

**HKN ENERGY LTD.**

Financial Statements

December 31, 2022 and 2021

(With Independent Auditors' Report Thereon)



KPMG LLP  
Suite 1400  
2323 Ross Avenue  
Dallas, TX 75201-2721

## **Independent Auditors' Report**

Board of Directors  
HKN Energy Ltd.:

### **Report on the Audit of the Financial Statements**

#### *Opinion*

We have audited the financial statements of HKN Energy Ltd. (the Company), which comprise the statements of financial position as of December 31, 2022 and 2021, and the related statements of comprehensive income, changes in equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

#### *Basis for Opinion*

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### *Responsibilities of Management for the Financial Statements*

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS as issued by the IASB, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise significant doubt about the Company's ability to continue as a going concern for one year after the date that the financial statements are authorized for issuance.

#### *Auditors' 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 auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.



In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise significant doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

*KPMG LLP*

Dallas, Texas  
March 29, 2023

# HKN ENERGY LTD.

## Statements of Financial Position

December 31, 2022 and 2021

*In thousands of US dollar*

	Note	December 31, 2022	December 31, 2021
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property and equipment - oil properties (net)	6	467,842	435,228
Other property and equipment (net)	7	4,186	4,017
<b>Total non-current assets</b>		<b>472,028</b>	<b>439,245</b>
<b>Current assets</b>			
Inventory	8	19,069	9,505
Prepaid expenses		844	615
Trade and other receivables	9	182,414	137,108
Affiliate receivables	19	366	122
Short-term investments	10	6,667	-
Cash and cash equivalents	11	111,193	177,628
Restricted cash	11	10,549	7,163
<b>Total current assets</b>		<b>331,102</b>	<b>332,141</b>
<b>TOTAL ASSETS</b>		<b>803,130</b>	<b>771,386</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity</b>			
Share capital		1	1
Additional paid-in capital		539,937	539,937
Retained earnings		35,478	12,678
<b>Total equity</b>		<b>575,416</b>	<b>552,616</b>
<b>Non-current liabilities</b>			
Debt (net of issuance costs and fees)	14	137,166	143,362
Lease liabilities	15	131	416
Decommissioning provisions	16	15,225	8,939
<b>Total non-current liabilities</b>		<b>152,522</b>	<b>152,717</b>
<b>Current liabilities</b>			
Trade and other payables	13	67,906	62,284
Debt	14	7,000	3,500
Lease liabilities	15	286	269
<b>Total current liabilities</b>		<b>75,192</b>	<b>66,053</b>
<b>Total liabilities</b>		<b>227,714</b>	<b>218,770</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>803,130</b>	<b>771,386</b>

See accompanying Notes to the Financial Statements

# HKN ENERGY LTD.

## Statements of Comprehensive Income

Years ended December 31, 2022 and 2021

*In thousands of US dollar*

	Note	2022	2021
<b>Continuing operations</b>			
Revenue	3	414,001	271,869
Operating expenses		57,165	33,248
Oil transportation expenses		9,180	6,566
Depletion, depreciation and amortization		90,986	63,612
Cost of sales	4	157,331	103,426
Impairment of trade receivables	9	9,559	-
<b>Gross profit</b>		<b>247,111</b>	<b>168,443</b>
General and administrative expenses	5	19,494	16,345
<b>Profit from operating activities</b>		<b>227,617</b>	<b>152,098</b>
Finance income	14	1,988	34
Finance expenses	14	(13,970)	(13,811)
Other expense		(100)	(79)
<b>Total profit</b>		<b>215,535</b>	<b>138,242</b>
<b>Other comprehensive expense</b>			
Unrealized gain on short-term investments	10	15	-
<b>Total comprehensive income</b>		<b>215,550</b>	<b>138,242</b>

See accompanying Notes to the Financial Statements

**HKN ENERGY LTD.**

Cash Flow Statements

Years ended December 31, 2022 and 2021

*In thousands of US dollar*

	<b>Note</b>	<b>2022</b>	<b>2021</b>
<b>OPERATING ACTIVITIES</b>			
Profit		215,535	138,242
<b>Adjustments to add non-cash items:</b>			
Depreciation, depletion and amortization	<b>6, 7, 16</b>	90,986	63,612
Finance income and expenses	<b>14</b>	11,982	13,777
Impairment of trade receivables	<b>9</b>	9,559	-
<b>Changes in working capital and provisions:</b>			
Trade and other receivables	<b>9</b>	(57,562)	(50,189)
Affiliate receivables	<b>19</b>	(244)	(47)
Prepaid expenses		(229)	(257)
Trade and other payables	<b>13</b>	6,652	15,538
<b>Cash from operating activities</b>		<b>276,679</b>	<b>180,676</b>
Interest received	<b>14</b>	1,910	32
Interest paid	<b>14</b>	(14,347)	(14,226)
<b>Net cash from operating activities</b>		<b>264,242</b>	<b>166,482</b>
 <b>INVESTING ACTIVITIES</b>			
Payments for property and equipment	<b>6, 7, 8</b>	(123,887)	(79,770)
Purchases of short-term investments	<b>10</b>	(117,680)	-
<b>Net cash used in investing activities</b>		<b>(241,567)</b>	<b>(79,770)</b>
 <b>FINANCING ACTIVITIES</b>			
Proceeds from debt, net of fees	<b>14</b>	-	11,500
Repayments of debt	<b>14</b>	(3,500)	-
Payments of lease liabilities	<b>15</b>	(295)	(3,258)
Shareholders' distributions	<b>12</b>	(81,929)	(261)
<b>Net cash from (used in) financing activities</b>		<b>(85,724)</b>	<b>7,981</b>
 <b>Net increase (decrease) in cash and cash equivalents, and restricted cash</b>		<b>(63,049)</b>	<b>94,693</b>
Cash and cash equivalents, and restricted cash at beginning of the period		184,791	90,098
<b>Cash and cash equivalents, and restricted cash at end of the period</b>	<b>11</b>	<b>121,742</b>	<b>184,791</b>
 Restricted cash	<b>11</b>	10,549	7,163
 Noncash capital expenditures in liabilities at period end		14,372	12,597
 See accompanying Notes to the Financial Statements			

# **HKN ENERGY LTD.**

## Statements of Changes in Equity

Years ended December 31, 2022 and 2021

*In thousands of US dollar*

	Note	Share capital	Additional paid-in capital	Retained earnings (accumulated deficit)	Total equity
<b>Total equity as of January 1, 2021</b>		<b>1</b>	<b>540,198</b>	<b>(125,564)</b>	<b>414,635</b>
Shareholders' distributions		-	(261)	-	(261)
Profit for the period allocated to Class A shareholder	12	-	-	93,654	<b>93,654</b>
Profit for the period allocated to Class B shareholder	12	-	-	44,588	<b>44,588</b>
<b>Total comprehensive income</b>		<b>-</b>	<b>-</b>	<b>138,242</b>	<b>138,242</b>
<b>Total equity as of December 31, 2021</b>		<b>1</b>	<b>539,937</b>	<b>12,678</b>	<b>552,616</b>
<b>Total equity as of January 1, 2022</b>		<b>1</b>	<b>539,937</b>	<b>12,678</b>	<b>552,616</b>
Shareholders' distributions	12	-	-	(192,750)	<b>(192,750)</b>
Profit for the period allocated to Class A shareholder	12	-	-	146,009	<b>146,009</b>
Profit for the period allocated to Class B shareholder	12	-	-	69,526	<b>69,526</b>
Unrealized gain on short-term investments	10	-	-	15	<b>15</b>
<b>Total comprehensive income</b>		<b>-</b>	<b>-</b>	<b>215,550</b>	<b>215,550</b>
<b>Total equity as of December 31, 2022</b>		<b>1</b>	<b>539,937</b>	<b>35,478</b>	<b>575,416</b>

At December 31, 2022 and 2021 there were 5,000,000 common shares authorized at a \$0.01 par value, with 33,250 Class A shares and 15,830 Class B shares issued and outstanding. As of December 31, 2022 and 2021, the Company held no treasury shares.

