JSC Lancaster Petroleum

Financial Statements

Year ended December 31, 2008
with Independent Auditors' Report

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INDEPENDENT AUDITORS' REPORT

To the Shareholder of Lancaster Petroleum JSC:

We have audited the accompanying financial statements of Lancaster Petroleum JSC ("the Company"), which comprise the balance sheet as of December 31, 2008 and the income statement, statement of changes in equity and cash flow statement 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 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.

Auditors' 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 auditors' 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 we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Ernst & Young

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Paul Cohn
Audit Partner

Evgeny Zhemaletdinov
General Director
Ernst & Young LLP

State Audit License for the audit activities on the territory of the Republic of Kazakhstan: series МФЮ - 2, № 0000003, issued by the Ministry of Finance of the Republic of Kazakhstan dated 15 July 2005

Audit Qualification Certificate № 0000553 dated 24 December 2003

June 12, 2009

BALANCE SHEET
As at December 31, 2008

In thousands of Tenge	Notes	2008	2007 (restated)
ASSETS			
Non-current assets			
Intangible assets		**67,388**	43,345
Property, plant and equipment	5	**5,568,246**	9,581,920
Other non-current assets	6	**491,015**	376,138
Deferred tax assets	22	**–**	89,113
Total non-current assets		**6,126,649**	10,090,516
Current assets			
Inventories	7	**441,201**	218,895
Trade receivables	8	**129**	721,110
Due from related parties	24	**1,793,044**	2,344,339
Advances given	9	**287,969**	228,532
Prepayment for corporate income tax		**54,164**	–
Other current assets	10	**632,572**	402,818
Bank deposits	11	**1,201**	58,696
Cash and cash equivalents	12	**188,929**	50,014
Total current assets		**3,399,209**	4,024,404
Assets of disposal group classified as held for sale	4	**4,639,751**	–
TOTAL ASSETS		**14,165,609**	14,114,920

BALANCE SHEET (continued)
As at December 31, 2008

In thousands of Tenge	Notes	2008	2007 (restated)
Equity			
Charter capital	13	1,500,000	1,500,000
Treasury shares	13	(150,000)	(150,000)
Retained earnings		4,334,514	5,360,014
Total equity		5,684,514	6,710,014
Liabilities			
Non-current liabilities			
Abandonment and site restoration liabilities	14	189,848	241,048
Deferred tax liability	22	89,035	–
Total non-current liabilities		278,883	241,048
Current liabilities			
Trade payables	15	601,333	568,200
Due to related parties	24	7,529	26,416
Short-term interest-bearing loans	16	3,810,797	5,558,410
Corporate income tax payable		–	163,024
Excess profits tax payable	22	440,376	686,586
Other taxes payables		384	8,031
Other current liabilities		62,421	153,191
Total current liabilities		4,922,840	7,163,858
Liabilities of disposal group classified as held for sale	4	3,279,372	–
Total liabilities		8,481,095	7,404,906
TOTAL EQUITY AND LIABILITIES		14,165,609	14,114,920

The accounting policies and explanatory notes on pages 7 through 28 form an integral part of these financial statements.

Signed and authorized for release on behalf of the Board of Directors of the Company:

«Lancaster Petroleum»

President — A. Shovkoplyas

Chief Accountant — Sh.Sarbopeyeva

INCOME STATEMENT
For the year ended December 31, 2008

In thousands of Tenge	Notes	2008	2007 (restated)
Revenue		8,237,228	7,673,788
Cost of sales	17	(1,984,408)	(1,965,748)
Gross profit		6,252,820	5,708,040
Dry hole expense		(1,078,347)	(293,552)
Geological and geophysical expenses	18	(90,294)	(62,989)
General and administrative expenses	19	(1,383,515)	(1,249,660)
Selling expenses	0	(1,366,889)	(872,334)
Loss on disposal of property, plant and equipment		(105,739)	(14,385)
Other operating (expense) / income		(43,563)	9,654
Profit from operating activities		2,184,473	3,224,774
Finance income	21	3,326	277
Finance costs	21	(494,039)	(364,020)
Gain on disposal of available for sale securities		–	12,934
Foreign exchange (loss) / gain, net		(35,889)	255,134
Profit before income tax		1,657,871	3,129,099
Income tax expense	22	(611,997)	(818,490)
Excess profit tax expense	22	(486,652)	(649,892)
Net profit for the year		559,222	1,660,717
Basic and diluted earnings per share	23	414	1,230

The accounting policies and explanatory notes on pages 7 through 28 form an integral part of these financial statements.

Signed and authorized for release on behalf of the Board of Directors of the Company:

President A. Shovkoplyas

Chief Accountant Sh.Sarbopeyeva

«Lancaster Petroleum» Қазақстан Республикасы Ақтөбе қаласы Акционерлік қоғамы Республика Казахстан город Актобе Акционерное общество

STATEMENT OF CASH FLOWS

For the year ended December 31, 2008

In thousands of tenge	Notes	2008	2007 (restated)
Cash flows from operating activities:			
Profit before income tax		1,657,871	3,129,099
Adjustments for:			
Depreciation and amortization	17, 19	614,559	597,736
Dry hole expense	5	1,078,347	293,552
Provision charge	19	18,038	9,672
Usage of the liquidation fund	14	(77,685)	(9,216)
(Reversal of) / provision for obsolete inventories	7	(5,547)	42,446
Finance costs, net	21	490,713	363,743
Loss from disposal of property, plant and equipment	5	105,739	798,367
Gain on sale of available for sale securities		–	(12,934)
Unrealized foreign exchange gain		25,124	(266,757)
Operating profit before working capital changes		3,907,159	4,945,708
(Increase) / decrease in operating assets:			
Inventories		(216,759)	(126,401)
Trade receivables		720,981	(651,169)
Advances paid		(60,347)	172,258
Due from related parties		(426,910)	(1,338,757)
Other current assets		(213,482)	(69,125)
Other non-current assets		(157,738)	145,243
Increase / (decrease) in operating liabilities:			
Due to related parties		(26,416)	(23,058)
Trade and other payables		59,098	(285,052)
Other current liabilities		(115,506)	96,434
Cash generated from operations		3,470,080	2,866,081
Interest paid		(924,268)	(693,591)
Interest received		3,028	–
Income tax paid		(1,466,879)	(583,325)
Net cash flows provided by operating activities		1,081,961	1,589,165
Cash flows from investing activities:			
Purchase of property, plant and equipment		(2,072,539)	(5,987,163)
Purchase of intangible assets		(33,415)	–
Proceeds from sale of property, plant and equipment		–	91,234
Proceeds from sale of available-for-sale securities		–	350,715
Placement of bank deposits		(477,126)	(51,799)
Withdrawal of bank deposit		537,406	–
Other		2,536	–
Net cash used in investing activities		(2,043,138)	(5,597,013)
Cash flows from financing activities:			
Proceeds from loans received		3,415,802	6,584,265
Dividends paid		(362,987)	–
Repayment of loans		(1,952,723)	(3,035,001)
Net cash provided by financing activities		1,100,092	3,549,264
Net increase / (decrease) in cash and cash equivalents		138,915	(458,584)
Cash and cash equivalents at the beginning of the year		50,014	508,598
Cash and cash equivalents at the end of the year		188,929	50,014

