

Joint Stock Company
Exploration and Production KazMunaiGas

Consolidated Financial Statements

For the year ended December 31, 2006

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Independent Auditors' Report

To the shareholders and management of Joint Stock Company Exploration and Production KazMunaiGas

We have audited the accompanying financial statements of Joint Stock Company Exploration and Production KazMunaiGas and its subsidiaries (the "Group"), which comprise the consolidated balance sheet as of December 31, 2006, and the consolidated statement of income, consolidated statement of changes in equity and consolidated statement of cash flows 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 consolidated 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 consolidated 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 consolidated 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 consolidated 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.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.



March 12, 2007

JSC EXPLORATION AND PRODUCTION KAZMUNAIGAS

Consolidated Balance Sheet

Tenge thousands

		As at December 31,	
	Notes	2006	2005
ASSETS			
Non-current assets			
Property, plant and equipment	7	259,333,372	243,131,834
Other financial assets	9	102,841,401	53,963,138
Intangible assets	8	7,921,252	1,340,657
Investments in associates		2,884,207	4,516,696
Other assets		3,843,312	2,808,028
Total non-current assets		376,823,544	305,760,353
Current assets			
Inventories	10	15,131,619	15,409,658
Taxes prepaid and VAT recoverable		11,690,358	22,121,101
Prepaid and deferred expenses		4,952,828	6,993,525
Trade and other receivables	9	37,356,601	45,918,226
Other financial assets	9	226,523,024	19,993,257
Cash and cash equivalents	9	62,459,415	20,187,588
Total current assets		358,113,845	130,623,355
Total assets		734,937,389	436,383,708
EQUITY			
Share capital	11	259,276,481	11,792,208
Other equity		92,249	–
Retained earnings		266,383,385	161,860,819
Equity holders of the Company		525,752,115	173,653,027
Minority interest		5,700	79,536
Total equity		525,757,815	173,732,563
LIABILITIES			
Non-current liabilities			
Borrowings	13	37,972,387	54,028,740
Deferred tax	18	10,715,701	14,197,680
Provisions	14	52,155,874	49,701,648
Total non-current liabilities		100,843,962	117,928,068
Current liabilities			
Borrowings	13	21,695,307	21,121,175
Income taxes payable		25,551,751	46,994,090
Trade and other payables		40,457,729	51,167,595
Provisions	14	20,630,825	25,440,217
Total current liabilities		108,335,612	144,723,077
Total liabilities		209,179,574	262,651,145
Total liabilities and equity		734,937,389	436,383,708

The notes on pages 5 to 29 are an integral part of these consolidated financial statements.

JSC EXPLORATION AND PRODUCTION KAZMUNAIGAS

Consolidated Statement of Income

Tenge thousands

	For the year ended December 31,		
	Notes	2006	2005
CONTINUING OPERATIONS			
Revenue	15	412,207,787	348,887,820
Operating expenses	16	(194,530,080)	(207,033,927)
Profit from operations		217,677,707	141,853,893
Finance (expense) income	17	(115,881)	1,381,060
Share of result of associates		(327,788)	(286,492)
Profit before tax		217,234,038	142,948,461
Income tax expense	18	(94,672,821)	(99,192,639)
Profit for the year from continuing operations		122,561,217	43,755,822
DISCONTINUED OPERATIONS			
Profit for the year from discontinued operations	6	–	1,521,130
Profit for the year		122,561,217	45,276,952
Attributable to:			
Equity holders of the Company		122,561,334	45,074,642
Minority interest		(117)	202,310
		122,561,217	45,276,952
EARNINGS PER SHARE			
	12		
Attributable to equity holders of the Company			
From continuing operations – basic and diluted		2.26	0.93
From discontinued operations – basic and diluted		–	0.03

The notes on pages 5 to 29 are an integral part of these consolidated financial statements.

JSC EXPLORATION AND PRODUCTION KAZMUNAIGAS

Consolidated Statement of Cash Flows

Tenge thousands

For the year ended December 31,

	Notes	2006	2005
Cash flows from operating activities			
Receipts from customers		410,468,348	333,283,661
Payments to suppliers and employees		(160,982,545)	(181,300,015)
Income tax paid		(127,275,342)	(76,929,923)
Net cash generated from operating activities		122,210,461	75,053,723
Cash flows from investing activities			
Purchases of property, plant and equipment (PPE)		(49,285,538)	(61,916,479)
Proceeds from sale of PPE		829,906	2,755,953
Purchases of intangible assets		(8,838,611)	(650,170)
Purchases of held-to-maturity financial assets		(170,235,221)	(25,696,389)
Loans granted to related parties		(118,250,000)	(30,304,487)
Loan repayments received from related parties		37,011,854	17,000,000
Investments in associates		-	(1,810,335)
Disposal of subsidiaries, net of cash disposed		3,653,483	(2,978,059)
Interest received		6,724,660	4,103,536
Net cash used in investing activities		(298,389,467)	(99,496,430)
Cash flows from financing activities			
Proceeds from the issue of shares		151,880,637	31,078
Transaction costs related to the issue of shares		(7,300,142)	-
Purchase of treasury shares		(3,818,100)	-
Proceeds from the issue of bonds		94,792,000	-
Transaction costs related to the issue of bonds		(721,328)	-
Proceeds from borrowings		7,681,060	71,002,146
Repayment of borrowings		(1,695,391)	(30,407,622)
Dividends paid		(17,631,460)	(3,408,598)
Other distributions to owners		-	(2,115,615)
Interest paid		(3,927,652)	(5,019,287)
Net cash from financing activities		219,259,624	30,082,102
Net change in cash and cash equivalents		43,080,618	5,639,395
Cash and cash equivalents at beginning of the year	9	20,187,588	14,127,579
Exchange (losses) gains on cash and cash equivalents		(808,791)	420,614
Cash and cash equivalents at end of the year	9	62,459,415	20,187,588

The notes on pages 5 to 29 are an integral part of these consolidated financial statements.

JSC EXPLORATION AND PRODUCTION KAZMUNAIGAS

Consolidated Statement of Changes in Equity

Tenge thousands

	Attributable to equity holders of the Company				Total Equity
	Share capital	Other equity	Retained earnings	Minority interest	
As at January 1, 2005	11,761,130	1,315,825	154,162,438	1,494,303	168,733,696
Issue of shares (Note 11)	31,078	–	–	–	31,078
Changes in ownership in subsidiaries	–	(1,315,825)	(31,253,594)	(1,617,077)	(34,186,496)
Profit for the year	–	–	45,074,642	202,310	45,276,952
Dividends (Note 11)	–	–	(3,499,715)	–	(3,499,715)
Other distributions to owners	–	–	(2,622,952)	–	(2,622,952)
As at December 31, 2005	11,792,208	–	161,860,819	79,536	173,732,563
Issue of shares (Note 11)	251,302,373	–	–	–	251,302,373
Treasury stock (Note 11)	(3,818,100)	–	–	–	(3,818,100)
Stock options (Note 11)	–	92,249	–	–	92,249
Changes in ownership in subsidiaries	–	–	–	(73,719)	(73,719)
Profit for the year	–	–	122,561,334	(117)	122,561,217
Dividends (Note 11)	–	–	(18,025,525)	–	(18,025,525)
Other distributions to owners (Note 19)	–	–	(13,243)	–	(13,243)
As at December 31, 2006	259,276,481	92,249	266,383,385	5,700	525,757,815

The notes on pages 5 to 29 are an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

1. Organization and principal activities

Joint Stock Company Exploration and Production KazMunaiGas (the “Company”) is engaged in the acquisition, exploration, development, production, processing and export of hydrocarbons with its core operations of oil and gas properties located in the Pre-Caspian and Mangistau basins of western Kazakhstan. The Company’s direct majority shareholder is Joint Stock Company National Company KazMunaiGas (“NC KMG” or the “Parent Company”), which represents the state’s interests in the Kazakh oil and gas industry and which holds 56.77% of the Company’s outstanding shares as at December 31, 2006. From June 2006 NC KMG was 100%-owned by Samruk State Holding which is in turn 100% owned by the government of the Republic of Kazakhstan (the “Government”).

