



**JSC Karazhanbasmunai**  
**IFRS Financial Statements**  
*For the year ended December 31, 2005*  
**and Independent Auditors' Report**

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## INDEPENDENT AUDITORS' REPORT

To the Board of directors of Joint Stock Company Karazhanbasmunai:

We have audited the accompanying balance sheet of Joint Stock Company Karazhanbasmunai (the "Company") as at December 31, 2005 and the related statements of income, changes in equity and cash flows for the year then ended (hereinafter, the "financial statements"). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on those financial statements based on our audit. The financial statements as at December 31, 2004 and the year then ended were audited by another auditor, whose report dated August 31, 2005 expressed an unqualified opinion with regard to those financial statements.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2005, and the results of its operations and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

*Deloitte & Touche*

March 17, 2006

## BALANCE SHEET

### As at December 31, 2005

<i>In thousands of Tenge</i>	Note	As at December 31, 2005	As at December 31, 2004
<b>Non-current assets</b>			
Property, plant and equipment, net	4	84,633,291	74,970,535
Intangible assets, net		163,250	167,615
Advances for fixed assets		1,037,613	1,689,755
		<b>85,834,154</b>	<b>76,827,905</b>
<b>Current assets</b>			
Inventories, net	5	5,012,544	3,568,667
Prepayment for corporate income tax		1,248,680	789,422
Other current assets, net	6	7,865,557	4,177,962
Amounts due from Parent, net	12	2,484,803	-
Trade accounts receivable		7,538,220	6,030,039
Cash and cash equivalents		4,481,634	2,356,150
		<b>28,631,438</b>	<b>16,922,240</b>
<b>Total assets</b>		<b>114,465,592</b>	<b>93,750,145</b>
<b>Shareholders' equity</b>			
Share capital	7	2,161,062	2,161,062
Retained earnings		33,369,350	30,008,851
		<b>35,530,412</b>	<b>32,169,913</b>
<b>Non current liabilities</b>			
Long-term debt	8	13,966,898	12,117,744
Bond obligations	8	10,947,527	10,903,239
Deferred tax liability	9	32,219,958	28,532,397
Other long-term liabilities		70,963	143,118
Future site restoration and abandonment liability	10	1,944,927	1,651,394
		<b>59,150,273</b>	<b>53,347,892</b>
<b>Current liabilities</b>			
Trade accounts payable	11	2,963,685	3,201,600
Current portion of long-term debt	8	4,598,338	1,300,000
Amounts due to Parent	12	-	1,686,504
Taxes payable	13	10,625,109	660,796
Accrued liabilities and other payables	14	1,597,775	1,383,440
		<b>19,784,907</b>	<b>8,232,340</b>
<b>Total liabilities and shareholders' equity</b>		<b>114,465,592</b>	<b>93,750,145</b>

First Vice President JSC Karazhanbasmunai  
Michael Long

Chief Accountant JSC Karazhanbasmunai  
Dinara Kulbayeva

March 17, 2006

*The accounting policies and explanatory notes on pages 6 through 21 form an integral part of these financial statements.  
The Independent Auditor's report is on page 1.*

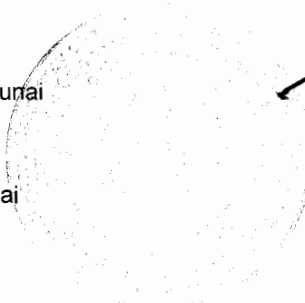
**STATEMENT OF INCOME**  
**For the year ended December 31, 2005**

<i>In thousands of Tenge</i>	Note	For the year ended December 31, 2005	For the year ended December 31, 2004
<b>Revenue</b>	15	<b>87,262,462</b>	57,511,476
<b>Cost of sales</b>	16	<b>(20,963,430)</b>	(16,621,262)
<b>Gross profit</b>		<b>66,299,032</b>	40,890,214
<b>Expenses</b>			
Transportation expenses		(7,923,056)	(8,764,205)
Selling, general and administrative expenses	17	(6,153,964)	(5,755,226)
Finance costs		(2,497,993)	(2,538,918)
Foreign exchange loss, net		(164,310)	(161,938)
Other non-operating income, net	18	369,341	499,316
<b>Profit before income taxes</b>		<b>49,929,050</b>	24,169,243
Income taxes	9	(27,334,655)	(19,999,699)
<b>Net profit</b>		<b>22,594,395</b>	4,169,544

First Vice President JSC Karazhanbasmunai  
 Michael Long

Chief Accountant JSC Karazhanbasmunai  
 Dinara Kulbayeva

March 17, 2006



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*(Handwritten signature of Dinara Kulbayeva)*  
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## STATEMENT OF CASH FLOW

### For the year ended December 31, 2005

<i>In thousands of Tenge</i>	Note	For the year ended December 31, 2005	For the year ended December 31, 2004
<b>Cash flows from operating activities:</b>			
Profit before taxation		49,929,050	24,169,243
Adjustments for:			
Depreciation, depletion and amortization	16, 17, 18	6,245,581	5,401,902
Loss on disposal of property, plant and equipment	18	255,622	46,148
Loss on disposal of investment	18	-	16,234
Foreign exchange loss, unrealized		36,925	161,938
Interest expenses		2,497,993	2,538,918
Production bonus		59,105	31,868
Provisions for obsolete inventory and doubtful accounts	17	629,907	31,948
Operating profit before changes in working capital		59,654,183	32,398,199
Increase in trade accounts receivable		(1,523,230)	(2,823,059)
Increase in inventories		(1,877,063)	(435,761)
Increase in other assets		(4,146,853)	(2,542,377)
(Decrease)/ Increase in trade accounts payable		(237,915)	911,815
(Decrease)/ Increase in taxes payable		(1,993,669)	68,385
Increase in accrued liabilities and other payables		1,612,803	102,054
Cash generated from operations		51,488,256	27,679,256
Interest paid		(2,227,795)	(1,386,639)
Income taxes paid		(11,689,113)	(9,401,328)
Production bonus paid		(131,260)	-
<b>Net cash flows from operating activities</b>		<b>37,440,088</b>	<b>16,891,289</b>
<b>Cash flows from investing activities:</b>			
Purchase of property, plant and equipment and intangible assets		(15,812,380)	(12,800,821)
Proceeds from sale of investment		-	1,460,766
Proceeds from sale of fixed assets	18	13,056	-
Long-term advances for fixed assets		652,142	(864,703)
<b>Net cash flows used in investing activities</b>		<b>(15,147,182)</b>	<b>(12,204,758)</b>
<b>Cash flows from financing activities:</b>			
Bonds issuance		-	10,904,286
Proceeds from long-term borrowings		7,671,004	20,101,000
Repayment of long-term borrowings		(2,630,135)	(19,841,417)
Loans given to Parent		(12,380,628)	-
Dividends paid		(12,827,663)	(14,897,440)
Repayment of loan by Parent		-	1,374,932
<b>Net cash flows used in financing activities</b>		<b>(20,167,422)</b>	<b>(2,358,639)</b>
Effect of exchange rate changes on cash and cash equivalents		-	(1,657)
<b>Net increase in cash and cash equivalents</b>		<b>2,125,484</b>	<b>2,326,235</b>
<b>Cash and cash equivalents at the beginning of year</b>		<b>2,356,150</b>	<b>29,915</b>
<b>Cash and cash equivalents at the end of year</b>		<b>4,481,634</b>	<b>2,356,150</b>