STATEMENT OF CASH FLOWS (continued)
For the year ended December 31, 2008

NON–CASH TRANSACTIONS – SUPPLEMENTAL DISCLOSURE:

Non–cash transactions, including the following, have been excluded from the statement of cash flows:

Capitalization of interest charge

During 2008 the Company capitalized borrowing costs of KZT 490,445 thousand related to the capital expenditures of North Karpovskiy field (2007: KZT 336,500 thousand) (Note 5).

Transfer of corporate income tax prepayment to other tax assets

In 2008, the Company transferred KZT 159,960 thousand of prepayment for corporate income tax for settlement of liabilities under other taxes (2007: nil).

Transfer of VAT refund to prepayment for corporate income tax

In 2008, the Company was eligible to receive VAT refund from tax authorities in amount of KZT 61,337 thousand, however, instead of receiving cash the Company decided to transfer this refund receivable to prepayment for corporate income tax (2007: nil).

Dividends

Dividends of KZT 1,199,972 thousand were declared on April 30, 2008 (2007: nil). Shareholders agreed to offset the dividends payable net of withholding tax against related party debt as consideration for the dividends.

Advances paid for non-current assets

In 2008, the additions to property, plant and equipment of KZT 20,171 thousand were financed by advance payments made in 2007 (2007: nil).

Sales of property, plant and equipment to related party

In 2008 the Company sold certain property to related party Lancaster Group Kazakhstan JSC in amount of KKZT 155,435 thousand (2007: nil) (Note 24) for which cash had not been received at the year end.

Return of damaged equipment

In 2008 the Company has returned certain damaged property items to the supplier costing KKZT 25,965 thousand and decreased payable for that amount (2007: nil) (Note 5).

The accounting policies and explanatory notes on pages 7 through 28 form an integral part of these financial statements.

Signed and authorized for release on behalf of the Board of Directors of the Company:

President	A. Shovkoplyas
Chief Accountant	Sh.Sarbopeyeva

«Lancaster Petroleum»

STATEMENT OF CHANGES IN EQUITY
For the year ended December 31, 2008

In thousands of tenge	Charter capital	Treasury shares	Retained earnings	Revaluation reserve of available-for-sale securities	Total
As at December 31, 2006	1,500,000	(150,000)	3,699,297	63,826	5,113,123
Sale of available for sale securities	–	–	–	(63,826)	(63,826)
Profit for the year (restated)	–	–	1,660,717	–	1,660,717
As at December 31, 2007 (restated)	1,500,000	(150,000)	5,360,014	–	6,710,014
Profit for the year	–	–	559,222	–	559,222
Dividends (Note 13)	–	–	(1,584,722)	–	(1,584,722)
As at December 31, 2008	**1,500,000**	**(150,000)**	**4,334,514**	–	**5,684,514**

The accounting policies and explanatory notes on pages 7 through 28 form an integral part of these financial statements.

Signed and authorized for release on behalf of the Board of Directors of the Company:

President — *A. Shovkoplyas*

Chief Accountant — *Sh.Sarbopeyeva*

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NOTES TO THE FINANCIAL STATEMENTS

In thousands of tenge

1. GENERAL INFORMATION

JSC Lancaster Petroleum (the "Company") was renamed on September 2, 2007 as an assignee of JSC KKM Operating Company, which was established on April 4, 2004 as a joint stock company through merger of Kumsai Munay LLP, Mortuk Munay LLP and Kokzhide Munay LLP, which were fully owned by JSC KKM Holding at the date of the merger. The Company is engaged in exploration and production of oil from properties within the Republic of Kazakhstan.

The Company signed a subsoil use contract with the Government of Kazakhstan on December 25, 1995 and holds licenses for hydrocarbon exploration and production (the "Licenses") on Kokzhide, Kumsai and Mortuk fields; along with these Licenses the Company concluded agreements with the Government of Kazakhstan on exploration and development of these oil fields (the "Agreements"). These Agreements were amended in December 2004, April 2005 and July 2007, and as the result, the rights to explore and produce oil for the Mortuk field were extended till mid 2026, and for Kokzhide and Kumsai fields till mid 2027. On December 29, 2006 the Company signed a subsoil use contract with the Government of Kazakhstan on North Karpovsky field.

The ultimate shareholders of the Company are Mr. Kaniyev B., Mr. Pak Y., Mr. Kapparov N. and Mr. Dossaev.

The Company's registered legal address is: 4 A Levitan Street, Aktobe, Republic of Kazakhstan.

The financial statements of the Company for the year ended December 31, 2008 were authorized for issue by the Board of Directors of the Company on June 12, 2009.

Operating environment

Republic of Kazakhstan continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Kazakhstan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Kazakhstan economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The ongoing global financial crisis has resulted in capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Kazakhstan. While the Kazakhstan Government has introduced a range of stabilization measures aimed at providing liquidity and supporting debt refinancing for Kazakhstan banks and companies, there continues to be uncertainty regarding the access to capital and cost of capital for the Company and its counterparties, which could affect the Company's financial position, operating results and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Company's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Company's operating results and financial position in a manner not currently determinable.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by International Accounting Standard Board ("IASB"). The financial statements have been prepared under the historical cost convention except for financial instruments which are carried at fair value.

The preparation of the financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 3.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Changes in accounting policy

In 2008 the Company changed from it's former accounting policy of expensing seismic studies to, in accordance with IFRS 6, capitalizing seismic studies. Management of the Company believes that capitalization of seismic studies provides reliable and more relevant information about the effect of seismic study costs on the financial position and financial performance of the Company. Therefore, the Company has followed the guidance of IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" and applied the changes retrospectively. The prior year financial statements have therefore been restated.

