

**BP EXPLORATION (AZERBAIJAN) LIMITED**

**(Registered No 02160234)**

**ANNUAL REPORT AND ACCOUNTS 2012**

Board of Directors: G Y Burrell  
S J MacRae  
B M Puffer

**REPORT OF THE DIRECTORS**

The directors present their report and accounts for the year ended 31 December 2012

**Results and dividends**

The profit for the year after taxation was \$355,738,000 which, when added to the retained profit brought forward at 1 January 2012 of \$1,114,420,000, gives a total retained profit carried forward at 31 December 2012 of \$1,470,158,000

The company has not declared any dividends during the year (2011 \$Nil). The directors do not propose the payment of a dividend.

**Principal activity and review of the business**

The company has had a satisfactory year and the directors believe that the trend will continue. The company is a party to Shah Deniz Production Sharing Agreement (the "PSA") in the Azerbaijan sector of the Caspian Sea, with a participating interest of 25.5%.

After the sanction of the Stage 1 development of the Shah Deniz Field on 27 February 2003, the project has progressed satisfactorily through execution phase having reached the first production in December 2006. The field has reached its plateau and gas is being sold under the current gas sales and purchased agreements to three countries: Turkey, Azerbaijan and Georgia.

During 2012 the company achieved the primary objective of maintaining and increasing production potential on Shah Deniz Stage 1 through operating efficiency, bringing wells on production after work-over jobs and asset wide turn-around activities. As a result of these efforts installed production capacity was increased.

Stage 2 development of Shah Deniz Field moved into Define stage on 31 March 2012. This enabled project engineering definition and contracting to progress further. Due to commercial misalignments that arose with State Oil Company of Azerbaijan Republic ("SOCAR") in the middle of 2012 the decision was made to suspend all project activities (with exception of drilling) until resolution was concluded. At the end of 2012 an agreement was reached with SOCAR on outstanding commercial misalignments and as a result all project activities were restarted.

Throughout the year intensive drilling activities were conducted by the company. It conducted well work-over operations reactivating SDA05 and recompleting SDA06 wells as well as commenced sidetracking of SDA03 well.

As part of Stage 2 pre-drill programme 'Istiglal' – mobile offshore drilling unit drilled top hole sections on the north and west flanks of the field for most of the year and then successfully completed NF-1 well and performed the flow test towards the end of the year. In September 2012 'Heydar Aliyev' – mobile offshore drilling unit was made available for pre-drill programme and that rig was used to continue drilling operations on WF-1 well.



**BP EXPLORATION (AZERBAIJAN) LIMITED****REPORT OF THE DIRECTORS****Principal activity and review of the business (continued)**

The primary objective of the company for 2013 is to maintain the Shah Deniz Stage 1 production potential through bringing on line SDA03 well and performing work over on SDA02 well. Additionally the company is planning to execute high flow rate trials across the value chain with an objective to further increase installed production capacity.

The selection of the EU pipelines delivering Shah Deniz Stage 2 gas volumes to Europe was completed on 28th June 2013.

The gas sales agreements (GSA) and the gas transit agreements (GTA) are planned to be finalized by end December 2013.

The key financial and other performance indicators during the year were as follows:

	<u>2012</u>	<u>2011</u>	<u>Variance</u>
	\$000	\$000	%
Turnover	622,306	678,159	(8)
Operating profit	432,881	428,362	1
Profit after taxation	355,738	379,876	(6)
Shareholders' funds	1,612,839	1,257,101	28
	<u>2012</u>	<u>2011</u>	<u>Variance</u>
	%	%	
Quick ratio*	239	114	125

\*Quick ratio is defined as current assets, excluding stock and debtors receivable after one year, as a percentage of current liabilities.

**Principal risks and uncertainties**

The company aims to deliver sustainable value by identifying and responding successfully to risks. Risk management is integrated into the process of planning and performance management at a group level. Monitoring and accountability for the management of these risks occur through quarterly performance reviews at a group level.

We urge you to consider carefully the risks described below. The potential impact of the occurrence or reoccurrence of any of the risks described below could have a material adverse effect on the company's business, financial position, results of operations, competitive position, cash flows, prospects, liquidity, shareholder returns and/or implementation of its strategic agenda.

Company level risks have been categorised against the following areas: strategic and commercial, compliance and control, safety and operational, and financial risk management. In addition, we have also set out a further category of risk for your attention – those resulting from the 2010 Gulf of Mexico oil spill (the Incident).

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **REPORT OF THE DIRECTORS**

#### **Principal risks and uncertainties (continued)**

##### **Gulf of Mexico oil spill**

The Gulf of Mexico oil spill has had and could continue to have a material adverse impact on BP as a group, and consequently may also have an adverse impact on BP Exploration (Azerbaijan) Limited

Whilst the BP group recognised significant charges in the income statement since the Incident occurred in 2010, there is significant uncertainty regarding the extent and timing of the remaining costs and liabilities relating to the Incident, the potential changes in applicable regulations and the operating environment that may result from the Incident, the impact of the Incident on the reputation of the group and the resulting possible impact on the group's licence to operate including its ability to access new opportunities. The amount of claims that become payable by the BP group, the amount of fines ultimately levied on the BP group (including any potential determination of the BP group's negligence or gross negligence), the outcome of litigation, the terms of any further settlements including the amount and timing of any payments thereunder, and any costs arising from any longer-term environmental consequences of the Incident, will also impact upon the ultimate cost for the BP group

Although the provisions recognised represent the current best estimates of expenditures required to settle certain present obligations that can be reasonably estimated at the end of the reporting period, there are future expenditures for which it is not possible to measure the obligations reliably and the total amounts payable by the BP group in relation to all obligations relating to the Incident are subject to significant uncertainty. These uncertainties are likely to continue for a significant period, increase the risks to which the group is exposed and may cause costs to increase. Thus, the Incident has had, and could continue to have, a material adverse impact on the group's business, competitive position, financial performance, cash flows, prospects, liquidity, shareholder returns and/or implementation of its strategic agenda, particularly in the US. The risks associated with the Incident could also heighten the impact of the other risks to which the group is exposed as further described below. Further information on the Incident, is included within the BP group Annual Report and Form 20-F for the year ended 31 December 2012

#### **Strategic and commercial risks**

##### ***Access and renewal***

Successful execution of the company's strategy depends on implementing activities to renew and reposition its portfolio. The challenges to renewal of the company's upstream portfolio are growing due to increasing competition for access to opportunities globally. Lack of material positions in new markets could impact the company's future hydrocarbon production.