First Vice President JSC Karazhanbasmunai  
Michael Long

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Dinara Kulbayeva

March 17, 2006

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## STATEMENT OF CHANGES IN EQUITY

### For the year ended December 31, 2005

<i>In thousands of Tenge</i>	Share Capital	Retained Earnings	Total
<b>As at January 1, 2004</b>	<b>2,161,062</b>	<b>40,491,606</b>	<b>42,652,668</b>
Net income for the year	-	4,169,544	4,169,544
Dividends	-	(14,652,299)	(14,652,299)
<b>As at December 31, 2004</b>	<b>2,161,062</b>	<b>30,008,851</b>	<b>32,169,913</b>
Net profit for the year	-	22,594,395	22,594,395
Dividends	-	(19,233,896)	(19,233,896)
<b>As at December 31, 2005</b>	<b>2,161,062</b>	<b>33,369,350</b>	<b>35,530,412</b>

First Vice President JSC Karazhanbasmunai  
Michael Long

Chief Accountant JSC Karazhanbasmunai  
Dinara Kulbayeva

March 17, 2006

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## **NOTES TO THE FINANCIAL STATEMENTS**

### **For the year ended December 31, 2005**

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#### **1. GENERAL**

The Experimental Oil and Gas Extracting Department of the Republic of Kazakhstan (“NGDU Karazhanbasneft”) was established in 1986 as an independent enterprise. NGDU Karazhanbasneft was subsequently restructured to form the Joint Stock Company Karazhanbasmunai (the “Company”). The Company was registered in Mangistau oblast, Western Kazakhstan, on April 23, 1993. The majority of the Company’s shares are owned by Nations Energy Company Ltd. (“Nations Energy” or the “Parent”). Nations Energy Company Ltd. is a company incorporated in Alberta, Canada. In accordance with paragraph 1, article 90 of the Joint Stock Company Law of the Republic of Kazakhstan dated May 13, 2003 # 415-II the Company was re-registered as a joint stock company on March 31, 2005.

The Company is engaged in the exploration, production and sale of oil from the Karazhanbas field in Western Kazakhstan. The Company signed a subsoil use contract with the Government of Kazakhstan on May 23, 1997 and has a license for hydrocarbon exploration and production (the “License”) on Karazhanbas field that is valid until June 7, 2020.

The Company is located in Aktau, Mangistau oblast, Republic of Kazakhstan (or “Kazakhstan”) at the following registered address: 8, Microdistrict 15, Aktau, 466200, Kazakhstan. The Company also has a branch in Almaty.

As at December 31, 2005 and 2004 the Company employed 1,786 and 2,682 employees, respectively. Total employees’ costs for 2005 and 2004 were 2,822 million Tenge and 4,360 million Tenge, respectively. A key management personnel comprises members of the Management Board and Board of Directors of the Company, and totaled 3 people as at December 31, 2005 and 2004. Total compensation to key management personnel included in general and administrative expenses in the statement of income was 109,791 thousand Tenge and 73,854 thousand Tenge for the years ended December 31, 2005 and 2004, respectively.

The accompanying financial statements were approved for issuance by First Vice President and Chief Accountant of the Company on March 17, 2006.

#### **2. BASIS OF PREPARATION**

##### **Adoption of New and Revised International Financial Reporting Standards**

In 2005, the Company has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for accounting periods beginning on 1 January 2005. The adoption of these new and revised Standards and Interpretations has not significantly affected the current and prior year financial statements of the Company.

##### **Basis of presentation**

The financial statements of the Company have been prepared in accordance with International Reporting Standards (“IFRS”). The Company maintains its accounting records in Kazakhstani Tenge (“Tenge”). In accordance with Kazakh legislation, all joint stock companies have to adopt IFRS from January 1, 2005. The Company elected January 1, 2004 to be its date of transition to IFRS.

These financial statements have been prepared in accordance with IFRS on a going concern basis, which assumes the realization of assets and discharge of liabilities in the normal course of business within the foreseeable future

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Use of estimates**

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of commitments and contingent assets and liabilities at the date of the financial statements and revenues and expenses for the period reported. The most significant of these are the estimates used concerning net realizable value of the Company's capital assets and related depreciation and depletion and the provision for site restoration costs. Actual results could differ from those estimates. The estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

#### **Foreign Currency Translation**

The Company transacts most of their business in Tenge and use Tenge as its measurement currency. Any currency other than Tenge, the Company's measurement currency, is considered a foreign currency. The Company translates its foreign currency transactions and balances into its measurement currency by applying to the foreign currency amount the exchange rate between the measurement currency and the foreign currency established by the Kazakhstan Stock Exchange ("KASE") at the date of the transaction. Exchange rate differences arising on the settlement of monetary items or on reporting monetary items at rates different from those at which they were initially recorded during the period or reported in previous financial statements are recognized in the income statement in the period in which they arise.

Starting from January 1, 2003, weighted average currency exchange rates established at Kazakhstan Stock Exchange (thereafter – KASE) are used as official currency exchange rates in Kazakhstan

Weighted average currency exchange rate of KASE of 133.77 Tenge and 130.00 Tenge to 1 US Dollar was used to translate balance sheet items as at December 31, 2005 and 2004.

#### **Oil and Gas Reserves**

The Company uses the reserve estimates provided by independent petroleum engineers to assess the oil and gas reserves. These reserve quantities are used as the basis for calculating the units of production depreciation within these financial statements.