See accompanying Notes to the Financial Statements

## HKN ENERGY LTD.

### Notes to Financial Statements

December 31, 2022 and 2021

#### (1) Nature of Operations

HKN Energy Ltd. (HKN Energy or the Company) is incorporated in the Cayman Islands. The registered office is at 133 Elgin Avenue, George Town, Grand Cayman. The principal activity of the Company is the exploration, development, and production of oil in the Kurdistan Region of Iraq ("Kurdistan"). HKN Energy's parent entities are HKN Energy III Ltd. (owner of Class A Shares) and HKN Energy II Ltd. (owner of Class B Shares). The parent entity of HKN Energy III Ltd. and HKN Energy II Ltd. is HKN Holding II (UK) Ltd. HKN Energy's ultimate parent is HKN Energy II, LP.

In November 2007, HKN Energy entered into a Production Sharing Contract (PSC) with the Kurdistan Regional Government (KRG) for the Sarsang block in northern Kurdistan. A joint operating agreement (JOA) between HKN Energy and Shamaran Sarsang A/S (Shamaran) governs joint operations in the Sarsang block. Under the Sarsang PSC, HKN Energy and Shamaran (together, the Contractor entities) bear the risks and costs of exploration, development, and production activities at their respective working interest percentages. HKN Energy has a working and production sharing interest (PSC interest) of 77.5% and 62%, respectively, and Shamaran has a working and PSC interest of 22.5% and 18%, respectively. The remaining 20% of the production sharing interest per the PSC is retained by the KRG. Proceeds from the sale of crude oil is distributed among the contractor entities and the KRG as follows:

- (a) The KRG is entitled to royalties of 10% of production from the Contract Area, in cash or in kind. The remaining production is referred to as available crude oil or available gas,
- (b) Each contractor entity is entitled to recover costs incurred in the conduct of petroleum operations in the amount of their working interest applied to 43% of all available production,
- (c) Each contractor entity's share of remaining petroleum revenues (profit petroleum) is equal to the amount of their PSC interest applied to a range of 15% to 35%, based upon an "R" factor where "R" equals cumulative revenues divided by cumulative costs,
- (d) Each contractor entity is required to pay 20% of their profit petroleum entitlement to the KRG as a capacity building fund payment.

The Company's revenue entitlement percentage of Sarsang block crude oil sales proceeds for the years ended December 31, 2022 and 2021 was 38.9%.

The Company faces specific risks related to doing business in Kurdistan as a result of the historical, legal, and financial position of the KRG and its relationships with the Federal Government of Iraq and other neighboring countries. These include, but are not limited to, the following risks and uncertainties.

- In 2012, the then Federal Minister of Oil (MoO) filed suit against the KRG, claiming the KRG's Oil and Gas Law is unconstitutional. The Iraq Federal Supreme Court (FSC) handed down a majority judgment on February 15, 2022 that purported to deem the oil and gas law regulating the oil industry in Kurdistan unconstitutional. The Company was not a party to that court action. Following the FSC ruling, the KRG issued a statement stating that the ruling was 'unjust, unconstitutional, and violates the rights and constitutional authorities of the Kurdistan Region', also stating that it 'will take all constitutional, legal, and judicial measures to protect and preserve all contracts made in the oil and gas sector.' The Company also notes reports of decisions made in absentia on July 4, 2022 in the Baghdad Commercial Court against the Company and several International Oil and Gas companies (IOCs) operating in Kurdistan. Any such decision was made without the Company having formal legal representation. Despite the reported July 4 decisions, the Company has not been formally notified or served with any judgment – a requirement under Iraqi law. Without being served or formally notified of any judgment, the Company has no comment on the contents of any



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### Notes to Financial Statements

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purported judgment. The PSC that the Company is a party to was signed with the KRG and is governed by English law with an arbitration provision calling for any dispute regarding the validity of the PSC to be heard before a panel of arbitrators governed by the London Court of International Arbitration. The Company continues to monitor the situation closely. Although the Company has not experienced any operational impacts as a result of this ruling to date, the Company cannot currently estimate the potential implications, if any, of the FSC ruling but it could materially impact future operations and financial results.

- There has been a historical precedent of delinquent payments made to oil and gas producers in the region from the KRG. See further discussion on collectability of these receivables in note 20.

## (2) Summary of Significant Accounting Policies

### (a) *Statement of Compliance*

The financial statements for the years ended December 31, 2022 and 2021 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the International Accounting Standards Board ("IASB"). The financial statements were authorized for issuance by management on March 29, 2023.

### (b) *Basis of Accounting*

The financial statements have been prepared under the historical cost basis, with the exception of derivatives which are recognized at fair value on a recurring basis. The principal accounting policies adopted are set out below.

### (c) *Going Concern*

The Company regularly evaluates its financial position, cash flow forecasts and its compliance with financial covenants through financial modeling and assessing the model outputs from multiple scenarios with different oil price, production, expenditure and cash receipt variables. The Company has unrestricted cash balances totaling \$111.2 million at December 31, 2022 and is significantly above the minimum requirements of debt holders with regard to equity ratio and minimum liquidity covenant. The Company's financial forecasts and models incorporating downside cases with regard to oil prices and cash receipts show sufficient financial resources to continue as a Going Concern for the foreseeable future.

### (d) *Joint Arrangements*

The Company is engaged in oil exploration, development and production through an unincorporated joint arrangement, which is classified as a joint operation in accordance with IFRS 11 *Joint Arrangements*. In its financial statements, the Company accounts for its share of the related revenues in accordance with the distribution of oil sales proceeds required under the Sarsang PSC (see note 1). The Company accounts for its share of the expenses, assets and liabilities based on its working interest, which reflects the Company's contractual rights under the arrangement. In addition, where the Company acts as operator to the joint operation, the gross liabilities and receivables (including amounts due to or from non-operating partner) of the joint operation have historically been included in the Company's statement of financial position (see notes 9 and 13). However as of September 2022, the Company is no longer marketing crude oil on behalf of the co-venturer, and therefore, is no longer carrying the co-venturer's receivables and revenues payable in the Company's statement of financial position.

## **HKN ENERGY LTD.**

### **Notes to Financial Statements**

December 31, 2022 and 2021

#### **(e) Use of Judgments and Estimates**

In preparing these financial statements, management has made judgments and estimates that affect the application of the Company's accounting policies and the reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

##### **(i) Judgments**

The following are the critical judgments, apart from those involving estimations (which are presented separately below), that management has made that have the most significant effect on the amounts recognized in the financial statements.

##### **Revenue Recognition**

The recognition of revenue is considered to be a key accounting judgment. In order for a contract to exist and be in the scope of IFRS 15, it has to be probable that the Company will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. The assessment of whether collection of consideration from the KRG is probable is based on management's evaluation of the reliability of the KRG's payments to the IOCs operating in Kurdistan.

See further information regarding revenue recognition in note 2(g).

