

# **KazakhGold Group Limited**

**Consolidated financial statements  
for the year ended 31 December 2010**

# KAZAKHGOLD GROUP LIMITED

## CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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# KAZAKHGOLD GROUP LIMITED

## STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group as of 31 December 2010, and the results of its operations, cash flows and changes in equity for the year then ended, in compliance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

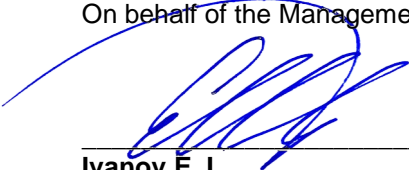
- properly selecting and applying accounting policies;
- presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- providing additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance; and
- making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- maintaining accounting records in compliance with statutory legislation and accounting standards in the jurisdictions in which the Group operates;
- taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- preventing and detecting fraud and other irregularities.

The consolidated financial statements of the Group for the year ended 31 December 2010 were approved by Management on 20 April 2011:

On behalf of the Management:



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**Ivanov E. I.**  
Chief Executive Officer  
KazakhGold Group Limited

20 April 2011

## INDEPENDENT AUDITORS' REPORT

To: Shareholders of KazakhGold Group Limited

We have audited the accompanying consolidated financial statements of KazakhGold Group Limited and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2010, and the consolidated statements of operations, comprehensive loss, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

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

### *Auditor's responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

*Emphasis of matter*

Without modifying our opinion, we draw your attention to Note 1 to the consolidated financial statements which describes the working capital deficiency and the Group's involvement in legal proceedings, the resolution of which is uncertain at the date of issuance of these consolidated financial statements and which may have a material impact on the Group's future operations and which may cast significant doubt about the Group's ability to continue as a going concern.

*Deloitte + Touche*

Moscow, Russia  
20 April 2011

# KAZAKHGOLD GROUP LIMITED

## CONSOLIDATED STATEMENT OF OPERATIONS FOR THE YEAR ENDED 31 DECEMBER (in thousands of US Dollars)

	Notes	<u>2010</u>	<u>2009</u>
Gold sales		114,448	58,434
Other sales		<u>1,246</u>	<u>1,943</u>
<b>Total revenue</b>		<b>115,694</b>	<b>60,377</b>
Cost of gold sales		(76,997)	(57,296)
Cost of other sales		<u>(3,306)</u>	<u>(2,846)</u>
<b>Gross profit</b>		<b>35,391</b>	<b>235</b>
Selling, general and administrative expenses		(24,260)	(39,746)
Other expenses, net	6	(35,230)	(32,621)
Finance costs	7	(32,929)	(31,841)
Foreign exchange gain/(loss), net		<u>1,086</u>	<u>(45,927)</u>
<b>Loss before income tax</b>		<b>(55,942)</b>	<b>(149,900)</b>
Income tax (expense)/benefit	8	<u>(1,329)</u>	<u>6,161</u>
<b>Loss for the year</b>		<b><u>(57,271)</u></b>	<b><u>(143,739)</u></b>
Attributable to:			
Shareholders of the Company		(56,265)	(142,899)
Non-controlling interests		<u>(1,006)</u>	<u>(840)</u>
		<b><u>(57,271)</u></b>	<b><u>(143,739)</u></b>
<b>Loss per share</b>			
Basic and diluted (US Dollars)	9	(0.66)	(2.70)

*The accompanying notes are an integral part of these consolidated financial statements.*

# KAZAKHGOLD GROUP LIMITED

## CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS FOR THE YEAR ENDED 31 DECEMBER (in thousands of US Dollars)

	<u>2010</u>	<u>2009</u>
<b>Loss for the year</b>	<b><u>(57,271)</u></b>	<b><u>(143,739)</u></b>
<b>Other comprehensive (loss)/income</b>		
Revaluation surplus on property, plant and equipment (2009: net of tax of USD 1,598 thousand)	-	8,627
Effect of translation to presentation currency	<u>(2,867)</u>	<u>13,561</u>
<b>Other comprehensive (loss)/income for the year</b>	<b><u>(2,867)</u></b>	<b><u>22,188</u></b>
<b>Total comprehensive loss for the year</b>	<b><u><u>(60,138)</u></u></b>	<b><u><u>(121,551)</u></u></b>
Attributable to:		
Shareholders of the Company	(59,133)	(121,551)
Non-controlling interests	<u>(1,005)</u>	<u>-</u>
	<b><u><u>(60,138)</u></u></b>	<b><u><u>(121,551)</u></u></b>

*The accompanying notes are an integral part of these consolidated financial statements.*

# KAZAKHGOLD GROUP LIMITED

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER (in thousands of US Dollars)

	Notes	2010	2009
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	10	190,151	197,051
Inventories	12	2,245	2,867
Other non-current assets	11	1,583	-
		<b>193,979</b>	<b>199,918</b>
<b>Current assets</b>			
Inventories	12	27,891	14,265
Reimbursable value added tax		4,538	-
Trade and other receivables	13	1,812	2,124
Advances paid to suppliers	14	2,560	1,905
Prepaid income tax		1,765	3,057
Cash and cash equivalents	15	8,162	3,531
Other current assets		1,019	953
		<b>47,747</b>	<b>25,835</b>
<b>TOTAL ASSETS</b>		<b>241,726</b>	<b>225,753</b>
<b>NEGATIVE EQUITY AND LIABILITIES</b>			
<b>Capital and reserves</b>			
Share capital	16	332,392	233,645
Revaluation surplus		7,787	7,787
Option premium on convertible debt	17	15,598	15,598
Translation reserve		22,533	25,401
Accumulated losses		(465,866)	(409,601)
<b>Negative equity attributable to shareholders of the Company</b>		<b>(87,556)</b>	<b>(127,170)</b>
Non-controlling interests		(1,005)	-
		<b>(88,561)</b>	<b>(127,170)</b>
<b>Non-current liabilities</b>			
Borrowings	17	24,155	20,812
Environmental obligations	18	20,758	13,356
Other non-current liabilities	19	4,458	15,526
		<b>49,371</b>	<b>49,694</b>
<b>Current liabilities</b>			
Borrowings	17	249,310	257,816
Trade, other payables and accrued expenses	20	27,507	20,668
Income taxes payable		1,332	-
Other taxes payable		2,767	24,745
		<b>280,916</b>	<b>303,229</b>
<b>TOTAL LIABILITIES</b>		<b>330,287</b>	<b>352,923</b>
<b>TOTAL NEGATIVE EQUITY AND LIABILITIES</b>		<b>241,726</b>	<b>225,753</b>

The accompanying notes are an integral part of these consolidated financial statements.

# KAZAKHGOLD GROUP LIMITED

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER (in thousands of US Dollars)

	<u>2010</u>	<u>2009</u>
<b>Operating activities</b>		
<b>Loss before income tax</b>	<b>(55,942)</b>	<b>(149,900)</b>
Adjustments for:		
Amortisation and depreciation	18,116	17,659
Loss on revaluation of property, plant and equipment	-	11,079
Impairment of property, plant and equipment	26,544	-
Finance costs	32,929	31,841
Foreign exchange (gain)/loss, net	(1,086)	45,927
Bank guarantee provision	-	11,650
Non-recoverable value added tax on construction, repair, maintenance and exploration works	-	5,219
Bad debt (release)/expense	(65)	3,594
Loss on disposal of property, plant and equipment	574	1,859
Other	1,996	1,881
	<b>23,066</b>	<b>(19,191)</b>
Movements in working capital:		
Inventories	(12,493)	(2,842)
Trade and other receivables	383	(229)
Advances paid to suppliers	(565)	(990)
VAT reimbursable	(5,259)	-
Other current assets	(62)	(851)
Trade, other payables and accrued expenses	(2,599)	707
Other taxes payable	(20,401)	(1,672)
<b>Cash flows used in operations</b>	<b>(17,930)</b>	<b>(25,068)</b>
Interest paid	(24,546)	(22,457)
Income tax paid	(1,410)	(1,462)
<b>Net cash used in operating activities</b>	<b>(43,886)</b>	<b>(48,987)</b>
<b>Investing activities</b>		
Purchase of property, plant and equipment	(33,548)	(7,372)
<b>Net cash used in investing activities</b>	<b>(33,548)</b>	<b>(7,372)</b>

# KAZAKHGOLD GROUP LIMITED

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER (CONTINUED) (in thousands of US Dollars)

	Notes	<u>2010</u>	<u>2009</u>
<b>Financing activities</b>			
Proceeds from borrowings		49,960	91,288
Repayments of borrowings		(60,841)	(43,145)
Repayments of finance lease obligations		-	(501)
Repayment of bank guarantee liability		(4,967)	-
Proceeds from issue of Company's share capital	16	100,000	-
Expenses on issue of Company's share capital		(1,253)	-
<b>Net cash generated by financing activities</b>		<u><b>82,899</b></u>	<u><b>47,642</b></u>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<u><b>5,465</b></u>	<u><b>(8,717)</b></u>
<b>Cash and cash equivalents at beginning of the year</b>		<u><b>3,531</b></u>	<u><b>13,966</b></u>
<b>Restricted cash</b>	11	<u><b>(862)</b></u>	<u><b>-</b></u>
Effect of foreign exchange rate changes		<u>28</u>	<u>(1,718)</u>
<b>Cash and cash equivalents at end of the year</b>	15	<u><u><b>8,162</b></u></u>	<u><u><b>3,531</b></u></u>

*The accompanying notes are an integral part of these consolidated financial statements.*

# KAZAKHGOLD GROUP LIMITED

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER (in thousands of US Dollars)