As the result of the change in accounting policy, the following adjustments were made to the 2007 financial statements:

As of December 31, 2007:	
Net change in property, plant and equipment	741,124
Net change in deferred tax assets	(72,017)
Total net change in total assets	669,107
Net change in retained earnings as at January 1, 2008	**(669,107)**
Total net change in equity	**(669,107)**
Net change in geological and geophysical expenses	**(741,124)**
Net change in income tax expense	**72,017**
Net change in profit for the year	**(669,107)**

The effect on basic and diluted earnings per share related to the restatement in 2007 is 496 Tenge.

New accounting developments

The following IFRS and IFRIC interpretations have been released however are not yet in effect as of December 31, 2008 and have not been adopted by the Company:

- IFRS 1 Amendment "First-time Adoption of International Financial Reporting Standards";
- IFRS 2 "Share-based Payments – Vesting conditions and Cancellations";
- IFRS 3R "Business Combinations";
- IFRS 7 Amendment "Improving Disclosures about Financial Instruments";
- IFRS 8 "Operating Segments";
- IAS 1R and Amendment "Presentation of Financial Statements";
- IAS 27R "Consolidated and Separate Financial Statements";
- IAS 32 Amendment "Financial Instruments: Presentation";
- IAS 39 "Financial Instruments: Recognition and Measurement";
- IFRIC 11, IFRS 2 "Group and Treasury Share Transactions";
- IFRIC 12 "Service Concession Arrangements";
- IFRIC 13 "Customer Loyalty Programs";
- IFRIC 14, IAS 19 "The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction";
- IFRIC 15 "Agreement for the Construction of Real Estate";
- IFRIC 16 "Hedges of a Net Investment in a Foreign Operation";
- IFRIC 17 "Distributions of Non-cash Assets to Owners";
- IFRIC 18 "Transfers of Assets from Customers".

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

New accounting developments (continued)

Management anticipates that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Company.

In May 2008 the Board issued its first omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The Company adopted those amendments and improvements to IFRSs which are applicable to its operating activities in 2008.

Functional currency and foreign currency translation

The Kazakhstan Tenge ("Tenge" or "KZT") is the functional currency of the Company as it is the currency that reflects the economic substance of the underlying events and circumstances relevant to the Company.

Transactions in other currencies are treated as transactions in foreign currencies.

Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates prevailing at the balance sheet dates. Transactions denominated in foreign currencies are recorded at the exchange rate prevailing 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 profit or loss.

The weighted average currency exchange rates established by the Kazakhstan Stock Exchange ("KASE") are used as the official currency exchange rates in Kazakhstan.

Currency exchange rate of KASE as of December 31, 2008 was equivalent to 120.79 Tenge to 1 US dollar and was used to translate monetary assets and liabilities denominated in US dollars as at December 31, 2008 (2007: 120.30 Tenge to 1 US dollar). The currency exchange rate of KASE as of June 12, 2009 was 150.39 Tenge to 1 US dollar (Note 27).

Intangible assets

Intangible assets include licenses for subsurface use and computer software reflected at initial cost less accumulated amortization. License expenses associated with exploration, development and production of oil and gas reserves are capitalized as intangible assets and amortized over the life of the license from the date the relevant field commences commercial production stage. Amortization of other intangible assets is calculated on a straight-line basis over the estimated useful lives of the assets, within a range of 1 to 10 years.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangibles are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to definite is made on a prospective basis.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment

Oil and Gas assets

Exploration expenditure

Geological and geophysical exploration costs, except seismic works, are charged against income as incurred. Costs directly associated with an exploration well are capitalized within property, plant and equipment as construction work-in-progress, until the drilling of the well is complete and the results have been evaluated. These costs include materials and fuel used, rig costs and payments made to contractors. If hydrocarbons are not found, the exploration expenditure is expensed. If hydrocarbons are found and, subject to further appraisal activity, which may include the drilling of further wells (exploration or exploratory-type stratigraphic test wells), are likely to be capable of commercial development, the costs continue to be carried as an asset. All such carried costs are subject to technical, commercial and management review at least once a year to confirm the continued intent to develop or otherwise extract value from the discovery. When this is no longer the case, the costs are written off.

When proved reserves of oil and natural gas are determined and development is sanctioned, the relevant expenditure is transferred to property, plant and equipment (oil and gas properties).

Development expenditure

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells is capitalized within oil and gas assets.

Oil and Gas Assets

Oil and gas assets are initially stated at cost less accumulated depreciation and impairment. The cost of self-constructed assets includes the cost of materials, direct labor and an appropriate proportion of overheads directly related to construction.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation and the initial estimate of any decommissioning obligation, if any. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Oil and natural gas properties are depreciated using a unit-of-production method over proved developed reserves.

Other Property, Plant and Equipment

Property, plant and equipment are initially stated at cost less accumulated depreciation, depletion and impairment. The cost of self-constructed assets includes the cost of materials, direct labor and an appropriate proportion of overheads directly related to construction.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation and the initial estimate of any decommissioning obligation, if any. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Property, plant and equipment, other than oil and gas properties, are carried at cost less accumulated depreciation and depreciated on a straight-line basis over the estimated useful lives set out in the following table:

Buildings and constructions	10-50 years
Machinery and equipment	15-30 years
Vehicles	7-11 years
Other	3-10 years

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Other Property, Plant and Equipment (continued)

Repair and maintenance expenditure is expensed as incurred. Major renewals and improvements are capitalised, and the assets replaced are retired. Gains and losses arising from the retirement of property, plant and equipment are included in the income statement as incurred.

When each major repair is performed, its cost is recognised as a component in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied.

All assets under construction are classified as "Capital Work in Progress" and are not depreciated. Once projects are completed and put into use they are transferred to in service assets and become subject for depreciation

Inventories

Inventories are stated at the lower of cost and net realizable value on a weighted average basis. Cost includes all costs incurred in the normal course of business in bringing each item to its present location and condition. The cost of crude oil is the cost of production, including the appropriate proportion of depreciation, depletion and amortization and overheads based on normal capacity. Net realizable value of crude oil is based on estimated selling price in the ordinary course of business less any costs expected to be incurred to complete the sale. Materials and supplies inventories are carried at amounts that do not exceed the expected amounts recoverable in the normal course of business

Impairment of non-financial assets

The Company assesses assets or groups of assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Individual assets are grouped for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. If any such indication of impairment exists or when annual impairment testing for an asset group is required, the Company makes an estimate of its recoverable amount. An asset group's recoverable amount is the higher of its fair value less costs to sell and its value in use. Where the carrying amount of an asset group exceeds its recoverable amount, the asset group is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are adjusted for the risks specific to the asset group and are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss.