Moreover, the Gulf of Mexico oil spill has damaged the BP group's reputation which may have a long-term impact on the group's ability to access new opportunities, both in the US and elsewhere. Adverse public, political and industry sentiment towards the BP group, and towards oil and gas drilling activities generally, could damage or impair the company's existing commercial relationships with counterparties, partners and host governments and could impair access to new investment opportunities, exploration properties, operatorships or other essential commercial arrangements with potential partners and host governments, particularly in the US. In addition, responding to the Incident has placed, and will continue to place, a significant burden on cash flow over the next several years which could also impede the BP group's ability to invest in new opportunities and deliver long-term growth, which in turn may impact the company. More stringent regulation of the oil and gas industry generally, and of the BP group's activities specifically, arising from the Incident, could increase this risk.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **REPORT OF THE DIRECTORS**

#### **Principal risks and uncertainties (continued)**

##### **Strategic and commercial risks (continued)**

###### ***Prices and markets***

Oil, gas and product prices are subject to international supply and demand. Political developments and the outcome of meetings of OPEC can particularly affect world supply and oil prices. Previous oil price increases have resulted in increased fiscal take, cost inflation and more onerous terms for access to resources. As a result, increased oil prices may not improve margin performance. In addition to the adverse effect on revenues, margins and profitability from any fall in oil and natural gas prices, a prolonged period of low prices or other indicators would lead to further reviews for impairment of the company's oil and natural gas properties. Such reviews would reflect management's view of long-term oil and natural gas prices and could result in a charge for impairment that could have a significant effect on the company's results of operations in the period in which it occurs. Rapid material or sustained change in oil, gas and product prices can impact the validity of the assumptions on which strategic decisions are based and, as a result, the ensuing actions derived from those decisions may no longer be appropriate.

Periods of global recession could impact the demand for the company's products, the prices at which they can be sold and affect the viability of the markets in which the company operates.

Governments are facing greater pressure on public finances, which may increase their motivation to intervene in the fiscal and regulatory frameworks of the oil and gas industry including the risk of increased taxation, nationalisation and expropriation.

The global financial and economic situation may have a negative impact on third parties with whom the company does, or may do, business with. In particular, on-going instability in or a collapse of the Eurozone could trigger a new wave of financial crises and push the world back into recession, leading to lower demand and lower oil and gas prices.

###### ***Climate change and carbon pricing***

Compliance with changes in laws, regulations and obligations relating to climate change could result in substantial capital expenditure, taxes, reduced profitability from changes in operating costs, and revenue generation and strategic growth opportunities being impacted.

###### ***Socio-political***

The diverse nature of the company's operations around the world exposes it to a wide range of political developments and consequent changes to the operating environment, regulatory environment and law.

The company has operations in countries where political, economic and social transition is taking place. Some countries have experienced or may experience in the future political instability, changes to the regulatory environment, expropriation or nationalisation of property, civil strife, strikes, acts of war and insurrections. Any of these conditions occurring could disrupt or terminate the company's operations, causing its development activities to be curtailed or terminated in these areas or its production to decline, could limit the company's ability to pursue new opportunities, could affect the recoverability of its assets and could cause it to incur additional costs.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **REPORT OF THE DIRECTORS**

#### **Principal risks and uncertainties (continued)**

#### **Strategic and commercial risks (continued)**

##### ***Competition***

The company's strategy depends upon continuous innovation in a highly competitive market

The oil, gas and petrochemicals industries are highly competitive. There is strong competition, both within the oil and gas industry and with other industries, in supplying the fuel needs of commerce, industry and the home. Competition puts pressure on the terms of access to new opportunities, licence costs and product prices. affects oil products marketing and requires continuous management focus on reducing unit costs and improving efficiency, while ensuring safety and operational risk is not compromised. The implementation of the BP group strategy requires continued technological advances and innovation including advances in exploration, production, refining, petrochemicals manufacturing technology and advances in technology related to energy usage. The company's performance could be impeded if competitors developed or acquired intellectual property rights to technology that it required or if its innovation lagged the industry, or by its failure to adequately protect the company's brands and trademarks. The company's competitive position could be adversely affected if it fails to control its operating costs or manage its margins, or if it fails to sustain, develop and operate efficiently a high quality portfolio of assets.

##### ***Joint ventures and other contractual arrangements***

Many of the company's major projects and operations are conducted through joint ventures or associates and through contracting and sub-contracting arrangements. These arrangements often involve complex risk allocation, decision-making process and indemnification arrangements. In certain cases, the company may have less control of such activities than it would have if the company had full operational control.

The company's partners may have economic or business interests or objectives that are inconsistent with, or opposed to, those of the company's and may exercise veto rights to block certain key decisions or actions that the company believes are in its or the joint venture's or associate's best interest, or approve such matters without the company's consent.

Additionally, the company's joint venture partners or associates or contractual counterparties are primarily responsible for the adequacy of the human or technical competencies and capabilities which they bring to bear on the joint project, and in the event these are found to be lacking the company's joint venture partners or associates may not be able to meet their financial or other obligations to their counterparties or to the relevant project, potentially threatening the viability of such projects.

Furthermore, should accidents or incidents occur in operations in which the company participates, whether as operator or otherwise, and where it is held that the company's sub-contractors or joint venture partners are legally liable to share any aspects of the cost of responding to such incidents, the financial capacity of these third parties may prove inadequate to fully indemnify the company against the costs it incurs on behalf of the joint venture or contractual arrangement. Should a key sub-contractor, such as a lessor of drilling rigs, be no longer able to make these assets available to the company, this could result in serious disruption to its operations. Where the company does not have operational control of a venture, the company may nonetheless still be pursued by regulators or claimants in the event of an incident.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **REPORT OF THE DIRECTORS**

#### **Principal risks and uncertainties (continued)**

##### **Strategic and commercial risks (continued)**

###### ***Investment efficiency***

The company's organic growth is dependent on creating a portfolio of quality options and investing in the best options. Ineffective investment selection and development could lead to loss of value and higher capital expenditure.

###### ***Reserves progression***

Successful execution of the BP group strategy depends critically on sustaining long-term reserves replacement. If upstream resources are not progressed in a timely and efficient manner due to commercial, technical or regulatory reasons or otherwise, the company will be unable to sustain long-term replacement of reserves.

###### ***Major project delivery***

Successful execution of the company's plan depends critically on implementing the activities to deliver the major projects over the plan period. Poor delivery of any major project that underpins production or production growth, and/or a major programme designed to enhance shareholder value, including maintenance turnaround programmes, could adversely affect the company's financial performance. Successful project delivery requires, among other things, adequate engineering and other capabilities and therefore successful recruitment and development of staff is central to the company's plans.

###### ***Digital infrastructure***

The reliability and security of the company's digital infrastructure are critical to maintaining the availability of its business applications, including the reliable operation of technology in its various business operations and the collection and processing of financial and operational data, as well as the confidentiality of certain third-party information. A breach of the company's digital security, either due to intentional actions or due to negligence, could cause serious damage to business operations and, in some circumstances, could result in the loss of data or sensitive information, injury to people, damage to assets, harm to the environment, reputational damage, breaches of regulations, litigation, legal liabilities and reparation costs.

###### ***Business continuity and disaster recovery***

Contingency plans are required to continue or recover operations following a disruption or incident. Inability to restore or replace critical capacity to an agreed level within an agreed timeframe would prolong the impact of any disruption and could severely affect business and operations.