The Company conducts its principal operations through the UzenMunaiGas and EmbaMunaiGas production divisions. These consolidated financial statements reflect the financial position and results of operations of those divisions and certain other controlling and non-controlling interests in predominantly non-core entities. Such other interests represented approximately 3% of the Company’s net assets at December 31, 2006 (2005: 7%). The Company plans to dispose of the remaining non-core businesses by the end of 2008.

These consolidated financial statements were authorized for issue by the Company’s Chief Executive Officer, Chief Financial Officer and Group Financial Controller on March 12, 2007.

2. Summary of significant accounting policies

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

2.1 Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”). The consolidated financial statements have been prepared under the historical cost convention except for financial instruments.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 5.

New accounting developments

The following new standards, amendments to standards and interpretations are mandatory for the financial year ended December 31, 2006:

IAS 19 (Amendment), *Actuarial Gains and Losses, Group Plans and Disclosures*, effective for annual periods beginning on or after January 1, 2006, introduces an additional recognition option for actuarial gains and losses in post-employment defined benefit plans. The amendments to IAS 19 did not have a material impact on the Company’s financial position or results of operations.

IAS 21 (Amendment), *Net Investment in a Foreign Operation*, effective for annual periods beginning on or after January 1, 2006. The amendments to IAS 21 did not have a material impact on the Company’s financial position or results of operations.

IAS 39 (Amendment), *The Fair Value Option*; IAS 39 (Amendment), *Cash Flow Hedge Accounting of Forecast Intragroup Transactions*; IAS 39 and IFRS 4 (Amendment), *Financial Guarantee Contracts*, all effective for annual periods beginning on or after January 1, 2006, clarified the use of fair values, clarified that the definition of a financial hedge extends to certain intercompany transactions and clarified the accounting for insurance contracts.

The amendments to IAS 39 and IFRS 4 did not have a material impact on the Company’s financial position or results of operations.

IFRS 6, *Exploration for and Evaluation of Mineral Resources*, is effective for annual periods beginning on or after January 1, 2006. IFRS 6 permits the continued use of recognition and measurement practices for exploration and evaluation assets applied immediately before adopting the IFRS. IFRS 6 also provides specific guidance on impairment of exploration and evaluation assets. The adoption of IFRS 6 did not have a material impact on the Company’s financial position or results of operations.

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

IFRIC 4, *Determining Whether an Arrangement Contains a Lease*, is effective for annual periods beginning on or after January 1, 2006. The adoption of IFRIC 4 did not have a material impact on the Company's financial position or results of operations.

IFRIC 5, *Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*, is effective for annual periods beginning on or after January 1, 2006. The adoption of IFRIC 5 did not have a material impact on the Company's financial position or results of operations.

IFRIC 6, *Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*, is effective for annual periods beginning on or after December 1, 2005. The adoption of IFRIC 6 did not have a material impact on the Company's financial position or results of operations.

IFRSs and IFRIC Interpretations not yet effective

The Company has not applied the following IFRSs and IFRIC Interpretations that have been issued but are not yet effective:

- IFRS 7 “Financial Instruments: Disclosures”;
- IAS 1 (amended 2005) “Presentation of Financial Statements – Capital Disclosures”;
- IFRIC 8 “Scope of IFRS 2”;
- IFRIC 9 “Reassessment of Embedded Derivatives”;
- IFRIC 10 “Interim Financial Reporting and Impairment”;
- IFRIC 11 “IFRS 2 - Group and Treasury Share Transactions”
- IFRIC 12 “Service Concession Arrangements”

The Company expects that the adoption of the pronouncements listed above will have no significant impact on the Company's results of operations and financial position in the period of initial application.

2.2 Consolidation

Subsidiaries

Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

Associates

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Company's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Company's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Company's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Company does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

Associates (continued)

Unrealised gains on transactions between the Company and its associates are eliminated to the extent of the Company's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Company.

Dilution gains and losses in associates are recognised in the income statement.

2.3 Foreign currency translation

Functional and presentation currency

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Kazakhstan Tenge ("Tenge"), which is also the Company's functional currency.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Subsidiaries

The results and financial position of all of the Company's subsidiaries (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and
- all resulting exchange differences are recognised as a separate component of equity.

2.4 Oil and natural gas exploration and development expenditure

License and property acquisition costs

License and property acquisition costs are capitalized within intangible assets and amortized on a straight-line basis over the estimated period of exploration. Each property is reviewed on an annual basis to confirm that drilling activity is planned and it is not impaired. If no future activity is planned, the remaining balance of the license and property acquisition costs is written off. Upon determination of economically recoverable reserves ('proved reserves' or 'commercial reserves'), amortization ceases and the remaining costs are aggregated with exploration expenditure and held on a field-by-field basis as proved properties awaiting approval within other intangible assets. When development is approved internally, the relevant expenditure is transferred to property, plant and equipment.

Exploration expenditure

Geological and geophysical exploration costs are charged against income as incurred. Costs directly associated with an exploration well are capitalized within property, plant and equipment (construction work-in-progress) until the drilling of the well is complete and the results have been evaluated. These costs include employee remuneration,

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

2. Summary of significant accounting policies (continued)

2.4 Oil and natural gas exploration and development expenditure (continued)

Exploration expenditure (continued)

materials and fuel used, rig costs and payments made to contractors. If hydrocarbons are not found, the exploration expenditure is written off as a dry hole. 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 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, except for expenditure related to development or delineation wells which do not find commercial quantities of hydrocarbons and are written off as dry hole expenditures in the period, is capitalized within property, plant and equipment.

2.5 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation, depletion and impairment.

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. Certain oil and gas property with useful lives less than the remaining life of the fields are depreciated on a straight-line basis over useful lives of 4-10 years. The cost of producing wells is amortized over proved developed reserves. License and property acquisition, decommissioning and field development costs are amortized over total proved reserves.

Other property, plant and equipment principally comprise buildings and machinery and equipment which are depreciated on a straight-line basis over average useful lives of 24 years and 7 years respectively.

The expected useful lives of property, plant and equipment are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

The carrying value of property, plant and equipment is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

An item of property, plant and equipment, inclusive of production wells which stop producing commercial quantities of hydrocarbons and are scheduled for abandonment, is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the period the item is derecognized.

