000
Cost				
Balance as at 1 January 2017	542,290	281	219	542,790
Additions	40,715	-	-	40,715
Disposal	-	-	(3)	(3)
Change in decommissioning estimate (note 16(b))	7,046	-	-	7,046
Balance as at 31 December 2017	590,051	281	216	590,548
Depletion and depreciation				
Balance as at 1 January 2017	363,750	213	172	364,135
Charge for the year	4,921	17	12	4,950
Disposal	-	-	(2)	(2)
Balance as at 31 December 2017	368,671	230	182	369,083
Net book value as at 31 December 2017	221,380	51	34	221,465
Net book value as at 31 December 2016	178,540	68	47	178,655

Included within oil and gas assets is cost balance for capitalised interest and ancillary costs of £7,037,000 (2016: £7,037,000), relating to the project loan for the Hudson field, and £16,805,000 (2016: £11,783,000), relating to term loans for development of the Western Isles project.

An impairment test was conducted at 31 December 2017 in accordance with accounting policy (ix). All oil and gas assets passed the impairment test.

The cost of oil and gas assets includes £74,298,000 (2016: £67,252,000) relating to capitalised decommissioning costs.

Oil and gas assets are depreciated on a unit-of-production basis as outlined in accounting policy (vii).

The Company manages the operations and monitors the performance of each of the Company's oil and gas fields so that optimum commercial recovery of reserves can be achieved and to maintain proper estimates of its remaining proven and probable reserves, which are used for some of the accounting estimates and reported in the 'Oil and gas reserve statistics'.

CIECO Exploration and Production (UK) Limited

Note 12. Stocks

	2017 £000	2016 £000
Material and supplies	<u>48</u>	<u>30</u>

There is no material difference between the balance sheet value of stocks and their replacement value.

Note 13. Debtors: amounts receivable within one year

	2017 £000	2016 £000
Trade debtors	5,403	595
Amounts due from fellow subsidiaries companies	3,333	2,652
Other debtors	77	40
Prepayments and accrued income	1,699	3,390
Corporation tax	1,107	-
Oil underlift	5,371	381
Total	<u>16,990</u>	<u>7,058</u>

Note 14. Creditors: amounts falling due within one year

	2017 £000	2016 £000
Trade creditors	283	13
Amounts due to parent company	392	284
Amounts due to fellow subsidiary companies	479	807
Accruals and deferred income	33,110	63,496
Other taxes and social security	160	181
Total	<u>34,424</u>	<u>64,781</u>

CIECO Exploration and Production (UK) Limited

Note 15. Creditors: amounts falling due more than one year

	2017 £000	2016 £000
Bank loan	133,700	87,300
Amounts due to fellow subsidiary company	164,053	125,043
Accruals	-	12,338
Total	<u>297,753</u>	<u>224,681</u>

The Company entered into a committed external borrowing facility on 30 January 2013 to provide regular advances for development expenditure of the Western Isles project. Under the revised terms of the facility, the drawdown will be repayable in full by 30 June 2021. Interest is payable on bank advances at a variable rate of LIBOR plus applicable margin on the principal amount. During the year, £1,620,406 (2016: £1,649,347) of interest charges were incurred and capitalised.

The Company entered into a committed floating rate term loan facility on 30 January 2013 with ITOCHU Treasury Centre Europe Plc, drawn in relevant tranches to cover development expenditure of the Western Isles project. Under the revised terms of the facility, the drawdown repayment will commence from 30 July 2021. Interest is payable on term loan at a variable rate of LIBOR plus applicable margin on the principal amount. During the year, £1,701,189 (2016: £1,627,212) of interest charges were incurred and capitalised.

CIECO Exploration and Production (UK) Limited

Note 15. Creditors: amounts falling due more than one year (continued)

Borrowings are repayable as follows:

	2017	2016
	£000	£000
<i>Bank Loan:</i>		
Between one and two years	81,156	-
Between two and five years	52,544	87,300
After five years	-	-
Total	<u>133,700</u>	<u>87,300</u>

	2017	2016
	£000	£000
<i>Amounts due to fellow subsidiary company:</i>		
Between one and two years	-	-
Between two and five years	164,053	125,043
After five years	-	-
Total	<u>164,053</u>	<u>125,043</u>

	2017	2016
	£000	£000
<i>Accruals:</i>		
Between one and two years	-	12,338
Between two and five years	-	-
After five years	-	-
Total	<u>-</u>	<u>12,338</u>

CIECO Exploration and Production (UK) Limited

Note 16. Provision for liabilities and deferred tax asset

a. Deferred tax asset

i) Movement on deferred tax balance in the year

	2017 £000	2016 £000
Opening balance	51,648	44,440
(Charge)/credit to profit and loss account (note 9)	(32,693)	7,208
Closing balance	<u>18,955</u>	<u>51,648</u>

ii) Analysis of deferred tax balance

	2017 £000	2016 £000
Accelerated capital allowances	(68,735)	(37,758)
Decommissioning provision	13,143	9,453
Losses not utilised	74,547	79,953
Undiscounted deferred tax asset	<u>18,955</u>	<u>51,648</u>