###### ***Crisis management***

Crisis management plans and capability are essential to deal with emergencies at every level of the company's operations. If the company does not respond, or is perceived not to respond, in an appropriate manner to either an external or internal crisis, its business and operations could be severely disrupted.

##### **Compliance and control risks**

###### ***Regulatory***

Due to the Gulf of Mexico oil spill, it is likely that there will be more stringent regulation of the BP group's oil and gas activities in the US and elsewhere, particularly relating to environmental, health and safety controls and oversight of drilling operations, as well as access to new drilling areas.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **REPORT OF THE DIRECTORS**

#### **Principal risks and uncertainties (continued)**

#### **Compliance and control risks (continued)**

##### ***Regulatory (continued)***

Regulatory or legislative action may impact the industry as a whole and could be directed specifically towards the BP group. New regulations and legislation, the terms of the BP group's settlements with US government authorities and future settlements or litigation outcomes related to the Incident, and/or evolving practices could increase the cost of compliance and may require changes to the company's drilling operations, exploration, development and decommissioning plans, and could impact the company's ability to capitalise on its assets and limit its access to new exploration properties or operatorships. In addition, increases in taxes, royalties and other amounts payable to governments or governmental agencies, or restrictions on availability of tax relief, could also be imposed as a response to the Incident.

In addition, the oil industry in general is subject to regulation and intervention by governments throughout the world in such matters as the award of exploration and production interests, the imposition of specific drilling obligations, environmental, health and safety controls, controls over the development and decommissioning of a field (including restrictions on production) and, possibly, nationalisation, expropriation, cancellation or non-renewal of contract rights.

Failure to respond to changes in trading regulations could result in regulatory action and damage to the company's reputation. The oil industry is also subject to the payment of royalties and taxation, which tend to be high compared with those payable in respect of other commercial activities, and operates in certain tax jurisdictions that have a degree of uncertainty relating to the interpretation of, and changes to, tax law. As a result of new laws and regulations or other factors, the company could be required to curtail or cease certain operations or could incur additional costs.

##### ***Ethical misconduct and non-compliance***

The code of conduct, which applies to all employees, defines the company's commitment to integrity, compliance with all applicable legal requirements, high ethical standards and the behaviours and actions the company expects of its businesses and people wherever it operates. The values are intended to guide the way the company and its employees behave and do business. Incidents of ethical misconduct or non-compliance with applicable laws and regulations, including non-compliance with anti-bribery, anti-corruption and other applicable laws could be damaging to the company's reputation and shareholder value. Multiple events of non-compliance could call into question the integrity of the company's operations.

##### ***Liabilities and provisions***

The BP group's potential liabilities resulting from pending and future claims, lawsuits, settlements and enforcement actions relating to the Gulf of Mexico oil spill, together with the potential cost and burdens of implementing remedies sought in the various proceedings, cannot be fully estimated at this time but they have had, and are expected to continue to have, a material adverse impact on the group's business and consequently may also impact the company's business. Further information is included within the BP group Annual Report and Form 20-F for the year ended 31 December 2012.

##### ***Reporting***

External reporting of financial and non-financial data is reliant on the integrity of systems and people. Failure to report data accurately and in compliance with external standards could result in regulatory action, legal liability and damage to the company's reputation.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **REPORT OF THE DIRECTORS**

#### **Principal risks and uncertainties (continued)**

##### **Compliance and control risks (continued)**

###### ***Changes in external factors***

The company remains exposed to changes in the external environment, such as new laws and regulations (whether imposed by international treaty or by national or local governments in the jurisdictions in which the company operates), changes in tax or royalty regimes, price controls, government actions to cancel or renegotiate contracts, market volatility or other factors. Such factors could reduce the company's profitability from operations in certain jurisdictions, limit its opportunities for new access, require it to divest or write-down certain assets or affect the adequacy of its provisions for pensions, tax, environmental and legal liabilities. Potential changes to pension or financial market regulation could also impact funding requirements of the company.

##### **Safety and operational risks**

###### ***Process safety, personal safety and environmental risks***

The nature of the company's operations exposes it to a wide range of significant health, safety, security and environmental risks. The scope of these risks is influenced by the geographic range, operational diversity and technical complexity of the company's activities. In addition, in many of the company's major projects and operations, risk allocation and management is shared with third parties, such as contractors, sub-contractors, joint venture partners and associates. See 'Joint ventures and other contractual arrangements'.

There are risks of technical integrity failure as well as risk of natural disasters and other adverse conditions in many of the areas in which the company operates, which could lead to loss of containment of hydrocarbons and other hazardous material, as well as the risk of fires, explosions or other incidents.

The company's operations are often conducted in difficult or environmentally sensitive locations, in which the consequences of a spill, explosion, fire or other incident could be greater than in other locations. These operations are subject to various environmental and safety laws, regulations and permits and the consequences of failure to comply with these requirements can include remediation obligations, penalties, loss of operating permits and other sanctions. Accordingly, inherent in the company's operations is the risk that if it fails to abide by environmental and safety and protection standards, such failure could lead to damage to the environment and could result in regulatory action, legal liability, material costs and damage to the company's reputation or licence to operate.

BP's group-wide operating management system (OMS) intends to address health, safety, security, environmental and operations risks, and to provide a consistent framework within which the group can analyse the performance of its activities and identify and remediate shortfalls. There can be no assurance that OMS will adequately identify all process safety, personal safety and environmental risk or provide the correct mitigations, or that all operations will be in conformance with OMS at all times.

###### ***Security***

Security threats require continuous oversight and control. Acts of terrorism, piracy, sabotage, cyber-attacks and similar activities directed against the company's operations and offices, pipelines, transportation or computer systems could cause harm to people and could severely disrupt business and operations. The company's business activities could also be severely disrupted by, amongst other things, conflict, civil strife or political unrest in areas where the company operates.



## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **REPORT OF THE DIRECTORS**

#### **Principal risks and uncertainties (continued)**

##### **Safety and operational risks (continued)**

###### ***Product quality***

Supplying customers with on-specification products is critical to maintaining the company's licence to operate and its reputation in the marketplace. Failure to meet product quality standards throughout the value chain could lead to harm to people and the environment and loss of customers.

###### ***Drilling and production***

Exploration and production require high levels of investment and are subject to natural hazards and other uncertainties, including those relating to the physical characteristics of an oil or natural gas field. The company's exploration and production activities are often conducted in extremely challenging environments, which heighten the risks of technical integrity failure and natural disasters discussed above. The cost of drilling, completing or operating wells is often uncertain. The company may be required to curtail, delay or cancel drilling operations because of a variety of factors, including unexpected drilling conditions, pressure or irregularities in geological formations, equipment failures or accidents, adverse weather conditions and compliance with governmental requirements.

In addition, exploration expenditure may not yield adequate returns, for example in the case of unproductive wells or discoveries that prove uneconomic to develop. The Gulf of Mexico incident illustrates the risks the company faces in its drilling and production activities.

