KazTransOil
Joint Stock Company

Consolidated Financial Statements

For the year ended 31 December 2006

CONTENTS

Page

ERNST & YOUNG

■ Ernst & Young Kazakhstan LLP
Furmanov Street, 240 G
Almaty 050059, Kazakhstan
Tel.: 7 (3272) 58-5960
Fax: 7 (3272) 58-5961
www.ey.com/kazakhstan

■ ТОО "Эрнст энд Янг Казахстан"
Казахстан, 050059 Алматы
ул. Фурманова, 240 Г
Тел.: 7 (3272) 58-5960
Факс: 7 (3272) 58-5961

INDEPENDENT AUDITORS' REPORT

To the Shareholder of KazTransOil JSC -

We have audited the accompanying consolidated financial statements of Joint Stock Company KazTransOil and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as of December 31, 2006, and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cash flow for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We did not audit the financial statements of Kazakhstan-China Pipeline LLP, a jointly controlled entity, which represents 16% of the total consolidated assets as of December 31, 2006, and 2% of the total consolidated revenue of the Group for the year then ended. Those financial statements were audited by other auditors whose unqualified report has been furnished to us, and our opinion, insofar as it relates to data included for Kazakhstan-China Pipeline LLP, is based solely on the report of the other auditors. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained and the report of other auditors are sufficient and appropriate to provide a basis for our audit opinion.

Opinion

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

Ernst & Young Kazakhstan LLP

February 25, 2007

CONSOLIDATED BALANCE SHEET

In thousands of Tenge	Note	As at December 31, 2006	2005
ASSETS			
Non-current assets			
Property, plant and equipment	5	**219,713,346**	203,023,964
Intangible assets	6	**1,462,587**	1,440,671
Available-for-sale investments	7	**99,920**	99,920
Financial investments	8	**–**	2,700,000
Advances to suppliers for non-current assets		**524,085**	954,387
Other non-current assets	9	**3,694,647**	6,173,853
		225,494,585	214,392,795
Current assets			
Inventories	10	**3,265,760**	6,320,884
Trade accounts receivable	11	**951,832**	383,666
Advances to suppliers	12	**2,720,793**	4,329,792
Prepaid income tax		**516**	200,719
Other taxes prepaid	13	**10,221,894**	8,036,131
Other current assets	15	**1,975,572**	3,839,450
Financial assets	17	**2,869,086**	33,878,600
Cash and cash equivalents	18	**22,573,424**	14,409,368
		44,578,877	71,398,610
Non-current assets classified as held for sale	14	**4,738,283**	233,145
		49,317,160	71,631,755
TOTAL ASSETS		**274,811,745**	286,024,550
EQUITY AND LIABILITIES			
Equity			
Share capital	19	**32,916,055**	32,916,055
Revaluation reserve	19	**55,800,150**	58,359,128
Reserve fund		**19,770,393**	20,471,378
Foreign currency translation		**(10,353)**	–
Retained earnings		**75,194,507**	63,055,625
Total equity		**183,670,752**	174,802,186
Non-current liabilities			
Interest bearing loans and borrowings	20	**11,300,503**	12,481,281
Corporate bonds	22	**37,683,780**	40,179,620
Deferred tax liabilities	31	**14,470,973**	11,017,903
Other non-current liabilities		**434,262**	230,695
		63,889,518	63,909,499
Current liabilities			
Current portion of interest bearing loans and borrowings	20	**1,300,328**	2,649,871
Current portion of long-term financial liabilities	21	**–**	516,874
Current portion of corporate bonds	22	**1,148,948**	20,065,500
Trade accounts payable	23	**6,031,546**	8,042,131
Advances received	24	**13,953,335**	12,365,262
Income tax payable		**123,042**	–
Other taxes payable	25	**1,082,861**	561,922
Other current liabilities	26	**3,611,415**	3,111,305
		27,251,475	47,312,865
Total liabilities		**91,140,993**	111,222,364
TOTAL EQUITY AND LIABILITIES		**274,811,745**	286,024,550

The accounting policies and explanatory notes on pages 6 through [illegible] form an integral part of these consolidated financial statements.

General Director — *Z. Tolumbayev*

Deputy General Director on Economics and Finance — *S. Satubaldina*

Chief Accountant — *D. Sultangaliyeva*

CONSOLIDATED INCOME STATEMENT

		For the year ended December 31,	
In thousands of Tenge	**Notes**	**2006**	2005
Sales	27	**75,227,520**	64,421,060
Cost of sales	28	**(40,224,597)**	(38,292,831)
Gross profit		**35,002,923**	26,128,229
General and administrative expenses	29	**(14,144,410)**	(14,077,295)
Other operating (loss) / income, net	30	**(668,957)**	2,056,302
Finance income		**2,122,456**	3,272,115
Interest expense		**(5,699,128)**	(5,080,738)
Net foreign exchange gain / (loss)		**1,990,352**	(809,308)
Profit before income tax expense		**18,603,236**	11,489,305
Income tax expense	31	**(8,073,210)**	(5,865,484)
Net profit for the year		**10,530,026**	5,623,821

The accounting policies and explanatory notes on pages 6 through 36 form an integral part of these consolidated financial statements.

General Director	*B. Z. Tolumbayev*
Deputy General Director on Economics and Finance	*Zh. S. Satubaldina*
Chief Accountant	*Zh. O. Sultangaliyeva*

CONSOLIDATED STATEMENT OF CASH FLOW

		For the year ended December 31,	
In thousands of Tenge	**Notes**	**2006**	2005
Cash flows from operating activities			
Profit before income tax expense		**18,603,236**	11,489,305
Adjustments:			
Depreciation of property, plant and equipment	**5**	**13,492,426**	11,969,194
Amortisation of intangible assets	**6**	**257,649**	164,126
Change in allowance for doubtful debts	**29**	**58,737**	(35,875)
Loss on disposal of property, plant and equipment	**30**	**1,314,671**	(501,233)
Unrealised foreign exchange (gain) / loss		**(2,716,834)**	521,807
Finance income		**(2,122,456)**	(3,272,115)
Interest expense		**5,699,128**	5,080,738
Impairment of property, plant and equipment	**29**	**1,086,091**	1,781,769
Income from write-off of payables		**–**	(5,113)
Allowance for obsolete inventory	**29**	**389,930**	322,611
Operating income before changes in working capital		**36,062,578**	27,515,214
Decrease in inventories		**3,361,154**	389,460
(Increase) / decrease in trade accounts receivable		**(584,730)**	157,093
Decrease in advances to suppliers		**1,597,738**	2,048,944
(Increase) / decrease in other current and non-current assets and other taxes prepaid		**(727,947)**	1,448,997
(Decrease) / increase in trade accounts payable		**(2,581,047)**	2,477,195
Increase / (decrease) in advances received		**1,588,073**	(755,384)
Increase / (decrease) in taxes payable other than income tax		**520,939**	(2,180,313)
Increase in other current and non-current liabilities		**703,677**	27,258
Cash flows provided by operating activities		**39,940,435**	31,128,464
Income tax paid		**(3,434,953)**	(3,512,690)
Interest paid		**(4,359,091)**	(5,001,286)
Interest received on short-term deposits		**429,637**	–
Net cash flows from operating activities		**32,576,028**	22,614,488

CONSOLIDATED STATEMENT OF CASH FLOW (continued)

		For the year ended December 31,	
In thousands of Tenge	**Notes**	**2006**	2005
Cash flows from investing activities			
Time deposits withdrawn inclusive of interest		**44,159,011**	16,607,475
Time deposits placed		**(8,245,267)**	(27,350,600)
Purchase of property, plant and equipment		**(38,561,249)**	(55,674,691)
Decrease / (increase) in advances for non-current assets		**430,305**	(591,054)
Proceeds from sale of property, plant and equipment, intangible assets and long-term assets classified as held for sale		**560,364**	2,119,191
Purchase of intangible assets		**(314,910)**	(252,706)
Financial aid issued to related parties		**(1,209,513)**	(1,980,000)
Net cash flows used in investing activities		**(3,181,259)**	(67,122,385)
Cash flows from financing activities			
Dividends paid		**(1,045,742)**	(857,134)
Proceeds from loans and financial liabilities		**1,270,000**	1,339,800
Repayment of loans and financial liabilities		**(3,414,769)**	(1,493,422)
Proceeds from issuance of corporate bonds		**–**	19,850,799
Repayment of corporate bonds		**(17,782,435)**	–
Net cash flows (used in) / from financing activities		**(20,972,946)**	18,840,043
Net increase / (decrease) in cash and cash equivalents		**8,421,823**	(25,667,854)
Effect of exchange rate changes on cash and cash equivalents		**(257,767)**	287,501
Cash and cash equivalents at the beginning of the year	**18**	**14,409,368**	39,789,721
Cash and cash equivalents at the end of the year	**18**	**22,573,424**	14,409,368

Refer to *Note 34* for information on significant non-cash transactions.

The accounting policies and explanatory notes on pages 6 through 36 form an integral part of these consolidated financial statements.

General Director — *B. Z. Tolumbayev*

Deputy General Director on Economics and Finance — *Zh. S. Satubaldina*

Chief Accountant — *O. Sultangaliyeva*

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the year ended December 31, 2006

In thousands of Tenge	Share Capital	Revaluation Reserve	Reserve Fund	Foreign currency translation	Retained Earnings	Total
	19	19	19			
As at December 31, 2004	32,916,055	64,041,859	20,473,974	–	52,606,207	170,038,095
Disposal of assets	–	–	(2,596)	–	–	(2,596)
Net profit for the year	–	–	–	–	5,623,821	5,623,821
Amortisation of revaluation reserve	–	(5,682,731)	–	–	5,682,731	–
Dividends declared and paid	–	–	–	–	(857,134)	(857,134)
As at December 31, 2005	32,916,055	58,359,128	20,471,378	–	63,055,625	174,802,186
Disposal of assets	**–**	**–**	**(97,500)**	**–**	**–**	**(97,500)**
Transferred to retained earnings	**–**	**–**	**(579,535)**	**–**	**579,535**	**–**
Impairment loss of revalued assets	**–**	**(507,865)**	**–**	**–**	**–**	**(507,865)**
Net profit for the year	**–**	**–**	**–**	**–**	**10,530,026**	**10,530,026**
Amortisation of revaluation reserve	**–**	**(2,051,113)**	**(23,950)**	**–**	**2,075,063**	**–**
Translation of foreign currencies	**–**	**–**	**–**	**(10,353)**	**–**	**(10,353)**
Dividends paid	**–**	**–**	**–**	**–**	**(1,045,742)**	**(1,045,742)**
As at December 31, 2006	**32,916,055**	**55,800,150**	**19,770,393**	**(10,353)**	**75,194,507**	**183,670,752**

The accounting policies and explanatory notes on pages 6 through 36 form an integral part of these consolidated financial statements.

