

**Zhaikmunai LP**

Consolidated financial statements

*For the year ended December 31, 2012*

*with Independent auditors' report*

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## **Independent Auditors' Report**

To the participants of Zhaikmunai LP:

We have audited the accompanying consolidated financial statements of Zhaikmunai LP (the "Partnership") and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

### ***Management's responsibility for the consolidated financial statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***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 about 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 consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 at 31 December 2012, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Ernst & Young LLP*

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Paul Cohn  
Audit Partner

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Evgeny Zhemaletdinov  
Auditor / General Director  
Ernst & Young LLP

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

Auditor Qualification Certificate  
No. 0000553 dated 24 December 2003

12 March 2013

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

As at December 31, 2012

| <i>In thousands of US dollars</i>                  | <b>Note</b> | <b>2012</b>      | <b>2011</b>      |
|--|-------------|------------------|------------------|
| <b>ASSETS</b>                                      |             |                  |                  |
| <b>Non-current assets</b>                          |             |                  |                  |
| Property, plant and equipment                      | 5           | 1,222,665        | 1,120,453        |
| Restricted cash                                    | 11          | 3,652            | 3,076            |
| Advances for non-current assets                    | 6           | 25,278           | 3,368            |
|  |             | <b>1,251,595</b> | <b>1,126,897</b> |
| <b>Current assets</b>                              |             |                  |                  |
| Inventories  | 7           | 24,964           | 14,518           |
| Trade receivables                                  | 8           | 54,004           | 12,640           |
| Prepayments and other current assets               | 9           | 24,369           | 23,279           |
| Income tax prepayment                              |             | –                | 3,453            |
| Short-term investments                             | 10          | 50,000           | –                |
| Cash and cash equivalents                          | 11          | 197,730          | 125,393          |
|  |             | <b>351,067</b>   | <b>179,283</b>   |
| <b>TOTAL ASSETS</b>                                |             | <b>1,602,662</b> | <b>1,306,180</b> |
| <b>EQUITY AND LIABILITIES</b>                      |             |                  |                  |
| <b>Partnership capital and reserves</b>            |             |                  |                  |
| Partnership capital                                | 12          | 371,147          | 368,203          |
| Additional paid-in capital                         |             | 6,095            | 1,677            |
| Retained earnings and translation reserve          |             | 317,862          | 215,351          |
|  |             | <b>695,104</b>   | <b>585,231</b>   |
| <b>Non-current liabilities</b>                     |             |                  |                  |
| Long-term borrowings                               | 13          | 615,742          | 438,082          |
| Abandonment and site restoration liabilities       | 14          | 11,064           | 8,713            |
| Due to Government of Kazakhstan                    | 15          | 6,122            | 6,211            |
| Employee share option plan                         | 24          | 9,788            | 11,734           |
| Deferred tax liability                             | 23          | 148,932          | 146,674          |
|  |             | <b>791,648</b>   | <b>611,414</b>   |
| <b>Current liabilities</b>                         |             |                  |                  |
| Current portion of long term borrowings            | 13          | 7,152            | 9,450            |
| Trade payables                                     | 16          | 58,390           | 81,914           |
| Advances received                                  |             | 60               | 3,154            |
| Income tax payable                                 |             | 11,762           | –                |
| Current portion of Due to Government of Kazakhstan | 15          | 1,031            | 1,031            |
| Other current liabilities                          | 17          | 37,515           | 13,986           |
|  |             | <b>115,910</b>   | <b>109,535</b>   |
| <b>TOTAL EQUITY AND LIABILITIES</b>                |             | <b>1,602,662</b> | <b>1,306,180</b> |

Chief Executive Officer of the General Partner of Zhaikmunai LP

*Kai-Uwe Kessel*

Chief Financial Officer of the General Partner of Zhaikmunai LP

*Jan-Ru Muller**The accounting policies and explanatory notes on pages 5 through 28 are an integral part of these consolidated financial statements*

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME****For the year ended December 31, 2012**

| <i>In thousands of US dollars</i>              | <b>Note</b> | <b>2012</b>      | <b>2011</b> |
|--|-------------|------------------|-------------|
| <b>Revenue:</b>                                |             |                  |             |
| Revenue from export sales                      |             | <b>630,412</b>   | 284,548     |
| Revenue from domestic sales                    |             | <b>106,653</b>   | 16,289      |
|  | 18          | <b>737,065</b>   | 300,837     |
| Cost of sales                                  | 19          | <b>(238,224)</b> | (70,805)    |
| <b>Gross profit</b>                            |             | <b>498,841</b>   | 230,032     |
| General and administrative expenses            | 20          | <b>(61,549)</b>  | (36,405)    |
| Selling and transportation expenses            | 21          | <b>(103,604)</b> | (35,395)    |
| Finance costs                                  | 22          | <b>(50,118)</b>  | (4,717)     |
| Foreign exchange (loss)/gain, net              |             | <b>776</b>       | (389)       |
| Interest income                                |             | <b>698</b>       | 336         |
| Other expenses                                 |             | <b>(6,612)</b>   | (7,855)     |
| Other income                                   |             | <b>3,940</b>     | 3,365       |
| <b>Profit before income tax</b>                |             | <b>282,372</b>   | 148,972     |
| Income tax expense                             | 23          | <b>(120,363)</b> | (67,348)    |
| <b>Profit for the year</b>                     |             | <b>162,009</b>   | 81,624      |
| <b>Total comprehensive income for the year</b> |             | <b>162,009</b>   | 81,624      |

Chief Executive Officer of the General Partner of Zhaikmunai LP

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*Kai-Uwe Kessel*

Chief Financial Officer of the General Partner of Zhaikmunai LP

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*Jan-Ru Muller*

**CONSOLIDATED STATEMENT OF CASH FLOWS****For the year ended December 31, 2012**

| <i>In thousands of US dollars</i>                                  | <b>Note</b> | <b>2012</b>      | <b>2011</b> |
|--|-------------|------------------|-------------|
| <b>Cash flow from operating activities:</b>                        |             |                  |             |
| Profit before income tax   |             | <b>282,372</b>   | 148,972     |
| Adjustments for:   |             |                  |             |
| Depreciation, depletion and amortization                           | 19, 20      | <b>102,632</b>   | 19,843      |
| Accrual of share option expenses                                   |             | <b>2,470</b>     | 3,545       |
| Finance costs  | 22          | <b>50,118</b>    | 4,717       |
| Interest income  |             | <b>(698)</b>     | (336)       |
| Loss on disposal of property, plant and equipment                  |             | <b>79</b>        |             |
| Reversal of tax provision  |             | <b>–</b>         | (728)       |
| Foreign exchange (gain)/loss on investing and financing activities |             | <b>(745)</b>     | 202         |
| <b>Operating profit before working capital changes</b>             |             | <b>436,228</b>   | 176,215     |
| Changes in working capital:  |             |                  |             |
| Change in inventories  |             | <b>(10,446)</b>  | (8,879)     |
| Change in trade receivables  |             | <b>(41,364)</b>  | (11,004)    |
| Change in prepayments and other current assets                     |             | <b>(9,190)</b>   | (6,519)     |
| Change in trade payables   |             | <b>(2,673)</b>   | 10,497      |
| Change in advances received  |             | <b>(3,094)</b>   | (8,539)     |
| Payment of obligation to Government of Kazakhstan                  | 15          | <b>(1,030)</b>   | (1,033)     |
| Change in other current liabilities                                |             | <b>21,983</b>    | (3,390)     |
| <b>Cash generated from operations</b>                              |             | <b>390,414</b>   | 147,348     |
| Income tax paid  |             | <b>(94,173)</b>  | (13,210)    |
| Payments under Employee Share Option Plan                          |             | <b>(4,416)</b>   | (1,915)     |
| <b>Net cash flows from operating activities</b>                    |             | <b>291,825</b>   | 132,223     |
| <b>Cash flow from investing activities:</b>                        |             |                  |             |
| Interest income  |             | <b>698</b>       | 336         |
| Purchases of property, plant and equipment                         |             | <b>(210,283)</b> | (104,017)   |
| Prepayments for licenses   |             | <b>(10,089)</b>  | –           |
| Placement of short-term bank deposits                              |             | <b>(50,000)</b>  | –           |
| <b>Net cash used in investing activities</b>                       |             | <b>(269,674)</b> | (103,681)   |
| <b>Cash flow from financing activities:</b>                        |             |                  |             |
| Finance costs paid   |             | <b>(53,735)</b>  | (50,583)    |
| Issue of notes   | 13          | <b>560,000</b>   | –           |
| Fees paid on arrangement of notes and borrowings                   |             | <b>(7,259)</b>   | –           |
| Repayment of notes   | 13          | <b>(357,495)</b> | –           |
| Premium paid for early repayment of notes                          |             | <b>(38,409)</b>  | –           |
| Transfer to/(from) restricted cash                                 |             | <b>(576)</b>     | 667         |
| Treasury capital sold  |             | <b>7,362</b>     | 2,938       |
| Dividend paid  |             | <b>(59,498)</b>  | –           |
| Realized gain on derivative financial instrument                   |             | <b>–</b>         | (372)       |
| <b>Net cash (used in)/provided by financing activities</b>         |             | <b>50,390</b>    | (47,350)    |
| Effects of exchange rate changes on cash and cash equivalents      |             | <b>(204)</b>     | –           |
| <b>Net increase/(decrease) in cash and cash equivalents</b>        |             | <b>72,337</b>    | (18,808)    |
| <b>Cash and cash equivalents at the beginning of the year</b>      | 11          | <b>125,393</b>   | 144,201     |
| <b>Cash and cash equivalents at the end of the year</b>            | 11          | <b>197,730</b>   | 125,393     |