##### **(ii) Assumptions and Estimation Uncertainties**

Information about assumptions and estimation uncertainties at December 31, 2022 and 2021 that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the next financial year is included in the following areas:

##### **Impairment of oil properties**

In line with the Company's accounting policy on impairment (see note 2(j)), management performs an impairment indicator evaluation at the end of each reporting period. If external or internal indicators of impairment are identified, management performs an impairment review of the Company's oil properties. The key assumptions used in the impairment review are subject to change based on market trends and economic conditions.

The Company's sole cash generating unit at December 31, 2022 and 2021 was the Sarsang block with a carrying value of \$467.8 million and \$435.2 million, respectively. The Company performed an impairment indicator evaluation as of December 31, 2022 and 2021 considering relevant factors such as global oil prices, expected future production, and potential changes to future development plans. The potential impact of such factors together with other possible changes to key assumptions and available mitigating actions showed that no impairment indicators arose for these reporting periods.

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### **Notes to Financial Statements**

December 31, 2022 and 2021

#### **(f) Foreign Currencies**

For the purpose of the financial statements, the results and the financial position of the Company are expressed in US dollar, which is the functional currency of the Company, and the presentation currency for the financial statements.

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the dates of the transactions. At each statement of financial position date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the statement of financial position date. Gains and losses arising on retranslation are included in the statement of comprehensive income for the year.

#### **(g) Revenue Recognition**

IFRS 15 applies to all revenue arising from contracts with customers, unless those contracts are in the scope of other standards. The standard establishes a five-step model to account for revenue arising from contracts with customers. A contract exists and is in the scope of IFRS 15 when the contract is legally enforceable and certain criteria, including collectability, are met. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The standard requires entities to exercise judgment, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract.

As disclosed in note 2(e)(i), management assesses whether collection of the consideration that the Company expects to be entitled to is probable based on its evaluation of the reliability of the KRG's payments to the IOCs operating in Kurdistan. The Company recognizes revenue according to the sales method, which is based on the volumes sold at the delivery point agreed to in the sales contract with the KRG.

Under the Sarsang PSC, the contractors' entitlement of crude oil is sold entirely to the KRG at the delivery point agreed to in the sales contract. The transaction price is defined per the contract and the consideration for deliveries in a given month is specifically allocated to the delivery of crude oil in that month. The Company recognizes revenue at the delivery point, when the KRG obtains control of the product, and its performance obligation is satisfied.

The Company records revenue in the month production is delivered to the KRG based upon actual production deliveries and known pricing. As such, for the years ended December 31, 2022 and 2021, there was no revenue recognized in the reporting period related to performance obligations satisfied in prior reporting periods.

Performance obligations under the Company's contract are typically satisfied at a point-in-time through delivery of each unit (barrel) of oil. Once performance obligations have been satisfied, payment is considered unconditional. Accordingly, the Company's contracts do not give rise to contract assets or liabilities. There is no significant financing component to the Company's revenue contract.

#### **(h) Property and Equipment – Oil Properties**

The Company follows the successful efforts method of accounting for exploration and evaluation ("E&E") costs. The Company transferred all E&E costs associated with successful discovery of commercial reserves to Property and Equipment – Oil Properties upon entering the development phase

## **HKN ENERGY LTD.**

### **Notes to Financial Statements**

December 31, 2022 and 2021

of the Sarsang PSC in 2014. As of December 31, 2022 and for all periods presented, the Company's oil properties are in the development phase.

All costs associated with the development of oil fields are capitalized and included in Property and equipment – oil properties on the accompanying statements of financial position. For accounting purposes, an oil field is considered to enter the development phase when the technical feasibility and commercial viability of extracting oil from the field are demonstrable. Property is recognized at historical cost and adjusted for accumulated depletion and impairment charges. The carrying amount of oil properties as stated in the accompanying statements of financial position represents the cost less accumulated depletion and impairment charges.

Development and production assets represent the cost of developing commercial reserves discovered and bringing them into production, together with the E&E expenditures incurred in finding commercial reserves transferred from intangible E&E assets as outlined above.

#### **Geological and Geophysical Costs**

All geological and geophysical expenses were capitalized within Oil Properties during 2022 and 2021, as the Company was in the development phase of the Sarsang PSC.

#### **Capitalized Interest**

The Company capitalizes interest expense related to debt incurred to finance the construction of qualifying assets. A qualifying asset is an asset that takes more than one year to be ready for its intended use. The Company uses a weighted average interest rate (annual interest expense on debt divided by total principal balance) to determine the amount of interest to be capitalized.

#### **Depletion of Oil Properties**

Producing assets are depleted generally on a PSC-wide basis using the unit-of-production basis of accounting which uses the ratio of oil production in the period to the remaining commercial reserves plus the production in the period. Under the unit of production method, depletion of oil producing assets commences upon initial commercial production. Costs used in the calculation comprise the carrying value of the field, and any further anticipated costs to develop such reserves.

Commercial reserves are proven ("1P") reserves.

#### ***(i) Other Property and Equipment***

Other property and equipment, which consist of containers, automobiles, leasehold improvements, office furniture, and other equipment not associated with the exploration, development, and production of oil reserves, are recognized at cost and depreciated on a straight line basis over the estimated useful lives. The carrying amount of other property and equipment as stated in the accompanying statements of financial position represents the cost less accumulated depreciation charges and any accumulated impairment losses.

The estimated useful lives are as follows:

## HKN ENERGY LTD.

### Notes to Financial Statements

December 31, 2022 and 2021

Containers	7 Years
Automobiles	5 Years
Leasehold improvements	1-6 Years
Office furniture	5 Years
Other equipment	3-5 Years

Gain or loss arising from the derecognition of other property and equipment is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item and recognized in other operating income/expenses in the statement of comprehensive income.

#### **(j) Impairment of Non-Financial Assets**

The carrying amounts of the Company's oil assets and other property and equipment are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The recoverable amount of an asset or cash generating unit is the greater of its value in use and its fair value less costs of disposal. For value in use, the estimated future cash flows arising from the Company's future plans for the asset are discounted to their present value using a pre-tax discount rate that reflects market assessments of the time value of money and the risks specific to the asset. For fair value less costs of disposal, an estimation is made of the fair value of consideration that would be received to sell an asset less associated selling costs.

Assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (cash generating unit). The Company has one cash generating unit (the Sarsang block as a whole), therefore has one asset grouping for impairment purposes.

The estimated recoverable amount is then compared to the carrying value of the asset. Where the estimated recoverable amount is lower than the carrying value of the asset, an impairment loss is recognized. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

#### **(k) Inventory**

Inventory consists of amounts paid toward ownership of well equipment, parts, and supplies, which the Company plans to use in its ongoing exploration and development activities in Kurdistan and which are carried at the lower of cost and realizable value.

#### **(l) Financial Instruments**

IFRS 9 sets out requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

Financial assets and liabilities are recognized on the Company's statement of financial position when the Company becomes a party to the contractual provisions of the instruments.

##### **(i) Cash and cash equivalents, and restricted cash**

Cash and cash equivalents includes cash in hand, deposits held on call with banks, other short-term highly liquid investments including US Treasury bills with maturities of 3 months or less and the Company's share of cash held in joint operations. Restricted cash represents cash balances held in debt service reserve accounts pursuant to the Company's debt agreements (see note 14).

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### **Notes to Financial Statements**

December 31, 2022 and 2021

#### ***(ii) Trade and other receivables***

The majority of trade and other receivables are due from the KRG, the Company's purchaser of oil, and from co-venturers, both of which are recorded at invoiced amounts and do not bear interest. Trade and other receivables are subsequently measured at amortized cost, less any impairment.