Notes	Equity attributable to shareholders of the Company					Total	Non-controlling interests	Total
	Share capital	Translation reserve	Revaluation surplus	Option premium on convertible debt	Accumulated losses			
<b>Balance at 1 January 2009</b>	<b>233,645</b>	<b>11,840</b>	-	-	<b>(266,702)</b>	<b>(21,217)</b>	-	<b>(21,217)</b>
Loss for the year	-	-	-	-	(142,899)	<b>(142,899)</b>	(840)	<b>(143,739)</b>
Other comprehensive income (net of tax in the amount of USD 1,598 thousand)	-	13,561	7,787	-	-	<b>21,348</b>	840	<b>22,188</b>
<b>Total comprehensive loss</b>	-	<b>13,561</b>	<b>7,787</b>	-	<b>(142,899)</b>	<b>(121,551)</b>	-	<b>(121,551)</b>
Issuance of convertible debt	17	-	-	15,598	-	<b>15,598</b>	-	<b>15,598</b>
<b>Balance at 31 December 2009</b>	<b>233,645</b>	<b>25,401</b>	<b>7,787</b>	<b>15,598</b>	<b>(409,601)</b>	<b>(127,170)</b>	-	<b>(127,170)</b>
Loss for the year	-	-	-	-	(56,265)	<b>(56,265)</b>	(1,006)	<b>(57,271)</b>
Other comprehensive loss	-	(2,868)	-	-	-	<b>(2,868)</b>	1	<b>(2,867)</b>
<b>Total comprehensive loss</b>	-	<b>(2,868)</b>	-	-	<b>(56,265)</b>	<b>(59,133)</b>	<b>(1,005)</b>	<b>(60,138)</b>
Issuance of ordinary shares	98,747	-	-	-	-	<b>98,747</b>	-	<b>98,747</b>
<b>Balance at 31 December 2010</b>	<b>332,392</b>	<b>22,533</b>	<b>7,787</b>	<b>15,598</b>	<b>(465,866)</b>	<b>(87,556)</b>	<b>(1,005)</b>	<b>(88,561)</b>

The accompanying notes are an integral part of these consolidated financial statements.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

### 1. GENERAL INFORMATION

#### *Organisation*

KazakhGold Group Limited (the “Company” or “KazakhGold”) was incorporated in Jersey on 26 September 2005. The principal activities of the Company and its subsidiaries (the “Group”) are the extraction, production and sale of cathodic gold, free gold and other gold-bearing products. Mining and processing facilities of the Group are located in the northern part of the Republic of Kazakhstan. The Group also performs research and exploration works, primarily in the existing production locations, in Central and Eastern Kazakhstan and in Romania. Details regarding the nature of the business and of the significant subsidiaries of the Group are presented below:

Subsidiaries	Country of incorporation	Nature of business	Effective % held <sup>1</sup>	
			2010	2009
JSC MMC Kazakhlytn	Kazakhstan	Mining	100.0	100.0
Romaltyn Mining S.R.L.	Romania	Mining (Exploration stage)	100.0	100.0
Romaltyn Exploration S.R.L.	Romania	Mining (Exploration stage)	100.0	100.0
Talas Gold Mining Company	Kyrgyzstan	Mining (Exploration stage)	66.7	66.7

<sup>1</sup> Effective % held by the Company, including holdings by other subsidiaries of the Company.

On 30 July 2009, a 50.2% interest in the Group was acquired by Open Joint Stock Company (“OJSC”) Polyus Gold through its 100% owned subsidiary Jenington International Inc. (“Jenington”) (hereinafter, is referred to as “Polyus Gold” or the “Ultimate Parent”). On 1 July 2010, the Company issued 66,666,667 ordinary shares, resulting in gross proceeds of USD 100 million. Polyus Gold, through its subsidiary Jenington, subscribed for 51,194,922 of these shares thereby increasing its ownership interest in the Company to 65% of the issued share capital.

#### *Authorisation for issuance*

The consolidated financial statements of the Group have been authorised for issuance by the Board of Directors on 20 April 2011.

#### *Going concern assumption*

Subsequent to the acquisition of KazakhGold by Polyus Gold in 2009, management has focused on cost reduction and investing in mining infrastructure as a means of facilitating increases in production. As a result of these actions, combined with the increase in gold prices, the Group’s gross profit has increased to USD 35,391 thousand for the year ended 31 December 2010 from USD 235 thousand for the year ended 31 December 2009 and selling, general and administrative expenses have decreased to USD 24,260 thousand for the year ended 31 December 2010 from USD 39,746 thousand for the year ended 31 December 2009.

Despite the improvement in operations, the Group continued to incur losses in 2010 of USD 57,271 thousand (2009: USD 143,739 thousand), and has negative working capital of USD 233,169 thousand at December 2010 (2009: USD 277,394 thousand) and had cash outflows from operations in 2010 of USD 43,886 thousand (2009: USD 48,987 thousand).

At 31 December 2010 the Group has the following borrowings (Note 7):

- Senior notes in the amount of USD 200,000 thousand (the “Notes”) guaranteed by Polyus Gold;
- A loan from Jenington of USD 49,310 thousand); and
- A loan from Gold Lion Holdings Limited (“Gold Lion”) of 24,155 thousand, a former related party.

Pursuant to the agreement relating to the Notes, the Group is obligated to comply with a number of restrictive covenants, including limitations on obtaining additional indebtedness, and meeting certain financial reporting timelines. At 31 December 2010 and 2009, the Group was not in compliance with certain of these covenants and as a consequence, the Group classified the Notes as a current liability. In addition, the loan from Jenington is also due in 2011. The Group’s working capital deficit has primarily resulted as a consequence of this breach of covenants.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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In addition to the Group's financial difficulties as described above, there is currently a dispute between the former and current shareholders of the Company whereby the current shareholders are asserting that the former shareholders were negligent in their fiduciary responsibilities related to the Group. On 25 June 2010, Polyus Gold filed a lawsuit with the High Court in London against the former controlling shareholders.

Subsequent to that date, the Government of the Republic of Kazakhstan (the "Government") has taken various actions against the current management and directors that have had both a direct and an indirect impact on the Group's operations. These actions include the following:

- on 12 July 2010, JSC MMC Kazakhaltyn ("Kazakhaltyn"), a major production subsidiary of the Company located in the Republic of Kazakhstan, received notification from the Ministry of Industry and New Technologies of the Republic of Kazakhstan indicating that the previous decisions of the competent authorities in Kazakhstan providing a waiver of the state's pre-emptive right to acquire the Company's securities had been annulled. These waivers were obtained in connection with (a) Jenington's acquisition of 50.2% of the shares of the Company in July 2009, (b) the issuance of shares by the Company in July 2010 that resulted in gross proceeds of USD 100 million, and (c) the proposed merger of Polyus Gold and the Company announced on June 30, 2010;
- on 2 August 2010, the KazakhAltyn received legal notification that a freeze had been placed by the Agency on Economic and Corruption Crimes ("AECC") in Kazakhstan on certain bank accounts held in Kazakhstan by Kazakhaltyn. This freeze is in connection with an investigation by the AECC into allegations of fraud by three members of its current Board of Directors. After clarification, Kazakhaltyn was permitted limited access to make payments to employees and certain key suppliers;
- on 23 August 2010, an unscheduled tax audit of Kazakhaltyn commenced relating to fiscal years 2009 and 2010. This tax audit subsequently resulted in the reopening of 2007 and 2008 for additional tax audits; and
- on 7 September 2010, major production assets owned by Kazakhaltyn were frozen under an AECC order which had been made in connection with its investigation. The restriction prohibits the Group from disposing of property, plant and equipment owned by Kazakhaltyn, but has no effect on Kazakhaltyn's current operating activities.

Management of the Group believe that based on the rapid sequence of these events, the actions of the Government are in direct response to the legal proceedings brought by the current shareholders against the former shareholders.

The Group is unable to predict the outcome of the actions taken by the Government and therefore cannot reasonably predict the impact that the ultimate resolution of such matters will have on its operations, ability to meet its obligations or ability to realise its assets.

On 8 December 2010, the Company entered into an agreement (the "Original Principal Agreement") to sell all of its operating subsidiaries in Kazakhstan, Romania and Kyrgyzstan (JSC MMC Kazakhaltyn, Romaltyn Mining S.R.L., Romaltyn Exploration S.R.L. and CJSC Talas Gold Mining Company) to AltynGroup, the former controlling shareholders of the Group for payment in two tranches totaling USD 509 million. The first tranche was due not later than 11 March 2011. The former controlling shareholder did not pay the first tranche in accordance with the terms of the Original Principal Agreement, resulting in termination of the Original Principal Agreement.

Following the termination of the Original Principal Agreement, the Company has continued with negotiations regarding the sale of the operating subsidiaries to the former shareholders. In April 2011, the Company and AltynGroup entered into a Restated and Amended Principal Agreement (the "RAPA") and a settlement deed in which the Company would release the claims against the former shareholders.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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Pursuant to the RAPA, AltynGroup will acquire all of the Company's operating subsidiaries in exchange for total consideration of USD 509 million comprised of cash consideration, and forgiveness of outstanding loans to Gold Lion Holdings Limited, an entity controlled by AltynGroup. The first tranche must be settled no later than 12 September 2011 for an amount equal to USD 259,590 thousand. On or before first tranche completion AltynGroup will provide funds to the Company in order to repay its shareholder loan from Jenington, a subsidiary of Polyus Gold. In addition to this consideration, AltynGroup must replace Polyus Gold as guarantor of the Group's Notes prior to the first tranche expiration date. The remaining consideration may occur in more than one tranche at the option of AltynGroup, but must be settled no later than 31 December 2012. The completion of the RAPA is subject to governmental approvals and consents as well as AltynGroup's ability to obtain the funds necessary to complete these transactions.

