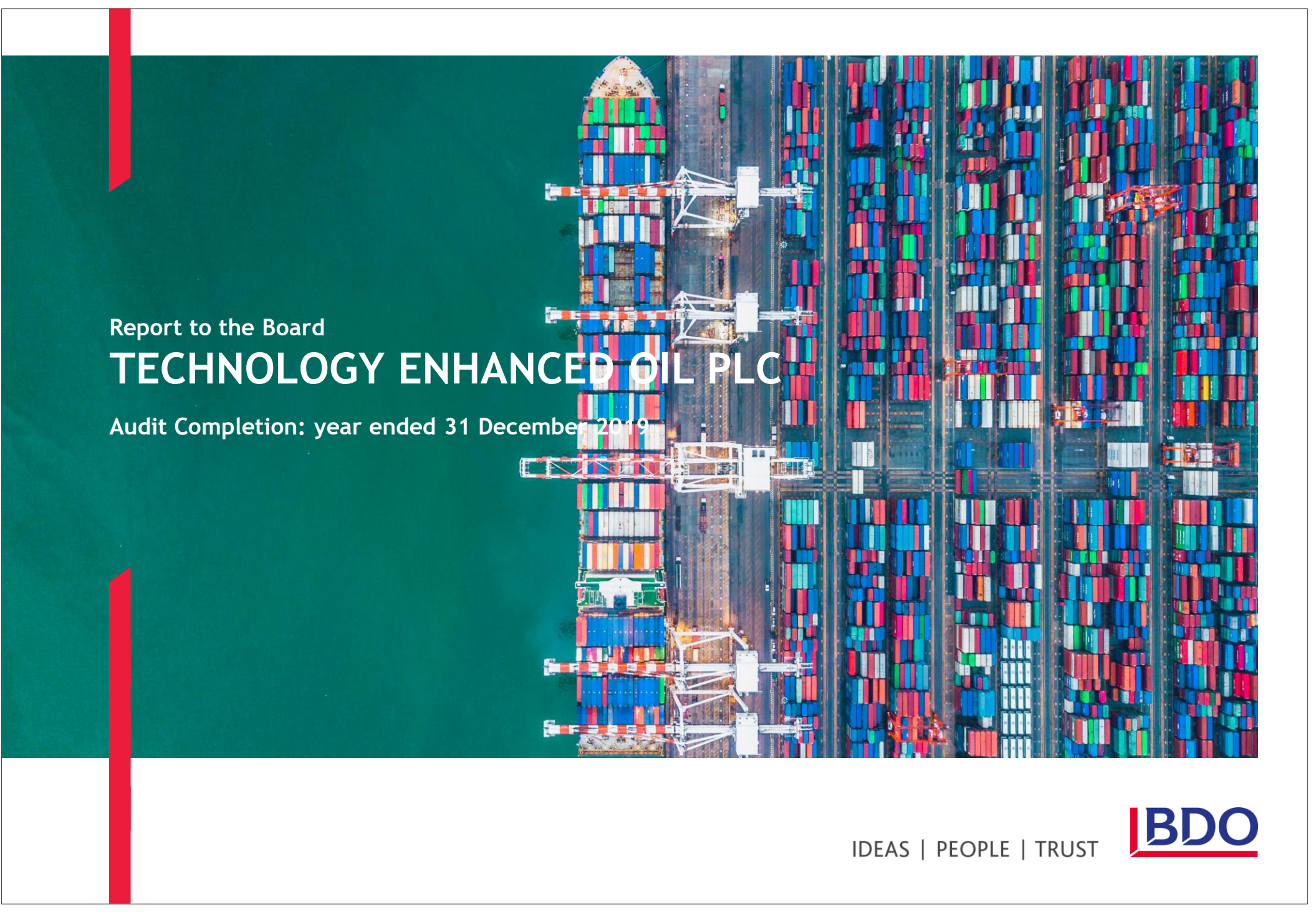




Report to the Board

TECHNOLOGY ENHANCED OIL PLC

Audit Completion: year ended 31 December 2019

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OVERVIEW



Following our recent audit of your financial statements, we are writing to advise you formally that, in our opinion, there were no significant matters arising from our audit that require us to put them in writing. Other findings that are not, in our opinion, so significant as to require inclusion in this letter were discussed with you during the audit.

As the purpose of the audit is to form an opinion on the Group and Company's financial statements, you will appreciate that our audit cannot necessarily be expected to disclose all matters that may be of interest to you and, as a result, the matters reported may not be the only ones which exist.

We have prepared this report for your use only. It should not be disclosed to any other person without our express permission in writing. We do not accept responsibility for this report to any other person and we hereby disclaim any and all such liability.