As at balance sheet date, a net deferred tax asset of £18,955,000 (2016: £51,648,000) has been recognised on taxable timing differences. A deferred tax asset has been recognised in respect of losses to the extent that they are expected to be utilised in future years. A deferred tax asset of £77,889,000 (2016: £25,199,000) has not been recognised on losses which are forecast to not be recovered in future periods.

b. Provision for decommissioning

	2017 £000	2016 £000
Opening balance	(38,772)	(30,184)
Change in estimate (note 11)	(251)	(7,313)
Additional provision (note 11)	(6,795)	(1,990)
Unwinding of discounted amount (note 8)	(1,837)	(1,500)
Utilisation of provision	3	2,215
Closing balance	<u>(47,652)</u>	<u>(38,772)</u>

CIECO Exploration and Production (UK) Limited

Note 16. Provision for liabilities (continued)

Provision has been made in accordance with accounting policy (vi), calculated as the present value of decommissioning costs expected to be incurred between 2018 and 2026. The additional provision recognised in the year reflects management's best estimate of the Company's share of decommissioning obligations which primarily relates to Western Isles.

Decommissioning expenditures expected to be incurred within one year amount to £111,000 (2016: £71,000).

	2017 £000	2016 £000
Total provision for liabilities	<u>(47,652)</u>	<u>(38,772)</u>
Total deferred tax asset	<u>18,955</u>	<u>51,648</u>

Note 17. Called up share capital

	2017 Number (in 000)	2016 Number (in 000)
a) Authorised:		
Ordinary shares of £1 each	<u>50,000</u>	<u>50,000</u>
b) Allotted, called up and fully paid:		
Ordinary shares of £1 each	<u>24,526</u>	<u>24,526</u>
	£000	£000
Nominal value of ordinary shares of £1 each	<u>24,526</u>	<u>24,526</u>

Note 18. Reconciliation of movements in shareholders' deficit

	2017 £000	2016 £000
Shareholders' deficit at 1 January	(57,925)	(54,353)
Loss for the year	(31,855)	(3,572)
Shareholders' deficit at 31 December	<u>(89,780)</u>	<u>(57,925)</u>

CIECO Exploration and Production (UK) Limited

Note 19. Cash flow statement

Reconciliation of operating loss to cash outflow by operations:

	2017 £000	2016 £000
Operating loss	(537)	(11,522)
Adjustments for:		
Depletion	4,921	1,543
Depreciation	29	38
Trading exchange (gain)/loss	(1,624)	9,942
Operating cash flow before movement in working capital	<u>2,789</u>	<u>1</u>
Increase in stocks	(18)	(10)
Increase in debtors	(8,565)	(1,982)
Decrease in creditors	4,163	(10,328)
Net cash outflow from operations	<u>(1,631)</u>	<u>(12,319)</u>

Note 20. Capital commitments

As at 31 December 2017 the Company had committed to but not contracted capital expenditure of £33,470,000 (2016: £90,754,000).

Total future minimum lease payments under non-cancellable operating leases are as follows:

	2017 £000	2016 £000
Operating lease which expires on 30 November 2025		
<i>Office rental:</i>		
- within one year	156	156
- between one and five years	808	808
- after five years	589	791
Total	<u>1,553</u>	<u>1,755</u>

In 2017, the Company has expensed operating lease costs of £170,782 (2016: £141,362).

Note 21. Pension schemes

The Company participates in a defined contribution pension scheme operated by ITOCHU Europe PLC. The contributions for the year were £123,503 (2016: £121,953). There were no contributions outstanding or prepaid at the balance sheet date.

CIECO Exploration and Production (UK) Limited

Note 22. Ultimate parent company and parent undertaking of largest group of which the Company is a member

The immediate and ultimate parent and controlling entity for which company financial statements are drawn up, and of which this company is a member, is ITOCHU Corporation, 5-1, Kita-Aoyama 2-chome, Minato-ku, Tokyo, 107-8077, Japan. Copies of these financial statements can be obtained from the registered office of CIECO Exploration and Production (UK) Limited.

The smallest and largest group in which the results of the Company are consolidated is that of ITOCHU Corporation.

ITOCHU Corporation has given a confirmation to the Department of Trade and Industry, dated 9 February 1993, that adequate funds will be made available to the Company to meet its share of costs in respect of the Hutton, North West Hutton and Hudson fields. Similarly, in December 2012, ITOCHU Corporation has given a confirmation to the Secretary of State for the Western Isles project.

CIECO Exploration and Production (UK) Limited

Oil and gas reserve statistics (Unaudited)

The net proven and probable oil and gas reserves to which the Company has an equity entitlement are:

	United Kingdom Crude oil Mmboe
Balance at 1 January 2017	12.024
Revisions to previous estimates	(0.430)
Production	(0.265)
Net proven and probable reserves as at 31 December 2017	<u>11.329</u>

Notes: 1) Crude oil includes natural gas liquids; and

2) Mmboe means million barrels of oil equivalent.