Vostok Energy Limited

Report and Financial Statements

31 December 2006

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Registered No 05806076

Directors
Charles Jamieson (Chairman)
Alexander Capelson (Chief Executive Officer)
Blaine Karst (Finance Director)
Roger Cagle
Robert Cathery
Ronald Harris
Mark Sadykhov

Secretary
Tony Hunter

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Bankers
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Solicitors
Ashurst
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Directors' report

The directors of Vostok Energy Limited ("the Company") present their report and financial statements for the year ended 31 December 2006

Principal activities

The principal activities of the Company and its subsidiaries ("the Group") during the year were oil and gas exploration, development and production The Group's operating activities during 2006 were in Russia where the Group holds a sub-soil license for geological exploration and production of hydrocarbons

Review of the business

The Company was incorporated in Great Britain on 4 May 2006 as Atlantic Energy Group Limited The name was changed to Vostok Energy Limited on 4 August 2006 The address of the registered office is Masters House, 107 Hammersmith Road, London, England, W14 0QH

The Group was established on 25 May 2006 through the acquisition of Royal Atlantic Energy (Cyprus) Limited ("RAECL") from Royal Atlantic Energy Corporation ("RAEC"), a Canadian company controlled by Alex Capelson, the Group's founder and Chief Executive Officer This acquisition entitled Vostok to the assets and liabilities of RAECL, and a 75% interest in Zhaikinvest LTD LLP ("Zhaikinvest"), in exchange for 46,500,000 shares in the Company The acquisition has been accounted for under the pooling of interests method, as it represents the combination of companies all under the common control of Alex Capelson As a result of this pooling of interests, results of these companies are disclosed since their incorporation – RAECL on 21 February 2006, and Zhaikinvest on 16 March 2006

Zhaikinvest held a right to acquire an exploration and development license in Kazakhstan Subsequent to the acquisition of Zhaikinvest, the Company made the decision not to exercise the right which legally expired in 2006 However management is confident an extension to the option can be obtained and is currently looking for a partner to cover the costs of developing the license or to dispose of the right

On 1 June 2006 the Company acquired an effective 70% interest in Diall Alliance LLC ('DIALL"), through its subsidiary RAECL, in exchange for cash and a 30% interest in RAECL DIALL is a Russian company that holds a hydrocarbon license covering an area of 3,215 square kilometers in the Saratov region (the Bortovoy license) The 25 year license is valid until January, 2025

On 8 August 2006 the Company acquired a controlling 93% interest in Logan Neftegas CJSC ("Logan"), a Russian incorporated company Logan employed locally based experts used by the Group to assist in evaluating opportunities in Russia and former CIS countries The Group subsequently changed the name of Logan to Vostok Energy Company CJSC ("VEC") By virtue of common control, VEC is viewed as being part of the Group since its incorporation, and results have therefore been presented since 8 June 2005

On 1 October 2006 the Company acquired 100% of Royal Atlantic Energy Company, a Delaware corporation ("RAECD") RAECD was used to facilitate and coordinate activities between the CEO and US based non-executive directors with Group operations The Group subsequently changed the name of RAECD to Vostok Energy Ltd ("VEL") By virtue of the common control VEL and the Company, VEL is viewed as being part of the Group since incorporation on 19 June 2006

Directors' report

Review of the business (continued)

The Company had the following subsidiaries at 31 December 2006

Subsidiary	*Nature of operations*	*Effective ownership percentage*
Royal Atlantic Energy (Cyprus) Limited	Intermediate holding company for DIALL (Incorporated in Cyprus 21/02/06)	70%
Diall Alliance LLC (100% subsidiary of RAECL)	Oil and gas exploration, development and production company in Russia (Incorporated in Russia, acquired 01/06/06)	70%
Zhaikinvest LTD LLP	Partnership set up for operations in Kazakhstan (Incorporated in Kazakhstan 16/03/06)	75%
Vostok Energy Company, CJSC	Management company for Russian operations and acquisition evaluation (Incorporated in Russia 08/06/05)	93%
Vostok Energy Ltd	Management company in United States (Incorporated in US 19/06/06)	100%
Vostok Energy Resources Limited	UK based holding Company, currently inactive (Incorporated in UK 16/11/06)	100%

Results of operations for the period

The Group is focused on adding value through increasing reserves and production During 2006, the Group put forth an aggressive programme designed to prove up existing assets and bring them to commercial production in the shortest possible time Towards this end, the Group completed the following work programme on the Bortovoy licensed area

Seismic

Completed processing and interpretation of 95 sq km of 3D seismic shot over two established gas fields The results of interpretation will serve as a basis for the development plan

Made significant progress in the re-interpretation of 700 km of old seismic as well as old well data to better understand the acreage's further potential

Commenced acquisition of 1400 km of new 2D seismic covering a number of very promising but under-explored structures in the eastern part of the licence block which previously tested for oil and/or gas

Drilling and re-entries

Completed re-entry of 4 wells and testing of 1 additional previously re-entered well on 3 different fields The results confirmed significant potential of the fields for the forthcoming commercial development

Continued drilling of a deep exploration well targeting several horizons in Permian, Carboniferous and Devonian formations At the end of 2006 the well was at 3200m and tested hydrocarbons in open hole at shallower depths Following the completion of the well in 2007, the company will test all the well's targets and in conjunction with results of new seismic to be shot over the structure in 2007 incorporate new reserves into preliminary development planning

Directors' report

Results of operations for the period (continued)

Development planning

As a result of the aggressive work programme combined with internal and external geological and geophysical studies, the Group continues to improve their understanding of the potential of the Bortovoy licence Given the positive results of this work in 2006, the Group will continue its aggressive development plans in addition to acquiring 2D seismic over the balance of the license as there are significant regions in the central and eastern areas that remain virtually unexplored

From the date of acquisition of DIALL on 1 June 2006 to 31 December 2006, the Group brought into production 2 new wells bringing the total number of wells available for production to 5 at the end of 2006 The average production during this period was 128 barrels of oil per day

Financial review

The Annual Report and Accounts are prepared under International Financial Reporting Standards (IFRS) The Group uses US dollars as its presentation currency as this reflects the primary economic environment under which the Group operates The Group revenue for 2006 was 587 thousand USD (2005 – USD NIL) and the net loss on ordinary activities after taxation was 4 0 million USD (2005 – 37 thousand USD) Detailed Group financial information is set out in the audited financial statements for 2006 on pages 10 to 35 of this report

Events since the end of the year

In January, 2007 directors exercised options to acquire 4,650,000 shares of the Company from Royal Atlantic Energy Corporation The options were granted pursuant to an agreement entered into in May, 2006 between the Company, Royal Atlantic Energy Corporation and three non-executive directors which provided the directors the option to acquire up to 15,500,000 shares of the Company currently held by Royal Atlantic Energy Corporation All unexercised options expire on 26 May 2016

Effective 1 May 2007, the Company entered into an employment contract with the Finance Director It is the Company's policy to offer key employees incentives as part of their compensation plan The Finance Director will receive up to 5 times his annual salary in shares of the Company by remaining in full time employment with the Company for the three year period ending 30 April 2010 The shares shall vest at specified time intervals or based upon the achievement of certain performance criteria A further contract on similar terms was entered into effective 1 December 2007 with the Vice President of Exploration and Development, granting 620,000 shares in the Company if he remains in full time employment with the Company for the next three years