#### **Oil and Gas Properties**

The Company follows the successful efforts method of accounting for its oil exploration, development and production activities.

Exploratory costs, excluding the costs of exploratory wells, are charged to expense as incurred. Costs of drilling exploratory wells, including stratigraphic test wells, are capitalized pending determination whether such wells have found proved reserves which justify commercial development. If such reserves are not found, the drilling costs are charged to exploratory expenses. Intangible drilling costs applicable to productive wells and to development dry holes, as well as tangible equipment costs and costs of injection wells related to development of oil and gas reserves are capitalized.

The Company currently operates a field with proven reserves. Costs incurred in development of proven reserves are capitalized.

Oil and gas properties are stated at cost less accumulated depreciation and depletion. The depreciation and depletion is estimated on a unit-of-production basis, in the proportion of actual production for the period to the total estimated remaining reserves of the field. The remaining reserves figure is that estimated at the end of the period plus the production for the period.

The reserves of the Company are estimated by the independent engineers in accordance with the standards of the Society of Petroleum Engineers, Inc. and World Petroleum Congress.

#### **Impairment of Oil and Gas Properties**

The Company reviews its oil and gas properties whenever events and circumstances indicate a decline in the recoverability of their carrying value. The Company compares the expected undiscounted future cash flows from proven reserves to the carrying amount to determine if the carrying amount is recoverable. Impairment adjustment is recorded to write-down the carrying value of oil and gas properties to their recoverable value, when the carrying value of oil and gas properties exceeds undiscounted future net cash flows.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation of non-production property, plant and equipment is calculated on a straight-line basis over each asset's estimated useful life, which are as follows:

Buildings and constructions	20 years
Machinery and equipment	5-14 years
Vehicles	14 years
Other	3-10 years

Repair and maintenance costs are charged to income as incurred. Renewals and betterment are capitalized. When assets are sold, retired or otherwise disposed of, the applicable income or expense is recognized in the income statement.

Construction in progress represents capital construction of projects not yet completed. When these assets begin to be used in production they are transferred to the appropriate asset class. Since construction in progress is not used in production, these assets are not subject to depreciation.

#### Intangible Assets

Intangible assets include software, re-registration expenses and License fees. These are stated at original cost and amortized on a straight-line basis over five years.

#### Cash and Cash Equivalents

Cash and cash equivalents represent cash on hand, demand deposits with original maturities not exceeding 90 days and short-term and highly liquid investments which are readily convertible to a known amount of cash and are subject to insignificant risk of changes in value.

Cash on hand and in banks and bank deposits, which are held to maturity, are carried at cost.

#### Trade and Other Receivables

Trade receivables are recognized and carried at original invoice amount less an allowance for doubtful debts. Bad debts are written off when identified.

#### Inventories

Inventories are stated at the lower of cost or net realizable value. Cost of crude oil is determined using FIFO, while cost of material and supplies inventory is determined using weighted average method. Crude oil inventory consists primarily of oil in pipelines and tanks. The cost of crude oil inventory includes all direct costs.

#### Loans and Borrowings

All loans and borrowings are initially recognized at cost, being the fair value of consideration received net of issue costs associated with the borrowing.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Gains and losses are recognized in net profit or loss when the liabilities are recognized or impaired, as well as through the amortization process.

#### Trade and Other Payables

Liabilities for trade and other amounts payable are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the Company.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Abandonment and Future Site Restoration (decommissioning)

The Company records the fair value of the liability associated with decommissioning in the period in which it is incurred, if a reasonable estimate of fair value can be made. The associated decommissioning costs are capitalized as part of the tangible fixed asset. This amount is subsequently depreciated and charged against income using the unit-of-production method based on proved developed reserves.

The fair value of the liability equals the present value of estimated future cash flows, discounted using a risk-free interest rate adjusted for the Company's credit standing. Unwinding of the discount is reported as accretion expense within finance costs in the statement of income. The provision for future site restoration costs is reviewed at each balance sheet date and adjusted to reflect the current best estimate. Any change in the present value of the estimated expenditure is reflected as an adjustment to the provision and the fixed asset.

#### Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, 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.

#### Pension

The Company pays certain post retirement insurance, which represent its contribution to the post retirement benefits of its employees. The Company has no other program or obligation for payment of post retirement benefits to its local and expatriate employees.

In accordance with the Law of the Republic of Kazakhstan "Pension provisioning in the republic of Kazakhstan" effective from January 1, 1998 and replacing the state mandated pension system, all employees have the right to receive pension payments from the individual pension accumulations accounts with accumulating pension funds provided by the compulsory pension contributions of 10% from employees' income with a maximum statutory limit on these contributions of 69,000 Tenge per month during the period from July 1 to December 31, 2005. For the first half of the year 2005, this amount was set at 52,500 Tenge and 49,500 Tenge in 2004.

#### Revenue Recognition

Revenue is recognized when it is probable that the economic benefits associated with the transaction will flow to the Company and the amount of revenue can be reliably measured.

Revenue from the sale of crude oil is recognized when delivery has taken place and significant risks and rewards of ownership of the crude oil have passed to the buyer and the amount of revenue can be measured reliably. Sales income does not include indirect taxes (excises, VAT, and royalties) and is stated at the net amount (after discounts and pipeline losses).

#### Income tax

Income tax for the year comprises current and deferred tax. Income tax is recognized in the income statement except to the extent that it relates to items charged or credited directly to equity, in which case it is recognized in equity. Excess profit tax is treated as an income tax and forms part of the income tax expense.

The current income tax charge is calculated in accordance with the regulations of the Republic of Kazakhstan and is based on the results reported in the Company's statement of operations prepared under KAS after adjustments for tax purposes. The statutory corporate income tax is currently 30%. Entities in Kazakhstan are obliged to make monthly advance corporate income tax payments.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled based on the tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Deferred excess profits tax is calculated with respect to temporary differences (after taking to the account corporate income tax effect) related to Company's assets and liabilities at the expected rate of excess profits tax to be paid under the subsoil use contract. In accordance with subsoil agreement, the Company should accrue 4% excess profit tax if the internal rate of return ("IRR") is between 20% and 22%, 8% if IRR is between 22% and 24%, 12% if IRR is between 24% and 26%, 18% if IRR is between 26% and 28%, 24% if IRR is between 28% and 30% and 30% excess profit tax if IRR exceeds 30%.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

#### **Derivative financial instruments and hedging**

The Company utilizes derivative instruments to manage the Company's exposure to fluctuations in the price of oil as described in Note 19. Derivative financial instruments are recognized at fair value. The effective portion of the gain or loss on a derivative instrument designated as a cash flow hedging instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings. If the forecasted transaction is no longer expected to occur, amounts previously recognized in equity are transferred to earnings.