We would like to take this opportunity to thank you and your staff for your help and cooperation during the course of our audit.

SCOPE, INDEPENDENCE, MATERIALITY AND OUTSTANDING MATTERS

Scope

Our audit approach is designed to ensure we obtain the requisite level of assurance across the whole Group. We have completed a full statutory audit of the Group, and Technology Enhanced Oil plc ('the Company'). In order to form an opinion on the Group financial statements, audit procedures on the Company's subsidiaries have been performed in accordance with the requirements of ISA 600. Weaver and Tidwell LLC have performed work on the Technology Enhanced Oil, Inc. group which is the sub Group we consider to be the significant component. All work on other entities within the Group was performed by BDO UK.

There have been no changes in audit scope since the issue of the planning report apart from recognising Going Concern as a significant risk following the outbreak of Coronavirus and the impact that this has had on the global economy and also the oil and gas prices.

Independence

We confirm that we comply with the Financial Reporting Council's Ethical Standard for Auditors and have policies and procedures as a Firm to ensure we maintain objectivity and independence in audit work. We have not identified any threats to our independence.

Materiality

We have determined final materialities as stated in the below table.

	Basis of materiality	Materiality \$'000	Clearly Trivial \$'000
Group	Total Assets	1,039	20
Technology Enhanced Oil plc	Total Assets	936	18
Technology Enhanced Oil America (UK) Limited	Total Assets	200	4
Technology Enhanced Oil, Inc.	Total Assets	33	1
Beauty Oil, LLC	Proportion of Group materiality	260	5
Lovely Oil, LLC	Proportion of Group materiality	730	15

Clearly trivial is the threshold over which we are required to report errors identified during our audit to those charged with governance (the Board).

SIGNIFICANT RISKS

Risk and detail	Work performed	Conclusion
Carrying value of Oil and Gas assets - In accordance with International Accounting Standard 36 at each period end, the Directors must consider whether there is any evidence of indicators of impairment for the Group's producing fields. If such an indicator of impairment is identified the Directors must perform an assessment of the recoverable value of the asset. Management identified that an indicator of impairment existed for the Lovely CGU and therefore performed an assessment of the value in use of the assets. An impairment was recorded. An indicator of impairment was also identified for the Beauty CGU but no impairment was recorded as sufficient headroom over the carrying value of the asset remained evident. We considered the value in use of Beauty along with the Lovely assets.	We assessed and confirmed the appropriateness of Management's determination that there are two cash generating units - Beauty and Lovely and concurred with the treatment as was the case in the prior years assessment. We assessed the Beauty and Lovely assets with reference to the impairment indicators included in IAS 36 <i>Impairment of assets</i> and found the declining oil price to be an indicator of impairment. We critically reviewed the key inputs into the reserve estimate (which is considered to be a value in use assessment of the wells) as follows: - Discount rate - we reviewed the workings for the discount rate provided by Management. We engaged with our valuations team who concluded that the rate used was reasonable. - Inflation rate - we ensured the inflation rate was reasonable with reference to the US consumer price index - Oil and gas prices - we agreed the prices were derived from Nymex futures (a reputable third party source) - Lease operating expenses (LOE) - we compared LOE in the reports to 2019 and 2020 actuals ytd and ensured that future LOE was in line with the historics and Management's plan to reduce LOE across the Group. We noted there were some differences between 2019 figures and forecast 2020 figures but when assessing the impact this resulted in clearly trivial differences to the value in use of the related fields - Capital costs - we ensured that the costs were part of NextOil's scope of review. We discussed the costs included in the costs with Management's expert and they deemed these costs reasonable considering the properties and the future plans for the wells - Reserves - We assessed the reliability and independence of Nextoil, as a Management expert, in the preparation the reserve report and found no issues - We tested the mechanics of the models for all fields. We recalculated the discounted cash flow calculation to ensure the value in use for each was determined correctly. We then ensured that the calculation of the actual impairment on the Lovely CGU was appropriately recorded - We ensured that the disclosures in the financial statements were reasonable and reflected sufficient narrative to inform the reader of the judgements taken and conclusions drawn.	We found there to be an indicator of impairment as a result of the declining oil price. We determined the impairment recognised to be reasonable. Disclosure made in the financial statements is considered reasonable.