There can be no assurance that the conditions to the transactions contemplated by the RAPA will be satisfied, or that the transactions will be completed.

The Directors of the Company have concluded that the factors described above relating to the Group's financial position at 31 December 2010, coupled with the actions taken by the government, indicate the existence of a material uncertainty that casts significant doubt upon the Group's ability to continue as a going concern and that therefore, the Group may be unable to realise its assets and meet its obligations in the ordinary course of business.

Management has considered the following in determining whether or not these consolidated financial statements should be prepared on a going concern basis:

- Polyus Gold guarantee of the Group's Notes
- Polyus Gold has confirmed its intention to support the Company's operations for a period to 30 April 2012, as long as it continues to be the Company's parent. Polyus Gold has a historical track record of profit from operations and generates sufficient cash flows to provide the Group with funding for its operations; and
- KazakhAltyn, the Company's largest operating subsidiary, continues to be a significant employer in the regions in Kazakhstan where it operates and therefore management believes that KazakhAltyn would obtain support from the local government authorities to continue operating in that region.

Based on this assessment, management believes that it is reasonable that the Group will be able to finance its operations and meet its obligations for a period not less than twelve months from the date of issuance of these consolidated financial statements. Accordingly, management has continued to adopt the going concern basis of accounting in preparing the consolidated financial statements for the year ended 31 December 2010.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### 2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

#### Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS"). IFRS includes standards and interpretations approved by the International Accounting Standards Board ("IASB"), including International Accounting Standards ("IAS") and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

#### New and revised standards and interpretations adopted in the current period

The following new standards, amendments to standards or interpretations are adopted by the Group and effective for the financial year commencing 1 January 2010:

- IFRS 2 "Share-based payment" – amendment;
- IAS 39 "Financial instruments: recognition and measurement" – amendment;
- IFRIC 17 "Distributions of non-cash assets to owners"; and
- Annual improvements to IFRS (April 2009)

The first time application of the aforementioned amendments to standards and interpretations from 1 January 2010 had no material effect on the consolidated financial statements of the Group.

#### Standards and interpretations in issue not yet adopted

At the date of approval of the Group's consolidated financial statements, the following new and revised Standards and Interpretations have been issued, but are not effective for the current year:

	<b>Effective for annual periods beginning on or after</b>
IAS 12 "Income taxes" – amendment	1 January 2012
IAS 24 "Related party disclosures" – revision	1 January 2011
IAS 32 "Financial instruments: presentation" – amendment	1 February 2010
IFRS 7 "Financial Instruments: Disclosures" – amendment	1 July 2011
IFRS 9 "Financial instruments" – amendment	1 January 2013
IFRIC 19 "Extinguishing financial liabilities with equity"	1 July 2010
Annual improvements to IFRS (May 2010)	1 January 2010

The impact of the adoption of these Standards and Interpretations in the preparation of the consolidated financial statements in future periods is currently being assessed by Group management, however no material effect on the Group's financial position or results of its operations is anticipated.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### 3. SIGNIFICANT ACCOUNTING POLICIES

#### **Basis of preparation**

The consolidated financial statements of the Group are prepared on the historical cost basis, except for periodic revaluation of property, plant and equipment in accordance with IAS 16 *Property, Plant and Equipment*, and certain financial instruments that are measured at fair values, as explained in the accounting policies below.

The entities of the Group maintain their accounting records in accordance with the laws, accounting and reporting regulations of the jurisdictions in which they are incorporated and registered. The accounting principles and financial reporting procedures in these jurisdictions may differ substantially from those generally accepted under IFRS. Accordingly, financial statements of such entities have been adjusted to ensure that the consolidated financial statements are presented in accordance with IFRS.

#### **Basis of consolidation**

The consolidated financial statements of the Group include the financial statements of the Company and its subsidiaries, from the date that control effectively commenced until the date that control effectively ceased. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Non-controlling interest in the net assets of consolidated subsidiaries is identified separately from the Group's equity therein. The interests of non-controlling shareholders may be initially measured at fair value or at the non-controlling interests' proportionate share of the fair value of the acquiree's identifiable net assets. The choice of measurement is made on an acquisition-by-acquisition basis. Subsequent to acquisition, the carrying amount of non-controlling interests is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity. Total comprehensive loss is attributed to non-controlling interests even if this results in the non-controlling interests having a deficit balance.

All intra-group balances, transactions and any unrealised profits or losses arising from intra-group transactions are eliminated in full on consolidation.

#### ***Changes in the Group's ownership interests in existing subsidiaries***

Changes in the Group's ownership interests in subsidiaries that do not result in the Group losing control over the subsidiaries are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to owners of the Company.

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), and liabilities of the subsidiary and any non-controlling interests. When assets of the subsidiary are carried at revalued amounts or fair values and the related cumulative gain or loss has been recognised in other comprehensive (loss)/income and accumulated in equity, the amounts previously recognised in other comprehensive (loss)/income and accumulated in equity are accounted for as if the Company had directly disposed of the relevant assets (i.e. reclassified to profit or loss or transferred directly to retained earnings as specified by applicable IFRSs). The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 *Financial Instruments: Recognition and Measurement* or, when applicable, the cost on initial recognition of an investment in an associate or a jointly controlled entity.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### **Business combinations**

Acquisitions of businesses, other than acquisitions from entities under common control, are accounted for using the acquisition method. The cost of the business combination is measured as the aggregate of the fair values (at the date of acquisition) of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree. Acquisition related costs are generally recognised in profit and loss as incurred.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition are recognised at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which are recognised and measured at fair value less costs to sell and deferred tax assets or liabilities, which are recognised and measured in accordance with IAS 12 *Income Taxes*.

### **Goodwill**

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest on the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the statement of operations.

Goodwill is not amortised but is reviewed for impairment at least annually. For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the gain or loss on disposal.

### **Common control transactions**

Subsidiaries acquired from entities under common control are recorded in the Group's financial statements at the transferor's carrying values of the assets and liabilities of such subsidiaries. Any difference between the carrying value of the net assets of subsidiaries acquired, and the consideration paid by the Group is accounted for as an adjustment to shareholder's equity. The net assets of the subsidiaries and their results are retrospectively recognised from the date on which control of the subsidiaries was obtained by the transferor.

Assets acquired from entities under common control (outside of business combinations) are recognised at the transferor's carrying value as of the date of the transaction. Any difference between the carrying value of the assets acquired and the consideration paid by the Group is accounted for as an adjustment to equity.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

### Functional and presentation currency

The individual financial statements of the Group's subsidiaries are prepared in their functional currency.

The US Dollar ("USD") is the functional currency of the Company. Kazakh Tenge ("KZT") is the functional currency of the Company's subsidiaries located in the Republic of Kazakhstan. The functional currencies of other subsidiaries operating with significant degrees of autonomy are presented below:

<b>Subsidiary</b>	<b>Functional currency</b>
Romaltyn Mining S.R.L.	Romanian Lei
Romaltyn Exploration S.R.L.	Romanian Lei
Talas Gold Mining Company	Kyrgyz Som

The Group has chosen to present its consolidated financial statements in USD, as management believes it a convenient presentation currency for international users of the consolidated financial statements of the Group. The translation of the financial statements of the Group entities from their functional currencies to the presentation currency is made as follows:

- All assets and liabilities, both monetary and non-monetary, are translated at closing exchange rates at each reporting period end date;
- All income and expenses in each statement of operations are translated at the average exchange rates for the years presented;
- Resulting exchange differences are included in other comprehensive (loss)/income and presented as Effect of translation to presentation currency within Translation reserve; and
- In the statement of cash flows, cash balances at beginning and end of each reporting period presented are translated at exchange rates at the respective dates. All cash flows are translated at the average exchange rates for the years presented, except for significant transactions that are translated at rates on the date of the transaction. Resulting exchange differences are presented as Effect of translation to presentation currency.

Exchange rates used in the preparation of the consolidated financial statements were as follows:

	<b>2010</b>	<b>2009</b>
<b><i>KZT/USD</i></b>		
31 December	147.40	148.36
Average for the year	147.35	147.51
<b><i>Romanian Lei/USD</i></b>		
31 December	3.20	2.94
Average for the year	3.18	3.05
<b><i>Kyrgyz Som/USD</i></b>		
31 December	47.10	44.09
Average for the year	45.99	42.99

### Foreign currencies

Transactions in currencies other than the entity's functional currencies (foreign currencies) are recorded at the exchange rates prevailing on the dates of the transactions. All monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates prevailing at the reporting date. Non-monetary items carried at historical cost are translated at the exchange rate prevailing on the date of transaction. Non-monetary items carried at fair value are translated at the exchange rate prevailing on the date on which the most recent fair value was determined. Exchange differences arising from changes in exchange rates are recognised in the consolidated statement of operations.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### **Property, plant and equipment**

#### ***Estimated ore reserves***

Estimated proven and probable ore reserves reflect the economically recoverable quantities which can be legally recovered in the future from known mineral deposits. The majority of the Group's reserves are estimated in accordance with the Former Soviet Union and Romanian National Agency for Mineral Resources classification codes.

#### ***Exploration and evaluation assets***

Exploration and evaluation assets represent capitalised expenditures incurred by the Group in connection with the exploration for and evaluation of gold resources, such as:

- Acquisition of rights to explore potentially mineralised areas;
- Topographical, geological, geochemical and geophysical studies;
- Exploratory drilling;
- Trenching;
- Sampling; and
- Activities in relation to evaluating the technical feasibility and commercial viability of extracting a gold resource.