**NON-CASH TRANSACTIONS**

Non-cash transaction, including the following, has been excluded from the consolidated statement of cash flows:

**Offset of Corporate Income Tax with Value Added Tax**

During the year ended December 31, 2012, the Group offset tax liabilities in the amount of US\$ 15,499 thousand, including corporate income tax liability of US\$ 8,100 thousand with value added tax receivables

Chief Executive Officer of the General Partner of Zhaikmunai LP

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*Kai-Uwe Kessel*

Chief Financial Officer of the General Partner of Zhaikmunai LP

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*Jan-Ru Muller*

*The accounting policies and explanatory notes on pages 5 through 28 are an integral part of these consolidated financial statements*

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY****For the year ended December 31, 2012**

| <i>In thousands of US dollars</i>              | <b>Partnership capital</b> | <b>Treasury capital</b> | <b>Additional paid-in capital</b> | <b>Retained earnings and reserves</b> | <b>Total</b>   |
|--|----------------------------|-------------------------|-----------------------------------|---------------------------------------|----------------|
| <b>As at December 31, 2010</b>                 | <b>366,942</b>             | –                       | –                                 | <b>133,727</b>                        | <b>500,669</b> |
| Profit for the year                            | –                          | –                       | –                                 | 81,624                                | 81,624         |
| <b>Total comprehensive income for the year</b> | <b>–</b>                   | <b>–</b>                | <b>–</b>                          | <b>81,624</b>                         | <b>81,624</b>  |
| Issuance of treasury capital (GDRs)            | 7,048                      | (7,048)                 | –                                 | –                                     | –              |
| Transaction costs                              | –                          | –                       | (238)                             | –                                     | (238)          |
| Sale of treasury capital                       | –                          | 1,261                   | 1,915                             | –                                     | 3,176          |
| <b>As at December 31, 2011</b>                 | <b>373,990</b>             | <b>(5,787)</b>          | <b>1,677</b>                      | <b>215,351</b>                        | <b>585,231</b> |
| Profit for the year                            | –                          | –                       | –                                 | 162,009                               | 162,009        |
| <b>Total comprehensive income for the year</b> | <b>–</b>                   | <b>–</b>                | <b>–</b>                          | <b>162,009</b>                        | <b>162,009</b> |
| Issuance of treasury capital (GDRs)            | 6,884                      | (6,884)                 | –                                 | –                                     | –              |
| Sale of treasury capital                       | –                          | 2,944                   | 4,418                             | –                                     | 7,362          |
| Dividends                                      | –                          | –                       | –                                 | (59,498)                              | (59,498)       |
| <b>As at December 31, 2012</b>                 | <b>380,874</b>             | <b>(9,727)</b>          | <b>6,095</b>                      | <b>317,862</b>                        | <b>695,104</b> |

Chief Executive Officer of the General Partner of Zhaikmunai LP

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*Kai-Uwe Kessel*

Chief Financial Officer of the General Partner of Zhaikmunai LP

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*Jan-Ru Muller*



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the year ended December 31, 2012**

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**1. GENERAL**

Zhaikmunai LP is a Limited Partnership formed on August 29, 2007 pursuant to the Partnership Act 1909 of the Isle of Man. Zhaikmunai LP is registered in the Isle of Man with registered number 295P.

The registered address of Zhaikmunai LP is: 7th Floor, Harbour Court, Lord Street, Douglas, Isle of Man, IM1 4LN.

These consolidated financial statements were authorized for issue by Kai-Uwe Kessel, Chief Executive Officer of the General Partner of Zhaikmunai LP and by Jan-Ru Muller, Chief Financial Officer of the General Partner of Zhaikmunai LP on March 12, 2013.

These consolidated financial statements include the results of the operations of Zhaikmunai LP (“Partnership”) and its wholly owned subsidiaries Zhaikmunai Netherlands B.V. (formerly Frans Van Der Schoot B.V.), Zhaikmunai Finance B.V., Zhaikmunai International B.V., Claydon Industrial Limited (“Claydon”), Jubilata Investments Limited (“Jubilata”), Zhaikmunai LLP and Condensate Holdings LLP (“Condensate”). Zhaikmunai LP and its subsidiaries are hereinafter referred to as “the Group”. The Group’s operations comprise of a single operating segment and are primarily conducted through its oil and gas producing entity Zhaikmunai LLP located in Kazakhstan. The General Partner of Zhaikmunai LP is Zhaikmunai Group Limited, which is responsible for the management of the Group (Note 4).

Zhaikmunai LLP carries out its activities in accordance with the Contract for Additional Exploration, Production and Production-Sharing of Crude Hydrocarbons in the Chinarevskoye oil and gas condensate field (the “Contract”) dated October 31, 1997 between the State Committee of Investments of the Republic of Kazakhstan and Zhaikmunai LLP in accordance with the license MG No. 253D (the “License”) for the exploration and production of hydrocarbons in Chinarevskoye oil and gas condensate field.

On August 17, 2012 Zhaikmunai LLP signed Asset Purchase Agreements to acquire 100% of the subsoil use rights related to three oil and gas fields – Rostoshinskoye, Darjinskoye and Yuzhno-Gremyachinskoye – all located in the Western Kazakhstan region.

*License terms*

The term of the license of Zhaikmunai LLP originally included a 5-year exploration period and a 25-year production period. The exploration period was initially extended for an additional 4 years and then for a further 2 years according to the supplements to the Contract dated January 12, 2004 and June 23, 2005, respectively. In accordance with the supplement dated June 5, 2008, Tournaisian North reservoir entered into production period as at January 1, 2007. Following additional commercial discoveries during 2008, the exploration period under the license, other than for the Tournaisian horizons, was extended for an additional 3 year period, which expired on May 26, 2011. An application for further extension has been made.

The extensions to the exploration periods have not changed the license term, which will expire in 2031.

*Royalty payments*

Zhaikmunai LLP is required to make monthly royalty payments throughout the entire production period, at the rates specified in the Contract. Royalty rates depend on recovery levels and the phase of production and can vary from 3% to 7% of produced crude oil and from 4% to 9% of produced natural gas.

*Government “profit share”*

Zhaikmunai LLP makes payments to the Government of its “profit share” as determined in the Contract. The “profit share” depends on hydrocarbon production levels and varies from 10% to 40% of production after deducting royalties and reimbursable expenditures. Reimbursable expenditures include operating expenses, costs of additional exploration and development costs. Government “profit share” is expensed as incurred and paid in cash.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012**

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**2. BASIS OF PREPARATION AND CONSOLIDATION****Basis of preparation**

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by International Accounting Standards Board (“IASB”). The consolidated financial statements have been prepared based on a historical cost basis, except for certain financial instruments which are carried at fair value as stated in the accounting policies (Note 4). The consolidated financial statements are presented in US dollars and all values are rounded to the nearest thousands, except when otherwise indicated.

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires from management to exercise its judgment in the process of applying the Group’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 4.

**Basis of consolidation**

The consolidated financial statements comprise the financial statements of the Partnership and its subsidiaries as at December 31, 2012.

A subsidiary and a special purpose entity are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies for all Group entities. All intra-group balances, transactions, unrealised gains and losses resulting from intra-group transactions and dividends are eliminated in full.

*Subsidiaries*

Subsidiaries are all entities over which the Partnership 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 the effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Partnership controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Partnership and continue to be consolidated until the date that such control ceases.

*Purchases of controlling interests in subsidiaries from entities under common control*

Purchases of controlling interests in subsidiaries from entities under common control are accounted for using the pooling of interests method.

The assets and liabilities of the subsidiary transferred under common control are recorded at the carrying values reported in the consolidated financial statements of the parent. Any difference between the total book value of net assets and the consideration paid is accounted for in the consolidated financial statements as an adjustment to the shareholders’ equity.

These consolidated financial statements, including corresponding figures, are presented as if the subsidiary had been acquired by the Group on the date it was originally acquired by the controlling entity.

**3. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES****New and amended standards and interpretations**

The accounting policies adopted are consistent with those of the previous financial year, except for the following amendments to IFRS effective as at January 1, 2012:

- IAS 12 *Income Taxes (Amendment) – Deferred Taxes: Recovery of Underlying Assets*
- IFRS 1 *First-Time Adoption of International Financial Reporting Standards (Amendment) – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters* IFRS 7 *Financial Instruments: Disclosures (Amendments)*
- IFRS 7 *Financial Instruments : Disclosures – Enhanced Derecognition Disclosure Requirements*

The adoption of the standards is described below:

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**For the year ended December 31, 2012**

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**3. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)****New and amended standards and interpretations (continued)***IAS 12 Income Taxes (Amendment) – Deferred Taxes: Recovery of Underlying Assets*

The amendment clarified the determination of deferred tax on investment property measured at fair value and introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. It includes the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 should always be measured on a sale basis. The amendment is effective for annual periods beginning on or after January 1, 2012 and had no effect on the Group's financial position, performance or its disclosures.