On 17 July 2007, the Company closed a financing for 19 4 million USD through the issue of 10,185,000 shares to existing shareholders The proceeds of the funds were used to acquire the 30% MI of RAECL and to fund ongoing operations

A transaction to acquire the 30% Minority Interest shareholdings of RAECL ("MI") closed on 24 July 2007 for a total cost of 28 0 million USD At closing, a cash payment of 8 0 million USD was made along with a commitment to issue 20 0 million USD of shares of the Company upon completion of the Company's Initial Public Offering ("IPO") at a 15% discount to the IPO price, if and when an IPO were to occur At the Company's option, the commitment to issue the shares can be fulfilled through a cash payment of 23 0 million USD at any time prior to the possible IPO Under the terms of the agreement, if an IPO is not completed prior to 24 January 2009, the former MI holders have up to 30 days to demand the immediate cash payment of 23 0 million USD The Company then has 14 days to pay the demand or the former MI holders have the option to buy back the 30% interest in RAECL for the price of 8 0 million USD

On 16 October 2007, the Group entered into an agreement to acquire a gas processing facility through Ventech Engineers International Corporation which includes re-engineering, refurbishment and procurement of specified components to make the plant operational to Russian standard The plant, which

Directors' report

ıs currently non-operatıonal, ıs located ın the western Unıted States and wıll be dısassembled, modıfied and shıpped to Russıa for use by DIALL The plant ıs expected to be operatıonal ın the first half of 2009 and wıll enable the Company to produce gas from the reserves sıtuated ın the fields ın the western portıon of the lıcensed area The total contract for the plant acquısıtıon, dısmantlıng, transportatıon and reassembly ın Russıa ıs estımated to cost 35 0 mıllıon USD The plant capacıty ıs approxımately 50 mıllıon cubıc feet per day or 540 mıllıon cu meters per year

On 24 October 2007, the Company sıgned a Mandate Letter wıth the Internatıonal Fınance Corporatıon ("IFC") for a financıng package of up to 50 mıllıon USD comprısıng equıty, senıor and mezzanıne debt to finance the acquısıtıon and ınstallatıon of a gas processıng plant, assocıated facılıtıes and ongoıng operatıng and capıtal expendıtures The first tranche of financıng, for an equıty ınvestment of 20 mıllıon USD, was receıved on 19 December 2007

Future developments

The Company ıs currently ın negotıatıons to sell theır 75% ınterest ın Zhaıkınvest LTD LLP No final agreement has been reached, however there ıs a reasonable expectatıon that the Company wıll recover 50% of theır ınvestment relatıng to thıs project Refer to Note 8 for further detaıls

Risk management

Financıal

The Fınance Dırector ıs responsıble for the Company's financıal rısk management functıon and the Audıt Commıttee provıdes oversıght of thıs whıle ultımate approval on financıal decısıons remaıns wıth the Board of Dırectors A revıew of rısks and theır management follows

Operatıons and commercial

The Group sells productıon at "spot" rates and does not maıntaın any fixed prıce or long term marketıng contracts Although oıl prıces may fluctuate, as a general polıcy, the Group does not hedge crude oıl sales However, under approprıate cırcumstances such as takıng advantage of attractıve oıl prıces, the Group may engage ın lımıted prıce hedgıng

The Group maıntaıns ınsurance over operatıons as requıred by local regulatıons As operatıons expand, the Group wıll revıew overall ınsurance requırements to ensure a proper balance between exposure and coverage Prımary operatıons are ın Russıa and whıle the Group recognızes the ınherent polıtıcal and economıc rısks the Group has made the decısıon not to carry any polıtıcal rısk or assocıated busıness ınterruptıon coverage The analysıs of rısks relatıng to the operatıng envıronment and taxatıon are ıncluded on pages 20-22 of thıs report

Strategıc and reputational

The Company ıs commıtted to promotıng and developıng hıgh standards of corporate responsıbılıty Responsıbılıty for ensurıng that these are followed lıes wıth the Board of Dırectors and senıor executıve officers and staff The Company belıeves that by ıncorporatıng hıgh standards ınto ıts corporate culture, the Company's rısk profile ıs reduced

A comprehensıve set of procedures and polıcıes ıs maıntaıned at the operatıonal level to ensure effectıve operatıons The Company revıews the Group's polıcıes and procedures on an ongoıng basıs ıncludıng envıronmental polıcıes to ensure complıance wıth local and ınternatıonal standards When requıred, the Company employs ındependent advısors to ensure good practıse ıs achıeved

Financial results and dividends

The Group loss for the perıod, after taxatıon, amounted to 4 0 mıllıon USD

The dırectors do not recommend a dıvıdend for the perıod

Directors' report

Directors

The directors at 31 December 2006 are given below

Alexander Abraham Capelson	appointed on 4 May 2006
Robert Maitland Cathery	appointed on 10 May 2006
Roger Dale Cagle	appointed on 26 May 2006
Ronald A Harris	appointed on 26 May 2006
Charles James Auldjo Jamieson	appointed on 26 May 2006
Mark Sadykhov	appointed on 26 May 2006

Subsequent to 31 December 2006, Blaine Edward Karst was appointed a director on 21 February 2007

Directors are not required to retire by rotation and there is no fixed term for the appointment

The interests of directors in the share capital of the Company (all beneficially held, other than as noted), are as follows

	At 25 January 2008 *Ordinary shares*	*At 31 December 2006* *Ordinary shares*
Roger Dale Cagle	1,500,000	–
Alexander Abraham Capelson*	22,100,000	22,100,000
Ronald A Harris	10,850,000	10,850,000
Charles James Auldjo Jamieson	3,100,000	–
Mark Sadykhov (held by MMS Holding Group LLC)	2,000,000	2,000,000
Robert Maitland Cathery	–	–
Blaine Edward Karst	–	–

* Of the shares in which Mr Capelson has an interest, 21,100,000 are held by Commonwealth American Partners GP, LLC

Statement as to disclosure of information to auditors

The directors who were in office on the date of approval of these financial statements have confirmed, as far as they are aware, that there is no relevant audit information of which the auditors are unaware Each of the directors have confirmed that they have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that it has been communicated to the auditor

Auditors

A resolution to reappoint Ernst & Young as auditors will be put to the members at the forthcoming Annual General Meeting

By order of the Board

Tony Hunter, Secretary

25 January 2008

Statement of directors' responsibilities

The directors are responsible for preparing the Report and the Financial Statements in accordance with applicable law and regulations The directors have elected to prepare financial statements for the Group in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") Company law requires the directors to prepare such financial statements in accordance with IFRS and the Companies Act 1985

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's "Framework for the preparation and presentation of Financial Statements" In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards

Directors are also required to

(a) properly select and apply accounting policies,

(b) present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information, and

(c) provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance

Independent auditor's report

to the members of Vostok Energy Limited

We have audited the group financial statements of Vostok Energy Limited for the year ended 31 December 2006 which comprise the Consolidated Income Statement, the Consolidated Balance Sheet, the Consolidated Statement of Changes in Equity and the Consolidated Statement of Cash Flows and the related notes 1 to 28 These group financial statements have been prepared under the accounting policies set out therein

We have reported separately on the parent company financial statements of Vostok Energy Limited for the year ended 31 December 2006

