

Review of financial reporting
The Board of Directors - Statoil ASA

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Partly exempt from public disclosure
Freedom of Information Act (FIA) § 13 (1),
cf Public Administration Act (PAA) § 13 (1) no 2

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1. Introduction

Finanstilsynet (The Financial Supervisory Authority of Norway) has reviewed certain aspects of the 2012 consolidated financial statement of Statoil ASA ("Statoil"), cf. the Securities Trading Act section 15-1 (3). The financial statements were published on 22 March 2013 and the first letter requesting information was sent Statoil on 3 June 2013.

Three errors have been identified in Statoil's financial statement for 2012. All relate to the accounting rules on impairment testing of non-financial assets. Statoil does not agree with Finanstilsynet's assessments of the three issues and views its practices to be within the applicable rules. In letters of 28 February and 9 March 2014, Statoil has nonetheless stated that, for two of the errors, it will change its accounting practices in line with Finanstilsynet's evaluation and correct in accordance with IFRS. Finanstilsynet orders Statoil to correct the third error in its historic financial reporting and change its accounting practices.

A summary of the review is presented in paragraph 2 below. Paragraph 3 discusses the question of error and materiality relative to Finanstilsynet's findings. In paragraph 4, Finanstilsynet's decision in the matter is included. The three errors are described in greater depth in appendices A-C, and Finanstilsynet's decision relates to the error described in Appendix C. Appendix D gives a summary of other topics addressed in the review.

2. Summary of the review

2.1 Process

The review of Statoil's 2012 financial statements has covered a number of topics and included an extensive correspondence. There have been several meetings with the issuer. Finanstilsynet sent Statoil an advanced notification of decision on 13 December 2013, and received the issuer's

response on 27 January 2014. Finanstilsynet has in several meetings requested the advice of the Advisory Expert Committee on Accounting Issues (the "Expert Committee"). The statements from the Expert Committee are attached to appendices A-C, respectively.

2.2 Background

Impairment issues have become more relevant for the exploration and production industry. Several factors have contributed to this, including the price developments for hydrocarbons, break-even prices being under pressure from an increase in supplier costs and the trend towards development of more inaccessible resources. Finanstilsynet's review of Statoil's financial statements for 2012 focused on key aspects of the issuer's principles for impairment testing, as well as assets and activities presumed to be affected by the recent shale revolution in the US.

IFRS-rules on impairment shall ensure that assets are not reflected in the financial statements at values exceeding their recoverable amount, defined as the higher of the asset's value in use and fair value less cost to sell. When determining value in use, an issuer shall reflect the expected present value of the future cash flows, i.e. the weighted average of all possible outcomes. Assumptions applied must be reasonable and supportable.

If indicators of impairment exist, IAS 36 "Impairment of Assets" requires an impairment test to be performed. In addition, certain intangible assets shall be tested for impairment annually. If it is not possible to determine an individual asset's recoverable amount, an entity shall determine the recoverable amount of the cash generating unit ("CGU") to which the asset belongs. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent from other assets or groups of assets. Impairment tests are generally sensitive to which level assets, or groups of assets, are identified as CGUs. Incorrect identification of a CGU at a too high level may result in assets generating significant cash inflows erroneously being grouped with assets that are not. This may in turn lead to write-downs not being carried out.

IAS 37 "Provisions, contingent liabilities and contingent assets" normally requires separate provisions for onerous contracts. If there are assets dedicated to an onerous contract, an entity recognizes an impairment loss for those assets (or the CGU to which they belong) before a separate provision for the contract is established. A CGU shall be determined consistently over time, unless a change is justified. In circumstances where it is justified to separate an onerous contract from the CGU, but a separate provision for the contract is not established, the financial statements will give an incomplete presentation of the total liabilities.

2.3 The three errors identified

2.3.1 Value in use for impairment purposes - Practice of using reliability intervals

The first error identified involves key elements of Statoil's accounting practice related to impairment testing of non-financial assets. More specifically the error relates to the application of a reliability interval (range) around the company's initial value in use ("VIU") estimate. In Finanstilsynet's view, the use of a reliability interval when testing assets for impairment is not in accordance with IFRS.