SIGNIFICANT RISKS

Risk and detail	Work performed	Conclusion
Management override of controls - ISA (UK) 240 requires us to presume that the risk of management override of controls is present and significant in all entities.	- We gained an understanding of the journal entry process through walkthroughs and system notes - We ensured that the journals listings received were complete and agreed to the movement between the opening and closing TB's. - We determined characteristics of journals to select for testing. These included manual journals above performance materiality, round sum journals, entries on the weekend, unusual journal descriptions, journals that are debiting revenue accounts and crediting expense accounts. We selected journals with these characteristics and agreed them to supporting documentation. - We reviewed the consolidation journals for appropriateness and completeness with reference to work performed on other financial statement areas and the prior year consolidation - We reviewed judgements and estimates applied by Management in the financial statements and assessed their appropriateness and the existence of any bias. The most significant judgements and estimates include the carrying value of the oil and gas assets (see slide 5) and going concern (see slide 7).	We did not find any issues in respect of the posting of journals or any evidence of management bias in the preparation of the financial statements.
Revenue Recognition - ISA (UK) 240 requires us to presume that there are risks of fraud in revenue recognition.	- We assessed revenue recognised in the year with reference to IFRS 15 and noted no issues. - We obtained the revenue breakdown for both Beauty and Lovely. Weaver selected a sample of transactions to test across both entities. - The samples selected were agreed to the production reports and the net amounts were recalculated to ensure the net revenue interest was appropriately determined. The samples were traced to payment support. - Weaver conducted cut-off testing by selecting post year end receipts to ensure sales had been recorded in the correct period. - Weaver ensured the working interest percentages applied were in line with supporting documentation.	Weaver did not find any issues with respect to revenue recognised in the year. We have reviewed Weaver's work on revenue as part of our oversight of the significant component work.

SIGNIFICANT RISKS

Risk and detail	Work performed	Conclusion
Going concern - When preparing financial statements, the Directors are required to make an assessment of the Groups' ability to continue as a going concern. The Directors are required to consider whether the Group has adequate resources to continue in operation for the foreseeable future which is a period of no less than twelve months from the date of anticipated signing of the financial statements. The outbreak of coronavirus has had a detrimental impact on the global economy and also the oil and gas prices which are significant to the group.	- We performed a detailed review of the base cash flow forecasts and considered the appropriateness of assumptions made by management. The forecast production shows a decrease on 2019 but this is due to the Group focusing on more profitable wells. - We have reviewed the recently signed subscription agreements with two investors which have bought a total of \$25m of funds into the Group. - We have verified the post year end cash position which is \$19.1m as at 28 July 2020. - We have discussed the potential impact of Covid-19 with Management, including their assessment of potential risks and uncertainties associated with areas such as the Group's operations and ability to secure funding. - Management prepared a stress test cash flow forecast based on the uncertainties discussed above. This involved a 50% reduction on the base case oil price of \$56/bbl to \$23/bbl, a 50% reduction in production from Beauty and a 25% reduction in production from Lovely. Without the inflow from the bonds the stressed test cash flows show cash will be negative in Q1 2021 with the total shortfall in December 2021 being around \$10m. However, as the \$25m bond receipts noted above has now been concluded this shortfall is covered. - We also noted that in the case of significant stress to the business and that if no revenue was generated in the period to December 2021 the total cash shortfall would be \$16m. Again this deficit would also now be covered by the bond raised. - We have discussed and considered other funding strategies which may be pursued by the Group as needs be. - We reviewed and considered the adequacy of the disclosure within the financial statements relating to the Directors' assessment of the going concern basis of preparation and the material uncertainties disclosed. We concur that the disclosure made is a reasonable summary of the Group's position and the uncertainties that face the Group.	Based on the work performed, we consider Management's assessment and the Directors conclusion in respect of going concern to be appropriate.

NORMAL RISKS

Risk and detail	Work performed	Conclusion
Decommissioning provision - Beauty Oil, LLC and Lovely Oil, LLC have a legal obligation to plug and abandon all wells at the end of their producing lives.	- We obtained the schedule of the decommissioning obligations for all wells and assessed its mechanical accuracy. We found no issues. - We selected a sample of items to test. For each sample we agreed the details to the Texas Railroad Commissions (TRC) information database, we agreed the working interest figures. We used data from the TRC site to ensure the costs per square foot for each well were appropriate. - We ensured the inflation rate was reasonable with reference to the consumer price index and that the discount rate was reasonable with reference to the rate for a US long term government bond.	We initially noted some differences in respect of the inflation rate used in the decommissioning calculation and this were subsequently updated by Management appropriately. No further issues were noted and we concur that the decommissioning provision is not materially misstated
IFRS 9 - The Standard is relevant to TEO as it applies to trade and inter-group receivables. Under the provisions of the Standard Management are required to assess trade receivables and intra-group receivable expected credit losses (ECLs). The identification of the ECLs relevant to these two financial statement areas is based on historic and forward looking assessments which require significant judgement.	- We reviewed Management's assessment of the impact of the implementation of IFRS 9 across all relevant financial assets and liabilities - We concur with Management that the only material impact of IFRS 9 is in relation to the expected credit losses (ECL) on the inter-company debtors included in the TEO plc company financial statements which are owed by the TEO Inc. - We assessed the calculation prepared by Management to determine the ECL. We noted there was a shortfall between the realisable assets in TEO Inc. compared to the receivable in TEO plc. We noted that the carrying value of the assets used in the calculation included the fair value of the reserves which are not liquid and challenged Management on whether this could be used to part settle the loan. Management subsequently updated the calculation to apply a discount of 15% to the assets of TEO Inc to take into account the discount a third party would pay for the business in the current climate. - We noted the three scenarios of full settlement, partial settlement and default on the loan and probabilities attached to each scenario of 10%, 60% and 30% respectively as being reasonable given the significant uncertainties. - We have ensured disclosures in the financial statements are complete and appropriate.	We did not identify any material issues in respect of the impact of IFRS 9 and concur with Management's judgements.