General Director — B. Z. Tolumbayev

Deputy General Director on Economics and Finance — S. Satubaldina

Chief Accountant — O. Sultangaliyeva

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the year ended December 31, 2006

1. CORPORATE INFORMATION

On April 2, 1997, in accordance with Resolution No. 461 of the Government of the Republic of Kazakhstan (the "Government"), the state owned entities – Yuzhnefteprovod PO (Aktau) and Magistralnye Nefteprovody of Kazakhstan and Central Asia PO (Pavlodar) - were reorganised and merged into a new entity named Kazakhnefteprovod. Subsequently, Kazakhnefteprovod was renamed to KazTransOil National Oil Transportation Company CJSC ("KazTransOil NOTC CJSC").

On May 2, 2001, the Government issued a resolution to create a new closed joint stock company National Company "Transportation of Oil and Gas" ("TNG") owned by the Government. Based on that resolution, the Committee for State Property and Privatisation of the Ministry of Finance of the Republic of Kazakhstan transferred the KazTransOil NOTC CJSC shares to TNG, and, as a result, KazTransOil NOTC CJSC was re-registered and renamed KazTransOil Closed Joint Stock Company (the "Company").

On May 31, 2004 the Company was reregistered as KazTransOil Joint Stock Company.

On February 20, 2002, based on a resolution of the Government TNG and National Oil and Gas Company "KazakhOil" CJSC merged. As a result of this merger, a new company, National Company KazMunayGas JSC ("KMG" or the "Parent company"), which became the Company's sole shareholder, was formed. KMG is wholly owned by the Government as represented by the Committee for State Property and Privatisation of the Ministry of Finance of the Republic of Kazakhstan (JSC "Kazakhstan Holding for the Management of State Assets "Samruk" - since June 2006).

During 2003 the Company created KazTransOil - Service JSC ("KazTransOil-Service") in which it holds a 100% interest.

On June 29, 2004, the Company together with the Chinese National Corporation for oil and gas exploration and production established the Kazakhstan – Chinese Pipeline LLP ("KCP"). The Company owns a 50% interest in KCP. KCP owns 100% of shares in the KCP subsidiary, KCP Finance B.V., registered in the Netherlands. This entity was established for the purpose of issuing bonds (*Note 22*).

On July 28, 2004, the Company acquired 51% of the shares of the North-West Pipeline Company MunayTas Joint Stock Company ("MunayTas") from KMG. 49% of the shares of MunayTas belong to "CNPC International in Kazakhstan" LLP.

The Company, its subsidiaries and jointly controlled organisations are hereafter referred to as the "Group".

The Group's main business activities include, but are not limited to:

- the coordination and management of crude oil transported within Kazakhstan and for export;
- the storage, loading and unloading, transhipment or transfer of crude oil to other related pipeline systems;
- transporting water supplies for the technological, production and economic needs of the Mangistau and Atyrau regions of Kazakhstan;
- performing activities to operate, service and repair mainline pipelines belonging to other legal entities;
- cooperation with oil transportation companies of other countries regarding the transportation of oil in accordance with intergovernmental agreements, including transportation forwarding services;
- the management of investment activity for the overall development of the main oil pipeline systems within Kazakhstan and other activities as described in the Company's charter.

On December 24, 2003, the Company concluded an investment contract ("Investment Contract 1") with the Committee for Investment of the Ministry of Industry and Trade of the Republic of Kazakhstan (the "Committee for Investment"). On December 24. 2003, MunayTas concluded a similar contract ("Investment Contract 2") with the Committee for Investment. On October 13, 2004, KCP concluded an investment contract with the Committee for Investment ("Investment Contract 3"). In accordance with Investment Contracts 1 and 2 the companies have been provided with the following investment tax concessions as stipulated by legislation of the Republic of Kazakhstan concerning investments:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

1. CORPORATE INFORMATION (continued)

- for corporate income tax purposes the Company has been provided with the right to deduct the cost of fixed assets entered into operation from aggregate annual income in equal shares for a period of two years (MunayTas – five years) beginning from January 1 of the year following the year when fixed assets entered in operation. The Company used the preferences in 2005 and 2006 and MunayTas will use the preferences in 2004 – 2008.
- an exemption from property tax for a period of three years for fixed assets that were newly entered into operation (MunayTas – five years) beginning from January 1 of the year following the year when fixed assets entered in operation. The Company will use the preferences in 2005 – 2007 and MunayTas will use the preferences in 2004 – 2008.
- an exemption from land tax for a period of three years for plots of land purchased and used for the implementation of an investment project (MunayTas – five years) beginning from January 1 of the year following the year when the fixed assets entered in operation. The Company will use the preferences in 2005 – 2007 and MunayTas will use the preferences in 2004 – 2008.

Under Investment Contract 3, KCP has been provided with a 1 year exemption from customs duties for the import of equipment and for components that have been imported to implement an investment project. The exemption period may be extended for a period that does not exceed 5 years. KCP used the exemption in 2004 and 2005.

On October 13, 2006 the Company entered into an investment contract ("Investment Contract 4") with the Committee for Investment for the provision of the following investment tax concessions from January 1, 2007 when implementing the investment project "Construction of the Supply Oil Pipeline "North Buzachi-Karazhanbas":

- for corporate income tax purposes the Company has been provided with the right to deduct the cost of fixed assets commissioned as part of the investment project from aggregate annual income for one year from January 1 of the year following the year fixed assets are commissioned as part of the investment project;
- an exemption from property tax on newly commissioned fixed assets as part of the investment project, for three years from January 1, of the year following the year fixed assets are commissioned as part of the investment project.

The Company's head office is located in Astana, Kazakhstan, at 20 Kabanbay Batyr Avenue. The Company has 4 branches, which are located in Atyrau (Western branch), Pavlodar (Eastern branch), a scientific-technical centre located in Almaty, a Multiaccess computing centre in Astana, and representative offices in Moscow, Orsk and Samara in the Russian Federation, and Kiev, Ukraine.

The accompanying consolidated financial statements were authorised for issue by the General Director, the Deputy General Director on Economics and Finance and the Chief Accountant of the Company on February 25, 2007.

2. CURRENT ECONOMIC ENVIRONMENT

Operating environment of the Group

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

Tariff setting

The Company is considered to be a monopolist, and as such, is regulated by the Agency for the Regulation of Natural Monopolies and the Protection of Competition of the Republic of Kazakhstan (the "Antimonopoly Committee"). This agency is responsible for approving the methodology for calculating tariffs and tariff rates, under which the Company derives substantially all of its primary revenues. Tariffs are generally based on the cost of capital for assets used. According to legislation of the Republic of Kazakhstan on the regulation of the activities of natural monopolies, tariffs may be no lower than costs to provide services, and should take into consideration the possibility of generating profit that ensures the effective performance of a natural monopoly.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

2. CURRENT ECONOMIC ENVIRONMENT (continued)

Tariff setting (continued)

Oil transportation services tariffs for mainline pipelines were approved by the Order of the Chairman of the Antimonopoly Committee dated February 20, 2003. The Order of the Company's General Director dated May 5, 2004 reduces oil pumping tariffs due to changes in Kazakhstan legislation. In this respect, tariffs are calculated based on the weighted tariff of 2,413 Tenge for the transportation of 1 tonne of oil for 1,000km.

Oil transportation services to Kazakhstan oil refineries for further refining are paid at tariffs that have been recalculated using a coefficient of 0.54.

Water is supplied to oil and gas producers and other consumers in the Western Kazakhstan region, and also to the local population.

Current water supply tariffs were approved by the Order of the Chairman of the Antimonopoly Committee dated November 21, 2006, and were entered into force from January 1, 2007. Water supply tariffs were set for four groups of consumers: the population, budget and non-commercial organisation; agricultural producers; industrial companies and other commercial organisations; and oil and gas production companies.

3. BASIS OF PREPARATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The consolidated financial statements have been prepared on the historical cost basis, except as described in the accounting policies and the Notes to these financial statements.

New accounting developments

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

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

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

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

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. BASIS OF PREPARATION (continued)

New accounting developments (continued)

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

IFRSs and IFRIC interpretations not yet effective

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

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

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

Significant accounting judgments and estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Actual outcomes could differ from these estimates.

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment of property, plant and equipment

The Group assesses at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the assets' recoverable amount. An asset's recoverable amount is higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or group of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the assets. In 2006 the Group recognized an impairment of 1,811,612 thousand Tenge (2005: 1,781,769 thousand Tenge), where the impairment of 1,086,091 thousand Tenge was recognized in income statement (2005: 1,781,769 thousand Tenge) and of 725,521 thousand Tenge was recognized directly in equity (2005: nil). Refer to *Notes 19* and *29.*

The determination of impairment of property, plant and equipment involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the industry, changes in the future availability of financing, technological obsolescence, discontinuance of service, current replacement costs and other changes in circumstances that indicate an impairment exists.

The recoverable amount and the fair values are typically determined using a discounted cash flow method which incorporates reasonable market participant assumptions. The identification of impairment indicators, the estimation of future cash flows and the determination of fair values for assets (or group of assets) requires management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values.

3. BASIS OF PREPARATION (continued)

Significant accounting judgments and estimates (continued)

Impairment of property, plant and equipment (continued)

The determination of the recoverable amount of a cash-generating unit involves the use of estimates by management. Methods used to determine the value in use include discounted cash flow-based methods. These estimates, including the methodologies used, can have a material impact on the fair value and ultimately the amount of any property, plant and equipment impairment.

Useful lives of items of property, plant and equipment

The Group assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end and, if expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors".

Allowances

The Group makes allowances for doubtful accounts receivable. Significant judgment is used to estimate doubtful accounts. In estimating doubtful accounts historical and anticipated customer performance are considered. Changes in the economy, industry, or specific customer conditions may require adjustments to the allowance for doubtful accounts recorded in the consolidated financial statements. As of December 31, 2006 and 2005, allowances for doubtful accounts have been created for the amount of 1,000,744 thousand Tenge and 1,006,253 thousand Tenge, respectively *(refer to Note 16)*.

Taxation

In assessing tax risks, management considers to be probable obligations the known areas of tax positions which the Group would not appeal or does not believe it could successfully appeal, if assessed by tax authorities. Such determinations inherently involve significant judgment and are subject to change as a result of changes in tax laws and regulations, the determination of expected outcomes from pending tax proceedings and current outcome of ongoing compliance audits by tax authorities. The provision for tax contingencies are disclosed in *Note 35*.