According to IAS 36, uncertainty in determining an asset's value in use should be reflected in one of two ways; either as adjustments to the future cash flows or the discount rate. Whichever approach an entity adopts to reflect expectations about possible uncertainties and variations, the result of the computation should be the weighted average of all possible outcomes. Finanstilsynet is of the opinion that IAS 36 requires the value in use to be estimated as a singular estimate (point estimate) and not an interval. Finanstilsynet believes this to be consistent with widespread IFRS practice. If the book value of an asset falls below the estimated value in use, the issuer shall record an impairment loss.

In its correspondence with Finanstilsynet, Statoil has described its methodology for testing non-financial assets for impairment. When calculating an asset's VIU as part of testing assets for impairment, Statoil first establishes an initial estimate of an asset's net present value where uncertainty is either reflected in the cash flow or discount rate. After this, according to Statoil's accounting manual, an interval of best estimates of value in use is set around the initial estimate. The interval will depend on the uncertainty deemed to be present, and will range from a minimum of 15 % up to 30 % on both sides of the initial estimate. As long as the book value of an asset is within the interval, Statoil will not record an impairment loss (even if the mid-point of the interval is below the book value). If the highest value within the interval is below the book value, Statoil will seek to determine the asset's fair value less cost to sell. Statoil will then determine the best estimate of an un-biased value of the asset as a single number. An impairment loss will be booked, and the asset written down to the mid-point of the interval, if the highest value within the interval is below the book value and fair value less cost to sell is below the initial VIU estimate.

[.....Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2.....]. Relative to the financial result, the most significant accounting effect of the principle in a reporting period was in Q1-2009 when the sum of Statoil's initial VIU estimates (mid-point of the range) was approximately NOK 1,5 billion below the sum of the book values. In Q1-2009 Statoil reported a net operating income of NOK 35,5 billion and a net income of NOK 4 billion.

In Finanstilsynet's view, the 2012 financial statements do not contain adequate disclosure of Statoil's principle for use of reliability intervals in determining recoverable amount. Such adequate information is important to enable users to understand the financial statements and the judgments applied by the issuer. Finanstilsynet has not observed a similar practice from other entities.

Application of a reliability interval in calculating recoverable amount will generally result in less variability in periodic financial results because there will be fewer instances of impairment and reversal than what follows from IFRS. On the other hand, in cases where additional changes in the value of the assets in subsequent periods nevertheless cause the recognition of impairments/reversals, these effects will be larger than they otherwise would have been.

Reference is made to appendix A for further description of Statoil's accounting practice and arguments, Finanstilsynet's evaluation and statement from the Expert Committee.

2.3.2 Identifying the Cash Generating Unit – the Marcellus Shale Play

The second error identified by Finanstilsynet relates to Statoil's practice of cash generating unit ("CGU") identification for unconventional onshore assets. Finanstilsynet is of the opinion that

Marcellus should be split into more than one CGU based on a bottom up analysis. The review has focused on the Marcellus Shale Play in USA, but the issue has general application for Statoil's unconventional assets.

The Marcellus play is the US shale play with the largest geographical extent, spanning over several states. In total, Marcellus covers an area of approximately 250.000 km², almost twice the size of the Norwegian part of the North Sea opened for petroleum exploration and production by Norwegian authorities (approx. 129.700 km²). By year-end 2012, Statoil had participated in the drilling of more than 800 wells on its Marcellus licenses.

For its offshore oil and gas assets, Statoil will normally view each field or plant as a separate CGU. Finanstilsynet understands this to be consistent with widespread IFRS practice. In relation to its onshore activity, Statoil's accounting principle disclosure states that each unconventional shale play is considered as one cash generating unit. Each of Statoil's four major unconventional shale plays in North-America, including the Marcellus asset, is consequently viewed as constituting one CGU for purposes of impairment testing.

According to IAS 36, identifying a CGU is a bottom-up process. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets. Based on information provided by Statoil, and as further described in appendix B, Finanstilsynet is of the opinion that the Marcellus asset generates more than one largely independent cash flow. The Marcellus CGU shall therefore be split into more than one CGU for the purposes of impairment testing.

During the review process Finanstilsynet asked Statoil if it deemed impairment indicators to be present for the Marcellus asset in 2012. Statoil originally stated that it did not view such indicators to be present and that it had not performed an impairment test, but has in its letter of 27 January 2014 supplemented this and informed that an impairment test was performed for Marcellus in Q2-2012. In line with Finanstilsynet's advance notice of decision, Statoil has stated that it will identify more than one CGU in Marcellus and perform impairment tests using 2012 input.