After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Financial assets

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, held to maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

The Company determines the classification of its financial assets on initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year end.

All regular way purchases and sales of financial assets are recognized on the trade date, which is the date that the Company commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial assets (continued)

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. After initial measurement held-to-maturity investments are measured at amortized cost using the effective interest method.

Trade and other receivables

Trade and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Trade accounts receivable generally have a short-term and are recognized and carried at original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Impairment of financial assets

The Company assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss shall be recognised in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date. Any subsequent reversal of an impairment loss is recognized in profit or loss.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

Derecognition of financial assets and liabilities

Financial asset

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement; or
- the Company has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and cash equivalents

Cash and cash equivalents are defined as cash on hand, demand deposits and short-term and highly liquid investments with original maturity of not more than three months readily convertible to known amounts of cash, are subject to insignificant risk of change in value and are carried at cost.

Non-current assets classified as held for sale

Non-current assets and disposal groups classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Non-current assets and disposal groups are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through the continuing use. This condition is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Property, plant and equipment once classified as held for sale are not depreciated/amortized.

Interest bearing loans and borrowings

All loans and borrowings are initially recognized at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method.

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

Interest relating to qualifying assets is capitalised to that asset. All other interest is expensed as finance costs in the statement of income.

Treasury shares

Own equity instruments which are reacquired (treasury shares) are deducted from equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Company's own equity instruments.

Deferred income tax

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences:

- except where the deferred income tax liability arises from goodwill amortization or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred income tax (continued)

Deferred income tax assets are recognized for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax assets and unused tax losses can be utilized:

- except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognized to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

Deferred income 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 tax rates (and tax laws) that have been enacted or substantially enacted at the balance sheet date.

Other taxes

Republic of Kazakhstan also has various taxes that are assessed on a Company's activities. These taxes are included as a component of cost of sales and general and administrative expenses in the income statement.

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.

Abandonment and Site Restoration (decommissioning)

Provision for decommissioning is recognized in full, on a discounted basis, at the commencement of drilling. The amount recognized is the present value of the estimated future expenditure determined in accordance with local conditions and requirements. A corresponding tangible fixed asset of an amount equivalent to the provision is also created. This asset is subsequently depreciated as part of the capital costs of the production and transportation facilities on a unit-of-production basis.

Changes in the measurement of an existing decommissioning liability that results from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required settling the obligation, or change in the discount rate is reflected as an adjustment to the provision and the fixed asset.

The long-term inflation and discount rates used to determine the balance sheet obligation at December 31, 2008 were 5% and 16% respectively (2007: 5% and 16%). Movements in the provision for asset retirement obligations are disclosed in Note 14.

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 sale of crude oil is recognized when delivery has taken place and risks and rewards of ownership of the goods have passed to the customer. Crude oil shipped but not yet delivered to the customer is recorded as inventory in the balance sheet.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Expense recognition

Expenses are accounted for at the time the actual flow of the related goods or services occur, regardless of when cash or its equivalent is paid, and are reported in the financial statements in the period to which they relate.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS IN APPLYING ACCOUNTING POLICIES

The preparation of the financial statements in conformity with IFRS requires management to make 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 revenues and expenses during the reporting period. The most significant estimates are discussed below:

Oil and gas reserves

The cost of oil and gas properties is amortized at the field level using the unit-of-production method using proved developed reserves. Unit of production rates are based on oil and gas reserves estimated to be recoverable from existing facilities based on expected terms of the respective production agreements. The Company's reserve estimates include only crude oil and natural gas which management believes can be reasonably produced within the expected terms of the respective production agreements. The Company uses reserve estimates provided by internationally recognized petroleum engineers to assess the oil and gas reserves of its oilfields. In interim periods between external evaluations, the Company uses its in house petroleum engineers to estimate the oil and gas reserves of its oil fields.

Proved oil and gas reserves cannot be measured exactly. Reserves estimates are based on many factors related to reservoir performance that requires evaluation by the engineers interpreting the available data, as well as price and other economic factors. The reliability of these estimates at any point in time depends on both the quality and quantity of the technical and economic data, and the production performance of the reservoirs as well as engineering judgment. Consequently, reserve estimates are subject to revision as additional data become available during the producing life of reservoir.

When commercial reservoir is discovered, proved reserves are initially determined based on limited data from the first well or wells. Subsequent data may better define the extent of the reservoir and additional production performance, well tests and engineering studies will likely improve the reliability of the reserve estimate. The evolution of technology may also result in the application of improved recovery techniques such as supplemental or enhanced recovery projects, or both, which have the potential to increase the reserves beyond those envisioned during the early years of reservoir's producing life.

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas and natural gas liquids, which geological and engineering data demonstrate with reasonable certainty to be recoverable in the future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions. Proved developed reserves are those reserves, which can be expected to be recovered through existing wells with existing equipment and operating methods. Proved undeveloped reserves are those reserves, which are expected to be recovered from new wells on undrilled acreages or from existing wells where relatively major expenditure is required.

When determining oil and gas reserves, assumptions that where valid at the time of estimation may change when new information becomes available. Any changes could affect prospective depreciation and depletion rates and assets carrying values.

The calculation of the units of production rate of depreciation and depletion could be impacted to the extent that actual production in the future is different from current forecast production based on proved developed mineral reserves, which would generally arise as a result of significant changes in any of factors or assumptions used in estimating oil reserves.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS IN APPLYING ACCOUNTING POLICIES (continued)

Oil and gas reserves (continued)

These factors could include:

- Changes to proved developed oil reserves;
- The grade of oil reserves varying significantly from time to time;
- Differences between actual commodity prices and commodity price assumptions used in the estimation of oil reserves;
- Unforeseen operational issues at oil fields; and
- Changes in capital, operating oil producing, processing and reclamation costs, discounts rates and foreign exchange rates possibly adversely affecting the economic viability of oil reserves.

The majority of other property, plant and equipment are depreciated on straight line basis over their useful economic lives. Management reviews the appropriateness of assets useful economic lives at least annually; any changes could affect prospective depreciation and depletion rates and asset carrying values.

Abandonment and Site Restoration (decommissioning)

The Company estimates future dismantlement and site restoration cost for oil and gas properties with reference to the estimates provided from either internal or external engineers after taking into consideration the anticipated method of dismantlement and the extent of site restoration required in accordance with current legislation and industry practice. The amount of the obligation is the present value of the estimated expenditures expected to be required to settle the obligation 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 provisions 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”.

