



**JSC Karazhanbasmunai**

IFRS Financial Statements

*For the year ended December 31, 2007*

and Independent Auditor's Report

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of the Joint Stock Company Karazhanbasmunai:

We have audited the accompanying financial statements of the Joint Stock Company Karazhanbasmunai (the "Company"), which comprise the balance sheet as at December 31, 2007, and the statement of income, statement of changes in equity and statement of cash flow for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and the fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence that we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.



*Other Matters*

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary information about oil and gas reserve quantities is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in our audit of the financial statements and, accordingly, we express no opinion on it.

*Ernst + Young LLP*

April 4, 2008

## BALANCE SHEET

### As at December 31, 2007

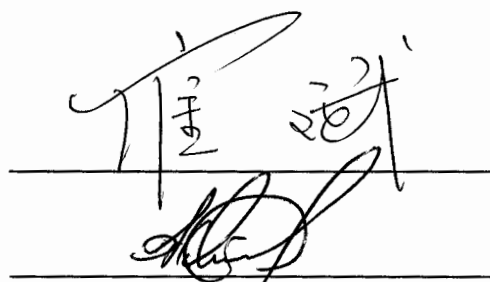
<i>In thousands of Tenge</i>	Note	December 31, 2007	December 31, 2006
<b>Non-current assets</b>			
Property, plant and equipment	4	106,342,300	94,810,324
Intangible assets		118,302	137,556
Advances for fixed assets		2,203,678	1,503,659
		<b>108,664,280</b>	<b>96,451,539</b>
<b>Current assets</b>			
Inventories	5	10,638,930	6,850,929
Prepayment for corporate income tax		2,699,801	1,475,461
Other current assets	6	12,746,538	5,458,898
Trade accounts receivable		6,134,753	7,603,857
Cash and cash equivalents	7	16,378,971	4,869,547
		<b>48,598,993</b>	<b>26,258,692</b>
<b>Total assets</b>		<b>157,263,273</b>	<b>122,710,231</b>
<b>Shareholders' equity</b>			
Share capital	8	2,161,112	2,161,112
Additional paid-in capital	9	3,713,480	-
Retained earnings		52,709,970	31,647,215
		<b>58,584,562</b>	<b>33,808,327</b>
<b>Non-current liabilities</b>			
Long-term debt	9	16,001,375	5,556,251
Bond obligations	9	-	10,994,905
Loan payable to Parent	9	7,202,905	-
Deferred tax liability	10	28,746,551	31,918,687
Future site restoration and abandonment liability	11	3,283,191	2,822,228
Long term interest payable		833,476	-
Other long-term liabilities		230,329	158,650
		<b>56,297,827</b>	<b>51,450,721</b>
<b>Current liabilities</b>			
Trade accounts payable	12	10,056,819	6,221,496
Current portion of long-term debt	9	1,503,750	12,223,749
Amounts due to Parent	13	4,201,752	3,708,818
Loan payable to Parent	9	1,443,600	-
Bond obligations	9	11,045,633	-
Taxes payable	15	11,343,865	13,594,686
Accrued liabilities and other payables	16	2,785,465	1,702,434
		<b>42,380,884</b>	<b>37,451,183</b>
<b>Total liabilities and shareholders' equity</b>		<b>157,263,273</b>	<b>122,710,231</b>

The accounting policies and explanatory notes on pages 7 through 27 form an integral part of these financial statements. The Independent Auditor's report is on page 1.

President JSC Karazhanbasmunai  
Cui Bin

Chief Accountant JSC Karazhanbasmunai  
Zhanbolat Mirmanov

April 4, 2008



## STATEMENT OF INCOME

### For the year ended December 31, 2007

<i>In thousands of Tenge</i>	Note	December 31, 2007	December 31, 2006
<b>Revenue</b>	17	<b>94,523,178</b>	103,519,617
<b>Cost of sales</b>	18	<b>(34,716,141)</b>	(29,370,045)
<b>Gross profit</b>		<b>59,807,037</b>	74,149,572
<b>Expenses</b>			
Transportation expenses		(5,462,397)	(6,890,900)
Selling, general and administrative expenses	19	(6,156,648)	(5,451,646)
Finance costs		(3,852,160)	(3,001,100)
Foreign exchange loss		(315,445)	(96,079)
Other non-operating (loss)/income	20	(39,889)	401,243
<b>Income before income taxes</b>		<b>43,980,498</b>	59,111,090
Income taxes	10	(22,859,704)	(30,556,046)
<b>Net income</b>		<b>21,120,794</b>	28,555,044

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President JSC Karazhanbasmunai  
Cui Bin

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Zhanbolat Mirmanov

April 4, 2008



## STATEMENT OF CASH FLOW

### For the year ended December 31, 2007

<i>In thousands of Tenge</i>	Note	December 31, 2007	December 31, 2006
<b>Cash flows from operating activities:</b>			
Profit before income tax		43,980,498	59,111,090
Adjustments for:			
Depreciation, depletion and amortization	18,19, 20	9,858,840	8,587,121
Loss on disposal of property, plant and equipment	20	512,237	280,947
Foreign exchange gain		(388,875)	(513,247)
Interest expense		3,852,160	3,001,100
Fee for early extinguishment of CSFB loan	19	1,039,584	-
Provisions for obsolete inventory and doubtful accounts		(53,719)	1,537,843
Non - cash stock compensation		-	50
Operating profit before changes in working capital		58,800,725	72,004,904
Trade accounts receivable		1,469,104	(65,637)
Inventories		(4,225,863)	(2,762,370)
Other current assets		(6,798,853)	(1,771,901)
Amounts due to Parent		492,934	786,814
Trade accounts payable		3,835,323	3,257,811
Taxes payable		(648,001)	133,851
Accrued liabilities and other payables		1,607,422	102,219
Cash generated from operations		54,532,791	71,685,691
Interest paid		(1,915,405)	(2,874,817)
Income taxes paid		(28,859,000)	(24,558,407)
<b>Net cash flows from operating activities</b>		<b>23,758,386</b>	<b>44,252,467</b>
<b>Cash flows from investing activities:</b>			
Purchase of property, plant and equipment and intangible assets		(22,405,078)	(18,578,475)
Loans given to Parent	13	-	(8,565,000)
Repayment of loan	13	-	1,588,349
<b>Net cash flows used in investing activities</b>		<b>(22,405,078)</b>	<b>(25,555,126)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from long-term borrowings		18,627,800	8,843,010
Repayment of long-term borrowings		(7,883,154)	(8,935,816)
Dividends paid		(60,150)	(17,874,875)
<b>Net cash flows used in financing activities</b>		<b>10,684,496</b>	<b>(17,967,681)</b>
Effect of exchange rate changes on cash and cash equivalents		(528,380)	(341,747)
<b>Net increase in cash and cash equivalents</b>		<b>11,509,424</b>	<b>387,913</b>
<b>Cash and cash equivalents at the beginning of the period</b>		<b>4,869,547</b>	<b>4,481,634</b>
<b>Cash and cash equivalents at the end of the period</b>		<b>16,378,971</b>	<b>4,869,547</b>

The accounting policies and explanatory notes on pages 7 through 27 form an integral part of these financial statements. The Independent Auditor's report is on page 1.