###### ***Transportation***

All modes of transportation of hydrocarbons involve inherent risks. An explosion or fire or loss of containment of hydrocarbons or other hazardous material could occur during transportation by road, rail, sea or pipeline. This is a significant risk due to the potential impact of a release on people and the environment and given the high volumes involved.

#### **Financial risk management**

The main financial risks faced by the company through its normal business activities, are market risk, commodity price risk, foreign currency exchange risk, interest rate risk, credit risk. The management of these financial risks is performed at BP group level. The company seeks to maintain a financial framework to ensure that it is able to maintain an appropriate level of liquidity and financial capacity. This framework constrains the level of assessed capital at risk for the purposes of positions taken in financial instruments. Failure to accurately forecast or maintain sufficient liquidity and credit to meet these needs could impact the company's ability to operate and result in a financial loss.

###### ***Market risk***

Market risk is the risk or uncertainty arising from possible market price movements and their impact on the future performance of a business. This includes the possibility that changes in foreign currency exchange rates, interest rates or oil, natural gas and power prices will adversely affect the value of the company's financial assets, liabilities or expected future cash flows. The management of such risks is performed at BP group level. The group has developed a control framework aimed at managing the volatility inherent in certain of its natural business exposures. In accordance with this control framework the group enters into various transactions using derivatives for risk management purposes.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **REPORT OF THE DIRECTORS**

#### **Principal risks and uncertainties (continued)**

##### **Financial risk management (continued)**

###### ***Commodity price risk***

The group's integrated supply and trading function uses conventional financial and commodity instruments and physical cargoes available in the related commodity markets. Oil and natural gas swaps, options and futures are used to mitigate price risk. Power trading is undertaken using a combination of over-the-counter forward contracts and other derivative contracts, including options and futures. This activity is on both a standalone basis and in conjunction with gas derivatives in relation to gas-generated power margin.

###### ***Foreign currency exchange risk***

Fluctuations in foreign exchange rates can have significant effects on the company's reported results. The company's financial assets and liabilities give rise to transactional currency exposures. Such exposures arise from transactions in a currency other than the company's functional currency. The management of such risks is performed at BP group level. The main underlying economic currency of the BP group's cash flows is the US dollar. This is because the BP group's major product, oil, is priced internationally in US dollars. The BP group's foreign exchange management policy is to minimise economic and significant transactional exposures arising from currency movements against the US dollar. The group co-ordinates the handling of foreign exchange risks centrally, by netting off naturally occurring opposite exposures wherever possible and then dealing with any material residual foreign exchange risks. For highly probable forecast capital expenditures the group locks in the US dollar cost of non US dollar supplies by using currency forwards and futures.

Crude oil prices are generally set in US dollars, while sales of refined products may be in a variety of currencies. Fluctuations in exchange rates can therefore give rise to foreign exchange exposures, with a consequent impact on underlying costs and revenues.

###### ***Interest rate risk***

The company is exposed to interest rate risk from the possibility that changes in interest rates will affect future cash flows or the fair values of its financial instruments, principally finance debt.

Where the company enters into money market contracts for entrepreneurial trading purposes, the activity is controlled at BP group level using value-at-risk techniques.

###### ***Credit risk***

Credit risk is the risk that a customer or counterparty to a financial instrument will fail to perform or fail to pay amounts due causing financial loss to the company. It arises from cash and cash equivalents, derivative financial instruments and deposits with financial institutions and principally from credit exposures to customers relating to outstanding receivables. The management of such risks is performed at BP group level. The group has a credit policy, approved by the CFO, which is designed to ensure that consistent processes are in place throughout the group to measure and control credit risk. Credit risk is considered as part of the risk-reward balance of doing business. On entering into any business contract the extent to which the arrangement exposes the group to credit risk is considered. Before trading with a new counterparty can start, its creditworthiness is assessed and a credit rating allocated that indicates the probability of default, along with a credit exposure limit. Creditworthiness continues to be evaluated after transactions have been initiated and a watch list of higher-risk counterparties is maintained.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **REPORT OF THE DIRECTORS**

#### **Principal risks and uncertainties (continued)**

#### **Financial risk management (continued)**

##### ***Credit risk (continued)***

Commercial credit risk is measured and controlled to determine the company's total credit risk. Inability to determine adequately the company's credit exposure could lead to financial loss. A credit crisis affecting banks and other sectors of the economy could impact the ability of counterparties to meet their financial obligations to the company. It could also affect the company's ability to raise capital to fund growth and to meet its obligations.

#### **Research and development**

The company incurs research and development expenditure in the ordinary course of business as it looks to improve its future performance.

#### **Future developments**

The directors aim to maintain the management policies which have resulted in the company's stability in recent years. They believe that the company is in a good position to take advantage of any opportunities which may arise in the future.

It is the intention of the directors that the business of the company will continue for the foreseeable future.

#### **Directors**

The present directors are listed on page 1.

Changes since 1 January 2012 are as follows:

	<u>Appointed</u>	<u>Resigned</u>
J H Bartlett	-	27 February 2012
S J MacRae	27 February 2012	-
R J O Javanshir	-	15 November 2012
G Y Birrell	15 November 2012	-

#### **Directors' indemnity**

The company indemnifies the directors in its Articles of Association to the extent allowed under section 232 of the Companies Act 2006.

#### **Policy and practice on payment of creditors**

It is the company's policy to follow the CBI's prompt payment code of practice for all suppliers to the company with payments made in accordance with the relevant contractual payment terms. A copy of the code of practice may be obtained from the CBI.

The number of days' purchases represented by trade creditors at the year-end was 75.

#### **Auditor**

In the absence of a notice proposing that the appointment be terminated, Ernst & Young LLP will be deemed to be re-appointed as the company's auditor for the next year.

**BP EXPLORATION (AZERBAIJAN) LIMITED**

**REPORT OF THE DIRECTORS**

**Directors' statement as to the disclosure of information to the auditor**

The directors who were members of the board at the time of approving the directors' report are listed on page 1. Having made enquiries of fellow directors and of the company's auditor, each of these directors confirms that

- To the best of each director's knowledge and belief, there is no information relevant to the preparation of their report of which the company's auditor is unaware, and
- Each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the company's auditor is aware of that information

By Order of the Board



For and on behalf of  
Sunbury Secretaries Limited  
Company Secretary

*17 September*

2013

Registered Office

Chertsey Road  
Sunbury on Thames  
Middlesex  
TW16 7BP  
United Kingdom

**BP EXPLORATION (AZERBAIJAN) LIMITED**

**REPORT OF THE DIRECTORS**

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom accounting standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and the profit or loss for that period. In preparing these accounts, the directors are required to

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable United Kingdom accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

The directors confirm that they have complied with these requirements and, having a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, continue to adopt the going concern basis in preparing the accounts.