*IFRS 1 First-Time Adoption of International Financial Reporting Standards (Amendment) – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters*

The IASB provided guidance on how an entity should resume presenting IFRS financial statements when its functional currency ceases to be subject to hyperinflation. The amendment is effective for annual periods beginning on or after July 1, 2011. The amendment had no impact on the Group.

*IFRS 7 Financial Instruments: Disclosures – Enhanced Derecognition Disclosure Requirements*

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Group's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about the entity's continuing involvement in derecognised assets to enable the users to evaluate the nature of, and risks associated with, such involvement. The amendment is effective for annual periods beginning on or after July 1, 2011. The Group does not have any assets with these characteristics so there has been no effect on the presentation of its financial statements.

**Standards issued but not yet effective**

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective.

*IAS 1 Presentation of Items of Other Comprehensive Income – Amendments to IAS 1*

The amendments to IAS 1 change the grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, net gain on hedge of net investment, exchange differences on translation of foreign operations, net movement on cash flow hedges and net loss or gain on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, actuarial gains and losses on defined benefit plans and revaluation of land and buildings). The amendment affects presentation only and has no impact on the Group's financial position or performance. The amendment becomes effective for annual periods beginning on or after July 1, 2012, and will therefore be applied in the Group's first annual report after becoming effective.

*IAS 19 Employee Benefits (Revised)*

The IASB has issued numerous amendments to IAS 19. These range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. These amendments are not expected to impact the Group's financial position or performance and become effective for annual periods beginning on or after January 1, 2013.

*IAS 28 Investments in Associates and Joint Ventures (as revised in 2011)*

As a consequence of the new IFRS 11 *Joint Arrangements*, and IFRS 12 *Disclosure of Interests in Other Entities*, IAS 28 *Investments in Associates*, has been renamed IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The revised standard becomes effective for annual periods beginning on or after January 1, 2013 and has no impact on Group's financial position or performance.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**For the year ended December 31, 2012**

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**3. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)****Standards issued but not yet effective (continued)***IAS 32 Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32*

These amendments clarify the meaning of “currently has a legally enforceable right to set-off”. The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. These amendments are not expected to impact the Group’s financial position or performance and become effective for annual periods beginning on or after January 1, 2014.

*IFRS 1 Government Loans – Amendments to IFRS 1*

These amendments require first-time adopters to apply the requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, prospectively to government loans existing at the date of transition to IFRS. Entities may choose to apply the requirements of IFRS 9 (or IAS 39, as applicable) and IAS 20 to government loans retrospectively if the information needed to do so had been obtained at the time of initially accounting for that loan. The exception would give first-time adopters relief from retrospective measurement of government loans with a below-market rate of interest. The amendment is effective for annual periods on or after January 1, 2013. The amendments have no impact on the Group.

*IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7*

These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity’s financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. These amendments will not impact the Group’s financial position or performance and become effective for annual periods beginning on or after January 1, 2013.

*IFRS 9 Financial Instruments: Classification and Measurement*

IFRS 9, as issued, reflects the first phase of the IASB’s work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after January 1, 2013, but *Amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued in December 2011, moved the mandatory effective date to January 1, 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will not have an impact on classification and measurements of Group’s financial assets and liabilities. The Group will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.

*IFRS 10 Consolidated Financial Statements, IAS 27 Separate Financial Statements*

IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also addresses the issues raised in SIC-12 *Consolidation – Special Purpose Entities*. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. Based on the preliminary analyses performed, IFRS 10 is not expected to have any impact on the currently held investments of the Group. This standard becomes effective for annual periods beginning on or after January 1, 2013.

*IFRS 11 Joint Arrangements*

IFRS 11 replaces IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly-controlled Entities – Non-monetary Contributions by Venturers*. IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. This standard becomes effective for annual periods beginning on or after January 1, 2013, and is to be applied retrospectively for joint arrangements held at the date of initial application. The application of this new standard will have no impact on the financial position of the Group.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**For the year ended December 31, 2012**

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**3. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)****Standards issued but not yet effective (continued)***IFRS 12 Disclosure of Interests in Other Entities*

IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required, but has no impact on the Group's financial position or performance. This standard becomes effective for annual periods beginning on or after January 1, 2013.

*IFRS 13 Fair Value Measurement*

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Group is currently assessing the impact that this standard will have on the financial position and performance, but based on the preliminary analyses, no material impact is expected. This standard becomes effective for annual periods beginning on or after January 1, 2013.

**Annual improvements May 2012**

These improvements will not have an impact on the Group, but include:

*IFRS 1 First-time Adoption of International Financial Reporting Standards*

This improvement clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS.

*IAS 1 Presentation of Financial Statements*

This improvement clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative information is the previous period.

*IAS 16 Property Plant and Equipment*

This improvement clarifies that major spare parts and servicing equipment that meet the definition of property, plant and equipment are not inventory.

*IAS 32 Financial Instruments, Presentation*

This improvement clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 *Income Taxes*.

*IAS 34 Interim Financial Reporting*

The amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. This clarification also ensures that interim disclosures are aligned with annual disclosures.

These improvements are effective for annual periods beginning on or after January 1, 2013.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012**

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**4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****Estimation and assumptions**

The key assumptions concerning the future, and other key sources of estimation uncertainty at the statement of financial position date, that have a significant risk of causing a material change to the carrying amounts of assets and liabilities are discussed below:

*Oil and gas reserves*

Oil and gas reserves are a material factor in the Group's computation of depreciation, depletion and amortization (the "DD&A"). The Group estimates its reserves of oil and gas in accordance with the methodology of the Society of Petroleum Engineers (the "SPE"). In estimating its reserves under SPE methodology, the Group 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 mainly on the amount of reliable geological and engineering data available at the time of the estimate and the interpretation of this data.

The relative degree of uncertainty can be conveyed by placing reserves into one of two principal classifications, either proved or unproved. Proved reserves are more certain to be recovered than unproved reserves and may be further sub-classified as developed and undeveloped to denote progressively increasing uncertainty in their recoverability. Estimates are reviewed and revised annually. Revisions occur due to the evaluation or re-evaluation of already available geological, reservoir or production data; availability of new data; or changes to underlying price assumptions. Reserve estimates may also be revised due to improved recovery projects, changes in production capacity or changes in development strategy. Proved developed reserves are used to calculate the unit of production rates for DD&A.

*Fair value of financial instruments*

Where the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flows model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

*Abandonment and site restoration liabilities*

The Group 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 Group 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*. Estimating the future closure costs involves significant estimates and judgments by management. Significant judgments in making such estimates include estimate of discount rate and timing of cash flow. The management made its estimate based on the assumption that cash flow will take place at the expected end of the licenses.

Management of the Group believes that the interest rates on its debt financing shall provide best estimates of applicable discount rate. The discount rate shall be applied to the nominal amounts the managements expect to spend on site restoration in the future. The Group 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, 2012 and 2011 were 7% and 10% respectively. Movements in the provision for decommissioning liability are disclosed in Note 14.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012**

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**4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Estimation and assumptions (continued)****Foreign currency translation**

Each entity in the Group determines its own functional currency and items included in the consolidated financial statements of each entity are measured using that functional currency. The functional currency of the Partnership and its subsidiaries is the United States dollar (the "US dollar" or "US\$").

*Transactions and balances denominated in foreign currencies*

Transactions in foreign currencies are initially recorded by the Group at their respective functional currency rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency spot rate of exchange ruling at the reporting date. All differences are taken to the profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

**Property, plant and equipment***Exploration expenditure*

Geological and geophysical exploration costs are charged against income as incurred. Costs directly associated with exploration wells 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 and materials and fuel used, rig costs and payments made to contractors and asset retirement obligation fees. 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. There was no exploration expenditure expensed during 2012 (2011: Nil).

*Oil and gas properties*

Expenditure on the construction, installation or completion of infrastructure facilities such as treatment facilities, pipelines and the drilling of development wells, is capitalized within property, plant and equipment as oil and gas properties. 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 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 are stated at cost less accumulated depreciation, depletion and impairment.

All capitalized costs of oil and gas properties are amortized using the unit-of-production method based on estimated proved developed reserves of the field, except the Group depreciates its oil pipeline and oil loading terminal on a straight line basis over the life of the license. In the case of assets that have a useful life shorter than the lifetime of the field the straight line method is applied.

*Oil and gas reserves*

Proved oil and gas reserves are estimated quantities of commercially viable hydrocarbons which existing geological, geophysical and engineering data show to be recoverable in future years from known reservoirs.