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

2. Summary of significant accounting policies (continued)

2.6 Impairment of 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.

2.7 Intangible assets

Intangible assets are stated at cost, less accumulated amortization and accumulated impairment losses. Intangible assets include expenditure on acquiring licenses for oil and natural gas exploration and computer software. Intangible assets acquired separately from a business are carried initially at cost. The initial cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

The expected useful lives of the assets are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively. Computer software costs have an estimated useful life of 3 to 7 years.

The carrying value of intangible assets is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable.

2.8 Financial assets

Financial assets within the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, 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 at initial recognition. 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.

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Company has the positive intention and ability to hold them to maturity. The Company classifies its cash deposits and bonds as held-to-maturity investments because management has the positive intention and ability to hold these instruments to maturity.

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

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

2. Summary of significant accounting policies (continued)

2.9 Inventories

Inventories are stated at the lower of cost and net realizable value on a first-in first-out (“FIFO”) basis. Cost includes all costs incurred in the normal course of business in bringing each product to its present location and condition. The cost of crude oil and refined products is the cost of production, including the appropriate proportion of DD&A and overheads based on normal capacity. Net realizable value of crude oil and refined products is based on estimated selling price in the ordinary course of business less any costs expected to be incurred to completion and disposal. Materials and supplies inventories are carried at amounts that do not exceed the expected amounts recoverable in the normal course of business.

2.10 Trade and other receivables

Trade receivables, which generally have a short term, 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.

2.11 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.

2.12 Cash and cash equivalents

Cash and cash equivalents include cash on hand, demand deposits with banks, other short-term highly liquid investments with original maturities of three months or less.

2.13 Share capital

Share Capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognised as an additional paid-in capital.

Treasury Shares

Where the Company or its subsidiaries purchases the Company’s shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from equity as treasury shares until they are cancelled or reissued. No gain or loss is recognized in the income statement on the purchase, sale, issue or cancellation of the Company’s own equity instruments. Where such shares are subsequently sold or reissued, any consideration received is included in equity. Treasury shares are stated at weighted average cost.

Minority Interest

Minority interest represents the interest in subsidiaries not held by the Company. Minority interest at the balance sheet date represents the minority shareholders' portion of the fair value of the identifiable assets and liabilities of the subsidiaries at the acquisition date and the minorities' portion of movements in equity since the date of the Company’s formation. Minority interest is presented within the shareholders’ equity. Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiaries unless there is a binding obligation of the minority to fund the losses. All such losses are allocated to the Company.

Dividends

Dividends are recognised as a liability and deducted from equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are authorised for issue.

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

2. Summary of significant accounting policies (continued)

2.14 Trade payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.15 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date. Borrowing costs are recognised as an expense when incurred.

2.16 Deferred income tax

Deferred tax assets and liabilities are calculated in respect of temporary differences using the balance sheet method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or 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.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

2.17 Employee benefits

Pension scheme

The Company withholds 10% from the salary of its employees as the employees' contribution to their designated pension funds. The pension deductions are limited to 75 minimal monthly salary levels of 9,200 Tenge per month in 2006 (2005: 7,000 Tenge). Under the current Kazakhstan legislation, employees are responsible for their retirement benefits.

2.18 Revenue recognition

The Company sells crude oil under short-term agreements priced by reference to Platt's index quotations and adjusted for freight, insurance and quality differentials. Title typically passes and revenues are recognized when crude oil is physically placed onboard a vessel or offloaded from the vessel, transferred into pipe or other delivery mechanism depending on the contractually agreed terms.

The Company's crude oil sale contracts generally specify maximum quantities of crude oil to be delivered over a certain period. Crude oil shipped but not yet delivered to the customer is recorded as inventory in the balance sheet. Revenues on sales of oil products are recognized when transfer of ownership occurs and title is passed, either at the point of delivery or the point of receipt, depending on contractual conditions.

2.19 Income taxes

Excess profit tax (EPT) is treated as an income tax and forms part of income tax expense. In accordance with the subsoil agreements, the Company accrues and pays EPT, at a rate in the range of 30 to 50% of after tax profit which has been adjusted for specific deductions in accordance with the applicable subsoil agreements, when certain internal rates of return are exceeded.

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

2. Summary of significant accounting policies (continued)

2.19 Income taxes

The internal rate of return is calculated based on the cash flows from each subsoil agreement, adjusted for the national inflation rate. Deferred tax is calculated with respect to both corporate income tax (CIT) and EPT. Deferred EPT is calculated on temporary differences for assets allocated to contracts for subsoil use at the expected rate of EPT to be paid under the contract.

2.20 Comparative amounts

Certain prior period amounts have been reclassified to conform to current period presentation.

3. Significant non-cash transactions

During 2006 the Company settled in crude oil 17,503,720 thousand Tenge due under the terms of a pre-export financing agreement (2005: 13,676,456 thousand Tenge).

At the date of IPO (Note 11.1) the Company exchanged 9,247,946 ordinary shares for US\$800 million senior notes plus accumulated interest. The Company's notes had been placed on July 10, 2006 (Note 9).

These non-cash transactions are excluded from the consolidated statement of cash flows.

4. Financial risk factors

Commodity price risk

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

Interest rate risk

The Company's interest rate risk relates to interest receivable and payable on its cash deposits and borrowings. The Company hedges its exposure on its variable rate debt instruments.

Foreign exchange risk

Most of the Company's cash inflows as well as accounts receivable balances are denominated in US dollars, while most of the Company's purchases are denominated in Tenge. The Company does not use foreign exchange or forward contracts to manage its exposure to changes in foreign exchange rates.

Credit risk

Financial instruments that could subject the Company to credit risk principally comprise related party loans, accounts receivable and cash deposits. Most notably, at December 31, 2006 the Company had 69% (2005: 57%) of total trade and other receivable from one customer, a related party (Note 19). 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.

Fair values

The fair value of financial instruments, consisting of cash, loans and receivables, and payables and obligations under debt instruments, approximate their carrying values. For trade receivables fair value is the nominal value less provision for uncollectible amounts. The fair value of financial liabilities and other financial assets for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments.

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

5. Significant accounting estimates and judgments

The preparation of consolidated 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 consolidated 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:

Oil and gas reserves

Oil and gas reserves are a material factor in the Company's computation of 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 long-term planning prices which are also used by management to make investment decisions about development of a field. Using planning prices for estimating proved reserves removes the impact of the volatility inherent in using year end spot prices. Management believes that long-term planning price assumptions are more consistent with the long-term nature of the upstream business and 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. The Company's proved reserves almost exclusively comprise proved developed reserves. 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 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. Given the relatively small number of producing fields, it is possible that any changes in reserve estimates year on year could significantly affect prospective charges for DD&A.