President JSC Karazhanbasmunai  
Cui Bin

Chief Accountant JSC Karazhanbasmunai  
Zhanbolat Mirmanov

April 4, 2008

## STATEMENT OF CHANGES IN EQUITY

### For the year ended December 31, 2007

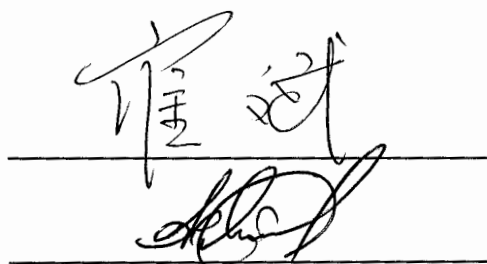
<i>In thousands of Tenge</i>	Share Capital	Note	Additional Paid- in Capital	Retained Earnings	Total
<b>As at January 1, 2006</b>	<b>2,161,062</b>		-	<b>33,369,350</b>	<b>35,530,412</b>
Issue of shares	50		-	-	50
Net income for the period	-		-	28,555,044	28,555,044
Dividends	-		-	(30,277,179)	(30,277,179)
<b>As at December 31, 2006</b>	<b>2,161,112</b>		-	<b>31,647,215</b>	<b>33,808,327</b>
Net income for the period	-		-	21,120,794	21,120,794
Discounting of interest-free loan	-	9	3,713,480	-	3,713,480
Dividends	-		-	(58,039)	(58,039)
<b>As at December 31, 2007</b>	<b>2,161,112</b>		<b>3,713,480</b>	<b>52,709,970</b>	<b>58,584,562</b>

*The accounting policies and explanatory notes on pages 7 through 27 form an integral part of these financial statements. The Independent Auditor's report is on page 1.*

President JSC Karazhanbasmunai  
Cui Bin

Chief Accountant JSC Karazhanbasmunai  
Zhanbolat Mirmanov

April 4, 2008





## NOTES TO THE FINANCIAL STATEMENTS

### For the year ended December 31, 2007

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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 February 16, 1994. 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 the 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.

The majority of the Company’s shares are owned by CITIC Canada Petroleum Limited (“the Parent” or “CCPL”).

On December 12, 2007, KazMunaiGas Exploration Production Joint Stock Company (“KMG”), a state-owned oil company of the Republic of Kazakhstan exercised its option to buy fifty percent of CITIC Canada Energy Limited (a 100% owner of CCPL), therefore its attributable interest of 47.3% in the Karazhanbas field.

As at December 31, 2007 and December 31, 2006 the Company employed 1,928 and 1,795 employees, respectively. Total employees’ costs for the years ended December 31, 2007 and 2006 were 4,722 million Kazakhstani Tenge and 4,005 million Tenge, respectively. Key management of the Company totaled 5 people as at December 31, 2007 and 3 as at December 31, 2006. Total compensation to key management personnel included in general and administrative expenses in the statement of income amounted to 174,798 thousand Tenge and 153,822 thousand Tenge for the years ended December 31, 2007 and 2006, respectively.

The accompanying financial statements were approved by the President and Chief Accountant of the Company on April 4, 2008.

#### 2. BASIS OF PREPARATION

##### Basis of Presentation

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (“IFRS”). The Company maintains its accounting records in Tenge.

The financial statements have been prepared under the historical cost convention, except for future site restoration and abandonment liability and financial instruments.

##### Changes in Accounting Policies

The accounting policies adopted are consistent with those of previous financial years, except as described below.

The Company has adopted the following new and amended IFRS during the year. Adoption of these revised standards did not have any effect on the financial performance or position of the Company. They did however give rise to additional disclosures, including in some cases, revisions to accounting policies.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

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#### 2. BASIS OF PREPARATION (CONTINUED)

##### Changes in Accounting Policies (continued)

###### IFRS 7 Financial Instruments: Disclosures

This standard requires disclosures that enable users of the financial statements to evaluate the significance of the Company's financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included throughout the financial statements. While there has been no effect on the financial position or results, comparative information has been revised where needed.

###### IAS 1 Presentation of Financial Statements

This amendment requires the Company to make new disclosures to enable users of the financial statements to evaluate the Company's objectives, policies and processes for managing capital. These new disclosures are shown in Note 22.

##### **IFRSs and IFRIC Interpretations not yet effective**

The following new standards, amendments to standards and interpretations have been issued but are not effective for 2007 and have not been early adopted:

- IFRS 3 Business Combinations – amendment
- IFRS 8 Operating Segments
- IAS 27 Consolidated and Separate Financial Statements – amendment
- IFRIC 12 Service Concession Arrangements
- IFRIC 13 Customer Loyalty Programmes
- IFRIC 14, Scope of IAS 19 – The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction

The management believes that these standards, amendments to standards and interpretations are not applicable to the Company.

In addition, the Company has not early adopted the following interpretation:

- IFRIC 11, Scope of IFRS 2 – Group and Treasury Share Transactions, effective for annual periods beginning on or after 1 March 2007.

IFRIC 11 requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed. The adoption of this interpretation will result in reclassification in equity and will reduce the retained earnings of the Company by 33 million US Dollars (approximately 4 billion Tenge).

#### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### **Use of Estimates**

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities during the reporting period. The most significant estimates are discussed below:

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

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

##### Use of Estimates (continued)

###### *Oil and gas reserves*

Oil and gas reserves are a material factor in the Company's computation of depreciation, depletion and amortization ("DD&A"). The Company estimates its reserves of oil and gas in accordance with the methodology of the Society of Petroleum Engineers (SPE). In estimating its reserves under SPE methodology, the Company uses constant prices. Management believes that constant price assumptions provide the most appropriate basis for estimating oil and gas reserves. All reserve estimates involve some degree of uncertainty. The uncertainty depends chiefly on the amount of reliable geological and engineering data available at the time of the estimate and the interpretation of this data.