**BP EXPLORATION (AZERBAIJAN) LIMITED**

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF**  
**BP EXPLORATION (AZERBAIJAN) LIMITED**

We have audited the financial statements of BP Exploration (Azerbaijan) Limited for the year ended 31 December 2012 which comprise the Profit and Loss Account, the Statement of Total Recognised Gains and Losses, the Balance Sheet, the accounting policies and the related notes 1 to 24. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

**Respective responsibilities of directors and auditor**

As explained more fully in the Statement of Directors' Responsibilities set out on page 13, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). These standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

**Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Opinion on financial statements**

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 December 2012 and of its profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

**Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

*Ernst + Young LLP*

Paul Walliek (Senior Statutory Auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor

London

*19/9/2013*

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **ACCOUNTING POLICIES**

#### **Accounting standards**

The financial statements of BP Exploration (Azerbaijan) Limited were approved for issue by the Board of Directors on *13 September* 2013

These accounts are prepared on a going concern basis and in accordance with the Companies Act 2006 and applicable UK accounting standards

In addition to the requirements of accounting standards, the accounting for exploration and production activities is governed by the Statement of Recommended Practice ('SORP') 'Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities' issued by the UK Oil Industry Accounting Committee on 7 June 2001

These accounts have been prepared in accordance with the provisions of the SORP with the exception of the following.

- (i) The SORP recommends that oil and gas reserve quantities be disclosed. The company is a wholly owned subsidiary of BP plc and, as such, the oil and gas reserve quantities of the company are included in the consolidated oil and gas reserve quantities disclosed in the Annual Report and Accounts of BP plc. Consequently the directors have elected not to publish this information for the company;
- (ii) The SORP contains rules around the estimation of future oil and gas reserves. The company, as part of the BP group, estimates and calculates its reserves in accordance with the US Securities and Exchange Commission (SEC) rules. The main differences relate to the SEC requirement to use a twelve-month average price to assess future reserves, being the unweighted average of the price on the first day of the month for the past twelve months. This is the basis applied in the BP group reporting and is comparable with other oil majors. It is not possible for the company to quantify the impact of this departure as SORP estimates of reserves are no longer maintained.

#### **Accounting convention**

The accounts are prepared under the historical cost convention

#### **Statement of cash flows**

The group accounts of the ultimate parent undertaking contain a consolidated cash flow statement. The company has taken advantage of the exemption granted by the Financial Reporting Standard No 1 (Revised), whereby it is not required to publish its own cash flow statement.

#### **Group accounts**

Group accounts are not submitted as the company is exempt from the obligation to prepare group accounts under Section 400 (1) of the Companies Act 2006. The results of subsidiary and associated undertakings are dealt with in the consolidated accounts of the ultimate parent undertaking, BP plc, a company registered in England and Wales. These accounts present information about the company as an individual undertaking and not about the group.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **ACCOUNTING POLICIES**

#### **Revenue recognition**

Revenues associated with the sale of oil, natural gas liquids, liquefied natural gas, petroleum and chemical products and all other items are recognised when title passes to the customer. Generally, revenues from the production of natural gas and oil properties in which the company has an interest with other producers are recognised on the basis of the company's working interests in those properties (the entitlement method). Differences between the production sold and the company's share of production (under / over lifts) are included as an adjustment to cost of sales.

#### **Foreign currency transactions**

Foreign currency transactions are initially recorded in dollars by applying the exchange rate ruling on the date of transaction. Foreign currency monetary assets and liabilities are translated into dollars at the rate of exchange ruling at the balance sheet date. Exchange differences are included in the profit and loss account.

#### **Research**

Expenditure on research is written off in the year in which it is incurred.

#### **Capitalisation of finance costs and interest**

Interest is capitalised gross of related tax relief during the period of construction where it relates either to the financing of major projects with long periods of development or to dedicated financing of other projects. All other interest is charged against income in the year in which it is incurred.

#### **Interest income**

Interest income is recognised on an accruals basis.

#### **Intangible assets**

Intangible assets include expenditure on the exploration for and evaluation of oil and natural gas resources, computer software, patents, licences, trademarks and product development costs. Product development costs are capitalised as intangible assets when a project has obtained sanction and the future recoverability of such costs can reasonably be regarded as assured.

Intangible assets are stated at cost, less accumulated depreciation and accumulated impairment losses. Intangible assets with a finite life are depreciated on a straight-line basis over their expected useful lives. The expected useful lives of the assets are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

#### **Oil and natural gas exploration and development expenditure**

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



## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **ACCOUNTING POLICIES**

#### **Exploration expenditure**

Geological and geophysical exploration costs are charged against income as incurred. Costs directly associated with an exploration well are capitalised as an intangible asset until the drilling of the well is complete and the results have been evaluated. These costs include employee remuneration, materials and fuel used, rig costs and payments made to contractors. If hydrocarbons are not found, the exploration expenditure is written off as a dry hole. If hydrocarbons are found and, subject to further appraisal activity, which may include the drilling of further wells, are likely to be capable of commercial development the costs continue to be carried as an asset. All such carried costs are subject to regular technical, commercial and management review to confirm the continued intent to develop or otherwise extract value from the discovery. When this is no longer the case, the costs are written off. When proved reserves of oil and natural gas are determined and development is sanctioned, the relevant expenditure is transferred to tangible production assets.

#### **Development expenditure**

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

#### **Tangible fixed assets**

Tangible fixed assets are stated at cost, less accumulated depreciation and accumulated impairment losses.

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

Oil and natural gas properties are depreciated using a unit-of-production method. The cost of producing wells is depreciated over proved developed reserves. Licence acquisition, decommissioning and field development costs are depreciated over total proved reserves. The unit-of-production rate for the depreciation of field development costs takes into account expenditures incurred to date, together with future development expenditure required to access the total proved reserves.

Other tangible assets, with the exception of freehold land and assets under construction, are depreciated on the straight line method over their estimated useful lives.

#### **Maintenance expenditure**

Expenditure on major maintenance refits or repairs comprises the cost of replacement assets or parts of assets, inspection costs and overhaul costs. Where an asset or part of an asset that was separately depreciated and is now written off is replaced and it is probable that future economic benefits associated with the item will flow to the company, the expenditure is capitalised. All other maintenance costs are expensed as incurred.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **ACCOUNTING POLICIES**

#### **Impairment of intangible and tangible fixed assets**

The company assesses assets or groups of assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Individual assets are grouped for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. If any such indication of impairment exists or when annual impairment testing for an asset group is required, the company makes an estimate of its recoverable amount. An asset group's recoverable amount is the higher of its net realisable value and its value in use. Where the carrying amount of an asset group exceeds its recoverable amount, the asset group is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are adjusted for the risks specific to the asset group and are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss. After such a reversal, the depreciation charge is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

#### **Proportional consolidation**

The company holds an interest in a joint agreement that is not an entity ('JANE'). As a result, it accounts for its proportionate share of the costs, revenues, assets and liabilities in the JANE.

#### **Stock valuation**

Stocks are valued at cost to the company, using the first-in first-out method or net realisable value, whichever is the lower. Stores are valued at cost to the company mainly using the average method or net realisable value, whichever is the lower.