4. DISPOSAL GROUP

On December 23, 2008 the Shareholders of the Company made a decision to separate the subsoil use contract on North Karpovskiy field (“North Karpovskiy”), and all directly related assets and liabilities, into a separate legal entity. The disposal was completed June 4, 2009 after approval of the regulators (Note 27). As at December 31, 2008 assets and liabilities directly associated with North Karpovskiy field were classified as disposal group held for sale.

The major classes of assets and liabilities of North Karpovskiy classified as disposal group held for sale as at December 31 are as follows:

	2008
Assets	
Property, plant and equipment	4,631,656
Other non-current assets	4,652
Advances paid	910
Other current assets	2,533
Assets of disposal group classified as held for sale	**4,639,751**
Liabilities	
Short-term interest-bearing loans	(3,239,051)
Other current liabilities	(22,142)
Deferred tax liabilities	(18,179)
Liabilities of disposal group classified as held for sale	**(3,279,372)**
Net assets of disposal group classified as held for sale	**1,360,379**

As at December 31, 2008 the Company pledged the property, plant and equipment of KZT 3,121,500 thousand included in disposal group to secure borrowings (Note 16)

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

5. PROPERTY, PLANT AND EQUIPMENT

The movement on property, plant, and equipment for the years ended December 31, 2008 and 2007 was as follows:

	Oil and gas properties	Buildings and constructions	Machinery and equipment	Vehicles	Other assets	Construction in progress	Total
Cost							
31-Dec-06 (restated)	3,609,180	620,926	177,197	236,099	66,177	1,204,807	5,914,386
Additions	548,165	22,839	14,466	76,726	21,417	5,950,051	6,633,664
Transfers	(446,255)	(374,371)	(133,312)	171,109	3,771	779,058	–
Disposals	(38,444)	–	(1,686)	(5,797)	(2,449)	(1,040,845)	(1,089,221)
31-Dec-07 (restated)	3,672,646	269,394	56,665	478,137	88,916	6,893,071	11,458,829
Additions	42,883	12,114	29,749	37,507	10,439	2,455,963	2,588,655
Transfer to disposal group	(5,272)	–	(2,184)	(7,359)	(859)	(4,623,008)	(4,638,682)
Transfers	1,862,749	–	3,940	–	3,221	(1,869,910)	–
Disposals	(94,630)	(146,081)	(10,506)	(48,314)	(40,246)	(1,079,006)	(1,418,783)
31-Dec-08	**5,478,376**	**135,427**	**77,664**	**459,971**	**61,471**	**1,777,110**	**7,990,019**
Accumulated depreciation:							
31-Dec-06 (restated)	(1,151,933)	(41,219)	(23,994)	(66,424)	(14,513)	–	(1,298,083)
Charge	(515,286)	(8,614)	(8,676)	(48,071)	(9,866)	–	(590,513)
Transfers	71,798	23,276	13,111	(106,981)	(1,204)	–	–
Disposals	7,029	–	1,232	2,409	1,017	–	11,687
31-Dec-07 (restated)	(1,588,392)	(26,557)	(18,327)	(219,067)	(24,566)	–	(1,876,909)
Charge	(504,453)	(9,773)	(22,361)	(56,090)	(12,510)	–	(605,187)
Transfer to disposal group	140	–	833	5,894	159	–	7,026
Disposals	1,555	10,185	8,411	17,773	15,373	–	53,297
31-Dec-08	**(2,091,150)**	**(26,145)**	**(31,444)**	**(251,490)**	**(21,544)**	**–**	**(2,421,773)**
Net book value:							
31-Dec-07	2,084,254	242,837	38,338	259,070	64,350	6,893,071	9,581,920
31-Dec-08	**3,387,226**	**109,282**	**46,220**	**208,481**	**39,927**	**1,777,110**	**5,568,246**

As at December 31, 2008 the Company pledged the property, plant and equipment with net book value of KZT 1,234,059 thousand to secure borrowings (2007: KZT 4,750,118 thousand) (Note 16)

Disposals of machinery and equipment in 2008 includes KZT 25,965 thousand that relates to return of damaged equipment acquired in 2007 to the vendor.

During 2008 the Company capitalized borrowing costs of KZT 490,445 thousand related to the capital expenditures of North Karpovskiy field (2007: 336,500 thousand Tenge). The weighted average rate used to determine the amount of borrowing costs eligible for capitalization was 16% (2007: 14%).

At December 31, 2008, oil and gas assets include net book value of exploration and evaluation assets in the amount of 369,981 thousand Tenge. Additions of these assets during 2008 amounted to 2,023,523 thousand Tenge and disposals and transfers amounted to 2,255,707 thousand Tenge. Write-off of dry exploratory wells and other exploration costs during the period amounted to 1,078,347 thousand Tenge.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

6. OTHER NON-CURRENT ASSETS

As at December 31, other non-current assets consisted of the following:

	2008	2007
Technological crude oil	235,644	124,636
Production spare parts	220,158	188,523
Advances to vendors for property, plant and equipment	35,213	62,979
	491,015	376,138

Technological crude oil represents oil in CPC and KTO pipelines.

Advances to vendors represented advances given for capital construction works. During the year provision was accrued in amount of KKZT 18,038 thousand for expected non-fulfillment of contractual obligations by certain vendors (Note 19).

7. INVENTORIES

As at December 31, inventories comprised:

	2008	2007
Spare parts	271,555	130,876
Crude oil	101,505	72,160
Fuel	18,100	11,123
Construction materials	2,085	7,520
Other materials	82,839	70,663
Total inventory	476,084	292,342
Less provision for obsolescence and impairment	(34,883)	(73,447)
Total Inventory net of provisions	441,201	218,895

No inventory was pledged as at December 31, 2008 and 2007 against bank loans.

The movements in obsolescence and impairment provision for the years ended December 31, were as follows:

	2008	2007
Reserve as at January 1	73,447	31,001
Reversal	(44,111)	–
Additional provision for the year	5,547	42,446
Obsolescence reserve as at December 31	34,883	73,447

The management changed certain expectation in respect of obsolescence and reversed portion of the obsolescence and impairment provision accrued in prior years.

8. TRADE RECEIVABLES

Trade receivables are interest free and normally receivable within 30 days. All trade receivables are current as at December 31, 2008 and 2007.

