

# INDEPENDENT AUDITORS' REPORT

To the Members of Falcon Energy Group Limited

## Report on the Financial Statements

### Qualified Opinion

We have audited the accompanying financial statements of Falcon Energy Group Limited (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position of the Group and the statement of financial position of the Company as at June 30, 2018, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows of the Group and the statement of changes in equity of the Company for the financial year then ended, and notes to the financial statements, including a summary of significant accounting policies, as set out on pages 45 to 125.

In our opinion, except for the possible effects of the matters described in the *Basis for Qualified Opinion* section of our report, the accompanying consolidated financial statements of the Group and the statement of financial position and statement of changes in equity of the Company are properly drawn up in accordance with the provisions of the Companies Act, Chapter 50 (the "Act") and Financial Reporting Standards in Singapore ("FRSs") so as to give a true and fair view of the consolidated financial position of the Group and the financial position of the Company as at June 30, 2018 and of the consolidated financial performance, consolidated changes in equity and consolidated cash flows of the Group and of the changes in equity of the Company for the year ended on that date.

### Basis for Qualified Opinion

As disclosed in Note 7(a) to the financial statements, as of June 30, 2018, the Group has an outstanding trade receivable balance from a debtor amounting to US\$63,382,000 (2017 : US\$62,884,000) before allowance of US\$23,382,000 (2017 : US\$22,884,000). We were not provided with sufficient appropriate audit evidence as to the basis of the allowance for doubtful debts. As there were no other practicable alternative audit procedures that we could perform, we were not able to conclude on the recoverability of the remaining balance of the trade receivable from the debtor and whether the allowance for doubtful debt is adequate and not excessive. Consequently, we were unable to determine whether any adjustments might be necessary in respect of the trade receivable in the accompanying financial statements for the financial year ended June 30, 2017 and 2018.

We conducted our audit in accordance with Singapore Standards on Auditing ("SSAs"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Group in accordance with the Accounting and Corporate Regulatory Authority ("ACRA") *Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities* ("ACRA Code") together with the ethical requirements that are relevant to our audit of the financial statements in Singapore, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ACRA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

### Material Uncertainties Related to Going Concern

We draw attention to Note 1 to the financial statements which indicates that as at June 30, 2018, the Group reported a net current liabilities position of US\$11,397,000 (2017 : US\$116,121,000) and incurred loss before tax of US\$93,453,000 (2017 : US\$173,788,000). The Company reported a net capital deficiency of US\$172,981,000 (2017 : US\$100,498,000).

The Group and Company are exposed to an increased liquidity risk in relation to their ability to successfully negotiate with principal and other lenders of the Group and finalise the debt restructuring plan which will determine the Group's and the Company's ability to service their borrowings when they fall due (Note 23), to resolve with a secured lender on the ongoing writ of summons and statements of claims in respect of the outstanding amount due to the lender (Note 23), exposure to the performance guarantee given by the Company in relation to the purchase of five rigs contracted by an associate (Notes 37 and 38) and the resolution of the on-going legal claim in relation to the reconstruction of a vessel (Note 38) in favour of the Group.

These conditions, along with other matters as set forth in Note 1, indicate the existence of material uncertainties exists which may cast significant doubt on the Group's and the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

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## Information Other than the Financial Statements and Auditor's Report Thereon

Management is responsible for the other information. The other information comprises the information included in the annual report, but does not include the financial statements and our auditor's report thereon. Other than the directors' statement which we obtained prior to the date of this auditor's report, the remaining other information is expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. As described in the Basis of Qualified Opinion section above, we were unable to obtain sufficient appropriate audit evidence to conclude on the recoverability of the remaining balance of the trade receivable from the debtor and whether the allowance for doubtful debt is adequate and not excessive. Accordingly, we are unable to conclude whether or not the other information is materially misstated with respect to this matter.

## Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current year. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in Basis for Qualified Opinion section we have determined the matters described below to be the key audit matters to be communicated in our report.

Key audit matters	How the scope of our audit responded to the key audit matters
<p><b>Appropriateness of carrying amounts of vessels</b></p> <p><i>(Refer to Notes 3(a)(iii), 3(b)(ii) and 11 of the accompanying financial statements)</i></p> <p>The Group has significant property, plant and equipment (including those presented as assets held for sale) which comprises mainly vessels and its related capitalised expenditures, which collectively represents 60.2% (2017 : 58.7%) of the Group's total assets as at June 30, 2018.</p> <p>As the challenging market conditions continue, the charter and utilisation rates remain depressed in the current year which are impairment indicators relevant to the Group's vessels.</p> <p>Management determined the recoverable amount of the Group's vessels by computing the value-in-use of the respective cash-generating units ("CGU") which involves significant judgement and estimates, including determination of CGUs, the estimation of the future charter rate, discount rate applied to the cash flow and economic life of the vessels.</p>	<p>Our audit procedures focused on evaluating and challenging the key assumptions used by management in conducting the impairment review.</p> <p>We performed the following procedures:</p> <ul style="list-style-type: none"> <li>• challenged the key assumptions used in the value-in-use which include the future charter rate, discount rate and the economic life of vessels of the Group by comparing to available industry and historical data applicable to the Group;</li> <li>• challenged management's assessment of CGU;</li> <li>• engaged our internal specialist to assess the reasonableness of the discount rate used by the group;</li> <li>• performed sensitivity analysis in regard to the discount rate and charter rates as these are the two significant key assumptions in the impairment model; and</li> </ul>