Exploration and evaluation expenditures are carried at historical cost. Exploration and evaluation expenditures are capitalised when it is expected that they will be recouped by future exploitation or sale, and when the exploration and evaluation activities have not reached a stage that permits a reasonable assessment of the existence of commercially recoverable gold reserves. When the technical feasibility and commercial viability of extracting a gold resource are demonstrable, capitalised exploration and evaluation assets are reclassified to mining assets.

#### ***Impairment of exploration and evaluation assets***

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. The following facts and circumstances, among others, indicate that exploration and evaluation assets must be tested for impairment:

- The term of exploration license in the specific area has expired during the reporting period or will expire in the near future, and is not expected to be renewed;
- Substantive expenditure on further exploration for and evaluation of gold resources in the specific area is neither budgeted nor planned;
- Exploration for and evaluation of gold resources in the specific area have not led to the discovery of commercially viable quantities of gold resources and the decision was made to discontinue such activities in the specific area; and
- Sufficient data exists to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

For the purpose of assessing exploration and evaluation assets for impairment, such assets are allocated to cash-generating units, being exploration license areas.

Any impairment loss is recognised as an expense in accordance with the policy on impairment of tangible assets set out below.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### ***Mining assets***

Mining assets are classified as, property, plant and equipment and are carried at revalued amounts, being the fair value at the date of the revaluation plus costs since the last revaluation and less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Revaluations are made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs is revalued.

If an asset's carrying amount is increased as a result of a revaluation, the increase is recognised in other comprehensive (loss)/income and accumulated in equity within *Revaluation surplus*. However, the increase is recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

If an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised in the consolidated statement of operations. However, the decrease is recognised in other comprehensive (loss)/income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive (loss)/income reduces the amount accumulated in equity within *Revaluation surplus*.

The revaluation surplus included in equity in respect of an item of property, plant and equipment is transferred directly to retained earnings when the asset is retired or disposed of.

Mining assets are amortised on a straight-line basis over the estimated useful life of individual assets or the life of mines of 23 years (which is based upon the mine development plans and supported by proven and probable ore reserves), whichever is shorter. Amortisation is charged from the date on which a mine reaches commercial production quantities and is included in the cost of production.

### ***Non-mining assets***

Non-mining assets such as buildings, structures, plant and equipment, trucks and vehicles and other non-mining assets are carried at revalued amounts on a similar basis as described in section Mining assets above, less subsequent accumulated depreciation. Land is not depreciated. Depreciation for all non-mining assets is provided on a straight-line basis over the economic useful lives of such assets:

- buildings, structures, plant and equipment 5-13 years;
- trucks and vehicles 3 years;
- other assets 3-7 years.

### ***Capital construction-in-progress***

Capital construction-in-progress comprises costs directly related to mine development, construction of buildings, infrastructure, processing plant, machinery and equipment. Amortisation or depreciation of these assets commences when the assets are placed into commercial production.

### ***Impairment of property, plant and equipment, other than exploration and evaluation assets***

An impairment review of property, plant and equipment is carried out when there is an indication that those assets have suffered an impairment loss. If any such indication exists, the carrying amount of the asset is compared to the estimated recoverable amount of the asset in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell and value-in-use. If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. The impairment loss is recognised in the statement immediately, unless the relevant asset is carried at revalued amount, in which case the impairment loss is treated as a revaluation decrease.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the original carrying amount that would have been determined had no impairment loss been recognised in prior periods.

A reversal of an impairment loss is recognised in the statement of operations immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

### **Inventories**

#### ***Finished goods***

Gold-bearing products, which represent finished goods, are measured at the lower of net production cost and net realisable value. The net cost of production per unit of gold-bearing products is determined by dividing production cost, by the saleable mine output of gold-bearing products.

Production costs include consumables and spares, labour, tax on mining, utilities, sundry costs, amortisation and depreciation of operating assets, adjustments for deferred stripping costs capitalised, change in provision for land restoration and change in gold-in-process and finished goods.

#### ***Gold-in-process and stockpiles***

Costs that are incurred in or benefit the production process are accumulated as stockpiles and gold in process. Net realisable value tests are performed at least annually and represent the estimated future sales price of the product, based on prevailing spot metal prices, less estimated costs to complete production and bring the product to sale.

Gold-in-process is valued at the weighted average cost.

Stockpiles are recorded at cost, and volumes measured by estimating the number of tonnes added and removed from the stockpile, the number of contained gold ounces based on assay data, and the estimated recovery percentage based on the expected processing method. Stockpile volumes are verified by periodic surveys.

#### ***Stores and materials***

Stores and materials consist of consumable stores and are valued at the weighted average cost less provision for obsolete and slow-moving items.

### **Financial assets**

Financial assets are recognised on trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned, and are initially measured at fair value, plus transaction costs, except for financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

The Group's financial assets represent trade and other receivables and are measured at amortised cost using the effective interest method less any impairment.

#### ***Impairment of financial assets***

When a trade or other receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in the consolidated statement of operations.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### ***Derecognition of financial assets***

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

### **Financial liabilities**

Financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs, and subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

### ***Effective interest method***

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash outflows through the expected life of the financial liability, or, where appropriate, a shorter period.

Expense is recognised on an effective interest rate basis for debt instruments.

### ***Compound instruments***

The component parts of compound instruments such as convertible loans issued by the Group are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangement. 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. This amount is recorded as a liability on an amortised cost basis using the effective interest method until extinguished upon conversion or at the instrument's maturity date. The equity component is determined by deducting the amount of the liability component from the fair value of the compound instrument as a whole. This is recognised and included in option premium on convertible debt within the statement of changes in equity, net of income tax effects, and is not subsequently remeasured.

### ***Derecognition of financial liabilities***

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

### **Finance costs**

Finance 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 finance costs eligible for capitalisation.

All other finance costs are recognised in the consolidated statement of operations in the period in which they are incurred.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### **Cash and cash equivalents**

Cash and cash equivalents comprise cash balances, cash deposits and highly liquid investments with original maturities of three months or less, which are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. Restricted cash is recorded as Other long-term assets.

### **Provisions**

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

### **Employee benefit obligations**

Remuneration to employees in respect of services rendered during a reporting period is recognised as an expense in that reporting period.

The Group's entities in Kazakhstan contribute to the state pension funds on behalf of all its current employees in accordance with the Law of the Republic of Kazakhstan "On pension provisioning in the Republic of Kazakhstan" effective from 1 January 1 1998. The plan is a defined contribution plan. These contributions are recognised in the statement of operations when employees have rendered services entitling them to the contribution.

### **Income tax**

Income tax expense represents the sum of the tax currently payable and deferred tax. Income taxes are computed in accordance with the laws of countries where the Group operates.

### ***Current tax***

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of operations because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

### ***Deferred tax***

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and are accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets arising from deductible temporary differences associated with such investments are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

### ***Current and deferred tax for the period***

Current and deferred tax are recognised as an expense or income in the consolidated statement of operations, except when they relate to items credited or debited directly to equity, in which case the tax is also recognised directly in equity, or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is taken into account in calculating goodwill or determining the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost.

### **Revenue recognition**

#### ***Gold sales revenue***

Revenue from the sale of cathodic gold, free gold and other gold-bearing products is recognised when the risks and rewards of ownership are transferred to the buyer. Gold sales revenue represents the invoiced value of gold shipped to customers, net of value-added tax. Revenues from sale of by-products are netted against production costs.

#### ***Other revenue***

Other revenue consists of sales of goods, other than gold-bearing products, and services the Group provides as necessary in the locations where it operates. Revenue from sale of goods is recognised when significant risks and rewards of ownership are transferred to the buyer in accordance with the shipping terms specified in the sales agreements. Revenue from services is recognised when the services are rendered.

### **Operating leases**

The lease of assets under which all the risks and benefits of ownership are retained by the lessor are classified as operating leases. Costs for operating leases are recognised on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

### **Environmental obligations**

Environmental obligations include decommissioning and land restoration costs.

Future decommissioning and land restoration costs, discounted to net present value, are added to respective assets and corresponding obligations raised as soon as the constructive obligation to incur such costs arises and the future cost can be reliably estimated. Additional assets are amortised on a straight-line basis over the corresponding asset. The unwinding of the obligation is included in the consolidated statement of operations as finance costs. Obligations are periodically reviewed in light of current laws and regulations, and adjustments made as necessary to the corresponding item of property, plant and equipment.

Ongoing restoration costs are expensed when incurred.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Preparation of the consolidated financial statements in accordance with IFRS requires the Group's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The determination of estimates requires judgments which are based on historical experience, current and expected economic conditions, and all other available information. Actual results could differ from those estimates.

#### **Critical judgements in applying accounting policies**

The following are the critical judgments, apart from those involving estimations (see below), that the management has made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the consolidated financial statements.

#### ***Revaluation of property, plant and equipment***

The Group applies a revaluation model to measurement of property, plant and equipment. Revaluations are made with sufficient regularity to determine whether the carrying amount of these assets differs materially from fair value. The Group carries out such reviews based on the depreciated replacement cost approach as the main approach to valuation of property, plant and equipment. For each item of property plant and equipment the replacement cost are estimated as the current cost to replace the assets with a functionally equivalent asset. The replacement cost is then adjusted for accrued depreciation, including physical depreciation and functional and economic obsolescence. In 2010, the Group concluded that the depreciated replacement cost did not differ materially from fair value and as such did not revalue its property, plant and equipment.

