Vostok Energy Limited

(Registered No 05806076)

Report and Financial Statements

31 December 2009

Registered No 05806076

Directors

Charles Jamieson (Chairman)
Alexander Capelson (Chief Executive Officer)
Blaine Karst (Finance Director)
Aric Cunningham (Chief Operating Officer)
Roger Cagle
Robert Cathery
Ronald Harris
Mark Sadykhov
Jacob Ulrich
Kevin Bortz

Secretaries

Tony Hunter
Denis Capelson

International Headquarters

4/5 Park Place
London SW1A 1LP
Tel +44 (0) 207 898 9209
Fax +44 (0) 207 898 9206

Registered Office

Masters House
107 Hammersmith Road
London W14 0QH
Tel +44 (0) 207 603 1515
Fax +44 (0) 207 603 8448

Auditor

Baker Tilly UK Audit LLP
2 Bloomsbury Street
London WC1B 3ST

Bankers

HSBC
27-32 Poultry,
London EC2P 2BX

Solicitors

Ashurst
Broadwalk House
5 Appold Street
London EC2A 2HA

Directors' report

The directors of Vostok Energy Limited ("the Company") present their report and financial statements for the year ended 31 December 2009

Principal activity and review of the business

The principal activities of the Company and its subsidiaries ("the Group" or "Vostok") during the year were oil and gas exploration, development and production The Group's operating activities during 2009 were in Russia where the Group holds a sub-soil licence for geological exploration and production of hydrocarbons

The Company had the following subsidiaries at 31 December 2009 (all are owned directly by the Company unless otherwise noted)

Active subsidiaries	*Country of incorporation*	*Effective ownership percentage* 2009	2008
Royal Atlantic Energy (Cyprus) Limited ("RAECL")	Cyprus	100	100
Diall Alliance LLC – 100% subsidiary of RAECL ("DIALL")	Russia	100	100
Vostok Energy Ltd	United States	100	100
Vostok Energy Company, CJSC ("VEC")	Russia	100	100
Inactive subsidiaries			
Zhaikinvest LTD LLP ("Zhaikinvest") – inactive since 2007	Kazakhstan	75	75
Vostok Energy Resources Limited ("VERL")	United Kingdom	100	100
(VERL was incorporated in 2006, inactive to 31 December 2009)			
Vostok (Cyprus) Limited ("VCL")	Cyprus	100	100
(VCL was incorporated in 2008, inactive to 31 December 2009)			

Chief Executive's Review

The Group remains focused on adding shareholder value through increasing reserves and production The Group's work programme has been based on three principal objectives continued exploration of the hydrocarbon potential of the Bortovoy licence (the "licence") via additional seismic and exploratory drilling, appraisal of the Group's known reserves through appraisal/development drilling and re-evaluation of existing seismic and other technical data, and commercializing the gas reserves through construction of a gas processing facility while increasing available production capacity through development drilling and an acid fracturing program on selected wells

During 2009 the Group moved closer to commercializing the reserves in the western area of the licence as the refurbishment of the gas processing facility acquired in late 2007 from Chevron in the United States (the "gas plant") was completed and the gas plant was shipped to Russia arriving on site in Saratov in May 2009 Construction was well underway by year end with completion expected during the first half of 2010 The startup of the gas plant will be a key milestone for Vostok

During the year, as in 2008, the Group continued to have an active exploration programme by completing the processing and interpretation of the large 2D seismic program acquired in 2008 plus acquiring additional 3D seismic in the far eastern area of the licence Several very promising prospects have been identified which pushed the Group to initiate an exploration program spudding a Permian exploration well in November 2009 on the Timoninskoye prospect Additional Permian exploration wells are planned for 2010 plus the Group intends to drill at least one very promising prospect in the Devonian which if successful, will significantly increase the Group's reserves and provide the basis for further drilling in the Devonian interval

In order to ensure the timely start-up of the gas plant and to finance the continued exploration and development work in the eastern area of the licence, the Company is planning a two phased financing program with an initial public offering ('IPO") of shares in the latter part of 2010 or early in 2011 and a pre-IPO financing in the summer of 2010 (Note 2) With the gas plant coming into production and potential successes from the planned exploration program, 2010 promises to be an exciting year for Vostok

Directors' report

Operations review

Drilling and re-entries

Exploration drilling

In the eastern area of the licence the Group commenced drilling the Timoninskoye 44 exploration well during Q4 of 2009 in fulfillment of licence commitment obligations The well, which is prognosed to be drilled to a total depth of 1800 m, will test the Lower Permian Timoninskoye bank margin reef prospect At year end the well was drilling ahead at a depth of approximately 1400 m

During Q1 of 2009 testing continued on the Krasnokutskoye 100 exploratory well drilled in 2008 Despite the geophysical log indicating hydrocarbon pay, no successful hydrocarbon recovery was obtained and the well was suspended pending possible future testing and acid fracturing

Development drilling

During 2009 the Group concentrated upon the completion and testing of three development wells which had commenced drilling in the Zhdanovskoye field during 2008 and drilling three additional wells in the Karpenskoye field for the purposes of adding deliverability of natural gas to supply the Group's natural gas processing facility at Karpenskoye

Zhdanovskoye field - The Zhdanovskoye 102 development well, which finished drilling during Q4 of 2008, was completed and tested during Q1 of 2009 and flow tested natural gas at rates from 40 to 80 thousand cubic meters per day (Km3/d) Drilling operations were completed during Q1 of 2009 on 2 other development wells started in 2008 in the Zhdanovskoye field, Zhdanovskoye 101 and Zhdanovskoye 103 Upon subsequent completion and testing of Z-101 and Z-103, the wells flowed gas at rates up to 50 Km3/d and 30 Km3/d respectively All three wells that were drilled in the Zhdanovskoye field during 2008-2009 have been shut in and suspended as potential natural gas production wells with an estimated combined initial on stream production capability of 150 Km3/d of gas

Karpenskoye Field - Three development wells, K1-16, K1-12D and K1-8 were drilled and completed for natural gas deliverability during 2009 Initial testing and completion of these three wells demonstrated a combined production potential of 180 Km3/d of gas This includes well K1-12D which tested 10 Km3/d of gas but which also tested 90 m3/d of oil and is considered as a potential oil production well

Well re-entries and recompletions

In the west area of the licence during 2009, 2 wells were recompleted in the Zhdanovskoye field and 1 well in the Karpenskoye field for the purposes of preparing the wells for production and to confirm well productivity No well recompletions were undertaken in the east area of the licence in 2009

Acid fracturing and stimulation

In October 2009 the Group undertook a trial acid fracturing and stimulation program on 3 wells in the Karpenskoye field to determine the effectiveness of such treatments to increase production capability The program increased well flow capability from 2 to 4 times in individual wells, increasing the combined potential flow rate in the 3 wells from a total of approximately 210 Km3/d to 590 Km3/d

Based upon the successful results of this program an additional 7 wells were selected for acid stimulation and fracturing including 2 wells, K1-12D and K1-8 which were drilled during 2009 At year end, results available from 5 of the 7 wells treated indicate that overall gas production capability at Karpenskoye has been increased by approximately 300 Km3/d and as a result the total gas production potential of the Karpenskoye field exceeded the 1 47 Million m3 per day maximum capacity of the gas plant

Seismic activity

Conventional 2D seismic

During 2009 further seismic interpretation work and selected custom reprocessing was undertaken on the Group's extensive 2D seismic data base which was acquired in 2007 and 2008 and upon older existing 2D seismic data Where possible this data was integrated with data from existing wells to increase the inventory of exploration prospects and leads on the licence

Directors' report

Operations review (continued)

3D Seismic

A 320 km2 3D seismic acquisition program which was began in the eastern most area of the licence in November 2008 completed recording in April 2009 Processing and preliminary interpretation of this data was completed by the end of September The ongoing interpretation data has permitted a refined interpretation of the Lower Permian bank margin from the Lipovskoye field to the eastern boundary of the licence to be completed which will be used as the basis for the Group's 2010 eastern area Lower Permian exploration drilling program

Interpretation of the deeper Devonian and Carboniferous intervals revealed a number of prospective exploration plays based upon which the Group will commence drilling a Devonian exploration well during Q2 2010 In addition, the structural detail provided for the Devonian interval has assisted in developing play concepts which can be applied elsewhere on the licence To further facilitate our understanding of the Devonian interval and to aid future Lower Permian development drilling, a 150 km2 3D seismic acquisition program covering the West Lipovskoye field and Timoninskoye prospect commenced recording during Q4 2009 immediately to the west of the previous 3D program and was ongoing at year end

Geological and geophysical evaluations

West Area

In the western area of the licence geophysical and geological work has provided for the identification of prospect leads on the continuation of the Lower Permian bank margin between the Karpenskoye and Mokrousovskoye fields and for refinement of potential future Lower Permian exploration drilling prospects in the Krasnokutskoye area In the area to the north and west of the Mokrousovskoye field this work has also allowed for refinement of prospect leads relating to the Upper Carboniferous bank margin which was identified in 2008 and possible deeper Middle and Upper Devonian structural prospects

Central Area

During 2009 interpretation of the conventional 2D seismic acquired in 2008 across the central area of the licence was completed This demonstrated that the central area, approximately one third of the licence lying between the Mokrousovskoye and Pavlovskoye fields, is occupied by basement uplift, the north-south trending Zhigulev-Pugachev Arch which plunges to the south across the licence This feature has uplifted the older Paleozoic, Devonian and Carboniferous sediments by about 1000m relative to the east and west areas and displaced the basin margin southwards beyond the boundary of the licence Two Lower Permian and one Devonian structural closures were identified in the eastern portion of the central area and although further interpretive work will continue, the area is considered to be less prospective than the remaining areas of the licence

East Area

Upper Permian - Geophysical and geological work in the greater Pavlovskoye area in the eastern licence area has identified an Upper Permian structural prospect designated the Antonovskoye prospect, which is considered as a potential future exploration drilling target The Antonovskoye structure is an east west elongated anticline with an area under closure exceeding 50 km2 which is developed on the first step or terrace into the Pre-Caspian Basin to the south of the Pavlovskoye field The structure involves sediments from the Upper Permian age which have not yet yielded hydrocarbons within the Bortovoy licence as this interval is not generally found in a prospective setting within the licence The Antonovskoye prospect can in many ways be considered as analogous to the Kamenskoye Field which is located less than 100 km to the east of the licence boundary within Kazakhstan This field, which occupies an identical structural setting in relation to the main basin margin, has reserves in excess of 10 billion m3 of gas contained in reservoirs of the intra salt Kazansky Dolomite interval of Upper Permian age

Lower Permian - Further interpretation of 2D seismic data in conjunction with the integration of existing well data in the greater Pavlovskoye area has identified additional Lower Permian prospects at Miloradovskoye and at East Miloradovskoye on the continuation of the bank margin reef trend east from the Pavlovskoye Field Both of the above prospects are coincident with underlying Carboniferous prospects, and in the East Miloradovskoye area a possible Devonian prospect A structural closure to the west also now demonstrates that the Lower Permian bank margin reef trend extends to the west of the Pavlovskoye Field

Directors' report

Operations review (continued)

Seismic interpretive work on the Timoninskoye structure was integrated with existing well data to provide a Lower Permian exploration model for the prospect An exploration drilling location was selected and an exploration well was commenced during November 2009 as a licence commitment well

Carboniferous - Further interpretation of 2D seismic and the interpretation of newly acquired 3D seismic permitted a refinement of several prospective structures that are developed along the Carboniferous shelf margin trend in the east area of the licence These closures are generally coincident with prospects on the overlying Lower Permian bank margin and in many cases also overlie older Devonian structures that formed by tectonic movement and faulting associated with the development of the Peri-Caspian basin The Carboniferous is a major hydrocarbon bearing interval in the Volga-Ural basin and is considered highly prospective within the Bortovoy licence The close association of Carboniferous prospects with both older and younger structures provides the opportunity for it to be tested in conjunction with other prospective intervals For this reason the company plans only to test this interval in wells where it is supported by another exploration objective rather than by drilling exploration wells targeted exclusively at the Carboniferous

Devonian - Three Devonian prospects of large areal and vertical extent were identified on the 3D seismic area in the easternmost portion of the licence In this area the transition from the Volga-Ural Platform into the developing Pre Caspian Basin is accomplished north to south across a series of two or three fault bounded terraces which developed at the margin of the proto basin margin during Middle to Late Devonian time Each of the identified prospects occupies a different position on this progression and differs from the others in its structural style and timing of its development As such they have provided different structural and tectono-stratigraphic concepts which can be applied to other Devonian prospects and leads elsewhere on the licence outside of the area of 3D seismic control Additionally, certain like elements of each prospect were recognized in analogous fields developed at the Pre-Caspian margin in Kazakhstan At year end the Group was preparing to drill the first of these prospects, the Nepryakhinskoye prospect in 2010 to a prognosed depth of 4700m