#### **Leases**

Leases where the lessor retains substantially all the risks and benefits of ownership of an asset are classified as operating leases. Operating lease payments are recognized as an expense in a statement of income on a straight-line basis over the lease term. Lease income is accounted for on a straight-line basis over the lease term on ongoing leases.

#### **Dividends**

Dividends payable are recognized as an appropriation of net profit in the period when declared.

#### **Borrowing Costs**

Borrowing costs are recognized as expenses in the period in which they are incurred. Any interest costs relating to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

The Company capitalizes costs relating to the fees incurred in connection with obtaining loan facilities which are amortized over the life of the maturity.

#### 4. PROPERTY, PLANT AND EQUIPMENT, NET

<i>In thousands of Tenge</i>	Oil Properties	Buildings and Premises	Machinery and equipment	Vehicles	Other	Construc- tion-in- progress	Total
<b>Balance as at January 1, 2004</b>	<b>61,814,956</b>	<b>1,179,198</b>	<b>1,429,379</b>	<b>209,331</b>	<b>120,139</b>	<b>2,895,686</b>	<b>67,648,689</b>
Additions	1,119,779	15,183	596,195	123,184	148,465	10,859,989	12,862,795
Transfers and adjustments	10,209,401	29,766	1,415	47	(1,065)	(10,239,564)	-
Disposals	(161,313)	-	(41,837)	(5,282)	(37,365)	-	(245,797)
Depreciation charge	(4,988,911)	(68,266)	(233,018)	(28,373)	(43,623)	-	(5,362,191)
Depreciation on disposals	19,480	-	30,211	3,414	13,934	-	67,039
<b>Balance as at December 31, 2004, net of accumulated depreciation</b>	<b>68,013,392</b>	<b>1,155,881</b>	<b>1,782,345</b>	<b>302,321</b>	<b>200,485</b>	<b>3,516,111</b>	<b>74,970,535</b>
At cost	72,982,823	1,224,147	1,985,152	327,280	230,174	3,516,111	80,265,687
Accumulated depreciation	(4,969,431)	(68,266)	(202,807)	(24,959)	(29,689)	-	(5,295,152)
<b>Net carrying amount as at December 31, 2004</b>	<b>68,013,392</b>	<b>1,155,881</b>	<b>1,782,345</b>	<b>302,321</b>	<b>200,485</b>	<b>3,516,111</b>	<b>74,970,535</b>
Reclass, net	298,922	(653,665)	(1,631,227)	1,283,029	119,783	583,158	-
<b>Net carrying amount as at January 1, 2005</b>	<b>68,312,314</b>	<b>502,216</b>	<b>151,118</b>	<b>1,585,350</b>	<b>320,268</b>	<b>4,099,269</b>	<b>74,970,535</b>
Additions	449,497	-	687	6,222	13,084	15,836,066	16,305,556
Transfers and adjustments	15,820,519	65,000	133,978	273,189	124,303	(16,416,989)	-
Disposals	(407,108)	(15,199)	(991)	(48,438)	(28,850)	-	(500,586)
Depreciation charge	(5,796,096)	(21,250)	(52,705)	(286,538)	(48,917)	-	(6,205,506)
Depreciation on disposals	45,570	596	242	10,598	6,286	-	63,292
<b>Balance as at December 31, 2005, net of accumulated depreciation</b>	<b>78,424,696</b>	<b>531,363</b>	<b>232,329</b>	<b>1,540,383</b>	<b>386,174</b>	<b>3,518,346</b>	<b>84,633,291</b>
At cost	89,381,614	617,784	426,404	2,636,382	558,322	3,518,346	97,138,852
Accumulated depreciation	(10,956,918)	(86,421)	(194,075)	(1,095,999)	(172,148)	-	(12,505,561)
<b>Net carrying amount as at December 31, 2005</b>	<b>78,424,696</b>	<b>531,363</b>	<b>232,329</b>	<b>1,540,383</b>	<b>386,174</b>	<b>3,518,346</b>	<b>84,633,291</b>

Interest expense of 219,398 thousand Tenge and 1,639 thousand Tenge calculated at the rate of 7.64% was capitalized as part of additions to assets under construction in 2005 and 2004 correspondingly.

The Company pledged assets with a carrying value of 85.5 million US Dollars as at December 31, 2005 and 2004 (please see Note 8).

#### 5. INVENTORIES, NET

<i>In thousands of Tenge</i>	2005	2004
Spare parts and materials	4,605,163	3,164,981
Crude oil	457,402	212,832
Other	564,837	190,854
Less: Provision for obsolete materials	(614,858)	-
	<b>5,012,544</b>	<b>3,568,667</b>

## 6. OTHER CURRENT ASSETS, NET

<i>In thousands of Tenge</i>	2005	2004
Short term deposits	4,019,400	-
VAT receivable	2,216,701	2,606,727
Advances to suppliers	1,496,397	1,510,252
Deferred expenses	144,811	111,132
Prepayments for taxes	4,732	-
Employee receivables	33,217	25,436
Less: reserve for possible non-performance	(49,701)	(75,585)
	<b>7,865,557</b>	<b>4,177,962</b>

Advances made to suppliers comprise prepayments for inventory and services utilized in the normal course of business.

## 7. SHAREHOLDERS' EQUITY

Share capital consists of shares of nominal value 1000.00 Tenge per each. As at December 31, 2005 and 2004, the shareholders of the Company were as follows:

<i>In thousands of Tenge</i>	Number of shares	Par Value in KZT	Paid up share capital
Nations Energy Company Ltd. – common stock	2,045,035	1,000	2,045,035
Employees of the Company – preferred stock	116,027	1,000	116,027
	<b>2,161,062</b>		<b>2,161,062</b>

The authorized share capital of the Company equals to 2,161,251 shares out of which 189 shares were not issued and paid. There have been no changes in the share capital during 2005.

Any dividend on shares is determined after consideration of the Company's profit, less income taxes and is a subject to approval by the Board of Directors. Holders of the preferred stock are entitled to annual dividends of 20% of the nominal value of their shares regardless of the Company's profits. Preferred stock does not carry the right to vote in relation to the Company's daily activities, however the preferred shareholders have liquidating preferences and voting right in case of Company's reorganization and bankruptcy.

