

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GALFAR ENGINEERING & CONTRACTING SAOG

### Report on the audit of the consolidated and separate financial statements

#### *Qualified opinion*

We have audited the consolidated and separate financial statements (the "financial statements") of Galfar Engineering & Contracting SAOG (the "Parent Company" or "Company") and its subsidiaries (together "the Group"), which comprise the statement of financial position as at 31 December 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the *Basis for qualified opinion* section of our report, the accompanying financial statements present fairly, in all material respects the consolidated financial position of the Group and the separate financial position of the Parent Company as at 31 December 2016 and their respective financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

#### *Basis for qualified opinion*

The management has carried out equity accounting based upon unaudited management accounts in respect of its investment in associate, Galfar Engineering & Contracting Kuwait, KSC, (the "associate") in the consolidated financial statements as at and for the year ended 31 December 2016. The audit of the associate is yet to be completed and therefore management was unable to obtain the audited financial statements. The carrying value of the investment in associate in the consolidated financial statements and separate financial statements as at 31 December 2016 amounted to RO 4.38 million and RO 6.9 million, respectively. We were unable to obtain sufficient appropriate audit evidence in respect of the carrying values of the associate included in these financial statements as at and for the year ended 31 December 2016. Consequently, we were unable to determine whether any adjustments might have been necessary in respect of the carrying value of the investment in associate included in these financial statements.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in the Sultanate of Oman, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GALFAR ENGINEERING & CONTRACTING SAOG (CONTINUED)

### *Emphasis of matter*

We draw attention to note 38 (b) of the financial statements which sets out the status of the ongoing negotiations, arbitration and litigation proceedings relating to the certain claims raised by the Parent Company and their recoverability. The note 38 (b) (iii) and 38 (b) (iv) also describes the Parent Company's position on the following matters:

- An offer received from a client during 2015 for settlement of a major contract claim and the reasons for which the Parent company has not accepted the offer and its position on any levy of penalty. A portion of these claims, net of impairment provision amounting to RO 26.3 million is included in receivable by the Parent company.
- The status of arbitration proceedings initiated by the Parent company towards recovery of certain claims filed against another client. A portion of these claims including an arbitration award, net of impairment provision, amounting to RO 18.6 million is included in receivable by the Parent Company.

Our opinion is not modified in respect of these matters.

### *Material uncertainty related to going concern*

We draw attention to the following:

- (i) note 2 of the financial statements, which indicates that the Group has reported a loss of RO 10.8 million for the year ended 31 December 2016 and has an accumulated loss position of RO 10.4 million as of 31 December 2016. It further describes the measures implemented by the Parent Company's Board of Directors to improve its financial position and the grounds on which the financial statements have been prepared on going concern basis.
- (ii) note 18 of the financial statements, which describes that the Parent Company is in breach of covenants stipulated in its certain facilities agreements with the lenders as at 31 December 2016.

These events or conditions indicate that a material uncertainty exists that may cast a significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

### *Other matter*

The financial statements of the Group and the Parent Company for the year ended 31 December 2015 were audited by another auditor who expressed an unmodified opinion on those statements on 13 March 2016 with emphasis of matter on the use of going concern assumption, breach of debt covenants and status of certain claims filed by the Parent Company and their recoverability.

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GALFAR ENGINEERING & CONTRACTING SAOG (CONTINUED)

### *Key audit matters*

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. In addition to the matter described in the *Basis for qualified opinion* section and *Material uncertainty related to going concern* section of our report, we have determined the matters described below to be the key audit matters to be communicated in our report. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

### **1. Contract revenue and profit recognition from construction contracts in the consolidated and separate financial statements**

The Group's business involves entering into contractual relationships with customers to provide a range of services with a significant proportion of the Group's revenues and profits derived from long-term construction contracts. Due to the nature of the construction business, contract revenue and profit recognition involves a significant degree of judgement, with estimates required to:

- Assess whether the outcome of the construction contract can be measured reliably;
- Assess the total contract costs including costs to completion;
- Assess the stage of completion of the contract;
- Forecast the profit margin after taking consideration of additional revenue and costs relating to variations in contract work, claims and incentive payments; and
- Identify and adequately provide for loss making contracts.

There is a range of acceptable outcomes resulting from these significant judgments made by the management that could lead to different contract revenue and profit being reported in the financial statements.

The accounting policies relating to contract revenue and profit recognition, critical accounting estimates and judgements are set out in notes 2 and 38 (b) to the financial statements. The related significant disclosures pertaining to contract work in progress, contract and trade receivables, provision for future loss on contracts are set out in notes 8, 9 and 23 to the financial statements.

**INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF  
GALFAR ENGINEERING & CONTRACTING SAOG (CONTINUED)**

***Key audit matters (continued)***

***1. Contract revenue and profit recognition from construction contracts in the consolidated and separate financial statements (continued)***

Our audit procedures, among others, included the following:

- Assessed the effectiveness of entity level controls with regard to detailed review of contracts performed by management that included estimating total costs, stage of completion of contracts, profit margin and evaluating contract profitability;
- Obtained an understanding of the performance and status of the major contracts through discussion with contract project teams as well as reading minutes of the Board of Directors and audit committee;
- On a sample basis, tested the calculation of stage of completion including testing the costs incurred and recorded against the contract for occurrence and accuracy, assessed the basis for determining the total contract cost and reperformed the percentage of completion calculation and assessing the recoverability of contract work in progress;
- Assessed the estimates of costs to complete for significant contracts and also assessed the historical accuracy of the estimates of total contract costs;
- Agreed the total contract revenue to the original signed customer contract agreement, approved variation orders and consideration for claims and incentive payments. We discussed with the contract project teams and evaluated the reasonableness of estimated revenue for considering portion of customer claims, including correspondence with the customer, latest payment certificates, independent third party consultants reports, internal assessments and legal advice received as appropriate;
- Assessed the adequacy of contract loss provisions recorded;
- Assessed the appropriateness of the Group's revenue recognition accounting policies including compliance with the relevant IFRSs.