Reserves evaluation

In July 2009 Vostok s independent engineers, Miller and Lents, prepared a revised reserves evaluation report in support of the Company's initiative to secure an equity funding and loan facility This evaluation incorporated data from completion and testing of 3 development wells drilled at Zhdanovskoye and geological and seismic interpretation work undertaken by Vostok during the first half of 2009 As a result of reserves re-evaluation for the Zhdanovskoye field due to an increase in gas well drainage areas and other adjustments, Miller and Lents decreased their 01 January 2009 estimate of economic recoverable 3P reserves of the Group from 797 Bcf of natural gas and 40 76 MMBbl of oil and condensate to 740 Bcf and 17 MMBbl of oil and condensate However as a result of the recognition of increased well drainage the proven natural gas reserves of the Group increased overall from 390 Bcf to 545 Bcf

Future developments

With sufficient natural gas deliverability capability secured as a result of 2009 drilling and completion operations, the key focus for the Group for 2010 is to complete the construction and commissioning of the gas plant for the western area of the licence No further drilling is proposed for the west area during 2010, instead the Group will focus its drilling and completion activities together with its geological and geophysical activity upon evaluating and increasing reserves and resources in the eastern area of the licence This will involve an exploration drilling program comprising four Lower Permian exploration wells and one Devonian exploration well in 2010, the results of which will provide a blueprint for future development and exploitation

Directors' report

Financial review

Review of 2009 results

The Annual Report and Financial Statements are prepared under International Financial Reporting Standards The Group uses US dollars as its presentation currency The Group revenue for 2009 was 46 thousand USD (2008 – 1 153 million USD) and the loss after taxation was 11 086 million USD (2008 – 15 563 million USD) Detailed Group financial information is set out in the audited financial statements for 2009 on pages 11-56 of this report

The Group is in an exploration and development phase and until the gas plant is operational, standard key performance indicators such as growth in sales, returns on invested capital and employee retention figures are not true indicators of group performance The key performance indicators at 31 December were

	2009	2008
Proven gas reserves in billion cubic feet (1)	544 8	390 3
Proven oil reserves in millions of barrels (1)	14 6	20 4
Available production capacity of gas in million cubic feet per day	59 5	26 6
Revenue for the year (in millions of USD) (2)	0 0	1 2
Loss for the year (in millions of USD)	11 1	15 6

(1) The oil and gas reserves are based on the most recent independent engineer's reports The decrease in oil reserves resulted from an evaluation of the drilling results in the western area of the license which demonstrated that estimates for condensate and oil recovery per million cubic feet of gas were less than originally assumed in the 2008 report

(2) The decrease in revenue resulted from producing oil wells being shut in at the start of 2009 to avoid flaring of associated gas Production will resume upon gas plant start-up

Corporate events

On 20 January 2009 the Company finalized contractual arrangements with Ogier Employee Benefit Trustee Limited (the "Trustee") to formally establish an Employee Benefit Trust (the "EBT") Of the 3,460,000 new shares approved for transfer to the EBT by the shareholders in 2008, 1,960,000 new shares have been issued under the terms of the EBT by year-end In addition, the 10,850,000 shares held at year end 2008 by Royal Atlantic Energy Corporation as option shares for designated non-executive directors were transferred to the EBT on 11 March 2009 The structure of the EBT enables the Company to consolidate all incentivised directors, officers and employees under one Group plan

On 31 July 2009 the shareholders approved

a An increase in the authorized share capital of the Company to 2,500,000 USD divided into 250,000,000 shares of $ 01 USD each

b An increase of 1,000,000 shares available for issue to its employees under the EBT from 3,460,000 to 4,460,000

On 18 September 2009 the Company finalized a combined equity and convertible debt financing of 100 0 million USD with the European Bank for Reconstruction and Development (the "EBRD") The EBRD invested 40 0 million USD of equity in exchange for 13,101,438 shares and committed an additional 60 million USD through convertible debt available for drawdown by the Company over the next 18 months At 31 December 2009 the Company had drawn-down 10 million USD of the convertible debt

Charitable donations

The primary Group operations are in the Saratov region in Russia and it is one of the goals of the Group to provide support to the local community to ensure the region benefits from the Group's presence on an enduring basis During the year, the Group spent 201 thousand USD (2008 – 278 thousand USD) on sponsorships and charitable donations for local government and non-governmental agencies that support local development and industry and for agencies focusing on maintaining and improving local environmental standards

Events since the end of the year

There have been no significant events since the end of the year

Directors' report

Risk management

Financial

The Finance Director is responsible for the Company's financial risk management function and the Audit Committee provides oversight of this while ultimate approval on financial decisions remains with the Board of Directors

Operations and commercial

The main activity of the Group will be the production and processing of gas as the majority of the reserves within the Bortovoy licence area are gas reserves There is oil associated with the gas reserves and prior to 2009 the Group produced and sold oil at "spot" rates Given the limited oil production to date, the Group does not maintain any fixed price or long term marketing contracts Although oil and gas prices may fluctuate, as a general policy, the Group does not and does not intend to hedge oil and gas sales until production volumes increase significantly Under appropriate circumstances such as taking advantage of attractive prices, the Group may engage in longer term sales contracts and price hedging

The Group maintains insurance over operations as required by local regulations In addition, the Group maintains internationally placed insurance coverage for their field assets, drilling and operating activities in Russia in recognition of the risks associated with expanded operations While the Group recognizes the inherent political and economic risks of working in Russia, the Group has made the decision not to carry any political risk or associated business interruption coverage The Group reviews overall insurance requirements regularly to ensure a proper balance between exposure and coverage

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 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

Taxation

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 and audits performed to date by the relevant authorities, there have been no significant tax fines or penalties incurred and management believes that as of 31 December 2009, its interpretation of the relevant legislation is appropriate and the Group's tax and currency positions will be sustained

Strategic and reputational

The Company is committed to promoting and developing high standards of corporate responsibility Responsibility for ensuring that these are followed lies with the Board of Directors and senior executive officers and staff The Company believes that by incorporating high standards into its corporate culture, the Company's risk profile is reduced

A comprehensive set of procedures and policies is maintained at the operational level to ensure effective operations The Company reviews the Group's policies and procedures on an ongoing basis including environmental policies to ensure compliance with local and international standards The Group has developed a comprehensive environmental monitoring and reporting system and when required, the Company employs independent advisors to ensure good practise is achieved

Directors' report

Directors

The directors at 31 December 2009 and 2008 are as given below except where noted otherwise

Alexander Abraham Capelson
Robert Maitland Cathery (a)
Roger Dale Cagle (a), (b)
Ronald Alan Harris (a), (b)
Charles James Auldjo Jamieson (a)
Mark Sadykhov
Blaine Edward Karst
Jacob Shields Ulrich
Aric Bruce Cunningham
Kevin Bortz *(appointed on 28 September 2009)*

(a) Remuneration Committee members
(b) Audit Committee members

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

Dividends

The directors do not recommend a dividend for the year (2008 – $nil)

Corporate governance

The role of the Audit Committee is to review and monitor the integrity of the financial reporting by the Company, to review the Group's internal control and risk management systems and oversee the relationship with the external auditors The Audit Committee meets and discusses issues throughout the year and approves the audit plan and audited financial report for submission to the Board for approval

The Remuneration Committee is primarily responsible for determining and recommending to the Board the framework for executive remuneration It is also responsible for the design of share incentive plans and allocation and issue of shares to employees under such plans The Remuneration Committee meets as required to discuss and determine remuneration issues and formally reports their activities and makes recommendations to the Board for approval

Statement as to disclosure of information to the auditor

The directors who were in office on the date of approval of these financial statements have confirmed that as far as they are aware, there is no relevant audit information of which the auditor is 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

Auditor

A resolution to reappoint Baker Tilly UK Audit LLP as auditor has been approved by the Board and the shareholders

By order of the Board

Tony Hunter
Secretary
6 May 2010

Statement of directors' responsibilities in relation to the financial statements

The directors are responsible for preparing the Directors Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare group and company financial statements for each financial year The directors have elected under company law to prepare group financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") and have elected under company law to prepare the company financial statements in accordance with IFRS as adopted by the EU

The financial statements are required by law and IFRS adopted by the EU to present fairly the financial position of the group and the company and the financial performance of the group The Companies Act 2006 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and the company and of the profit or loss of the group for that period

In preparing the group and company financial statements, the directors are required to

a select suitable accounting policies and then apply them consistently,
b make judgements and accounting estimates that are reasonable and prudent,
c state whether they have been prepared in accordance with IFRSs adopted by the EU,
d prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the group's and the company's transactions and disclose with reasonable accuracy at any time the financial position of the group and the company and enable them to ensure that the financial statements comply with the Companies Act 2006 They are also responsible for safeguarding the assets of the group and the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

Independent auditors' report

to the members of Vostok Energy Limited

We have audited the group and parent company financial statements ("the financial statements") on pages 11 to 56 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006

This report is made solely to the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 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 auditor's 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

As more fully explained in the Directors' Responsibilities Statement set out on page 9, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/UKNP

Opinion on the financial statements

In our opinion

- the financial statements give a true and fair view of the state of the group's and the parent's affairs as at 31 December 2009 and of the group's loss for the year then ended
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union,
- the parent financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the Companies Act 2006, and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006

Emphasis of matter – going concern

In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosures made in the Basis of Preparation section of note 2 to the consolidated financial statements concerning the group's ability to continue as a going concern The group needs to raise additional finance to fund its activities in the period until the gas plant becomes revenue producing and to provide funds to develop its eastern licence area A description of the proposed financing arrangements is given in note 2 and the directors believe that these arrangements will be satisfactorily concluded However, the proposed financing arrangements have not yet been committed and this fact along with the other matters described in note 2 indicate the existence of a material uncertainty which may cast doubt about the group's ability to continue as a going concern The financial statements do not include any adjustments that would result if the group was unable to continue as a going concern

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent company financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made or
- we have not received all the information and explanations we require for our audit

Baker Tilly UK Audit LLP

Nigel Digby Ware (Senior Statutory Auditor)
For and on behalf of BAKER TILLY UK AUDIT LLP, Statutory Auditor
Chartered Accountants
2 Bloomsbury Street
London WC1B 3ST
6 May 2010

Consolidated statement of comprehensive income

for the year ended 31 December 2009

	Notes	2009 USD'000	2008 USD'000
Revenue		46	1,153
Expenses			
Operating expenses	5	(3,410)	(4,252)
Administrative expenses	6	(10,291)	(9,145)
Other gains/(losses)	7	1,921	(6,435)
Total expenses		(11,780)	(19,832)
Operating loss		(11,734)	(18,679)
Finance income	8	250	1,749
Finance costs	9	(214)	(887)
Loss before taxation	4	(11,698)	(17,817)
Income tax benefit	13	612	2,254
Loss for the year attributable to owners of the parent		(11,086)	(15,563)
Other comprehensive income			
Foreign exchange movements on translation of foreign entities		3,369	(13,287)
Income tax relating to components of other comprehensive income		(458)	3,320
Total comprehensive income attributable to owners of the parent		(8,175)	(25,530)

Loss per share during the year (Note 14)

	2009 USD	2008 USD
– basic	0 06	0 10
– diluted	0 06	0 10

Consolidated balance sheet

at 31 December 2009

	Notes	2009 USD '000	2008 USD '000
Non-current assets			
Intangible assets	15	36,233	29,389
Property, plant and equipment	16	157,882	59,321
Trade and other receivables	17	13,430	18,620
Deferred tax	13	5,389	5,344
		212,934	112,674
Current assets			
Inventories	18	33	55
Trade and other receivables	19	11,624	2,371
Cash and cash equivalents	20	18,361	85,470
		30,018	87,896
Total assets		242,952	200,570
Current liabilities			
Trade and other payables	21	4,592	2,675
Non-current liabilities			
Borrowings	22	4,775	2,168
Provisions	23	6,969	675
		11,744	2,843
Total liabilities		16,336	5,518
Net assets		226,616	195,052
Equity			
Share capital	24	1,851	1,701
Share premium	24	294,971	252,195
Own shares held	24	(5,983)	-
Equity component of convertible debt	24	1,964	-
Currency translation reserve	24	(6,837)	(9,748)
Share option reserve	24	1,426	594
Accumulated deficit		(60,776)	(49,690)
Total equity attributable to owners of the parent		226,616	195,052

These financial statements were approved and authorised for issue by the Board of Directors on 6 May 2010