In February and June 2004, the Company declared the fourth quarter of 2003 dividends in the total amount of 1,859 million Tenge and 1,880 million Tenge, respectively, on both types of shares. During 2004 the Company declared and paid dividends in total amount of 10,913 million Tenge for the first three quarters of 2004 on both common and preferred stock.

In March 2005 the Company declared the fourth quarter of 2004 dividends in the amount of 4,106 Million Tenge. Dividends for the fourth quarter of 2004 constituted 1,900 Tenge for each common and preferred stock.

In May and August 2005, the Company declared the first and second quarters of 2005 dividends in the amount of 7,564 million and 7,564 million Tenge, respectively, on both types of shares. Dividends for the first and second quarter of 2005 constituted 3,500 Tenge for each common and preferred stock.

## 8. LONG-TERM DEBT AND BOND OBLIGATIONS

<i>In thousands of Tenge</i>	Date of Issue	Maturity Date	Annual Interest rate	Original Currency	2005	2004
Bank TuranAlem loan	Jun 19, 2003	March 28, 2008	10%	USD	3,344,250	1,950,000
Bank TuranAlem loan revolving credit line	Dec 20, 2005	3 months from the draw down date December 30,	10%	USD	3,344,250	-
CSFB Bank loan	Aug 24, 2004	2010	LIBOR+4%	USD	12,039,300	11,700,000
Less: transaction costs					(162,564)	(232,256)
					18,565,236	13,417,744
Less: current portion of long-term debt					(4,598,338)	(1,300,000)
					13,966,898	12,117,744
Bonds	Dec 2003	Dec 2008	8%	KZT	10,973,029	10,937,237
Less: transaction costs					(25,502)	(33,998)
					10,947,527	10,903,239
					24,914,425	23,020,983

In June 2003, the Company entered into a 20 million US Dollars facility agreement with Bank Turan Alem ("BTA"). In March 31, 2005 KBM prolonged its 20 million US Dollars credit line with BTA for two more years and also increased the credit line limit up to 25 million US Dollars. The new contract gives KBM a grace period of 12 months and demands repayment of the loan by equal monthly portions starting from April 31, 2006. As a result, the full amount of BTA loan is long-term as at December 31, 2005.

The BTA loan bears interest at 10% and provides for a 12-month grace period after which it has to be repaid by equal monthly installments over 24 months starting April 2006. As at December 31, 2005 and 2004, the total outstanding balance on the BTA loan is 3,344 million Tenge (25 million US Dollars) and 1,950 million Tenge (15 million US Dollars), respectively, out of which 1,254 million Tenge (9.4 million US Dollars) and 1,300 million Tenge (10 million US Dollars) is the current portion as at December 31, 2005 and 2004 respectively.

In April 12, 2004, the Company entered into the revolving credit agreement with BTA. The Company can call up to 25 million US Dollars at 10% anytime, which is to be refunded in three months from the day of disbursement. On December 20, 2005, the Company used this credit facility to finance its short-term working capital. The entire loan in amount of 25 million US Dollars was repaid on March 2006 and in April 2006 the Company called up for another 20 million US Dollars within this credit agreement.

The Company pledged assets with a carrying value of 85.5 million US Dollars as at December 31, 2005 and 2004 (See Note 4) and future cash receipts from crude oil sales amounting to 40 million US Dollars to secure the loans from BTA.

BTA Loan outstanding as at December 31, 2005 and 2004 is subject to a number of covenants, such as, maximum amount of additional financing should not exceed 145 million US Dollars, coefficients of coverage of the principal amount should not be less than 1.6, average coefficient of coverage of principal amount should not be less than 1.25. Management of the Company believes that the Company is in compliance with the covenants.

In June 2004, the Company and its Parent obtained a joint 150 million US Dollar credit facility from Credit Swiss First Boston International, London Branch ("CSFB") at LIBOR +4% per annum. The Company's share in the joint loan facility is 90 million US Dollars and the Parent's share is 60 million US Dollars.

In January 2006, the Company and its Parent signed an additional agreement with the CSFB where the total joint loan facility have increased from 150 million US Dollars to 200 million US Dollars. The Parent's share in the joint loan facility was increased from 60 million to 110 million US Dollars.

The loan matures in December 2010 and the Company's share is to be repaid by equal semiannual installments of 12.9 million US Dollars starting in December 2007 by automatic withdrawals from the Company's bank account with DZ Bank AG.

## 8. LONG-TERM DEBT AND BOND OBLIGATIONS (continued)

This facility is collateralized by the Company's sales proceeds under 60-month contracts for the shipment of 600,000 barrels of oil per month in total from June 2004 until May 2009. This loan was obtained for the purpose of financing capital expenditures and other purchases of production equipment. The Company incurred 2 million US Dollars transaction costs with respect to this facility, which resulted in the effective interest rate of LIBOR + 4.7%. CSFB Loan outstanding as at December 31, 2005 and 2004 is subject to a number of covenants, such as: the aggregate outstanding principal amount of Financial Indebtedness shall not exceed 275 million US Dollars; the ratio of adjusted Cash from Operations to Debt Service shall not be less than 1.3. Management of the Company believes that the Company is in compliance with the covenants.

In December 2003, the Company issued and registered 11,100,000 non-callable coupon bonds in the aggregate amount of 85,385 million US Dollars with Kazakh Stock Exchange with five year maturity. All bonds were sold at the beginning of 2004 to various Pension Funds and Commercial Banks of Kazakhstan. The bonds bear interest at a rate of 8% per annum during the first 6 months at the bond nominal value and floating rate depending on the inflation index, as reported by the Kazakstani Agency of Statistics starting on the 7<sup>th</sup> month, payable semi-annually. The maximum floating rate is capped at 14%. The bonds were issued at a discount and the Company incurred transaction costs of 295 thousand US Dollars which resulted in the bonds effective interest rate of 8.44%.