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities

Our responsibility is to audit the group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion we also evaluated the overall adequacy of the presentation of information in the group financial statements

Independent auditor's report
to the members of Vostok Energy Limited

Opinion

In our opinion

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the group's affairs as at 31 December 2006 and of its loss for the year then ended,
- the group financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the group financial statements

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 2 in the consolidated financial statements which indicates that the Company is dependent upon additional funding from investors in order to continue as a going concern The Company raised 19 4 million USD on 17 July 2007 from investors, and has a mandate agreement for 50 million USD equity and loans, of which 20 million USD has closed and funded as equity, at the date of this report The consolidated financial statements do not include any adjustments required if the Company was not able to obtain funding from investors or other sources and was therefore not able to continue as a going concern

Ernst & Young LLP

Ernst & Young LLP
Registered auditor
London
25 January 2008

Consolidated income statement

for the year ended 31 December 2006

	Notes	2006 USD'000	2005 USD'000
Revenue		587	-
Cost of sales	5	(368)	-
Gross profit		219	-
Other operating losses	6	(554)	(3)
Administrative expenses	7	(3,332)	(46)
Operating loss		(3,667)	(49)
Non-operating losses	8	(529)	-
Investment income	9	70	-
Finance costs	10	(81)	-
Loss on ordinary activities before taxation	4	(4,207)	(49)
Taxation	12	202	12
Loss on ordinary activities after taxation		(4,005)	(37)
Equity shareholders in the parent		(3,690)	(34)
Minority interests		(315)	(3)
		(4,005)	(37)

The operating loss for the year arises from the Company's continuing operations

Losses per share for loss attributable to the equity holders of the Company (see note 13) during the year

	2006 USD	2005 USD
- basic	0 07	9 26
- diluted	0 07	9 26

The notes on pages 14 to 35 are integral part of these financial statements

Consolidated balance sheet

at 31 December 2006

	Notes	2006 USD'000	2005 USD'000
Non-current assets			
Intangible assets	15	41,257	–
Property, plant and equipment	16	2,275	52
Trade and other assets	17	2,255	–
Deferred tax	12	798	12
		46,585	64
Current assets			
Inventories	18	66	–
Trade receivables and other assets	19	1,531	27
Cash and cash equivalents	20	11,600	32
		13,197	59
Total assets		59,782	123
Current liabilities			
Trade and other payables	21	1,809	58
Non-current liabilities			
Loans from related parties	22	1,930	100
Environmental provision	23	379	–
		2,309	100
Total liabilities		4,118	158
Net assets/(liabilities)		55,664	(35)
Equity			
Share capital	24	945	2
Share premium account	24	50,508	–
Accumulated losses		(4,404)	(34)
Equity attributable to shareholders of parent		47,049	(32)
Equity attributable to minority interests		8,615	(3)
Total equity		55,664	(35)

The notes on pages 14 to 35 are an integral part of these financial statements

The financial statements on pages 10 to 13 were approved by the Board of Directors and authorised for issue on 25 January 2008 and are signed on its behalf by

Blaine Karst

Blaine Karst, Director

25 January 2008

Consolidated statement of changes in equity

for the year ended 31 December 2006

	Attributable to equity holders of the company					
	Share capital USD'000	*Share premium USD'000*	*Accumulated deficit USD'000*	*Sub-total USD'000*	*Minority interest USD'000*	*Total equity USD'000*
Balance at 8 June 2005						
Share issues	2			2		2
Net loss for the year			(34)	(34)	(3)	(37)
Balance at 31 December 2005	2		(34)	(32)	(3)	(35)
Share issues	945	50,520		51,465		51,465
Share issue costs		(12)		(12)		(12)
Legal acquisition of subsidiary	(2)			(2)		(2)
Distribution to shareholder			(680)	(680)		(680)
Shares issued by subsidiary (RAECL)					8,933	8,933
Net loss for the year			(3,690)	(3,690)	(315)	(4,005)
Balance at 31 December 2006	945	50,508	(4,404)	47,049	8,615	55,664

The notes on pages 14 to 35 are an integral part of these financial statements

Consolidated statement of cash flows

for the year ended 31 December 2006

	Notes	2006 USD'000	2005 USD'000
Operating activities			
Net cash flow used in operating activities	25	(4,770)	(70)
Net cash used in operating activities		(4,770)	(70)
Investing activities			
Sale of property, plant and equipment		3	–
Purchase of intangible assets	15	(5,070)	–
Purchase of property, plant and equipment	16	(558)	–
Purchase consideration settled in cash, net of cash acquired	14	(23,821)	–
Net cash used in investing activities		(29,446)	-
Financing activities			
Proceeds on issue of share capital		49,202	2
(Decrease)/increase in long-term debt		(3,418)	100
Net cash provided by financing activities		45,784	102
Net increase in cash and cash equivalents		11,568	32
Cash and cash equivalents at beginning of year		32	–
Cash and cash equivalents at end of year		11,600	32

The notes on pages 14 to 35 are an integral part of these financial statements

Notes to the consolidated financial statements
at 31 December 2006

1. Organisation and principal activities

The Company was incorporated in Great Britain on 4 May 2006 under the Companies Act of 1985 as Atlantic Energy Group Limited The Company changed its name to Vostok Energy Limited on 4 August 2006 The principal activities of the Company and its subsidiaries (the "Group") are the exploration, development, and production of hydrocarbons The Group's operating activities during 2006 were in Russia, where the Group holds a sub-soil license for geological exploration and production of hydrocarbons The registered office of the Company is Masters House, 107 Hammersmith Road, London, England, W14 0QH

2. Basis of preparation and significant accounting policies

Basis of preparation

The consolidated financial statements of the Company and its subsidiaries have been prepared on a historical cost basis in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union (EU) and the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB as adopted by the European Union up to 31 December 2006

The consolidated financial statements are presented in US dollars

The Company is dependent upon the financial support of its investors until revenues from primary business activities are sufficient to satisfy its obligations and fully-finance its exploration and development programs The Company believes that it has the necessary capital resources at the balance sheet date to continue as a going concern when taking into account the financings completed subsequent to year-end and the commitment of the investors to continue to fund future operations until the Company can fund its own operations through internally generated cash flow Accordingly, the financial statements have been prepared on the going concern basis, which assumes that the Company and its subsidiaries will continue in operational existence for the foreseeable future

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries Subsidiaries are those entities controlled by the Group The Group was established on 25 May 2006 through the transfer of ownership of Royal Atlantic Energy (Cyprus) Limited (RAECL) and a 75% interest in Zhaikinvest LTD LLP from Royal Atlantic Energy Corporation, a Canadian company controlled by Alex Capelson, the Group's founder and Chief Executive Officer, to the Company This transfer of ownership was accounted for as a business combination involving entities under common control as it falls outside of the scope of IFRS 3

Consequently, the consolidated financial statements for the Group include the following

Vostok Energy Limited from 4 May 2006 (date of incorporation)
Royal Atlantic Energy Cypress from 21 February 2006 (date of incorporation)
Diall Alliance LLC from 1 June 2006 (date of acquisition)
Zhaikinvest LTD from 16 March 2006 (date of incorporation)
Logan Neftegas CJSC from 8 June 2005 (date of incorporation)
Royal Atlantic Energy Company from 19 June 2006 (date of incorporation)
Vostok Energy Resources Limited from 16 November 2006 (date of incorporation)