#### ***Contingencies***

By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of such contingencies inherently involves the exercise of significant judgments and estimates of the outcome of future events.

#### **Key sources of estimation uncertainty**

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

The most significant areas requiring the use of management estimates and assumptions relate to:

- Useful economic lives of property, plant and equipment;
- Impairment of assets;
- Calculation of allowance for doubtful debts;
- Environmental obligations; and
- Income taxes.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### ***Useful economic lives of property, plant and equipment***

The Group's mining assets, classified within property, plant and equipment, are amortised on a straight-line basis over estimated useful life of individual assets or the life of mines of 23 years (which is based on estimated proven and probable ore reserves), whichever is shorter.

When determining life of mine, assumptions that were valid at the time of estimation, may change when new information becomes available.

The factors that could affect estimation of life of mine include the following:

- Change of estimates of proven and probable ore reserves;
- The grade of mineral reserves varying significantly from time to time;
- Differences between actual commodity prices and commodity price assumptions used in the estimation of ore reserves;
- Unforeseen operational issues at mine sites; and
- Changes in capital, operating mining, processing and reclamation costs, discount rates and foreign exchange rates possibly adversely affecting the economic viability of ore reserves.

Any of these changes could affect prospective amortisation of mining assets and their carrying value.

Non-mining property, plant and equipment are depreciated on a straight-line basis over their useful economic lives. Management periodically reviews the appropriateness of assets' useful economic lives. The review is based on the current condition of the assets and the estimated period during which they will continue to bring economic benefit to the Group.

### ***Allowance for doubtful debts***

The Group creates allowances for doubtful debts to account for estimated losses resulting from the inability of counterparties to make required payments. When evaluating the adequacy of an allowance for doubtful debts, management bases its estimates on the current overall economic conditions, the aging of accounts receivable balances, historical write-off experience, customer creditworthiness and changes in payment terms. Changes in the economy, industry or specific customer conditions may require adjustments to the allowance for doubtful debts recorded in the consolidated financial statements.

### ***Impairment of tangible and intangible assets***

The Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets are impaired. In making the assessment for impairment, assets that do not generate independent cash flows are allocated to an appropriate CGU.

Management necessarily applies its judgment in allocating assets that do not generate independent cash flows to appropriate cash generating units, and also in estimating the timing and value of underlying cash flows within the value in use calculation. In determining the value in use calculation, future cash flows are estimated based on cash flows projection utilising the latest budget information available.

In line with ongoing operational changes, the Group is continually reassessing their property, plant and equipment requirements, and plans for their future use. During the year ended 31 December 2010, the Group identified assets for which the book value exceeded the anticipated recoverable value, and accordingly an impairment was recorded in the amount of USD 26,544 thousand.

Due to its subjective nature, these estimates may differ from actual results of operations and cash flows, and may therefore result in further asset impairments in the future.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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### *Environmental obligations*

The Group's mining and exploration activities are subject to various environmental laws and regulations. The Group estimates environmental obligations based on the management's understanding of the current legal requirements in the various jurisdictions, terms of the license agreements and internally generated engineering estimates. Provision is made, based on net present values, for decommissioning and land restoration costs as soon as the obligation arises. Actual costs incurred in future periods could differ materially from the amounts provided. Additionally, future changes to environmental laws and regulations, life of mine estimates and discount rates could affect the carrying amount of this provision.

### *Income taxes*

The Group is subject to income taxes in numerous jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes due to the complexity of legislation. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

The Group is subject to income taxes in the Republic of Kazakhstan. The taxation system in Kazakhstan is relatively new and is characterized by frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by various levels of authorities, which have the authority to impose severe fines, penalties and interest charges. These circumstances may create tax risks in Kazakhstan that are more significant than in other countries. The Group recognises liabilities for anticipated additional tax based its interpretations of the current tax laws and the amount it believes that is probable to be paid upon any inspection by the tax authorities.

Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax provisions in the period in which such determinations are made.

Deferred tax assets are reviewed at the end of each reporting period and are reduced to the extent that it is not probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilised. Various factors are considered in assessing the probability of the future utilisation of deferred tax assets, including past operating results, operational plans, expiration of tax losses carried forward, and tax planning strategies. If actual results differ from these estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. As a result of changes in estimates, the Group has recognised income tax benefits in the years presented for assets created, but not recognised, in prior years.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

### 5. EMPLOYEE BENEFIT EXPENSE

	<u>2010</u>	<u>2009</u>
Wages and salaries	28,415	25,535
Direct social taxes	2,650	2,156
Other employee benefits	<u>40</u>	<u>630</u>
<b>Total</b>	<b><u>31,105</u></b>	<b><u>28,321</u></b>

Employee benefit expenses in the amount of USD 22,669 thousand (2009: USD 18,823 thousand), USD 567 thousand (2009: USD 360 thousand) and USD 7,869 thousand (2009: USD 9,138 thousand) were recognised as part of cost of gold sales, cost of other sales and selling, general and administrative expenses, respectively.

### 6. OTHER EXPENSES, NET

	<u>2010</u>	<u>2009</u>
Bank guarantee provision (refer to Note 19)	-	11,650
Loss on revaluation of property, plant and equipment	-	11,079
Non-recoverable value added tax on construction, repair, maintenance and exploration works	8,600	5,219
Bad debt (release)/expense	(65)	3,594
Impairment of property, plant and equipment	26,544	-
Loss on disposal of property, plant and equipment	574	1,859
Other	<u>(423)</u>	<u>(780)</u>
<b>Total</b>	<b><u>35,230</u></b>	<b><u>32,621</u></b>

### 7. FINANCE COSTS

	<u>2010</u>	<u>2009</u>
Interest on borrowings	26,951	26,309
Unwinding of discount on decommissioning obligations	1,555	1,392
Unwinding of discount on borrowings	2,692	3,657
Interest on bank guarantee	1,190	-
Unwinding of discount on historical cost	<u>541</u>	<u>483</u>
<b>Total</b>	<b><u>32,929</u></b>	<b><u>31,841</u></b>

### 8. INCOME TAX

	<u>2010</u>	<u>2009</u>
Current tax expense	(1,329)	-
Deferred tax benefit	<u>-</u>	<u>6,161</u>
<b>Total income tax (expense)/benefit</b>	<b><u>(1,329)</u></b>	<b><u>6,161</u></b>

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

The corporate income tax rates in the countries where the Group has a taxable presence vary from 0% to 28%. A reconciliation of statutory income tax at the rate effective in the Republic of Kazakhstan, the location of the Group's production entities and substantially all operations, to the amount of actual income tax expense recorded in the consolidated income statement is as follows:

	<u>2010</u>	<u>2009</u>
<b>Loss before income tax</b>	<b>(55,942)</b>	<b>(149,900)</b>
Income tax at statutory rate of 20% (2009: 20%)	11,188	29,980
Tax effect of expenses not deductible for tax purposes	(1,524)	(11,374)
Unrecognised tax losses and deferred tax asset not recognised	<u>(10,993)</u>	<u>(12,445)</u>
<b>Income tax (expense)/benefit at effective rate of 2.4% (2009: 4.1%)</b>	<b><u>(1,329)</u></b>	<b><u>6,161</u></b>

At 31 December 2010, the Group has not recognised deferred tax assets in the amount of USD 21,963 thousand (2009: USD 10,970 thousand) in respect of tax losses carried forward due to uncertainty of available future taxable profit. These unrecognised tax losses are available for offset against future taxable profit of the Group for a period of up to ten years.

The tax rate used for the 2010 reconciliations above is the income tax rate of 20% (2009: 20%) payable by Kazakhaltyn, the Group's main operating subsidiary in the Republic of Kazakhstan, on taxable profits.

Deferred taxation is attributable to the temporary differences that exist between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. The tax effects of temporary differences that give rise to deferred taxation are presented below:

	<u>31 December 2009</u>	<u>Recognised in statement of operations</u>	<u>Effect of translation to presentation currency</u>	<u>31 December 2010</u>
Property, plant and equipment	5,441	2,220	(1)	7,660
Environmental obligations	(1,379)	(2,774)	1	(4,152)
Historical cost liability	(677)	(423)	-	(1,100)
Inventory write-downs and bad debt expense	(766)	533	-	(233)
Other	(789)	394	-	(395)
Tax losses	<u>(1,830)</u>	<u>50</u>	<u>-</u>	<u>(1,780)</u>
<b>Total</b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>	<b><u>-</u></b>

	<u>31 December 2008</u>	<u>Recognised in statement of operations</u>	<u>Recognised in equity on revaluation surplus</u>	<u>Effect of translation to presentation currency</u>	<u>31 December 2009</u>
Property, plant and equipment	5,081	931	1,598	(2,169)	5,441
Environmental obligations	-	(1,371)	-	(8)	(1,379)
Historical cost liability	-	(673)	-	(4)	(677)
Inventory write-down and bad debt expense	-	(762)	-	(4)	(766)
Other	1,691	(2,466)	-	(14)	(789)
Tax losses	<u>-</u>	<u>(1,820)</u>	<u>-</u>	<u>(10)</u>	<u>(1,830)</u>
<b>Total</b>	<b><u>6,772</u></b>	<b><u>(6,161)</u></b>	<b><u>1,598</u></b>	<b><u>(2,209)</u></b>	<b><u>-</u></b>

The Group did not recognise a deferred tax asset for temporary differences associated with investments in subsidiaries of USD 18,521 thousand (2009: USD 16,535 thousand), because management believes that it is able to control the timing of reversal of such differences and has no intention to reverse them in the foreseeable future.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

### 9. LOSS PER SHARE

The following reflects the income and share data used in the calculation of basic and diluted loss per share:

	<u>2010</u>	<u>2009</u>
Loss for the year attributable to shareholders of the parent company	56,265	142,899
Weighted average number of ordinary shares in issue during the year	<u>85,453,082</u>	<u>52,941,666</u>
<b>Basic and diluted loss per share (US Dollars)</b>	<b><u>0.66</u></b>	<b><u>2.70</u></b>

In 2010 and 2009, the convertible loans were antidilutive: 59,547,167 contingently issuable shares on conversion of the loans were therefore excluded from the weighted average number of ordinary shares for the purposes of diluted loss per share.