Asset retirement obligations

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 non-productive wells and final closure activities such as removal of pipes, buildings and recultivation of the contract territories. Since the license terms cannot be extended at the discretion of the Company, the settlement date of the final closure obligations has been assumed to be the end of each license period. If the asset retirement obligations were 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 abandonment and closure costs. The extent of the Company's obligations to finance the abandonment of wells and for final closure costs depends on the terms of the respective contracts and current legislation. Where neither contracts nor legislation include an unambiguous obligation to undertake or finance such final abandonment and closure costs at the end of the license term, 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. If the Company's asset retirement obligation included the costs of abandoning all productive wells at the end of the license period and recultivating the related sites, the total asset retirement obligation would increase by approximately 9.5 billion Tenge. The Company calculates asset retirement obligations separately for each contract. 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

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

5. Significant accounting estimates and judgments (continued)

Asset retirement obligations (continued)

Kazakhstan market. The Company reviews site restoration provisions at each balance sheet date, and adjusts them to reflect the current best estimate in accordance with IFRIC 1 “Changes in Existing Decommissioning, Restoration and Similar Liabilities”. Estimating the future closure costs involves significant estimates and judgments by management. Most of these obligations are many years in the future and, in addition to ambiguities in the legal requirements, the Company’s estimate can be affected by changes in asset removal technologies, costs and industry practice. Approximately 9.4% of the provision at December 31, 2006 and 2005 relates to final closure costs. Uncertainties related to the final closure costs are mitigated by the effects of discounting the expected cash flows. The Company estimates future well abandonment cost 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, 2006 were 5.0% and 7.9% respectively (2005: 5.0% and 7.9%). Movements in the provision for asset retirement obligations are disclosed in Note 14.

Environmental remediation

The Company also makes judgments and estimates in establishing provisions for environmental remediation obligations. Environmental expenditures are capitalized or expensed depending upon their future economic benefit. Expenditures that relate to an existing condition caused by past operations and do not have a future economic benefit are expensed.

Liabilities are determined based on current information about costs and expected plans for remediation and are recorded on an undiscounted basis if the timing of the procedures has not been agreed with the relevant authorities. The Company’s environmental remediation provision represents management’s best estimate based on an independent assessment of the anticipated expenditure necessary for the Company to remain in compliance with the current regulatory regime in Kazakhstan. Pursuant to a memorandum of understanding (“MOU”) signed with the Ministry of the Environment in July 2005, the Company agreed to take responsibility for remediation of certain soil contamination and oil waste disposal which resulted from oil extraction dating back to the commencement of production. As at the date of these financial statements the scope and timing of the remediation plan has not been formally agreed with the Government. Accordingly, the liability has not been discounted. Because the original terms of the liability have not yet been established and management reasonably expects to execute the remediation plan over a period of up to ten years, the Company has classified this obligation as non-current except for the portion of costs expected to be incurred in 2007. For environmental remediation provisions, actual costs can differ from estimates because of changes in laws and regulations, public expectations, discovery and analysis of site conditions and changes in clean-up technology. Further uncertainties related to environmental remediation obligations are detailed in Note 20. Movements in the provision for environmental remediation obligations are disclosed in Note 14.

Taxation

In assessing tax risks, management considers to be probable obligations the known areas of tax positions which the Company would not appeal or does not believe it could successfully appeal, if assessed by tax authorities. Such determinations inherently involve significant judgment and are subject to change as a result of changes in tax laws and regulations, amendments to the taxation terms of the Company’s subsoil agreements, the determination of expected outcomes from pending tax proceedings and current outcome of ongoing compliance audits by tax authorities. The provision for tax risks disclosed in Note 14 relates mainly to the Company’s application of Kazakhstan transfer pricing legislation to export sales of crude oil during the years 2002 to 2006. Further uncertainties related to taxation are detailed in Note 20.

Historical obligation

Included in trade and other payables is an accrual of 8.0 billion Tenge (2005: 8.4 billion) related to obligations of the Company under one of the subsoil agreements to reimburse the Government for exploration costs incurred prior to the beginning of the current license agreements. The Company was to conclude a separate agreement with the Government with respect to such reimbursement within sixty days of the signing of the subsoil use contract in 1998. As at December 31, 2006 no such agreement had been concluded. For about half of the contract fields the amount of

Notes to the Consolidated Financial Statements*Tenge thousands unless otherwise stated***5. Significant accounting estimates and judgments (continued)***Historical obligation (continued)*

the accrual has been determined based on calculations prepared by regulatory authorities in 2003. The remaining part of the accrual was estimated by management based on historical exploratory well data. The accrual is classified as current at December 31, 2006 due to the Company not having the unconditional right to defer such obligation for at least 12 months. The obligation is denominated in US dollars and the carrying value is adjusted each period for foreign exchange movements.

6. Discontinued operations

On December 29, 2005 the Company disposed of Atyrau refinery within the NC KMG Group for 3.5 billion Tenge after acquiring the refinery in a par value share exchange with the Parent Company. In 2005 the Company increased its interest from 86.7% to 99.1% through cash contributions of approximately 25 billion Tenge. The disposal resulted in a decrease in shareholders equity of 34.2 billion Tenge. The effects of the disposal were recorded in equity because the counterparty to this transaction is controlled by the principal equity holder. The disposal also resulted in decreases in the following balance sheet items: non-current assets (primarily property, plant and equipment) 58.7 billion Tenge, current assets 17.7 billion Tenge, borrowings 32.5 billion Tenge and other liabilities of 6.1 billion Tenge.

	2005
Revenue	8,854,241
Expenses	(5,350,959)
Profit before tax of discontinued operations	3,503,282
Tax	(1,982,152)
Profit after tax of discontinued operations	1,521,130
Operating cash flows	160,194
Investing cash flows	(13,401,139)
Financing cash flows	(809,995)
Total cash flows of discontinued operations	(14,050,940)

Historically the Company has purchased tolling services from the refinery to meet its local market obligation. Tolling expenses amounted to around 5 billion Tenge in each of the years presented and have been eliminated in these financial statements with all other inter-company transactions. In late 2005 the Company began selling crude oil directly to the refinery. Those sales amounted to around 6.5 billion Tenge and were also eliminated in consolidation. Going forward at least through 2010 the Company expects to increase crude oil sales to the refinery to around 2.2 million metric tons (“tons”) per year at terms of cost plus 3% and reduce to an insignificant amount the purchase of tolling services.