The relative degree of uncertainty can be conveyed by placing reserves into one of two principal classifications, either proved or unproved. Proved reserves are more certain to be recovered than unproved reserves and may be further sub-classified as developed and undeveloped to denote progressively increasing uncertainty in their recoverability. Estimates are reviewed and revised annually. Revisions occur due to the evaluation or re-evaluation of already available geological, reservoir or production data; availability of new data; or changes to underlying price assumptions. Reserve estimates may also be revised due to improved recovery projects, changes in production capacity or changes in development strategy. Proved developed reserves are used to calculate the unit of production rates for DD&A. The Company has included in proved reserves only those quantities that are expected to be produced during the initial license period. This is due to the uncertainties surrounding the outcome of such renewal procedures, since the renewal is ultimately at the discretion of the Government. An increase in the Company's license periods and corresponding increase in reported reserves would generally lead to lower DD&A expense and could materially affect earnings. A reduction in proved developed reserves will increase DD&A expense (assuming constant production), reduce income and could also result in an immediate write-down of the property's book value. It is possible that any changes in reserve estimates year on year could significantly affect prospective charges for DD&A.

###### *Future site restoration and abandonment liability*

Under the terms of certain contracts, legislation and regulations the Company has legal obligations to dismantle and remove tangible assets and restore the land at each production site. Specifically, the Company's obligation relates to the ongoing closure of all wells. The extent of the Company's obligations to finance for final closure costs depends on the terms of the respective contract and current legislation. Where neither contract nor legislation include an unambiguous obligation to undertake or finance such final closure costs at the end of the license term because this liability appears at the end of field economical life only, no liability has been recognized. There is some uncertainty and significant judgment involved in making such a determination. Management's assessment of the presence or absence of such obligations could change with shifts in policies and practices of the Government or in the local industry practice.

Since the license terms cannot be extended at the discretion of the Company, the settlement date of the final future site restoration and abandonment liability has been assumed to be the end of the license period. If the site restoration provision was to be settled at the end of the economic life of the properties, the recorded obligation would increase significantly due to the inclusion of all closure costs.

The amount of the site restoration provision is the present value of the estimated expenditures expected to be required to settle the liability adjusted for expected inflation and discounted using average long-term risk-free interest rates for emerging market sovereign debt adjusted for risks specific to the Kazakhstan market. The Company reviews site restoration provision at each balance sheet date, and adjusts it to reflect the current best estimate in accordance with IFRIC 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities". The Company estimates future site restoration provision using current year prices and the average long-term inflation rate.

The long-term inflation and discount rates used to determine the balance sheet obligation at December 31, 2007 were 5.0% and 10.0% respectively (2006: 5.0% and 10.0%). Movements in the provision for future site restoration are disclosed in Note 11.

###### *Slow-moving and obsolete inventory*

The Company reduces the carrying value of inventory for the amount of slow-moving and obsolete items at each balance sheet date. Such amount is estimated based on the percentage thresholds applied to slow-moving or obsolete inventory depending on the level of damage and frequency of use.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****For the year ended December 31, 2007****3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)****Foreign Currency Translation**

The financial statements are presented in Tenge which is the Company's functional and presentation currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the income statement in the period in which they arise. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the dates when the fair value was determined.

Starting from January 1, 2003, exchange rates established at KASE are used as official currency exchange rates in the Republic of Kazakhstan. As at December 31, 2007 and 2006, the official exchange rates were 120.3 and 127, respectively.

**Oil and Gas Properties**

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 of oil and gas properties with a life longer or equal to the license life is estimated on a unit-of-production basis, in the proportion of actual production for the period to the total remaining proved developed reserves of the field. The remaining reserves figure is estimated up to the license expiration date plus the production for the period.

Oil and gas properties with a useful life less than the license life is calculated based on a straight-line basis over each asset's estimated useful life that ranges from 3 to 10 years.

**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 proved 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.

**Property, Plant and Equipment**

Property, plant and equipment are recorded at purchase or construction cost, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Such costs include the cost of replacing part of plant and equipment when that cost is incurred if the recognition criteria are met. At each reporting date management assess whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount, and the difference is recognized as an expense (impairment loss) in the statement of income. An impairment loss recognized for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

Depreciation of 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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

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

##### Property, Plant and Equipment (continued)

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial period end.

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

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.

##### Prepayments

Prepayments are recognized and carried at the original amount of payment less provision for any amount at risk of non-performance by the counterparty. Prepayments are classified as either current or non-current depending on the expected period of expiration and the nature of goods and services purchased.

##### 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. The cost of crude oil comprises raw material, direct labor, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

##### Trade and Other Receivables

Trade accounts receivable represents amount receivable from customers for crude oil that are non interest bearing and are generally 30 days terms.

Trade and other receivables are carried at original invoice amount less an allowance for any uncollectible amounts. Allowance is made when there is objective evidence that the Company will not be able to collect the debts.

##### Cash and Cash Equivalents

Cash and cash equivalents represent cash on hand, demand deposits with original maturities not exceeding 90 days and short-term 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.

##### Loans and Borrowings

Loans and borrowings are initially recognized at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, loans and borrowings are measured at amortized cost using the effective interest method; any difference between the fair value of the consideration received (net of transaction costs) and the redemption amount is recognized as an adjustment to interest expense over the period of the borrowings. The carrying value of outstanding amounts of loans and borrowings is estimated to approximate the fair value.

##### Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

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

#### Leases (continued)

##### *The Company as a lessor*

Leases where the Company does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same bases as rental income. Contingent rents are recognized as revenue in the period in which they are earned.

##### *The Company as a lessee*

Operating lease payments are recognized as an expense in the income statement on a straight line basis over the lease term.

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

The Company records the fair value of the liability associated with future site restoration and abandonment (decommissioning) in the period in which it is incurred, if a reasonable estimate of fair value can be made. The associated 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.

#### 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.

#### 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 73,140 Tenge and 69,000 Tenge per month as at December 31, 2007 and 2006, respectively.

#### 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 is recognized net of royalty.

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 is stated at the net amount (after discounts and pipeline losses).

## **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

### **For the year ended December 31, 2007**

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

##### **Income Tax**

Income tax for the period 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.

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 IFRS after adjustments for tax purposes. The statutory corporate income tax is currently 30%. Entities in the Republic of Kazakhstan are obliged to make monthly advance corporate income tax payments.