The Group uses the reserve estimates provided by an independent appraiser to assess the oil and gas reserves of its oil and gas fields. These reserve quantities are used for calculating the unit of production depreciation rate as it reflects the expected pattern of consumption of future economic benefits by the Group.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012****4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Impairment of non-financial assets**

The Group 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 Group 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 the 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.

**Other properties**

All other property, plant and equipment are stated at historical cost less accumulated depreciation and impairment. Historical cost includes expenditures that are directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the profit or loss during the year in which they are incurred.

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

|                            | <b>Years</b> |
|----------------------------|--------------|
| Buildings and Improvements | 7-15         |
| Vehicles                   | 8            |
| Machinery and equipment    | 3-13         |
| Other                      | 3-10         |

**Borrowing costs**

The Group capitalizes borrowing costs on qualifying assets. Assets qualifying for borrowing costs capitalization include all assets under construction that are not being depreciated, depleted, or amortized, provided that work is in progress at that time. Qualifying assets mostly include wells and other operations field infrastructure under construction. Capitalized borrowing costs are calculated by applying the capitalization rate to the expenditures on qualifying assets. The capitalization rate is the weighted average of the borrowing costs applicable to the Group's borrowings that are outstanding during the period.

**Inventories**

Inventories are stated at the lower of cost or net realizable value ("NRV"). Cost of oil, gas condensate and liquefied petroleum gas ("LPG") is determined on the weighted-average method based on the production cost including the relevant expenses on depreciation, depletion and impairment and overhead costs based on production volume. Net realizable value is the estimated selling price in the ordinary course of business, less selling expenses.

**Provisions**

Provisions are recognized when the Group 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 of the amount of the obligation can be made.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012**

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**4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Provisions (continued)***Abandonment and site restoration (decommissioning)*

Provision for decommissioning is recognized in full, on a discounted cash flow basis, when the Group has an obligation to dismantle and remove a facility or an item of plant and to restore the site on which it is located, and when a reasonable estimate of that provision can be made. 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 interest rates for emerging market debt adjusted for risks specific to the Kazakhstan market. The unwinding of the discount related to the obligation is recorded in finance costs. A corresponding amount equivalent to the provision is also recognized as part of the cost of the related property, plant and equipment. This asset is subsequently depreciated as part of the capital costs of the oil and gas properties on a unit-of-production basis.

Changes in the measurement of an existing decommissioning liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or changes to the discount rate:

- (a) are added to, or deducted from, the cost of the related asset in the current period. If deducted from the cost of the asset the amount deducted shall not exceed its carrying amount. If a decrease in the provision exceeds the carrying amount of the asset, the excess is recognized immediately in the profit or loss; and
- (b) if the adjustment results in an addition to the cost of an asset, the Group considers whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the Group tests the asset for impairment by estimating its recoverable amount, and accounts for any impairment loss in accordance with IAS 36.

**Financial assets***Initial recognition and measurement*

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition.

All financial assets are recognised initially at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the marketplace (regular way trades) are recognised on the trade date, i.e., the date that the Group commits to purchase or sell the asset.

The Group's financial assets include cash and short-term deposits, trade and other receivables.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate method (EIR), less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the EIR.

The EIR amortisation is included in finance income in the statement of comprehensive income. The losses arising from impairment are recognised in the statement of comprehensive income in finance costs.

*Accounts receivable*

Accounts receivables are recognized and carried at original invoice amount less an allowance for any uncollectible amounts. An estimate for uncollectible amounts is made when collection of the full amount is no longer probable. These estimates are reviewed periodically, and as adjustments become necessary, they are reported as expense (credit) in the period in which they become known.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012**

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**4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Financial assets (continued)***Derecognition*

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

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

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset.

In that case, the Group also recognizes an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

*Impairment of financial assets*

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

*Financial assets carried at amortized cost*

For financial assets carried at amortized cost the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has 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 yet been incurred). The present value of the estimated future cash flows is discounted at the financial assets original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the profit or loss. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of finance income in the profit or loss. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to finance costs in the profit or loss.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012**

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**4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Financial liabilities***Initial recognition and measurement*

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial liabilities at initial recognition. All financial liabilities are recognized initially at fair value and in the case of loans and borrowings, net of directly attributable transaction costs.

The Group's financial liabilities include trade and other payables and borrowings.

*Subsequent measurement*

After initial recognition, interest bearing borrowings are subsequently measured at amortized cost using the effective interest rate method (EIR). Gains and losses are recognized in the profit or loss when the liabilities are derecognized as well as through the EIR amortization process.

Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the EIR. The EIR amortization is included in finance cost in the profit or loss.

*Derecognition*

A financial liability is derecognized 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 recognized in the profit or loss.

*Offsetting of financial instruments*

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

*Fair value of financial instruments*

The fair value of financial instruments that are traded in active markets at each reporting date is determined by reference to quoted market prices or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques. Such techniques may include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; discounted cash flow analysis or other valuation models.

An analysis of fair values of financial instruments and further details as to how they are measured are provided in Note 27.

**Derivative financial instruments and hedging**

The Group uses a hedging contract for oil export sales to cover part of its risks associated with oil price fluctuations. Such derivative financial instruments are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently premeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivatives during the year that do not qualify for hedge accounting are taken directly to profit or loss.

The fair value of financial instruments contracts is determined by reference to market values for similar instruments.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012**

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**4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Taxation**

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability 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 utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted at the reporting 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.

**Revenue recognition**

The Group sells crude oil, gas condensate and LPG under short-term agreements priced by reference to Platt's and/or Argus' index quotations and adjusted for freight, insurance and quality differentials where applicable.

Revenue from the sale of crude oil, gas condensate and LPG is recognized when delivery has taken place and risks and rewards of ownership have passed to the customer.

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**

For the year ended December 31, 2012

**5. PROPERTY, PLANT AND EQUIPMENT**

The movement of property, plant and equipment for the years ended December 31, 2011 and 2012 was as follows:

| <i>In thousand of US dollar</i>                                      | Oil and gas properties |                | Total oil and gas properties | Non oil and gas properties |                       |              |              | Total non oil gas properties | Total            |
|--|------------------------|----------------|------------------------------|----------------------------|-----------------------|--------------|--------------|------------------------------|------------------|
|  | Working assets         | CIP            |                              | Buildings                  | Machinery & equipment | Vehicles     | Others       |                              |                  |
| <b>Balance at December 31, 2010, net of accumulated depreciation</b> | <b>456,005</b>         | <b>490,825</b> | <b>946,830</b>               | <b>2,614</b>               | <b>3,325</b>          | <b>1,504</b> | <b>1,638</b> | <b>9,081</b>                 | <b>955,911</b>   |
| Additions  | 6,318                  | 180,042        | 186,360                      | 2,714                      | 789                   | 40           | 1,360        | 4,903                        | 191,263          |
| Transfers  | 464,860                | (465,625)      | (765)                        | 765                        | –                     | –            | –            | 765                          | –                |
| Disposal   | (38)                   | –              | (38)                         | (123)                      | (98)                  | (234)        | (181)        | (636)                        | (674)            |
| Depreciation charge  | (23,967)               | –              | (23,967)                     | (482)                      | (1,097)               | (204)        | (297)        | (2,080)                      | (26,047)         |
| <b>Balance at December 31, 2011, net of accumulated depreciation</b> | <b>903,178</b>         | <b>205,242</b> | <b>1,108,420</b>             | <b>5,488</b>               | <b>2,919</b>          | <b>1,106</b> | <b>2,520</b> | <b>12,033</b>                | <b>1,120,453</b> |
| Additions  | 5,816                  | 192,032        | 197,848                      | 609                        | 4,062                 | 378          | 2,026        | 7,075                        | 204,923          |
| Transfers  | 192,872                | (194,486)      | (1,614)                      | 358                        | 1,245                 | –            | 11           | 1,614                        | –                |
| Disposals  | (61)                   | –              | (61)                         | –                          | (143)                 | –            | (201)        | (344)                        | (405)            |
| Disposals depreciation   | 6                      | –              | 6                            | –                          | 140                   | –            | 180          | 320                          | 326              |
| Depreciation charge  | (99,209)               | –              | (99,209)                     | (848)                      | (1,727)               | (314)        | (534)        | (3,423)                      | (102,632)        |
| <b>Balance at December 31, 2012, net of accumulated depreciation</b> | <b>1,002,602</b>       | <b>202,788</b> | <b>1,205,390</b>             | <b>5,607</b>               | <b>6,496</b>          | <b>1,170</b> | <b>4,002</b> | <b>17,275</b>                | <b>1,222,665</b> |
| Cost at December 31, 2011  | 1,010,746              | 205,242        | 1,215,988                    | 7,594                      | 5,813                 | 2,625        | 4,017        | 20,049                       | 1,236,037        |
| Accumulated depreciation   | (107,568)              | –              | (107,568)                    | (2,106)                    | (2,894)               | (1,519)      | (1,497)      | (8,016)                      | (115,584)        |
| <b>Balance at December 31, 2011, net of accumulated depreciation</b> | <b>903,178</b>         | <b>205,242</b> | <b>1,108,420</b>             | <b>5,488</b>               | <b>2,919</b>          | <b>1,106</b> | <b>2,520</b> | <b>12,033</b>                | <b>1,120,453</b> |
| Cost at December 31, 2012  | 1,209,373              | 202,788        | 1,412,161                    | 8,561                      | 10,977                | 3,003        | 5,853        | 28,394                       | 1,440,555        |
| Accumulated depreciation   | (206,771)              | –              | (206,771)                    | (2,954)                    | (4,481)               | (1,833)      | (1,851)      | (11,119)                     | (217,890)        |
| <b>Balance at December 31, 2012, net of accumulated depreciation</b> | <b>1,002,602</b>       | <b>202,788</b> | <b>1,205,390</b>             | <b>5,607</b>               | <b>6,496</b>          | <b>1,170</b> | <b>4,002</b> | <b>17,275</b>                | <b>1,222,665</b> |

The category "Oil and Gas properties" represents mainly wells, oil and gas treatment facilities, oil transportation and other related assets.