9. ADVANCES GIVEN

As at December 31, advances given comprised:

	2008	2007
Advances for raw materials	170,217	102,421
Advances for services	127,424	135,783
Less provision for non – performance	(9,672)	(9,672)
	287,969	228,532

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

10. OTHER CURRENT ASSETS

As at December 31, other current assets comprised:

	2008	2007
VAT recoverable	**491,036**	339,886
Customs duty prepaid	**81,815**	–
Property tax prepaid	**15,148**	15,129
Due from employees	**3,556**	3,313
Other	**41,017**	44,490
	632,572	402,818

As at December 31, 2008 and 2007 VAT recoverable consists of Tenge denominated VAT paid on local services provided and goods supplied by Kazakhstani suppliers.

11. BANK DEPOSITS

Bank deposits represent short-term deposits with original maturities greater than 3 months. The deposits on hand as at December 31, 2008 and 2007 had an interest rate of 6.5%. All deposits were denominated in Tenge.

12. CASH AND CASH EQUIVALENTS

As at December 31, cash and cash equivalents comprised the following:

	2008	2007
US Dollar bank account	**183,290**	33,432
KZT bank account	**5,545**	7,472
Cash on hand	**94**	2,841
Cash in transit	**–**	6,269
	188,929	50,014

As at December 31, 2008 and 2007 current accounts with banks were interest free.

13. CHARTER CAPITAL

At December 31, 2008 the Company's authorized, issued and paid-in charter capital comprised 1,350,000 common shares (2007: 1,350,000 common shares).

In December 2005 the Company purchased back 150,000 of its own shares from KKM Holding JSC.

Following is a list of shareholders:

		2008		2007
	Share	**Number of Shares**	Share	Number of Shares
Lancaster Energy Pte. Ltd.	**89.5%**	**1,342,500**	–	–
Lancaster Holding Pte. Ltd.	**–**	**–**	89.5%	1,342,500
Oman CPC Company	**0.5%**	**7,500**	0.5%	7,500
Treasury shares	**10%**	**150,000**	10%	150,000
	100%	**1,500,000**	100%	1,500,000

Common shares give the holders the right to participate in the management of the Company and shareholders are permitted one vote per share.

On October 23, 2008 Lancaster Holding Pte. Ltd. has transferred all of it's shares of the Company to its wholly owned subsidiary Lancaster Energy Pte. Ltd.

In 2008 the Company declared dividends of KZT 1,199,972 thousand for 2007 and KZT 384,750 thousand for first half of 2008 (2007: nil). The Company offset KZT 1,133,640 thousand, net of withholding tax, against receivables from the shareholders and paid KZT 362,987 thousand in cash (2007: nil).

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

14. ABANDONMENT AND SITE RESTORATION LIABILITY

The abandonment and site restoration liability has been recorded in the financial statements to reflect the cost of restoring well sites to their original condition. The cost has been estimated based on management's best estimates and available historical data.

The movements in the abandonment and site restoration liability for the years ended December 31, were as follows:

	2008	2007
Abandonment and site restoration liability as at January 1	**241,048**	157,199
Unwinding of discount	**20,985**	25,268
Revision of estimates	**(7,023)**	63,793
Used during the year	**(77,685)**	(9,216)
Additional provision for the year	**12,523**	4,004
Abandonment and site restoration liability as at December 31	**189,848**	241,048

As Kazakh laws and regulations concerning environmental assessments and cleanups evolve, the Company may incur future costs the amount of which is currently indeterminable. Such costs, when known, will be provided for as new information, legislation and estimates evolve.

15. TRADE PAYABLES

At December 31, 2008 and 2007, the ten largest suppliers accounted for 70% and 80% of the total trade accounts payable, respectively. Trade accounts payable are represented by payables to suppliers and denominated in KZT.

16. SHORT-TERM INTEREST-BEARING LOANS

At December 31, interest-bearing loans comprised:

	Original Currency	Date of Issue	Maturity Date	Interest rate	Frequency of payments	2008	2007
KazKommertsBank	USD	July, 2006	June, 2009	till March 3, 2008 - 14%; from March 3, 2008 - 16%	interest - monthly; principal - at maturity	**3,810,797**	5,558,410

Kazkommertsbank

On July 17, 2006 the Company opened a credit line of USD 80,000 thousand with Kazkommertsbank for two years. Under this credit line Kazkommertsbank provided a number of short-term and long-term loans to the Company for capital investments and to replenish its working capital. Original interest on the loans was 10.7 % per annum. The interest rate can be varied at the discretion of the bank in the event the bank's cost of capital changes. Interest rate was increased by the bank in September 2007 to 14% and in March 2008 to 16%. The Company pledged the movable and real property and right for subsurface usage on Kokzhide in the amount of KKZT 1,234,059 thousand (2007: KKZT 4,750,118 thousand) (Note 5).

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

17. COST OF SALES

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

	2008	2007
Salaries and related costs	**546,672**	588,844
Depreciation and amortization	**568,348**	570,128
Royalty	**231,622**	213,301
Services	**163,138**	108,442
Security	**204,276**	94,601
Fuel and electricity	**72,333**	70,156
Repair and maintenance	**55,469**	83,440
Materials	**48,685**	98,808
Taxes and fees	**32,002**	58,439
Transportation expenses	**16,845**	18,063
Other	**185,191**	85,266
Total	**2,124,581**	1,989,488
Change in work in progress, finished goods and technological oil:		
Work in progress, finished goods and technological oil at 1 January	**196,976**	173,056
Work in progress, finished goods and technological oil at 31 December	**(337,149)**	(196,796)
Net changes in work in progress and finished goods	**(140,173)**	(23,740)
Total cost of sales	**1,984,408**	1,965,748

18. GEOLOGICAL AND GEOPHYSICAL EXPENSES

Geological and geophysical expenses for the year ended December 31, were divided between fields as follows:

	2008	2007 (restated)
Kokgide field	**87,894**	51,279
Mortuk field	**2,400**	–
Kumsai field	**–**	11,710
	90,294	62,989

Geological and geophysical expenses for the years ended December 31, 2008 and 2007 represent costs related to geophysical research, and exploration of reserves.

