Enterprise Risk Management
Risk Management Process

Dragon Oil’s business is potentially exposed to different risks. However, some business risks can be accepted by the Group provided that acceptance of such risks creates value and that the risks are properly managed.

Risk overview

Dragon Oil’s business is potentially exposed to different risks, oil & gas industry-specific risks as well as business-specific risks. However, some business risks can be accepted by the Group provided that acceptance of such risks creates value and that the risks are properly managed. We recognise that the effective management of the business risks is crucial to our continued growth and success. In 2012, we adopted an Enterprise Risk Management (ERM) framework. ERM consists of policies, procedures and the Group’s organisational structure with clear roles, responsibilities and accountabilities aimed at risk identification, risk assessment, risk treatment and risk monitoring and reporting.

The key objectives of the group’s ERM are:
- to ensure that the significant business risks to which Dragon Oil is exposed are systematically identified, assessed and managed to acceptable levels based on risk tolerance and appetite levels as approved by the Board;
- to achieve an optimal risk-reward balance; and
- to ensure that risk management is embedded in all decision-making processes.

Our approach to risk management

The Board is ultimately responsible for risk management within the Group in accordance with corporate governance requirements and provides an oversight of the strategic direction of the business. The business planning process extends over a five-year period and provides the principal parameters against which the performance of the Group is measured. These include annual objectives and targets covering production, development, exploration, HSE and financial performance. Business plans are approved by the Board together with defined operational targets and risks to delivery.

Enterprise Risk Management process at Dragon Oil

<table>
<thead>
<tr>
<th>Establish context</th>
<th>Risk management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establish strategic, organisational and risk management process context by considering the environment within which the risks are present</td>
<td>Quarterly exercise</td>
</tr>
</tbody>
</table>

- **Risk Identification**
  - Identifying and characterising Dragon Oil risks (corporate and department levels) to objectives and agreeing appropriate risk ownership

- **Risk Assessment**
  - Assessing risk severity through establishing the impact and likelihood (gross, net and target basis) and the effectiveness of existing controls and mitigants in order to prioritise risks

- **Risk Treatment**
  - Consideration for further risk mitigating actions or treatment alternatives

**COMMUNICATION AND CONSULTATION**
Oversight of risk management at corporate level takes place through reporting to the Audit Committee and the Board annually. Risk Owners at department level assess the risks and evaluate the mitigation factors and progress of planned improvements quarterly while reporting to the Executive Committee semi-annually.

To manage risks and embed these into business activities and processes a Corporate Risk Register, comprising key Group level risks, and the Department Risk Registers, dealing with key activity risks, are created and reviewed periodically.

The CEO is the Group Risk Owner for the significant risks at corporate level and, along with the COO as the Risk Sponsor, is responsible for ensuring that each department completes an assessment of their risks, for challenging the robustness and completeness of the risk profile, for performing in-depth reviews of the key risks and monitoring the planned improvements.

A designated risk manager assists all Department Risk Owners in the ERM process to ensure that risk management complies with the relevant standards and that it is working effectively covering all aspects of the business.

The Group adopts risk management strategies based on the nature and types of risks categorising them into: strategic, operational, financial and compliance risks.

In 2013, the programme of cascading the risk management process down to departments continued. Risks identified in the preceding year were reviewed in the current operating environment and updated in risk registers at corporate and department levels. The review of department risks arising from the risk assessment was focused on the critical risks that were considered in depth for mitigating measures.

Several training sessions were conducted on the use of improved tools aiming to standardise the documentation.

Despite significant improvements in documentation, targets have been set to modify the templates used to better reflect control over the changes between periodic assessments and mitigation plans.

The focus for the next year is embedding the ERM in the strategy and planning processes through a series of communication and consultation meetings across the Group.
Principal risks
The Board and management are committed to an effective and proactive approach to risk management as a tool to enhance shareholder value.