Notes to the Consolidated Financial Statements*Tenge thousands unless otherwise stated***7. Property, plant and equipment**

	Oil-and-gas properties	Other assets	Construction work-in-progress	Total
2005				
Opening net book amount at January 1, 2005	171,791,340	51,018,310	35,148,550	257,958,200
Additions	10,975,517	10,766,359	60,065,268	81,807,144
Disposals related to discontinued operations	–	(10,935,164)	(50,852,587)	(61,787,751)
Other disposals	(3,003,271)	(6,218,463)	(999,857)	(10,221,591)
Transfers from work-in-progress	26,314,228	7,160,857	(33,475,085)	–
Depreciation charge	(18,332,498)	(6,224,762)	–	(24,557,260)
Impairment	–	(66,908)	–	(66,908)
Closing net book amount at December 31, 2005	187,745,316	45,500,229	9,886,289	243,131,834
At December 31, 2005				
Cost	235,613,254	54,966,841	9,886,289	300,466,384
Accumulated depreciation	(47,867,938)	(9,466,612)	–	(57,334,550)
Net book amount	187,745,316	45,500,229	9,886,289	243,131,834
2006				
Opening net book amount at January 1, 2006	187,745,316	45,500,229	9,886,289	243,131,834
Additions	16,642,063	8,352,989	29,711,178	54,706,230
Disposals	(2,829,741)	(6,047,369)	(3,803,098)	(12,680,208)
Transfers from work-in-progress	22,551,461	2,846,849	(25,398,310)	–
Depreciation charge	(21,438,939)	(4,385,545)	–	(25,824,484)
Closing net book amount At December 31, 2006	202,670,160	46,267,153	10,396,059	259,333,372
At December 31, 2006				
Cost	270,185,271	56,644,462	10,396,059	337,225,792
Accumulated depreciation	(67,515,111)	(10,377,309)	–	(77,892,420)
Net book amount	202,670,160	46,267,153	10,396,059	259,333,372

As at December 31, 2006, construction work-in-progress includes a net book value of exploration and evaluation assets in the amount of 166,298 thousand Tenge (2005: 343,928 thousand Tenge). Additions of these assets during 2006 amounted to 1,312,855 thousand Tenge (2005: 1,201,023 thousand Tenge) and disposals amounted to 1,490,485 thousand Tenge (2005: 1,304,754 thousand Tenge), including write off of dry exploratory wells during the period amounting to 526,596 thousand Tenge (2005: 1,304,754 thousand Tenge).

Notes to the Consolidated Financial Statements*Tenge thousands unless otherwise stated***8. Intangible assets**

	2006	2005
At January 1		
Opening net book amount	1,340,657	972,875
Additions	9,413,856	747,954
Disposals	(4,757)	(53,832)
Amortization charge	(2,828,504)	(326,340)
Closing net book amount	7,921,252	1,340,657
At December 31		
Cost	10,908,011	1,622,555
Accumulated amortization	(2,986,759)	(281,898)
Net book amount	7,921,252	1,340,657

Included in additions for 2006 are the contract and license rights for exploration and production activities in Western Kazakhstan that the Company purchased from Aral Petroleum LLP in January 2006 for total cash consideration of 8.6 billion Tenge. The acquired exploration rights expire in February 2009.

9. Financial assets*Other financial assets*

	2006	2005
Loan receivable from NC KMG (Note 19)	100,786,068	–
US dollar-denominated deposits	–	47,488,350
Other	2,055,333	6,474,788
Total non-current	102,841,401	53,963,138
Tenge-denominated deposits	131,995,651	–
US dollar-denominated deposits	90,461,651	6,688,500
Loans receivable (Note 19)	–	12,639,487
Other	4,065,722	665,270
Total current	226,523,024	19,993,257
	329,364,425	73,956,395

The weighted average interest rate on US dollar-denominated deposits in 2006 was 7.6% (2005: 6.6%). The weighted average interest rate on Tenge-denominated deposits in 2006 was 8.1%. Other current financial assets as of December 31, 2006 consist primarily of US dollar-denominated bonds with weighted average interest rates of 4%.

On June 30, 2006 the Company entered into an agreement with NC KMG to acquire NC KMG's interests in JV KazGerMunai, representing 50% of the participatory interest in JV KazGerMunai (see Note 22). Under the terms of the agreement, in consideration of the Company providing financial support to NC KMG to finance the acquisition, the Company received a right to purchase the acquired interest at fair market value, which is to be negotiated and determined between the Company and NC KMG. Pursuant to the above on July 10, 2006, the Company's finance subsidiary, Munaishy Finance B.V., issued US\$800 million of 6.5% fixed rate senior notes due in 2009 and loaned the proceeds from the issue to NC KMG (Note 3). The repayment of the loan is scheduled for 2009 (same date as the Munaishy Finance B.V. issuance) and accrues interest at 6.6% fixed per annum.

No amount has been recognised in these financial statements to account for the option to acquire KazGerMunai due to the negligible value of the option and ultimate exercise of the option being outside of the control of the Company.

Notes to the Consolidated Financial Statements*Tenge thousands unless otherwise stated***9. Financial assets (continued)***Trade and other receivables*

	2006	2005
Trade receivables	37,273,438	38,752,145
Other	3,378,453	8,061,865
Allowance for doubtful receivables	(3,295,290)	(895,784)
	37,356,601	45,918,226

As of December 31, 2006 US dollar-denominated trade and other receivables represented 89% of total receivables (2005: 80%). The remaining balances are Tenge-denominated.

In 2004 the Company purchased a 50% interest in Atoll JSC for approximately 5 billion Tenge. In 2005 the Company sold a 35% interest in Atoll to the other shareholder for 3.2 billion Tenge.

In 2006 the Company has fully provided for the 3.2 billion Tenge receivable from the above sale. Additionally, an impairment loss has been recognised as at December 31, 2006 to write the remaining investment in Atoll down to zero, which is management's best estimate of the current fair value of the investment.

Cash and cash equivalents

	2006	2005
Term deposits	58,399,928	9,815,804
Cash in bank and in hand	4,059,487	10,371,784
	62,459,415	20,187,588

The weighted average interest rate on US dollar-denominated deposits in 2006 was 5.6% (2005: 5%). The weighted average interest rate on Tenge-denominated deposits in 2006 was 5.6% (2005: 3.2%). Approximately 23% of total cash and cash equivalents at year end 2006 are US dollar-denominated (about 70% for 2005). The remaining balances are Tenge-denominated.

10. Inventories

	2006	2005
Materials	10,053,765	11,060,833
Crude oil	5,077,854	4,348,825
	15,131,619	15,409,658

Notes to the Consolidated Financial Statements*Tenge thousands unless otherwise stated***11. Share capital**

	Shares outstanding (number of shares)				Total share capital
	Common shares	Preferred shares	Common shares	Preferred shares	
As at January 1, 2005	42,926,820	4,117,699	10,731,705	1,029,425	11,761,130
Issue of shares	124,312	–	31,078	–	31,078
As at December 31, 2005	43,051,132	4,117,699	10,762,783	1,029,425	11,792,208
Issue of shares	27,169,803	18,408	251,297,771	4,602	251,302,373
Treasury stock	(341,530)	–	(3,818,100)	–	(3,818,100)
As at December 31, 2006	69,879,405	4,136,107	258,242,454	1,034,027	259,276,481

11.1 Share capital*Authorized shares*

The total number of authorized ordinary and preferred shares is 70,220,935 (2005: 70,220,935) and 4,136,107 (2005: 4,136,107), respectively.

Initial public offering (IPO)

On September 28, 2006, the Company placed Ordinary Shares at 11,163.39 Tenge per share and Global Depository Receipts (“GDR”) at US \$14.64 (equivalent to 1,860.57 Tenge) per GDR (each GDR represents 1/6 of an ordinary share), on the Kazakhstan Stock Exchange and London Stock Exchange, respectively. The global offer consisted of 23,086,791 newly issued ordinary shares and 3,463,019 ordinary shares, which were offered by NC KMG. Ordinary Share and GDR trading has commenced on the Exchanges on October 4, 2006. At the time of the IPO 539,125 ordinary shares were issued to minority shareholders at 250 tenge per share. Each Ordinary share has the same voting rights as 6 GDRs.