Deferred tax assets

Deferred tax assets are recognized for all provisions for doubtful debts, allowances for slow-moving inventories and accruals to the extent that it is probable that taxable temporary differences and business nature of such expenses will be proved, as well as on the successful implementation of tax planning strategies. The amount of recognized deferred tax assets as of December 31, 2006 was 1,033,604 thousand Tenge (2005: 1,494,954 thousand Tenge). Further details are contained in *Note 31*.

Operating lease – Group as lessee

The Group has entered into leases with respect to land. The Group has determined that the lease does not transfer substantially all the risks and rewards incidental to ownership of this land and, therefore, the lease is classified as an operating lease.

Fair value of financial support provided to related parties

The financial support provided to related parties have been valued based on the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics. This valuation requires the Group to make estimates about expected future cash flows and discount rates, and hence they are subject to uncertainty. The fair value of the financial support to related parties as of December 31, 2006 was 3,072,784 thousand Tenge (2005: 1,674,582 thousand Tenge). Further details are contained in *Notes 9* and *15*.

Foreign currency translation

The consolidated financial statements are presented in Kazakhstan Tenge, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the date of the transaction.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

3. BASIS OF PREPARATION (continued)

Foreign currency translation (continued)

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated statement of income. 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.

The functional currency of KCP Finance B.V. is the United States Dollar. As at the reporting date, the assets and liabilities of KCP Finance B.V. are translated into the presentation currency of Company at the rate of exchange ruling at the balance sheet date and their income statements are translated at the weighted average exchange rates for the year. The exchange differences arising on the translation are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognized in equity relating to that particular foreign operation is recognized in the consolidated statement of income.

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

The currency exchange rate for KASE gives an equivalent exchange of 127 Tenge to 1 US Dollar which was used to translate monetary assets and liabilities denominated in US Dollars as at December 31, 2006 (2005: 133.77 Tenge to 1 US Dollar). The currency exchange rate of KASE as at February 25, 2007, was 123.54 Tenge to 1 US Dollar.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

Consolidated financial statements comprise the accounts of the Company, its 100% subsidiary and jointly controlled companies, after all material intercompany transactions have been eliminated. Subsidiaries are consolidated from the date that the Company obtains control until such time as control ceases. The financial statements of subsidiaries are prepared for the same reporting period as for the Company, using consistent accounting policies. Adjustments are made to ensure that no dissimilar accounting policies exist.

As discussed in Note 1, the Company has control over one subsidiary, KazTransOil-Service, which has been fully consolidated in these consolidated financial statements.

Interest in joint ventures

As discussed in *Note 1*, the Company participates in two jointly controlled entities, KCP and MunayTas. Investments in entities where the Company has joint control are consolidated on a prorata basis by including the Company's share of each of the assets, liabilities, revenues and expenses of the joint venture on a line-by-line basis with similar items in the consolidated financial statements.

Financial assets

Financial assets within the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, or available for sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets at initial recognition. All regular way purchases and sales of financial assets are recognized on the trade date, which is the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Group has the positive intention and ability to hold them to maturity.

The Group classifies its cash deposits and bonds as held-to-maturity investments because management has the positive intention and ability to hold these instruments to maturity.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment

Property, plant and equipment are stated at revalued cost less accumulated depreciation and impairment. The initial cost of the fixed assets at the acquisition comprises its purchase price, including import duties and non-refundable taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Depreciation is computed on a straight-line basis over the estimated useful lives. The estimated useful life of certain fixed assets is presented as follows (in years):

	Years
Buildings and constructions	20 – 50
Machinery and equipment	2 – 25
Pipelines and other transportation assets	10 – 33
Other	2– 15

Expenditures incurred after the fixed assets have been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to income statement in the period when such costs are incurred. The expenditures that have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of tangible fixed assets beyond its originally assessed standard performance (increase of useful life, capacity, etc.) are capitalized as an additional cost of fixed assets.

When property, plant and equipment is sold or retired, the revalued cost and related accumulated depreciation are eliminated from accounts. Any resulting gains or losses are included in the determination of net income or loss.

Impairment of assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognised in the consolidated statement of income. The recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or group of assets.The fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction less the costs of disposal while value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the assets. Reversal of impairment losses recognised in prior years is recorded when there is an indication that the impairment losses recognised for the asset no longer exist or have decreased. The reversal is recorded in the consolidated statement of income. However, the increased carrying amount of an asset due to a reversal of an impairment loss is recognised only to the extent it does not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for that asset in prior years.

Revaluation of property, plant and equipment

The Group periodically engages independent appraisers to revalue property, plant and equipment to their depreciated replacement cost. Valuations are performed frequently enough to ensure that the fair value of a revalued assets does not differ materially from its carrying amount.

An increase in an asset's carrying amount as a result of a revaluation is credited to the revaluation reserve account net of the related deferred tax amount, except to the extent that it reverses a revaluation decrease of the same asset previously recognized in the consolidated statement of income, in which case the increase is recognized in the consolidated statement of income. If an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised as an expense. However, a revaluation decrease is charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that same asset.

Revaluation reserve is amortised on the same basis as the property, plant and equipment through a charge directly to retaining earnings. A transfer from revaluation reserve to retained earnings is not made through the consolidated statements of income.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revaluation of property, plant and equipment (continued)

Upon the retirement or disposal of property, plant and equipment the surplus of the revaluation reserve is transferred directly to retained earnings. This transfer is shown in the consolidated statement of changes in equity as a release for the disposals of property, plant and equipment.

Construction-in-progress

Assets in the course of construction are capitalised as a separate component of property, plant and equipment. On completion, the cost of construction is transferred to the appropriate category.

The cost of a tangible fixed asset comprises its purchase price and any costs directly attributable to bringing it into working condition for its intended use.

Construction-in-progress is not depreciated.

Intangible assets

Intangible assets, which represent the cost of software acquired, license agreements and other intangible assets, are recorded at historical cost less accumulated amortisation and any accumulated impairment losses. Amortisation is provided on a straight line basis over the estimated useful economic life of the assets. Intangible assets are generally amortised over five years. The amortisation expense on intangible assets is recognised in the consolidated statement of income in the expense category consistent with the function of the intangible asset.

Inventories

Inventories are stated at the lower of cost and net realisable value on a first-in first-out ("FIFO") basis. Cost includes all costs incurred in the normal course of business in bringing each product to its present location and condition.

Non-current assets classified as held for sale

Assets are classified as non-current assets held for sale if they meet the following criteria:

- are available for immediate sale in their current condition;
- there is a firm intention to ensure their planned sale;
- actions have been taken to determine the purchaser and other necessary measures to execute the plan;
- there is a high possibility of making a sale, and it is expected that the sale will be made within one year from classification.

The Group measures a non-current assets classified as held for sale at the lower of their carrying amount and fair value less costs to sell. Immediately before the initial classification of the asset as held for sale, the carrying amounts of the asset is measured in accordance with applicable IFRSs. Non-current assets classified as held for sale have been presented separately in the consolidated financial statements within current assets category on the face of the consolidated balance sheet.

Trade and other receivables

Trade and Other receivables are carried at original invoice amount less provision made for impairment of these receivables. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers. The amount of the provision is recognised in the consolidated statement of income.

Value added tax

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

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and cash equivalents

Cash in the balance sheet comprises cash at banks and in hand and short-term deposits with an original maturity of three months or less.

Borrowings

Borrowings are initially recognised at cost, being the fair value of the consideration received, net of transaction costs incurred. In subsequent periods, borrowings are measured at amortised cost using the effective interest rate method. Amortized cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Gains and losses are recognized in income statement when the liabilities are derecognized, as well as through application of the effective interest rate method.

Corporate bonds

Corporate bonds are non-callable registered coupon bonds that are carried at par less discount. Discount is amortised over the term of the bonds' lives and includes costs related to the bonds' issuance. In 2002 the Company decided to establish and maintain a special sinking fund in the form of deposits held with banks *(Notes 8, 17, 18)* to provide for the future cash outflow associated with interest payments and bond retirement.

Trade and other accounts payable

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

Provisions

Provisions are recognised 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 can be made of the amount of the obligation. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

Dividends

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

Revenue recognition

Rendering of services and sales of goods

Revenue is recognised when it is probable that the economic benefits associated with the transaction will flow to the Group and the amount of revenue can be measured reliably. Sales are recognised net of related taxes (excise, VAT). Revenue from transportation services is recognised based on actual volumes of crude oil or water transported during the reporting period. Revenue from sale of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably.

Revenues are measured at the fair value of the consideration received or receivable. When the fair value of consideration received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

Interest income

Revenue is recognized as interest accrues (using the effective interest method that is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

Expense recognition

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

Income taxes

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the tax authorities. The tax rate and tax law used to compute the amount are those that are enacted or substantially enacted by the balance sheet date in the Republic of Kazakhstan.

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

Deferred tax liabilities are recognised for all taxable temporary differences.

Deferred tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised.

The carrying amount of the deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised, and when there is uncertainty regarding tax treatment of the differences under the tax law.

Deferred income tax assets and liabilities are measured at the rate that is expected to apply to the year when the asset is realised or the liability is settled, based on the tax rate (and tax law) that has been enacted or substantially enacted at the balance sheet date.

Deferred income tax assets and liabilities are offset, if legally enforceable rights exist to offset current tax assets against current tax liabilities.

Pension

The Group does not have any pension arrangements in addition to the State pension scheme of the Republic of Kazakhstan, which requires current contributions by the employee calculated as a percentage of current gross salary payments. According to legislation, employees are responsible for their retirement benefits and the Group has no present or future obligation to pay its employees upon their retirement.