### 10. PROPERTY, PLANT AND EQUIPMENT

	<u>Exploration and evaluation assets</u>	<u>Mining assets</u>	<u>Non-mining assets</u>	<u>Capital construction- in-progress</u>	<u>Total</u>
<b>Cost</b>					
<b>Balance at 1 January 2009</b>	<b>927</b>	<b>197,731</b>	<b>1,452</b>	<b>57,475</b>	<b>257,585</b>
Additions	3,464	1,380	616	4,244	9,704
Transfers	-	631	1,354	(1,985)	-
Change in estimate of decommissioning costs	-	(3,934)	-	-	(3,934)
Disposals	(652)	(931)	(157)	(340)	(2,080)
Effect of translation to presentation currency	133	(34,184)	(281)	(9,842)	(44,174)
<b>Balance at 31 December 2009</b>	<b>3,872</b>	<b>160,693</b>	<b>2,984</b>	<b>49,552</b>	<b>217,101</b>
Additions	8,656	6,844	-	20,514	36,014
Transfers	-	9,131	-	(9,131)	-
Change in estimate of decommissioning costs	-	5,779	-	-	5,779
Disposals	-	(727)	-	(3)	(730)
Impairment loss	-	(19,835)	-	(6,709)	(26,544)
Effect of translation to presentation currency	13	(729)	(78)	(1,556)	(2,350)
<b>Balance at 31 December 2010</b>	<b>12,541</b>	<b>161,156</b>	<b>2,906</b>	<b>52,667</b>	<b>229,270</b>
<b>Accumulated amortisation, depreciation and impairment</b>					
<b>Balance at 1 January 2009</b>	-	-	-	-	-
Charge for the year	-	(19,734)	(365)	-	(20,099)
Disposals	-	64	157	-	221
Effect of translation to presentation currency	-	(173)	1	-	(172)
<b>Balance at 31 December 2009</b>	-	<b>(19,843)</b>	<b>(207)</b>	-	<b>(20,050)</b>
Charge for the year	-	(19,355)	(85)	-	(19,440)
Disposals	-	156	-	-	156
Effect of translation to presentation currency	-	258	(43)	-	215
<b>Balance at 31 December 2010</b>	-	<b>(38,784)</b>	<b>(335)</b>	-	<b>(39,119)</b>
<b>Net book value</b>					
<b>31 December 2009</b>	<b>3,872</b>	<b>140,850</b>	<b>2,777</b>	<b>49,552</b>	<b>197,051</b>
<b>31 December 2010</b>	<b>12,541</b>	<b>122,372</b>	<b>2,571</b>	<b>52,667</b>	<b>190,151</b>

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

As at 31 December 2010 property, plant and equipment with a carrying value of USD 3,620 thousand have been pledged to secure bank guarantee liability (see Notes 19, 20). As at 31 December 2009 property, plant and equipment with a carrying value of USD 20,510 thousand have been pledged to secure borrowings and bank guarantee liability (see Notes 17, 19, 20).

The Group, as a result of its previous experience with fires, missing assets, and excessive wear and tear, combined with ongoing operational changes and revisions of plans, has been actively reassessing its property, plant and equipment requirements, and plans for their future use. During the year ended 31 December 2010, the Group identified assets for which the book value exceeded the anticipated recoverable value and also reassessed expected useful life of certain assets, and accordingly an impairment was recorded in the amount of USD 26,544 thousand.

### 11. OTHER NON-CURRENT ASSETS

Other non-current assets include:

- Bank accounts in the amount of USD 862 thousand that were frozen by the Kazakhstan authorities as security in legal proceedings initiated by the Government (see Note 1). Management believes that this cash is recoverable and will be available when legal proceedings are finalised;
- Input value added tax borne from import purchases in the amount of USD 721 thousand, which expected to be refunded in 2012.

### 12. INVENTORIES

	<u>2010</u>	<u>2009</u>
<b>Inventories expected to be recovered after twelve months</b>		
Ore stockpiles	2,245	2,867
<b>Total</b>	<b><u>2,245</u></b>	<b><u>2,867</u></b>
<b>Inventories expected to be recovered in the next twelve months</b>		
Gold-in-process	9,288	5,462
Finished goods	7,901	4,926
<b>Total</b>	<b><u>17,189</u></b>	<b><u>10,388</u></b>
Stores and materials	11,206	4,954
Less: Allowance for obsolescence	(504)	(1,077)
	<b><u>27,891</u></b>	<b><u>14,265</u></b>
<b>Total</b>	<b><u>30,136</u></b>	<b><u>17,132</u></b>

The Group consumed USD 20,820 thousand of stores and materials during the year ended 31 December 2010, which has been recognised in Cost of gold sales (2009: USD 13,518 thousand).

### 13. TRADE AND OTHER RECEIVABLES

	<u>2010</u>	<u>2009</u>
Trade receivables for gold sales	1,004	1,359
Other receivables	7,575	9,404
	<b><u>8,579</u></b>	<b><u>10,763</u></b>
Less: Allowance for doubtful debts	(6,767)	(8,639)
<b>Total</b>	<b><u>1,812</u></b>	<b><u>2,124</u></b>

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

The average credit period on gold sales was 4 days in 2010 (7 days in 2009). No interest is charged on trade receivables for the first 5 days from the date of invoice. Thereafter, interest is charged at 0.045% per annum on the outstanding balance.

The Group has fully provided for all receivables over 365 days because historical experience is such that receivables that are past due beyond 365 days are generally not recoverable.

At 31 December 2010, the Group's two major customers individually exceeding 5% of the total balance represented 63% of the outstanding balance of trade and other receivables.

At 31 December 2010, there were no trade receivables which were past due but not impaired (at 31 December 2009: USD 1,359 thousand).

The movement in the allowance for doubtful debts is as follows:

	<u>2010</u>	<u>2009</u>
<b>Balance at beginning of the year</b>	<b>8,639</b>	<b>6,364</b>
Receivable balances written off	(1,929)	-
Increase in allowance	-	3,594
Effect of translation to presentation currency	57	(1,319)
<b>Balance at end of the year</b>	<b><u>6,767</u></b>	<b><u>8,639</u></b>

Included in the allowance for doubtful debts were individually impaired other receivables amounting to USD 6,767 thousand (31 December 2009: USD 8,639 thousand) relating to counterparties which have been placed under liquidation. The Group does not hold any collateral over these balances.

### 14. ADVANCES PAID TO SUPPLIERS

At 31 December 2010, advances paid to suppliers in the amount of USD 2,560 thousand (31 December 2009: USD 1,905 thousand) were presented net of impairment losses of USD 805 thousand (31 December 2009: USD 990 thousand).

### 15. CASH AND CASH EQUIVALENTS

	<u>2010</u>	<u>2009</u>
Current bank accounts – KZT	6,188	942
Current bank accounts – foreign currencies	1,842	2,320
Other cash and cash equivalents	132	269
<b>Total</b>	<b><u>8,162</u></b>	<b><u>3,531</u></b>

### 16. SHARE CAPITAL

At 31 December 2010, the authorised share capital of the Company was comprised of 200,000,000 ordinary shares at par value of GBP 0.0001 and the issued and fully paid share capital of the Company comprised of 119,608,333 ordinary shares.

At 31 December 2009, authorised share capital of the Company comprised of 100,000,000 ordinary shares at par value of GBP 0.0001 and issued and fully paid share capital of the Company comprised of 52,941,666 ordinary shares.

On 1 July 2010, the Company issued 66,666,667 new ordinary shares at a price of USD 1.5 per share for a total consideration of USD 98,747 thousand, net of expenses of USD 1,253 thousand. The amount raised was used to provide additional working capital for the Group and repay the USD 50 million Jenington loan obtained in February 2010 (Note 17).

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

### 17. BORROWINGS

		Currency	Rate, %	2010	2009
				Outstanding balance	Outstanding balance
Guaranteed senior notes	(i)	USD	9.375	200,000	200,000
Convertible loan received from Jenington	(ii)	USD	LIBOR+6	49,310	47,892
Convertible loans received from Gold Lion Holdings Limited	(iii)	USD	10	24,155	19,783
Secured bank loan	(iv)	KZT	-	-	1,854
Secured bank loan	(iv)	USD	-	-	4,751
Unsecured bank loan	(v)	USD	-	-	4,348
<b>Total</b>				<b>273,465</b>	<b>278,628</b>
Less: Current portion due within twelve months				(249,310)	(257,816)
<b>Long-term borrowings</b>				<b>24,155</b>	<b>20,812</b>

#### Summary of borrowing agreements

##### (i) Guaranteed senior notes (the "Notes")

In November 2006, the Company issued the Notes at par with interest payable semi-annually in arrears on 6 May and 6 November of each year, and with principal due on 6 November 2013. The Notes are unconditionally and irrevocably guaranteed by Kazakhaltyn, a wholly owned subsidiary of the Company, and its subsidiaries.