Preferred stock

Preferred stockholders are entitled to participate equally in dividends with the holders of common stock and in any case are entitled, at the discretion of the Company’s Board of Directors, to an annual cumulative dividend of 25 Tenge per share. Preferred shareholders receive the right to vote if the general meeting of shareholders considers decisions restricting rights of preferred shareholders, decisions on reorganization or liquidation of the Company and if dividends on preferred shares are not paid within three months after a specified payment date.

Treasury stock

On September 28, 2006 the Company purchased 2,049,180 GDRs at a weighted average price of US \$14.64. The shares are held in trust by a special purpose entity and are expected to be used for employee share option plans. The Company consolidates the trust, as in substance, the activities of the trust are being conducted on behalf of the Company. Additionally, the ultimate benefits and risks of the trust reside with the Company.

Dividends

In accordance with Kazakhstan legislation, dividends may not be declared if the Company has negative equity in its Kazakh statutory financial statements or if the payment of dividends would result in negative equity in the statutory financial statements. Total dividends per share recognized as distributions to equity holders during the period amounted to 382 Tenge per share (2005: 74.20 Tenge per share) for both ordinary and preferred shares.

Notes to the Consolidated Financial Statements

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11. Share capital (continued)

11.2 Employee share option plan

During 2006 the Company established a share option plan. A one-time award for its employees and directors was established to reward performance in relation to the IPO process. The IPO award date was December 29, 2006. An additional plan with an award date of October 4, 2006 was created to incentivise management. The following outlines the details of both plans and activity in the year:

	IPO Plan		Incentive Plan	
	Number of GDR's	Exercise price (\$)	Number of GDR's	Exercise price (\$)
Granted options	342,553	Nil	575,059	14.64
Outstanding as at December 31, 2006	342,553	Nil	575,059	14.64
	Other Plan Details		Other Plan Details	
Weighted average fair value of options granted during the year (\$)	19.17		7.93	
Vesting period	1 year		1/3 each year over 3 years	
Average life remaining	6 years		6 years	

The Company recognized total expenses of 92,249 thousand Tenge related to equity-settled share-based payment transactions in 2006.

12. Earnings per share

	2006	2005
Weighted avg. number of all shares outstanding	54,119,532	47,150,748
Continuing operations		
Profit attributable to equity holders of the Company	122,561,334	43,755,822
Basic and diluted earnings per share	2.26	0.93
Discontinued operations		
Profit attributable to equity holders of the Company	–	1,318,820
Basic and diluted earnings per share	–	0.03

The above presentation includes both ordinary and preferred shares as preferred shareholders have cumulative participating rights which result in identical earnings per share for both classes of shares.

Notes to the Consolidated Financial Statements*Tenge thousands unless otherwise stated***13. Borrowings**

	2006	2005
Fixed interest rate borrowings	53,947,580	69,309,083
Weighted average interest rates	5.83%	6.32%
Variable interest rate borrowings	5,720,114	5,840,832
Weighted average interest rates	5.44%	6.33%
Total borrowings	59,667,694	75,149,915
Tenge-denominated borrowings	664,257	859,377
US dollar-denominated borrowings	59,003,437	74,290,538
Total borrowings	59,667,694	75,149,915
Current portion	21,695,307	21,121,175
Maturity between 1 and 2 years	19,816,717	19,082,221
Maturity between 2 and 5 years	17,393,391	34,451,834
Maturity over 5 years	762,279	494,685
Total borrowings	59,667,694	75,149,915
Undrawn facilities at fixed rate:		
Expiring within one year	2,514,098	3,986,709
Expiring beyond one year	-	13,709,100
	2,514,098	17,695,809

Most of the Company's borrowings (2006: 51,094,758 thousand Tenge, 2005: 66,598,200 thousand Tenge) relate to a pre-export financing arrangement which expires in 2009 and requires settlement in crude oil.

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Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

14. Provisions

	Environmental remediation	Taxes	Asset retirement obligation	Other	Total
At January 1, 2005	33,028,060	18,644,946	16,305,869	1,659,876	69,638,751
Additional provisions	–	4,874,542	351,046	1,072,412	6,298,000
Unused amounts reversed	–	–	(29,772)	–	(29,772)
Unwinding of discount	–	–	1,293,055	–	1,293,055
Changes in estimate	(663,230)	–	995,322	–	332,092
Used during the year	(1,331,100)	–	(869,172)	(189,989)	(2,390,261)
Current portion	821,577	23,519,488	900,163	198,989	25,440,217
Non-current portion	30,212,153	–	17,146,185	2,343,310	49,701,648
At December 31, 2005	31,033,730	23,519,488	18,046,348	2,542,299	75,141,865
Additional provisions	–	974,524	805,286	868,694	2,648,504
Unused amounts reversed	–	(4,915,889)	(35,118)	–	(4,951,007)
Unwinding of discount	–	–	1,431,075	–	1,431,075
Changes in estimate	–	–	2,186,862	–	2,186,862
Used during the year	(1,014,767)	(1,792,643)	(677,185)	(186,005)	(3,670,600)
Current portion	1,619,352	17,785,480	1,026,968	199,025	20,630,825
Non-current portion	28,399,611	–	20,730,300	3,025,963	52,155,874
At December 31, 2006	30,018,963	17,785,480	21,757,268	3,224,988	72,786,699

Release of tax provision during 2006 primarily relates to the clarification in the Company's subsoil agreement for the Uzen field (Note 18) and expiration of the statute of limitations with respect to provisions related to activities in 2001.

15. Revenue

	2006	2005
Export:		
Crude oil	359,386,708	302,488,673
Refined products	–	651,491
Domestic (Note 19):		
Crude oil	37,087,091	6,930,889
Refined products	7,618,461	32,812,045
Gas products	3,623,586	4,082,068
Other sales and services	4,491,941	1,922,654
	412,207,787	348,887,820

Notes to the Consolidated Financial Statements

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16. Operating expenses

	2006	2005
Transportation	44,060,096	40,106,224
Employee benefits	37,512,548	37,116,032
Depreciation, depletion and amortization	27,758,826	24,362,896
Repairs and maintenance	18,988,262	16,845,303
Royalties	15,850,891	15,180,580
Materials and supplies	11,661,063	21,658,853
Other taxes	9,666,804	7,103,491
Social projects	7,850,402	1,791,551
Management fees and commissions (Note 19)	7,678,179	11,976,634
Energy	6,563,701	5,824,741
Fines and penalties	363,994	4,056,539
Environmental fine (Note 20)	(11,427,595)	11,427,595
Other	18,002,909	9,583,488
	194,530,080	207,033,927

17. Finance (expense) income

	2006	2005
Financial income	13,525,630	6,221,012
Financial expense	(9,581,373)	(5,115,993)
Foreign exchange (losses) gains	(4,060,138)	276,041
	(115,881)	1,381,060

18. Income taxes

Income tax expense comprised the following for the years ended December 31:

	2006	2005
Corporate income tax	75,691,683	55,407,550
Excess profit tax	41,105,194	47,411,026
Excess profit tax of prior years	(18,642,077)	-
Current income tax	98,154,800	102,818,576
Corporate income tax	(1,046,070)	(1,983,507)
Excess profit tax	(2,435,909)	(1,642,430)
Deferred income tax	(3,481,979)	(3,625,937)
Income tax expense	94,672,821	99,192,639

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18. Income taxes (continued)

The following table provides a reconciliation of the Kazakhstan income tax rate (30% in 2006 and 2005) to the effective tax rate of the Company on profit before tax.