#### **Trade and other debtors**

Trade and other debtors are carried at the original invoice amount, less allowances made for doubtful receivables. Provision is made when there is objective evidence that the company will be unable to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

#### **Trade and other creditors**

Trade and other creditors are carried at payment or settlement amounts. If the effect of the time value of money is material, trade and other creditors are determined by discounting the expected future cash flows at a pre-tax rate.

## **BP EXPLORATION (AZERBAIJAN) LIMITED**

### **ACCOUNTING POLICIES**

#### **Provisions**

Provisions are recognised when the company has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the company expects some or all of a provision to be reimbursed, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the profit and loss account net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate.

A contingent liability is disclosed where the existence of an obligation will only be confirmed by future events or where the amount of the obligation cannot be measured with reasonable reliability. Contingent assets are not recognised, but are disclosed where an inflow of economic benefits is probable.

#### **Decommissioning**

Provision for decommissioning costs is recognised when the company has an obligation to dismantle and remove a facility or an item of plant and to restore the site on which it is located, and when a reasonable estimate of that provision can be made. Where an obligation exists for a new facility, such as oil and natural gas production or transportation facilities, this will be on construction or installation. An obligation for decommissioning may also crystallise during the period of operation of a facility through a change in legislation or through a decision to terminate operations. The amount recognised is the present value of the estimated future expenditure determined in accordance with the local conditions and requirements. A corresponding tangible fixed asset of an amount equivalent to the provision is also recognised. This is subsequently depreciated as part of the capital costs of the production and transportation facilities.

Any change in the present value of the estimated expenditure is reflected as an adjustment to the provision and the fixed asset.

#### **Environmental liabilities**

Environmental expenditures that relate to current or future revenues are expensed or capitalised as appropriate. Expenditures that relate to an existing condition caused by past operations and that do not contribute to current or future earnings are expensed.

Liabilities for environmental costs are recognised when environmental assessments or clean-ups are probable and the associated costs can be reasonably estimated. Generally the timing of these provisions coincides with the commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites. The amount recognised is the best estimate of the expenditure required. Where the time value of money is material, the amount recognised is the present value of the estimated future expenditure.

#### **Discounting**

The unwinding of the discount on provisions is included within interest expense. Any change in the amount recognised for environmental and other provisions arising through changes in discount rates is included within interest expense, apart from decommissioning provisions where the change is adjusted against the decommissioning asset.

**BP EXPLORATION (AZERBAIJAN) LIMITED**

**ACCOUNTING POLICIES**

**Leases**

Assets held under leases which transfer to the company substantially all risks and rewards incidental to ownership of the leased item are classified as finance leases, and are capitalised at inception of the lease at the fair value of the leased property or, if significantly lower, at the estimated present value of the minimum lease payments. Lease payments are apportioned between the finance charges and the reduction of the lease liability. The total finance charge is charged over the lease term so as to achieve a constant rate of interest on the remaining balance of the liability.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

All other lease arrangements are classified as operating leases. Operating lease payments are recognised as an expense in the profit and loss account on a straight-line basis over the lease term.

**Use of estimates**

The preparation of accounts in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the accounts and the reported amounts of revenues and expenses during the reporting period. Actual outcomes could differ from those estimates.

**BP EXPLORATION (AZERBAIJAN) LIMITED****PROFIT AND LOSS ACCOUNT**  
**FOR THE YEAR ENDED 31 DECEMBER 2012**

		<u>2012</u>	<u>2011</u>
	Note	\$000	\$000
<b>Turnover</b>	<b>1</b>	622,306	678,159
<b>Cost of sales</b>		<u>(192,496)</u>	<u>(251,389)</u>
<b>Gross profit</b>		429,810	426,770
 Exploration expenses		 (450)	 (243)
Administration expenses		<u>3,521</u>	<u>1,836</u>
<b>Operating profit</b>	<b>2</b>	432,881	428,362
 Loss on disposal of operations	<b>4</b>	 -	 (127)
<b>Profit on ordinary activities before interest and taxation</b>		<u>432,881</u>	<u>428,235</u>
 Interest payable and similar charges	<b>5</b>	 (4,398)	 (6,178)
Interest receivable and similar income	<b>6</b>	<u>327</u>	<u>1,397</u>
<b>Profit before taxation</b>		428,810	423,454
 Taxation	<b>7</b>	 (73,072)	 (43,578)
<b>Profit for the year</b>		<u>355,738</u>	<u>379,876</u>

The profit of \$355,738,000 for the year ended 31 December 2012 was derived in its entirety from continuing operations

**STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES**  
**FOR THE YEAR ENDED 31 DECEMBER 2012**

There are no recognised gains or losses attributable to the shareholders of the company other than the profit of \$355,738,000 for the year

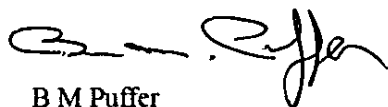
**BP EXPLORATION (AZERBAIJAN) LIMITED**

(Registered No 02160234)

**BALANCE SHEET AT 31 DECEMBER 2012**

		2012	2011
	Note	\$000	\$000
<b>Fixed assets</b>			
Intangible assets	9	627,205	378,035
Tangible assets	10	892,546	977,455
Investments	11	41	41
		<u>1,519,792</u>	<u>1,355,531</u>
<b>Current assets</b>			
Stocks	12	49,075	50,719
Debtors	13	471,038	233,666
		<u>520,113</u>	<u>284,385</u>
<b>Creditors: amounts falling due within one year</b>	14	(196,768)	(204,016)
<b>Net current assets</b>		<u>323,345</u>	<u>80,369</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<u>1,843,137</u>	<u>1,435,900</u>
<b>Creditors: amounts falling due after more than one year</b>	14	(74,644)	(46,463)
<b>Provisions for liabilities and charges</b>			
Other provisions	16	(155,654)	(132,336)
<b>NET ASSETS</b>		<u>1,612,839</u>	<u>1,257,101</u>
<b>Represented by</b>			
<b>Capital and reserves</b>			
Called up share capital	17	142,681	142,681
Profit and loss account	18	1,470,158	1,114,420
<b>SHAREHOLDERS' FUNDS – EQUITY INTERESTS</b>		<u>1,612,839</u>	<u>1,257,101</u>

On behalf of the Board


B M Puffer  
Director

17 September 2013

**BP EXPLORATION (AZERBAIJAN) LIMITED****NOTES TO THE ACCOUNTS****1. Turnover**

Turnover, which is stated net of value added tax, customs duties and sales taxes represents amounts invoiced to third parties

The country of origin and destination is substantially the Rest of World geographic area

Turnover is attributable to one continuing activity, the production and selling of petroleum products

2012 turnover includes \$73,072,000 of tax barrels revenue (2011 \$43,578,000) Tax barrels revenue is additional revenue recognized by BP driven by the terms of the PSA The PSA sets out pay-on-behalf tax regime, where SOCAR pays income tax on behalf of Contractor Parties in lieu of entitlement to production. Income tax expense was recognized and a corresponding increase in revenue was reported in BP Exploration (Azerbaijan) Limited's books.