The Company recognizes loss allowances for expected credit losses ("ECLs") on financial assets measured at amortized cost. For accounts receivable, the Company applies a simplified approach in calculating ECLs and recognizes a loss allowance based on lifetime ECLs at each reporting date. The carrying amount of these assets in the statements of financial position is stated net of any loss allowance.

The Company considers that the carrying amount of trade receivables approximates their fair value.

#### ***(iii) Short Term Investments***

Short-term investments are measured at fair value through other comprehensive income. These investments include US Treasury bills and notes with maturities greater than 3 months but within one year from the date of purchase.

#### ***(iv) Trade and other payables***

Trade and other payables are recognized initially at fair value and subsequently measured at amortized cost. The Company considers that the carrying amount of trade payables approximates their fair value.

#### ***(v) Interest-bearing liabilities***

All interest-bearing liabilities are recognized initially at fair value, net of any discount in issuance and transaction costs incurred. Liabilities are subsequently carried at amortized cost. Fees paid on the establishment of loan facilities are recognized as debt issuance costs when the draw-down of the loan occurs. Any difference between the proceeds (net of debt issuance costs) and the redemption value is recognized as interest expense (finance costs) in the statement of comprehensive income using the effective interest method.

#### ***(vi) Derivative financial instruments***

The Company from time to time enters into derivative financial instruments in order to manage its exposure to oil price risk. Derivatives are initially measured at fair value. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are generally recognized in profit or loss. These instruments have not been designated as hedging instruments.

The Company did not have any derivatives for the years ended December 31, 2022 and 2021.

#### ***(vii) Offsetting***

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and

## **HKN ENERGY LTD.**

### **Notes to Financial Statements**

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there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

#### **(m) Fair Value Measurements**

A number of the Company's accounting policies and disclosures require the measurement of fair values, for both financial and non-financial assets and liabilities.

When measuring the fair value of an asset or a liability, the Company uses observable market data as far as possible. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows.

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability fall into different levels of the fair value hierarchy, then the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Company recognizes transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

#### **(n) Provisions**

Provisions are recognized when the Company has a present obligation as a result of a past event, and it is probable that the Company will be required to settle that obligation. Provisions are measured at the Company's best estimate of the expenditure required to settle the obligation at the statement of financial position date and are discounted to present value where the effect is material. At December 31, 2022 and 2021, the Company had only made provision for decommissioning costs.

#### **Decommissioning**

Provision is made for the cost of decommissioning assets at the time when the obligation to decommission arises. Such provision represents the estimated discounted liability for costs which are expected to be incurred in removing production facilities and site restoration at the end of the producing life of each field. A corresponding cost is capitalized to oil properties and subsequently depreciated as part of the capital costs of the production facilities. Any change in the present value of the estimated expenditure attributable to changes in the estimates of the cash flow or the current estimate of the discount rate used are reflected as an adjustment to the provision. The accretion of the discounted liability is included in Depletion, Depreciation and Amortization within Cost of Sales in the statement of comprehensive income.

Decommissioning provisions are recognized at the present value of expected future cash flows, discounted using a pre-tax discount rate. The discount rate is updated at each statement of financial position date, if necessary, and reflects the risks inherent in the asset.

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#### **(o) Leases**

IFRS 16 outlines the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-statement of financial position model. Upon commencement of a lease, the lessee recognizes a liability to make lease payments and an asset representing the right to use the underlying asset during the lease term (right-of-use asset or RoU asset). Lessees are required to separately recognize interest expense on the lease liability and depreciation expense on the RoU asset.

The RoU asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received.

The RoU asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term, unless the lease transfers ownership of the underlying asset to the Company by the end of the lease term or the cost of the right-of-use asset reflects that the Company will exercise a purchase option. In that case the right-of-use asset will be depreciated over the useful life of the underlying asset, which is determined on the same basis as those of property and equipment.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if the rate cannot be readily determined, the Company's incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate.

The lease liability is subsequently measured at amortized cost by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made. It is remeasured when there is a change in future lease payments arising from a change in an index rate, or if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee, if the Company changes its assessment of whether it will exercise a purchase, extension or termination option or if there is a revised in-substance fixed lease payment.

The Company has elected not to recognize right-of-use assets and lease liabilities for short-term leases or low value items, and instead recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

As of December 31, 2022, the Company's accompanying statement of financial position includes RoU assets, net of accumulated depreciation, of \$8.8 million (\$10.5 million assets net of \$2.1 million depreciation included in oil properties and \$1.3 million assets net of \$0.9 million depreciation included in other property and equipment) and lease liabilities of \$0.4 million (\$0.3 million current and \$0.1 million non-current). As of December 31, 2021, the Company's accompanying statement of financial position includes RoU assets, net of accumulated depreciation, of \$9.5 million (\$10.5 million assets net of \$1.5 million depreciation included in oil properties and \$1.2 million assets net of \$0.7 million depreciation included in other property and equipment) and lease liabilities of \$0.7 million (\$0.3 million current and \$0.4 million non-current).

#### **(p) Taxes**

The income tax basis results of realized operations of the Company are included in the United States federal income tax returns of the individual shareholders. Due to the nature of the Company's activities



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and its organization as a Cayman company limited by shares, state income taxes are generally not imposed on the Company. As such, no provision or credit for federal or state income taxes is recorded in the accompanying financial statements. The Company's tax returns and the amount of allocable income or loss are subject to examination by United States taxing authorities.

The Company files an annual tax return with the KRG that has resulted in no tax liability owed to the KRG through the date of this report.

Under the terms of the Sarsang PSC, payment of any corporate income tax assessed in Kurdistan is to be paid by the KRG for the account of the Company and its co-venturer from the KRG's share of profit petroleum.

#### **(q) Standards Issued but Not Applicable or Not Yet Effective**

The following new and amended standards are effective for annual periods beginning on 1 January 2022 and earlier application is permitted; however, the Company has not adopted the new or amended standards in preparing these financial statements as they are not applicable for 2021 or 2022.

- COVID-19-Related Rent Concessions (Amendment to IFRS 16)
- Onerous contracts – Cost of Fulfilling a Contract (Amendments to IAS 37)
- Reference to Conceptual Framework (Amendments to IFRS 3)
- Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16)
- Annual Improvements to IFRS Standards 2018–2020 Cycle (Amendments to IFRS 1, IFRS 9, IAS 16 and IFRS 41)

The following new and amended standards are effective for annual periods beginning after 1 January 2023 and earlier application is permitted; however, the Company has not early adopted the new or amended standards in preparing these financial statements, as the Company does not expect them to have a significant impact on the Company's financial statements or does not expect them to be applicable to the Company when they become effective.

- IFRS 17 Insurance Contracts and amendments to IFRS 17 Insurance Contracts
- Disclosure of Accounting Policies (Amendments to IAS 1)
- Definition of Accounting Estimates (Amendments to IAS 8)
- Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)
- Classification of Liabilities as Current or Non-current (Amendments to IAS 1)

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**(3) Revenue**

<i>In thousands of US dollar</i>	<b>2022</b>	<b>2021</b>
<b>Revenue</b>		
Oil sales.....	414,001	271,869
	<b>414,001</b>	<b>271,869</b>

The company sells 100% of its production volumes to the KRG. The KRG currently controls all marketing and crude exports from Kurdistan.

**(4) Cost of Sales**

<i>In thousands of US dollar</i>	<b>2022</b>	<b>2021</b>
<b>Cost of Sales</b>		
Operating expenses.....	(41,665)	(33,248)
Production bonus.....	(15,500)	-
Total operating expenses.....	(57,165)	(33,248)
Depletion, depreciation and amortization.....	(90,986)	(63,612)
Transportation costs.....	(9,180)	(6,566)
	<b>(157,331)</b>	<b>(103,426)</b>

Operating expenses include expenses related to the production of oil including operating and maintenance of facilities and well intervention activities.