Subsequent events

The results of post-year-end events that provide evidence of conditions that existed at the balance sheet date (adjusting events) are reflected in the consolidated financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Reclassifications

Certain 2005 corresponding amounts were reclassified to comply with 2006 presentation. These reclassification are as follows:

In thousands of Tenge	Amount
Consolidated balance sheet	
Current portion of deferred income was reclassified to other current liabilities	224,131
Non-current deferred income was reclassified to other non-current liabilities	202,226
Consolidated income statement	
Revenue from operator's services rendered was reclassified from other operating income / (loss) to sales revenue	679,967
Cost of sales related to revenue from operator's services rendered was reclassified from other operating income / (loss) to cost of sales	(736,128)
Consolidated statement of cash flows	
Increase in VAT receivable was reclassified to decrease in other current and non-current assets	(3,511,511)
Deferred income was reclassified to increase in other current and non-current liabilities	(83,034)
Interest received was reclassified to time deposits withdrawn inclusive of interest	1,107,475

5. PROPERTY, PLANT AND EQUIPMENT

The movement of property, plant and equipment for the year ended December 31, 2005, was as follows:

In thousands of Tenge	Land	Buildings	Machinery and equipment	Pipelines and other transportation assets	Other	Construction -in-progress	Total
As at January 1, 2005, net of accumulated depreciation	396,110	22,202,830	49,439,780	76,776,830	890,222	13,319,395	163,025,167
Additions	31,764	1,399,919	1,129,935	1,044,868	676,878	51,560,456	55,843,820
Disposals	(39,832)	(1,495,098)	(820,686)	(765,162)	(489,178)	(669,448)	(4,279,404)
Transfers and adjustments	–	(131,740)	(2,294,327)	(270,692)	2,696,759	–	–
Transfer from construction in progress	–	2,915,958	6,631,723	6,933,478	3,164,631	(20,119,310)	(473,520)
Impairment charge	–	(154,406)	(220,302)	(146,701)	(24,993)	–	(546,402)
Depreciation charge	–	(1,191,764)	(5,411,694)	(4,600,355)	(765,381)	–	(11,969,194)
Depreciation on disposals	–	143,536	819,733	126,310	333,918	–	1,423,497
As at December 31, 2005, net of accumulated depreciation	388,042	23,689,235	49,274,162	79,098,576	6,482,856	44,091,093	203,023,964
As at January 1, 2005							
Cost or revalued amount	396,110	24,908,016	50,705,938	77,791,647	1,603,876	13,319,395	168,724,982
Impairment	–	(2,479,060)	(587,278)	–	(212,541)	–	(3,278,879)
Accumulated depreciation	–	(226,126)	(678,880)	(1,014,817)	(501,113)	–	(2,420,936)
Net carrying amount	396,110	22,202,830	49,439,780	76,776,830	890,222	13,319,395	163,025,167
As at December 31, 2005							
Cost or revalued amount	388,042	27,597,055	55,352,583	84,734,139	7,652,966	44,091,093	219,815,878
Impairment	–	(2,633,466)	(807,580)	(146,701)	(237,534)	–	(3,825,281)
Accumulated depreciation	–	(1,274,354)	(5,270,841)	(5,488,862)	(932,576)	–	(12,966,633)
Net carrying amount	388,042	23,689,235	49,274,162	79,098,576	6,482,856	44,091,093	203,023,964

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

5. PROPERTY, PLANT AND EQUIPMENT (continued)

The movement of property, plant and equipment for the year ended December 31, 2006 was as follows:

In thousands of Tenge	Land	Buildings	Machinery and equipment	Pipelines and other transportation assets	Other	Construction -in-progress	Total
As at January 1, 2006, net of accumulated depreciation	388,042	23,689,235	49,274,162	79,098,576	6,482,856	44,091,093	203,023,964
Additions	522,649	688,277	2,229,196	3,477,195	578,056	31,951,248	39,446,621
Disposals	(244,442)	(347,001)	(538,993)	(1,727,902)	(429,100)	(527,110)	(3,814,548)
Transfer to non-current assets classified as held for sale	(26,076)	(1,648,057)	(723,661)	(16,635)	(2,543,742)	–	(4,958,171)
Transfers and adjustments	–	2,369	134,118	(269,039)	132,552	–	–
Transfer from construction in progress	–	3,860,195	12,526,712	43,276,107	5,288,932	(64,951,946)	–
Impairment charge	(75,167)	(377,705)	(41,721)	(1,013,572)	(17,985)	(285,462)	(1,811,612)
Depreciation charge	–	(1,269,544)	(5,619,424)	(5,430,253)	(1,173,205)	–	(13,492,426)
Depreciation on disposals	–	219,646	271,578	523,431	304,863	–	1,319,518
As at December 31, 2006, net of accumulated depreciation	565,006	24,817,415	57,511,967	117,917,908	8,623,227	10,277,823	219,713,346
As at January 1, 2006							
Cost or revalued amount	**388,042**	**27,597,055**	**55,352,583**	**84,734,139**	**7,652,966**	**44,091,093**	**219,815,878**
Impairment	–	**(2,633,466)**	**(807,580)**	**(146,701)**	**(237,533)**	–	**(3,825,280)**
Accumulated depreciation	–	**(1,274,354)**	**(5,270,841)**	**(5,488,862)**	**(932,577)**	–	**(12,966,634)**
Net carrying amount	**388,042**	**23,689,235**	**49,274,162**	**79,098,576**	**6,482,856**	**44,091,093**	**203,023,964**
As at December 31, 2006							
Cost or revalued amount	**640,173**	**30,151,245**	**68,995,611**	**129,462,611**	**10,676,586**	**10,563,285**	**250,489,511**
Impairment	**(75,167)**	**(3,011,171)**	**(849,301)**	**(1,160,273)**	**(255,519)**	**(285,462)**	**(5,636,893)**
Accumulated depreciation	–	**(2,322,659)**	**(10,634,343)**	**(10,384,430)**	**(1,797,840)**	–	**(25,139,272)**
Net carrying amount	**565,006**	**24,817,415**	**57,511,967**	**117,917,908**	**8,623,227**	**10,277,823**	**219,713,346**

In connection with the social support program for the employees of the oil industry in the Republic of Kazakhstan, the Company sold apartments to employees at a price of approximately 30% of the acquisition cost under a program that began in 2000. The loss from sale of these apartments amounted to 738,010 thousand Tenge in 2005 and was reported as non-monetary employee compensation within the administrative expenses (2006: nil). As of December 31, 2006, the carrying value of apartments included in the buildings was 2,889,715 thousand Tenge (2005: 2,478,183 thousand Tenge).

The revaluation of the Group's property, plant and equipment was performed as at December 31, 2004 by an independent appraiser. The fair market value was determined using a depreciated replacement cost approach and for certain assets – by reference to market-based evidence.

Accumulated depreciation of revalued assets was eliminated against the gross carrying amount of the assets and the net amount was restated to the revalued amount of the asset.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. PROPERTY, PLANT AND EQUIPMENT (continued)

The carrying value of each revalued class of property, plant and equipment that would have been recognized in the consolidated financial statements had the assets been carried at cost less any accumulated depreciation and any accumulated impairment loss was as follows:

	Land	Buildings	Machinery and equipment	Pipelines and other transportation assets	Other	Construction-in-progress	Total
At December 31, 2005	388,042	15,874,742	25,799,751	24,581,841	6,482,856	44,091,093	117,218,325
At December 31, 2006	**565,006**	**19,303,315**	**39,315,565**	**61,913,910**	**8,623,227**	**10,277,822**	**139,998,845**

The construction-in-progress balance as at December 31, 2005, is mainly represented by the costs incurred by Kazakhstan-China Pipeline LLP for the construction of the 962 kilometers long Atasu-Alashankou trunk pipeline with a capacity of 10 million tonnes per year. The construction started in September 2004 and was completed on July 28, 2006.

The 25 kilometers long North Buzachi-Karazhanbas oil pipeline project was commissioned on May 31, 2006 with a capacity of 3,500 thousand tonnes per year.

As of December 31, 2006 construction-in-progress ("CIP") mainly includes pump stations, tanks and transportation assets under construction.

The disposals of property, plant and equipment in 2006 mainly represents write-off of Kenkiyak – Orsk pipeline.

The transfers to long-term assets classified as held for sale mainly represent transfers of a universal sports facility "Sary-Agash", with the carrying amount of 2,286,759 thousand Tenge, sanatorium Sary-Agash with the carrying amount of 869,330 thousand Tenge, Meirim medical centre with the carrying amount of 1,047,369 thousand Tenge, a closed parking lot and canteen. The disposal of the assets is expected to be completed within one year from the balance sheet date.

The additional charge in the property, plant and equipment impairment reserve in 2006 equalled 1,811,612 thousand Tenge. The impairment of previously revalued assets in the amount of 507,865 thousand Tenge, net of related deferred tax, was charged against revaluation reserve reported in the consolidated statement of changes in equity.

As at December 31, 2006, the Group has fully depreciated property, plant and equipment of 199,793 thousand Tenge revalued cost (in 2005: 542,925 thousand Tenge revalued cost).

6. INTANGIBLE ASSETS

The movement of intangible assets for the year ended December 31, 2005 was as follows:

In thousands of Tenge	Licenses	Software	Other	Total
Balance as at January 1, 2005, net of accumulated amortisation	4,160	976,040	36,357	1,016,557
Additions	–	599,510	–	599,510
Disposals	–	(19,532)	(11,681)	(31,213)
Amortisation charge	(500)	(163,626)	–	(164,126)
Amortisation on disposals		18,903	1,040	19,943
Balance as at December 31, 2005, net of accumulated amortisation	3,660	1,411,295	25,716	1,440,671
Balance as at January 1, 2005				
At cost	4,940	1,334,710	37,397	1,377,047
Accumulated amortisation	(780)	(358,670)	(1,040)	(360,490)
Net book value	4,160	976,040	36,357	1,016,557
Balance as at December 31, 2005				
At cost	4,940	1,914,688	25,716	1,945,344
Accumulated amortisation	(1,280)	(503,393)	–	(504,673)
Net book value	3,660	1,411,295	25,716	1,440,671

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

6. INTANGIBLE ASSETS (continued)

The movement of intangible assets for the year ended December 31, 2006 was as follows:

In thousands of Tenge	**Licenses**	**Software**	**Other**	**Total**
Balance as at January 1, 2006, net of accumulated amortisation	3,660	1,411,295	25,716	1,440,671
Additions	48,393	266,517	–	314,910
Disposals	(5,376)	(16,205)	(25,716)	(47,297)
Amortisation charge	(2,078)	(255,571)	–	(257,649)
Amortisation on disposals	428	11,524	–	11,952
Balance as at December 31, 2006, net of accumulated amortisation	45,027	1,417,560	–	1,462,587
Balance as at January 1, 2006				
At cost	**4,940**	**1,914,688**	**25,716**	**1,945,344**
Accumulated amortisation	**(1,280)**	**(503,393)**	**–**	**(504,673)**
Net book value	**3,660**	**1,411,295**	**25,716**	**1,440,671**
Balance as at December 31, 2006				
At cost	**47,957**	**2,164,999**	**–**	**2,212,956**
Accumulated amortisation	**(2,930)**	**(747,439)**	**–**	**(750,369)**
Net book value	**45,027**	**1,417,560**	**–**	**1,462,587**

The cost of fully amortised intangible assets at December 31, 2006 was 207,950 thousand Tenge (in 2005: 190,515 thousand Tenge).