## 9. INCOME TAXES

The components of the income tax expenses reported in the statements of income for the years ended as at December 31 are as follows:

<i>In thousands of Tenge</i>	2005	2004
Current income taxes	14,052,606	8,113,004
Deferred Corporate income tax	3,687,561	138,061
Excess profit tax	9,594,488	11,748,634
	<b>27,334,655</b>	<b>19,999,699</b>

The movement in deferred tax liability during the years 2005 and 2004 are as follows:

<i>In thousands of Tenge</i>	2005	2004
Liability as at January 1	28,532,397	8,532,698
Charge to the statement of income	3,687,561	19,999,699
<b>Liability as at December 31</b>	<b>32,219,958</b>	<b>28,532,397</b>

The provision for income taxes differs from the amount, which would have been obtained by applying the statutory tax rate of 30% to the Company's income before income tax. The difference results from the following items:

<i>In thousands of Tenge</i>	2005	2004
Statutory Kazakhstan income tax rate	30%	30%
Income tax expense at statutory rate	14,978,715	7,250,773
Non-deductible amounts, net	2,761,452	1,000,292
Excess profit tax	9,594,488	11,748,634
	<b>27,334,655</b>	<b>19,999,699</b>

Deferred income taxes are provided for the temporary differences between the financial statement and tax basis of the Company's assets and liabilities.

Deferred excess profits tax is calculated with respect to temporary differences (after taking in to account the corporate income tax effect) related to the Company's assets and liabilities at the 30% expected rate of excess profits tax to be paid by the Company under the subsoil use contract.

## 10. FUTURE SITE RESTORATION AND ABANDONMENT LIABILITY

<i>In thousands of Tenge</i>	2005	2004
Liability as at January 1	1,651,394	1,417,950
Increase in liability for new wells drilled	128,394	91,649
Accretion expense	165,139	141,795
<b>Liability as at December 31</b>	<b>1,944,927</b>	<b>1,651,394</b>

The Company is legally required to restore its oil fields to their original condition. Estimated future site restoration costs related to Kazakhstan operations are based on engineering estimates of the anticipated method and extent of site restoration, in accordance with current legislation, industry practices and costs. The estimated future cash flows related to the liability were discounted using the credit-adjusted risk-free interest rate, which was estimated at 10% for the Company and inflation rate of 5%. Management of the Company estimates that the assets will begin to be abandoned at the expiration date of the hydrocarbon exploration license, which is June 7, 2020. Accretion expenses related to future site restoration and abandonment reserve are included within finance costs.

## 11. TRADE ACCOUNTS PAYABLE

As at December 31, 2005 and 2004 trade accounts payable comprised amounts due to suppliers for goods and services incurred during regular business activities.

<i>In thousands of Tenge</i>	2005	2004
Tulpar Munai Service Ltd	178,714	1,356,686
Argymak Trans Service Ltd	684,412	-
Other	2,100,559	1,844,914
	<b>2,963,685</b>	<b>3,201,600</b>

Tulpar Munai Service and Argymak Trans Service are subsidiaries of the Parent company.

The Company rents drilling and well workover rigs and machines to the Parent's subsidiary, Tulpar Munai Service. Rent income from this operation amounted to 660 million Tenge and 608 million Tenge in 2005 and 2004 correspondingly. Tulpar Munai Service provided drilling and well workover services to the Company totaling 3,395 million Tenge and 2,816 million Tenge in 2005 and 2004 respectively.

Starting March 2005, the Company rents its fleet of vehicles to the Parent's subsidiary, Argymak Trans Service. Rent income from this operation amounted to 214 million Tenge in 2005. Argymak Trans Service provided transportation services to the Company totaling 4,573 million Tenge in 2005.

Transactions with Tulpar Munai Service and Argymak Trans Service are made in the ordinary course of business on normal commercial terms.

## 12. AMOUNTS DUE FROM PARENT, NET

<i>In thousands of Tenge</i>	2005	2004
Short term loan receivable	3,170,349	53,597
Management fee payable	(298,008)	(78,606)
Dividends payable	-	(1,255,244)
Other payables	(387,538)	(406,251)
	<b>2,484,803</b>	<b>(1,686,504)</b>

In March 2003, the Company signed an agreement with Nations Energy, under which the Company shall grant to Nations Energy a renewable non - interest bearing loan in the amount of 20 million US Dollars. The loan can be given by installments and the time for repayments of each installments of the loan shall not exceed 180 days after the money has been transferred by the Company. Nations Energy shall have the right to offset the loan payable to the Company against Nations Energy's dividends, under other counter-obligations based on offset agreements signed by the parties, or any other mutually agreeable manner does not contradict Kazakhstani legislation.

## 12 AMOUNTS DUE FROM PARENT, NET (continued)

During 2005, the Company provided loans in the amount of 12,381 million Tenge (93.2 million US Dollars) to Nations Energy and 9,264 million Tenge (69.9 million US Dollars) that were offset by: outstanding dividends in the amount of 7,651 million Tenge (57.6 million US Dollars), by management fees in the amount of 992 million Tenge (7.5 million US Dollars) and salary in the amount of 621 millions Tenge (4.8 million US Dollars).

During 2004, the Company provided loans in the amount of 13,082 million Tenge (96.0 million US Dollars) to Nations Energy and 17,554 million Tenge (128.7 million US Dollars) that were offset by: outstanding dividends in the amount of 15,958 million Tenge (117 million US Dollars), by management fees in the amount of 1,094 million Tenge (8.0 million US Dollars) and salary in the amount of 503 million Tenge (3.7 million US Dollars)

In March 2000 the Company signed an agreement with Nations Energy, under which Nations Energy renders management services, including administration, consulting, marketing and other services (the "Management Agreement"). For the year 2000 and thereafter the Management Agreement calls for a quarterly management fee of 750,000 US Dollars plus costs for third party consulting charges, materials and corporate general and administrative expenses of Nations Energy, incurred during fulfillment of its duties under the Management Agreement. During 2005 the Company accrued 1,499 million Tenge (11.3 million US Dollars) and offset 992 million Tenge (7.5 million US Dollars), paid withholding tax on that in the amount of 288 million Tenge (2.2 million US Dollars). In 2004 the Company paid 1,257 millions Tenge (9.2 million US Dollars) to the Parent in management fees.

As at December 31, 2005, unpaid dividends to the Parent were nil (2004:1,255 millions Tenge or 9.6 million US Dollars).