19. GENERAL AND ADMINISTRATIVE EXPENSES

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

	2008	2007
Salaries and related costs	**520,142**	279,842
Professional services	**333,011**	516,289
Rent and office maintenance	**74,482**	20,282
Insurance	**51,947**	78,537
Depreciation and amortization	**46,211**	27,608
Communication	**44,974**	13,694
Business trips	**43,852**	72,408
Operating taxes	**34,979**	9,250
Fines and penalties	**31,604**	24,128
Bank commissions	**30,117**	30,316
Training	**22,315**	18,091
Operational expenses	**21,500**	36,082
Bad debt provision	**18,038**	9,672
Charity	**4,469**	75,042
(Reversal) / provision for inventory obsolescence	**(38,564)**	5,383
Other expenses	**144,438**	33,036
Total	**1,383,515**	1,249,660

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

20. SELLING EXPENSES

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

	2008	2007
Transportation	725,957	845,431
Customs fees	625,532	18,536
Salaries and related expenses	8,871	3,908
Oil loading	–	208
Other expenses	6,529	4,251
Total	**1,366,889**	872,334

Transportation expenses in 2008 and 2007 represent costs related to transportation of oil through the pipeline, which is owned by CPC and KTO that provides oil pipeline transportation services throughout Kazakhstan.

21. FINANCE INCOME / (COSTS)

The composition of finance income / (costs) for the year ended December 31, was as follows:

	2008	2007
Finance income		
Interest income	3,326	277
	3,326	277
Finance costs		
Interest expenses – bank loans	(440,436)	(312,196)
Interest on advance payments from customers	(32,618)	(26,556)
Unwinding of discount for restoration provision (Note 14)	(20,985)	(25,268)
	(494,039)	(364,020)

In 2008 and 2007 interest on advance payments from customers mostly represents interest charged on the advance from KazMunayGas Trade House, a subsidiary of National Company "KazMunayGas". The Company sells oil to its major customers KazMunayGas Trade House on a prepayment basis. According to the contract the Company is obliged to pay interest for prepayment from the date of payment till the bill of lading date in amount of LIBOR+2.5%.

22. INCOME TAXES

The Company is subject to income tax of 30% on taxable profit as determined under the laws of the Republic of Kazakhstan. Income tax expense consisted of the following for the year ended December 31:

	2008	2007 (restated)
Corporate income tax	461,946	983,043
Excess profit tax	440,376	686,586
Current income tax	**902,322**	1,669,629
Corporate income tax	150,051	(164,553)
Excess profit tax	46,276	(36,694)
Deferred income tax	**196,327**	(201,247)
Income tax expense	**1,098,649**	1,468,382

A reconciliation of the income tax expense applicable to profit before income tax at the statutory income tax rate against current income tax expense was as follows for the year ended December 31:

	2008	2007 (restated)
Accounting profit before income tax	**1,657,871**	3,129,099
Corporate income tax expense at statutory rate	**497,361**	938,730
Excess profit tax expense at statutory rate	**348,153**	657,111
Effect of change in income tax rate	(21,049)	–
Other non-temporary differences	274,184	(127,459)
Income tax expense reported in the accompanying financial statements	**1,098,649**	1,468,382

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

22. INCOME TAXES (continued)

Deferred tax balances calculated by applying the statutory tax rates in effect at the respective balance sheet dates plus the estimated excess profit tax rates the Company is expected to incur against temporary differences between the tax basis of assets and liabilities and the amounts reported in the financial statements, consisted of the following at December 31:

	2008	2007 (restated)
Deferred tax assets:		
Losses carried forward	89,854	291,252
Accrued expenses	45,959	128,595
Inventory	7,577	37,458
	143,390	457,305
Deferred tax liabilities:		
Property, plant and equipment	(211,627)	(319,614)
Disposal group assets (Note 4)	(15,643)	(40,127)
Deferred expenses	(14,409)	–
Intangible assets	(8,925)	(8,451)
	(250,604)	(368,192)
Net deferred tax (liability) / asset	(107,214)	89,113

On January 1, 2009 a new tax code became effective in the Republic of Kazakhstan, which resulted in the corporate income tax rate being reduced to 2009: 20%, 2010: 17.5% and 2011: 15%. This decrease in the corporate income tax rate has resulted in a decrease in the deferred tax asset in the amount of 21,049 thousand Tenge.

23. BASIC AND DILUTED EARNINGS PER SHARE

Earnings per share is calculated by dividing the net income attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period, excluding the average number of ordinary shares purchased by the Company and held as treasury shares (Note 13).

The following reflects the income and share data used in the basic and diluted earnings per share computation:

	2008	2007 (restated)
Weighted average number of ordinary shares outstanding	1,350,000	1,350,000
Profit for the year attributable to equity holders	559,222	1,660,717
Basic and diluted earnings per share, KZT	414	1,230

24. RELATED PARTY TRANSACTIONS

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.

Balances and transactions with related parties of the Company as at and for the year ended December 31, 2008 and 2007 consisted of the following:

Revenues

	Nature of Transactions	2008	2007
Lancaster Group Kazakhstan	Sale of property, plant and equipment	155,435	–
		155,435	–

Expenses

	Nature of Transactions	2008	2007
Lancaster Group Kazakhstan	Consulting services and cost of property, plant and equipment sold	316,880	301,899
Oman CPC Company	Transportation	–	143,451
LFK Arlan	Interest free loan	–	12,200
		316,880	457,550

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

24 RELATED PARTY TRANSACTIONS (continued)

Trade and other receivables

	Nature of Transactions	2008	2007
Lancaster Group Kazakhstan	Interest free loan, consulting fee and sales of property, plant and equipment	**1,605,664**	2,283,506
LFK Arlan	Interest free loan	**12,380**	20,930
KKM Holding JSC	Interest free loan	–	10,000
Lancaster Realty	Interest free loan	–	29,903
Syrymbet	Interest free loan	**151,000**	–
Mr. Kaniyev (Shareholder)	Interest free loan	**24,000**	–
		1,793,044	2,344,339

Accounts payable

	Nature of Transactions	2008	2007
Oman CPC Company	Dividends / Transportation	**7,529**	26,416
		7,529	26,416

Accounts receivable are unsecured, interest free with no fixed terms of repayment.

Accounts payable are interest free and normally payable within 30 days.

Compensation to key management personnel

Key management personnel totaled 4 and 6 persons as at December 31, 2008 and 2007, respectively. Total compensation to key management personnel included in personnel costs in the accompanying statement of income amounted to KZT 66,522 thousand and KZT 199,861 thousand for the years ended December 31, 2008 and December 31, 2007, respectively. Compensation to key management personnel consists of contractual salary.

25. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company, in connection with its activities, is exposed to various financial risks associated with its financial instruments. Financial instruments are comprised primarily of cash and cash equivalents, trade receivables, other receivables, accounts payable and loans.

Interest rate risk

The Company's only interest rate risk relates to interest payable associated with its loans. The Company does not enter into any hedging instruments to mitigate any potential risk, as management does not believe the interest rate risk associated with the loan obligation is significant. The interest rates on the loans are fixed subject to variation at the discretion of the bank in the event the bank's cost of capital changes. The loan was discharged to the Shareholder subsequent to the balance sheet date.