Signed on behalf of the Board of Directors

Blaine Karst

Blaine Karst,
Director

Consolidated statement of changes in equity

for the year ended 31 December 2009

	Share capital USD'000	*Own shares held USD'000*	*Equity element of convertible debt USD'000*	*Share premium USD'000*	*Currency translation reserve USD'000*	*Share option reserve USD'000*	*Accumulated deficit USD'000*	*Total equity USD'000*
Balance at 1 January 2008	1,147	–	–	89,675	219	160	(34,127)	57,074
Loss for the year	–	–	–	–	–	–	(15,563)	(15,563)
Other comprehensive income								
Currency translation differences	–	–	–	–	(13,287)	–	–	(13,287)
Deferred tax effect of currency translation differences	–	–	–	–	3,320	–	–	3,320
Total comprehensive income for the year	–	–	–	–	(9,967)	–	(15,563)	(25,530)
Transactions with owners								
Share issues	554	–	–	168,604	–	–	–	169,158
Share issue costs	–	–	–	(6,084)	–	–	–	(6,084)
Share option charge	–	–	–	–	–	434	–	434
Total of transactions with owners	554	–	–	162,520	–	434	–	163,508
Balance at 31 December 2008	1,701	–	–	252,195	(9,748)	594	(49,690)	195,052
Loss for the year	–	–	–	–	–	–	(11,086)	(11,086)
Other comprehensive income								
Currency translation differences	–	–	–	–	3,369	–	–	3,369
Deferred tax effect of currency translation differences	–	–	–	–	(458)	–	–	(458)
Total comprehensive income for the year	–	–	–	–	2,911	–	(11,086)	(8 175)
Transactions with owners								
Share issues	150	–	–	45,833	–	–	–	45,983
Own shares issued to the employee benefit trust	–	(5,983)	–	–	–	–	–	(5,983)
Equity element of convertible debt	–	–	1,964	–	–	–	–	1,964
Share issue costs	–	–	–	(3,057)	–	–	–	(3,057)
Share option charge	–	–	–	–	–	832	–	832
Total of transactions with owners	150	(5,983)	1,964	42,776	–	832	–	39,739
Balance at 31 December 2009	1,851	(5,983)	1,964	294,971	(6,837)	1,426	(60,776)	226,616

Consolidated statement of cash flows

for the year ended 31 December 2009

	Notes	2009 USD 000	2008 USD'000
Operating activities			
Net cash flow used in operating activities	25	(8,088)	(12,293)
Net cash used in operating activities		(8,088)	(12,293)
Investing activities			
Interest earned on cash and cash equivalents	8	250	1,749
Purchase of intangible assets		(8,068)	(9,993)
Purchase of property, plant and equipment		(93,790)	(53,038)
Net cash used in investing activities		(101,608)	(61,282)
Financing activities			
Proceeds on issue of share capital	24	36,943	153,984
Repayment of short-term borrowings		–	(56)
Payment of interest on long-term borrowings	22	(112)	(1,465)
Proceeds on issue of convertible debt	22	6,693	–
Repayment of long-term borrowings	22	(2,168)	(10,936)
Net cash provided by financing activities		41,356	141,527
Net (decrease)/increase in cash and cash equivalents		(68,340)	67,952
Cash and cash equivalents at beginning of year		85,470	16,073
Effect of exchange rate changes on cash and cash equivalents		1,231	1,445
Cash and cash equivalents at end of year		18,361	85,470

Notes to the consolidated financial statements

for the year ended 31 December 2009

1. Corporate Information

Organisation and principal activities

Vostok Energy Limited (the 'Company'') is a limited liability company incorporated in Great Britain The principal activities of the Company and its subsidiaries ('the Group') are the exploration, development, and production of hydrocarbons The Group's operating activities are in Russia, where the Group holds a sub-soil licence for geological exploration and production of hydrocarbons The registered office of the Company is Masters House, 107 Hammersmith Road, London, England, W14 0QH

The Group comprises the Company and its significant subsidiaries as set out below

Operating Entity	*Principal Activity*	*Country of Incorporation*
Vostok Energy Limited	Management and holding company	United Kingdom
Royal Atlantic Energy (Cyprus) Limited	Holding company	Cyprus
Diall Alliance LLC	Oil and gas exploration	Russia
Vostok Energy Company, CJSC	Geophysical & geological activities	Russia
Vostok Energy Ltd	Administrative centre	United States

Russian business environment and country risk

The Group's operations are subject to country risk being the economic, political and social risks inherent in doing business in Russia These risks include matters arising out of the policies of the Government, economic conditions, imposition of, or changes to, taxes and regulations and foreign exchange rate fluctuations

Financial risk management

The Group's long term success is exposed to the effect of fluctuations of oil and gas prices in the local markets which are influenced by international prices Refer to Note 27 for a description of other financial risks

2. Significant accounting policies

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards as endorsed by the EU ("IFRS"), IFRIC interpretations and the Companies Act 2006 applicable to companies reporting under IFRS

The financial statements have been prepared on the historical cost basis The principal accounting policies adopted are set out below

Basis of preparation

The consolidated financial statements are presented in US dollars

The Group has been dependent upon the financial support of investors to fully-finance its exploration and development programme Based on the review of financial forecasts the Director's believe the Group has adequate funds available to complete construction of the gas plant and that forecasted revenue generated from its operation will be sufficient to cover ongoing operational cash flow requirements This is based on the Director's best estimate that the gas plant will be operational in July 2010 However, to implement current development plans for the eastern licence area, the Directors have concluded that additional funding will be required in order to build a second gas processing facility and provide the necessary production to support its operation

After reviewing financing alternatives, the Directors have resolved to appoint Deutsche Bank to act as financial advisors to the Company Deutsche Bank will assist the Company in raising the required funds to complete the eastern development through an initial public offering ("IPO) of shares Deutsche Bank has also agreed to assist the Company with pre-IPO financing through the issue of a convertible debenture for up to 50 million USD Both Deutsche Bank and the Directors believe that the pre-IPO financing will be completed by July 2010 which will ensure funds are available to finance the initial eastern development plans and the start-up of the gas plant The Directors recognize there are still construction and commissioning risks that could delay gas plant start-up resulting in costs exceeding current forecasts

Notes to the consolidated financial statements

for the year ended 31 December 2009

2. Significant accounting policies (continued)

Based on current market conditions, the Directors believe that the Company will be able to raise the required new funds as described above These new funds combined with current funding available from the EBRD (Note 22) and the projected revenue generated from the sale of product from the gas plants, will enable the Group to fund ongoing operations and meet its liabilities as and when they fall due Therefore, the Directors continue to adopt the going concern basis of accounting

Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial year except as follows

During the year the following standards have been adopted in these financial statements

- IAS 1 (revised 2007) Presentation of Financial Statements – In the current year the Group has adopted IAS 1 (revised 2007) which introduces the option of a statement of comprehensive income, which presents all items of income and expenses which are not recognised in the income statement The Group has chosen to present a consolidated statement of comprehensive income
- IFRS 7 Financial Instruments Disclosures – Amendment, Improving Disclosures About Financial Instruments
- IFRS 8 Operating Segments – IFRS 8 is a disclosure standard IFRS 8 states that segment information should be based on management's internal reporting structure and accounting principles The Group's segment information was already based on the management reporting structure and therefore the operating segments are the same as previously reported

At the date of authorisation of these financial statements, the following Standards and Interpretations relevant to the Group operations were in issue but not yet effective or endorsed (unless otherwise stated)

IFRS 1 (amended)/ IAS 27 amended	Cost of an investment in a Subsidiary, Jointly Controlled Entity or Associate
IFRS 2 (amended)	Share Based Payments – Amendment, Cash-settled Share –based payment transactions
IFRS 3 (revised 2008)	Business Combinations – Comprehensive revision on applying the acquisition method (endorsed)
IFRS 9	Financial Instruments
IAS 24 (revised 2009)	Related Party Disclosures
IAS 27 (revised 2008)	Consolidated and separate Financial Statements –Consequential amendments arising from amendments from IFRS 3 (endorsed)
IAS 28 (revised 2008)	Investments in Associates –Consequential amendments arising from amendments to IFRS 3 (endorsed)
IAS 31	Interest in Joint Ventures - Consequential amendments arising from amendments to IFRS 3 (endorsed)
IAS 32 (amended)	Classification of rights issues
IAS 39	Financial Instruments Recognition and Measurement – Amendments relating to eligible hedged items (endorsed)
IFRIC 14 (amended)	Prepayments of a Minimum Funding requirement
IFRIC 17	Distribution of Non-Cash Assets to Owners (endorsed)
IFRIC 18	Transfer of Assets from customers (endorsed)
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments
	Annual Improvement Project May 2008 (endorsed)
	Annual Improvement Project April 2009 (endorsed)

The Directors anticipate that the adoption of these Standards and Interpretations as appropriate in future periods will have no material impact on the financial statements of the Group

Notes to the consolidated financial statements

for the year ended 31 December 2009

2. Significant accounting policies (continued)

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at 31 December each year

Subsidiaries are consolidated from the date of their acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases Control comprises the power to govern the financial and operating policies of the investee so as to obtain benefit from its activities and is achieved through direct or indirect ownership of voting rights, currently exercisable or convertible potential voting rights, or by way of contractual agreement The financial statements of subsidiaries used in the preparation of the consolidated financial statements are prepared for the same reporting year-end as the parent company and are based on consistent accounting policies All intergroup balances and transactions, including unrealised profits arising from them, are eliminated

The Group applies the equity concept method of consolidation

Comparative figures

Where a change in presentational format of the consolidated financial statements has been made during the year, comparative figures have been restated accordingly

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 statement of comprehensive income from the date on which control was obtained Combinations of businesses under common control have been accounted for using the pooling of interests method

Foreign currency translation

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date All differences are taken to profit or loss

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined

The assets and liabilities of foreign operations are translated into USD at the rate of exchange ruling at the balance sheet date Income and expenses are translated at weighted average exchange rates for the year The resulting exchange differences are recognised in other comprehensive income On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in profit or loss

The functional currency of the Company is the US dollar while the functional currency of its Russian subsidiaries is the Russian ruble ("RUR") The exchange rate at the year-end was 30 3135 RUR to 1 USD (2008 – 29 380) and the average exchange rate for the year was 31 7409 RUR to 1 USD (2008 – 24 8575) For UK operations, the exchange rate at year-end was 0 6193 £ to 1 USD (2008 – 0 6910) and the average exchange rate for the year was 0 6408 £ per 1 USD (2008 – 0 5320)

Revenue recognition

Revenue is 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 is measured at the fair value of the consideration received, excluding discounts, rebates, VAT and other sales taxes The following criteria must also be met before revenue is recognised

Sale of goods

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer, usually on dispatch of the goods

Finance income

Revenue is recognised as interest accrues using the effective interest method The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to its net carrying amount

Notes to the consolidated financial statements

for the year ended 31 December 2009

2. Significant accounting policies (continued)

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation Capitalisation of borrowing costs is suspended during extended periods in which active development is interrupted All other borrowing costs are recognised in profit or loss in the period in which they are incurred

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 realised 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 to other comprehensive income if it relates to items that are credited or charged to other comprehensive income Otherwise income tax is recognised in profit or loss

Share-based payments

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award Fair value is determined by an appropriate pricing model with the assistance of an external valuer if required In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of the Company (market conditions)

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions and of the number of equity instruments that will ultimately vest or, in the case of an instrument subject to a market condition, treated as vesting as described above The movement in cumulative expense since the previous balance sheet date is recognised in profit or loss, with a corresponding entry in equity

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of

Notes to the consolidated financial statements

for the year ended 31 December 2009

2. Significant accounting policies (continued)

the original award and the fair value of the modified award, both as measured on the date of the modification No reduction is recognised if this difference is negative

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in profit or loss for the award is expensed immediately Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over fair value treated as an expense in profit or loss

Intangible assets – exploration and evaluation expenditures

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'

Drilling, seismic and other costs

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 values of the related intangible assets are reclassified as development and production assets If commercial reserves have not been discovered, the costs are charged to profit or loss 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 and in any event prior to the transfer of the carrying value to development and production assets When facts and circumstances suggest that the carrying amount exceeds the recoverable amount, the impairment will be measured, presented and disclosed in accordance with IAS 36 'Impairment of assets'

Sub-soil licences

Costs incurred prior to the award of oil and gas licences, concessions and other exploration rights are expensed in profit or loss Costs incurred on the acquisition of a licence interest are initially capitalised on a licence by licence basis and are capitalised within intangible fixed assets and held un-depleted until the exploration phase on the licence is complete or commercial reserves have been discovered at which time the costs are reclassified as development and production assets

Property plant and equipment

Oil and gas assets

Oil and gas assets are stated at cost less accumulated depletion or accumulated depreciation and impairment costs Costs incurred to develop commercial reserves and bringing them into production together with their related exploration and evaluation expenditures are capitalised within property, plant and equipment on a field by field basis Major facilities may be capitalised separately if they relate to more than one field or to the licence area as a whole Subsequent expenditure is capitalised only if it either enhances the economic benefits of the development/production asset or replaces part of the existing development/production 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

Motor vehicles, office equipment and furniture

Motor vehicles, office equipment and furniture are stated at cost less accumulated depreciation and impairment losses

Depletion

Depletion is provided on oil and gas properties in production, including related pipeline costs, using the unit of production method, based on proven reserves, applied to the sum of the total capitalised exploration, evaluation and development costs, together with estimated future development and decommissioning costs at current prices Depletion is provided based on the expected production profile on a field by field basis which may exceed the existing licence period It is standard industry practice in Russia to receive licence extensions providing production plans demonstrate that additional time is required to economically produce the field