Excess profit tax (EPT) is treated as an income tax and forms part of income tax expense. In accordance with the 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%. Entities in the Republic of Kazakhstan are obliged to make payments of EPT on an annual basis.

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.

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.

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.

##### **Value Added Tax (VAT)**

The tax authorities permit the settlement of VAT on sales and purchases on a net basis. VAT recoverable represents VAT on domestic purchases net of VAT on domestic sales. Export sales are zero rated.

##### **Related Party Disclosures**

For the purposes of IFRS financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

It is the nature of transactions with related parties that they cannot be presumed to be carried out on an arms' length basis.

##### **Dividends**

Dividends payable are recognized as an appropriation of retained earnings in the period when declared.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

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

##### Borrowing Costs

Borrowing costs are recognized as expenses in the period in which they are incurred. The Company capitalizes costs relating to the fees incurred in connection with obtaining loan facilities which are amortized over the life of the loan.

##### Reclassifications

Certain 2006 amount was reclassified to conform with the presentation of 2007 financial statements. This reclassification is summarized below:

<i>In thousands of Tenge</i>	<b>Amount</b>
<b>Statement of Income:</b>	
Road tax was reclassified from selling, general and administrative expenses to cost of sales	544,039

#### 4. PROPERTY, PLANT AND EQUIPMENT

<i>In thousands of Tenge</i>	<b>Oil Properties</b>	<b>Buildings and Premises</b>	<b>Machinery and Equipment</b>	<b>Vehicles</b>	<b>Other</b>	<b>Construc- tion-in- progress</b>	<b>Total</b>
<b>Cost:</b>							
<b>At December 31, 2005</b>	<b>89,392,919</b>	<b>576,477</b>	<b>312,942</b>	<b>2,084,543</b>	<b>470,472</b>	<b>3,518,124</b>	<b>96,355,477</b>
Additions	689,171	-	498	306	1,139	18,434,713	19,125,827
Transfers	16,377,257	(642)	93,611	371,536	146,359	(16,988,121)	-
Disposals	(467,134)	(3,569)	(8,665)	(24,754)	(6,900)	-	(511,022)
<b>At December 31, 2006</b>	<b>105,992,213</b>	<b>572,266</b>	<b>398,386</b>	<b>2,431,631</b>	<b>611,070</b>	<b>4,964,716</b>	<b>114,970,282</b>
Additions	190,394	-	-	6,930	1,788	21,684,338	21,883,450
Transfers	15,788,981	20,267	109,086	542,578	133,859	(16,594,771)	-
Disposals	(812,557)	-	(3,866)	(6,362)	(12,403)	(4,486)	(839,674)
<b>At December 31, 2007</b>	<b>121,159,031</b>	<b>592,533</b>	<b>503,606</b>	<b>2,974,777</b>	<b>734,314</b>	<b>10,049,797</b>	<b>136,014,058</b>
<b>Accumulated depreciation:</b>							
<b>At December 31, 2005</b>	<b>(10,956,918)</b>	<b>(45,115)</b>	<b>(93,435)</b>	<b>(544,119)</b>	<b>(82,599)</b>	<b>-</b>	<b>(11,722,186)</b>
Charge for the period	(8,102,654)	(25,572)	(57,805)	(301,430)	(55,123)	-	(8,542,584)
Transfers	(392)	-	-	(349)	741	-	-
Disposals	86,305	853	5,303	9,852	2,499	-	104,812
<b>At December 31, 2006</b>	<b>(18,973,659)</b>	<b>(69,834)</b>	<b>(145,937)</b>	<b>(836,046)</b>	<b>(134,482)</b>	<b>-</b>	<b>(20,159,958)</b>
Charge for the period	(9,326,404)	(23,455)	(63,548)	(335,525)	(66,053)	-	(9,814,985)
Transfers	(1,822)	(9)	767	(25)	1,089	-	-
Disposals	298,990	-	1,077	1,380	1,738	-	303,185
<b>At December 31, 2007</b>	<b>(28,002,895)</b>	<b>(93,298)</b>	<b>(207,641)</b>	<b>(1,170,216)</b>	<b>(197,708)</b>	<b>-</b>	<b>(29,671,758)</b>
<b>Net book value:</b>							
At December 31, 2006	87,018,554	502,432	252,449	1,595,585	476,588	4,964,716	94,810,324
<b>At December 31, 2007</b>	<b>93,156,136</b>	<b>499,235</b>	<b>295,965</b>	<b>1,804,561</b>	<b>536,606</b>	<b>10,049,797</b>	<b>106,342,300</b>

Interest expense of 349,433 thousand Tenge calculated at the rate of 9.69% was capitalized as part of additions to assets under construction in 2006. No interest expense was capitalized in 2007.

The Company pledged assets with a carrying value of 9.1 billion Tenge and 9.9 billion Tenge as at December 31, 2007 and 2006, respectively (See Note 9).

Property, plant and equipment includes items fully depreciated and still in use with a historical cost of 1,167,732 thousand Tenge and 893,013 thousand Tenge as at December 31, 2007 and 2006, respectively.



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

#### 5. INVENTORIES

<i>In thousands of Tenge</i>	December 31, 2007	December 31, 2006
Spare parts and materials	9,032,769	5,515,476
Crude oil	1,693,683	357,614
Inventory in transit	432,164	1,020,658
Other	80,314	87,181
Less: Provision for obsolete materials	(600,000)	(130,000)
	<b>10,638,930</b>	<b>6,850,929</b>

In 2007 the Company reversed prior year write-off of materials in the amount of 32,138 thousand Tenge and created an additional provision in the amount of 470,000 thousand Tenge. In 2006 the Company created an additional provision for obsolete materials in the amount of 1,049,248 thousand Tenge and wrote off obsolete inventory in the amount of 1,534,106 thousand Tenge against this provision.

#### 6. OTHER CURRENT ASSETS

<i>In thousands of Tenge</i>	December 31, 2007	December 31, 2006
VAT receivable	9,345,614	3,170,672
Advances to suppliers	2,882,156	2,389,524
Deferred expenses	367,426	234,833
Prepayments for taxes	85,345	147,481
Employee receivables	85,044	54,684
Interest receivable	46,271	-
Less: reserve for possible non-performance	(65,318)	(538,296)
	<b>12,746,538</b>	<b>5,458,898</b>

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

The management believes that the balance of VAT receivable of 9,345,614 thousand Tenge as at December 31, 2007 is fully recoverable.

During 2006 the Company offset 3,689,965 thousand Tenge corporate income tax payable against VAT receivable.