The Group subsequently changed the name of Logan to Vostok Energy Company CJSC

Notes to the consolidated financial statements
at 31 December 2006

2. Basis of preparation and significant accounting policies (continued)

Basis of consolidation (continued)

All inter-company balances and transactions have been eliminated upon consolidation As a consolidated income statement is published, a separate income statement for the parent company is not presented by virtue of Section 230 of the Companies Act 1985

Minority interests represent the portion of profit or loss and net assets in subsidiaries that are not held by the Group and are presented separately within equity in the consolidated balance sheet

Business combinations

Business combinations are accounted for using the purchase method of accounting The assets and liabilities of the acquiree are measured at fair value on the date of acquisition The results of acquired operations are included in the consolidated income statements from the date on which control was obtained The acquisition of Diall Alliance LLC has been accounted for using the purchase method of accounting

Transactions between businesses under common control have been accounted for using the pooling of interests method

Foreign currency

The US Dollar is the functional and presentation currency of the Group Each subsidiary determines its own functional currency, based on the currency of the primary economic environment in which it operates In the individual Group companies, transactions in currencies other than US dollars are recorded in the local currency at actual exchange rates at the date of the transaction Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to US dollars at actual exchange rates at the period end

Income and expenses

Revenue recognition

Revenue represents the Group's share of oil and gas sales recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured Revenue excludes any applicable sales taxes

Investment income and finance costs

Investment income comprises of interest income on funds invested Interest income is recognised as it accrues, calculated in accordance with the effective interest method

Finance costs comprise of interest expense on borrowings All borrowing costs are recognised in the income statement using the effective interest method Any interest payable for funds borrowed for the purpose of obtaining a qualifying asset will be capitalized as a cost of that asset No interest was capitalized in the period

Notes to the consolidated financial statements
at 31 December 2006

2. Basis of preparation and significant accounting policies (continued)

Taxation

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date

Deferred income tax is recognised on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, with the following exceptions

- where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss,

- in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future, and

- deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised

Deferred income tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the related asset is realized or liability is settled, based on tax rates and laws enacted or substantively enacted at the balance sheet date

Income tax is charged or credited directly to equity if it relates to items that are credited or charged to equity Otherwise income tax is recognised in the income statement

Pension costs

The contributions payable in the year in respect of defined contribution schemes for pension costs and post-retirement benefits are charged to the income statement Differences between contributions payable in the year and contributions actually paid are shown either as accruals or prepayments in the balance sheet

Notes to the consolidated financial statements
at 31 December 2006

2. Basis of preparation and significant accounting policies (continued)

Oil and gas assets

The Group has adopted the successful efforts method of accounting for oil and gas assets, with regard to the requirements of IFRS 6 "Exploration for and Evaluation of Mineral Resources"

Costs incurred prior to the award of oil and gas licenses, concessions and other exploration rights are expensed in the income statement Cost incurred on the acquisition of a license interest is initially capitalised on a license by license basis Cost are capitalised within intangible fixed assets and held un-depleted until the exploration phase on the license is complete or commercial reserves have been discovered Costs are stated at cost less accumulated amortisation and impairment losses and are amortised on a straight line basis over their estimated useful lives

Extraction License	25 years
Other License	5 years

All costs incurred in technical services, seismic data, and for exploration and appraisal activities are initially capitalised as intangible assets on a well by well basis until the results of the drilling have been determined If commercial reserves have been discovered and development has been approved, the carrying value of the related intangible assets is reclassified as development and production assets If commercial reserves have not been found, the costs are charged to expense after appraisal activities are completed

Exploration and evaluation assets are assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount When facts and circumstances suggest that the carrying amount exceeds the recoverable amount, then the impairment will be measured, presented and disclosed in accordance with IAS 36 Impairment of assets'

Development and production assets

Costs incurred to develop the reserves and bringing them into production together with exploration and evaluation costs are capitalised within property, plant and equipment on a field by field basis Subsequent expenditure is capitalised only if it either enhances the economic benefits of the development/producing asset or replaces part of the existing development/producing asset Any costs remaining associated with the part replaced are expensed Directly attributed overheads and finance costs are capitalised where they relate to specific exploration and development activities

Development and production assets are carried on the balance sheet at cost less accumulated depreciation and impairment allowances

Depletion

Depletion is provided on oil and gas assets in production using the unit of production method, based on proven reserves, applied to the sum of the total capitalized exploration, evaluation and development costs, together with estimated future development costs at current prices

Environmental restoration

The environmental restoration provision is calculated at the net present value of the total costs expected to be incurred at the end of the producing life of each field in the removal and decommissioning of the production, storage and transportation facilities currently in place The cost of recognizing the environmental restoration provision is included as part of the cost of the relevant property, plant and equipment and is charged to the income statement on a unit of production basis

Notes to the consolidated financial statements
at 31 December 2006

2. Basis of preparation and significant accounting policies (continued)

Development and production assets (continued)

Inventories

Inventories represent unsold oil in storage and consumables and are recorded at the lower of cost or net realizable value on a first-in first-out basis Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses

Property, plant and equipment- other

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses Such cost includes costs directly attributable to making the asset capable of operating as intended

Depreciation is provided on all property, plant and equipment, other than freehold land, at rates calculated to write off the cost, less estimated residual value based on prices prevailing at the balance sheet date, of each asset evenly over its expected useful life as follows

Office equipment	5 years
Furniture and fixtures	5 years
Motor vehicles and machinery	5 years

Impairment of assets

Impairment of non-current assets

The carrying amounts for non-current assets are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable If there are indicators of impairment, an exercise is undertaken to determine whether the carrying values are in excess of their recoverable amount Such review is undertaken on an asset by asset basis, except where such assets do not generate cash flows independent of other assets, in which case the review is undertaken at the cash generating unit level

If the carrying amount of an asset or its cash generating unit exceeds the recoverable amount, a provision is recorded to reflect the asset at the lower amount Impairment losses are recognised in the income statement

Calculation of recoverable amount

The recoverable amount of assets is the greater of their value in use and fair value less costs to sell 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 assessments of the time value of money and the risks specific to the asset For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash generating unit to which the asset belongs The Group's cash generating units are the smallest identifiable groups of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets

Reversals of impairment

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognised

Notes to the consolidated financial statements
at 31 December 2006

2 Basis of preparation and significant accounting policies (continued)

Financial instruments

The Group's financial instruments include cash and borrowings together with various items such as other receivables and trade payables, which arise directly from its operations The main purpose of these financial instruments is to provide working capital

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument There are no material financial assets and liabilities for which differences between carrying amount and fair value are required to be disclosed

Loans and convertible loans

Loans are recognised in the balance sheet at nominal value, any interest is put through the income statement as and when it is charged

Borrowings are recognised initially at fair value, net of transaction costs incurred Borrowings are subsequently stated at amortized cost, any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method

Trade receivables

Trade and other receivables do not carry any interest and are recognised and carried at their nominal value less an allowance for any uncollectible amounts Bad debts are written off when identified

Cash and cash equivalents

Cash and cash equivalents include balances with banks and short-term investments with maturities of three months or less at the date acquired

Trade payables

Trade payables are stated at their nominal value

Share capital

Share capital issued by the Company is recorded at the proceeds received net of issue costs