## 13. TAXES PAYABLE

<i>In thousands of Tenge</i>	2005	2004
Excess Profit tax	9,594,488	-
Royalty	323,190	234,023
Social tax	109,649	135,335
Withholding income tax	68,728	160,456
Individual income tax	36,054	106,248
Other	493,000	24,734
	<b>10,625,109</b>	<b>660,796</b>

## 14. ACCRUED LIABILITIES AND OTHER PAYABLES

<i>In thousands of Tenge</i>	2005	2004
Interest payable	930,467	853,408
Salaries payable	602,585	460,051
Dividends payable	31,468	21,114
Pension funds	30,542	44,254
Other payables	2,713	4,613
	<b>1,597,775</b>	<b>1,383,440</b>

## 15. REVENUE

The composition of revenue for the year ended December 31 was as follows:

<i>In thousands of Tenge</i>	2005	2004
Export crude oil sales	85,078,565	62,697,461
Domestic crude oil sales	4,841,643	2,823,200
Hedge Loss	-	(6,101,754)
Royalty	(2,657,746)	(1,907,431)
	<b>87,262,462</b>	<b>57,511,476</b>

In 2005 export sales were made to two customers and in 2004 export sales were made to three customers.

## 16. COST OF SALES

The composition of cost of sales for the year ended December 31 was as follows:

<i>In thousands of Tenge</i>	2005	2004
Maintenance and repair	7,198,977	4,184,609
Depreciation, depletion and amortization	5,470,802	5,189,880
Salary and related benefits	2,453,494	2,629,894
Materials and supplies	1,681,037	1,024,951
Electricity	823,990	739,630
Field taxes	791,459	290,571
Field services (catering, security, housing, medical facility)	621,275	1,139,498
Field supervision	530,484	417,243
Gas	436,301	287,489
Water supply	367,825	463,359
Other	587,786	254,138
	<b>20,963,430</b>	<b>16,621,262</b>

## 17. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

The composition of selling, general and administrative expenses for the year ended December 31 was as follows:

<i>In thousands of Tenge</i>	2005	2004
Salary and related benefits	1,278,784	1,730,196
Management fees (Note 12)	1,499,334	1,256,937
Operating taxes	528,863	904,939
Depreciation and amortization	449,322	111,890
Provision for obsolete materials	614,858	-
Third parties services	386,655	311,967
Other selling expenses	317,718	268,080
Social sphere and trainings	311,457	292,121
Insurance cost	280,983	185,454
Business trips	161,752	176,219
Consulting fees	101,389	146,083
Bad debt provision	15,049	31,948
Other	207,800	339,392
	<b>6,153,964</b>	<b>5,755,226</b>

## 18. OTHER NON-OPERATING INCOME, NET

The composition of other non-operating income for the year ended December 31 was as follows:

<i>In thousands of Tenge</i>	2005	2004
Operating lease income	876,542	622,784
Interest income	42,766	3,801
Trade income	18,056	35,245
Loss on sale of investment	-	(16,234)
Loss on disposal of capital assets	(242,566)	(46,148)
Depreciation and amortization of leased assets	(325,457)	(100,132)
	<b>369,341</b>	<b>499,316</b>

## 19. FINANCIAL INSTRUMENTS

The nature of the Company's operation exposes the Company to fluctuations in commodity prices, foreign currency exchange rates, interest rates and credit risk.

The Company's financial instruments include cash and cash equivalents, accounts receivable, all current liabilities and long-term debt. The carrying values of cash, accounts receivable and current liabilities approximate their fair values because of the short-term nature of these instruments. The carrying value of long-term debt also approximates fair value as virtually all debt has been obtained under market conditions, which were still applicable at year-end.

### Commodity price risk

Commodity hedging is primarily undertaken to ensure the Company has limited exposure to fluctuations in the oil prices.

In April 2004 the Company entered into an oil price hedge agreement with Societe General for a series of costless collars covering 600,000 barrels per month from April to December 2004 with an average ceiling price of 32.70 US Dollars and an average floor price of 29.64 US Dollars. There were no hedging transactions in 2005.

### Foreign currency exchange rate risk

The Company's revenues from sales of crude oil are denominated in US dollars and substantial portions of operating costs are denominated in Kazakh Tenge. The Company manages this exposure by operating in a manner that minimizes the need to convert between these currencies.

### Interest rate risk

The Company manages its interest rate risk through utilizing fixed and floating rate debt to finance its operations. The floating rate debt exposes the Company to fluctuations in interest payments due to changes in interest rate (see Note 8).

### Credit Risk

Financial instruments, which potentially subject the Company to credit risk, consist primarily of accounts receivable. While the Company may be subject to losses up to the monthly contract value of the instruments in the event of non-performance by its counterparts, it does not expect such losses to occur. No collateral is required by the Company to support financial instruments subject to credit risk.

The Company places its cash with high credit quality financial institutions.

During 2004 and 2005 the Company received significant share of its revenue from two customers, as a result had substantial credit concentration risk. For the year ended December 31, 2005 revenues from these customers amounted to 85,078,565 thousand Tenge and which comprises 95% of total Company's revenues.

## **19 FINANCIAL INSTRUMENTS (continued)**

### **Fair Values**

The fair value of financial instruments, consisting of cash, receivables, payables and obligations under debt instruments, are considered to be equal to their carrying values. Adequate provisions are made in respect of accounts receivable. The fair values of the Company's investments are equivalent to the Company's share in the underlying net assets of the investee companies.

## **20. CONCENTRATION OF BUSINESS RISK**

The Company's business activities are within the Republic of Kazakhstan. Laws and regulations affecting businesses operating in the Republic of Kazakhstan are subject to rapid changes and the Company's assets and operations could be at risk due to negative changes in the political and business environment.

## **21. CONTINGENT LIABILITIES**

### **Current Economic Environment**

Kazakhstan continues to undergo substantial political, economic and social changes. As emerging market, Kazakhstan does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature free market economy. Furthermore, the Government of Kazakhstan has not yet fully implemented the reforms necessary to create banking, judicial, taxation and regulatory systems that usually exist in more developed markets. As a result, operations carried out in Kazakhstan can involve significant risks that are not typically associated with those in developed markets. Although in recent years inflation has not been significant, certain risks persist in the current environment with results that include, but are not limited to, a currency that is not freely convertible outside of the country, certain currency controls, and undeveloped debt and equity markets characterized by low liquidity levels. The Company could be affected, for the foreseeable future, by these risks and their consequences.

Management is unable to estimate what changes may occur in the fundamental business infrastructure in which the Company currently operates or the resulting effect of any such changes on the Company's financial position or results of its operations.

### **Contingent Liabilities**

The Company is party to various legal proceedings related to business operations, such as property damage claims and employee claims. The Company does not believe that pending or threatened claim of these types, individually or in aggregate, are likely to have any material adverse effect on the Company's financial position or results of operations.