#### 7. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are comprised of the following as at December 31, 2007 and 2006:

<i>In thousands of Tenge</i>	December 31, 2007	December 31, 2006
Short term deposits-US Dollars	8,315,104	-
Current bank accounts-US Dollars	7,670,314	4,415,078
Current bank accounts and petty cash-Kazakhstani Tenge	393,553	454,469
	<b>16,378,971</b>	<b>4,869,547</b>

Short term deposits are made for various periods of between ten days and three months, depending on the immediate cash requirements of the Company and earn interest at the respective short-term deposit rates.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****For the year ended December 31, 2007****8. SHAREHOLDERS'S EQUITY**

Share capital consists of shares with nominal value of 1000 Tenge per share. As at December 31, 2007 and 2006 the shareholders of the Company were as follows:

	Number of Shares	Par Value	Paid up share capital <i>In thousands of Tenge</i>
CITIC Canada Petroleum Ltd. – common stock	2,045,035	1,000	2,045,035
Employees of the Company – preferred stock	116,077	1,000	116,077
	<b>2,161,112</b>		<b>2,161,112</b>

The authorized share capital of the Company as at December 31, 2007 and 2006 equals to 2,161,251 shares out of which 139 shares were not issued and paid. No shares were issued in 2007.

As mentioned in Note 1, on December 12, 2007 KMG acquired fifty percent of CITIC Canada Energy Limited (a 100% owner of CCPL).

Any dividend on shares is determined after consideration of the Company's profit, less income taxes and is 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 rights in case of the Company's reorganization or bankruptcy.

On November 14, 2007, the Company declared dividends of 500 Tenge per preferred share totaling 58,039 thousand Tenge.

**9. LONG-TERM DEBT AND BOND OBLIGATIONS**

<i>In thousands of Tenge</i>	Date of Issue	Maturity Date	Annual Interest rate	Original Currency	December 31, 2007	December 31, 2006
Bank TuranAlem loan	June 19, 2003	July 1, 2011	11.8%	USD	5,263,125	6,350,000
Halyk Bank loan	April 12, 2007	April 12, 2009	9.5%	KZT	12,242,000	-
CSFB Bank loan	August 24, 2004	January 12, 2007	LIBOR+4%	USD	-	11,430,000
					<b>17,505,125</b>	17,780,000
Less: current portion of long-term debt					<b>(1,503,750)</b>	(12,223,749)
					<b>16,001,375</b>	5,556,251
Bonds	Dec'2003	Dec'2008	Floating rate	KZT	11,054,134	11,011,906
Less: transaction costs					<b>(8,501)</b>	(17,001)
					<b>11,045,633</b>	10,994,905
CCPL loan	January 12, 2007	January 12, 2012	Interest free	USD	8,646,505	-
Less: current portion of long-term debt					<b>(1,443,600)</b>	-
					<b>7,202,905</b>	-

In June 2003, the Company entered into a 20 million US Dollars facility agreement with Bank Turan Alem ("BTA"). In March 31, 2005 the Company 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 gave the Company a grace period of 12 months and demanded repayment of the loan by equal monthly portions starting from April 31, 2006. In July 2006, the Company increased the credit line limit up to 50 million US Dollars and renegotiated a repayment schedule of the loan that demanded repayment of the loan by equal monthly portions starting from July 25, 2007 till July 1, 2011.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

#### 9. LONG-TERM DEBT AND BOND OBLIGATIONS (CONTINUED)

The Company pledged assets with a carrying value of 9.1 billion Tenge and 9.9 billion Tenge as at December 31, 2007 and 2006, respectively, 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, 2007 and 2006 is subject to a number of covenants, such as, maximum amount of additional financing should not exceed 275 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. The Company is in compliance with these covenants.

On April 12, 2004, the Company entered into another revolving credit agreement with BTA. The Company can call up to 25 million US Dollars at 10% anytime until February 2008, which is to be refunded in six months from the day of disbursement. Amount of loan called up under revolving credit agreement was fully repaid as at December 31, 2007 and 2006.

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. 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 an effective interest rate of LIBOR + 4.7%.

On January 12, 2007, CSFB loan was fully repaid by CCPL. Total amount repaid consisted of face value of 90 million US Dollars (11,298,600 thousand Tenge), accrued interest payable in amount of 3.3 million US Dollars (414,511 thousand Tenge) and fee for early extinguishment of the loan in amount of 8.28 million US Dollars (1,039,584 thousand Tenge). As a result, the Company recognized an interest-free loan payable to CCPL in the amount of 101.58 million US Dollars of which 6 million US Dollars were repaid immediately. The outstanding loan of 95.58 million US Dollars which matures in July 2012 was discounted using 10% interest rate and as a result 30 million US Dollars (3,713,480 thousand Tenge) was recognized through additional paid-in capital.

In April 2007 the Company received the loan in the amount of 12,242,000 thousand Tenge from Halyk Bank Kazakhstan with the maturity in two years and interest of 9.5%. The loan was used to settle the Company's excess profit tax obligation.

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 the Kazakh Stock Exchange with a five year maturity. All bonds were sold at the beginning of 2004 to various Pension Funds and Commercial Banks of the Republic 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 Kazakhstani 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. During 2007, the Company exercised its right to decrease annual interest rate by 2 percent and as at December 31, 2007, the coupon rate reflected the inflation index and equaled to 8.8%.

#### 10. INCOME TAXES

The components of the income tax expenses reported in the Statement of Income for the years ended December 31, 2007 and 2006 are as follows:

<i>In thousands of Tenge</i>	2007	2006
Current income taxes	14,888,143	18,013,786
Deferred income tax benefit/expense	(3,172,136)	433,905
Excess profit tax	11,143,697	12,108,355
	<b>22,859,704</b>	<b>30,556,046</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

#### 10. INCOME TAXES (CONTINUED)

As at December 31, 2007 and 2006 the Company's net deferred tax position comprised the following:

<i>In thousands of Tenge</i>	December 31, 2007	December 31, 2006
Deferred income tax liability:		
Property, plant and equipment	31,008,203	31,888,115
Other	(2,261,652)	30,572
<b>Deferred tax liability as at December 31,</b>	<b>28,746,551</b>	<b>31,918,687</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>	2007	2006
Statutory Kazakhstan income tax rate	30%	30%
Income tax expense at statutory rate	13,194,149	17,733,327
Deferred excess profit tax expense	(1,306,173)	178,667
Non-deductible amounts	(171,969)	535,697
Excess profit tax	11,143,697	12,108,355
	<b>22,859,704</b>	<b>30,556,046</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 into 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.