The depletion rate for oil and gas working assets was 11.96% and 4.8% in 2012 and 2011, respectively. The unamortized costs of oil and gas properties include all capitalized costs net of accumulated amortization.

The Group engaged independent petroleum engineers to perform a reserves evaluation as at December 31, 2011. Depletion has been calculated using the unit of production method based on these reserves estimates.

The Group incurred borrowing costs including amortization of arrangement fee of US\$ 74,401 thousand, and US\$ 54,647 thousand for the years ended December 31, 2012 and 2011. For the same periods, the Group capitalized borrowing costs totaling US\$ 26,080 thousand and US\$ 51,590 thousand, at capitalization rates of 15.65% and 11.73%, respectively.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012****6. ADVANCES FOR NON-CURRENT ASSETS**

As at December 31, advances for non-current assets comprised the following:

| <i>In thousands of US dollars</i>             | <b>2012</b>   | 2011  |
|---|---------------|-------|
| Advances for purchase of licenses             | <b>10,089</b> | –     |
| Advances for pipes and construction materials | <b>9,126</b>  | 485   |
| Advances for construction services            | <b>6,063</b>  | 2,883 |
|   | <b>25,278</b> | 3,368 |

**7. INVENTORIES**

As at December 31, inventories comprised the following:

| <i>In thousands of US dollars</i> | <b>2012</b>   | 2011   |
|-----------------------------------|---------------|--------|
| Materials and supplies            | <b>17,127</b> | 9,979  |
| Gas condensate                    | <b>4,633</b>  | 2,161  |
| Crude oil                         | <b>2,750</b>  | 2,081  |
| LPG                               | <b>454</b>    | 297    |
|                                   | <b>24,964</b> | 14,518 |

As at December 31, 2012 and 2011 inventories are carried at cost.

**8. TRADE RECEIVABLES**

As at December 31, 2012 and 2011 trade receivables were denominated in US dollars, their collection period was less than 30 days and they were not impaired.

**9. PREPAYMENTS AND OTHER CURRENT ASSETS**

As at December 31, prepayments and other current assets comprised the following:

| <i>In thousands of US dollars</i> | <b>2012</b>   | 2011   |
|-----------------------------------|---------------|--------|
| Advances paid                     | <b>12,613</b> | 9,356  |
| VAT receivable                    | <b>10,782</b> | 12,500 |
| Other                             | <b>974</b>    | 1,423  |
|                                   | <b>24,369</b> | 23,279 |

Advances paid consist primarily of prepayments made to service providers.

**10. SHORT-TERM INVESTMENTS**

As at December 31, 2012 short-term investments were represented by an interest bearing short-term deposit placed by Zhaikmunai International B.V. on November 16, 2012 at for a six-month period.

**11. CASH AND CASH EQUIVALENTS**

| <i>In thousands of US dollars</i>                 | <b>2012</b>    | 2011    |
|---|----------------|---------|
| Bank deposits with maturity less than three month | <b>100,000</b> | –       |
| Current accounts in US dollars                    | <b>84,615</b>  | 123,112 |
| Current accounts in tenge                         | <b>10,595</b>  | 692     |
| Cash accounts in other currencies                 | <b>2,520</b>   | 1,589   |
|   | <b>197,730</b> | 125,393 |

The Group has restricted cash accounts as liquidation fund deposit in the amount of US\$ 3,652 thousand with Kazkommertsbank JSC in Kazakhstan (December 31, 2011: US\$ 3,066 thousand), which is kept as required by the license for abandonment and site restoration liabilities of the Group.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012****12. PARTNERSHIP CAPITAL**

The ownership interests in Zhaikmunai LP consist of (a) Common Units, which represent a fractional entitlement in respect of all of the limited partner interests in Zhaikmunai LP and (b) the interest of the General Partner. At any general meeting every holder of Common Units shall have one vote for each Common Unit of which he or she is the holder. Under the Partnership Agreement, distributions to limited partners will be made either as determined by the General Partner in its sole discretion or following the approval of a majority of limited partners provided such amount does not exceed the amount recommended by the General Partner. Any distributions to Zhaikmunai LP's limited partners will be made on a pro rata basis according to their respective partnership interests in Zhaikmunai LP and will be paid only to the recorded holders of Common Units.

In September 2012, the Board of Directors of the General Partner approved the payment of Zhaikmunai LP's inaugural distribution of U.S.\$ 0.32 per Common Unit to the holders of Zhaikmunai LP Common Units, representing a cash distribution of U.S.\$ 60,219 thousand (equal to approximately 20% of retained earnings at June 30, 2012). The distribution (in the amount of US\$ 59,498 thousand, since the ESOP Trustee referenced in the following paragraph declined the distribution) was paid on October 2, 2012 to Common Unit holders on the register of partners and interests at the close of business on October 1, 2012.

As at December 31, 2011 Zhaikmunai LP had issued 186,761,882 common units, all but 10 of which are represented by GDRs. During the year ended December 31, 2012 Zhaikmunai LP issued 1,421,076 new common units (represented by GDRs) to support its obligations to employees under the Employee Share Option Plan (ESOP). The issued GDRs are held by Ogier Employee Benefit Trustee Limited ("the Trustee"), which upon request from employees to exercise options, sells GDRs on the market and settles respective obligations under the ESOP. This trust constitutes a special purpose entity under IFRS and therefore, these newly issued GDRs are recorded as treasury capital of Zhaikmunai LP. During the year ended December 31, 2012 735,894 share options were exercised by employees (year ended December 31, 2011: 315,341 GDRs).

The movements in GDR's during the years ended December 31, 2012 and 2011 were as follows:

| <i>In thousands of US dollar</i> | <b>2012</b>        | <b>2011</b>        |
|----------------------------------|--------------------|--------------------|
| Balance at January 1,            | <b>186,761,882</b> | 185,000,000        |
| Issued during the year           | <b>1,421,076</b>   | 1,761,882          |
| <b>Balance at December 31,</b>   | <b>188,182,958</b> | <b>186,761,882</b> |

**13. BORROWINGS**

Borrowings comprise the following as at December 31:

| <i>In thousands of US dollar</i>    | <b>2012</b>    | <b>2011</b>    |
|-------------------------------------|----------------|----------------|
| Notes payable with maturity in 2019 | <b>530,425</b> | –              |
| Notes payable with maturity in 2015 | <b>92,469</b>  | 447,532        |
|                                     | <b>622,894</b> | 447,532        |
| Less: amounts due within 12 months  | <b>(7,152)</b> | (9,450)        |
| <b>Amounts due after 12 months</b>  | <b>615,742</b> | <b>438,082</b> |

**2015 Notes**

On October 19, 2010 Zhaikmunai Finance B.V. (the "2015 Initial Issuer") issued US\$ 450,000 thousand notes (the "2015 Notes").

On February 28, 2011 Zhaikmunai LLP (the "2015 Issuer") replaced the 2015 Initial Issuer of the 2015 Notes, whereupon it assumed all of the obligations of the 2015 Initial Issuer under the 2015 Notes.

The 2015 Notes bear interest at the rate of 10.50% per year. Interest on the 2015 Notes is payable on April 19 and October 19 of each year, beginning on April 19, 2011. Prior to October 19, 2013, the 2015 Issuer may, at its option, on any one or more occasions redeem up to 35% of the aggregate principal amount of the 2015 Notes with the net cash proceeds of one or more equity offerings at a redemption price of 110.50% of the principal amount thereof, plus accrued and unpaid interest, if any, to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date); provided that (1) at least 65% of the original principal amount of the 2015 Notes (including Additional Notes as defined in the indenture relating to the 2015 Notes) remains outstanding after each such redemption; and (2) the redemption occurs within 90 days after the closing of the related equity offering.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012**

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**13. BORROWINGS (continued)****2015 Notes (continued)**

In addition, the 2015 Notes may be redeemed, in whole or in part, at any time prior to October 19, 2013 at the option of the 2015 Issuer upon not less than 30 nor more than 60 days' prior notice mailed by first-class mail to each holder of 2015 Notes at its registered address, at a redemption price equal to 100% of the principal amount of the 2015 Notes redeemed plus the Applicable Premium (as defined below) as of, and accrued and unpaid interest to, the applicable redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date). Applicable Premium means, with respect to any 2015 Note on any applicable redemption date, the greater of: (1) 1.0% of the principal amount of such 2015 Note; and (2) the excess, if any, of: (a) the present value at such redemption date of (i) the redemption price of such 2015 Note at October 19, 2013 plus (ii) all required interest payments (excluding accrued and unpaid interest to such redemption date) due on such 2015 Note through October 19, 2013 computed using a discount rate equal to the United States treasury rate as of such redemption date plus 50 basis points; over (b) the principal amount of such 2015 Note.