Reference is made to appendix B for further description of Statoil's accounting practice and arguments, Finanstilsynet's evaluation and statement from the Expert Committee.

2.3.3 Re-definition of Cash Generating Unit and provision for Cove Point loss contract

The third error identified, relates to Statoil's operationalization of certain guidance in IAS 36 pertaining to changes in the components included in the CGU identified. The operationalization was developed in relation to onerous take- or pay contracts for import capacity at the Cove Point terminal in Maryland, USA. Part of the import capacity was acquired by Statoil in 2002 from El Paso Merchant Energy L.P. together with an agreement for the purchase of liquefied natural gas ("LNG") from Snøhvit/Melkøya, and these contracts were grouped in the Statoil Natural Gas LLC CGU. Part of the import capacity was acquired by way of an expansion agreement in 2006.

The capacity contracts in question were meant to give Statoil access to the North-American gas market. A considerable part of the LNG from Snøhvit/Melkøya was originally destined for the US. Under the take-or-pay contracts, Statoil is obliged to make payments even if it does not make use of

the terminal's capacity. Due to falling US natural gas prices and expectations of low future prices caused by new domestic shale gas production, Statoil started viewing the Cove Point capacity contracts as loss contracts from 2010.

In Q2-2011, an updated evaluation of the accounting for the Cove Point contracts was undertaken by Statoil. Based on new assumptions for inter alia US gas prices, the expected use of the contracts was virtually nil for the remaining time of the capacity contracts. Statoil decided that the following criteria had to be met to justify a re-definition of the CGU: "Positive management decision not to use the terminal capacity, where the decision should involve permanent and/or irreversible non-usage consequences, or, alternatively; -expectations of no utilization to be sustained and evidences over an extended time period (i.e. trend establishment)". Statoil did not regard that either of these criteria were met, and hence did not redefine the CGU and make the loss provision in Q2-2011. This was also the case in the following quarterly assessments in 2011 and 2012. An early termination agreement with its counterpart Dominion Resources Inc. was signed on 19 March 2013 for the expansion contract and a provision for the Cove Point contracts made in Q1-2013. At the time of recognition, Statoil measured the loss contracts at NOK 4,9 billion, and stated that it included all remaining future payment obligations under all the Cove Point capacity contracts.

In Finanstilsynet's opinion, Statoil's operationalization constitutes a higher threshold for redefining the CGU than what a reasonable application of IAS 36 allows for. The evaluation of when a change in the composition of a CGU is justified must be based on other guidance relating to CGU identification in IAS 36. Statoil's evaluation of whether the Cove Point capacity would be used effectively included an evaluation of whether the contracts were expected to generate future cash inflows (and not just costs). The expected usage of the capacity contract, and hence the expected inflows of cash, were nil in Q2-2011. It can be argued that from that point on, the other assets in the CGU generated cash inflows independently of the onerous contract. Developments subsequent to Q2-2011 served to further substantiate the arguments for splitting the Cove Point capacity contracts from the SNG CGU. Finanstilsynet finds that a redefinition of the CGU and booking of a separate provision for the Cove Point contracts should have been done prior to Q1-2013.

Reference is made to appendix C for further description of Statoil's accounting practice and arguments, Finanstilsynet's evaluation and statement from the Expert Committee. In paragraph 4, Finanstilsynet's decision in the matter is included.

2.4 Other aspects of the review

The review has covered a number of topics which Finanstilsynet has taken under advisement or discontinued work on due to reasons of materiality. Statoil is recommended to present DPNA (Development and Production North America) as a separate reporting segment in the disclosures.

Reference is made to appendix D for further description of Statoil's accounting practice and arguments, and Finanstilsynet's evaluation.

3. Question of error and materiality

Even though Statoil has stated that it will treat two of the three issues as errors and change its accounting practices in line with Finanstilsynet's evaluation, Statoil does not agree with the

presentation of any of the three issues as errors. In its letter of 27 January 2014 in response to Finanstilsynet's advance notice of decision, Statoil writes that the three issues should be characterized as "different views on how to interpret relevant accounting standards in complicated areas and apply them to factual situations". It is underlined that the issuer has used its best professional judgment and professional advice.