Production bonus expense of \$15.5 million, included in operating expenses, represents the Company's working interest share of a \$20 million Contractor obligation owed to the KRG in 2022 in accordance with the PSC. The corresponding \$20 million payable is recorded as a PSC obligation within trade and other payables on the accompanying consolidated statements of financial position. The co-venturer's \$4.5 million share is recorded as a receivable from co-venturer within trade and other receivables on the accompanying consolidated statements of financial position.

Depletion, depreciation and amortization includes unit of production depletion of oil properties (see note 2(h)), straight-line depreciation of other property and equipment (see note 2(i)), accretion expense on decommissioning provision (see note 2(n)), and depreciation of RoU assets recognized under IFRS 16 *Leases* (see note 2(o)).

Transportation costs include trucking and unloading expenses related to delivery of the Company's proportionate share of entitled oil production to the sales location and is incurred prior to the delivery point.

# HKN ENERGY LTD.

## Notes to Financial Statements

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### (5) General and Administrative Expenses

<i>In thousands of US dollar</i>	<b>2022</b>	<b>2021</b>
<b>General and administrative expenses</b>		
Personnel costs.....	(10,947)	(9,041)
Legal and consulting.....	(3,091)	(2,346)
Office and apartment rent, security and supplies.....	(3,829)	(3,241)
Travel costs.....	(787)	(506)
Other general and administrative.....	(840)	(1,211)
	<b>(19,494)</b>	<b>(16,345)</b>

Personnel costs of \$10.9 million and \$9.0 million in 2022 and 2021, respectively, include salaries, bonuses, employer's payroll tax expenses, deferred compensation, and other miscellaneous costs.

### (6) Property and Equipment – Oil Properties

<i>In thousands of US dollar</i>	<b>December 31, 2022</b>	<b>December 31, 2021</b>
<b>Oil assets</b>		
Balance at January 1.....	659,265	563,584
Additions.....	114,436	92,423
RoU asset additions/remeasurements.....	-	(504)
Capitalized interest.....	1,385	1,407
Decommissioning provision.....	5,812	2,355
Balance at December 31.....	<b>780,898</b>	<b>659,265</b>
<b>Accumulated depletion and impairment</b>		
Balance at January 1.....	(224,037)	(162,109)
Depletion charge.....	(88,522)	(61,415)
Depreciation of RoU assets.....	(497)	(513)
Balance at December 31.....	<b>(313,056)</b>	<b>(224,037)</b>
<b>Carrying value - oil assets</b>		
at January 1.....	435,228	401,475
at December 31.....	467,842	435,228

The carrying value of oil assets at December 31, 2022 and 2021 is comprised of property, plant and equipment relating to the Sarsang block and has a carrying value of \$467.8 million and \$435.2 million, respectively.

Oil properties additions during 2022 and 2021 primarily include costs for the drilling, stimulation and completion of wells and the equipment and construction of production facilities.

The Company's oil properties balance as of December 31, 2022 and December 31, 2021 included \$10.5 million of right-of-use ("RoU") assets, which are related to oil production facility leases (see note 15). The RoU assets are depreciated straight-line over the lifetime of their underlying asset.

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During the years ended December 31, 2022 and 2021, \$1.4 million and \$1.4 million, respectively, of interest expense was capitalized within oil properties in relation to debt incurred to finance the construction of PP&E assets (see discussion of accounting policy in note 2(h)). The Company uses a weighted average interest rate (annual interest expense on debt divided by total principal balance) to determine the amount of interest to be capitalized.

For each of the reporting periods presented, the depletion charges and depreciation of RoU assets have been included in Depletion, Depreciation and Amortization within Cost of Sales on the accompanying statements of comprehensive income (see note 4). The carrying values of oil properties are depreciated on a PSC-wide basis using the unit-of-production basis. RoU assets are depreciated on a straight-line basis.

For details of the key assumptions and judgments underlying the impairment assessment, refer to note 2(e) - Use of Judgments and Estimates.

### (7) Other Property and Equipment

<i>In thousands of US dollar</i>	December 31, 2022	December 31, 2021
<b>Acquisition cost</b>		
Balance at January 1.....	10,572	9,666
Additions.....	1,662	906
Balance at December 31.....	<b>12,234</b>	<b>10,572</b>
<b>Accumulated depreciation and impairment</b>		
Balance at January 1.....	(6,555)	(5,139)
Depreciation charge.....	(1,242)	(1,165)
Depreciation of RoU Assets.....	(251)	(251)
Balance at December 31.....	<b>(8,048)</b>	<b>(6,555)</b>
<b>Carrying value</b>		
at January 1.....	4,017	4,527
at December 31.....	4,186	4,017

Additions to Other Property and Equipment include assets such as containers, housing, computers, and other equipment not directly associated with the exploration and development of the Sarsang block. Assets in Other Property and Equipment are depreciated on a straight-line basis.

### (8) Inventory

<i>In thousands of US dollar</i>	December 31, 2022	December 31, 2021
<b>Inventory</b>		
Warehouse stocks and materials.....	19,069	9,505
	<b>19,069</b>	<b>9,505</b>

Inventory consists of amounts paid toward ownership of well equipment, parts, and supplies, which the Company plans to use in its ongoing development activities in the Sarsang Block in Kurdistan and which are carried at recoverable cost. \$9.2 million and \$1.2 million of additions to inventory were included in

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purchases of property and equipment on the accompanying statements of cash flows for the years ended December 31, 2022 and 2021, respectively.

### (9) Trade and Other Receivables

<i>In thousands of US dollar</i>	December 31, 2022	December 31, 2021
<b>Trade and other receivables</b>		
Receivables from oil sales.....	183,835	132,937
Receivables from transportation costs.....	5,995	4,161
Receivables from co-venturer.....	4,827	-
Other receivables.....	91	10
	<b>194,748</b>	<b>137,108</b>
Less impairment allowance.....	(12,334)	-
	<b>182,414</b>	<b>137,108</b>

**Receivables from oil sales:** The majority of accounts receivable are from oil sales to the KRG as purchaser of the Company's oil. Throughout 2021 and until September 2022, the company marketed oil on behalf of its co-venturer, and as such also carried the co-venturer's receivable on the accompanying statements of financial position. A corresponding payable of \$9.5 million and \$29.9 million at December 31, 2022 and 2021, respectively, was recorded in revenues payable within trade and other payables (see note 13). As of September 1, 2022, the Company is no longer marketing oil on behalf of the co-venturer. See note 20 for further discussion regarding oil sales receivables from the KRG.

**Receivables from transportation costs:** The Company incurs transportation and oil unloading expenses to deliver oil produced from its wellsite facilities to the sales location, which is an injection facility linked to the KRG export pipeline. The KRG reimburses the Company for transportation cost proportionate to their entitled production as participant to the PSC.

**Receivables from co-venturer:** The Company's co-venturer is billed monthly for their portion of forecasted capital spending in advance, with amounts due from or owed to the co-venturer from the previous month netted against the current funding request. At December 31, 2022, the amount of receivables due from the Company's co-venturer exceeded the amount of cash advances paid, resulting in a net receivable position of \$4.8 million. At December 31, 2021, the amount of cash advances paid by the Company's co-venturer exceeded the amount of receivables due from the co-venturer, resulting in a net capital spending advance position of \$0.5 million, included within trade and other payables on the accompanying consolidated statements of financial position (see note 13).