The 2015 Notes are jointly and severally guaranteed (the "2015 Guarantees") on a senior basis by Zhaikmunai LP and all of its subsidiaries other than the 2015 Issuer (the "2015 Guarantors"). The 2015 Notes are the 2015 Issuer's and the 2015 Guarantors' senior obligations and rank equally with all of the 2015 Issuer's and the 2015 Guarantors' other senior indebtedness. The 2015 Notes and the 2015 Guarantees have the benefit of first-priority pledges over the shares of Zhaikmunai Finance B.V. and Zhaikmunai Netherlands B.V.

On October 19, 2012, Zhaikmunai International B.V. commenced a cash tender offer (the "Tender Offer") to purchase any and all of the 2015 Notes. US\$ 357,495 thousand aggregate principal amount of the 2015 Notes had been tendered into the Tender Offer, representing approximately 77% of the outstanding 2015 Notes, by the time the Tender Offer for 2015 Notes expired on November 19, 2012. The holders of US\$ 200,732 thousand 2015 Notes that accepted the Tender Offer have subscribed to the 2019 Notes of the same amount.

**2019 Notes**

On November 13, 2012, Zhaikmunai International B.V. (the "2019 Initial Issuer") issued US\$ 560,000 thousand notes (the "2019 Notes").

Under the terms of the indenture relating to the 2019 Notes, Zhaikmunai LLP is permitted, subject to certain conditions, to be substituted for the 2019 Initial Issuer as issuer of the 2019 Notes.

The 2019 Notes bear interest at the rate of 7.125% per year. Interest on the 2019 Notes is payable on May 14 and November 13 of each year, beginning on May 14, 2013. Prior to November 13, 2016, the 2019 Issuer may, at its option, on any one or more occasions redeem up to 35% of the aggregate principal amount of the 2019 Notes with the net cash proceeds of one or more equity offerings at a redemption price of 107.125% of the principal amount thereof, plus accrued and unpaid interest, if any, to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date); provided that (1) at least 65% of the original principal amount of the 2019 Notes (including Additional Notes as defined in the indenture relating to the 2019 Notes) remains outstanding after each such redemption; and (2) the redemption occurs within 90 days after the closing of the related equity offering.

In addition, the 2019 Notes may be redeemed, in whole or in part, at any time prior to November 13, 2016 at the option of the 2019 Issuer upon not less than 30 nor more than 60 days' prior notice mailed by first-class mail to each holder of 2019 Notes at its registered address, at a redemption price equal to 100% of the principal amount of the 2019 Notes redeemed plus the Applicable Premium (as defined below) as of, and accrued and unpaid interest to, the applicable redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date). Applicable Premium means, with respect to any 2019 Note on any applicable redemption date, the greater of: (1) 1.0% of the principal amount of such 2019 Note; and (2) the excess, if any, of: (a) the present value at such redemption date of (i) the redemption price of such 2019 Note at November 13, 2016 plus (ii) all required interest payments (excluding accrued and unpaid interest to such redemption date) due on such 2019 Note through November 13, 2016 computed using a discount rate equal to the United States treasury rate as of such redemption date plus 50 basis points; over (b) the principal amount of such 2019 Note.

The 2019 Notes are jointly and severally guaranteed (the "2019 Guarantees") on a senior basis by Zhaikmunai LP and all of its subsidiaries other than the 2019 Issuer (the "2019 Guarantors"). The 2019 Notes are the 2019 Issuer's and the 2019 Guarantors' senior obligations and rank equally with all of the 2019 Issuer's and the 2019 Guarantors' other senior indebtedness. The 2019 Notes and the 2019 Guarantees do not have the benefit of first-priority pledges over the shares of Zhaikmunai Finance B.V. and Zhaikmunai Netherlands B.V.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012****14. ABANDONMENT AND SITE RESTORATION LIABILITIES**

The summary of changes in abandonment and site restoration liabilities during the years ended December 31 are as follows:

| <i>In thousands of US dollar</i>                                    | <b>2012</b>   | <b>2011</b> |
|---|---------------|-------------|
| Abandonment and site restoration liability as at January 1          | <b>8,713</b>  | 4,543       |
| Unwinding of discount (Note 22)                                     | <b>847</b>    | 706         |
| Additional provision  | <b>1,743</b>  | 952         |
| Change in estimates   | <b>(239)</b>  | 2,512       |
| <b>Abandonment and site restoration liability as at December 31</b> | <b>11,064</b> | 8,713       |

The long-term inflation and discount rates used to determine the abandonment and site restoration liabilities at December 31, 2012 were 7% and 10%, respectively (2011: 7% and 10%).

**15. DUE TO GOVERNMENT OF KAZAKHSTAN**

The amount due to Government of the Republic of Kazakhstan has been recorded to reflect the present value of a liability in relation to the expenditures made by the Government in the time period prior to signing the Contract that were related to exploration of the Contract territory and the construction of surface facilities in fields discovered therein and that are reimbursable by the Group to the Government during the production period. The total amount of liability due to Government as stipulated by the Contract is US\$ 25,000 thousand.

Repayment of this liability commenced in 2008 with the first payment of US\$ 1,030 thousand in March 2008 and with further payments by equal quarterly instalments of US\$ 258 thousand until May 26, 2031. The liability was discounted at 13%.

The balances as at December 31, and changes in the amount due to Government of Kazakhstan for the year were as follows:

| <i>In thousands of US dollar</i>                         | <b>2012</b>    | <b>2011</b> |
|--|----------------|-------------|
| Due to Government of Kazakhstan as at January 1          | <b>7,242</b>   | 7,321       |
| Unwinding of discount                                    | <b>942</b>     | 954         |
| Paid during the year                                     | <b>(1,031)</b> | (1,033)     |
|  | <b>7,153</b>   | 7,242       |
| Less: current portion of due to Government of Kazakhstan | <b>(1,031)</b> | (1,031)     |
| <b>Due to Government of Kazakhstan at December 31</b>    | <b>6,122</b>   | 6,211       |

**16. TRADE PAYABLES**

| <i>In thousands of US dollars</i>              | <b>2012</b>   | <b>2011</b> |
|--|---------------|-------------|
| Tenge denominated trade payables               | <b>48,622</b> | 79,424      |
| US dollar denominated trade payables           | <b>6,659</b>  | 1,367       |
| Trade payables denominated in other currencies | <b>3,109</b>  | 1,123       |
|  | <b>58,390</b> | 81,914      |

**17. OTHER CURRENT LIABILITIES**

| <i>In thousands of US dollars</i>              | <b>2012</b>   | <b>2011</b> |
|--|---------------|-------------|
| Taxes payable, other than corporate income tax | <b>24,650</b> | 3,459       |
| Training liability accrual                     | <b>9,256</b>  | 7,398       |
| Due to employees                               | <b>1,180</b>  | 973         |
| Pension obligation                             | <b>162</b>    | 138         |
| Other  | <b>2,267</b>  | 2,018       |
|  | <b>37,515</b> | 13,986      |

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012****18. REVENUE**

| <i>In thousands of US dollars</i> | <b>2012</b>    | 2011    |
|-----------------------------------|----------------|---------|
| Oil and gas condensate            | <b>587,371</b> | 289,947 |
| Gas products                      | <b>149,694</b> | 10,890  |
|                                   | <b>737,065</b> | 300,837 |

In November 2011 the Group started recording revenue from sales of products from the gas treatment unit, which allows the Group to produce gas condensate, LPG and gas. During 2012 the revenue from sales to two major customers amounted to US\$ 268,643 thousand and US\$ 222,150 thousand, respectively (2011: US\$ 227,043 thousand and nil, respectively).

**19. COST OF SALES**

| <i>In thousands of US dollars</i>        | <b>2012</b>    | 2011    |
|--|----------------|---------|
| Depreciation, depletion and amortization | <b>101,374</b> | 19,448  |
| Repair, maintenance and other services   | <b>55,470</b>  | 16,637  |
| Royalties                                | <b>34,195</b>  | 8,684   |
| Payroll and related taxes                | <b>18,409</b>  | 9,233   |
| Government profit share                  | <b>7,899</b>   | 1,825   |
| Well workover costs                      | <b>7,639</b>   | 4,000   |
| Other transportation services            | <b>5,350</b>   | 2,737   |
| Materials and supplies                   | <b>5,332</b>   | 4,952   |
| Management fees                          | <b>1,880</b>   | 1,789   |
| Environmental levies                     | <b>1,614</b>   | 817     |
| Change in stock                          | <b>(3,298)</b> | (1,592) |
| Other                                    | <b>2,360</b>   | 2,275   |
|  | <b>238,224</b> | 70,805  |

During 2011 depreciation capitalized within the cost of goods sold as a result of test production of the gas treatment unit amounted to US\$ 6,484 thousand.