#### 11. FUTURE SITE RESTORATION AND ABANDONMENT LIABILITY

<i>In thousands of Tenge</i>	December 31, 2007	December 31, 2006
Liability as at beginning of the year	2,822,228	1,944,927
Change in estimates	21,787	518,560
Increase in liability for new wells drilled	156,953	164,248
Accretion expense	282,223	194,493
<b>Liability as at end of the year</b>	<b>3,283,191</b>	<b>2,822,228</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 an inflation rate of 5%. Management of the Company estimates that major part of 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

#### 12. TRADE ACCOUNTS PAYABLE

As at December 31, 2007 and 2006 trade accounts payable comprised amounts due to suppliers for goods and services incurred during regular business activities.

<i>In thousands of Tenge</i>	<b>December 31, 2007</b>	December 31, 2006
Tulpar Munai Service Ltd	<b>4,139,529</b>	1,894,261
Argymak Trans Service Ltd	<b>3,174,768</b>	1,882,917
Other	<b>2,742,522</b>	2,444,318
	<b>10,056,819</b>	6,221,496

The Company rents drilling and well workover rigs and machines to the Parent's subsidiary, Tulpar Munai Service Ltd ("TMS"). Rent income from this operation amounted to 285 million Tenge and 658 million Tenge in 2007 and 2006, respectively. TMS provided drilling and well workover services to the Company totaling 7,234 million Tenge and 6,201 million Tenge during 2007 and 2006, respectively.

Starting March 2005, the Company rents its fleet of vehicles to the Parent's subsidiary, Argymak Trans Service Ltd ("ATS"). Rent income from this operation amounted to 300 million Tenge and 285 million Tenge during 2007 and 2006, respectively. ATS provided transportation services to the Company totaling 8,835 million Tenge and 7,344 million Tenge during 2007 and 2006, respectively.

The management believes that transactions with ATS and TMS are carried on an arms' length basis.

#### 13 AMOUNTS DUE (TO)/FROM PARENT

<i>In thousands of Tenge</i>	<b>December 31, 2007</b>	December 31, 2006
Dividends payable	<b>(3,096,458)</b>	(3,096,458)
Management fee (payable) / prepayment	<b>(442,464)</b>	23,779
Other payables	<b>(662,830)</b>	(636,139)
	<b>(4,201,752)</b>	(3,708,818)

In March 2003, the Company signed an agreement with Parent, whereby the Company shall grant to the Parent 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 installment of the loan shall not exceed 180 days after the money has been transferred by the Company. The Parent shall have the right to offset the loan payable to the Company against the Parent's dividends, under other counter-obligations based on offset agreements signed by the parties, or any other mutually agreeable manner if it does not contradict Kazakhstani legislation.

During 2006 the Company provided loans in the amount of 8,565 million Tenge (68 million US Dollars) to the Parent. During 2006, 10,147 million Tenge (81.4 million US Dollars) were offset by: outstanding dividends in the amount of 9,287 million Tenge (75 million US Dollars), by management fees in the amount of 449 million Tenge (3.5 million US Dollars) and salary in the amount of 411 millions Tenge (3.2 million US Dollars). The residual amount was repaid by the Parent.

In March 2000 the Company signed an agreement with Parent, under which the Parent renders management services, including administration, consulting, marketing and other services (the "Management Agreement"). During 2007 the Company accrued 784 million Tenge (6.5 million US Dollars) of management fee and paid 302 million Tenge (2.5 million US Dollars) including withholding tax in amount of 60 million Tenge (0.5 million US Dollars). During 2006 the Company accrued 743 million Tenge (5.8 million US Dollars) of management fee, reversed 471 million Tenge (3.5 million US Dollars) of management fee accrued during 2005 due to change of allocation base used for the calculation of management fee, offset 449 million Tenge (3.5 million US Dollars) with a loan receivable from the Parent, and paid withholding tax on management fee in the amount of 141 million Tenge (1.1 million US Dollars). Residual difference related to management fee payable represents foreign exchange difference.

**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****For the year ended December 31, 2007****14. RELATED PARTY DISCLOSURE**

During 2007 and 2006 the Company has entered into certain transactions with its related parties, as summarised below:

<i>In thousands of Tenge</i>		Amounts owed to related parties (Note 12,13)	Amounts prepaid to related parties (Note 6)	Non- operating income (Note 20)	Purchases of goods and services	Loan from Parent Company (Note 9)
Entities under common control	<b>2007</b>	<b>7,314,297</b>	-	<b>585,801</b>	<b>16,069,184</b>	-
	<b>2006</b>	<b>3,777,178</b>	-	<b>943,072</b>	<b>13,545,000</b>	-
Other state-controlled enterprises	<b>2007</b>	-	<b>717,709</b>	-	<b>6,402,596</b>	-
	<b>2006</b>	-	<b>593,775</b>	-	<b>7,058,224</b>	-
The Parent	<b>2007</b>	<b>4,201,752</b>	-	-	<b>784,092</b>	<b>8,646,505</b>
	<b>2006</b>	<b>3,708,818</b>	-	-	<b>272,070</b>	-

**15. TAXES PAYABLE**

Taxes payable are comprised as the following as at December 31, 2007 and 2006:

<i>In thousands of Tenge</i>	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Excess profit tax	<b>10,889,912</b>	12,430,214
Royalty	<b>282,729</b>	354,915
Social tax	<b>94,477</b>	333
Individual income tax	<b>41,655</b>	39,755
Withholding tax	-	576,562
Other	<b>35,092</b>	192,907
	<b>11,343,865</b>	13,594,686

**16. ACCRUED LIABILITIES AND OTHER PAYABLES**

Accrued liabilities and other payables are comprised as the following as at December 31, 2007 and 2006:

<i>In thousands of Tenge</i>	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Ecological provision	<b>1,683,900</b>	-
Salaries payable	<b>501,066</b>	616,681
Interest and coupon payable	<b>498,751</b>	1,001,748
Dividends payable on preferred shares	<b>48,203</b>	50,314
Pension funds	<b>43,233</b>	27,783
Other payables	<b>10,312</b>	5,908
	<b>2,785,465</b>	1,702,434

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

#### 17. REVENUE

The composition of revenue for the years ended December 31, 2007 and 2006 was as follows:

<i>In thousands of Tenge</i>	2007	2006
Export crude oil sales	92,946,719	101,744,021
Domestic crude oil sales	4,408,546	5,048,572
Royalty	(2,832,087)	(3,272,976)
	<b>94,523,178</b>	<b>103,519,617</b>

In 2007 and 2006 export sales were made in US Dollars to two customers.