The Company assesses the likelihood of material liabilities arising from individual circumstances and makes provision in its financial statements only where it is probable that actual events giving rise to liability will occur and the amount of the liability can be reasonably estimated. No provision has been made in these financial statements for any of the contingent liabilities mentioned above.

### **Taxation**

Various legislation and regulations are not always clearly written and their interpretation is subject to the opinions of the local tax inspectors and the officials of the Ministry of Finance. Instances of inconsistent opinions between local, regional and national tax authorities are not unusual.

The current regime of penalties and interest related to reported and discovered violations of Kazakhstan's law, are severe. Penalties include fines, which are generally 50% of the taxes additionally assessed, and fines assessed at 14% rate per annum. As a result, penalties and fines can amount to multiples of any unreported taxes.

The Company believes that it has paid or accrued all taxes that are applicable. Where practice concerning the tax application is unclear, the Company has accrued tax liabilities based on management's best estimate. The Company's policy is to accrue contingencies in the accounting period in which a loss is deemed probable and the amount is reasonably determinable.

## **21. CONTINGENT LIABILITIES (continued)**

During 2005, the Company's books and records for 2002, 2003 and 2004 have been audited by the state tax authorities. In December 2005, as result of the tax audit, the Company received a claim from the Tax Committee of the Ministry of Finance of the Republic of Kazakhstan to pay additional taxes in the amount of 6,686,552 thousand Tenge as well as penalties and fines 4,949,490 thousand Tenge (the "Tax Claim"). On January 2006 the Company has contracted a legal firm in Kazakhstan and appealed these claims. The Company's management believes that the Company is in compliance with the tax legislation and the Company will be successful in the appeal process. Therefore, the Company has not recorded any provision for the amounts of the Tax Claim as of December 31, 2005.

The Company believes that it has paid or accrued all taxes that are applicable. Where practice concerning the provision of taxes is unclear, the Company has accrued tax liabilities based on management's best estimate. The Company's policy is to accrue contingencies in the accounting period in which a loss is deemed probable and the amount is reasonably determinable.

Because of the uncertainties associated with the Kazakhstan tax system, the ultimate amount of taxes, penalties and interest, if any, may be in excess of the amount expensed to date and accrued at December 31, 2005. Although such amounts are possible and may be material, it is the opinion of the Company's management that these amounts are either not probable, not reasonably determinable, or both.

The Company's operations and financial position may be affected by Kazakh political developments, including the application of existing and future legislation and tax regulations. The Company does not believe that these contingencies, as related to its operations, are any more significant than those of similar enterprises in Kazakhstan.

### **Environment**

The Company may also be subject to loss contingencies relating to regional environmental claims that may arise from the past operations of the related fields in which it operates. As Kazakh laws and regulations evolve concerning environmental assessments and site restoration, the Company may incur future costs, the amount of which is currently indeterminable due to such factors as the ultimate determination of responsible parties associated with these costs and the government's assessment of respective parties' ability to pay for the costs related to environmental reclamation. However, depending on any unfavorable claims or penalties assessed by the Kazakh regulatory agencies, it is possible that the Company's future results of operations or cash flow could be materially affected in a particular period. It is the opinion of management that such costs will not have a material effect on the financial condition of the Company and accordingly no further provisions, other than those disclosed in Note 10, for future environmental claims or penalties are included in the accompanying financial statements.

### **Governmental Influence, Pricing and Transportation Issues**

The current political and economic situation in Kazakhstan is such that the Government, from time to time, attempts to influence oil producers to supply production to domestic refineries at prices that are substantially lower than prices for export sales. Prices for domestic sales have approximated 30-35% of world market prices during the year ended December 31, 2004.

Despite the fact that the Sale-Purchase Agreement between the Parent and Government provides that the Company will be entitled to compensation at world market prices for any forced domestic sales, management considers such volumes sold locally reasonable in terms of Kazakhstan's current economic situation. However, management is unable to predict what future actions may be taken by the Government to influence its future commercial operations and/or export sales.

The Company's oil production must be transported through pipelines owned by state oil transportation company KazTransOil ("KTO"). KTO has a monopoly on the transport market and as such, is able to directly impact transportation costs incurred by the Company as well as volumes of crude that the Company is able to export. As such, there is no assurance that the Company will be able to export all, or significant portions, of its production.

**22. COMMITMENTS**

**Commitments under the License**

According to the subsoil use contract the Company is obliged to spend 250 thousand US Dollars annually for the training and educational programs for its employees. For the year ended December 31, 2005 and 2004, the Company incurred 745 and 545 thousand US Dollars of training and educational expenses respectively.

**Guarantees Issued**

At December 31, 2005 and 2004, the Company had issued guarantees in favor of Kazakh banks for loans taken by its employees in the amount of 32 million Tenge (240 thousand US Dollars) and 377 million Tenge (2,900 thousand US Dollars).

## **SUPPLEMENTAL INFORMATION – DISCLOSURES ABOUT OIL AND GAS PRODUCING ACTIVITIES-UNAUDITED**

### **Proved Oil and Gas Reserve Quantities**

The reserves of the Company are estimated by the independent engineers in accordance with the standards of the Society of Petroleum Engineers, Inc. and World Petroleum Congress that define the reserves as follows:

Proved reserves are those quantities of petroleum which, by analysis of geological and engineering data, can be estimated with reasonable certainty to be commercially recoverable, from a given date forward, from known reservoirs and under current economic conditions, operating methods, and government regulations. Proved reserves are categorized on developed and undeveloped.

Proved developed reserves are those that are expected to be recovered from existing wells including reserves behind pipe. Improved recovery reserves are considered developed only after the necessary equipment has been installed, or when the costs to do so are relatively minor.

Proved undeveloped reserves are those that are expected to be recovered from new wells on undrilled acreage, from deepening existing wells to a different reservoir, or where a relatively large expenditure is required.

	<b>Oil Reserves (mbbls.)</b>
Proved developed and undeveloped reserves:	
Balance January 1, 2004	391,510
Revision of previous estimates	30,128
Extensions, discoveries and other additions	-
Production	(15,537)
Balance December 31, 2004	406,101
<b>Proved developed reserves</b>	<b>265,143.9</b>

As at December 31, 2004 64,097.8 mbbls. of proved developed reserves are expected to be extracted after the expiration of the license for hydrocarbon exploration and production that is valid until June 7, 2020.