Following the acquisition of the Company by Jenington, Polyus Gold became an additional limited liability guarantor of the Notes.

The Group is obliged to comply with a number of restrictive covenants under the agreement relating to the Notes, including limitations on obtaining additional indebtedness, and financial reporting timelines. At 31 December 2010 and 2009, the Group was not in compliance with certain of these covenants related to reporting obligations. As a result, the USD 200 million Notes balance has been classified as a current liability.

As at the date of issuance of consolidated financial statements, the Group has not received any enforcement notice from the bondholders regarding early redemption.

##### (ii) Loan received from Jenington

On 14 August 2009, the Company signed a USD 50,000 thousand unsecured loan agreement with Jenington. The loan agreement has a floating rate of LIBOR+6% per annum. The loan is used for general corporate purposes, including working capital requirements.

The principal amount together with accrued interest are payable when the Company completes a capital raising of USD 100,000 thousand, which management estimates will occur in 2011; consequently, the loan has been classified as current. The principal amount of the loan together with accrued interest can be converted by Jenington into the Company's ordinary shares at a rate of USD 1.5 per one share at any point during the term of the loan, subject to several restrictions, including regulatory approval from the Government of Kazakhstan. The net proceeds received under the convertible loan agreement were split between a liability element and an equity component, representing the residual equity attributable to the option, as follows:

Fair value of the convertible instrument	49,310
Fair value of liability component at date of issue	(47,083)
<b>Residual equity component</b>	<b>2,227</b>

On 4 February 2010, the Company obtained an additional USD 49,960 thousand unsecured loan from Jenington. This loan yielded an annual interest rate of 9.27%. On 6 July 2010, the Company repaid this loan together with accrued interest, from the proceeds from a USD 100 million share issue (Note 16).

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

### (iii) Loans received from Gold Lion

On 11 June 2009, the Company signed two loan agreements with Gold Lion, an entity that was, at that time, a related party. The loan agreements have a 10% interest rate per annum. Principal amounts of USD 21,650 thousand and USD 9,375 thousand together with accrued interest are payable on 6 November 2014. Until their maturity date, these loans are convertible wholly or in part into the Company's ordinary shares at a rate of USD 1.5 per one share. Conversion is subject to several restrictions, including Republic of Kazakhstan regulatory approval and approval from the Company. In June 2009, Gold Lion Holdings Limited granted a call option to Jenington, or any other direct or indirect subsidiary of Polyus Gold, to acquire all rights and interests under these loan agreements, including the conversion right.

The net proceeds received under the convertible loan agreements have been split between a liability element and an equity component, representing the residual equity attributable to the instrument, as follows:

Fair value of the convertible instrument	31,025
Fair value of liability component at date of issue	<u>(17,654)</u>
<b>Residual equity component</b>	<b><u>13,371</u></b>

The borrowing is discounted at an effective interest rate of 22.1%.

### 18. ENVIRONMENTAL OBLIGATIONS

	<u>2010</u>	<u>2009</u>
<b>Balance at beginning of the year</b>	<b>13,356</b>	<b>20,106</b>
Change in estimate	5,779	(5,021)
Unwinding of discount on decommissioning obligations	1,555	1,392
Effect of translation to presentation currency	<u>68</u>	<u>(3,121)</u>
<b>Balance at end of the year</b>	<b><u>20,758</u></b>	<b><u>13,356</u></b>

The principal assumptions used for the estimation of environmental obligations were as follows:

	<u>2010</u>	<u>2009</u>
Discount rates, %	10.0	12.0
Expected mine closure dates	2032	2032

### 19. OTHER NON-CURRENT LIABILITIES

	<u>2010</u>	<u>2009</u>
Bank guarantee liability	300	11,014
Historical costs liability	<u>4,158</u>	<u>4,512</u>
<b>Total</b>	<b><u>4,458</u></b>	<b><u>15,526</u></b>

#### ***Bank guarantee liability***

In April 2006, the Group entered into a contractual arrangement to guarantee a credit facility of USD 15,000 thousand provided by "Kazkommertsbank" ("KKB") to "Akir Group" LLP, a former related party to the Group. That credit facility has a maturity date of 4 April 2013. Funds received from the credit facility were used by the "Akir Group" to acquire mining and other equipment which was subsequently leased to the Group under finance lease agreements concluded during 2006-2007.

In 2009, the "Akir Group" LLP defaulted on its loan agreement with KKB. The Group fully provided for probable losses related to this guarantee liability at 31 December 2009.

Liability in the amount of USD 5,996 due in 2011 was reclassified to other payables (Note 20).

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

### *Historical costs liability*

The Group has a financial liability to reimburse the Government of Kazakhstan an amount of USD 8,991 thousand incurred for the historical cost of geological studies performed in respect to the Group's subsoil use contracts. The historical cost of geologic studies is expected to be repaid in 10 equal annual instalments, commencing from 2011 subject to approval from the appropriate governmental authority. The effective interest rate on the liability is 12% per annum.

	<u>2010</u>	<u>2009</u>
<b>Balance at beginning of the year</b>	<b>4,512</b>	<b>4,029</b>
Reclassified to current liabilities	(895)	-
Unwinding of discount on historical cost	541	483
<b>Balance at end of the year</b>	<b><u>4,158</u></b>	<b><u>4,512</u></b>

## 20. TRADE, OTHER PAYABLES AND ACCRUED EXPENSES

	<u>2010</u>	<u>2009</u>
Trade payables to third parties	1,778	1,771
Accrued expenses	1,977	3,046
Wages and salaries	2,473	3,519
Interest on loans	6,805	3,469
Bank guarantee liability – current	5,996	2,235
Historical cost – current	895	-
Other payables	7,583	6,628
<b>Total</b>	<b><u>27,507</u></b>	<b><u>20,668</u></b>

In 2010, the credit period for trade and other payables was 38 days (2009: 44 days).  
There is no interest charged on the outstanding payables balance during the credit period.

## 21. RELATED PARTIES

Related parties include shareholders, entities under common ownership and control with the Group, companies presumed by management to be under control of members of the Company's Board of Directors and key management personnel.

As a result of changes in the shareholders of the Company, Polyus Gold and its subsidiaries became related parties to the Group from 30 July 2009.

As at 31 December 2010 and 2009, the Group had the following outstanding balances with shareholders of the Group:

	<u>2010</u>	<u>2009</u>
<b>Jenington</b>		
Borrowings	49,310	47,892
Interest payable	3,928	644
<b>UK Polyus Geologorazvedka</b>		
Trade payables	129	-
<b>Gold Lion</b>		
Borrowings	-	19,783
<b>Total</b>	<b><u>53,367</u></b>	<b><u>68,319</u></b>

The amounts outstanding are unsecured and are expected to be settled in cash.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

During the years ended 31 December 2010 and 2009, the Group entered into the following transactions with shareholders of the Group:

	<u>2010</u>	<u>2009</u>
<b>Jenington</b>		
Proceeds from borrowings	49,960	49,310
Repayments of borrowings	(49,960)	-
Interest accrued	1,333	-
Interest paid	(1,333)	-
<b>UK Polyus Geologorazvedka</b>		
Purchase of goods and services	207	
<b>Gold Lion</b>		
Loans received	-	31,025

### Compensation of key management personnel

	<u>2010</u>	<u>2009</u>
Short-term employee benefits	1,698	2,546
<b>Total</b>	<u>1,698</u>	<u>2,546</u>

## 22. CONTINGENCIES

### Operating environment

Emerging markets such as Kazakhstan are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. As has happened in the past, actual or perceived financial problems or an increase in the perceived risks associated with investing in emerging economies could adversely affect the investment climate in the country and the country's economy in general.

Laws and regulations affecting businesses in Kazakhstan continue to change rapidly. Tax, currency and customs legislation within the country are subject to varying interpretations, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in Kazakhstan. The future economic direction of the country is largely dependent upon economic, fiscal and monetary measures undertaken by the government, together with legal, regulatory, and political developments.

The global financial turmoil that negatively affected Kazakhstan financial and capital markets in 2008 and 2009 has receded and Kazakhstan's economy returned to growth in 2010. However, significant economic uncertainties remain. Adverse changes arising from systemic risks in global financial systems, including any tightening of the credit environment could slow or disrupt Kazakhstan's economy, adversely affect the Group's access to capital and cost of capital for the Group and, more generally, its business, results of operations, financial condition and prospects.

Kazakhstan is facing a relatively high level of inflation (according to the government's statistical data consumer price inflation for the years ended 31 December 2010 and 2009 was 5% and 7%, respectively). Because Kazakhstan produces and exports large volumes of mineral resources, the country's economy is particularly sensitive to the price of mineral resources on the world market that fluctuated significantly during 2010 and 2009.

The Group continues to be exposed to the risk that the impacts of the global financial turmoil may have a direct and indirect impact on its business in the future. Specifically, the Group's cost of borrowings could increase if further borrowings were needed by the Group due to the fact there is less overall liquidity in the market. In addition, the Group may be impacted if the price of gold decreases as a result of decreased global demand. Further economic turmoil could prevent or postpone purchases of gold from the Group and delays in the building of new power plants by the Group's customers would decrease the future demand for gold.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

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The consolidated financial statements reflect management's assessment of the impact of the Kazakhstan business and political environment on the Group's performance and financial position. The actual business environment may differ from the management's assessment

### **Capital commitments**

The Group's budgeted capital expenditures for the year ended 31 December 2011 amount to USD 21,592 thousand, including USD 17,392 thousand of contractual capital commitments (2010: USD 62,068 thousand and 2,372 thousand respectively).