**Other receivables:** Other receivables at December 31, 2022 and 2021 consisted primarily of interest receivable on cash invested in money market accounts.

**Impairment allowance:** An impairment allowance of \$12.3 million was recorded at December 31, 2022 to account for receivables from oil sales for which the Company is uncertain if the amounts will be collected from the KRG. See note 20 for further discussion. The Company's share of the allowance amounting to \$9.6 million is recorded as impairment of trade receivables on the accompanying statements of comprehensive income. Revenues payable within trade and other payables on the accompanying consolidated statements of financial position was reduced for the company's co-venturer's share of the allowance.

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All accounts receivable are recorded at invoiced amounts and do not bear interest.

### (10) Short Term Investments

In May 2022, the Company purchased US Treasury bills and notes with maturities within one year from the date of purchase. These securities have been recorded as short-term investments on the accompanying consolidated statements of financial position. In August 2022, the Company distributed \$110.8 million in short-term investments to its shareholders (see note 12). As the Company has distributed a portion of these securities and could distribute the remainder of these securities to shareholders rather than holding to maturity, in accordance with IFRS 9 *Financial Instruments*, the securities have been measured at fair value with the change in fair value presented as unrealized gain on short-term investments within other comprehensive income on the accompanying consolidated statements of comprehensive income.

<i>In thousands of US dollar</i>	December 31, 2022	December 31, 2021
<b>Short-term investments</b>		
Beginning balance.....	-	-
Purchase of 1-year US Treasury securities.....	117,680	-
Distribution of 1-year US Treasury securities.....	(110,821)	-
Realized loss on securities distributed.....	(207)	-
Change in fair value of securities.....	15	-
Balance at period end.....	<b>6,667</b>	-

### (11) Cash and Cash Equivalents and Restricted Cash

<i>In thousands of US dollar</i>	December 31, 2022	December 31, 2021
<b>Cash and cash equivalents</b>		
Cash in bank accounts and on hand.....	637	657
Cash in money market investment account.....	14,770	176,971
Cash equivalents (US Treasury Securities with 3 month maturity).....	95,786	-
	<b>111,193</b>	<b>177,628</b>
<b>Restricted cash</b>		
Restricted cash.....	10,549	7,163
	<b>10,549</b>	<b>7,163</b>

See note 14 for information on the restricted cash balance.

In 2022, the Company purchased US Treasury bills with original maturities of three months or less. These securities had a fair value of \$95.8 million at December 31, 2022, and are included as cash and cash equivalents on the accompanying consolidated statement of financial position. The change in fair value at the end of each reporting period is recorded as finance income or finance expense on the accompanying consolidated statement of comprehensive income.

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#### (12) Equity

During the year ended December 31, 2022, the Company made distributions to its common shareholders in the form of cash and short-term investments of \$81.9 million and \$110.8 million, respectively, for a total of \$192.75 million in distributions. The Company did not receive any cash contributions from its Class A or Class B common shareholders during the year ended December 31, 2022. During the year ended December 31, 2021, the Company made a \$0.3 million cash distribution. The Company did not receive any cash contributions from its Class A or Class B common shareholders during the year ended December 31, 2021.

For the year ended December 31, 2022, net profit attributable to the Company's Class A and B common shareholders was \$146 million and \$69.5 million, respectively. For the year ended December 31, 2021, net profit attributable to the Company's Class A and Class B common shareholders was \$93.7 million and \$44.6 million, respectively.

#### (13) Trade and Other Payables

<i>In thousands of US dollar</i>	<b>December 31, 2022</b>	<b>December 31, 2021</b>
<b>Trade and other payables</b>		
Accounts payable.....	24,761	20,280
Revenues payable to co-venturer.....	9,452	29,911
Capital spending advances to co-venturer.....	-	532
Transportation payable.....	2,598	2,446
<b>Accrued expenses</b>		
Compensation payable.....	6,324	4,828
Accrued interest.....	3,886	3,916
PSC obligations.....	20,399	57
Other accrued expenses.....	486	314
	<b>67,906</b>	<b>62,284</b>

Accounts payable comprise invoices due to suppliers and are normally settled within 30 days. See note 9 for explanation of revenues and transportation payable. Compensation payable consists primarily of bonuses payable, which are settled in the subsequent year. Accrued interest relates to debt payable (see note 14). See note 18 for explanation of PSC obligations. Other accrued expenses primarily include payables to related affiliates for general and administrative services (see note 19).

#### (14) Debt and Finance Income/Expenses

On May 5, 2020, the Company closed on a nine-year loan of \$49 million from the United States International Development Finance Corporation (DFC) in order to finance the development of a 25,000 barrel per day production facility on the Sarsang Block. The loan matures on May 15, 2029. The Company received the first installment payout of \$37.5 million on May 27, 2020. The first installment bears interest at a rate of 6.86% (5.75% stated interest rate plus a 1.11% rate necessary to fund the loan through the marketing of the lender's certificates of participation). The Company received the second and final installment payout of \$11.5 million on January 27, 2021. The second installment bears interest at a rate of 6.55% (5.75% stated interest rate plus a 0.80% rate necessary to fund the loan through the marketing of the lender's certificates of participation).

Per the loan terms, the Company must establish an account and keep it funded up to the Debt Service Reserve Requirement, which equals amounts due on the loan for the immediately succeeding six months. Therefore, the Company had \$5.0 million in a debt service reserve for the loan included as restricted cash

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## Notes to Financial Statements

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on the accompanying statement of financial position at December 31, 2022. Per the loan's financial covenants, the Company must maintain a Reserve Tail Ratio of no less than 20%, a ratio of Current Assets to Current Liabilities of 1:1, and funds or assets on deposit with a market value at least equal to the Debt Service Reserve Requirement (see discussion above). Upon completion of the production facility, the Company must maintain a ratio of Net Cash Flow to Debt Service of not less than 1.4 to 1 for both the most recently completed and the next succeeding four consecutive full fiscal quarters. As of December 31, 2022 and 2021 and during all interim testing periods within the years, the Company was in compliance with all required financial covenants. The Company expects to remain in compliance with all of the loan's required financial covenants for a period of one year from the date the financial statements are authorized to be issued.

On March 6, 2019, the Company closed on a five-year unsecured bond of \$100 million with semi-annual interest payments at a coupon rate of 11%. The bond matures on March 6, 2024. Per the bond terms, the bond should be on a pari passu basis with any additional debt the Company secures. Therefore, as a result of the Company securing the loan discussed above, the Company had \$5.5 million (six months of interest) in a debt service reserve for the bond included as restricted cash on the accompanying statement of financial position at December 31, 2022. Per the bond's financial covenants, the Company must maintain a minimum Equity Ratio of 40%, and a minimum liquidity of 1.5 times the estimated next 12 months interest based on the outstanding debt as of the calculation date. As of December 31, 2022 and 2021 and during all interim testing periods within the years, the Company was in compliance with all required financial covenants. The Company expects to remain in compliance with all of the bond's required financial covenants for a period of one year from the date the financial statements are authorized to be issued.