Liquidity risks

Liquidity risk arises from the possibility that customers may not be able to settle obligations to the Company within the normal terms of trade. To manage this risk the Company enters into prepayment contracts with the majority of its customers.

Cash flow requirements are monitored on a regular basis and management ensures that sufficient funds are available to meet any commitments as they arise. The management of the Company believes that any possible fluctuations of future cash flows associated with a monetary financial instrument will not have a material impact on the Company's operations.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

25. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

Liquidity risks (continued)

The table below summarizes the maturity profile of the Company's financial liabilities at December 31, 2008 and 2007 based on contractual undiscounted payments:

December 31, 2008	On demand	Less than 3 months	3-12 months	1-5 years	More than 5 years	Total
Interest-bearing loans	19,188	152,432	3,861,608	–	–	4,033,228
Interest-bearing loans on disposal group	24,678	129,562	3,282,238	–	–	3,436,478
Trade and other payables	41,081	608,862	–	–	–	649,943
	43,866	890,856	7,143,846	–	–	8,078,568

December 31, 2007	On demand	Less than 3 months	3-12 months	1-5 years	more than 5 years	Total
Interest-bearing loans	5,000	194,369	5,553,410	–	–	5,752,779
Trade and other payables	842,808	594,616	–	–	–	1,437,424
	847,808	788,985	5,553,410	–	–	7,190,203

Commodity price risk

The Company is exposed to commodity price risk, since oil prices are determined by world market. The Company does not hedge this risk.

Credit risks

Credit risks or the risk of counterparties defaulting is controlled by the application of credit approvals, limits and monitoring procedures. The extent of the Company's credit exposure is represented by the balance of accounts receivable. While the Company may be subject to losses up to the contract value of the instruments in the event of non-performance by its counterparts, it does not expect such losses to occur.

Currency risk

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Company has transactional currency exposures. Such exposure arises from revenues in US Dollars. Almost 100% of the Company's revenue is denominated in the US Dollars, whilst almost none of cost of sales is denominated in US Dollars.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of the Company's profit before tax (due to changes in the fair value of monetary assets and liabilities). There was no effect on equity.

	Increase / decrease in US dollar rate	*Effect on profit before tax*
	+40%	**(2,785,090)**
2008	**+25%**	**(1,740,681)**
	+5%	241,044
2007	-5%	(241,044)

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

25. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

Fair value of financial instruments

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the balance sheet:

	Carrying amount		Fair value	
	2008	2007	**2008**	2007
Financial assets:				
Trade and other receivables	**2,767,878**	3,696,799	**2,767,878**	3,696,799
Cash and cash equivalents and Bank deposits	**190,130**	108,710	**190,130**	108,710
Financial liabilities:				
Short term interest bearing loans	**7,049,848**	5,558,410	**7,049,848**	5,558,410
Trade and other payables	**1,134,185**	1,605,448	**1,134,185**	1,605,448

The fair value of borrowings is based on cash flows discounted using the market interest rates. Fair values of available-for-sale investments, bank deposits, trade and other receivables, cash and cash equivalents and trade and other payables approximate their carrying amounts due to their short maturity.

26. COMMITMENTS AND CONTINGENCIES

Commitment under minimal work program

As at December 31, 2008 Company had commitments for a minimal work program in an amount of KZT 9,786,914 thousand (2007: KZT 13,063,200 thousand).

Contractual commitments

The Company had contractual commitments of KZT 155,918 thousand (2007: KZT 187,464 thousand) as at December 31, 2008 relating to purchase of oil and gas equipment and construction materials.

Social and education commitments

As required by the Contract with the Government, the Company is obliged to spend: (i) KZT 22,550 thousand per annum to finance social infrastructure and (ii) 1 percent from the operating expenditures incurred during the year for education purposes of the citizens of Kazakhstan on an annual basis until the end of the Mortuk, Kokzhide and Kumsai Contracts and 1,5 percent from the exploration expenditures incurred during the year for education purposes on an annual basis until the end of the North Karpovskiy Contract.

Legal actions and claims

The Company is subject to various legal proceedings related to business operations, such as property damage claims. The Company does not believe that pending or threatened claims 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 events giving rise to the 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

26. COMMITMENTS AND CONTINGENCIES (continued)

Tax contingencies

The various tax legislative acts and regulations are not always clearly written and their interpretation is subject to the opinions of local tax inspectors and 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 unreported and discovered violations of Kazakhstan tax law are severe. Fines are generally 50% of any taxes additionally assessed and interest is assessed at the refinancing rate established by the National Bank of Kazakhstan multiplied by 2.5. As a result, fines and interest 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 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.

Because of the uncertainties associated with the Kazakhstan tax system, the ultimate amount of taxes, fines and interest, if any, may be in excess of the amount expensed to date and accrued at December 31, 2008. Although, such amounts are possible and may be material, it is the opinion of Company management that these amounts are either not probable, not reasonably determinable, or both.

The Company's operations and financial position may be affected by Kazakhstan 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.

As at December 31, 2008 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company's tax positions will be sustained.

Environmental matters

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 Kazakhstani 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. The calculation of abandonment and site restoration is considered in Note 14. 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 provisions for future environmental claims or penalties are included in the accompanying financial statements.

However, depending on any unfavorable claims or penalties assessed by the Kazakhstani regulatory agencies, it is possible that the Company's future results of operations or cash flow could be materially affected in a particular period.

NOTES TO THE FINANCIAL STATEMENTS (continued)

In thousands of tenge

27. SUBSEQUENT EVENTS

USD exchange rate

On February 4, 2009 the Tenge devalued against the US dollar and other major currencies. The exchange rate before and after devaluation was 120 Tenge / US dollar and 150 Tenge / US dollar, respectively.

North Karpovskiy

In accordance with a decision of the Shareholders made on December 23, 2008, and approval of the regulators on February 20, 2009 the Company disposed of the licence for exploration of North Karpovskiy field and all related assets and liabilities to North Karpovskiy JSC, another entity fully owned by the Shareholders (Note 4). In consideration the Company transferred to the Shareholder a portion of borrowings resulting in net loss of 144 million Tenge.

Kazkommertsbank loan

On June 4, 2009 the Company fully discharged receivables from Lancaster Group Kazakhstan and remaining liability under the loan facility provided by Kazkommertsbank to the majority Shareholder, Lancaster Energy Pte Ltd. Discharge resulted in no gain or loss.