Notes to the consolidated financial statements

for the year ended 31 December 2009

2. Significant accounting policies (continued)

Depreciation

Major oil and gas facilities that have a shorter useful life than the related production expected from the fields are depreciated on a straight-line basis over the expected useful life of the facility Depreciation is provided on motor vehicles, office equipment and furniture at rates calculated to write off the cost, less estimated residual value, evenly over its expected useful life

For depreciation purposes, useful lives are estimated as follows

Buildings, facilities – 15-30 years
Office equipment and furniture – 5 years
Furniture and fixtures – 5 years
Motor vehicles and machinery – 5 years

Decommissioning and environmental restoration provision

The decommissioning and 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 provision is included as part of the cost of the relevant assets within exploration and development costs or property, plant and equipment and is charged to profit or loss on a unit of production basis

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 profit or loss

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

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

Financial assets

Financial assets are recognised when the Group becomes party to the contracts that give rise to them and are classified as financial assets at fair value through profit or loss, loans and receivables, held-to maturity investments, or as available-for-sale financial assets, as appropriate The Group determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates

Notes to the consolidated financial statements

for the year ended 31 December 2009

2. Significant accounting policies (continued)

this designation at each financial year-end When financial assets are recognised initially, they are measured at fair value, being the transaction price plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs The Group considers whether a contract contains an embedded derivative when the entity first becomes a party to it The embedded derivatives are separated from the host contract if it is not measured at fair value through profit or loss and when the economic characteristics and risks are not closely related to those of the host contract Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required

All purchases and sales of financial assets are recognised on the trade date, being the date that the Group commits to purchase or sell the asset Transactions require delivery of assets within the timeframe generally established by regulation or convention in the market place The subsequent measurement of financial assets depends on their classification, as follows

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either fair value through profit and loss or available-for-sale Such assets are carried at amortised cost using the effective interest method if the time value of money is significant Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process

Trade and other receivables

Trade receivables, which generally have 30-90 day terms, are recognised and carried at the lower of their original invoiced value and recoverable amount Where the time value of money is material, receivables are carried at amortised cost Provision is made when there is objective evidence that the Group will not be able to recover balances in full Balances are written off when the probability of recovery is assessed as being remote

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

Impairment of financial assets

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

Assets carried at amortised cost

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

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

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

Notes to the consolidated financial statements

for the year ended 31 December 2009

2. Significant accounting policies (continued)

Interest bearing loans and borrowings

Obligations for loans and borrowings are recognised when the Group becomes party to the related contracts and are measured initially at the fair value of consideration received less directly attributable transaction costs

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

Gains and losses arising on the repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in finance income and finance cost

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to substance of the contractual arrangements entered into An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs

Convertible debt

Instruments where the holder has the option to redeem for cash or convert into a pre-determined quantity of equity instruments are classified as compound instruments in the balance sheet and presented partly as a liability and partly within equity

At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for a similar non-convertible instrument The difference between the proceeds of issue and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the Group, is included in equity

Transaction costs are apportioned between the liability and equity components of the convertible debt based on their relative carrying amounts at the date of issue The portion relating to the equity component is charged directly against equity

The interest expense on the liability component is calculated by applying the prevailing market interest rates for similar non-convertible debt to the instrument The difference between this amount and the interest paid is added to the carrying value of the convertible debt

Derecognition of financial assets and liabilities

A financial asset or liability is generally derecognised when the contract that gives rise to it is settled, sold, cancelled or expires Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognised in profit or loss

Employee benefit trust

The Group operates an employee benefit trust ("EBT") which holds shares in the company The Group and Company record the assets and liabilities of the EBT as their own The shares in the Company owned by the EBT are presented as a reduction in equity shareholders funds in the consolidated and parent company balance sheet and included in a separate negative reserve described as "Own shares held'

Judgements and key sources of estimation uncertainty

The preparation of financial statements requires management to make judgements, 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, management has made judgements that have a significant effect on the amounts recognised in the financial statements

Notes to the consolidated financial statements

for the year ended 31 December 2009

2. Significant accounting policies (continued)

Taxation

The Company's subsidiaries in Russia are subject to routine tax audits and also a process whereby tax computations are discussed and agreed with the appropriate authorities Whilst the ultimate outcome of such tax audits and discussions cannot be determined with certainty, management estimates the level of provisions required for both current and deferred tax on the basis of professional advice and the nature of current discussions with the tax authority concerned

Estimates and assumptions

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

Fair value of acquisition

Upon acquisition, assets and liabilities, including exploration and evaluation assets, are included in the financial statements at their fair market value The actual value that will be realised from exploration and evaluation 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 licence and its term and the availability of financial and other resources required to progress exploration and development activities

Use of estimates and judgements

Impairment review of intangible assets and oil and gas plant and equipment (Notes 15 and 16)

Management is required to assess the level of the Group's commercial reserves, which are utilised in determining the depletion charge for the period and assessing whether any impairment charge is required The Group 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 licences (Note 15)

The Group is subject to periodic reviews of its activities by governmental authorities in Russia with respect to the requirements of its sub-soil licences and seeks amendments to the licences when supported by the results of ongoing exploration and development activities The requirements under the licences are subject to interpretation and enforcement policies of the relevant authorities In management's opinion, as of 31 December 2009, there are no serious non-compliance issues that will have an adverse effect on the financial position or the operating results of the Group

Decommissioning and environmental restoration (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 obligations 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

Share-based payments (Note 12)

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted Judgement is required in determining the most appropriate valuation model for a grant of equity instruments, depending on the terms and conditions of the grant Management is also required to use judgement in determining the most appropriate inputs to the valuation model including expected life of the option, volatility and dividend yield The assumptions and models used are disclosed in Note 12

Notes to the consolidated financial statements

for the year ended 31 December 2009

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 operations in Russia

4. Loss before taxation

	2009	*2008*
	USD'000	*USD'000*
Loss from operations is stated after (crediting)/charging		
Net foreign exchange (gains)/losses	(638)	382
Depletion	–	252
Depreciation	586	171
Amortisation	10	3
(Reversal of impairment)/impairment of intangible assets	(41)	4,919
Reversal of impairment of property, plant and equipment	(1602)	–
Staff costs		
Administrative	4,869	3,731
Operating expenses	223	393
Auditor's remuneration for services		
Statutory audit - Company	150	132
Subsidiary audits	138	159
Taxation and advisory services	157	236

5. Operating expenses

	2009	*2008*
	USD'000	*USD'000*
Repair and maintenance	870	141
Depreciation, depletion and amortization	425	282
Rental, heating and other operating costs	369	551
Environmental and conservation	294	176
Material and transport services	292	272
Operations and property insurance	273	188
Property, transport, environmental and water utilization taxes	243	279
Exploration	238	1,093
Salaries and benefits	223	393
Subsoil usage royalties	55	65
Mineral extraction tax	46	601
Subcontractor costs	43	188
Land rental	39	23
	3,410	4,252

For 2009 presentation purposes the 2008 cost of sales (1 816 million USD) and other operating expenses (2 436 million USD) have been combined into operating expenses Oil production was shut-in at the start of 2009 except for incidental production as a result of work-over and testing operations As such, the allocation of expenses between cost of sales and other operating expenses would be arbitrary and potentially misleading With the start-up of the gas plant scheduled for 2010, the Group believes this presentation format for operating expenses is more appropriate as the Group completes the transition to primarily a gas producer

Notes to the consolidated financial statements

for the year ended 31 December 2009

6. Administrative expenses

	2009 USD'000	2008 USD'000
Salaries and benefits	4,869	3,731
Professional fees	2,930	3,092
Office	1,280	1,081
Travel and training	976	1,005
Depreciation	171	144
Insurance	65	92
	10,291	9,145

7. Other gains and losses

	2009 USD'000	2008 USD'000
(Reversal of impairment)/impairment of intangibles	(41)	4,919
Reversal of impairment of property, plant and equipment	(1,602)	–
Exchange (gain)/loss	(638)	382
Sponsorships and charitable donations	201	272
Provision for impairment of prepayments	139	732
Other losses	20	130
	(1,921)	6,435

The reversal of the impairment charges for 2009 is a reversal of a provision set up in 2007 The reversal is primarily for gas plant costs of 873 thousand USD that are now believed to have future value and for well drilling and re-entry costs of 770 thousand USD that the Group had not expected to be recovered based on production tests in 2007 During 2009 the decision was made to re-enter the wells and apply further acid fracturing stimulation of old and new target zones and it has now been determined that the well costs will be recoverable through future production revenues For 2008 the impairment provision was for the write off of drilling and testing costs for a dry hole

The exchange (gain)/loss is the result of changes in exchange rates from the time a transaction is recorded until it is settled The majority of the gain of 638 thousand USD (2008 – 382 thousand USD loss) was incurred by the subsidiary operations in Russia

The provision for impairment of prepayments of 139 thousand USD (2008 - 732 thousand USD) is for advance payments on contracts where the services were not provided and costs are not recoverable In 2008 the costs primarily related to advances for design work on a de-sulfuring facility

8. Finance income

	2009 USD'000	2008 USD'000
Interest on short-term deposits	250	1,749

9. Finance costs

	2009 USD'000	2008 USD'000
Interest on non-current liabilities	214	886
Interest on short term borrowings	–	1
	214	887

The interest on non-current liabilities relates to non-current borrowings that were paid out during 2009 (Note 22) and unwinding of the discount on the decommissioning and environmental restoration provision (Note 23) For 2008 the interest relates primarily to a debt incurred on the acquisition of the minority interest of RAECL that was paid out in 2008

Notes to the consolidated financial statements

for the year ended 31 December 2009

10. Directors' emoluments

Included in staff costs is directors' emoluments of 2 192 million USD (2008 – 1 231 million USD) Total emoluments for non-executive directors for the year were 23 thousand USD (2008 – 35 thousand USD) The highest paid director's emoluments was 1 084 million USD (2008 – 542 thousand USD) which includes an accrual for share based payments of 455 thousand USD (2008 – 190 thousand)

In accordance with the service agreement with the COO, the Company advanced funds to cover employment taxes in Russia At 31 December 2009 the Company had advances receivable of 133 thousand USD (2008 – $nil) as a result of the actual Russian employment tax liability being less than originally estimated

11. Staff costs

	2009	*2008*
	USD'000	*USD'000*
Wages and salaries	3,424	2,772
Share-based payment benefits	832	434
Social security costs	657	581
Rental benefits	354	393
	5,267	4,180

Total salaries and benefits for the Group for the year ending 31 December 2009 includes 223 thousand USD (2008 – 393 thousand USD) recorded as operating expenses, 4 869 million USD (2008 – 3 731 million USD) included in administrative expenses and 175 thousand USD (2008 – 56 thousand USD) recorded as seismic and development costs included in intangible assets

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

	2009	*2008*
	No	*No*
Operations	65	42
Head office and administration	38	57
	103	99

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

Notes to the consolidated financial statements

for the year ended 31 December 2009

12. Share-based payments

The Company grants awards of shares to senior management of the Company at nil cost to the executive The share awards vest at specified time intervals and vesting is dependent on senior management remaining in full employment with the Company for a three year period The awards are equity settled

The fair value of the share awards was estimated at the grant date using a Black Scholes simulation model, taking into account the terms and conditions upon which the awards were granted

The following table shows details of share awards outstanding during the year

	2009	*2008*
	Shares	*Shares*
As at 1 January	1,960,000	1,460,000
Granted during the year	500,000	500,000
As at 31 December	2,460,000	1,960,000
Vested at 31 December	898,667	-

The following table lists the inputs to the model

	2009	*2008*
Award grant date	1 October	1 October
Number of awards	500,000	500,000
Fair value at grant date	$1 52	$1 52
Share price at grant date	$1 53	$1 53
Amount payable by executive	$nil	$nil
Risk free rate	6%	6%
Dividend yield	nil	nil
Expected volatility	32 7%	38 3%
Expected life of awards	2 years	2 years
Weighted average remaining contractual life of share options at the end of the year	1 1 years	1 6 years

Expected volatility is based on historic share price movements The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome The probability that not all the awards will vest due to the resignation of senior management is set at 20%, which is based on management's estimates and may not necessarily be the actual outcome No other features of options' terms were incorporated into the measurement of fair value

The expense recognised for share-based payments in respect of employee services received during the year is 832 thousand USD (2008 – 434 thousand USD)

Notes to the consolidated financial statements

for the year ended 31 December 2009

13. Tax

The tax charge for the year comprises

	2009 *USD'000*	*2008* *USD'000*
Current tax – foreign tax	37	26
Deferred tax	(649)	(2,280)
	(612)	(2,254)

The income tax benefit in the statement of comprehensive income is lower than the standard rate of corporation tax in the UK of 28% (2008 – 28 5%) The differences are reconciled below