**2. Operating profit**

This is stated after charging

	2012	2011
	\$000	\$000
Expenditure on research	5,190	2,615
Depreciation of owned fixed assets	119,773	89,549
Depreciation of assets held under finance leases	827	827

Administrative expense is a net effect of allowable recovery from PSAs in respect of administrative overhead receivable from the partners to those PSAs In 2012 and 2011 amounts received and receivable were higher than actual administrative expenses

**3. Auditor's remuneration**

	2012	2011
	\$000	\$000
Fees for the audit of the company	52	50

Fees paid to the company's auditor, Ernst & Young LLP, and its associates for services other than the statutory audit of the company are not disclosed in these accounts since the consolidated accounts of BP Exploration (Azerbaijan) Limited's ultimate parent, BP plc, are required to disclose non-audit fees on a consolidated basis

**4. Exceptional items**

Exceptional items comprise the loss on disposal of operations as follows

	2012	2011
	\$000	\$000
Loss on disposal of operations	-	127

The loss on disposal of operations of \$127,000 in 2011 arose due to the company's decision to exit from the Hyde field operations

There is no tax effect on this disposal of operations

**BP EXPLORATION (AZERBAIJAN) LIMITED****NOTES TO THE ACCOUNTS****5. Interest payable and similar charges**

	<u>2012</u>	<u>2011</u>
	\$000	\$000
Interest expense on		
Overdraft from group undertakings	521	1 823
Finance leases	323	356
Unwinding of discount on provisions – See note 16	3,554	3,999
	<u>4,398</u>	<u>6,178</u>

**6. Interest receivable and similar income**

	<u>2012</u>	<u>2011</u>
	\$000	\$000
Interest income from parent and subsidiary undertakings	266	18
Interest income (2011 AGSC BOTAS price adjustment)	61	1,379
	<u>327</u>	<u>1,397</u>

**7. Taxation**

The Company is a member of a group for the purposes of relief within Part 5, Corporation Tax Act 2010. No UK corporation tax has been provided because another group company, BP International Limited, has undertaken to procure the claim or surrender of group relief to the extent it is required and to provide for any current or deferred UK tax that arises without charge.

The tax charge is made up as follows

	<u>2012</u>	<u>2011</u>
	\$000	\$000
<u>Current tax</u>		
Overseas tax on income for the year – see note 1	73,072	43,578
Total current tax charged	<u>73,072</u>	<u>43,578</u>
Tax charged on profit on ordinary activities	<u>73,072</u>	<u>43,578</u>

**(a) Factors affecting the current tax charge**

The tax assessed on the profit on ordinary activities for the year is lower than the standard rate of corporation tax in the UK of 24% for the year ended 31 December 2012 (2011 – 26%). The differences are reconciled below

	<u>2012</u>	<u>2011</u>
	UK	UK
	\$000	\$000
Profit on ordinary activities before tax	428,810	423,454
Current taxation	73,072	43,578
Effective current tax rate	17%	10%



**BP EXPLORATION (AZERBAIJAN) LIMITED****NOTES TO THE ACCOUNTS****7. Taxation (continued)****(a) Factors affecting the current tax charge (continued)**

	<u>2012</u>	<u>2011</u>
	UK	UK
	%	%
UK corporation tax rate	24	26
Overseas corporation tax rate	17	10
Decrease resulting from		
Fixed asset timing differences	(2)	(8)
Non deductible expenditure / non taxable income	(22)	-
Double tax relief	-	(10)
Current overseas tax	17	10
Group relief	-	(8)
Effective current tax rate	<u>17</u>	<u>10</u>

The permanent and timing difference shown in the current tax rate reconciliation above are those that arise for UK corporation tax purposes, rather than overseas tax purposes

**8. Directors and employees****(a) Remuneration of directors**

None of the directors received any fees or remuneration for services as a director of the company during the financial year (2011 \$ Nil)

**(b) Employee costs**

The company had no employees during the year (2011 Nil)

**9. Intangible assets**

	<u>Total</u>
<b>Cost</b>	<b>\$000</b>
At 1 January 2012	378,035
Additions	221,640
Transfers	27,530
At 31 December 2012	<u>627,205</u>
<b>Amortisation</b>	
At 1 January 2012 and	-
31 December 2012	<u>-</u>
<b>Net book value</b>	
At 31 December 2012	<u>627,205</u>
At 31 December 2011	<u>378,035</u>

**BP EXPLORATION (AZERBAIJAN) LIMITED****NOTES TO THE ACCOUNTS****10. Tangible assets**

	Fixtures & fittings	Oil & gas properties	Total	Of Which AUC*
Cost	\$000	\$000	\$000	\$000
At 1 January 2012	623	1,316,623	1,317,246	623
Additions	4,204	59,018	63,222	4,204
Transfers	-	(27,530)	(27,530)	-
At 31 December 2012	<u>4,827</u>	<u>1,348,111</u>	<u>1 352,938</u>	<u>4,827</u>
<b>Depreciation and impairment</b>				
At 1 January 2012	-	339,792	339,792	-
Charge for the year	-	120,600	120,600	-
At 31 December 2012	<u>-</u>	<u>460 392</u>	<u>460,392</u>	<u>-</u>
<b>Net book value</b>				
At 31 December 2012	<u>4,827</u>	<u>887,719</u>	<u>892 546</u>	<u>4,827</u>
At 31 December 2011	<u>623</u>	<u>976,832</u>	<u>977,455</u>	<u>623</u>
Principal rates of depreciation			Unit of production	

\*AUC = assets under construction Assets under construction are not depreciated

Assets held under finance leases and capitalised interest included above, are

	Cost	Depreciation	Net book value
	\$000	\$000	\$000
<b>Leased assets – Vessels</b>			
At 31 December 2012	8 273	(2,362)	5 911
At 31 December 2011	8,273	(1,535)	6 738
<b>Capitalised interest</b>			
At 31 December 2012	69,198	(16,370)	52,828
At 31 December 2011	69,198	(12,009)	57,189

**BP EXPLORATION (AZERBAIJAN) LIMITED**

**NOTES TO THE ACCOUNTS**

**11. Investments**

	Joint venture shares
<b>Cost</b>	<b>\$000</b>
At 1 January 2012 and 31 December 2012	41
	<u>41</u>
<b>Impairment losses</b>	
At 1 January 2012 and 31 December 2012	-
	<u>-</u>
<b>Net book amount</b>	
At 31 December 2012	41
	<u>41</u>
At 31 December 2011	41
	<u>41</u>

The investments in the joint venture shares is unlisted.

The joint ventures in which the company participates at 31 December 2012 and the percentage of equity capital held are set out below. The principal country of operation is generally indicated by the company's country of incorporation or by its name.

Joint ventures	Class of share held	%	Principal place of business	Principal activity
Azerbaijan Gas Supply Company	Ordinary	20.4	Azerbaijan	Natural Gas Supply

**12. Stocks**

	2012	2011
	<u>\$000</u>	<u>\$000</u>
Petroleum	1,811	1,876
Stores	47,264	48,843
	<u>49,075</u>	<u>50,719</u>

The difference between the carrying value of stocks and their replacement cost is not material.