7. AVAILABLE-FOR-SALE INVESTMENTS

As at December 31, 2006 and 2005, available-for-sale investments comprised:

In thousands of Tenge	**2006**		2005	
	Ownership interest	**Book Value**	Ownership interest	Book Value
Accumulative Pension Fund of Halyk Bank of Kazakhstan JSC	**10%**	**99,920**	10%	99,920
		99,920		99,920

As of December 31, 2006 and 2005 the carrying amount of the available-for-sale investments equals their fair value.

8. FINANCIAL INVESTMENTS

As at December 31, 2006 and 2005, financial investments comprised:

In thousands of Tenge	**2006**	2005
Tenge denominated time deposits with Kazakhstan Banks with maturity more than 1 year	–	2,700,000
	–	2,700,000

At December 31, 2005 the Tenge denominated time deposit included a deposited in a Kazakhstan bank with interest rate of 10% per annum and maturing on November 1, 2007. At December 31, 2006 the deposit was reclassified to current assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

9. OTHER NON-CURRENT ASSETS

As at December 31, 2006 and 2005, other non-current assets comprised:

In thousands of Tenge	2006	2005
VAT receivable (a)	**2,042,965**	4,373,451
Financial aid provided to related parties (*Note 33*) (b)	**1,268,797**	1,529,354
Loans to employees (c)	**206,582**	165,620
Financial aid to third parties	**-**	193,773
Deferred expenses	**38,085**	4,105
Other receivables (d)	**698,508**	809,337
	4,254,937	7,075,640
Less allowance for doubtful debts (*Note 16*)	**(560,290)**	(901,787)
	3,694,647	6,173,853

(a) The Group estimated that VAT of 2,042,965 thousand Tenge will only be recovered subsequent to 2007. Accordingly, the above VAT was classified as a non-current asset.

(b) As at December 31, 2006, due from related parties represent amounts due from "KazMunayGas-Service" LLP and "Trade House KazMunayGas" JSC amounting to 1,220,279 thousand Tenge and 48,518 thousand Tenge, respectively (2005: 1,385,537 thousand Tenge and 143,817 thousand Tenge, respectively). At initial recognition amounts due from "KazMunayGas-Service" LLP and "Trade House KazMunayGas" JSC were recorded at the fair values using 7.5% and 9% discount rates, respectively, and thereafter carried at amortised cost. Discount rates represent refinancing rate of the National Bank of Kazakhstan as at origination date.

(c) As at December 31, 2006 and 2005, the amount due from employees represents interest-free Tenge denominated loans given to employees under long-term contracts repayable within 15 years. At initial recognition, loans were recorded at the fair value using 10% discount rate (2005: 13%), and thereafter carried at amortised cost.

(d) Other receivables include amounts due for sales of inventory and other receivables.

As at December 31, 2006 and 2005, other non-current assets were mainly denominated in Tenge.

10. INVENTORIES

As at December 31, 2006 and 2005, inventories comprised:

In thousands of Tenge	2006	2005
Spare parts	**2,878,592**	5,948,966
Fuel	**350,583**	379,855
Construction materials	**84,149**	153,942
Other materials	**450,222**	160,732
	3,763,546	6,643,495
Less - allowance for obsolete inventory	**(497,786)**	(322,611)
	3,265,760	6,320,884

The movements in the allowance for obsolete and slow-moving inventories were as follows for the years ended December 31:

In thousands of Tenge	2006	2005
At the beginning of the year	**(322,611)**	-
Charge	**(562,134)**	(322,611)
Write-offs	**214,755**	-
Recovery	**172,204**	-
At the end of the year	**(497,786)**	(322,611)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

11. TRADE ACCOUNTS RECEIVABLE

As at December 31, 2006 and 2005, trade accounts receivable comprised:

In thousands of Tenge	2006	2005
Receivables from related parties (*Note 33*)	**453,305**	71,178
Receivables from water transportation	**83,813**	64,410
Receivables from storage services	**584**	560
Receivables from crude oil transportation	**–**	75,794
Other receivables	**430,481**	172,044
	968,183	383,986
Less allowance for doubtful debts (*Note 16*)	**(16,351)**	(320)
	951,832	383,666

As at December 31, 2006 and 2005, trade accounts receivable were mainly denominated in Tenge.

12. ADVANCES TO SUPPLIERS

As at December 31, 2006 and 2005, advances to suppliers comprised:

In thousands of Tenge	2006	2005
Advances for work and services	**2,619,553**	4,160,456
Advances given to related parties (*Note 33*)	**96,974**	15,091
Advances for inventory	**47,765**	186,483
	2,764,292	4,362,030
Less allowance for doubtful debts (*Note 16*)	**(43,499)**	(32,238)
	2,720,793	4,329,792

At December 31, 2006, advances to suppliers of 1,956,646 thousand Tenge and 260,658 thousand Tenge were denominated in US Dollars and other currencies, respectively (2005: 3,020,654 thousand Tenge and nil, respectively). At December 31, 2006 and 2005 other advances to suppliers were mainly denominated in Tenge.

13. OTHER TAXES PREPAID

As at December 31, 2006 and 2005, tax advances comprised:

In thousands of Tenge	2006	2005
VAT recoverable	**10,133,361**	7,813,728
Other taxes	**88,533**	222,403
	10,221,894	8,036,131

At December 31, 2006 and 2005, tax advances were denominated in Tenge.

At December 31, 2006 and 2005 management assessed that a part of VAT recoverable in the amounts of 10,133,361 thousand Tenge and 7,813,728 thousand Tenge, respectively, should be paid or offset against future VAT or other tax liabilities within twelve months of the respective balance sheet date and, as a result, this VAT recoverable was classified as a current asset. The remaining balance of VAT recoverable of 2,042,965 thousand Tenge and 4,373,451 thousand Tenge at December 31, 2006 and 2005, respectively, which was expected to be realized twelve months after the respective balance sheet date, was classified as a non-current asset (*Note 9*).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

14. NON-CURRENT ASSETS CLASSIFIED AS HELD FOR SALE

At December 31, 2006 non-current assets classified as held for sale by the Group of 4,738,283 thousand Tenge (2005: 233,145 thousand Tenge) were mainly represented by social facilities, including sanatorium Saryagash, Meirim medical centre, Saryagash universal sports facility, a closed parking lot and canteen. The disposal of the assets was expected to be completed within one year from the balance sheet date.

The Group is required to dispose of the assets based on the Resolution of KMG and the Antimonopoly Law, which requires all state owned companies to dispose of non-core assets. The Group will dispose of the assets by holding a tender and selecting the buyer offering the highest price.

The non-current assets classified as held for sale were recorded at the lower of the carrying value and fair value less costs to sell.

15. OTHER CURRENT ASSETS

As at December 31, 2006 and 2005, other current assets comprised:

In thousands of Tenge	**2006**	2005
Financial aid provided to related parties (*Note 33*)	**1,803,987**	145,228
Due from employees	**77,249**	94,630
Prepaid insurance	**63,358**	79,248
Interest on deposits receivable	**16,584**	3,313,141
Deferred expenses	**11,027**	52,927
Other	**383,971**	226,184
	2,356,176	3,911,358
Less allowance for doubtful debts (*Note 16*)	**(380,604)**	(71,908)
	1,975,572	3,839,450

As at December 31, 2006 and 2005, other current assets were mainly denominated in Tenge.

16. ALLOWANCE FOR DOUBTFUL DEBTS

As at December 31, 2006 and 2005, allowance for doubtful debts comprised:

In thousands of Tenge	Other non-current assets	Trade accounts receivable	Advances to suppliers	Other current assets	Total
Allowance for doubtful debts as at December 31, 2004	1,019,980	390	–	55,510	1,075,880
Charge for the year	18,110	791	32,374	71,908	123,183
Reversal of a provision for doubtful debts	(158,828)	(94)	(136)	–	(159,058)
Reclassifications	55,510	–	–	(55,510)	–
Write-offs of receivables	(32,985)	(767)	–	–	(33,752)
Allowance for doubtful debts as of December 31, 2005	901,787	320	32,238	71,908	1,006,253
Charge for the year	**65,143**	**20,713**	**60,127**	**111,510**	**257,493**
Reversal of a provision for doubtful debts	**(119,213)**	**(4,149)**	**(48,866)**	**(26,528)**	**(198,756)**
Reclassifications	**(223,714)**	**–**	**–**	**223,714**	**–**
Write-offs of receivables	**(63,713)**	**(533)**	**–**	**–**	**(64,246)**
Allowance for doubtful debts as at December 31, 2006	**560,290**	**16,351**	**43,499**	**380,604**	**1,000,744**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

17. FINANCIAL ASSETS

As at December 31, 2006 and 2005, financial assets comprised:

In thousands of Tenge	**2006**	2005
Tenge denominated time deposits with Kazakhstan Banks with maturity from 3 months to 12 months	**2,869,086**	8,000,793
Foreign currency denominated time deposits with Kazakhstan Banks with maturity from 3 months to 12 months	–	25,877,807
	2,869,086	33,878,600

At December 31, 2006 Tenge denominated timed deposits included a deposit in a Kazakhstan bank with an interest rate of 10% per annum and with maturity on November 1, 2007 of 2,700,000 thousand Tenge and deposits in Kazakhstan banks with interest rates of 6.5% per annum (in 2005: between 5% and 8.5%) and with maturity between February 20, 2007 and August 28, 2007 (2005: from January 18, 2006 to November 29, 2006).

At December 31, 2005 US Dollar denominated time deposits placed in Kazakhstan banks with interest rates from 5.5% and 9% per annum and maturing on periods from January 4, 2006 to October 23, 2006.

18. CASH AND CASH EQUIVALENTS

As at December 31, 2006 and 2005, cash and cash equivalents comprised:

In thousands of Tenge	**2006**	2005
Tenge denominated time deposits with Kazakhstan Banks	**21,432,572**	8,447,388
Tenge denominated current accounts with Kazakhstan Banks	**716,378**	2,687,637
US Dollar denominated time deposits with Kazakhstan Banks	–	2,245,818
Foreign currency denominated current accounts with Kazakhstan Banks	**398,236**	815,782
Letter of credit	**181**	200,338
Tenge denominated petty cash	**26,057**	12,405
	22,573,424	14,409,368

At December 31, 2006 Tenge denominated timed deposits included deposits in Kazakhstan banks with interest rates ranging from 4% and 7.5% per annum (2005: from 1.5% to 4.5%) and maturity from January 3, 2007 to January 22, 2007 (2005: from January 5, 2006 to March 16, 2006).

As at December 31, 2006 and 2005, most current accounts with Kazakhstan Banks carried interest at 1.5% per annum.

At December 31, 2005 US Dollar denominated deposits included deposits placed in Kazakhstan banks with interest rates ranging from 3.5% to 4.8% per annum and maturity from January 4, 2006 to March 16, 2006.