	2009 *USD'000*	*2008* *USD'000*
Loss before taxation	(11,698)	(17,817)
Tax at applicable rate of tax of 28% (2008 – 28 5%)	(3,275)	(5,078)
Tax affect of		
– UK losses not recognised	1,137	978
– foreign losses not recognised	204	165
– effect of different foreign tax rates	202	498
– effect of change in tax rate	–	404
– items which are not deductible for tax	985	591
– income which is not taxable	(180)	22
– derecognition of items from prior year	308	166
– other	7	–
Total tax benefit reported in profit or loss	(612)	(2,254)

The effect of different foreign tax rates is the result of losses incurred in subsidiaries located in countries where lower levels of tax rates are applied

The UK corporate tax rate decreased from 28 5% to 28% with effect from 1 January 2009 The Russian corporation tax rate decreased from 24% to 20% with effect from 1 January 2009

The Group has not recognised a deferred tax asset on tax losses which arose in the UK of 11 949 million USD (2008 – 7 899 million USD) and in the US of 727 thousand USD (2008 – 579 thousand USD) Deferred tax has not been provided for these losses on the basis that it is not sufficiently certain there will be adequate taxable profits arising in the future to offset against the tax losses The losses incurred in the UK are available to carry forward indefinitely for offset against future taxable profits The losses arising in the US will expire 20 years from the year incurred

A deductible temporary difference of 832 thousand USD (2008 – 434 thousand USD) arising from the share based payments in the UK has also not been recognised in the financial statements on the basis that there will not be sufficient taxable profits for the temporary difference to be reversed in the foreseeable future

Notes to the consolidated financial statements

for the year ended 31 December 2009

13. Tax (continued)

The tax charge/(credit) to equity during the year is

	2009	*2008*
	USD '000	*USD '000*
Deferred tax on exchange losses/(gains)	458	(3,220)

Deferred tax

The deferred tax included in the balance sheet is as follows

	2009	*2008*
	USD '000	*USD '000*
Deferred tax assets		
– tax losses carried forward	6,180	4,430
– current assets	1,072	–
– other allowances	–	231
– property, plant and equipment	–	849
Deferred tax liabilities		
– intangible assets	(1,633)	–
– property, plant and equipment	(230)	–
– current assets	–	(166)
	5,389	5,344

The movement in the net deferred tax asset in the consolidated financial statements is as follows

	2009	*2008*
	USD '000	*USD '000*
As at 1 January	5,344	784
Credited to profit or loss	648	2,280
(Charged)/credited to other comprehensive income	(458)	3,320
Net exchange adjustment	(145)	(1,040)
As at 31 December	5,389	5,344

A net deferred tax asset has been recognised on the basis that there will be sufficient taxable profits, based on the group's profit forecast, against which these temporary differences can be utilised

The deferred tax included in profit or loss is as follows

	2009	*2008*
	USD '000	*USD '000*
Deferred tax assets		
– tax losses carried forward	(2,213)	(1,506)
– other allowances	229	159
– property, plant and equipment	1,078	(1,337)
– current assets	(1,375)	–
Deferred tax liabilities		
– intangible assets	1,633	–
– effect from change in tax rate	–	40
	(648)	(2,280)

Notes to the consolidated financial statements

for the year ended 31 December 2009

14. 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

	2009	*2008*
Loss for the purposes of basic loss per share (USD'000)	11,086	15,563
Weighted average number of ordinary shares for the purposes of basic loss per share	175,280,273	148,456,397
Loss per Share (USD)		
Basic	0 06	0 10
Diluted	0 06	0 10

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

Pursuant to terms of service agreements with senior management 500,000 shares (2008 – 500,000 shares) have been approved as compensation subject to vesting conditions being met, such shares vesting over a three year period from the date of the agreement For 2009, 1,960,000 shares were issued to the EBT pursuant to the service agreements (2008 – nil)

Notes to the consolidated financial statements

for the year ended 31 December 2009

15. Intangible assets

	Exploration and evaluation expenditures		
	Drilling, seismic & other costs USD'000	*Sub-soil licences USD'000*	*Total USD'000*
Cost:			
Balance at 1 January 2008	25,888	32,970	58,858
Translation difference	(2,635)	(11)	(2,646)
Additions	9,301	9	9,310
Transfers	(15,612)	(15,364)	(30,976)
At 31 December 2008	16,942	17,604	34,546
Translation difference	(16)	(2)	(18)
Additions	6,831	–	6,831
At 31 December 2009	23,757	17,602	41,359
Amortisation and impairment			
Accumulated balance at 1 January 2008	(1,651)	(7)	(1,658)
Translation difference	(231)	3	(228)
Amortisation for the year	–	(3)	(3)
Impairment charge	(4,919)	–	(4,919)
Transfers	1,651	–	1,651
At 31 December 2008	(5,150)	(7)	(5,157)
Amortisation for the year	–	(10)	(10)
Reversal of impairment charge	41	–	41
At 31 December 2009	(5,109)	(17)	(5,126)
Net book value:			
At 31 December 2008	11,792	17,597	29,389
At 31 December 2009	18,648	17,585	36,233

Amortisation is recognized in profit or loss as part of operating expenses (Note 5) Impairment and reversal of impairment provisions are recognized in profit or loss as part of other gains and losses (Note 7)

During 2008, the Group transferred 30,976 million USD of exploration and evaluation costs net of impairment allowances of 1,651 million USD to property, plant and equipment in accordance with IFRS 6 Upon completing the required tests for impairment, the Board determined that based on the reserve report from the independent engineers and the financings completed during 2008, the development of the western area of the licence had achieved both technical feasibility and commercial viability in 2008

The sale of the Bortovoy license and major assets belonging to Diall is restricted pursuant to the EBRD convertible loan agreement (Note 22)

Notes to the consolidated financial statements

for the year ended 31 December 2009

16. Property, plant and equipment

	Oil and gas assets USD'000	*Motor vehicles USD'000*	*Other equipment and furniture USD'000*	*Total USD'000*
Cost:				
Balance at 1 January 2008	3,436	439	368	4,243
Translation differences	(6,528)	(78)	(16)	(6,622)
Transfer from intangible assets	29,325	–	–	29,325
Additions	33,189	100	98	33,387
Disposals	(204)	(61)	–	(265)
At 31 December 2008	59,218	400	450	60,068
Translation differences	1,678	(11)	142	1,809
Additions	95,931	33	12	95,976
Reversal of impairment charge	1,602	–	–	1,602
Disposals	(158)	(10)	(7)	(175)
At 31 December 2009	158,271	412	597	159,280
Depreciation:				
Accumulated depreciation at 1 January 2008	(158)	(45)	(75)	(278)
Translation differences	(78)	(11)	4	(85)
Depreciation and depletion	(252)	(89)	(95)	(436)
Disposals	20	32	–	52
At 31 December 2008	(468)	(113)	(166)	(747)
Translation differences	(9)	–	(12)	(21)
Depreciation and depletion	(451)	(78)	(119)	(648)
Disposals	8	7	3	18
At 31 December 2009	(920)	(184)	(294)	(1,398)
Net book value.				
At 31 December 2008	58,750	287	284	59,321
At 31 December 2009	157,351	228	303	157,882

Depletion is charged to profit or loss through operating expenses (Note 5) Depreciation is charged to the profit or loss through operating expenses (Note 5) and administrative expenses (Note 6) During the year 62 thousand USD (2008 – 13 thousand USD) of depreciation was capitalized and included as additions to property plant and equipment

The reversal of impairment charges is recognized in profit and loss as part of other gains and losses (Note 7)

The sale of property, plant and equipment belonging to Diall is restricted pursuant to the EBRD convertible loan agreement (Note 22)

Notes to the consolidated financial statements

for the year ended 31 December 2009

17. Trade and other receivables – non current

	2009 USD'000	2008 USD'000
Other receivables	8,659	5,072
Prepayments	4,771	13 548
	13,430	18,620

Prepayments are advance payments on contracts for capital projects relating to exploration, development and production and therefore classified as non-current assets Other receivables are for value added taxes which are to be used as an offset against future value added tax liabilities but are not expected to be recovered within the next twelve months

18. Inventories

	2009 USD'000	2008 USD'000
Crude oil	33	55

Crude oil inventory represents amounts held in storage pending sales to customers The major component of crude oil inventory costs expensed during the period as a part of operating expenses was 101 thousand USD (2008 – 666 thousand USD) for mineral extraction and sub-soil usage royalty taxes (Note 5)

19. Trade receivables and other receivables – current

	2009 USD'000	2008 USD'000
Tax receivables	10,164	635
Prepayments	1,081	1 229
Other	377	418
Trade receivables	2	89
	11,624	2,371

Tax receivables relate primarily 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

The amounts shown in prepayments are net of an impairment provision for the year of 139 thousand USD (2008 – 732 thousand USD) as the Group does not expect to recover advance payments on the related projects

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

20. Cash and cash equivalents

Cash is kept on deposit with banks and earns interest at the daily deposit rates or placed in short-term deposits such as money market funds which can be redeemed upon demand At 31 December 2009 the cash and cash equivalents totaled 18 361 million USD (2008 – 85 470 million USD)

21. Current liabilities

	2009 USD'000	2008 USD'000
Trade payables	3,421	2,336
Accruals and other payables	1,171	339
	4,592	2,675

Notes to the consolidated financial statements

for the year ended 31 December 2009

22. Non-current borrowings

	Effective interest rate	*2009 USD'000*	*2008 USD'000*
Amounts due in less than 5 years			
EBRD convertible debt	LIBOR + 4%	3,183	–
Energy Growth Management Services (Note 28)	6%	–	1,760
Logan Energy Resources Inc (Note 28)	LIBOR + 3%	–	408
		3,183	2,168
Amounts due in more than 5 years			
EBRD convertible debt	LIBOR + 4%	1,592	–
		4,775	2,168

EBRD convertible debt comprises		
Drawdown of the loan	10,000	–
Equity element	(1,964)	–
	8,036	–
Cost of borrowing	(3,261)	–
Net EBRD convertible debt	4,775	–

On 18 September 2009, the Company entered into an agreement with the EBRD to borrow up to 60 million USD prior to 18 March 2011 As of 31 December 2009, the Company had drawn down 10 million USD of the convertible debt facility

The debt is convertible into common shares of the Company at any time up to 18 March 2012 at the EBRD s option Conversions done prior to 19 March 2011 are to be converted at a price of 3 0531 USD per share From 19 March 2011 to 18 March 2012, the debt is convertible at 3 0531 USD per share plus a pro-rated amount of margin payments at 4% interest made up to the time of the conversion For any unconverted amounts, the debt is to be repaid in six equal semi-annual installments beginning 15 June 2013 and ending on 15 December 2015

The net proceeds received from the issue of the convertible debt have been split between a debt component and an embedded equity element The fair value of the debt component has been calculated as the present value of the contracted future cash flows using an assumed market interest rate of LIBOR plus 9% The equity element is calculated as the difference between the principal amount and the fair value of the convertible debt

The interest charged for the year is calculated by applying an effective interest rate of LIBOR plus 9% to the liability component for the period since the convertible debt was issued
LIBOR is the British Bankers Association London Interbank Offered Rate

23. Provisions

	2009 USD'000	*2008 USD'000*
Beginning of period	675	245
Change in provision	5,917	126
Unwinding of discount	101	431
Translation differences	276	(127)
	6,969	675

The provision is for decommissioning and environmental restoration costs relating to the Bortovoy licence The increase in the provision recorded for the year of 6 018 million USD (2008 – 557 thousand USD) was primarily for forecasted decommissioning and dismantling costs related to the gas plant and related infrastructure

Notes to the consolidated financial statements

for the year ended 31 December 2009

24. Equity

Authorised and issued share capital

Authorised	*2009 USD '000*
250,000,000 ordinary shares of USD 0 01 each	2,500

In 2009, the shareholders approved an increase in the authorized share capital of the Company from 200,000,000 to 250,000,000 shares

	Ordinary shares		*Share*	*Share*	*Own*
	Shares	*Amount*	*capital*	*premium*	*shares held*
Allotted, called up and fully paid	*No*	*USD '000*	*USD '000*	*USD '000*	*USD '000*
At 1 January 2008	114,655,000	90,865	1,147	89,675	–
Share issue 20 May 2008	52,413,760	160,000	524	159,476	–
Share issue 21 July 2008	3,000,000	9,158	30	9,128	–
Share issue costs	–	–	–	(6,084)	–
At 31 December 2008	170,068,760	260,023	1,701	252,195	–
Share issue 20 January 2009	1,460,000	4,457	14	4,443	(4,457)
Share issue 15 June 2009	500,000	1,526	5	1,521	(1,526)
Share issue 24 September 2009	13,101,438	40,000	131	39,869	–
Share issue costs	–	–	–	(3,057)	–
At 31 December 2009	185,130,198	306,006	1,851	294,971	(5,983)

Own shares held

The Company has approval to transfer up to 4,460,000 shares to the EBT for allocation to officers and employees of the Group The formal establishment of the EBT was completed on 20 January 2009 In 2009 1,960,000 shares equal to 1% of called up share capital were issued pursuant to the EBT (2008 – nil) For presentation purposes, the shares held in the EBT are included as own shares held

Currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of subsidiaries whose functional currency is not in US dollars into the group's presentation currency

Share option reserve

The share option reserve relates to the fair value of the equity settled share based payments that have been expensed through profit or loss

Equity element of convertible debt

The equity element of convertible debt is the difference between the principal amount and the fair value of the EBRD convertible debt reflecting the value of the convertible option of the debt This recognizes that the margin interest rate of 4% on the convertible debt is less than the margin interest rate, assumed at 9%, that the Company could have borrowed debt had there been no convertible option

Notes to the consolidated financial statements

for the year ended 31 December 2009

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

	2009 *USD'000*	*2008* *USD'000*
Loss before taxation	(11,698)	(17,817)
Adjustments for		
Foreign exchange losses/(gains)	638	(382)
Depreciation, depletion and amortisation	596	426
Increase/(decrease) in impairment provisions	(1,504)	5,651
Interest on long-term borrowings	112	837
Taxes paid	(32)	(9)
Interest earned on cash and cash equivalents	(250)	(1,749)
Accrued share based payments	832	434
Decrease in trade and other receivables	119	3,094
Decrease/(increase) in inventories	22	(23)
Increase/(decrease) in trade and other payables	3,077	(2,755)
Net cash flow used in operating activities	(8,088)	(12,293)

26. Operating lease obligations

Operating lease payments are mainly rentals by the Group for land, office space and equipment required for use on a temporary basis Leases are normally signed on a short term basis of one to two years with options to extend

Lease payments under operating leases recognised in the statement of comprehensive income for the year were 918 thousand USD (2008 – 748 thousand USD)

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows

	2009 *USD'000*	*2008* *USD'000*
Within one year	510	731
In two to five years	35	109
More than five years	201	-

Notes to the consolidated financial statements

for the year ended 31 December 2009

27. Financial Instruments

Financial instruments recognised in the balance sheet

	Loans and receivables USD '000	*Other financial liabilities at amortised cost USD '000*	*Total USD '000*
Year ended 31 December 2009			
Financial assets			
Trade and other receivables	175	–	175
Cash and cash equivalents	18,361	–	18,361
	18,536	–	18,536
Financial liabilities			
Trade payables	–	3,421	3,421
Accruals and other payables	–	1,171	1,171
Non-current borrowings	–	4,775	4,775
	–	9,367	9,367
Year ended 31 December 2008			
Financial assets			
Trade and other receivables	197	–	197
Cash and cash equivalents	85,470	–	85,470
	85,667	–	85,667
Financial liabilities			
Trade payables	–	2,336	2,336
Accruals and other payables	–	339	339
Non-current borrowings	–	2,168	2,168
	–	4,843	4,843

The Group had no financial instruments held at fair value through profit and loss, held to maturity or available for sale and no derivatives used for hedging

The main financial risks faced by the Group through its normal business activities are credit risk, foreign currency risk, liquidity risk and interest rate risk

Interest rate risk

The Group has financial assets and liabilities which are exposed to interest rate risk Changes in interest rates impacting borrowings change either their fair value (fixed rate borrowings) or their future cash flows (floating rate borrowings) The Group's aim is to finance its operations through equity and debt financing

Whilst fixed rate interest bearing borrowings are not exposed to cash flow interest rate risk, there is no opportunity for the Group to enjoy a reduction in borrowing costs in markets where rates are falling In addition, the fair value risk inherent in fixed rate borrowing means that the Group is exposed to unplanned costs should borrowings be restructured or repaid early as part of the liquidity management process In contrast, whilst floating rate borrowings are not exposed to changes in fair value, the Group is exposed to cash flow risk as costs increase if market rates rise

Interest on financial instruments classified as floating rate is re-priced at intervals of less than one year Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument The other financial instruments of the Group that are not included in the tables below are non-interest bearing and are therefore not subject to interest rate risk

Notes to the consolidated financial statements

for the year ended 31 December 2009

27. Financial Instruments (continued)

The following tables set out the carrying amount, by maturity of the Group's financial instruments that are exposed to interest rate risk

	Within 1 year *USD'000*	*1-2 years* *USD'000*	*3+ years* *USD'000*	*Total* *USD'000*
Year ended 31 December 2009				
Fixed rate				
Non-current borrowings	–	–	–	–
Floating rate				
Cash and cash equivalents	18,361	–	–	18,361
Non-current borrowings	–	–	(4,775)	(4,775)
Year ended 31 December 2008				
Fixed rate				
Non-current borrowings	–	(1,760)	–	(1,760)
Floating rate				
Cash and cash equivalents	85,470	–	–	85,470
Non-current borrowings	–	(408)	–	(408)

A one per cent increase/decrease in interest rates on floating rate assets and liabilities would have decreased/increased loss before taxation by 136 thousand USD (2008 – 851 thousand USD) and would impact the Group's equity by the same value

Credit risk

Credit risk is the potential exposure of the Group to loss in the event of non-performance by a counter-party The amount that best represents the maximum credit exposure of the Group's financial assets is the carrying value of the financial assets at the balance sheet date

This risk arises principally from cash and cash equivalents Management's policy is to hold cash and cash equivalents in reputable financial institutions of which 66 4% (2008 – 96 3%) of cash and cash equivalents are held in reputable financial institutions in the UK To limit exposure to credit risk on trade receivables, management's policy is to use prepayments or payment upon delivery for product sales whenever possible The average credit period taken on sale of goods is less than seven days There is no allowance for estimated irrecoverable amounts from sale of goods for the year (2008 – $nil)

Maximum credit risk exposure relating to financial assets is represented by carrying value as at the balance sheet date

Foreign currency risk

Fluctuations in exchange rates can have significant affects on the Group's reported profit or loss The Group's financial assets and liabilities give rise to transactional currency exposures Such exposures arise from transactions in a currency other than the Group's functional currency

The Group s primary operations are within Russia where the functional currency of the Group's subsidiaries is the Russian ruble ("RUR") The currencies giving rise to this foreign currency risk are US dollar based intra-group borrowings and payables The recent instability of the RUR to US dollar has increased the risks of significant unrealized gains and losses associated with the intra-group borrowings

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 as circumstances dictate, the Group considers hedging positions to protect the value of any cash balances it holds in non-US dollar currency or to protect against exchange fluctuations on future non-USD denominated commitments or obligations

Notes to the consolidated financial statements

for the year ended 31 December 2009

27. Financial Instruments (continued)

The following table demonstrates the Group s exposure to foreign currency risk based on gross amounts

	US dollar USD'000	Sterling USD'000	Canadian dollar USD'000	Euro USD'000	Russian ruble USD'000	Total USD'000
Year ended 31 December 2009						
Cash and cash equivalents	12,601	174	–	–	5,586	18,361
Trade and other receivables	–	172	–	–	3	175
Trade payables	(828)	(86)	–	(9)	(2,498)	(3,421)
Accruals and other payables	(15)	(477)	–	–	(679)	(1,171)
Non-current borrowings	(4,775)	–	–	–	–	(4,775)
	6,983	(217)	–	(9)	2,412	9,169
Year ended 31 December 2008						
Cash and cash equivalents	82,484	269	–	–	2,717	85,470
Trade and other receivables	–	107	–	–	90	197
Trade payables	(301)	(255)	(34)	(71)	(1,675)	(2,336)
Accruals and other payables	(16)	(184)	–	–	(139)	(339)
Non-current borrowings	(2,168)	–	–	–	–	(2,168)
	79,999	(63)	(34)	(71)	993	80,824

A ten per cent strengthening of US dollar against the following currencies would have decreased loss before tax and impact the Group's equity by the amounts shown below For a ten per cent strengthening of the US dollar against the Canadian dollar or euro, there is no significant impact on loss before tax or on the Group's equity This analysis assumes that all other variables remain constant and the analysis is performed on the same basis for 2008

	Effect on loss before tax/equity USD'000
2009	
Sterling	20
Russian ruble	(240)
2008	
Sterling	10
Russian ruble	(100)

A ten per cent weakening of US dollar against the above currencies would have had an equal but opposite effect on the basis that all other variables remain constant

Liquidity risk

Liquidity risk is the risk that sources of funding for the Group s business activities may not be available

Given the early stages of developing its oil and gas licenced area, management is continually monitoring cash requirements for the Group and evaluating potential sources to fund its operating and capital expenditures All Group entity operations are controlled through annual and monthly budget reviews to mitigate liquidity risk It is the goal of management to ensure adequate funding is available through an appropriate mix of debt and equity instruments To further limit liquidity risk, all significant cash and cash equivalents are deposited with banks or in liquid funds with high credit-ratings assigned by international credit-rating agencies During the year the Group arranged a convertible debt financing facility with the EBRD (Note 22) of which 50 0 million USD was available for drawdown at 31 December 2009 to cover development and exploration costs

Notes to the consolidated financial statements

for the year ended 31 December 2009

27 Financial Instruments (continued)

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2009 and 2008 based on contractual undiscounted payments

Year ended 31 December 2009

	On demand USD'000	*Less than 3 months USD'000*	*3 to 12 months USD'000*	*1 to 5 years USD'000*	*>5 years USD'000*	*Total USD'000*
Year ended 31 December 2009						
Trade payables	–	3,421	–	–	–	3,421
Accruals and other payables	–	1,171	–	–	–	1,171
Non-current borrowings	–	–	–	(6,667)	(3,333)	(10,000)
Year ended 31 December 2008						
Trade payables	–	2,336	–	–	–	2,336
Accruals and other payables	–	339	–	–	–	339
Non-current borrowings	–	–	–	2,290	–	2,290

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments that are carried in the financial statements Fair value has been determined as at the balance sheet date by discounting the estimated future cash flows at prevailing interest rates

	Book value		*Fair value*	
	2009 USD'000	*2008 USD'000*	*2009 USD'000*	*2008 USD'000*
Cash and cash equivalents	18,361	85,470	18,361	85,470
Trade and other receivables	175	197	175	197
Trade payables	3,421	(2,336)	3,421	(2,336)
Accruals and other payables	(1,171)	(339)	(1,171)	(339)
Non-current borrowings	(4,775)	(2,168)	(4,775)	(1,994)

Capital management

The primary objective of the Group's capital management is to ensure that it maintains healthy capital ratios in order to support its business and maximise shareholder value The Group has no externally imposed capital requirements

The Group's objectives when managing capital are to safeguard the group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt No changes were made in the objectives, policies or processes during the years ended 31 December 2009 and 2008

The Group monitors capital using a gearing ratio, which is non-current borrowings divided by capital The Group's strategy is to reduce its gearing when the opportunity arises Capital comprises equity attributable to the equity holders of the parent

	2009 USD'000	*2008 USD'000*
Non-current borrowings	4,775	2,168
Capital	226,616	195,052
Gearing ratio	2%	1%

Notes to the consolidated financial statements

for the year ended 31 December 2009

28. Related party transactions

Obligations to related parties

Prior to 31 December 2009 the Company paid off the promissory notes (Note 22) due to Energy Growth Management Services (2008 – 1 760 million USD) and to Logan Energy Resources Inc (2008 – 408 thousand USD) Both companies are owned and controlled by shareholders of Vostok

Transactions with related parties

	Charges to related parties USD'000	*Purchases from related parties USD'000*	*Amounts owed by related parties USD'000*	*Amounts owed to related parties USD'000*
2009	92	375	172	236
2008	84	102	91	118

Transactions primarily relate to the provision of goods and services from companies whose Boards have common directors with the Company's Board

Key management compensation

Key management is considered to comprise all senior executives and directors of the Company including the CEO, COO, Executive Vice President, Vice President Exploration and Development and the Finance Director

	2009 USD'000	*2008 USD'000*
Salaries and other short-term employee benefits	2,075	1,659
Share-based payments	832	434
	2,907	2,093

The share-based payments represent the IFRS 2 charge for the period

29. Capital commitments

The Group has commitments pursuant to its sub-soil licence agreements to continue to explore and develop the licence area Management estimates that at 31 December 2009 the above non accrued licence commitments totaled approximately 2 8 million USD (2008 – 5 1 million USD)

Prior to 31 December 2009 the Group entered into contracts relating to work on the new gas plant, 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 14 8 million USD as at 31 December 2009 (2008 – 20 9 million USD)

30. Contingencies

Russian business operating environment

During the year ended 31 December 2009 all of the Group's business was conducted in Russia through its investment in subsidiaries operating in the oil and gas industry These operations and those of similar companies in Russia are subject to the economic, political and regulatory uncertainties prevailing in Russia

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 Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product, Russia continues to develop economic reforms and improve its legal, tax and regulatory frameworks to bring it more in line with a stable market economy The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government

Notes to the consolidated financial statements

for the year ended 31 December 2009

30. Contingencies (continued)

Taxation

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 may be challenged by the relevant regional and federal authorities Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged As such, significant additional taxes, penalties and interest may be assessed It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavorable outcome Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review Under certain circumstances reviews may cover longer periods