The net proceeds from the debt instruments have been and will continue to be used to fund ongoing operations of the Company. At December 31, 2022 and 2021, total current and non-current debt, net of debt issuance costs and fees consisted of the following:

<i>In thousands of US dollar</i>	<b>December 31, 2022</b>	<b>December 31, 2021</b>
<b>Debt, net of issuance costs and fees - current</b>		
Debt payable - current.....	7,000	3,500
	<b>7,000</b>	<b>3,500</b>
<b>Debt, net of issuance costs and fees - non-current</b>		
Debt payable - non-current.....	138,500	145,500
Debt issuance fees.....	(2,941)	(2,941)
Debt issuance costs.....	(1,236)	(1,236)
Amortization of debt issuance costs and fees.....	2,843	2,039
	<b>137,166</b>	<b>143,362</b>

The following table provides a summary of the Company's principal payments on debt instruments by year they are due:



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*In thousands of US dollar*

2023	7,000
2024	107,000
2025	7,000
2026	7,000
2027	7,000
Thereafter	10,500
	<b>145,500</b>

At December 31, 2022 and 2021, accrued interest of \$3.9 million was included within Trade and Other Payables on the accompanying statements of financial position (see note 13). For the years ended December 31, 2022 and 2021, finance income and finance expense consisted of the following:

<i>In thousands of US dollar</i>	<b>2022</b>	<b>2021</b>
<b>Finance income</b>		
Interest income from money market account.....	1,368	32
Interest income from US Treasury securities .....	542	-
Change in interest receivable.....	78	2
	<b>1,988</b>	<b>34</b>
<b>Finance expense</b>		
Cash payments for interest.....	(14,347)	(14,226)
Realized loss on short-term investments.....	(207)	-
Change in interest accrual.....	30	(111)
Amortization of debt issuance costs and fees.....	(804)	(809)
Interest expense on leases.....	(27)	(72)
Transfer to capitalized interest.....	1,385	1,407
	<b>(13,970)</b>	<b>(13,811)</b>

**(15) Lease Liabilities**

As of December 31, 2022, current lease liabilities of \$0.3 million and non-current lease liabilities of \$0.1 million are included on the accompanying statement of financial position. These lease liabilities are related to the fixed rent component of office space leases. As of December 31, 2021, current lease liabilities of \$0.3 million and non-current lease liabilities of \$0.4 million are included on the accompanying statement of financial position. These lease liabilities are related to the fixed rent component of office space leases.

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## Notes to Financial Statements

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<i>In thousands of US dollar</i>	<b>2022</b>	<b>2021</b>
<b>Lease liabilities</b>		
Balance at January 1.....	685	4,375
Remeasurement of lease liability.....	-	(504)
Lease payments.....	(295)	(3,258)
Interest expense.....	27	72
Balance at December 31.....	<b>417</b>	<b>685</b>
Current portion (within one year).....	286	269
Non-current portion (two to five years).....	131	416
	<b>417</b>	<b>685</b>

The identified lease liabilities have no significant impact on the Company's financing or debt covenants. The Company does not have any residual value guarantees. Extension options are included in the lease liability when, based on management's judgment, it is reasonably certain that an extension will be exercised. The Company also has short-term apartment and office leases. Some office leases include a variable rent component. Total payments for short-term leases and the variable rent component of office leases were \$0.8 million and \$0.5 million for the years ended December 31, 2022 and 2021, respectively, and were recognized within general and administrative expenses.

<i>In thousands of US dollar</i>	<b>2022</b>	<b>2021</b>
<b>Lease maturity analysis</b>		
Year 1.....	164	-
Year 2.....	253	320
Year 3.....	-	365
Year 4.....	-	-
Year 5.....	-	-
	<b>417</b>	<b>685</b>
<b>Amounts payable under leases</b>		
Within one year.....	299	295
Two to five years.....	135	434
	<b>434</b>	<b>729</b>
Less future interest charges.....	(17)	(44)
Less future remeasurement of lease liability.....	-	-
<b>Net present value of lease obligations</b>	<b>417</b>	<b>685</b>

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## Notes to Financial Statements

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### (16) Decommissioning Provisions

<i>In thousands of US dollar</i>	<b>2022</b>	<b>2021</b>
<b>Decommissioning provisions</b>		
Balance at January 1.....	8,939	6,316
Additions.....	5,812	2,355
Accretion expense.....	474	268
Balance at December 31.....	<b>15,225</b>	<b>8,939</b>

Provision for decommissioning costs is made in full when the Company has an obligation associated with future plugging and abandonment costs on its oil properties. The amount recognized is the present value of the estimated future expenditure. An amount equivalent to the discounted initial provision for decommissioning costs is capitalized and amortized over the life of the underlying asset on a unit of production basis over proven reserves. Any change in the present value of the estimated expenditure is reflected as an adjustment to the provision and the oil asset.

### (17) Financial Instruments – Fair Value and Risk Management

<i>In thousands of US dollar</i>	<b>December 31, 2022</b>	<b>December 31, 2021</b>
<b>Financial assets</b>		
Cash and cash equivalents.....	111,193	177,628
Restricted cash.....	10,549	7,163
Trade and other receivables.....	182,414	137,108
Affiliate receivables.....	366	122
Short-term investments.....	6,667	-
	<b>311,189</b>	<b>322,021</b>
<b>Financial liabilities</b>		
Trade and other payables.....	67,906	62,284
Current and non-current debt - bonds.....	97,293	103,576
Current and non-current debt - loans.....	45,500	49,000
	<b>210,699</b>	<b>214,860</b>

#### Fair values of financial assets and trade and other payables:

The Company considers that the carrying value of its financial assets excluding short-term investments and the carrying value of its trade and other payables approximates their fair values due to the short-term maturity of these instruments. Short-term investments (see note 10) are marked to fair value using quoted prices that are classified as Level 1 in the fair value hierarchy at the end of each reporting period.

#### Fair values of debt:

The Company obtained quoted prices for its \$100 million bond (see note 14), noting that the bond was trading at 97.293 percent of par and 103.576 percent of par at December 31, 2022 and 2021, respectively. Therefore, the fair value of the bond approximated \$97.3 million and \$103.6 million at December 31, 2022 and 2021, respectively. The Company considers the carrying value of its DFC loan (see note 14) to approximate fair value at December 31, 2022 and 2021 as there is no quoted price available for the DFC

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loan. The fair values of the Company's debt are estimated based upon observable inputs that are classified as Level 2 in the fair value hierarchy.

#### **Capital risk management:**

The Company manages its capital to ensure that the entity will be able to continue as a going concern while maximizing the return to shareholders through the optimization of the debt and equity balance. The capital structure of the Company consists of cash, cash equivalents, debt, and equity attributable to equity holders of the Company. Equity comprises issued capital, reserves and accumulated earnings as disclosed in the statement of changes in equity.

#### **Capital structure:**

The Company's management reviews the capital structure on a regular basis and will make adjustments in light of changes in economic conditions. As part of this review, management considers the cost of capital and the risks associated with each class of capital.

#### **Financial risk management objectives:**

The Company's management monitors and manages the financial risks relating to the operations of the Company. These financial risks include market risk (including commodity price, currency and fair value interest rate risk), credit risk, liquidity risk and cash flow interest rate risk.

As of December 31, 2022 and 2021, the Company does not have any derivative financial instruments.

The Company currently has no currency risk or other hedges against financial risks as the benefit of entering into such agreements is not considered to be significant enough to outweigh the significant cost and administrative burden associated with such hedging contracts. The Company does not use derivative financial instruments for speculative purposes.

The risks are closely reviewed by management on a regular basis and steps are taken where necessary to ensure these risks are minimized.

#### **Market risk:**

The Company's activities expose it primarily to the financial risks of changes in oil prices.

The Company's success is dependent on the price of oil, as the price the Company receives for the oil it produces heavily influences the revenue, profitability, cash flow available for capital expenditures, access to capital, and future rate of growth. Oil is a commodity and, therefore, oil prices are subject to wide fluctuations in response to relatively minor changes in supply and demand. Historically, the market for oil has been volatile and will likely continue to be volatile in the future. During 2022 and 2021, the average price of oil was approximately \$101.19 per Bbl and \$70.91 per Bbl, respectively, based on published Dated Brent Crude Oil daily settlement prices.