19. EQUITY

Share capital

As at December 31, 2006 and 2005, share capital of the Company comprised the following:

	Authorised	**Issued and Fully paid**	**Par value, Tenge**	**Amount, thousand Tenge**
December 31, 2005	32,916,055	32,916,055	1,000	32,916,055
December 31, 2006	**32,916,055**	**32,916,055**	**1,000**	**32,916,055**

As at December 31, 2006 and 2005, all issued shares of the Company were owned by KMG.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

19. EQUITY (continued)

Share capital (continued)

During 2006, the Company declared and paid dividends for 2005, totalling 1,045,742 thousand Tenge (2005: 857,134 thousand Tenge). The dividend per share amount was 31.77 Tenge per common stock (2005: 26.04 Tenge).

Dividends are not paid if (a) the equity becomes negative, (b) the Company becomes insolvent, (c) the court of the Shareholder decided to liquidate the Company. The Parent company has the right to decide not to pay dividends on the Company's shares with obligatory publication in newspapers within 10 days from the day of such decision.

Revaluation reserve

Revaluation reserve was formed based on a revaluation of property, plant and equipment performed by an independent appraisal firm for certain groups of assets as at December 31, 2004 and January 1, 2000. The movement of revaluation reserve for the years ended December 31, 2006 and 2005 was as follows:

In thousands of Tenge	**2006**	2005
Balance as at January 1	**58,359,128**	64,041,859
Amortisation, net of deferred tax	**(2,051,113)**	(5,682,731)
Impairment of previously revalued property, plant and equipment, net of deferred tax	**(507,865)**	–
Balance as at December 31	**55,800,150**	58,359,128

Reserve fund

As stated in the charter, the Company is required to maintain a general reserve fund of not less than 15% of its share capital. During 2006, due to changes to legislation, the reserve capital of the jointly controlled company MunayTas was transferred to retained earnings in accordance with a shareholder decision.

At December 31, 2006 and 2005, the reserve capital included amount of 17,173 thousand Tenge and 138,623 thousand Tenge, respectively, which comprised the social objects contributed by the Government of the Republic of Kazakhstan to the Company in 1997. These social objects were recorded as property, plant and equipment back in 1997. The right for disposal of these assets requires Government approval in the form of the Committee for State Property and Privatisation of the Republic of Kazakhstan. During 2006 and 2005 certain social facilities with net book value of 97,500 thousand Tenge and 2,596 thousand Tenge, respectively, were disposed under the resolution of Anti-Monopoly Committee of the Republic of Kazakhstan, in accordance with the "Law on privatisation". The remaining part of reserve capital on the disposed facilities of 23,950 thousand Tenge which represents accumulated depreciation of the disposed facilities accrued for the period from inception to the date of disposal was reclassified to retained earnings. No gain or loss was recognized by the Company on these disposals.

20. INTEREST BEARING LOANS AND BORROWINGS

As at December 31, 2006 and 2005, interest bearing loans and borrowings were as follows:

	Date of contract	Maturity	Annual interest rate	2006	2005
Non-current loans					
Citibank	December 2002	December 2011	LIBOR+2.25%	**6,060,706**	6,987,250
EBRD	July 2004	July 2014	LIBOR+2.25%	**5,266,341**	5,559,574
HSBC	October 2005	October 2006	LIBOR+1.60%	–	1,351,633
ABN AMRO Bank	December 2003	December 2007	LIBOR+2.75%	–	1,232,695
Bank of China	December 2006	December 2010	LIBOR+0.85%	**1,273,784**	–
				12,600,831	15,131,152
Current portion of long-term loans				**(1,300,328)**	(2,649,871)
				11,300,503	12,481,281

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

20. INTEREST BEARING LOANS AND BORROWINGS (continued)

Citibank

As at December 31, 2006 the Group's share of a loan received from Citibank N.A. (Singapore branch) was USD 47,722 thousand or 6,060,706 thousand Tenge (2005: USD 52,233 thousand or 6,987,250 thousand Tenge). On December 4, 2002 MunayTas entered into an agreement for a USD 80,000 thousand or 12,360,000 thousand Tenge credit facility with Citibank N.A., acting through its Singapore branch.

On June 30, 2003 Citibank agreed to increase the facility limit to USD 102,000 thousand or 15,096,000 thousand Tenge. On June 8, 2005 Citibank agreed to decrease an interest rate from 8.8% to LIBOR + 2.25% and maturity on December 4, 2011. Under the terms of the loan agreement, MunayTas should not sell, lease, transfer or otherwise dispose of all or any part (book value of which is 20% or more of the book value of all assets) of its revenues or its assets. As at December 31, 2006 the current part of the loan, inclusive of interest, comprised 1,126,670 thousand Tenge (2005: 608,408 thousand Tenge). As at December 31, 2006 and 2005 MunayTas had executed all loan agreement conditions.

EBRD

As at December 31, 2006, the Group's share in a loan received from EBRD amounted to USD 41,467 thousand or 5,266,341 thousand Tenge (2005: USD 41,561 thousand or 5,559,574 thousand Tenge). On July 29, 2004 MunayTas entered into an agreement for a USD 81,600 thousand or 11,127,792 thousand Tenge credit facility with EBRD with an annual interest rate of LIBOR+2.25% and maturity on July 14, 2014. The purpose of this loan was to repay MunayTas liabilities to Halyk Bank. According to the loan agreement and a guarantee agreement, the Company and MunayTas are obligated to comply with certain financial and non-financial covenants. At December 31, 2006, the current portion of the loan comprised 169,875 thousand Tenge (2005: 57,475 thousand Tenge). As at December 31, 2006 and 2005 the Company and MunayTas had executed all loan agreement and guarantee agreement conditions.

HSBC Kazakhstan

On October 27, 2005 the Company received a loan of USD 10,000 thousand or 1,338,200 thousand Tenge in accordance with Agreement on state procurements of banking services # US 440/05 from June 2, 2005, supplementary agreement #1 from October 27, 2005. Principal accrued interest rate of LIBOR +1.6% per annum with maturity in October 2006. The loan was repaid in full in July 2006.

ABN AMRO Bank

On December 12, 2003, MunayTas entered into an agreement for USD 23,000 thousand or 3,337,990 thousand Tenge credit facility with ABN AMRO Bank with maturity on December 12, 2007. On May 13, 2005 the addendum was signed to decrease the interest rate to LIBOR +2.75% per annum. MunayTas should also pay commission of 0.1% per annum for any unused amounts of the credit line. The loan was fully repaid in August 2006.

Bank of China

As at December 31, 2006 the Company's share in a loan received from the Bank of China is USD 10,030 thousand or 1,273,784 thousand Tenge. On December 15, 2006 KCP entered into a loan agreement with the Bank of China for USD 80,000 thousand or 10,160,000 thousand Tenge with an interest rate of LIBOR + 0.85% per annum to finance the construction and operation of the Atasu-Alahankou oil pipeline with maturity in December 2010. Receipts for oil transportation services from PetroKazakhstan Kumkol Resources for the amount of USD 90 million were used as collateral for the loan agreement. At December 31, 2006, the current portion of the loan comprised 3,783 thousand Tenge (2005: nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

20. INTEREST BEARING LOANS AND BORROWINGS (continued)

Future Maturities of Loans

Maturities of interest bearing loans and borrowings for the years succeeding December 31, 2006 and 2005 were as follows:

In thousands of Tenge	2006	2005
Within one year	**1,300,328**	2,649,871
In the second year	**1,625,382**	1,919,214
In the third to the fifth years inclusive	**7,598,789**	5,785,681
After five years	**2,076,332**	4,776,386
Less: Amount due for settlement within 12 months (shown under current liabilities)	**(1,300,328)**	(2,649,871)
	11,300,503	12,481,281

21. LONG-TERM FINANCIAL LIABILITIES

As at December 31, 2006 and 2005, long-term financial debt comprised the following:

In thousands of Tenge	Date of contract	Maturity	Annual interest rate	2006	2005
Long–term financial liabilities					
Sumitomo - Fujikura Consortium	Jun, 2001	Feb, 2007	3 month LIBOR + 3.75%	–	516,874
Current portion of long–term financial liabilities				–	(516,874)
				–	–

On June 8, 2001, the Company entered into an agreement to modernise a telecommunication network with Sumitomo-Fujikura Consortium for a value of USD 31,991 thousand or 4,680,247 thousand Tenge. In accordance with the agreement, inventories and equipment related to the construction are purchased in 20 equal quarterly instalments starting from February 2003, along with interest accrued at the rate of 3 month LIBOR + 3.75%. This loan was paid ahead of schedule in March 2006.

22. CORPORATE BONDS

As at December 31, 2006 and 2005, corporate bonds comprised:

In thousands of Tenge	2006	2005
Corporate bonds	–	20,065,500
KCP corporate bonds	**38,832,728**	40,179,620
	38,832,728	60,245,120
Current portion of corporate bonds	**(1,148,948)**	(20,065,500)
	37,683,780	40,179,620

Corporate bonds

On July 6, 2001, the Company issued unsecured Eurobonds for a total amount of USD 150,000 thousand or 21,990,000 thousand Tenge with maturity in July 2006. Net proceeds amounted to USD 148,965 thousand or 21,838,269 thousand Tenge. The Eurobonds pay 8.5% annual interest on par value, payable twice a year, in January and July. As at December 31, 2006, the Eurobonds had been repaid in full.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

22. CORPORATE BONDS (continued)

KCP corporate bonds

As at December 31, 2006, the Company's share in liabilities of KCP bonds amounted to USD 305,770 thousand or 38,832,728 thousand Tenge. In 2005 KCP issued bonds worth USD 150,000 thousand or 19,850,799 thousand Tenge with an interest rate of 7% for the period between September 22, 2005 and September 22, 2009, and with an annual interest rate of 8.8% between September 22, 2009, and September 22, 2020. The bonds mature on September 22, 2020. The bonds were issued through the subsidiary KCP Finance B.V. against a guarantee from China National Petroleum Company JSC (CNPC). The change in the interest rate from September 22, 2009, until the bonds mature is due to the expiry of the guarantee issued by CNPC.

23. TRADE ACCOUNTS PAYABLE

As at December 31, 2006 and 2005, trade payables comprised:

In thousands of Tenge	**2006**	2005
Payables for construction services	**2,849,750**	3,420,212
Payables for other services	**1,198,585**	1,620,338
Due to related parties (*Notes 32, 33*)	**1,157,264**	1,325,458
Payables for supplies	**825,947**	1,669,691
Payables for transportation services	**–**	6,432
	6,031,546	8,042,131

As at December 31, 2006 trade accounts payable were mainly denominated in Tenge. As at December 31, 2005, trade accounts payable of 1,577,165 thousand Tenge were denominated in US Dollars and other payables were mainly denominated in Tenge.