The Board is ultimately responsible for risk management within the Group in accordance with corporate governance requirements and provides oversight of the strategic direction of the business. Oversight of risk management at corporate level takes place through reporting to the Audit Committee and the Board annually. Risk Owners assess the risks and evaluate the mitigating factors and progress of planned improvements quarterly while reporting to the Executive Committee at department level semi-annually.

The Audit Committee and management work closely to ensure that risk management remains relevant, is periodically reviewed to comply with the approved policy and ensure it is working effectively. In addition, to ensure that management of risk is an integral part of our activities across the Group and the action plans to mitigate their impact on the business are implemented. Risk Owners at department level are responsible and accountable for overall management of risks in their respective areas of responsibilities. Significant risks are identified, assessed, monitored and reported to the Audit Committee. Mitigating factors and planned improvements are discussed and implemented to manage these risks.

The Board recognises that risk management is an ongoing process and, while significant steps have been taken in the past, it is expected that the risk framework adopted in 2012 will improve risk monitoring. However, the implementation process will take place over a number of years and so the integration of risk management with business plans and objectives will continue during 2014 with a view to further refining and enhancing the process.

As is consistent with best practices for the industry, the Dragon Oil Control Framework document was reviewed in 2013 to ensure the relevancy of the key elements of controls. Policies and procedures aimed at managing the strategic, operational, financial and compliance risks inherent in our business exposures are developed. The application and consistency of these policies and procedures are regularly reviewed by the Group’s Internal Audit function, and are then overseen by and reported to the Audit Committee, who are ultimately responsible for reporting on the same to the Board.

Key risks for the business
We recognise that managing risks requires a continuous effort from the organisation. Our risk management strategy is to embed risk identification, assessment, monitoring and reporting into the decision making processes.

Our Corporate Risk Register is compiled across the Group through a top down and bottom up review process. Those risks identified as critical and potentially affecting our employees, reputation, operations, performance and assets needed to deliver the Group’s strategic goals and targets are identified and recorded through this process. During the year we have reviewed, identified and assessed the risks the Group faces. The risks are grouped into four categories: strategic, operational, financial and compliance-related. The principal risks and uncertainties, together with mitigating actions, are set out in the table opposite.
**STRATEGIC RISKS**

<table>
<thead>
<tr>
<th>RISK DESCRIPTION</th>
<th>MITIGATION</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Limited export routes for our entitlement share of crude oil production</strong></td>
<td>The Group possesses considerable experience in marketing within the Caspian Sea region. It has reached an agreement with Baku for the export of its current production via Baku until 31 December 2014. Dragon Oil continues to seek alternative marketing opportunities that would be deployed should the current arrangements experience disruption. Alternative options are available for partial volumes through Makhachkala in Russia or Kazakhstan, but sales would likely be at comparable or larger discounts than currently achieved. Developments in the various sanctions against Iran and Iranian entities are monitored closely and discussed with specialist lawyers.</td>
</tr>
<tr>
<td><strong>Reliance on sole producing asset</strong></td>
<td>The Group’s revenues are dependent on the continued performance of its single producing asset, offshore Turkmenistan. The satisfaction felt by shareholders, the Board and Dragon Oil staff arising from the success of the PSA may create a culture that is too risk averse in terms of acquiring new assets elsewhere resulting in missed opportunities to grow or diversify the business and alleviate the reliance on a single asset.</td>
</tr>
<tr>
<td><strong>Political and country context</strong></td>
<td>The Group has considerable experience in conducting business in the jurisdictions in which it operates. In Turkmenistan, there are strong and well-established government relationships. Further, few significant changes in Turkmenistan’s fiscal and legal systems since 2000 have not led to changes in the PSA. In other assets, we have partners with significant experience of operating in the relevant regions. In countries where it operates or has exploration assets, Dragon Oil focuses on corporate social responsibility (CSR) programmes and undertakes community and environment-related projects to ensure sustainability of its operations.</td>
</tr>
</tbody>
</table>