***2. Impairment of contract and trade receivables in the consolidated and separate financial statements***

Contract and trade receivables are significant to the Group as of 31 December 2016. The collectability of contract and trade receivables is a key element of Group's working capital management. Management establishes credit limits and approves such limits above certain thresholds, where applicable. Given the judgment involved in the collectability assessment of contract and trade receivables, and considering delayed payments due to the present market conditions, impairment of trade receivables was a key audit matter. The application of judgment and the use of assumptions are described in critical accounting estimates and judgments in note 38 (b) of the financial statements. Specific factors considered by the management included:

- the age of the outstanding amounts;
- independent reports on the recoverability of claims;
- results of consultations with external lawyers;
- existence of disputes;
- recent historical payment patterns;

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GALFAR ENGINEERING & CONTRACTING SAOG (CONTINUED)

### *Key audit matters (continued)*

#### **2. Impairment of contract and trade receivables in the consolidated and separate financial statements (continued)**

- expectations of timing of collectability and any other available information concerning the creditworthiness of counterparties.

Management uses this information to determine whether a provision for impairment is required for a specific transaction for the customer's balance. The related details are set out in notes 9 and 36 respectively, to the financial statements.

We evaluated management's assumptions and methods applied in the calculating the provision for impairment of contract and trade receivables by carrying out the following procedures, among others:

- On a sample basis, tested aged balances to check for indicators of impairment. This included verifying receipts subsequent to the yearend, reviewing historical payment patterns and any correspondence with customers on expected settlement dates.
- On a sample basis, assessed the recoverable amounts of claims by discussing with the respective project managers and with legal consultants for any amounts in dispute, reading correspondences with the customers and reports produced by independent consultants and evaluating the responses received from external lawyers for claims involving arbitration and litigations.
- Obtained the management's calculation of the provision for various age categories made in accordance with the impairment policy and checked these in line with the assumptions made by the management. We have also considered the appropriateness of the policy based on historical experience.
- Considered appropriateness of the disclosures in the financial statements in accordance with the relevant requirements of IFRSs.

#### **3. Impairment assessment of investment in associates in the separate financial statements**

In the separate financial statements, the investment in associates are carried at cost less impairment. As of reporting date, the two associates Mahakaleswar Tollways Pvt. Ltd. (MTPL) and International Water Treatment LLC (IWT) have deficiency of assets as of 31 December 2016. This decline as compared to cost of investments triggered a requirement for an impairment assessment to be performed and accordingly an impairment loss of RO 6.1 million was recorded in the separate financial statements. We considered this as a key audit matter, as the related impairment charge was material to the separate financial statements.

The accounting policies relating to the impairment assessment of the investment in associates and the related disclosures are set out in notes 2, 6 and 38 (g), respectively to the financial statements.



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## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GALFAR ENGINEERING & CONTRACTING SAOG (CONTINUED)

### *Key audit matters (continued)*

#### **3. Impairment assessment of investment in associates in the separate financial statements (continued)**

Our audit procedures, among others, included the following:

- Obtained audited financial statements of MTPL and unaudited management accounts of IWT and recalculated the share of net asset value and compared it with the cost of the investment;
- Obtained and checked the management's calculation of impairment loss and ensured its appropriate recognition;
- Assessed the appropriateness of the related disclosures in the financial statements in accordance with IFRS.

#### **Other information included in the Group's 2016 Annual Report**

Those charged with governance and management are responsible for the other information. Other information consists of the information included in the Group's 2016 Annual Report other than the financial statements and our auditor's report thereon. We obtained the following information prior to the date of our auditor's report, and we expect to obtain the published 2016 Annual Report after the date of our auditor's report:

- Chairman's report
- Corporate governance report
- Management discussion and analysis

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

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

If, based on the work we have performed on the other information obtained prior to the date of the auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

#### **Responsibilities of management and those charged with governance for the financial statements**

Those charged with governance are responsible for the preparation and fair presentation of the financial statements in accordance with IFRS and the relevant requirements of the Commercial Companies Law of 1974, as amended, and the Capital Market Authority ("the CMA") of the Sultanate of Oman, and for such internal control as those charged with governance determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GALFAR ENGINEERING & CONTRACTING SAOG (CONTINUED)

### *Responsibilities of management and those charged with governance for the financial statements (continued)*

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

Those charged with governance are responsible for overseeing the Group's financial reporting process.

### *Auditor's responsibilities for the audit of the financial statements*

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of those charged with governance's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF GALFAR ENGINEERING & CONTRACTING SAOG (CONTINUED)

### *Auditor's responsibilities for the audit of the financial statements (continued)*

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

### Report on other legal and regulatory requirements

In our opinion, the financial statements comply, in all material respects, with the relevant requirements of the Commercial Companies Law of 1974, as amended, and CMA of the Sultanate of Oman.



Sanjay Kawatra  
Muscat  
14 March 2017