	2006	2005
Profit before tax	217,234,038	142,948,461
Income tax	94,672,821	99,192,639
Effective tax rate	44%	69%
	% of profit before tax	
Statutory income tax	30	30
Increase (decrease) resulting from		
Excess profit tax	20	32
Excess profit tax of prior years	(9)	–
Movement in provisions	(2)	–
Tax effect of items which are not deductible or assessable for taxation purposes	5	7
Effective tax rate	44	69

The movements in the deferred tax liability relating to CIT and EPT were as follows:

	Fixed assets	Provisions	Other	Total
At January 1, 2005	29,500,770	(2,707,958)	(8,306,998)	18,485,814
Income statement effect	(4,965,164)	70,825	1,268,402	(3,625,937)
Acquisitions and disposals	(662,197)	–	–	(662,197)
At December 31, 2005	23,873,409	(2,637,133)	(7,038,596)	14,197,680
Income statement effect	(5,609,303)	1,261,990	865,334	(3,481,979)
At December 31, 2006	18,264,106	(1,375,143)	(6,173,262)	10,715,701

On December 29, 2006 the Kazakhstan government as represented by the Ministry of Energy and Mineral resources and the Company signed Agreement # 2 (state registration number 2272) on the introduction of changes and amendments to Contract # 40 dated 31 May 1996 on exploration and production of the Uzen and Karamandybas oil fields in the Mangistau oblast (“the Contract”). Agreement # 2 clarified certain aspects of the Contract’s tax regime and also introduced the direct inclusion of social infrastructure obligations in the amount of up to KZT 900 million per year into the Contract.

Specifically, Agreement #2 has established clear excess profit tax calculation methodology, which was previously absent or lacking in the Contract. In prior periods the Company calculated and paid to the budget excess profit tax based on a conservative understanding of the Contract’s provisions.

In accordance with the Agreement #2, the introduction of the specific excess profit tax calculation methodology was applied retrospectively from the Contract’s inception date and resulted in a material decrease (18.6 billion Tenge) in the Company’s prior years’ excess profit tax liabilities. The effects of the change in the tax rate for the Contract have been fully reflected in the 2006 income tax expense.

Notes to the Consolidated Financial Statements*Tenge thousands unless otherwise stated***18. Income taxes (continued)**

In addition, Agreement #2 introduced certain changes that will be applied prospectively in the Company's financial statements. The Company's obligations on road use fund of 0.5% of turnover were abolished in exchange for an increase in royalty rate from 3% to 3.5%. Also, the social tax and value added tax rates were brought in line with the existing rates in current legislation. Other changes to the Contract were made in relation to smaller local taxes, which are not expected to have a material effect on the Company's financial statements.

As of December 31, 2006, total prepaid income taxes were 6.1 billion Tenge (2005: 4.1 billion Tenge).

19. Related party transactions

The category 'entities under common control' comprises entities of the Parents and all of those entities are state-controlled. Halyk Bank of Kazakhstan is a related party due to the bank being controlled by a member of the Parent Company's Board of Directors.

	2006	2005
Sales of goods and services (Note 15)		
Entities under common control	321,037,075	260,878,868
Parent Company	3,856,643	–
Associates	16,217	8,965
Purchases of goods and services (Note 16)		
Entities under common control	43,727,299	33,260,013
Parent Company	7,489,949	11,244,000
Associates	668,736	1,007,035
Halyk Bank of Kazakhstan affiliates	395,883	–
Interest earned on financial assets		
Halyk Bank of Kazakhstan	1,204,307	–
Average interest rate on deposits	3.25%	–
Parent Company	3,589,287	–
Trade and other receivables (Note 9)		
Entities under common control	31,996,067	36,719,618
Parent Company	–	180,772
Associates	226	667,877
Halyk Bank of Kazakhstan affiliates	273,492	–
Trade payables		
Entities under common control	1,725,051	1,128,480
Parent Company	2,114,180	408,124
Associates	293,088	129,324
Loans receivable		
Entities under common control	94,185	3,639,487
Parent Company (Note 9)	100,786,068	9,000,000
Loans payable (Note 13)		
Parent Company	5,720,113	5,840,833

Notes to the Consolidated Financial Statements*Tenge thousands unless otherwise stated***19. Related party transactions (continued)**

	2006	2005
Financial assets (Note 9)		
Halyk Bank of Kazakhstan	26,085,624	–
Cash and cash equivalents (Note 9)		
Halyk Bank of Kazakhstan	35,697,194	–
Key management compensation		
Salaries and other short-term benefits	574,077	133,483
Share-based payments	31,276	–

Sales and receivables

Sales to related parties comprise mainly export and domestic sales of crude oil and oil products to KMG group entities. Export sales to related parties represented 4,972,199 tons of crude oil in 2006 (2005: 4,693,968 tons). The sales of crude oil are priced by reference to Platt's index quotations and adjusted for freight, insurance and quality differentials. For these exports of crude oil the Company received an average price per ton of approximately 55,430 Tenge in 2006 (2005: 47,837 Tenge). In addition, the Company supplies oil and oil products to the local market at the directive of the Kazakhstan government, the ultimate controlling shareholder of the Parent Company. These supplies to the domestic market represented 2,541,685 tons of crude oil production in 2006 (2005: 2,733,409 tons). Prices for the local market sales are determined by agreement with the distributors. For deliveries to the local market in 2006 the Company received an average price per produced crude oil ton of around 15,748 Tenge (2005: 13,288 Tenge). Trade and other receivables from related parties principally comprise amounts related to export sales transactions.

At December 31, 2006 the Company had commitments under a government directive to deliver 2.2 million tons of crude oil to local markets in 2007.

Purchases and payables

Management fees to the Parent Company amounted to 7,000,000 thousand Tenge in 2006 (2005: 11,244,000 thousand Tenge). Agency commissions for crude oil sales amounted to 678,179 thousand Tenge in 2006 (2005: 732,634 thousand Tenge). Transportation services related to the shipment of 7,649,026 tons of crude oil in 2006 (2005: 7,554,859 tons) were purchased from a KMG group entity for 32,024,409 thousand Tenge in 2006 (2005: 28,965,459 thousand Tenge). The remaining services purchased from Samruk group entities include primarily payments for demurrage, sales commissions and electricity.

Loans and guarantees

In 1996 a predecessor entity of the Company received from the Parent Company a facility of US \$109,000 thousand for the rehabilitation of the Uzen oil field. Amounts drawn in 2006 totaled US \$10,007 thousand (2005: US \$2,633 thousand). The Company pays semi-annual installments of US \$4,540 thousand through 2013 and a commitment charge of 0.75% per annum on the principal amount of the unutilized facility. This loan is secured by certain non-current assets of the Company (Note 20).