Use of estimates and judgments

The preparation of financial statements in conformity with generally accepted accounting practice requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities as well as the disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting period Actual outcomes could differ from those estimates

In the process of applying the Group's accounting policies described above, management has made judgments that have a significant effect on the amounts recognised in the financial statements

Notes to the consolidated financial statements
at 31 December 2006

2. Basis of preparation and significant accounting policies (continued)

Use of estimates and judgments (continued)

Fair value of acquisition (see note 14)

Upon acquisition, assets and liabilities, including exploration and evaluation assets, are to be included in the financial statements at their fair market value The actual value that will be realized from these assets is inherently uncertain and reflects a wide range of factors including but not limited to geographical and geophysical factors, future costs and commodity prices, the duration of the license and its term and the availability of financial and other resources need to progress exploration and development activities

Impairment review of intangible assets (see note 15)

Management is required to assess the level of the Company's commercial reserves, which are utilised in determining the amortization and depreciation charge for the period and assessing whether any impairment charge is required The Company utilizes independent experts and their own internal expertise to assess the commercial viability of reserves and any future capital expenditures, on a field by field basis

Sub-soil licenses (see note 15)

The Group is subject to periodic reviews of its activities by governmental authorities with respect to the requirements of its sub-soil licenses and seeks amendments to the licenses when supported by the results of ongoing exploration and development activities The requirements under the licenses are subject to interpretation and enforcement policies of the relevant authorities In management's opinion, as of 31 December 2006, there are no serious non-compliance issues that will have an adverse effect on the financial position or the operating results of the Company

Environmental restoration (see note 23)

The Group operates in the upstream oil industry in the Russian Federation and its activities may have an impact on the environment The enforcement of environmental regulations in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered The Group periodically evaluates its obligation related thereto The outcome of environmental liabilities under proposed or future legislation, or as a result of stricter interpretation and enforcement of existing legislation, cannot reasonably be estimated at present, but could be material Under the current levels of enforcement of existing legislation, management believes there are no significant liabilities in addition to amounts which are already accrued and which would have a material adverse effect on the financial position of the Group

Financial risk management

Currency risk

The Group's primary operations are within Russia and the combination of Russian Ruble ("RUR") denominated costs and sales and US dollar denominated debt gives rise to foreign exchange exposure For the past several years the risk has been minimized due to the stability of the RUR to the US dollar

Cash balances in the Group are usually held in US dollars, but smaller amounts may be held in British Sterling or local currencies to meet operating and administrative expenses or to comply with local legislation The Group does not have formal arrangements to mitigate foreign exchange risks at this time however should circumstances dictate, the Group may consider hedging positions to protect the value of any cash balances it holds in non-US dollar currency

Notes to the consolidated financial statements

at 31 December 2006

2. Basis of preparation and significant accounting policies (continued)

Financial risk management (continued)

Currency risk (continued)

The following table demonstrates the sensitivity to a reasonably possible change in the Russian ruble compared to the US dollar exchange rates on the Group's loss before tax and equity respectively

	Increase/ (decrease)	*Effect on loss for period Increase/ (decrease) USD 000's*	*Effect on Equity Increase/ (decrease) USD 000's*
2006	5%	(54)	46
	(5%)	54	(46)

Commodity price risk

Currently production is sold on near term contracts, with prices fixed at the time of a transfer of custody or as agreed in the contract As the license area is developed and production increases, consideration will be given to entering into fixed price, long term market contracts The Group's policy is not to hedge commodity prices unless hedging is required to mitigate financial risks associated with debt financing of its assets or to meet its commitments

Interest rate and liquidity risk

Given the early stages of developing its oil and gas licensed area, management is continually monitoring cash requirements for the Group and evaluating potential sources to fund its operating and capital expenditures It is the goal of management to ensure adequate funding is available through an appropriate mix of debt and equity instruments To limit liquidity risk, all significant cash and cash equivalents are deposited with banks with high credit-ratings assigned by international credit-rating agencies

The Group has limited borrowings with floating rates as at 31 December 2006 and any reasonable change in interest will not have a significant impact on the Group loss or equity

Operating and financial risks

Operating environment

Ongoing operations and those of similar companies in Russia are subject to the prevailing economic, political and regulatory uncertainties

The Russian economy, while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of a market in transition These characteristics have in the past included higher than normal historic inflation, lack of liquidity in the capital markets, and the existence of currency controls which cause the national currency to be illiquid outside Russia The continued success and stability of the Russian economy will be significantly impacted by the government's continued actions with regard to supervisory, legal and economic reforms

Notes to the consolidated financial statements
at 31 December 2006

2. Basis of preparation and significant accounting policies (continued)

Operating and financial risks (continued)

Taxation (continued)

Russian tax, currency and customs legislation is subject to varying interpretations and changes which can occur frequently Management's interpretation of such legislation as applied to the transactions and activity of the Group in Russia may be challenged by the relevant regional and federal authorities Based on reviews performed to date by the relevant authorities, there have been no significant tax fines or penalties incurred and management believes that as at 31 December 2006, its interpretation of the relevant legislation is appropriate and the Group's tax and currency positions will be sustained

New standards and interpretations not applied

At the date of authorization of these financial statements the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective in respect of the year being reported on

IFRS 7	Financial instruments Disclosures, and the related amendments to IAS 1 on capital disclosures (effective 1 January 2007)
IFRS 8	Operating segments (effective 1 January 2009)
IFRIC 8	Scope of IFRS 2 Share-based payments (effective 1 May 2006)
IFRIC 9	Reassessment of Embedded Derivatives (effective 1 June 2006)
IFRIC 10	Interim Financial Reporting and Impairment (effective 1 November 2006)
IFRIC 11	IFRS 2 – Group and Treasury Share Transactions (effective 1 March 2007)
IFRIC 12	Service Concession Arrangements (effective 1 January 2008)
IFRIC 13	Customer Loyalty Programmes (effective 1 July 2008)
IFRIC 14	IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective 1 January 2008)

The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group when the relevant standards come into effect for the periods commencing on or after dates shown above

3. Segment information

The Group's operations comprise one class of business being oil and gas exploration, development and production

The primary Group operation is in one geographical region which is Russia Companies incorporated outside of Russia are mainly administrative centers which primarily support the Company operations in Russia

Notes to the consolidated financial statements
at 31 December 2006

4. Loss on ordinary activities before taxation

	2006 USD'000	2005 USD'000
Loss from operations after charging		
Net foreign exchange losses	28	–
Depletion	18	–
Depreciation	22	1
Amortisation	2	–
Impairment of intangibles	500	–
Staff costs		
Administrative	1,338	40
Cost of sales	72	–
Auditors' remuneration for audit services		
Statutory audit	192	–
Other services	24	1

5 Cost of sales

	2006 USD'000	2005 USD'000
Mineral extraction tax	184	–
Direct labour	72	–
Subsoil usage royalties	48	–
Subcontracting costs	33	–
Depletion and amortisation	20	–
Land rental	8	–
Other	3	–
	368	–

6. Other operating expenses

	2006 USD'000	2005 USD'000
Repair and maintenance	337	–
Rental, heating, other	153	3
Other taxes	54	–
Exploration	10	–
	554	3

Other taxes of 54 thousand USD are comprised of property, transport, environmental and water utilization taxes