**OPERATIONAL RISKS**

<table>
<thead>
<tr>
<th>RISK DESCRIPTION</th>
<th>MITIGATION</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Failure to attract and retain skilled and talented human capital</strong></td>
<td>Focus is on continuous development of both technical and non-technical skills within Dragon Oil, including training within the Group’s Centre of Excellence and development of all staff, in particular local nationals, in Turkmenistan. Regular bench-marking of remuneration packages to ensure competitiveness against market levels is undertaken.</td>
</tr>
<tr>
<td><strong>Unexpected loss/unavailability of drilling rigs in Turkmenistan</strong></td>
<td>Dragon Oil’s producing asset is the Cheleken Contract Area, offshore Turkmenistan. The availability of drilling rigs, specifically new platform-based and jack-up rigs, is limited due to the fact that the Caspian Sea is land-locked with restricted access. This creates significant challenges for contractors willing to bring in new rigs. Unavailability or loss of a drilling rig or significant delays in rig deliveries may result in significant negative impact on field development, impose higher costs and inhibit the strategy to increase production. The Group has contracted several jack-up and platform-based rigs for its operations in Turkmenistan. It is expected that the Group will have four rigs operational for all or part of 2014. On the basis of awarded contracts and pending delivery of two rigs later in 2014, we expect to have five rigs operating in 2015. In the near term, there is a greater reliance on jack-up rigs introducing greater flexibility into the drilling programme.</td>
</tr>
</tbody>
</table>
Principal risks
Continued

**OPERATIONAL RISKS continued**

**Quality of contractors to undertake projects**

There is a small pool of top international contractors capable of completing offshore construction projects and few construction yards within the Caspian Sea region. Outside this pool, the contractors may have limited capability, making them less reliable and capable of delivery on time. This may result in delays to project delivery, missed production opportunities, inefficiencies and increased HSE exposure.

We have seen an increased number of high quality contractors tender for Dragon Oil’s projects and a programme to diversify actively the Group’s supplier base has been successful over the last three years. With many new companies now working for the Group, this programme will continue.

**HSE hazards, incidents and liability**

Health, safety and environmental risks are inherently associated with oil and gas extraction and recovery. The Group also has to meet country-specific environmental standards. Specifically for our producing asset in Turkmenistan, an oil spill in the Caspian Sea and inadequate crisis management could adversely impact production capability and profitability.

In addition, the local conditions related to security in countries where we have exploration assets may impact the exploration and operations of those assets.

Extensive monitoring and review of HSE policies and procedures as well as contracts with specialist service providers for the clean-up of oil spills have been conducted. Dragon Oil undertakes regular HSE training for operational staff together with annual HSE and crisis management exercises across the Group. Robust security management programme is to be developed.

**Impairment of production due to integrity of assets in Turkmenistan**

Integrity of very old infrastructure, particularly in the Dzhigalybeg (Zhdanov) field in the Cheleken Contract Area, presents significant operational, maintenance and safety challenges and uncertainties, and increases the likelihood of an accident. Breakdown can impair the production capability.

The Group has refurbished the producing pre-PSA infrastructure and replaced key components. There are plans in place to survey and/or dismantle and remove inactive old infrastructure. Going forward, the Group has adequate resources to build new infrastructure to modern design standards.

**FINANCIAL RISKS**

**Prolonged or sharp decline in oil price**

Historically, oil prices have been strong over the last five years but have proven to be highly volatile. Wide fluctuations in the oil price can impact the Group’s profitability, cash flows, liquidity and ability to finance planned capital expenditure as a result of lower revenue and impairment of the Group’s oil and gas properties.

The Group does not currently hedge its oil price exposure but does actively monitor it.

Our operations in Turkmenistan are cost efficient and one of our business objectives is to maintain operating costs within a pre-determined range. The Group also has significant cash resources and aims to finance capital expenditure on the producing and exploration assets internally. We intend to retain appropriate levels of cash resources to ensure we can finance capital expenditure in a low oil price environment.