In 2006 the Company made an interest-free loan to the Parent Company in the amount of 24,371,325 thousand Tenge (2005: 26 billion Tenge), which was repaid in November 2006. The difference between the nominal value and the discounted amount of the loan has been recorded in equity.

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20. Contingencies

Operating environment

The Kazakh economy, while deemed to be of market status beginning in 2002, continues to display certain characteristics consistent with that of an economy in transition. These characteristics have in the past included higher than normal historical inflation, lack of liquidity in the capital markets, and the existence of currency controls, which cause the national currency to be illiquid outside of Kazakhstan.

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

Local market obligation

The Kazakhstan government requires oil producers to supply a portion of their crude oil production to meet domestic energy requirements (Note 19). While the price for such additional supplies of crude oil is agreed with the Company's Parent, this price may be materially below international market prices and may even be set at the cost of production. If the Government does require additional crude oil to be delivered over and above the quantities currently supplied by the Company, such supplies will take precedence over market sales and will generate substantially less revenue than crude oil sold on the export market, which may materially and adversely affect the Company's business, prospects, financial condition and results of operations.

Taxation

Kazakhstan's tax legislation and regulations are subject to ongoing changes and varying interpretations. 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 tax laws are severe. Penalties are generally 50% of the 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, penalties and interest can amount to multiples of any assessed taxes. Fiscal periods remain open to review by tax authorities for five calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. Because of the uncertainties associated with Kazakhstan's tax system, the ultimate amount of taxes, penalties and interest, if any, may be in excess of the amount expensed to date and accrued at December 31, 2006. As at December 31, 2006 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, except as provided for or otherwise disclosed in these financial statements (Notes 5 and 14).

Environment

The enforcement of environmental regulation in Kazakhstan is evolving and subject to ongoing changes. Penalties for violations of Kazakhstan's environmental laws can be severe. At year end 2005 the Company accrued fines of 11.4 billion Tenge for exceeding permitted norms at certain production sites. The Government linked the fines to the delayed submission by the Company of a remediation plan in accordance with the terms of a Memorandum of Understanding ("MOU") signed with the Company in mid-2005. Until the terms of the MOU are amended to extend the deadline specified therein, there can be no assurances that additional fines will not be assessed. Potential liabilities which may arise as a result of stricter enforcement of existing regulations, civil litigation or changes in legislation cannot be reasonably estimated. On July 7, 2006 the Specialized Inter-District Economic Court of the city of Astana ("SIDECA") decided the case in favor of the Company and fully dismissed the claim. On July 20, 2006, the Mangistau department of the MEP filed an appeal of the above court decision which was subsequently rejected by the Collegium on Civil Cases of the Astana City Court on August 9, 2006. The effect of the Collegium's rejection of the appeal is that the July 7 decision comes into force. Further to the August 9, 2006 decision the General Prosecutor's Office issued a supervisory protest with respect to the court judgment issued in favor of the Company on the payment of penalties for environmental damages. On November 16, 2006 the Supervisory Board of the Court of Astana dismissed the supervisory protest and upheld the prior judgments made in favor of the Company. The Mangistau MEP can still ask the Supreme Court to reconsider the case as a whole and has until August 9, 2007 to do so. Following the favorable outcome of the SIDECA proceedings and the appeal court decision, management has released the accrual of 11.4 billion Tenge in 2006. Notwithstanding these developments, there can be no assurances that additional fines will

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

20. Contingencies (continued)

not be assessed. Potential liabilities which may arise as a result of stricter enforcement of existing regulations, civil litigation or changes in legislation cannot be reasonably estimated. Other than those contingencies discussed here and obligations disclosed in Note 14, under existing legislation management believes that there are no probable or possible environmental liabilities which could have a material adverse effect on the Company's financial position, statement of income or cash flows.

Legal proceedings

During the year, the Company was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. There are no current legal proceedings or claims outstanding which management believes could have a material effect on the Company's financial position, statement of income or cash flows and which have not been accrued or disclosed in these financial statements.

Oilfield licenses

The Company is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its oilfield licenses and related subsoil use contracts. Management cooperates with governmental authorities to agree on remedial actions necessary to resolve any findings resulting from these reviews. Failure to comply with the terms of a license could result in fines, penalties, license limitation, suspension or revocation. The Company's management believes that any issues of non-compliance will be resolved through negotiations or corrective actions without any material effect on the Company's financial position, statement of income or cash flows.

The Company's oil and gas fields are located on land belonging to the Mangistau and Atyrau regional administrations. Licenses are issued by the Ministry of Energy and Mineral Resources of Kazakhstan and the Company pays royalties and excess profits tax to explore and produce oil and gas from these fields.

The principle licenses of the Company and their expiry dates are:

Field	Contract	Expiry date
Uzen (8 fields)	No. 40	2021
Emba (1 field)	No. 37	2021
Emba (1 field)	No. 61	2017
Emba (23 fields)	No. 211	2018
Emba (15 fields)	No. 413	2020

Management believes that the Company will be successful in its attempts to extend its licenses beyond the initial expiration date under existing legislation where such extension is in the economic interest of the Company.

Guarantees, pledges and covenants

At December 31, 2006 the Company had collateralized non-current assets related to loans received in the amount of approximately 24 billion Tenge (2005: approximately 23 billion Tenge). Also, some of the Company's financing agreements require compliance with certain financial ratios and other terms. Non-compliance with such terms could result in long-term debt becoming callable by the creditor. At the end of each period presented management believes that the Company was in full compliance with all terms of such agreements.

Notes to the Consolidated Financial Statements

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21. Commitments

Oilfield licenses and contracts

Year	Capital expenditures	Operational expenditures
2007	24,362,706	4,510,761
2008	1,471,190	4,240,886
2009	858,000	3,875,761
2010	841,000	3,875,126
2011	841,000	3,875,126
2012-2021	–	30,377,170
Total	28,373,896	50,754,830

Crude oil supply commitments

Under the provisions of a pre-export financing agreement the Company has committed to deliver 150,000 tons of crude oil per month to the lender until September 2009 for fair value consideration determined at the date of shipment. The Company has further obligations to supply oil and oil products to the local market under government directives (Note 19).

22. Subsequent events

On March 5, 2007 the Company announced an agreement to purchase a 50% share of JV KazGerMunai from National Company KazMunaiGas (see Note 9) for cash consideration of 133.3 billion Tenge. The independent non-executive directors unanimously approved the purchase, which is subject to satisfaction of a number of conditions including the approval of a majority of non-controlling shareholders including GDR holders at an Extraordinary General Meeting scheduled for April 12, 2007 in Astana. If approved, the transaction is expected to close during the second quarter of 2007.

This report has been signed below by the following persons on behalf of the Company and in the capacities indicated March 12, 2007.

Chief Executive Officer

Balzhanov A.K

Chief Financial Officer

Bekezhanova Zh.D.

Group Financial Controller

Drader Sh.

JSC EXPLORATION AND PRODUCTION KAZMUNAIGAS

Notes to the Consolidated Financial Statements

Tenge thousands unless otherwise stated

Contact information

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