**20. GENERAL AND ADMINISTRATIVE EXPENSES**

| <i>In thousands of US dollars</i>    | <b>2012</b>   | 2011   |
|--------------------------------------|---------------|--------|
| Social program                       | <b>21,818</b> | 1,064  |
| Management fees                      | <b>13,497</b> | 9,949  |
| Payroll and related taxes            | <b>4,966</b>  | 4,295  |
| Training                             | <b>4,118</b>  | 3,215  |
| Professional services                | <b>4,012</b>  | 5,973  |
| Business travel                      | <b>2,739</b>  | 4,114  |
| Employee share option plan (Note 24) | <b>2,470</b>  | 3,545  |
| Insurance fees                       | <b>1,403</b>  | 743    |
| Depreciation and amortization        | <b>1,258</b>  | 395    |
| Bank charges                         | <b>1,069</b>  | 625    |
| Other taxes                          | <b>987</b>    | 261    |
| Communication                        | <b>824</b>    | 718    |
| Sponsorship                          | <b>721</b>    | 525    |
| Materials and supplies               | <b>602</b>    | 624    |
| Lease payments                       | <b>406</b>    | 352    |
| Provision for tax claims             | <b>-</b>      | (728)  |
| Other                                | <b>659</b>    | 735    |
|                                      | <b>61,549</b> | 36,405 |

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**

For the year ended December 31, 2012

**21. SELLING AND TRANSPORTATION EXPENSES**

| <i>In thousands of US dollar</i> | 2012           | 2011          |
|----------------------------------|----------------|---------------|
| Transportation costs             | 73,973         | 29,655        |
| Loading and storage costs        | 21,622         | 1,441         |
| Payroll and related taxes        | 2,330          | 1,413         |
| Management fees                  | 1,882          | 1,071         |
| Other                            | 3,797          | 1,815         |
|                                  | <b>103,604</b> | <b>35,395</b> |

**22. FINANCE COSTS**

| <i>In thousands of US dollar</i>                                    | 2012          | 2011         |
|---|---------------|--------------|
| Interest expense on borrowing                                       | 48,329        | 3,057        |
| Unwinding of discount on amounts Due to Government                  | 941           | 954          |
| Unwinding of discount on Abandonment and Site Restoration Liability | 848           | 706          |
|   | <b>50,118</b> | <b>4,717</b> |

**23. INCOME TAX EXPENSES**

The provision for income taxes consisted of the following:

| <i>In thousands of US dollar</i> | 2012           | 2011          |
|----------------------------------|----------------|---------------|
| Current income tax expense       | 118,105        | 21,497        |
| Deferred income tax expense      | 2,258          | 45,851        |
| <b>Total income tax expense</b>  | <b>120,363</b> | <b>67,348</b> |

As at December 31, 2012, the Group's profits were assessed for income taxes only in the Republic of Kazakhstan. A reconciliation between tax expense and the product of accounting profit multiplied by the Kazakhstani tax rate applicable to the license for the year ended December 31 is as follows:

| <i>In thousands of US dollar</i>                               | 2012           | 2011          |
|--|----------------|---------------|
| Profit before income tax                                       | 282,372        | 148,972       |
| Statutory tax rate   | 30%            | 30%           |
| <b>Expected tax provision</b>                                  | <b>84,712</b>  | <b>44,692</b> |
| Non-deductible interest expense on borrowings                  | 26,579         | 22,385        |
| Non-assessable income  | (4,223)        | (4,755)       |
| Non-deductible other tax expenses                              | 5,243          | –             |
| Change of the tax base   | 2,312          | 704           |
| Non-deductible social expenditures                             | 1,589          | –             |
| Non-deductible cost of gas                                     | 1,226          | –             |
| Non-deductible training expenditures                           | 552            | 697           |
| Foreign exchange loss  | 491            | 30            |
| Adjustment in respect of current income tax of prior periods   | –              | 1,663         |
| Other non-deductible expenses                                  | 1,882          | 1,932         |
| <b>Income tax expense reported in the financial statements</b> | <b>120,363</b> | <b>67,348</b> |

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012****23. INCOME TAX EXPENSES (continued)**

Deferred tax balances are calculated by applying the Kazakhstani statutory tax rates in effect at the respective reporting dates to the temporary differences between the tax amounts and the amounts reported in the financial statements and are comprised of the following at December 31:

| <i>In thousands of US dollar</i>  | 2012             | 2011             |
|-----------------------------------|------------------|------------------|
| <b>Deferred tax asset:</b>        |                  |                  |
| Accounts payable and provisions   | 2,690            | 2,289            |
| <b>Deferred tax liability:</b>    |                  |                  |
| Property, plant and equipment     | (151,622)        | (148,963)        |
|                                   | (151,622)        | (148,963)        |
| <b>Net deferred tax liability</b> | <b>(148,932)</b> | <b>(146,674)</b> |

The movements in the deferred tax liability were as follows:

| <i>In thousands of US dollar</i>        | 2012             | 2011             |
|---|------------------|------------------|
| Balance at January 1                    | (146,674)        | (100,823)        |
| Current period charge to profit or loss | (2,258)          | (45,851)         |
| <b>Balance at December 31</b>           | <b>(148,932)</b> | <b>(146,674)</b> |

**24. EMPLOYEE SHARE OPTION PLAN**

Employees (including senior executives and executive directors) of members of the Group receive remuneration in the form of equity-based payment transactions, whereby employees render services as consideration for share appreciation rights, which can only be settled in cash ("cash-settled transactions").

The cost of cash-settled equity-based employee compensation is measured initially at fair value at the grant date using a binomial model. This fair value is expensed over the period until vesting with the recognition of a corresponding liability. The liability is remeasured at each reporting date up to and including the settlement date with changes in fair value recognised in the statement of comprehensive income.

The equity-based payment plan is described below.

During 2008-2012, 3,182,958 equity appreciation rights (SARs) were granted to senior employees and executive directors of members of the Group, which can only be settled in cash. These generally vest over a five year period from the date of grant, so that one fifth of granted SARs vests on each of the five anniversaries from the date of grant. The contractual life of the SARs is ten years. The fair value of the SARs is measured at the grant date using a binomial option pricing model taking into account the terms and conditions upon which the instruments were granted. SARs are exercisable at any time after vesting till the end of the contractual life and give its holder a right to a difference between the market value of the Group's GDRs at the date of exercise and a stated base value. The services received and a liability to pay for those services are recognised over the expected vesting period. Until the liability is settled it is remeasured at each reporting date with changes in fair value recognised in profit or loss as part of the employee benefit expenses arising from cash-settled share-based payment transactions.

The carrying value of the liability relating to 2,131,723 of SARs at December 31, 2012 is US\$ 9,788 thousand (2011: 2,867,617 SARs with carrying value of US\$ 11,734 thousand). During the year ended December 31, 2012, 426,345 SARs were fully vested (2011: 474,455).

The following table illustrates the number (No.) and exercise prices (EP) of, and movements in, SARs during the year:

|   | December 31, 2012 |          | December 31, 2011 |          |
|---|-------------------|----------|-------------------|----------|
|   | No.               | EP, US\$ | No.               | EP, US\$ |
| Outstanding at the beginning of the year (with EP of US\$ 4)  | 2,667,617         | 4        | 2,982,958         | 4        |
| Outstanding at the beginning of the year (with EP of US\$ 10) | 200,000           | 10       | –                 | –        |
| <b>Total outstanding at the beginning of the year</b>         | <b>2,867,617</b>  |          | 2,982,958         |          |
| Granted   | –                 | –        | 200,000           | 10       |
| Exercised   | (735,894)         | 4        | (315,341)         | 4        |
| <b>Outstanding at the end of year</b>                         | <b>2,131,723</b>  |          | 2,867,617         |          |
| <b>Exercisable at the end of year</b>                         | <b>1,311,170</b>  |          | 1,394,434         |          |

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012****24. EMPLOYEE SHARE OPTION PLAN (continued)**

The following table lists the inputs to the models used for the plan for the year ended December 31, 2012:

| <i>In thousands of US dollars</i> | <b>2012</b> | <b>2011</b> |
|-----------------------------------|-------------|-------------|
| Dividend yield (%)                | <b>1.5</b>  | –           |
| Expected volatility (%)           | <b>86</b>   | 86          |
| Risk-free interest rate (%)       | <b>2.0</b>  | 3.2         |
| Expected life (years)             | <b>3.5</b>  | 3.5         |
| Option turnover (%)               | <b>10</b>   | 10          |
| Price trigger                     | <b>2</b>    | 2           |

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome.

**25. RELATED PARTY TRANSACTIONS**

For the purpose of these consolidated financial statements transactions with related parties mainly comprise transactions between the members of the Group and the participants and/or their subsidiaries or associated companies.