#### 18. COST OF SALES

The composition of cost of sales for the years ended December 31, 2007 and 2006 was as follows:

<i>In thousands of Tenge</i>	2007	2006
Maintenance and repair	12,777,759	10,699,557
Depreciation, depletion and amortization	9,374,679	8,152,104
Salary and related benefits	3,165,882	2,639,799
Ecological clearance	1,881,551	-
Field taxes	1,609,955	1,615,004
Gas	1,367,812	1,023,744
Materials and supplies	1,234,478	1,921,876
Electricity	973,588	982,197
Water supply	942,371	435,876
Field services (catering, housing, medical facility)	490,789	669,126
Field supervision	143,379	490,566
Other	753,898	740,196
	<b>34,716,141</b>	<b>29,370,045</b>

#### 19. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

The composition of selling, general and administrative expenses for the years ended December 31, 2007 and 2006 was as follows:

<i>In thousands of Tenge</i>	2007	2006
Salary and related benefits	1,556,015	1,365,189
Fee for early extinguishment of CSFB loan	1,039,584	-
Management fees expenses	784,092	272,070
Insurance cost	574,664	344,046
Social sphere and trainings	553,964	399,453
Third parties services	452,972	430,145
Obsolete inventory	437,862	1,049,248
Other selling expenses	431,936	360,295
Consulting fees	208,145	230,617
Business trips	197,443	157,333
Depreciation and amortization	84,003	90,605
Operating taxes	61,682	73,501
Bad debt expense	(491,581)	488,595
Other	265,867	190,549
	<b>6,156,648</b>	<b>5,451,646</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

#### 20. OTHER NON-OPERATING INCOME

The composition of other non-operating income for the years ended December 31, 2007 and 2006 was as follows:

<i>In thousands of Tenge</i>	2007	2006
Operating lease income	585,801	943,072
Trade income	153,713	33,928
Interest income	132,992	49,602
Loss on disposal of property, plant and equipment	(512,237)	(280,947)
Depreciation and amortization of assets given into lease	(400,158)	(344,412)
	(39,889)	401,243

During 2007 the Company dismantled part of its property, plant and equipment in the amount of 24,252 thousand Tenge and included to the inventory balance to be used in the future production (2006: 125,263 thousand Tenge).

#### 21. NON-CASH TRANSACTIONS

The following non-cash transactions are excluded from the consolidated statement of cash flows:

<i>In thousands of Tenge</i>	2007	2006
Reclassification of CSFB loan to CITIC loan payable (Note 9)	11,298,600	-
Fee for early extinguishment of the loan to CSFB (Note 9)	1,039,584	-
Reclassification of CSFB interest payable to loan payable to Parent (Note 9)	414,511	-
Non-cash increase in fixed assets due to change in future site restoration and abandonment liability (Note 11)	178,740	682,808
Offset of loan receivable from Parent with dividends, management fee and salaries payable to Parent	-	10,147,000
Offset of VAT recoverable against corporate income tax payable	-	3,689,965

#### 22. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company's principal financial liabilities comprise trade payables, accrued liabilities (excluding employees' benefits), loans and bonds payable, dividends payable and amounts due to related parties. The main purpose of these financial liabilities is to raise finance for the Company's operations. Cash and cash equivalents, short-term deposits and accounts receivable represent Company's financial assets arising directly from its operations.

The Company believes the amounts presented as financial instruments in the accompanying financial statements are reasonable estimates of their fair values. The fair value of cash and cash equivalents, accounts receivable and other monetary current assets and liabilities is estimated to approximate carrying value due to their short-term nature.

The main risks arising from the Company financial instruments are foreign currency risk, liquidity risk, credit risk, and interest rate risk. Management reviews and agrees policies for managing each of these risks which are summarized below.

##### Interest Rate Risk

The Company's exposure to the risk of changes in interest rate relates to the bonds principal as at December 31, 2007 and 2006, and CSFB loan as at December 31, 2006.



**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)****For the year ended December 31, 2007****22. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)****Interest Rate Risk (continued)**

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Company's profit before tax (through the impact on floating rate borrowings). There is no impact on the Company's equity.

<i>In thousands of Tenge</i>	Increase/Decrease in basis points	Effect on profit before tax
<b>2007</b>		
Tenge	+300	(333,300)
Tenge	-300	333,300
<b>2006</b>		
Tenge	+300	(333,300)
USD	+300	(342,900)
Tenge	-300	333,300
USD	-300	342,900

**Foreign Currency Exchange Rate Risk**

Transaction exposure arises on cash and cash equivalents, accounts receivable, loans and bonds payable and other payables due to related parties as at December 31, 2007 that are denominated in a foreign currency other than the functional currency in which they are measured.

The following table demonstrates the sensitivity to a reasonable possible change in the foreign currency exchange rate, with all variables held constant, of the Company's profit before tax: (due to change in the fair value of monetary assets and liabilities)

<i>In thousands of Tenge</i>	Increase/Decrease in US Dollar rate	Effect on profit before tax
<b>2007</b>		
	+5%	(789,686)
	-5%	789,686
<b>2006</b>		
	+5%	(244,498)
	-5%	244,498

**Credit Risk**

The Company trades only with reputable, creditworthy third parties. The extent of the Company's credit exposure is represented by the balance of cash and accounts receivable as at December 31, 2007 and December 31, 2006. Accounts receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debts is not significant. 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 counterparties, it does not expect such losses to occur. No collateral is required by the Company to support financial instruments subject to credit risk.

With respect to credit risk arising from cash and cash equivalents, the Company's exposure to the risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments. The Company mostly places the deposits with Kazakhstan banks. The Company's management reviews credit ratings of these banks periodically and transacts with the resident and non-resident banks that have at least a credit rating of BB on long-term US dollar deposits from Standard and Poor's rating agency.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

#### 22. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

##### Credit Risk (continued)

The table below shows cash held in banks at the balance sheet date and Standard and Poor's credit rating symbols for Kazakhstan banks:

Bank	Location	Rating <sup>1</sup>		Balance <i>In thousands of Tenge</i>	
		2007	2006	2007	2006
Halyk Bank	Kazakhstan	BB+ (negative)	BB+ (stable)	15,025,617	96,595
Bank Turan Alem	Kazakhstan	BB (negative)	BB+ (stable)	1,183,021	2,900,961
Kazkommertsbank	Kazakhstan	BB (negative)	BB (positive)	168,948	307,717

The management believes that in case of any default of these financial institutions the risk associated with the Company's cash balances is mitigated by loans payable to those financial institutions.