24. ADVANCES RECEIVED

As at December 31, 2006 and 2005 advances received from customers comprised:

In thousands of Tenge	**2006**	2005
Advances for oil and water transportation	**2,904,037**	4,998,798
Advances from related parties (*Note 32, 33*)	**7,739,243**	6,091,071
Advances for oil transportation coordination services	**3,150,981**	775,862
Other	**159,074**	499,531
	13,953,335	12,365,262

As at December 31, 2006, advances received of 135,779 thousand Tenge (2005: 342,565 thousand Tenge) were denominated in US Dollars. As at December 31, 2006 and 2005, other advances received were mainly denominated in Tenge.

25. OTHER TAXES PAYABLE

As at December 31, 2006 and 2005, taxes payable comprised:

In thousands of Tenge	**2006**	2005
Withholding Tax	**569,335**	198,409
Personal income tax	**230,347**	115,132
Social tax	**197,564**	85,881
Property tax	**72,876**	151,068
Other taxes	**12,739**	11,432
	1,082,861	561,922

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

26. OTHER CURRENT LIABILITIES

As at December 31, 2006 and 2005, other current liabilities comprised:

In thousands of Tenge	2006	2005
Wages	**2,542,913**	2,732,257
Estimated liability for environmental protection (*Note 35*)	**483,534**	-
Payable to pension fund	**243,628**	84,951
Current portion of deferred income	**45,781**	224,131
Other	**295,559**	69,966
	3,611,415	3,111,305

As at December 31, 2006 and 2005, other current liabilities were mainly denominated in Tenge.

27. SALES

The composition of sales for the years ended December 31, 2006 and 2005 was as follows:

In thousands of Tenge	2006	2005
Crude oil transportation	**71,047,386**	60,916,319
Water transportation	**1,974,113**	1,817,331
Pipeline operation services	**843,441**	679,967
Oil transportation coordination services	**737,028**	729,775
Oil storage services	**110,455**	70,131
Other	**515,097**	207,537
	75,227,520	64,421,060

For 2006 approximately 82% of total revenue was derived from sales to 12 major customers (2005: 84% from 12 major customers).

28. COST OF SALES

The composition of the cost of sales for the years ended December 31, 2006 and 2005 was as follows:

In thousands of Tenge	2006	2005
Depreciation	**12,950,769**	11,158,732
Personnel costs	**9,352,703**	8,924,823
Repair and maintenance costs	**4,884,728**	6,227,058
Materials and fuel	**3,919,317**	3,842,813
Energy	**1,913,894**	1,567,996
Taxes other than Income Tax	**1,421,470**	971,706
Security services	**972,742**	896,684
Air services	**897,088**	726,379
Cost of pipeline operation services	**666,930**	512,449
Diagnostics	**518,173**	589,075
Environmental protection	**364,064**	344,325
Insurance	**330,051**	324,779
Business trip expenses	**225,424**	273,023
Communication services	**156,065**	151,332
Other	**1,651,179**	1,781,657
	40,224,597	38,292,831

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

29. GENERAL AND ADMINISTRATIVE EXPENSES

The composition of general and administrative expenses for the years ended December 31, 2006 and 2005 was as follows:

In thousands of Tenge	2006	2005
Personnel costs	**5,013,271**	5,155,178
Management fees *(Note 33)*	**1,200,000**	1,200,000
Taxes other than Income Tax and VAT	**1,174,630**	1,094,012
Impairment of property, plant and equipment	**1,086,091**	1,781,769
Depreciation and amortisation	**799,306**	974,588
Social sphere expenses	**658,339**	596,481
VAT expenses	**539,174**	501,764
Provision for environmental damages	**483,534**	–
Provision for obsolete inventory	**389,930**	322,611
Charity expenses	**387,287**	374,987
Office maintenance	**354,232**	301,263
Communication services	**221,150**	384,352
Business trip expenses	**211,433**	230,605
Materials	**208,322**	122,882
Consulting	**155,311**	363,094
Lease expenses	**143,447**	18,791
Insurance and security	**137,773**	118,379
Bank costs	**122,759**	244,980
Training	**112,066**	99,580
Advertising	**95,682**	163,126
Changes in doubtful debts	**58,737**	(35,875)
Other	**591,936**	64,728
	14,144,410	14,077,295

30. OTHER OPERATING (LOSS) / INCOME, NET

The composition of results from other activities for the years ended December 31, 2006 and 2005 was as follows:

In thousands of Tenge	2006	2005
(Loss) / gain on disposal of property, plant and equipment, net	**(1,314,671)**	501,233
Income from fines and penalties	**356,221**	1,057,635
Income from stock excess	**42,129**	155,802
Income from writing off accounts payable	**–**	5,113
Loss from the sale of inventory	**(2,070)**	(21,013)
Other income	**249,434**	357,532
	(668,957)	2,056,302

31. INCOME TAX EXPENSE

The Company, its subsidiary and jointly controlled companies are subject to corporate income tax at the prevailing statutory rate of 30%. Income tax expenses for the years ended December 31, 2006 and 2005 were as follows:

In thousands of Tenge	2006	2005
Current income tax	**4,402,484**	4,877,084
Deferred income tax	**3,670,726**	988,400
	8,073,210	5,865,484

Current corporate income tax expenses are based on the taxable income of the Company prepared in accordance with the requirements of Kazakhstan tax legislation. As at December 31, 2006 and 2005, the reconciliation of income tax expenses recorded in financial statements, and income prior to taxation multiplied by the statutory tax rate of 30%, is as follows:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

31. INCOME TAX EXPENSE (continued)

In thousands of Tenge	2006	2005
Income before corporate income tax	**18,603,236**	11,489,305
	30%	30%
Income tax expense computed on financial income before tax at statutory rate of 30%	**5,580,971**	3,446,792
Add / (deduct) tax effect of:		
Loss on impairment of social assets	–	91,484
(Gain) / loss on disposal of property, plant and equipment, net	–	(130,304)
Foreign exchange (gain) / loss, net	–	(17,938)
Tax expenses (other than VAT)	**185,046**	96,552
Non-recoverable VAT	**159,300**	150,529
Interest expenses	**113,587**	846,109
Entertainment expenses	**376,978**	399,705
Tax effect of temporary differences not recognised as measured by the change in the valuation allowance	**887,258**	512,360
Reconsideration of the tax base for property, plant and equipment	–	124,425
Financial aid and sponsorship	**341,929**	–
Other permanent differences	**428,141**	345,770
Income tax expense	**8,073,210**	5,865,484

Deferred corporate income taxes are provided for all temporary differences between the financial statement and tax basis of the Group's assets and liabilities. As at December 31, 2006 and 2005, the Group's net deferred tax position comprised of the following:

In thousands of Tenge	2006	2005
Deferred tax assets:		
Bonuses and other employee compensation and related costs	**352,198**	713,359
Allowance for doubtful debts	**299,783**	301,876
Taxes	–	69,684
Allowance for obsolete inventory	**149,336**	96,783
Investment income	–	98,613
Loss carry-forward	**1,045,437**	811,451
Property, plant and equipment	**1,636,771**	1,111,460
Payables for environmental damages	**145,609**	–
Allowance for unrecognised deferred tax assets	**(2,595,530)**	(1,708,272)
	1,033,604	1,494,954
Deferred tax liabilities:		
Taxes	**(5,846)**	–
Property, plant and equipment	**(15,498,731)**	(12,512,857)
	(15,504,577)	(12,512,857)
Net deferred tax liabilities	**(14,470,973)**	(11,017,903)

Aggregate deferred tax relating to items credited directly to equity amounted to 217,656 thousand Tenge for the year ended December 31, 2006 (2005: zero). This credit was made as a result of the impairment of previously revalued property, plant and equipment in the amount of 725,521 thousand Tenge *(Note 19)*.

Certain deferred tax assets relate to the Company's subsidiary and jointly controlled entity that consistently incur losses. In management's opinion, it is uncertain whether sufficient taxable profit will be available in the future against which the deductible temporary differences giving rise to the deferred tax asset above can be utilized. On this basis a provision of 2,595,530 thousand Tenge was recognized as at December 31, 2006 (2005: 1,708,272 thousand Tenge), against deferred tax assets of the Company's loss making subsidiary and jointly controlled entity.

The remaining balance of deferred tax assets of 1,033,604 thousand Tenge (2005: 1,494,954 thousand Tenge) after provision for valuation represents the deferred tax effect from temporary differences which, in managements opinion, can be utilized based on the assessment of taxable profit, which is expected to be available in the future.

Tax losses carried forward expire for taxation purposes in Kazakhstan within three years from when they were incurred. Consequently, the majority of tax losses carried forward accumulated by the Group at December 31, 2006 expire in 2007–2009.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

32. CONSOLIDATION

The following entities, registered in Kazakhstan have been included in these consolidated financial statements:

Subsidiaries	Company's Ownership in 2006	Company's Ownership in 2005	Business Activity
JSC KazTransOil - Service	100%	100%	Management of non-production assets

The following joint ventures have been proportionally consolidated according to their percentage ownership by the Company.

Jointly-controlled entities	Company's Ownership in 2006	Company's Ownership in 2005	Business Activity
North-West Pipeline Company MunayTas JSC	51%	51%	Transportation of oil
Kazakhstan- Chinese Pipeline LLP	50%	50%	Transportation of oil

The Company's share of the jointly controlled assets, liabilities, incurred expenses and revenue employed in the joint ventures included in the consolidated balance sheet and statements of income are as follows:

In thousands of Tenge	2006	2005
Assets:		
Property, plant and equipment	50,636,926	44,534,173
Other long-term assets	326,977	515,650
Inventory	99,020	21,409
Other current assets	7,754,806	17,147,553
Total assets	58,817,729	62,218,785
Liabilities:		
Long-term liabilities	48,984,282	52,243,427
Deferred tax liabilities	1,644,774	730,383
Current portion of long-term liabilities	1,296,546	1,247,302
Trade accounts payable	984,561	1,928,247
Taxes payable	47,819	137,149
Other current liabilities	2,239,525	869,209
Total liabilities	55,197,507	57,155,717
Revenues and expenses		
Revenues	4,836,779	3,093,709
Expenses	5,607,875	5,418,224
Cash flow information		
Cash flows used in from operating activities	(600,155)	(33,115,954)
Cash flows used in investing activities	(7,559,149)	(437,774)
Cash flows (used in) / from financing activities	(1,122,760)	18,851,486

The major transactions with Chinese National Corporation for oil and gas exploration, another shareholder of the jointly controlled entities MunayTas and KCP, and its related parties during the years ended December 31, 2006 and 2005 were as follows:

In thousands of Tenge	2006	2005
Sales	8,414,401	8,128,053
Services received	9,358	-
Deferred revenue	131,387	-
Trade accounts payable *(Note 23)*	626,366	950,030
Advances received *(Note 24)*	1,932,968	1,736,716

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

33. RELATED PARTIES TRANSACTIONS

Related parties include key management personnel of the Company, entities in which a substantial interest in the voting power is owned, directly or indirectly, by the Company's key management personnel, KMG Group companies and entities controlled by the Government.