Notes to the consolidated financial statements
at 31 December 2006

7. Administrative expenses

	2006	*2005*
	USD'000	*USD'000*
Professional fees	1,448	–
Salaries and benefits	1,338	40
Travel and training	238	–
Office	246	5
Depreciation	22	1
Insurance	40	–
	3,332	46

8. Non-operating losses

	2006	*2005*
	USD'000	*USD'000*
Impairment provision for Zhaikinvest	500	–
Exchange losses	28	–
Other	1	–
	529	–

An impairment provision has been recorded for the investment in Zhaikinvest (see Note 15) given the uncertainty as to the recoverability of the carrying value of the investment The investment has been written down to its expected net realizable value and the impairment losses recognised in the income statement

9. Investment income

	2006	*2005*
	USD'000	*USD'000*
Interest on short-term deposits	70	-

10. Finance costs

	2006	*2005*
	USD'000	*USD'000*
Interest on non-current liabilities	68	-
Interest on short term borrowings	8	-
Unwinding of discount of provsions	5	-
	81	-

Notes to the consolidated financial statements
at 31 December 2006

11 Salaries and directors' emoluments

(a) Staff costs

	2006 USD'000	2005 USD'000
Administrative wages and salaries	1,306	40
Social costs and other benefits	104	–
	1,410	40

Total salaries for the Group for the year ending 31 December 2006 includes 72 thousand USD (2005 $nil) recorded as direct labor costs included in cost of sales

The average monthly number of employees (including executive directors) for the year for the Group was as follows

	2006 No	2005 No
Operations	30	–
Head office and administration	23	4
	53	4

The Group does not have any employee retirement or pension benefit plan however funds are paid into the required government pension funds or social benefit programs for all its employees as they arise No significant post retirement benefits were paid during the year

(b) Directors' emoluments

Included in staff costs, is director compensation of 196 thousand USD No compensation was paid to non-executive directors during the period

Notes to the consolidated financial statements
at 31 December 2006

12. Taxation

The income tax credit for the period of 202 thousand USD arises from the Group's Russian operations and all relates to deferred tax The taxation recovery can be reconciled to Loss per the Income Statement as follows

	2006 *USD'000*	*2005* *USD'000*
Loss before taxation	(4,207)	(48)
Tax at applicable rate of tax (30%)	(1,262)	(14)
Tax affect of		
– UK losses not recognised	625	–
– foreign losses not recognised	145	–
– effect of different foreign tax rates	116	2
– items which are not deductible for tax	174	–
Current year taxation provision	(202)	(12)

The applicable rate of tax is assumed to be the UK corporation tax rate of 30% The effect of different foreign tax rates is the result of the losses incurred in Russia where the corporate tax rate is 24%

Deferred tax

The following deferred tax has been recognised

	2006 *USD'000*	*2005* *USD'000*
Deferred tax assets		
– tax losses carried forward	761	12
– impairment allowances	193	–
– other allowances	22	–
Deferred tax liabilities		
– prepaids and other current assets	(125)	–
– property, plant and equipment	(53)	–
	798	12

A net deferred tax asset has been recognised on the basis of future profit projections, which show that sufficient taxable profit is expected to arise against which these losses can be utilised

In addition, the group has tax losses which arose in the UK of 2 083 million USD, in Kazakhstan of 211 thousand and in the US of 246 thousand USD, in respect of which deferred tax assets have not been recognised This is on the basis that it is not sufficiently certain that taxable profits will arise against which to offset these tax losses The UK tax losses are available to be carried forward indefinitely, to be offset against future profits in the same company in which the loss arose Russian tax losses expire after 10 years

Notes to the consolidated financial statements
at 31 December 2006

The amount of deferred tax that has been recognised in the income statement is as follows

	2006 *USD'000*	*2005* *USD'000*
Deferred tax assets		
– tax losses carried forward	165	12
– impairment allowances	193	–
– other allowances	22	–
Deferred tax liabilities		
– prepaids and other current assets	(125)	–
– property, plant and equipment	(53)	–
	202	12

13. Loss per share

The calculation of basic loss per ordinary share is based on the loss for the period and the weighted average number of shares in issue

	2006	*2005*
Loss for the purposes of basic loss per share (USD'000)	3,690	34
Weighted average number of ordinary shares for the purposes of basic loss per share	49,383,691	3,673
Basic	0 07	9 26
Diluted	0 07	9 26

As the Group has made a loss in the period, basic and diluted LPS are equal

Notes to the consolidated financial statements
at 31 December 2006

14. Business acquisitions

DIALL

On 25 May 2006 the Group completed a transaction with RAEC to acquire RAECL which held the right to acquire DIALL, a company owning oil and gas rights in the Saratov region of Russia

	2006
	USD'000
Analysis of acquisitions costs and net assets acquired in DIALL	
Purchase consideration	
– cash paid including commissions	21,843
– stock issued from RAECL	8,933
– other costs	2,068
Total acquisition costs	32,844
Fair market value of net assets acquired	
– intangible assets	3,581
– property, plant and equipment	1,704
– trade and other assets – long term	364
– inventories	60
– deferred tax asset	582
– trade and other assets – current	717
– cash and cash equivalents	93
– non-current liabilities	(5,728)
– environmental provisions	(139)
– trade and other payables – current	(1,289)
Net liabilities acquired	(55)
Total acquisition costs	32,844
Intangible asset uplift	32,899

Upon review of the fair market value of the assets at the time of acquisition, it was determined that there were no significant differences between the net book value of the assets and their fair market value except for the intangible assets whose book value was 3 581 million USD on closing The increase of 32 899 million USD reflects the difference between the purchase consideration paid and the fair market value of the net assets which has been allocated to the sub-soil license rights and included as part of intangible assets (see note 15)

In the period since acquisition, DIALL has contributed a net loss of 514 thousand USD after tax to the Group result If DIALL had been acquired as at 1 January 2006, revenue recognised in the year to 31 December 2006 for the Group would have increased by 99 thousand USD, to 686 thousand USD, and the net loss would have increased by 305 thousand USD, to 4 310 million USD

Notes to the consolidated financial statements
at 31 December 2006

15. Intangible assets

	Seismic costs *USD'000*	*Development costs* *USD'000*	*Sub-soil licences* *USD'000*	*Sub-soil licence rights* *USD'000*	*Total* *USD'000*
Cost					
Beginning of period	–	–	–	–	–
Acquisition of subsidiaries	986	2,537	58	–	3,581
Uplift on acquisition	–	–	32,899	–	32,899
Additions	680	3,599	–	1,000	5,279
At 31 December 2006	1,666	6,136	32,957	1,000	41,759
Amortisation and impairment					
Beginning of period	–	–	–	–	–
Amortisation for the year	–	–	2	–	2
Impairment charge	–	–	–	500	500
At 31 December 2006	–	–	2	500	502
Carrying amount					
At beginning of period	–	–	–	–	–
At 31 December 2006	1,666	6,136	32,955	500	41,257

Sub-soil licences acquired through acquisition and the related acquisition costs are from the acquisition of DIALL Sub-soil licence rights were acquired through the acquisition of Zhaikinvest for 1 0 million USD which, upon impairment review, was written down to 500 thousand USD as at 31 December 2006