Financial statements reviewed by Finanstilsynet and other enforcers in the EEA have in addition to being prepared by issuers' in accordance with their best professional judgment, also been audited. The concept of an error within IFRS includes more than mathematical mistakes. Generally, enforcement actions will focus on errors relating to oversights and misinterpretation of facts and mistakes in applying accounting policies.

Finanstilsynet agrees that the application of professional judgment is a key factor, both in preparing financial statements in general and particularly relating to accounting estimates. Statoil highlights that for all three issues, the internal processes relating to the development and operationalization of accounting principles had the characteristics of sound accounting judgment, and as such must be deemed a reasonable application of IFRS.

The existence of a sound process does not preclude Finanstilsynet from reviewing the accounting judgments made by the preparer and consider whether these are reasonable and in accordance with IFRS.

The three errors all relate to the accounting rules on impairment testing of non-financial assets. In Statoil's 2012 financial statements, property, plant and equipment and intangible assets constitute 2/3 of the total assets, with a book value of approximately NOK 527 billion.

Statoil agrees that the accounting principles subject to discussion are important. However, Statoil in its 27 January 2014 letter holds that "the question of whether they are "material" in the sense in which such term is used in IAS 8 and other accounting standards is a question of the actual effect on the financial statements affected by Statoil's interpretation and application of the relevant accounting standards."

Although not disagreeing with this, Finanstilsynet emphasizes that errors are material if they could influence the economic decisions that users make on the basis of the financial statements. Furthermore, materiality depends on both the size and nature of the error. The materiality evaluation includes an evaluation of the effects of the errors in the financial statement both individually and collectively. The rules in IAS 8 "Accounting policies, changes in accounting estimates and errors" and the accompanying evaluation of materiality apply not only to annual financial statements, but also to interim financial statements. If one error individually is deemed material and corrected retrospectively, the restatement shall also include the effect of the other identified errors.

Among others, the errors identified affect the historic interim and annual financial statements up to and including 2012. As such they are prior period errors. According to IAS 8, material errors in prior periods shall be corrected retrospectively in the first set of financial statements authorized for use after their discovery. Based on the information Finanstilsynet has reviewed, and with regard to the size and nature of the three errors identified, as well as the effect they have had on prior periods,

Finanstilsynet is of the opinion that they collectively are material. Finanstilsynet emphasizes, however, that a complete materiality assessment in accordance with IAS 8 has not been performed.

Statoil must evaluate the materiality of the errors described in paragraphs 2.3.1 and 2.3.2 and assess corresponding corrections in accordance with IAS 8. The error described in paragraph 2.3.3. shall be corrected in line with Finanstilsynet's decision in paragraph 4. Since the onerous contract provision affected Statoil's Q1-2013 interim financial report, a retrospective correction of the error will affect Statoil's 2013 annual financial statement still not authorized for issue.

4. Finanstilsynet's decision and closing remarks

Pursuant to the Securities Trading Act section 15-1 subsection (3) and the Securities Trading Regulations of 29 June 2007 no. 876 section 13-8 litra a and b, Finanstilsynet orders Statoil to:

Change its future accounting practices for redetermination of CGUs containing onerous contracts. Correct the described error by establishing a separate onerous contract provision for the Cove Point capacity contract in a financial period prior to Q1-2013. The correction shall be presented in the next periodic financial report. Information about the circumstance shall be given in notes to the accounts.

Finanstilsynet's decisions can be appealed, cf. the Public Administration Act section 28. The Appellate instance is the Ministry of Finance. The appeal shall be filed with Finanstilsynet. The time limit for filing an appeal is within 3 weeks of receipt of this notification of decision. In accordance with section 18 and 19 of the Public Administration Act, Statoil has the right to acquaint itself with the documents in the matter.

Finanstilsynet confirms that in relation to the two errors described in paragraphs 2.3.1 and 2.3.2, cf. appendices A and B, the review will be closed, provided that Statoil will correct in accordance with IFRS and change its accounting practices in line with Finanstilsynet's evaluation.

Finanstilsynet emphasizes that this letter may contain information subject to the Securities Trading Act section 5-2 (1), cf. section 3-2 on disclosure of inside information, and requests the issuer to consider if this is the case.

Please contact Gaute S. Gravir, Head of Section, if you have any questions or need of clarification. Finanstilsynet has forwarded a copy of this letter to the issuer's appointed auditor and to Oslo Børs.

On behalf of Finanstilsynet.

Anne Merethe Bellamy
Director

Gaute S. Gravir
Head of Section