Terms and conditions of transactions with related parties

Related party transactions were made on terms agreed to between the parties that may not necessarily be at market rates, except for crude oil and water transportation services which are provided based on the tariffs established for related and third parties. Outstanding balances at the year-end are unsecured, interest free and settlement occurs in cash. For the years ended December 31, 2006 and 2005, the Group has not recorded any impairment of receivables relating to amounts owned by related parties. This assessment is undertaken each financial year through examining the financial position of the related party and the market in which the related party operates.

The major transactions with related parties during the years ended December 31, 2006 and 2005 were as follows:

In thousands of Tenge	2006	2005
Crude oil transportation		
Entities under common control	**33,837,476**	22,532,717
Income from other activities		
Parent company	**1,047**	41,433
Entities under common control	**625,731**	142,193
Halyk Bank of Kazakhstan and its affiliates	**38,800**	–
Services received		
Parent company	**1,234,761**	1,251,004
Entities under common control	**3,065,345**	2,795,313
Halyk Bank of Kazakhstan and its affiliates	**312,812**	–
Non-current assets *(Note 9)*		
Entities under common control	**1,268,797**	1,529,354
Advances given *(Note 12)*		
Entities under common control	**96,974**	15,091
Trade accounts receivable *(Note 11)*		
Entities under common control	**453,305**	71,178
Other current assets *(Note 15)*		
Entities under common control	**1,803,987**	145,228
Deferred revenue		
Entities under common control	**263,544**	221,836
Trade accounts payable *(Note 23)*		
Parent company	**115,110**	115,000
Entities under common control	**413,388**	260,428
Halyk Bank of Kazakhstan and its affiliates	**2,400**	–
Advances received *(Note 24)*		
Entities under common control	**5,806,275**	4,354,355

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

33. RELATED PARTIES TRANSACTIONS (continued)

Services received

In 2006 and 2005 services received from Parent company include management fees of 1,200,000 thousand Tenge paid to KMG for management services *(Note 29).*

Cash and cash equivalents

As of December 31, 2006 and 2005 cash and cash equivalents held with Halyk Bank Kazakhstan totalled 13,183,493 thousand Tenge and 4,204,348 thousand Tenge, respectively, including time deposits of 12,834,242 thousand Tenge and 2,286,268 thousand Tenge, respectively. Interest income on these time deposits for the years ended December 31, 2006 and 2005 totalled 41,891 thousand Tenge and 382 thousand Tenge, respectively.

Long-term cash deposits held with Halyk Bank Kazakhstan as of December 31, 2006 and 2005 totalled nil thousand Tenge and 11,294,514 thousand Tenge, respectively.

Compensation to key management personnel

Key management personnel totalled 12 persons as at December 31, 2006 and 2005. Total compensation to key management personnel included in general and administrative expenses in the consolidated statement of income amounted to 188,282 thousand Tenge and 344,811 thousand Tenge for the years ended December 31, 2006 and 2005, respectively. The compensation to key management personnel consists of contractual salary and performance bonuses based on operating results.

Financial support

All related party financial supports are given interest free. These financial supports are initially recorded at fair value of the amounts given, thereafter accounted for at amortized cost using an effective interest rate ranging from 7.5% to 9% per annum *(Notes 9, 15)*. The difference between the amounts given and fair value is recorded as finance costs.

34. SIGNIFICANT NON-CASH TRANSACTIONS

During the year the Group transferred property, plant and equipment totalling 695,962 thousand Tenge to inventory (2005: nil).

During the year the Group offset income tax payable totalling 644,286 thousand Tenge against other taxes receivable (2005: nil).

In 2006 3,420,212 thousand Tenge was paid for property, plant and equipment purchased last year. Property, plant and equipment of 2,849,750 thousand Tenge was purchased in 2006 but not paid by December 31, 2006.

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

35. COMMITMENTS AND CONTINGENT LIABILITIES

Capital commitments

The Group generally enters into contracts for the completion of construction projects. As at December 31, 2006, the Group has contractual obligations approximating 6,691,526 thousand Tenge. The Group's share of contractual obligations of jointly controlled entities amounted to 7,954,058 thousand Tenge.

Sales contracts

MunayTas has commitments to transport the following minimal volume of crude oil over the next five years:

	Crude oil per year in thousands of tons
2007	6,401
2008	6,394
2009	6,510
2010	6,533
2011	6,509

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

35. COMMITMENTS AND CONTINGENT LIABILITIES (continued)

Sales contracts (continued)

Such commitments may change as a result of future events, like a significant decrease in the oil price.

If MunayTas is not able to transport a minimal volume of crude oil, it will be subject to penalties equivalent to the value of the service fee had the MunayTas rendered its services in full.

Taxation

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

The current regime of penalties and interest related to reported and discovered violations of Kazakhstan law are severe. Fines are generally 50% of any taxes additionally assessed and interest is assessed at the rate of 20% per annum. As a result, fines and interest can amount to multiples of any unreported taxes.

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

Because of the uncertainties associated with the Kazakhstan tax system, the ultimate amount of taxes, fines and interest, if any, may be in excess of the amount expensed to date and accrued at December 31, 2006. Although, such amounts are possible and may be material, it is the opinion of Group management that these amounts are either not probable, not reasonably determinable, or both.

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

Tax preferences

The Group has certain tax preferences related to Investment Contracts with the Committee for Investment as stated in *Note 1*. In order to use the tax preferences the Group must comply with certain requirement, such as provision of timely financial reports and use of the investment assets for designated purposes only. Management believes that as of December 31, 2006 and 2005 the Group meets the requirements.

Environmental matters

Kazakhstan environmental protection legislation is currently being developed and is therefore constantly being amended. Fines for violating Kazakhstan environmental protection legislation may be extremely severe. Potential liabilities that may arise as a result of a stricter interpretation of existing provisions, civil cases or changes to legislation may not be accurately assessed.

The Group is subject to various environmental laws and regulations of the Republic of Kazakhstan regarding environmental protection. While management believes that substantial compliance with such laws and regulations has been achieved, there can be no assurances that contingent liabilities do not exist.

Environmental pollution

The Group has recognised estimated liabilities to rectify environmental pollution, resulting from the accidental oil spill from the Pavlodar-Shymkent oil pipeline, of 483,534 thousand Tenge and recorded them in consolidated financial statements (*Note 26*).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

35. COMMITMENTS AND CONTINGENT LIABILITIES (continued)

Asset retirement obligation

Currently, management does not believe that the Group has or will have legal or constructive obligation related to retirement of its property, plant and equipment. Therefore, no accrual for such obligation has been made in the consolidated financial statements. Future changes in the regulations or legislation might change management's assessment.

Legal issues

In the ordinary course of business, the Group can be subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial position or the results of future operations of the Group.

Insurance matters

On March 30, 2006 the Group has obtained full insurance coverage including business interruption and third party environmental liability coverage for its pipeline facilities through March 31, 2007.

36. FINANCIAL INSTRUMENTS

The Group's principal financial instruments comprise bank loans, bonds payable and cash and cash equivalents. The main purpose of these financial instruments is to raise financing for the Group's operations. The Group has various other financial assets and liabilities such as trade accounts receivable, trade accounts payable, advances received and advances paid, which arise directly from its operations. During the year the Group did not undertake trading in financial instruments.

Foreign exchange risk

The Group's operations are carried out primarily in Kazakhstan and, as such, a significant portion of the Group's business is transacted in Tenge. The Group has a number of other financial instruments denominated in US Dollars. These include amounts in advances made to suppliers, certain accounts payable, long-term loans and corporate bond obligations. The Group does not hedge these financial instruments since management does not believe the foreign exchange risk is significant.

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Group's potential interest rate risk relates to interest rates associated with its loans received from banks, debt securities issued and long–term accounts payable. The Group does not enter into any hedging instruments to mitigate any potential risks since management does not believe the interest rate risk associated with the loans and debt securities issued is significant because interest rates are reviewed periodically.

Credit risks

Credit risks, or the risk of counterparties defaulting, are controlled by the application of credit approvals, limits and monitoring procedures. The extent of the Group's credit exposure is represented by aggregate balance of accounts receivable, advances to suppliers, VAT recoverable and loans receivable from related parties.

Counterparties to financial instruments consist primarily of large Kazakh oil producers, represented by both domestic companies and international oil companies. After considering provisions made for allowances for doubtful accounts, the Group does not expect any counterparties to fail to meet their obligations. As at December 31, 2006, five customers accounted for 66.1% (2005: two customers accounted for 51.2%) of total trade accounts receivable and 84.7% of advances to suppliers relates to three suppliers (2005: 94% relates to two suppliers).

The Group manages the credit risk related to VAT recoverable by complying with tax legislation.

The Group can manage credit risk related to loans receivable from related parties through KMG.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(continued)

36. FINANCIAL INSTRUMENTS (continued)

Fair value of financial instruments

The carrying amount of cash, trade accounts receivable and payable, short-term debts and other current monetary assets and liabilities approximates their fair value due to the short-term maturity of these financial instruments. Similarly, the carrying amounts of receivables and payables, which are all subject to normal trade credit terms, approximate their fair values.

The fair value of long-term borrowings is estimated using discounted cash flow analysis based on borrowing rates currently available to the Group for bank loans with similar terms and average maturities. The fair value of long-term debts is estimated to approximate carrying value.

37. SUBSEQUENT EVENTS

On November 6, 2006 the Company signed an agreement to purchase 50% of the shares of Naftrans Capital Partners Limited ("NCPL"). NCPL is a holding company that has investment in 61.8% shares of Batumi Terminal Limited, which operates the oil-loading terminal in Batumi, Georgia. The total consideration to be paid under the agreement amounted to USD 64,000 thousand, which equals the fair value of the net assets acquired. The agreement envisages the parties executing certain preliminary conditions prior to transferring ownership and control to the Company. The preliminary conditions were not met by December 31, 2006. Accordingly, NCPL's financial statements were not accounted for in the Group's consolidated financial statements for 2006.