There were no intangible assets in 2005

Notes to the consolidated financial statements
at 31 December 2006

16. Property, plant and equipment

	Oil and gas plant and equipment USD'000	*Motor vehicles USD'000*	*Office equipment and furniture USD'000*	*Total USD'000*
Historical cost:				
Opening balance at 8 June 2005	–	–	–	–
Additions	–	53	–	53
At 31 December 2005	–	53	–	53
Acquisition of subsidiaries	1,675	26	3	1,704
Additions	452	31	79	562
Disposal	–	(5)	(1)	(6)
At 31 December 2006	2,127	105	81	2,313
Depreciation:				
Opening accumulated depreciation at 8 June 2005	–	–	–	–
Depreciation and depletion	–	(1)	–	(1)
At 31 December 2005	–	(1)	–	(1)
Depreciation and depletion	(18)	(16)	(6)	(40)
Disposal	–	3	–	3
At 31 December 2006	(18)	(14)	(6)	(38)
Net book value				
At 31 December 2005	–	52	–	52
At 31 December 2006	2,109	91	75	2,275

There are no restrictions on the use or sale of the property, plant and equipment nor have any of the assets been pledged on debt or used as security during the period

Notes to the consolidated financial statements
at 31 December 2006

17. Trade and other assets – non current

	2006 USD'000	2005 USD'000
Prepayments	1,262	–
Other receivables	993	–
	2,255	–

The prepayments are advance payments on contracts for capital projects (on capital expansion and developments of the wells) and are therefore classified as a non-current asset Other receivables are for value added taxes which will be used as an offset against future value added tax liabilities but are not expected to be recovered within the next twelve month period

18. Inventories

	2006 USD'000	2005 USD'000
Crude oil	35	–
Other materials	31	–
	66	–

Crude oil inventory represents amounts held in storage pending sales to customers

19. Trade and other assets – current

	2006 USD'000	2005 USD'000
Trade receivables	6	–
Tax receivables	740	–
Prepayments	751	25
Other	34	2
	1,531	27

Tax receivables relate to value added tax payments that are expected to be recovered within the next twelve months Prepayments are advance payments on contracts for services to be rendered within the next twelve months

As at 31 December 2006 and 2005 no provision was provided for impairment of current assets

No trade receivables have been pledged as security for any credit facilities

Notes to the consolidated financial statements
at 31 December 2006

20. Cash and cash equivalents

Cash is kept on deposit and earns interest at floating rates at the daily bank deposit rates Short-term deposits are made for varying periods based on immediate cash requirements but normally for periods of 30 days or less At 31 December 2006 the cash and cash equivalents of 11 6 million USD were on deposit at banks

21. Current financial liabilities

	2006 *USD'000*	*2005* *USD'000*
Trade payables	907	54
Accruals and other payables	340	4
Short term borrowings	562	–
	1,809	58

The short-term borrowings are a series of promissory notes due in 2007

22. Non-current liabilities

	Interest rate Charged	*2006* *USD'000*	*2005* *USD'000*
Amounts due in less than 5 years			
Energy Growth Management Services (see note 28)	6%	1,578	–
Logan Energy Resources Inc (see note 28	LIBOR + 3%	352	–
Royal Atlantic Energy Corporation		–	100
		1,930	100

LIBOR is the British Bankers Association London Interbank Offered Rate

The obligation to RAEC was settled when ownership of Logan was transferred to the Company on 8 August 2006

23. Environmental provisions

	2006 *USD'000*	*2005* *USD'000*
Beginning of period	–	–
Assumed on acquisition	139	–
New or increased provision	235	–
Unwinding of discount	5	–
	379	–

The provision for environmental restoration includes the decommissioning and restoration liability relating to liquidation of wells The provision recorded for the period was 240 thousand USD

Notes to the consolidated financial statements
at 31 December 2006

24. Share capital

	2006
Authorised	*USD'000*
200,000,000 ordinary shares of USD 0 01 each	2,000

	Ordinary shares		*Share*	*Share*
	Shares	*Amount*	*capital*	*premium*
Issued and fully paid	*No*	*USD'000*	*USD'000*	*USD'000*
Share issue 25 May 2006	46,500,000	465	465	–
Share issue 27 June 2006	40,000,000	40,000	400	39,600
Share issue 26 July 2006	1,000,000	1,000	10	990
Share issue 22 December 2006	7,000,000	10,000	70	9,930
	94,500,000	51,465	945	50,520
Share issue costs				(12)
				50,508

In 2005, the share capital (2 thousand USD) represented the share capital of Logan Neftegas CJSC, a company under common control On transformation of the Group in 2006, the shares in this company were acquired by Vostok Energy Limited in a common control transaction, and are therefore eliminated upon consolidation

Upon the formation of the Company on 25 May 2006, RAEC received 46,500,000 shares in the Company Of these shares, 15,500,000 were held as Option Securities by RAEC, which were granted to three non-executive directors of Vostok The options are valued at $0 01 per share

25. Reconciliation of loss from operations to net cash used in operating activities

	2006	*2005*
	USD'000	*USD'000*
Loss from operations before taxation	(4,207)	(49)
Adjustments for		
Depreciation, depletion and amortisation	41	1
Impairment provision	500	–
Accrued interest	69	–
Increase in trade and other receivables	(1,394)	(27)
Increase in inventories	(6)	–
Increase in trade and other payables	213	5
Increase in short-term borrowings	14	–
Net cash flow used in operating activities	(4,770)	(70)

Notes to the consolidated financial statements
at 31 December 2006

26. Operating lease obligations

Operatıng lease payments maınly represent rentals payable by the Group for land, office space and equıpment requıred for use on a temporary basıs Land leases for well sıtes are normally 10 years, whıle other leases are normally negotıated on a short term basıs of one to two years wıth optıons to extend Longer term office leases wıll be done ıf terms are favourable but would ınclude break clauses by provıdıng one to two year notıce perıod

Lease payments under operatıng leases recognısed ın ıncome for the year were 142 thousand USD (2005 – USD nıl)

At the balance sheet date, the Group had outstandıng commıtments for future mınımum lease payments under non-cancellable operatıng leases, whıch fall due as follows

	2006	*2005*
	USD'000	*USD'000*
Wıthın one year	157	-
In two to five years	5	-
Later than five years	5	-

27. Related party transactions

The acquısıtıon of the 70 per cent ownershıp ınterest ın Royal Atlantıc Energy (Cyprus) Ltd, the 100% owner of DIALL and the acquısıtıon of the 75% ownershıp ınterest ın Zhaıkınvest completed on 25 May 2006, were effected through the ıssuance of 46,500,000 shares of Vostok Energy Lımıted to the shareholders of Royal Atlantıc Energy Company thereby makıng the majorıty shareholders of Royal Atlantıc Energy Company the majorıty shareholders of the Company upon completıon of the transactıon In addıtıon to ıssuıng the shares, the Company assumed certaın benefits and oblıgatıons as per the terms of the agreement As at 31 December 2006 the Company had a promıssory note for 1 578 mıllıon USD due to Energy Growth Management Servıces, a company owned and controlled by shareholders of Vostok (see Note 22) The promıssory note plus accumulated ınterest ıs due on 15 May 2008