During 2007 and 2006 the Company received a significant share of its revenue from two customers, as a result had a substantial credit concentration risk. For the years ended December 31, 2007 and 2006 revenues from these customers amounted to 92,946,719 thousand Tenge and 101,744,021 thousand Tenge, respectively, which comprised 95% of total Company's revenues.

##### Liquidity Risk

The Company monitors its risk to a shortage of funds by reviewing its net financial debt indicator on a regular basis. The net financial debt represents the difference between total financial liabilities and cash and cash equivalents.

The Company's objective is to maintain a balance between continuity of funding and flexibility through the use of credit line facilities.

The table below summarizes the maturity profile of the Company's financial liabilities as at December 31, 2007 and December 31, 2006 based on contractual undiscounted payments:

<i>In thousands of Tenge</i>	On Demand	Less than 3 months	3-12 months	1- 5 years	Over 5 years	Total
<b>Year ended December 31, 2007</b>						
Interest bearing loans and borrowings	-	1,237,489	13,958,710	23,503,387	-	38,699,586
Trade payables	10,048,812	685	2,026	5,296	-	10,056,819
Loan payable to Parent	-	-	1,443,600	10,055,002	-	11,498,602
Amount due to Parent	-	-	3,756,715	-	-	3,756,715
Other financial liabilities	-	-	1,742,415	230,329	3,283,191	5,255,935
	<b>10,048,812</b>	<b>1,238,174</b>	<b>20,903,466</b>	<b>33,794,014</b>	<b>3,283,191</b>	<b>69,267,657</b>
<b>Year ended December 31, 2006</b>						
Interest bearing loans and borrowings	-	12,743,276	2,235,083	25,351,036	-	40,329,395
Trade payables	6,205,514	4,431	24	11,527	-	6,221,496
Amount due to Parent	-	-	3,306,209	-	-	3,306,209
Other financial liabilities	-	-	56,222	158,650	2,822,228	3,037,100
	<b>6,205,514</b>	<b>12,747,707</b>	<b>5,597,538</b>	<b>25,521,213</b>	<b>2,822,228</b>	<b>52,894,200</b>

<sup>1</sup> Source: Interfax – Kazakhstan, Factiva, official sites of the banks

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

#### 22. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

##### Capital Management

The primary objective of the Company's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize shareholder value.

The Company's capital represents equity attributable to the shareholders and consists of share capital, additional paid-in capital and retained earnings including current year profit less accrued dividends.

The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may obtain additional borrowing on the market, adjust the amount of dividends paid to shareholders or issue new shares.

The Company monitor capital using gearing ratio, which is net debt divided by total capital plus net debt. The Company's policy is to keep gearing ratio between 40% and 65%.

<i>In thousands of Tenge</i>	2007	2006
Interest bearing loans and borrowings	29,882,985	29,776,653
Trade and other payables	40,049,175	27,206,564
Less cash and short term deposits	(16,378,971)	(4,869,547)
Net Debt	53,553,189	52,113,670
Equity	58,584,562	33,808,327
<b>Total Capital</b>	<b>58,584,562</b>	<b>33,808,327</b>
Capital and net debt	112,137,751	85,921,997
Gearing ratio	48%	61%

#### 23. 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.

#### 24. CONTINGENT LIABILITIES

##### Political and Economic Environment

Whilst there have been certain improvements in the Kazakhstani economy, such as an increase in the gross domestic product, the Republic of Kazakhstan continues to implement economic reforms and improve development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Kazakhstani economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

##### 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

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#### 24. CONTINGENT LIABILITIES (CONTINUED)

##### Contingent Liabilities (continued)

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.

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 a 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 of 4,949,490 thousand Tenge (the "tax claims"). On January 2006 the Company appealed to the Tax Committee of the Ministry of Finance in respect of these tax claims. The Company did not receive a formal response from the Tax Committee and further appealed to Astana city court. The case was finally closed on January 16, 2008, when the court ruled to charge the Company with 113,464 thousand Tenge. The amount was accrued by the Company in 2007 financial statements.

During 2007, the Company's books and records have been audited by the state tax authorities with regard to the calculation and accrual of withholding tax from the source of payment for the years 2002-2006. As a result, the Company received a claim from the Tax Committee of the Ministry of Finance of the Republic of Kazakhstan to pay additional tax in the amount of 244,790 thousand Tenge and penalty in amount of 98,032 thousand Tenge.

In 2007 the Company's books have also been audited by the tax authorities with regard to the calculation and accrual of the excess profit tax for the years 2002-2004. As a result, the Company received a claim from the Tax Committee of the Ministry of Finance of the Republic of Kazakhstan to pay additional tax in the amount of 11,781,577 thousand Tenge, fines in the amount of 5,890,789 thousand Tenge and penalty in the amount of 6,891,013 thousand Tenge.

On March 11, 2008 the Company has appealed the excess profit tax claims to Astana city court. The outcome of this appeal remains uncertain as of the date when the financial statements were authorized for issue. However, the Company believes that the case will be ruled in its favour.

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 as at December 31, 2007. 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.

## **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

### **For the year ended December 31, 2007**

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#### **24. CONTINGENT LIABILITIES (CONTINUED)**

##### **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 there is a remote likelihood that such costs will have a material effect on the financial condition of the Company and accordingly no further provisions, other than those disclosed in Note 11 and Note 16, for future environmental claims or penalties are included in the accompanying financial statements.

#### **25. COMMITMENTS**

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

The current political and economic situation in the Republic of 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 35% of world market prices during the year ended December 31, 2007.

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.

##### **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. During the year ended December 31, 2007 the Company incurred 1,166 thousand US Dollars of training and educational expenses.

In accordance with the License for hydrocarbon exploration and production the Company has to perform minimal work program for 2008. This minimal work program was agreed with the Governmental Agency ZAPKAZNEDRA. In accordance with this minimal work program the Company has a capital commitment obligation for 220.2 million US Dollars, to drill 250 wells and produce 2,100 thousand tons of crude oil.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### For the year ended December 31, 2007

#### 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, 2007	363,789
Revision of previous estimates	(9,244)
Extensions, discoveries and other additions	-
Production	(12,972)
Balance December 31, 2007	341,573
Proved developed reserves	179,953

As at December 31, 2007 55,819 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.