Accounts payable to and borrowings from related parties as at December 31 consisted of the following:

| <i>In thousands of US dollars</i> | <b>2012</b> | <b>2011</b> |
|-----------------------------------|-------------|-------------|
| <b>Trade payables</b>             |             |             |
| Prolag BVBA                       | <b>298</b>  | 18          |
| Probel Capital Management B.V.    | <b>288</b>  | 242         |
| Amersham Oil LLP                  | <b>48</b>   | 39          |

During the year ended December 31, 2012 and 2011 the Group had the following transactions with related parties:

| <i>In thousands of US dollars</i>              | <b>2012</b>   | <b>2011</b> |
|--|---------------|-------------|
| <b>Management fees and consulting services</b> |               |             |
| Probel Capital Management N.V.                 | <b>13,648</b> | 10,293      |
| Prolag BVBA                                    | <b>2,195</b>  | 1,892       |
| Amersham Oil LLP                               | <b>1,415</b>  | 1,360       |

Management fees are payable in accordance with the Technical Assistance Agreements signed between the members of the Group and Amersham Oil LLP, Prolag BVBA and Probel Capital Management N.V. related to the rendering of geological, geophysical, drilling, technical and other consultancy services.

Annual remuneration of key managers amounted to US\$ 624 thousand for 2012 (2011: US\$ 484 thousand). Other key management personnel were employed and paid by Amersham Oil LLP and Probel Capital Management and whose remuneration forms part of management fees and consulting services above.

**26. CONTINGENT, COMMITMENTS AND OPERATING RISKS****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, 2012. As at December 31, 2012 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax position will be sustained.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)**For the year ended December 31, 2012

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**26. CONTINGENT, COMMITMENTS AND OPERATING RISKS (continued)****Abandonment and site restoration (decommissioning)**

As Kazakh laws and regulations concerning site restoration and cleanup evolve, the Group 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.

**Environmental obligations**

The Group may also be subject to loss contingencies relating to regional environmental claims that may arise from the past operations of the related fields in which it operates. As Kazakh laws and regulations evolve concerning environmental assessments and site restoration, the Group may incur future costs, the amount of which is currently indeterminable.

**Capital commitments**

As at December 31, 2012 the Group had contractual capital commitments in the amount of US\$ 23,088 thousand (2011: US\$ 17,880 thousand) mainly in respect to the Group's oil field development activities.

**Operating lease**

Zhaikmunai LLP entered into a cancellable lease agreement for the main administrative office in Uralsk in October 2007 for a period of 20 years at US\$ 15 thousand per month.

In March 2010 the Zhaikmunai LLP entered into an agreement on lease of 200 railway tank wagons for transportation of LPG and other hydrocarbon products for a period of 7 years for KZT 6,989 (equivalent of US\$ 47) per day per one wagon.

**Social and education commitments**

As required by the Contract (as amended by, inter alia, Supplement #9), Zhaikmunai LLP is obliged to:

- (i) spend US\$ 300 thousand per annum to finance social infrastructure;
- (ii) perform repair and reconstruction of state automobile roads for the amount of US\$ 12,000 thousand in 2012;
- (iii) make an accrual of one percent of the capital expenditure per annum for the purposes of educating Kazakh citizens; and
- (iv) adhere to a spending schedule on education which lasts until (and including) 2020.

**Domestic oil sales**

In accordance with Supplement #7 to the Contract, Zhaikmunai LLP is required to sell at least 15% of produced oil on the domestic market on a monthly basis for which prices are materially lower than export prices.

**27. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES**

The group's principal financial liabilities comprise the 2015 Notes, the 2019 Notes, payables to Government of Kazakhstan, trade payables and other current liabilities. The main purpose of these financial liabilities is to finance the development of the Chinarevskoye oil and gas condensate field and its operations. The Group's financial assets consist of trade and other receivables, short-term investments and cash and cash equivalents.

The main risks arising from the Group's financial instruments are interest rate risk, foreign exchange risk, liquidity risk and credit risk. The Group's management reviews and agrees policies for managing each of these risks, which are summarized below.

**Interest rate risk**

The Group is not exposed to interest rate risk in 2012 and 2011 as the Group had no floating-rate borrowings as at December 31, 2012 and 2011.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012****27. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)****Foreign currency risk**

As a significant portion of the Group's operation is the Kazakhstani Tenge denominated, the Group's statement of financial position can be affected significantly by movements in the US dollar / Tenge exchange rates. The Group mitigates the effect of its structural currency exposure by borrowing in US dollars and denominating sales in US dollars.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollars exchange rate, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities).

|                           | Change in<br>Tenge to US\$<br>exchange rate | Effect on profit<br>before tax |
|---------------------------|---|--------------------------------|
| <b>2012</b>               |   |                                |
| <b>US dollar thousand</b> | <b>+1.57%</b>                               | <b>(235)</b>                   |
| <b>US dollar thousand</b> | <b>-1.57%</b>                               | <b>235</b>                     |
| <b>2011</b>               |   |                                |
| US dollar thousand        | +10.72%                                     | (2,341)                        |
| US dollar thousand        | -10.72%                                     | 2,341                          |

**Liquidity risk**

Liquidity risk is the risk that the Group will encounter difficulty in raising funds to meet commitments associated with its financial liabilities. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value.

Liquidity requirements are monitored on a regular basis and management ensures that sufficient funds are available to meet any commitments as they arise.

The table below summarizes the maturity profile of the Group's financial liabilities at December 31, 2012 and 2011 based on contractual undiscounted payments:

| Year ended<br>December 31, 2012         | On demand     | Less than<br>3 months | 3-12 months   | 1-5 years      | More than<br>5 years | Total            |
|---|---------------|-----------------------|---------------|----------------|----------------------|------------------|
| Borrowings                              | –             | 740                   | 51,873        | 277,531        | 639,800              | <b>969,944</b>   |
| Trade payables                          | 59,855        | –                     | –             | –              | –                    | <b>59,855</b>    |
| Other current liabilities               | 10,437        | –                     | –             | –              | –                    | <b>10,437</b>    |
| Due to Government of Kazakhstan         | –             | 258                   | 773           | 4,124          | 13,402               | <b>18,557</b>    |
|   | <b>70,292</b> | <b>998</b>            | <b>52,646</b> | <b>281,655</b> | <b>653,202</b>       | <b>1,058,793</b> |
| <b>Year ended<br/>December 31, 2011</b> |               |                       |               |                |                      |                  |
| Borrowings                              | –             | 746                   | 49,504        | 600,750        | –                    | <b>651,000</b>   |
| Trade payables                          | 81,914        | –                     | –             | –              | –                    | <b>81,914</b>    |
| Other current liabilities               | 8,361         | –                     | –             | –              | –                    | <b>8,361</b>     |
| Due to Government of Kazakhstan         | –             | 258                   | 773           | 4,124          | 14,433               | <b>19,588</b>    |
|   | <b>90,275</b> | <b>1,004</b>          | <b>50,277</b> | <b>604,874</b> | <b>14,433</b>        | <b>760,863</b>   |

**Credit risk**

Financial instruments, which potentially subject the Group to credit risk, consist primarily of accounts receivable and cash in banks. The maximum exposure to credit risk is represented by the carrying amount of each financial asset. The Group considers that its maximum exposure is reflected by the amount of trade accounts receivable and advances paid.

The Group places its Tenge denominated cash with Sberbank, which has a credit rating of Baa1 (stable) from Moody's rating agency and its US dollar denominated cash with BNP Paribas with a credit rating of A2 (stable) and ING with a credit rating of A2 (negative) from Moody's rating agency at December 31, 2012. The Group does not guarantee obligations of other parties.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)****For the year ended December 31, 2012**

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**27. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)****Credit risk (continued)**

The Group sells its products and makes advance payments only to recognized, creditworthy third parties. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts and recoverability of prepayments made is not significant and thus risk of credit default is low.

**Fair values of financial instruments**

Fair value is defined as the amount at which an instrument could be exchanged in a current transaction between knowledgeable willing parties according to arm's length conditions, other than in a forced or liquidation sale. As no readily available market exists for a large part of the Group's financial instruments, judgment is needed to arrive at a fair value, based on current economic conditions and the specific risks attributable to the instrument.

The fair value of borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates. The Group's borrowings are at market rates of interest specific to those instruments and as such are stated at fair value. The Group's derivative is valued with a reference to a quoted market price in an active market. The fair value of other financial assets has been calculated using market interest rates.

Management believes that the Group's carrying value of financial assets and liabilities consisting of cash and cash equivalents, trade accounts receivable, trade and other payables are not significantly different from their fair values at December 31, 2012 and 2011.

**28. EVENTS AFTER THE REPORTING PERIOD**

Zhaikmunai LLP has acquired legal ownership of the subsoil rights related to three oil and gas fields (Rostoshinskoye, Darinskoye and Yuzhno-Gremyachenskoye) in Kazakhstan following the signing of the respective supplementary agreements related thereto by the Ministry of Oil and Gas (MOG) of the Republic of Kazakhstan effective March 1, 2013.