**Failure to replace, acquire and develop additional reserves**

Future production growth and successful implementation of the growth strategy are highly dependent on maintaining long-term reserve replacement. This includes undertaking activities in the existing producing asset leading to the booking of additional reserves (such as drilling appraisal wells, water flooding and application of artificial lift techniques), organic reserves replacement, as well as acquiring and developing additional reserves, inorganic reserves replacement. Additionally, inherent to the oil and gas industry are risks related to the continued discovery, production and processing of hydrocarbons in economically viable quantities as well as low success rates associated with exploration.

For the Cheleken Contract Area, our reservoir department conducts evaluations of considerable volumes of historical and 3D seismic data on which to base our future drilling programmes and select drilling targets. The reservoir team has specialist and experienced reservoir engineers and, if needed, employs external specialists. The oil, condensate and gas reserves and contingent resources in Turkmenistan are assessed annually by an independent energy consultant.

Exploration is risky and may not always result in a successful outcome. Dragon Oil has six exploration blocks in five countries and our plan is to add more exploration assets, thus increasing our chances of success.
### RISK DESCRIPTION

<table>
<thead>
<tr>
<th><strong>FINANCIAL RISKS continued</strong></th>
<th><strong>MITIGATION</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economics under the PSA in Turkmenistan</strong></td>
<td>A significant breach of compliance with the PSA, whether caused willfully or inadvertently, or due to differing interpretations of key provisions can affect the underlying economics of an investment project and shareholder value.</td>
</tr>
<tr>
<td><strong>Gas development project in Turkmenistan</strong></td>
<td>Dragon Oil’s project to develop the gas from the Cheleken Contract Area is dependent upon many factors including construction of the Gas Treatment Plant (GTP), demand for gas, execution of a gas sales agreement, accessibility to a gas transportation network, and overall economic conditions. They affect Dragon Oil’s ability to develop its gas reserves.</td>
</tr>
<tr>
<td><strong>Security of cash balances</strong></td>
<td>Dragon Oil’s cash balances are held with banks, both international and local, that have substantial operations in the UAE. Default due to an extreme financial stress could result in loss or restricted access to this asset with significant impact on Dragon Oil’s future viability.</td>
</tr>
</tbody>
</table>

### COMPLIANCE RISKS

| **Difficulties in securing approval processes, licences and visas** | The Group relies on the approval by government bodies in different jurisdictions of the appropriate licences, permits and regulatory consents as well as visas for foreign nationals to continue its operations. Difficulties with securing the necessary approvals could potentially limit the Group’s ability to achieve production targets, materially increase cost, and/or increase the chance of HSE non-compliance and accidents. | The Group has considerable experience in operating in countries with strong and well-established government relationships, both at central and local level. The Group is taking additional steps to communicate and engage at the highest levels to resolve any concerns. |
| **Sanctions against Iran** | Various, differing sanctions against Iran and Iranian entities passed by the UN, the EU, individual EU Member States and the USA intensified during 2012. Sanctions imposed currently may impact on the Group’s ability to transact with Iranian counterparts. They also restrict the ability of certain companies in the Group to transact with Iranian entities and may also impact US and non-US suppliers engaged in business with Dragon Oil in some respects. There may be additional impact on the operations of the Group if it re-commenced the earlier swap arrangement for export of crude oil through Iran. | The scope and applicability of each sanctions regime to companies in the Group are discussed and reviewed with specialist lawyers on a regular basis; EU sanctions have resulted in substantial changes to the Group’s business and to the way that the Group transacts with Iranian counterparts, for example in relation to the leasing of one of the jack-up rigs. Our lawyers are instructed to maintain constant vigilance on developments and advise accordingly. We maintain regular dialogue with suppliers regarding the implications of the sanctions regimes. |