Management believes that the Group has complied with all regulations, and paid and accrued all taxes that are applicable However, it is possible that the relevant local or national governmental authorities may attempt to revise their previous approach to such transactions and assess additional income and other taxes and duties against the Group

Restoration, rehabilitation, and environmental costs

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

Sub-soil licences

The Group is subject to periodic reviews of its activities by Russian governmental authorities with respect to the requirements of its oilfield licences Management of the Group corresponds with governmental authorities to agree on remedial actions, if necessary, to resolve any findings resulting from these reviews Failure to comply with the terms of a licence could result in fines, penalties, licence limitation, suspension or revocation The Group's management believes any issues of non-compliance will be resolved through negotiations or corrective actions without any materially adverse effect on the financial position or the operating results of the Group Management believes that in practice the relevant authorities rarely suspend or restrict the licences, especially at the exploration stage, and tend to terminate licences only in the event of continuous non-compliance and the failure of the licence holder to remedy breaches The Group is attempting to comply with its licence requirements and has not received any official warnings or notifications about continuous non-compliance or any risk of suspension, restriction or termination

31. Post balance sheet events

There have been no significant posts balance sheet events

Parent company balance sheet

at 31 December 2009

	Notes	2009 USD'000	2008 USD'000
Non –current assets			
Property, plant and equipment	5	298	231
Investments in subsidiaries	6	264,627	158,663
		264,925	158,894
Current assets			
Trade and other receivables	7	621	350
Cash and cash equivalents		12,287	82,695
		12,908	83,045
Total assets		277,833	241,939
Current liabilities			
Trade and other payables	8	1,288	897
Non-current liabilities	9	4,775	2,168
Total liabilities		6,063	3,065
Net assets		271,770	238,874
Equity			
Share capital	10	1,851	1,701
Share premium	10	294,971	252,195
Own shares held	10	(5,983)	–
Currency translation reserve	10	27	29
Share option reserve	10	1,426	594
Equity element of convertible debt	9	1,964	–
Accumulated deficit		(22,486)	(15,645)
Total equity attributable to owners of the parent		271,770	238,874

These financial statements were approved and authorised for issue by the Board of Directors on 6 May 2010

Signed on behalf of the Board of Directors

Blaine Karst

Blaine Karst
Director

Parent company statement of changes in equity

for the year ended 31 December 2009

	Share capital USD'000	Own shares held USD'000	Equity element of convertible debt USD'000	Share premium USD'000	Currency translation reserve USD'000	Share option reserve USD'000	Accumulated deficit USD'000	Total equity USD'000
Balance at 1 January 2008	1,147	–	–	89,675	–	160	(8,198)	82,784
Loss for the year	–	–	–	–	–	–	(7,447)	(7,447)
Other comprehensive income								
Currency translation credit	–	–	–	–	29	–	–	29
Total comprehensive income for the year	–	–	–	–	29	–	(7,447)	(7,418)
Transactions with owners								
Share issues	554	–	–	168,604	–	–	–	169,158
Share issue costs	–	–	–	(6,084)	–	–	–	(6 084)
Share option charge	–	–	–	–	–	434	–	434
Total of transactions with owners	554	–	–	162,520	–	434	–	163,508
Balance at 31 December 2008	1,701	–	–	252,195	29	594	(15,645)	238,874
Loss for the year	–	–	–	–	–	–	(6,841)	(6,841)
Other comprehensive income								
Currency translation debit	–	–	–	–	(2)	–	–	(2)
Total comprehensive income for the year	–	–	–	–	(2)	–	(6,841)	(6,843)
Transactions with owners								
Share issues	150	–	–	45,833	–	–	–	45,983
Own shares issued to the employee benefit trust	–	(5,983)	–	–	–	–	–	(5,983)
Equity element of convertible debt	–	–	1,964	–	–	–	–	1,964
Share issue costs	–	–	–	(3,057)	–	–	–	(3,057)
Share option charge	–	–	–	–	–	832	–	832
Total of transactions with owners	150	(5,983)	1,964	42,776	–	832	–	39,739
Balance at 31 December 2009	1,851	(5,983)	1,964	294,971	27	1,426	(22,486)	271,770

Parent company statement of cash flows

for the year ended 31 December 2009

	Notes	2009 USD'000	2008 USD'000
Operating activities			
Net cash flow used in operating activities	11	(5,912)	(5,472)
Net cash used in operating activities		(5,912)	(5,472)
Investing activities			
Investments in subsidiaries		(105,918)	(69,520)
Interest income on cash investments		210	1,991
Purchase of property, plant and equipment		(126)	(72)
Net cash used in investing activities		(105,834)	(67,601)
Financing activities			
Proceeds on issue of share capital		36,943	153,984
Interest payments on long term liabilities		(112)	(1,465)
Proceeds from convertible debt		6,693	-
Repayment of non-current borrowings		(2,168)	(10,842)
Net cash provided by financing activities		41,356	141,677
Net (decrease)/increase in cash and cash equivalents		(70,390)	68,604
Cash and cash equivalents at beginning of year		82,695	14,094
Effect of exchange rate changes on cash and cash equivalents		(18)	(3)
Cash and cash equivalents at end of year		12,287	82,695

Notes to the parent company financial statements

for the year ended 31 December 2009

1. Corporate information

Organisation and principal activities

The Company is a limited liability company incorporated in Great Britain The principal activity of the Company is the management of investments in subsidiaries engaged in the exploration, development, and production of hydrocarbons The Company's main operating subsidiary is in Russia where the subsidiary holds a sub-soil licence for geological exploration and production of hydrocarbons To assist in management operations, the Company has a registered branch office in Moscow, Russia The registered UK office of the Company is Masters House, 107 Hammersmith Road, London, England, W14 0QH

2. Significant accounting policies

The Company's accounting policies, key accounting estimates and judgements follow those of the Group as set out in Note 2 to the consolidated financial statements The following accounting policies also apply to the Company

Basis of preparation

The financial statements are presented in US dollars No income statement is presented by the Company as permitted by section 408(3) of the Companies Act 2006

Investments in subsidiaries

Non-current investments in subsidiaries are included in the financial statements at cost The Company assesses investments for impairment whenever events or changes in circumstances indicate that the carrying value of an investment may not be recoverable If any such indication of impairment exists, the Company makes an estimate of its recoverable amount Where the carrying amount of an investment exceeds its recoverable amount, the investment is considered impaired and is written down to its recoverable amount

3. Taxation

The Company has not recognised a deferred tax asset on tax losses which arose in the UK of 11 949 million USD (2008 – 7 889 million USD) Deferred tax has not been provided for in respect of these losses on the basis that it is not sufficiently certain that there will be adequate taxable profits arising in the future to offset against these tax losses The losses incurred in the UK are available to carry forward indefinitely for offset against future taxable profits of the same trade

A deferred tax asset relating to share based payments accrued during the year of 832 thousand USD (2008 – 434 thousand USD) has not been recognised in the financial statements on the basis that there will not be sufficient taxable profits for the temporary difference to be reversed in the foreseeable future

4. Loss attributable to members of the parent company

The loss dealt with in the financial statements of the parent company is 6 841 million USD (2008 – 7 447 million USD)

Notes to the parent company financial statements

for the year ended 31 December 2009

5. Property, plant and equipment

	Office equipment and furniture USD'000	*Motor vehicles USD'000*	*Total USD'000*
Cost:			
At 1 January 2008	241	–	241
Additions	107	–	107
Translation differences	(2)	–	(2)
At 31 December 2008	346	–	346
Additions	114	61	175
Disposals	(6)	–	(6)
Translation differences	12	3	15
At 31 December 2009	466	64	530
Depreciation:			
Accumulated depreciation at 1 January 2008	49	–	49
Charge for the year	66	–	66
At 31 December 2008	115	–	115
Charge for the year	96	10	106
Disposals	(2)	–	(2)
Translation differences	13	–	13
At 31 December 2009	222	10	232
Net book value			
At 31 December 2008	231	–	231
At 31 December 2009	244	54	298

6. Investments in subsidiaries

	Investment in subsidiary undertakings USD'000	*Loans to subsidiary undertakings USD'000*	*Total USD'000*
Balance at 1 January 2008	30,744	61,115	91,859
Additions	–	69,570	69,570
Impairment charge	(151)	(2,615)	(2,766)
Balance at 31 December 2008	30,593	128,070	158,663
Additions	11,375	94,589	105,964
Balance at 31 December 2009	41,968	222,659	264,627

Information on investments in subsidiaries can be found in the Directors' Report in the consolidated financial statements The investment costs relate to the acquisition and funding of exploration and development operations in Russia

The impairment charge of 2 766 million USD in 2008 was for VEC, an inactive Russian subsidiary There is no expectation of recovering the investment as the decisions was made to wind up VEC resulting in a write down of the investment to $nil

All loans to subsidiaries are demand loans but are classified as long term as the Company does not expect to demand repayment of the advances in 2010

No interest was charged on loans to subsidiaries in the year (2008 – $nil)

Notes to the parent company financial statements

for the year ended 31 December 2009

7. Trade and other receivables

	2009 *USD'000*	*2008* *USD'000*
Prepayments	231	152
Other receivables	390	198
	621	350

Prepayments are for advances on contracts for services and deposits Other receivables are for recoverable VAT or for reimbursable costs incurred pursuant to contractual arrangements

8. Trade and other payables

	2009 *USD'000*	*2008* *USD'000*
Trade payables	804	672
Accruals and other payables	444	184
Short-term borrowings	40	41
	1,288	897

The short-term borrowings are due to VEC and repayable on demand (Note 14)

9. Non-current liabilities

	Effective interest rate	*2009* *USD'000*	*2008* *USD'000*
Amounts due in less than 5 years			
EBRD convertible debt	LIBOR + 4%	3,183	–
Energy Growth Management Services	6%	–	1,760
Logan Energy Resources Inc	LIBOR + 3%	–	408
		3,183	2,168
Amounts due in more than 5 years			
EBRD convertible debt	LIBOR + 4%	1,952	–
		4,775	2,168

EBRD convertible debt comprises		
Drawdown of the loan	10,000	-
Equity element	(1,964)	-
	8,036	-
Cost of borrowing	(3,261)	-
Net EBRD convertible debt	4,775	-

On 18 September 2009 the Company entered into an agreement with the EBRD to borrow up to 60 million USD prior to 18 March 2011 As of 31 December 2009 the Company had drawn down 10 million USD of the convertible debt facility

The debt is convertible at any time up to 18 March 2012 at the EBRD's option Conversions done prior to 19 March 2011 are to be converted at a price of 3 0531 USD per share From 19 March 2011 to 18 March 2012, the debt is convertible at 3 0531 USD per share plus a pro-rated amount of margin payments (4% interest) made up to the time of the conversion

Notes to the parent company financial statements

for the year ended 31 December 2009

9. Non-current liabilities (continued)

For any unconverted amounts, the debt is to be repaid in six equal semi-annual installments beginning 15 June 2013 and ending on 15 December 2015

The net proceeds received from the issue of the convertible debt have been split between a debt component and an embedded equity element The fair value of the debt component has been calculated as the present value of the contracted future cash flows using an assumed market interest rate of LIBOR plus 9% The equity element is calculated as the difference between the principal amount and the fair value of the debt component

The interest charged for the year is calculated by applying an effective interest rate of LIBOR plus 9% to the liability component for the period since the convertible debt was issued

The borrowings from Energy Growth Management Services and Logan Energy Resources plus interest were paid out in 2009

LIBOR is the British Bankers Association London Interbank Offered Rate

10. Equity

Authorised and issued share capital

Authorised	*2009 USD '000*
250,000,000 ordinary shares of USD 0 01 each	2,500

In 2009, the shareholders approved an increase in the authorized share capital of the Company from 200,000,000 to 250,000,000 shares

Allotted, called up and fully paid	*Ordinary shares Shares No*	*Ordinary shares Amount USD '000*	*Share capital USD '000*	*Share premium USD '000*	*Own shares held USD '000*
At 1 January 2008	114,655,000	90,865	1,147	89,675	–
Share issue 20 May 2008	52,413,760	160,000	524	159,476	–
Share issue 21 July 2008	3,000,000	9,158	30	9,128	–
Share issue costs	–	–	–	(6,084)	–
At 31 December 2008	170,068,760	260,023	1,701	252,195	–
Share issue 20 January 2009	1,460,000	4,457	14	4,443	(4,457)
Share issue 15 June 2009	500,000	1,526	5	1,521	(1,526)
Share issue 24 September 2009	13,101,438	40,000	131	39,869	–
Share issue costs	–	–	–	(3,057)	–
At 31 December 2009	185,130,198	306,006	1,851	294,971	(5,983)

Own shares held

The Company has approval to transfer up to 4,460,000 shares to the EBT for allocation to officers and employees of the Group The formal establishment of the EBT was completed on 20 January 2009 In the current year 1,960,000 shares were issued pursuant to the EBT (2008 – nil)

Currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of the branch operations in Russia whose functional currency is not US dollars into the Company's presentation currency

Notes to the parent company financial statements

for the year ended 31 December 2009

10. Equity (continued)

Share option reserve

The share option reserve relates to the fair value of the equity-settled share based payments that have been expensed through profit or loss

Equity element of convertible debt

The equity element of convertible debt is the difference between the principal amount and the fair value of the EBRD convertible debt reflecting the value of the convertible option of the debt This recognizes that the margin interest rate of 4% on the convertible debt is less than the margin interest rate, estimated at 9%, at which the Company could have borrowed debt had there been no convertible option

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

	2009	*2008*
	USD'000	*USD'000*
Loss before taxation	(6,841)	(7,447)
Adjustments for		
Foreign exchange losses	17	34
Depreciation, depletion and amortization	106	66
Impairment charges	–	2,766
Interest expense re non-current debt	112	743
Interest income on cash invested	(210)	(1,991)
Accrued share based payments	832	434
Increase in trade and other receivables	(271)	(83)
Increase in trade and other payables	343	6
Net cash flow used in operating activities	(5,912)	(5,472)

Notes to the parent company financial statements

for the year ended 31 December 2009

12. Share-based payments

The Company grants awards of shares to senior management of the Company at nil cost to the executive The share awards vest at specified time intervals and vesting is dependent on senior management remaining in full employment with the Company for a three year period The awards are equity settled

The fair value of the share awards was estimated at the grant date using a Black Scholes simulation model, taking into account the terms and conditions upon which the awards were granted

The following table shows details of share awards outstanding during the year

	2009 *Shares*	*2008* *Shares*
As at 1 January	1,960,000	1,460,000
Granted during the year	500,000	500,000
As at 31 December	2,460,000	1,960,000
Vested at 31 December	898,667	–

The following table lists the inputs to the model

	2009	*2008*
Award grant date	1 October	1 October
Number of awards	500,000	500,000
Fair value at grant date	$1 52	$1 52
Share price at grant date	$1 53	$1 53
Amount payable by executive	$nil	$nil
Risk free rate	6%	6%
Dividend yield	nil	nil
Expected volatility	32 7%	38 3%
Expected life of awards	2 years	2 years
Weighted average remaining contractual life of share options at the end of the year	1 1 years	1 6 years

Expected volatility is based on historic share price movements The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome The probability that not all the awards will vest due to the resignation of senior management is set at 20%, which is based on management's estimates and may not necessarily be the actual outcome No other features of options' terms were incorporated into the measurement of fair value

The expense recognised for share-based payments in respect of employee services received during the year is 832 thousand USD (2008 – 434 thousand USD)

Notes to the parent company financial statements

for the year ended 31 December 2009

13. Financial instruments

Financial instruments recognised in the balance sheet

	Loans and receivables USD'000	*Other financial liabilities at amortised cost USD'000*	*Total USD'000*
Year ended 31 December 2009			
Financial assets			
Non-current investments	222,659	-	222,659
Trade and other receivables	172	-	172
Cash and cash equivalents	12,287	-	12,287
	235,118	-	235,118
Financial liabilities			
Trade and other payables	-	1,247	1,247
Short-term borrowings	-	40	40
Non-current borrowings	-	4,775	4,775
	-	6,062	6,062
Year ended 31 December 2008			
Financial assets			
Non-current investments	128,070	-	128,070
Trade and other receivables	107	-	107
Cash and cash equivalents	82,695	-	82,695
	210,872	-	210,872
Financial liabilities			
Trade and other payables	-	856	856
Short-term borrowings	-	41	41
Non-current borrowings	-	2,168	2,168
	-	3,065	3,065

The Company had no financial instruments held at fair value through profit and loss, held to maturity and no derivatives used for hedging

The main financial risks faced by the Company through its normal business activities are interest rate risk, credit risk, foreign currency risk and liquidity risk

Interest rate risk

The Company has financial assets and liabilities which are exposed to interest rate risk Interest on floating rate borrowings is re-priced at intervals of less than one year Interest on fixed rate borrowings is fixed until the maturity of the instrument

Changes in interest rates impacting borrowings change either their fair value (fixed rate borrowings) or their future cash flows (floating rate borrowings) The Company's aim is to finance its operations through a combination of equity and debt financing

Whilst fixed rate interest bearing borrowings are not exposed to cash flow interest rate risk, there is no opportunity for the Company to enjoy a reduction in borrowing costs in markets where rates are falling In addition, the fair value risk inherent in fixed rate borrowing means that the Company is exposed to unplanned costs should borrowings be restructured or repaid early as part of liquidity management

In contrast, whilst floating rate borrowings are not exposed to changes in fair value, the Company is exposed to cash flow risk as costs increase if market rates rise

Notes to the parent company financial statements

for the year ended 31 December 2009

14. Financial instruments (continued)3

The financial instruments of the Company that are not included in the tables below are non-interest bearing and are therefore not subject to interest rate risk

The following tables set out the carrying amount, by maturity of the Company's financial instruments that are exposed to interest rate risk

	Within 1 year *USD'000*	*1-2 years* *USD'000*	*3-5 years* *USD'000*	*> 5 years* *USD'000*	*Total* *USD'000*
Year ended 31 December 2009					
Fixed rate					
Non-current borrowings	-	-	-	-	-
Floating rate					
Cash and cash equivalents	12,287	-	-	-	12,287
Non-current borrowings	-	-	(3,183)	(1,592)	(4,775)
Year ended 31 December 2008					
Fixed rate					
Non-current borrowings	-	(1,760)	-	-	(1,760)
Floating rate					
Cash and cash equivalents	82,695	-	-	-	82,695
Non-current borrowings	-	(408)	-	-	(408)

A one per cent increase/decrease in interest rates on floating rate non-current borrowings would have decreased/increased loss before tax by 75 thousand USD (2008 - 823 thousand USD) and would impact the Company's equity by the same value

Credit risk

Credit risk is the potential exposure of the Company to loss in the event of non-performance by a counter-party The amount that best represents the maximum credit exposure of the Company's financial assets is the carrying value of the financial assets at the balance sheet date

This risk arises principally from cash and cash equivalents Management s policy is to hold all cash and cash equivalents in reputable financial institutions in the UK

Foreign currency risk

Fluctuations in exchange rates can have significant effects on the Company's reported profit or loss The Company's financial assets and liabilities give rise to transactional currency exposures Such exposures arise from transactions in currencies other than the Company s functional currency

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

The following table demonstrates the Company's exposure to foreign currency risk based on gross amounts

Notes to the parent company financial statements

for the year ended 31 December 2009

13. Financial instruments (continued)

	US dollar USD'000	Sterling USD'000	Canadian dollar USD'000	Euro USD'000	Russian ruble USD'000	Total USD'000
Year ended 31 December 2009						
Intercompany advances	222,659	–	–	–	–	222,659
Cash and cash equivalents	12,015	173	–	–	99	12,287
Trade and other receivables	–	172	–	–	–	172
Trade payables	(636)	(86)	–	(9)	(72)	(803)
Accruals and other payables	–	(444)	–	–	–	(444)
Current borrowings	–	–	–	–	(40)	(40)
Non-current borrowings	(4,775)	–	–	–	–	(4,775)
Year ended 31 December 2008						
Intercompany advances	128,070	–	–	–	–	128,070
Cash and cash equivalents	82,309	269	–	–	117	82,695
Trade and other receivables	–	107	–	–	–	107
Trade payables	(267)	(256)	(34)	(58)	(57)	(672)
Accruals and other payables	–	(184)	–	–	–	(184)
Current borrowings	–	–	–	–	(41)	(41)
Non-current borrowings	(2,168)	–	–	–	–	(2,168)

A ten per cent strengthening of the US dollar against the sterling would have decreased loss before tax by 20 thousand USD in 2009 (2008 – 10 thousand USD) and impacted the Company's equity by the same value A ten per cent strengthening of the US dollar against the Canadian dollar, euro or Russian ruble would not have had a significant impact on the loss before tax or on the Company's equity The analysis is performed on a consistent basis with 2008 and assumes that all other variables remain constant

A ten per cent weakening of US dollar against the above currencies would have had an equal but opposite effect on the basis that all other variables remain constant

Liquidity risk

Liquidity risk is the risk that sources of funding for the Company's business activities may not be available

Given the early stages of developing its oil and gas licenced area, management is continually monitoring cash requirements for the Company and evaluating potential sources to fund its operating and capital expenditures All Company operations are controlled through annual and monthly budget reviews to mitigate liquidity risk It is the goal of management to ensure adequate funding is available through an appropriate mix of debt and equity instruments To further limit liquidity risk, all significant cash and cash equivalents are deposited with banks or in liquid funds with high credit ratings assigned by international credit-rating agencies

The table below summarises the maturity profile of the Company's financial liabilities at 31 December 2009 and 2008 based on contractual undiscounted payments

	On demand USD'000	Less than 3 months USD'000	3 to 12 months USD'000	1 to 5years USD'000	>5 years USD'000	Total USD'000
Year ended 31 December 2009						
Trade payables	–	803	–	–	–	803
Accruals and other payables	–	444	–	–	–	444
Current borrowings	–	40	–	–	–	40
Non-current borrowings	–	–	–	6,667	3,333	10,000

Notes to the parent company financial statements

for the year ended 31 December 2009

13. Financial instruments (continued)

	On demand	*Less than 3 months*	*3 to 12 months*	*1 to 5years*	*>5 years*	*Total*
	USD'000	*USD'000*	*USD'000*	*USD'000*	*USD'000*	*USD'000*
Year ended 31 December 2008						
Trade payables	–	672	–	–	–	672
Accruals and other payables	–	184	–	–	–	184
Current borrowings	–	41	–	–	–	41
Non-current borrowings	–	–	–	2,168	–	2,168

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the financial statements Fair value has been determined as at the balance sheet date by discounting the estimated future cash flows at prevailing interest rates

	Book value		*Fair value*	
	2009	*2008*	*2009*	*2008*
	USD'000	*USD'000*	*USD'000*	*USD'000*
Intercompany advances	222,659	128,070	222,659	128,070
Cash and cash equivalents	12,287	82,695	12,287	82,695
Trade and other receivables	172	107	172	107
Trade payables	(803)	(672)	(803)	(672)
Accruals and other payables	(444)	(184)	(444)	(184)
Current borrowings	(40)	(41)	(40)	(41)
Non-current borrowings	(4,775)	(2,168)	(4,775)	(1,995)

Capital management

The primary objective of the Company's capital management is to ensure that it maintains healthy capital ratios in order to support its business and maximise shareholder value

The Company's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital To maintain or adjust the capital structure, the Company may adjust the dividend payment to shareholders return capital to shareholders, issue new shares or sell assets to reduce debt No changes were made in the capital management objectives, policies or processes during the years ended 31 December 2009 and 2008

The Company monitors capital using a gearing ratio, which is non-current liabilities divided by capital The Company's strategy is to reduce its gearing when the opportunity arises Capital comprises equity

	2009	*2008*
	USD'000	*USD'000*
Non-current liabilities	4,775	2,168
Capital	271,770	238,874
Gearing ratio	2%	1%

Notes to the parent company financial statements

for the year ended 31 December 2009

14 Related party transactions

Obligations to related parties

As at 31 December 2009 the Company had no non-current obligations to related parties as all obligations were paid out during the year

Transactions with related parties

	Charges to related parties USD '000	*Purchases from related parties USD '000*	*Amounts owed by related parties USD '000*	*Amounts owed to related parties USD '000*
2009	92	204	172	245
2008	84	145	91	202

Transactions primarily relate to the provision of goods and services with VEC, Diall and with companies whose Boards have common directors with the Company's Board

The Company advances funds to its subsidiaries There was no interest accrued on the advances in 2009 (2008 – $nil) See Note 6 that details movements and year-end balances in respect of subsidiary undertakings

Key management compensation

Key management is considered to comprise all senior executives and directors of the Company including the CEO, COO, Executive Vice President, Vice President Exploration and Development and the Finance Director

	2009 USD '000	*2008 USD '000*
Salary and other short term employee benefits	1,453	1,160
Share-based payments	832	434
	2,285	1,594

The share-based payments represent the IFRS 2 charge for the period

According to the service agreement with the COO, the Company advanced funds to cover employment taxes in Russia At 31 December 2009 the Company had advances receivable of 133 thousand USD (2008 – $nil) as a result of the actual Russian employment tax liability being less than originally estimated

15. Operating lease obligations

Operating lease payments primarily represent rentals payable by the Company for office space and equipment required for use on a temporary basis Longer term office leases will be entered into if terms are favourable but would include break clauses providing for a one to two year notice period

Lease payments under operating leases recognised in profit or loss for the year were 560 thousand USD (2008 – 433 thousand USD)

At the balance sheet date, the Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows

	2009 USD '000	*2008 USD '000*
Within one year	127	326
In two to five years	–	109

16 Post balance sheet events

There have been no post balance sheet events requiring disclosure