NORMAL RISKS

Risk and detail	Work performed	Conclusion
Convertible loan notes -The convertible loan note issued by the Company represents a complex financial instrument, and involves significant judgement in respect of identifying the appropriate accounting treatment.	- We reviewed the issue of a new tranche in 2019 with respect to IFRS 9 and confirmed that this should be accounted for as a compound instrument - We agreed the effective interest rate for historic tranches to prior year workings and recalculated the effective interest rate for the newly issued bond with no issue. We recalculated the interest charge using the interest rate \$12.7m of convertible bonds were issued by the Company on 6 December. We agreed the cash receipt to the bank statement. We have re-performed the calculation to determine the equity and liability components with no issues noted. BDO Valuations team assessed that the discount rate used on the new issued tranches was reasonable. - We agreed payments made on the loan balance to the bank statement - We ensured the classification between long term and short term liabilities was appropriate	We did not find any material issues in respect of the accounting for the compound instrument.
IFRS 16 - The implementation of IFRS 16 is mandatory for accounting periods beginning on or after 1 January 2019. IFRS 16 requires leases previously accounted for as operating leases and finance leases to be accounted for as a right of use asset and a lease liability. This means operating leases will be brought onto the balance sheet	- We discussed with Management whether there were any lease agreements that fall within the scope of the standard. Management confirmed that have reviewed all agreements and that they did not identify any. Management confirmed that production site equipment is wholly owned. There were some short term and low value leases identified that fall out of the scope of IFRS 16. - We reviewed expenses in the profit and loss and assess whether all potential leases have been included in the IFRS 16 assessment. We have also reviewed operating agreements with Iskandia in order to determine where responsibility for any leases falls. We note that Iskandia is operator for the Group assets and therefore contracts any leases on behalf of the TEO Group.	We found no material lease agreements that meet the IFRS 16 criteria and therefore no material right of use assets and lease liabilities are recorded within the financial statements.

UNADJUSTED AUDIT DIFFERENCES

We are required to bring to your attention unadjusted differences

There are 3 unadjusted audit differences identified by our audit work which would reduce the draft loss before tax of \$15.4m by \$46,000 and would increase draft net assets of \$18.9m by \$46,000. Management have noted they consider the remaining differences to be immaterial in the context of the financial statements as a whole.

Some of these adjustments are below the Group clearly trivial threshold (\$0.02m) but we have included the proposed adjustment's communicated to us by the component auditors according to their clearly trivial levels in the subsequent tables as this was specifically requested by Management.

Unadjusted audit differences	Income and expenditure			Balance sheet	
	\$'000	\$'000	\$'000	\$'000	\$'000
Loss for the year before adjustments	15,413				
Adjustment 1: Inflation rate of 2.5% used in the decommissioning provision calculation for Lovely compared to BDO rate of 2.3%					
DR Decommissioning provision				760	
CR Oil and Gas assets					760
Adjustment 2: Inflation rate of 2.5% used in the decommissioning provision calculation for Beauty compared to BDO rate of 2.3%					
DR Decommissioning provision				36	
CR Oil and Gas assets					36
Adjustment 3: Variance on recalculation of lifetime expected credit losses due to differing LIBOR rates used					
DR Expected credit loss provision				46	
CR Income statement			46		
Total unadjusted audit differences		-	46	842	796
Loss for the year if adjustments accounted for	15,367				

FOR MORE INFORMATION:

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The matters raised in our report prepared in connection with the audit are those we believe should be brought to your attention. They do not purport to be a complete record of all matters arising. This report is prepared solely for the use of the company and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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