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## Key Audit Matters (cont'd)

Key audit matters	How the scope of our audit responded to the key audit matters
<p><b>Appropriateness of carrying amounts of vessels (cont'd)</b></p> <p>As a result of the impairment review, the Group recognised an impairment loss of US\$23,719,000 (2017 : US\$85,013,000) during the financial year ended June 30, 2018.</p> <p>The key sources of estimation uncertainty made in the assessment of recoverable amounts of vessels have been appropriately disclosed in Note 3(b)(ii).</p>	<ul style="list-style-type: none"> <li>reviewed the adequacy of disclosures on the key sources of estimation used in determining the recoverable amount of vessels in the consolidated financial statement.</li> </ul> <p>Based on our procedures, we noted management's key assumptions to be within a reasonable range of our expectations.</p>
<p><b>Contract for purchase of rigs entered by FTS Derricks Pte Ltd ("FTS")</b></p> <p><i>(Refer to Notes 37 and 38 of the accompanying financial statements)</i></p> <p>In prior years, an associate of the Group, FTS had entered into contract agreements to acquire 5 rigs. Performance guarantees for the five rigs were given by the Group and the Company as disclosed in Note 38.</p> <p>During the year, the contract for a rig with a third party shipyard has been terminated and the rig was subsequently disposed by the third party shipyard. The external legal counsel engaged by the Company is of the view that the performance guarantee provided is not legally binding on the Group and the Company, and the exposure is limited to the difference between the amount owed under the contract and the price in which the rig is sold. As the shipyard has not informed FTS the price of the rig sold, management is of the view that no provision is required to be made in respect of the performance guarantee on the basis that the amount is currently not measurable.</p> <p>In addition, the contracts for the remaining four rigs with another third party shipyard was terminated in prior years. Last year, FTS engaged an external legal counsel to dispute the basis of the termination by the shipyard. Consequently, FTS had exercised their right to terminate the contracts and the directors and management believed that the four performance guarantees issued by the Company for the due and punctual payment by FTS of the final instalment of the contract price payable by FTS upon delivery of the four rigs were no longer in effect. In September 2018, the Company engaged another external legal counsel to reaffirm the position taken by the Company on this matter.</p> <p>In accordance with FRS 37 Provisions, Contingent Liabilities and Contingent Assets, the directors and management are of the opinion that the performance guarantee given for contracts for the purchase of rigs is not probable and not remote. Accordingly, the Group and Company have disclosed contingent liabilities amounting to US\$1,002,278,000 (Notes 37 and 38) as at the end of the reporting period.</p>	<p>Our audit procedures focused on evaluating and challenging the key assumptions used by management in conducting the review on the obligations under FRS 37.</p> <p>We have performed the following:</p> <ul style="list-style-type: none"> <li>We obtained an understanding of the progress of the rig construction and reviewed the terms of the contract;</li> <li>We have also obtained management's updates in the current year on the contracts for purchase of rigs and reviewed their assessment of such resolution in accordance with FRS 37;</li> <li>We have held discussions with management and the external legal counsels surrounding the legal implications arising from the termination. We have also assessed the competence and objectivity of the legal counsels; and</li> <li>We have also assessed the adequacy and appropriateness of the disclosures made in the financial statements.</li> </ul>

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

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with the provisions of the Act and FRSs, and for devising and maintaining a system of internal accounting controls sufficient to provide a reasonable assurance that assets are safeguarded against loss from unauthorised use or disposition; and transactions are properly authorised and that they are recorded as necessary to permit the preparation of true and fair financial statements and to maintain accountability of assets.

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

The directors' responsibilities include overseeing the Group's financial reporting process.

## **Auditor's Responsibilities for the Audit of the Financial Statements**

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

As part of an audit in accordance with SSAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- (a) Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- (b) 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.
- (c) Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- (d) Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the group to cease to continue as a going concern.
- (e) Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- (f) Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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## **Auditor's Responsibilities for the Audit of the Financial Statements (cont'd)**

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

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the financial statements of the current year and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

## **Report on Other Legal and Regulatory Requirements**

In our opinion, except for the possible effects of the matter described in the *Basis for Qualified Opinion* section, the accounting and other records required by the Act to be kept by the Company and by the subsidiary corporations incorporated in Singapore of which we are the auditors have been properly kept in accordance with the provisions of the Act.

The engagement partner on the audit resulting in this independent auditor's report is Chua How Kiat.

Deloitte & Touche LLP  
Public Accountants and  
Chartered Accountants  
Singapore

October 9, 2018