On 8 August 2006, Vostok Energy Company, CJSC was acquıred from Logan Energy Resources Inc ("Logan Inc "), a company controlled by shareholders of Vostok Energy Lımıted As per the terms of the acquısıtıon agreement, Vostok ıssued a demand promıssory note for 340 thousand USD to Logan Inc The amount plus ınterest of 12 thousand USD ıs outstandıng as at 31 December 2006 and the prıncıples of Logan have agreed that the no demand shall be made for payment prıor to 31 December 2007 (see note 22)

Based on remuneratıon packages for key staff, the Company may agree to reımburse employees for accommodatıon costs when the employee ıs requıred to lıve or work for extended perıods outsıde theır country of prıncıple resıdency Durıng 2006, the Company ıncurred expenses of 29 thousand USD relatıng to accommodatıon costs for theır Chıef Operatıng Officer who ıs also a shareholder of the Company

Durıng 2006 the Group utılısed a sub-contractor to supervıse drıllıng actıvıtıes ın Russıa A senıor officer of the sub-contractor ıs a dırector and has an ownershıp ınterest ın Vostok Energy Lımıted

Notes to the consolidated financial statements
at 31 December 2006

28. Capital commitments

The Group has commitments pursuant to its sub-soil license agreements to continue to explore and develop the license area Management estimates that at 31 December 2006 the above non accrued license commitments totaled approximately 12 5 million USD

Prior to 31 December 2006, the Group entered into several contracts for drilling, work-over and seismic services as part of the normal business activity Pursuant to these contracts, there were outstanding work commitments still to be delivered of 4 1 million USD as at 31 December 2006

No such contracts existed in 2005

Independent auditor's report

to the members of Vostok Energy Limited

We have audited the parent company financial statements of Vostok Energy Limited for the year ended 31 December 2006 which comprise the Balance Sheet, the Statement of Changes in Equity and Statement of Cash Flows and the related notes 1 to 8 These parent company financial statements have been prepared under the accounting policies set out therein

We have reported separately on the group financial statements of Vostok Energy Limited for the year ended 31 December 2006

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the parent company financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities

Our responsibility is to audit the parent company financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements have been properly prepared in accordance with the Companies Act 1985 We also report to you whether in our opinion the information given in the directors' report is consistent with the parent company financial statements

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company financial statements are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent company financial statements

Independent auditor's report
to the members of Vostok Energy Limited

Opinion

In our opinion

- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the company's affairs as at 31 December 2006,
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the parent company financial statements

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 2 in the consolidated financial statements which indicates that the Company is dependent upon additional funding from investors in order to continue as a going concern The Company raised 19 4 million USD on 17 July 2007 from investors, and has a mandate agreement for 50 million USD equity and loans, of which 20 million USD has closed and funded as equity, at the date of this report The consolidated financial statements do not include any adjustments required if the Company was not able to obtain funding from investors or other sources and was therefore not able to continue as a going concern

Ernst & Young LLP
Registered auditor
London
25 January 2008

Parent company financial statements of Vostok Energy Limited

Company balance sheet as at 31 December 2006

	Notes	2006 USD'000
Non-current assets		
Property, plant and equipment	2	4
Investments in subsidiaries	3	3,188
Intercompany advances	4	37,159
		40,351
Current assets		
Trade and other assets	5	249
Cash and cash equivalents		11,252
		11,501
Total assets		51,852
Current liabilities		
Trade and other payables	6	558
Non-current liabilities	7	1,930
Total liabilities		2,488
Net assets		49,364
Equity		
Share capital		945
Share premium account		50,508
Accumulated losses		(2,089)
Total equity		49,364

The notes on pages 41 to 43 are an integral part of these financial statements

The financial statements on pages 38 to 40 were approved by the board of directors and authorised for issue on 25 January 2008 and are signed on its behalf by

Blaine Karst

Blaine Karst, Director

25 January 2008

Parent company financial statements of Vostok Energy Limited

Company statement of changes in equity for the year ended 31 December 2006

	Attributable to equity holders of the company			
	Share capital USD'000	*Share premium USD'000*	*Accumulated deficit USD'000*	*Total equity USD'000*
Balance at 4 May 2006	–	–	–	–
Share issues	945	50,520	–	51,465
Share issue costs	–	(12)	–	(12)
Net loss for the year	–	–	(2,089)	(2,089)
Balance at 31 December 2006	945	50,508	(2,089)	49,364

Parent company financial statements of Vostok Energy Limited

Company statement of cash flows for the year ended 31 December 2006

	Notes	2006 USD'000
Operating activities		
Net cash flow used in operating activities	*8*	(1,423)
Net cash used in operating activities		(1,423)
Investing activities		
Investments in subsidiaries		(1,594)
Purchase of property, plant and equipment		(5)
Loans to subsidiaries		(34,929)
Net cash used in investing activities		(36,528)
Financing activities		
Proceeds on issue of share capital		49,203
Net cash provided by financing activities		49,203
Net increase/(decrease) in cash and cash equivalents		11,252
Cash and cash equivalents at beginning of year		–
Cash and cash equivalents at end of year		11,252

The notes on pages 41 to 43 are an integral part of these financial statements

Parent company financial statements of Vostok Energy Limited

Notes to the company financial statements at 31 December 2006

1. Basis of preparation

The Company is dependent upon the financial support of its investors until revenues from primary business activities are sufficient to satisfy its obligations and fully-finance its exploration and development programs The Company believes that it has the necessary capital resources at the balance sheet date to continue as a going concern when taking into account the financings completed subsequent to year-end and the commitment of the investors to continue to fund future operations until the Company can fund its own operations through internally generated cash flow Accordingly, the financial statements have been prepared on the going concern basis, which assumes that the Company and its subsidiaries will continue in operational existence for the foreseeable future

2. Property, plant and equipment

	Office equipment and furniture USD'000	*Total USD'000*
Historical cost:		
Opening balance at 4 May 2006	–	–
Additions	4	4
At 31 December 2006	4	4
Depreciation:		
Opening accumulated depreciation at 4 May 2006	–	–
Depreciation	–	–
At 31 December 2006	–	–
Net book value		
Opening at 4 May 2006	–	–
At 31 December 2006	4	4

3 Investments in subsidiaries

	2006 USD'000
RAECL and DIALL	2,537
Vostok Moscow	151
Zhaikinvest	500
	3,188

Parent company financial statements of Vostok Energy Limited

Notes to the company financial statements at 31 December 2006

4 Intercompany advances

	2006 USD'000
RAECL	33,720
DIALL	2,154
Vostok Moscow	740
Zhaikinvest	316
Vostok US	229
	37,159

5. Trade and other assets

	2006 USD'000
Prepayments	72
Other receivables	177
	249

6. Trade and other payables

	2006 USD'000
Trade payables	325
Accruals	233
	558

7. Non-current liabilities

	Interest rate Charged	2006 USD'000
Amounts due in less than 5 years		
Energy Growth Management Services	6%	1,578
Logan Energy Resources Inc	LIBOR + 3%	352
		1,930

LIBOR is the British Bankers Association London Interbank Offered Rate

Parent company financial statements of Vostok Energy Limited

Notes to the company financial statements at 31 December 2006

8. Reconciliation of loss from operations to net cash used in operating activities

	2006 *USD'000*
Loss from operations	(2,089)
Adjustments for	
Depreciation, depletion and amortisation	–
Impairment	500
Interest	69
Increase in trade and other receivables	(229)
Increase in trade and other payables	326
Net cash flow used in operating activities	(1,423)