There have been no changes to the Company's exposure to other market risks or any changes to the manner in which the Company manages and measures the risk. The risks are monitored by management on a regular basis.

The Company conducts and manages its business predominantly in US dollars, the operating currency of the industry in which it operates.

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A small portion of cash balances are held in Iraqi Dinar, the currency of the country in which the Company operates, to meet immediate operating and administrative expenses or to comply with local currency regulations. Additionally, some administrative costs are paid in British Pound. Fluctuations of these currencies do not pose a significant risk to the Company.

At December 31, 2022, a 10% weakening or strengthening of the US dollar against the other currencies in which the Company's monetary assets and monetary liabilities are denominated would not have a material effect on the Company's net current assets or profit before tax.

#### **Interest rate risk management:**

The Company's policy on interest rate management is agreed at the management level and is reviewed on an ongoing basis. The current policy is to maintain a certain amount of funds in the form of cash for short-term liabilities and have the rest on relatively short-term deposits, usually between one and three months, to maximize returns and accessibility.

Based on the exposure to the interest rates for cash and cash equivalents at the statement of financial position date, a 0.5% increase or decrease in interest rates would not have a material impact on the Company's profit for the year or the previous year. A rate of 0.5% is used as it represents management's assessment of a reasonable change in interest rates.

#### **Credit risk management:**

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Company. At December 31, 2022 and 2021, the maximum exposure to credit risk from a trade receivable outstanding from the KRG, the Company's sole customer, was \$177.5 million and \$137.1 million, respectively, representing receivables for oil sales and transportation. Non-payment of receivables by the KRG poses a material risk to the Company.

#### **Liquidity risk management:**

Ultimate responsibility for liquidity risk management rests with the Company's management. It is the Company's policy to finance its business by means of internally generated funds and external capital. In common with many exploration companies, the Company raises finance for its exploration and appraisal activities in discrete tranches to finance its activities for limited periods. The Company seeks to raise further funding as and when required.

### **(18) Commitments and Contingencies**

The Company is not currently a party to any litigation that it believes would have a materially adverse effect on the Group's business, financial condition, results of operations, or liquidity, other than the matter previously described in note 1.

The Company and its co-venturer have certain commitments defined by the PSC that are contingent upon the timing and length of the exploration, development, and production periods. These include Contractor obligations of \$0.3 million due in each year (unpaid amounts are accrued as PSC obligations within trade and other payables) and total aggregate payments of up to \$37.5 million due upon meeting four defined thresholds during the development phase of the PSC, of which \$2.5 million and \$5 million were paid by the Contractor to the KRG in 2014 and 2018, respectively. The third defined production threshold of 25 million barrels of crude oil was met in April 2020, and the required \$10 million was offset against the outstanding oil sales receivables from the KRG (see further discussion in note 20). The Company's working interest share of the \$2.5 million and \$5 million production bonuses paid, as well as the \$10 million production

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bonus offset against receivables, were expensed within operating expenses on the statements of comprehensive income for the periods in which the respective thresholds were reached. The fourth defined production threshold was reached in September 2022 when production from the contract area reached a cumulative amount of 50 million barrels of crude oil. The \$20 million owed by the Contractor to the KRG remains accrued as of December 31, 2022 within trade and other payables in the accompanying statement of financial position (see note 13). The Company's \$15.5 million share of the \$20 million accrued was expensed within operating expenses on the accompanying statement of comprehensive income for 2022 (see note 4). The production bonuses represent an outflow of the Company's resources as an economic benefit to the KRG, rather than as an exchange for a service, and are therefore accounted for in accordance with IFRIC 21 *Levies* which requires that the obligation be recognized on the date at which the production milestone is reached.

In addition, 20% of HKN Energy's profit petroleum is committed to a capacity building fund as set forth in the PSC. This value is retained by the KRG as a portion of its entitled production and is not included in HKN revenues or expenses.

The Company projects to have cash flows sufficient to satisfy the Company's obligations for the twelve months from the date the financial statements were authorized to be issued.

#### (19) Related Party Transactions

On a periodic basis, net amounts due to and from affiliates under common control are settled through cash payments and cash receipts from affiliates. During 2022 and 2021, the Company paid general and administrative expenses of \$1.2 million and \$1.1 million, respectively, to related entities for management and administrative services provided to the Company, and rent. At December 31, 2022 and 2021, there was a net related party receivable outstanding of \$0.4 million and \$0.1 million, respectively, as affiliate receivables on the accompanying statements of financial position.

Key management personnel compensation during 2022 and 2021 comprised the following:

<i>In thousands of US dollar</i>	<b>2022</b>	<b>2021</b>
Short-term employee benefits.....	5,325	4,585
Post-employment benefits.....	126	101
	<b>5,451</b>	<b>4,686</b>

#### (20) Oil Sales Receivables and Offsetting of Liabilities owed to the KRG

In December 2020 and May 2021, the KRG presented plans to the Company detailing how it would pay the overdue November 2019 through February 2020 oil sales invoices, amounting to \$88.5 million of receivables from oil sales and transportation costs (\$68.6 million net to the Company). Under the terms of the plans, certain outstanding liabilities owed by the Company to the KRG were offset against oil sales receivables. The Company was also entitled to supplemental payments on monthly invoices when Dated Brent prices exceeded \$50 per barrel. These amounts were fully collected through supplemental payments and the offsetting of liabilities during 2021 and 2022.

Effective January 2022, the KRG implemented a price adjustment that was not in accordance with the current sales contract in order to account for increased export pipeline tariffs incurred by the KRG. The \$11.7 million shortfall in payments relates to sales originating in 2021 and 2022, as noted within the table below.

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The Company recorded revenue for July and August 2022 with reductions in sales price associated with new tariffs imposed by the KRG in January 2022. However, the Company continued to record an impairment of receivables for amounts associated with certain revenue reducing tariffs amounts that the Company continues to dispute. The \$0.6 million disputed amount for July and August was recorded as an additional impairment of receivables.

<i>In thousands of US dollar</i>	<b>Impairment of Receivables</b>	<b>Impairment Expense</b>
2021	5,112	3,962
January - June 2022	6,569	5,091
July - August 2022	653	506
	<b>12,334</b>	<b>9,559</b>

In September 2022, the Company entered into a new sales contract incorporating a new pricing benchmark. Under the new sales contract, the Company's crude oil sales price is based upon the monthly average price achieved for Kurdistan oil exports marketed by the KRG, adjusted for quality differences between the Kurdistan export blend and Sarsang crude sold to the KRG. The Company began recording revenue in accordance with the new sales contract in September 2022.

The Company continues to receive payments for its outstanding oil sales receivables in the normal course of business, affirming that amortized cost, net of impairments, approximates fair value for its oil sales receivables.

#### **(21) Subsequent Events**

On March 25, 2023, the Company was formally notified that the Iraq-Turkey pipeline was shut in at Turkey's request. This notification follows reports of a favorable ruling for Iraq in its arbitration case against Turkey which dates back to 2014. The Iraq-Turkey pipeline is the export route for the KRG's crude oil exports, which includes the crude oil sold by the Company to the KRG. The Company cannot estimate the financial statement impact of the Iraq-Turkey pipeline shut-in at this time. The Company's crude oil sales are suspended until the pipeline is re-opened or alternative crude oil sales arrangements can be agreed.

The Company has evaluated subsequent events through the date on which the consolidated financial statements were authorized for issuance by management and determined that there are no other items to disclose.