**BP EXPLORATION (AZERBAIJAN) LIMITED**

**NOTES TO THE ACCOUNTS**

**13. Debtors**

	<u>2012</u>	<u>2011</u>
	Within	Within
	1 year	1 year
	\$000	\$000
Trade debtors	119,186	85,490
Amounts owed by group undertakings	307,771	122,441
Other debtors	38,401	22,239
Prepayments and accrued income	5,520	3,254
VAT recoverable	160	242
	<u>471 038</u>	<u>233.666</u>

**14. Creditors**

	<u>2012</u>	<u>2012</u>	<u>2011</u>	<u>2011</u>
	Within	After	Within	After
	1 year	1 year	1 year	1 year
	\$000	\$000	\$000	\$000
Trade creditors	82,556	-	120,638	-
Amounts owed to group undertaking	9,093	-	5,487	-
Amounts owed to associates	1,841	-	1,864	-
Other creditors	28,837	-	18,192	-
Accruals and deferred income	46,271	69 093	35,340	40,154
Obligations under leases (see note 15)	758	5,551	725	6,309
Tax creditors	27,412	-	21,770	-
	<u>196,768</u>	<u>74,644</u>	<u>204,016</u>	<u>46,463</u>

**15. Obligations under leases**

Amounts due under finance leases are as follows

	<u>2012</u>	<u>2011</u>
	\$000	\$000
Amounts payable		
Within 1 year	1 045	1,048
Between 2 to 5 years	4 183	4,183
Thereafter	2 259	3 304
	<u>7,487</u>	<u>8,535</u>
Less finance charges	<u>(1,178)</u>	<u>(1,501)</u>
Net obligations	<u>6 309</u>	<u>7 034</u>

**16. Other provisions**

	<u>Decom-</u> <u>missioning</u>
	\$000
At 1 January 2012	132,336
New or increased provisions	19,764
Unwinding of discount	3,554
At 31 December 2012	<u>155,654</u>

**BP EXPLORATION (AZERBAIJAN) LIMITED****NOTES TO THE ACCOUNTS****16. Other provisions (continued)**

The company makes full provision for the future cost of decommissioning oil and natural gas production facilities and related pipelines on a discounted basis on the installation of those facilities. At 31 December 2012, the provision for the costs of decommissioning these production facilities and pipelines at the end of their economic lives was \$155,654,000 (2011 \$132,336,000). The provision has been estimated using existing technology, at current prices and discounted using a real discount rate of 2.5% (2011 2.5%). These costs are expected to be incurred over the next 11 to 18 years. While the provision is based on the best estimate of future costs and the economic lives of the facilities and pipelines, there is uncertainty regarding both the amount and timing of incurring these costs.

**17. Called up share capital**

	<u>2012</u>	<u>2011</u>
	\$000	\$000
Allotted, called up and fully paid		
2 Ordinary shares of £1 each for a total nominal value of £2	-	-
39,444,444 ordinary shares of £1 each for a total nominal value of £39,444,444	71,181	71,181
29,487,546 ordinary shares of £1 each for a total nominal value of £29,487,546	51,500	51,500
10,137,361 ordinary shares of £1 each for a total nominal value of £10,137,361	<u>20,000</u>	<u>20,000</u>
	<u>142,681</u>	<u>142,681</u>

**18. Capital and reserves**

	Called up share capital	Profit and loss account	Total
	\$000	\$000	\$000
At 1 January 2012	142,681	1,114,420	1,257,101
Profit for the year	-	355,738	355,738
At 31 December 2012	<u>142,681</u>	<u>1,470,158</u>	<u>1,612,839</u>

**19. Reconciliation of movements in shareholders' funds**

	<u>2012</u>	<u>2011</u>
	\$000	\$000
Profit for the year	355,738	379,876
Net increase in shareholders' funds	355,738	379,876
Shareholders' funds at 1 January	1,257,101	877,225
Shareholders' funds at 31 December	<u>1,612,839</u>	<u>1,257,101</u>

**BP EXPLORATION (AZERBAIJAN) LIMITED****NOTES TO THE ACCOUNTS****20. Guarantees and other financial commitments**

Pursuant to agreements governing the sales and purchase of natural gas and its transportation, the company has undertaken the following commitments as a direct party to gas sales and transportation contracts or as a guaranteeing and indemnifying party thereto

In accordance with the Upstream Sales and Purchase Agreement, the Company agreed to sell the entire Stage I gas to Azerbaijan Gas Supply Company ("AGSC") AGSC then ships the gas to redelivery points on the Georgian-Turkish border via the South Caucasus Pipeline ("SCP") system

AGSC has a Minimum Monthly Payment ("MMP") obligation to the SCP Company for the transportation capacity reserved by the latter for AGSC's needs under the Annual Reserves Capacity Deed The Company with the participants under the Shah Deniz PSA guaranteed to indemnify AGSC for the MMP payable to SCP Company The guarantee to AGSC is a cross guarantee in the event a participant defaults

The company's share of the commitment as at 31 December 2012 is \$148,000,000 (2011 \$171,000,000)

**21. Related party transactions**

The company has taken advantage of the exemption contained within Financial Reporting Standard No 8 "Related Party Disclosures", and has not disclosed transactions entered into with group companies

During the year the company entered into transactions in the ordinary course of business, with other related parties Transactions entered into, and trading balances outstanding at 31 December, are as follows

Related party	Relationship	Description	Purchases from related party	Amounts owed to related party
			\$000	\$000
BTC Company	Group Associate	Transportation Services		
2012			18,364	1,841
2011			17,515	1,864

During the year the company entered into transactions with South Caucasus Pipeline Company ("SCP Co") that has a joint arrangement with BP Pipelines (SCP) Ltd, wholly BP group owned company. These transactions included funding of SCP Expansion Project ownership of which was transferred to SCP Co in 2013

**BP EXPLORATION (AZERBAIJAN) LIMITED****NOTES TO THE ACCOUNTS****21. Related party transactions (continued)**

Related party	Relationship	Description	Amounts owed from related party	Amounts owed to related party
			\$	\$
South Caucasus Pipeline Company	Joint arrangement	Funding of SCP Expansion Project		
2012			9,624	-
2011			-	4,094

**22. Pensions**

The company does not directly employ any staff and therefore does not directly bear any pension charge

**23. Comparative figures**

Certain prior year figures have been reclassified to conform to the 2012 presentation. This had no impact on the profit and loss for the year or net assets.

**24. Immediate and ultimate controlling parent undertaking**

The immediate parent undertaking is BP Exploration Operating Company Limited, a company registered in England and Wales. The ultimate controlling parent undertaking is BP plc, a company registered in England and Wales, which is the parent undertaking of the smallest and largest group to consolidate these financial statements. Copies of the consolidated financial statements of BP plc can be obtained from 1 St James's Square, London, SW1Y 4PD.