### **Contractual obligations in the Republic of Kazakhstan**

The Group's subsoil use rights are not granted in perpetuity, and any renewal must be approved before the expiration of the relevant subsoil use contract or license. These rights may be terminated by the Government if the Group does not fulfil its contractual obligations. Management believes it fulfilled all required contractual obligations during the year ended 31 December 2010.

Pursuant to the subsurface use contracts ("SSU") the Group has committed to the following contractual obligations:

#### **(a) Minimum working program**

The Group approved a minimum working program for exploration ("MWP") which can be updated on a periodic basis to take account of the economic and operating conditions of the fields. Each year the Group agrees the annual working program ("AWP") with the Ministry of Industry and New Technologies of the Republic of Kazakhstan. According to the AWP, the agreed mining expenditures for 2010 were set at USD 4,821 thousand, while the actual mining expenditures incurred under AWP amounted to USD 14,284 thousand.

#### **(b) Training of local staff**

The Group is obliged to finance on an annual basis professional training of its Kazakhstan personnel. Actual obligations materialise over the passage of time and, as such, the Group recognises such expenses in the consolidated statement of operations as they are incurred.

#### **(c) Social programs**

The Group is obliged to participate in social development programs in the territory in which the Group entities operate and to transfer funds agreed with local authorities for development of social programs in the Eastern Kazakhstan and Akmola regions. Actual obligations materialise over the passage of time and, as such, the Group recognises such expenses in the consolidated statement of operations as they are incurred.

#### **(d) Environmental matters**

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

According to the Group's subsurface use contracts #2526 and #2527 (relating to mines in exploration stage), the Group is obliged to finance environmental works related to projects. Group management believes that its mining and production technologies are in compliance with the existing environmental legislation in the countries in which it operates. However, environmental laws and regulations continue to evolve. The Group is unable to predict the timing or extent to which those laws and regulations may change. Such change, if it occurs, may require that the Group modernise technology to meet more stringent standards. As these subsurface use contracts are still in the exploration stage, the Group is not yet liable for financing environmental works and has not recognised a provision for these contracts as at 31 December 2010.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

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### Litigation

At the date of issuance of these consolidated financial statements the Group was party to a number of significant claims and litigation outstanding:

- Prior to 2010, the Group received a claim by Ministry of Natural Resources of Kyrgyzstan for lack of geological documentation against Talas Gold Mining Company, a subsidiary of the Group. The Group's renewal costs for the completion of the geological documentation would not exceed USD 3 million. As this is not a claim for penalties, but rather a request for required documentation, the Group will not record a provision until the service is received from an external party for the geological documentation;
- General Prosecutor's office of Kyrgyzstan launched a lawsuit to liquidate Talas Gold Mining Company. The amount of assets held in the subsidiary is equivalent to USD 36,172 thousand;
- A claim in the amount of USD 2,344 thousand against the Group by a former executive of the Group for compensation of losses;
- Oxus mining has submitted a claim against the Group for the restitution of drilling machines in the amount of USD 850 thousand; and
- A claim in the amount of USD 8,700 thousand was obtained from the Maed Group, a former supplier of the Group. The claim is in relation to Maed Group's claimed compensation of losses.

Management believes that none of these claims, individually or in aggregate, will have a material adverse impact on the Group.

### Compliance with licenses

The business of the Group depends on the continuing validity of its licenses, particularly subsoil licenses for the Group's exploration and mining operations, the issuance of new licences and the Group's compliance with the terms of its licenses. Kazakhstan regulatory authorities exercise considerable discretion in the timing of license issuance and renewal and the monitoring of a licensee's compliance with the terms of a license. Requirements imposed by these authorities, including requirements to comply with numerous industrial standards, recruit qualified personnel and subcontractors, maintain necessary equipment and quality control systems, monitor the operations of the Group, maintain appropriate filings and, upon request, submit appropriate information to the licensing authorities, may be costly and time-consuming and may result in delays in the commencement or continuation of exploration or production operations. Accordingly, licenses that may be needed for the operations of the Group may be invalidated or may not be issued or renewed, or if issued or renewed, may not be issued or renewed in a timely fashion.

The legal and regulatory basis for the licensing requirements is subject to frequent change, which increases the risk that the Group may be found in non-compliance. In the event that licensing authorities discover a material violation by the Group, the Group may be required to suspend its operations or incur substantial costs in eliminating or remediating the violation, which could have a material adverse effect on the Group's business and financial condition.

The Subsoil Use Law of the Republic of Kazakhstan stipulates that assignments, transfers and amendments of subsoil use rights may be made only with the prior consent of the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan (except when such assignment or transfer is to a subsidiary of the subsoil user in question or is as a result of a reorganisation of the subsoil user whereby its legal successor assumes all its rights and obligations). The Government has a pre-emptive right in respect of a transfer of any part of the subsoil use rights and of a participation share (shares) in the legal entity holding such subsoil use rights for assets in the Republic of Kazakhstan, provided that the terms and conditions (upon which such pre-emption right may be exercised) are not less favourable than those on which the proposed transferee is prepared to assume such subsoil use rights.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

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### Insurance

The insurance industry in the Republic of Kazakhstan is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group has the following insurance coverage:

- insurance of the Group's plant facilities, in respect of natural disasters, fire, flood and theft;
- coverage for the Group's plant facilities and third party liability in respect of property or environmental damage arising from accidents on Group's property or relating to Group's operations;
- civil liability of owners of vehicles; and
- employer's legal liability for all employees of the Group.

The Group has not yet obtained coverage for business interruption.

### Taxation contingencies in the Republic of Kazakhstan

The tax system of Kazakhstan is quite new and characterised by a large number of taxes (corporate income tax, value added tax, and personal income tax being material to the Company's operations) and frequent changes in legislation, official regulation and court rulings. Taxes are subject to review by a number of bodies which are entitled to charge fines, interest and penalties. Tax years remain open to reviews by tax authorities during 5 calendar years subsequent to year-end; however in certain circumstances the tax year can remain open longer. Various Kazakh legislative acts and normative are not always clearly set forth and their interpretation depends on the opinion of local tax inspectors and the Ministry of Finance of the Republic of Kazakhstan, for example, the definition of taxable turnover for VAT purposes, the deductibility of certain expenses for CIT purposes, questions of application of the new tax code effective from 2009, the determination of the timing of revenue recognition, and other issues. The opinions of the local, regional, and republican tax officials often differ. The existing regime of charging penalties and fines in case of declared and discovered violations of laws, decrees and standards of Kazakhstan are very strict. Tax authorities are very aggressive in the inspection of subsurface users. The sanctions include confiscation of disputable amounts (for violation of rules of exchange operations), and penalties of 2.5 times the official refinancing rate set by the National Bank of the Republic of Kazakhstan for each day of the violation. The rate of the penalty comprises 50% of the additional charge of the tax. As a result, penalties and fines can result in amounts many times greater than the incorrectly calculated taxes.

Such conditions can create more serious tax, penalty, and interest risks in Kazakhstan than in other countries. Management believes that it has appropriately provided for all tax liabilities based on existing interpretations of applicable tax laws, regulations and court rulings. Nonetheless, the opinions of the respective authorities can differ, which can significantly impact the financial statements if the authorities manage to prove the legality of their own interpretations.

Starting from 1 July 2010 the tax code set a restriction for refund of the excess of an input value added tax ("VAT") from the state budget. Thus, VAT input borne from purchase of fixed assets as well as import VAT shall not be refundable. The above said amendments are rather ambiguous and provide no clarity on whether the newly introduced restriction applies to taxpayers having 0% VAT turnovers. At that, any VAT which is not subject to refund may be offset against future VAT liability.

During 2010, JSC MMC KazakhAltyn (the Company), a subsidiary of the Group, was the subject of a tax audit for the 2007 – 2008 years. As the result of this tax audit, the Company was exposed to tax and penalties of approximately USD 16 thousand. The Company accepted these assessments and did not submit an appeal. However, the tax authorities are now in the process of re-auditing these periods, simultaneously auditing 2009 and the first six months of 2010.

During 2010, JSC MMC KazakhAltyn became subject to a VAT audit for 2010. As the result of audit for 3 quarters of 2010, a VAT refund of approximately USD 1,090 thousand was not confirmed by the tax authorities (including import VAT in the amount of USD 721 thousand). The Company is in the process of appeal of the tax audit results and intends to defend its position with respect to all amounts not confirmed for refund. The VAT audit for the 4th quarter of 2010 is currently in process.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 *(in thousands of US Dollars)*

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### **Stability of applicable tax regime**

Subsoil use contracts in Kazakhstan have traditionally always contained tax terms that reflected the tax law in effect when the contract was signed, and these tax terms were “stabilised,” meaning that they were to remain in effect for the life of the contract, regardless of how tax law changed over time. All subsoil use contracts of the Group have been stabilised.

In 2008, Kazakhstan enacted a new tax law which came into effect on 1 January 2009. Only production sharing agreements and concessionary agreements with a tax regime approved by a legislative act of the Kazakhstan Parliament retained their tax stability. The Group’s subsoil use contracts do not fall within either of these two categories and the tax regime applicable to these subsoil use contracts may therefore change.

### **Environmental matters**

The Group is subject to extensive federal, local environmental controls and regulations in the regions in which it operates. The Group’s operations involve the discharge of materials and contaminants into the environment, disturbance of land that could potentially impact on flora and fauna, and give rise to other environmental concerns.

The Group’s management believes that its mining and production technologies are in compliance with the existing environmental legislation in the countries in which it operates. However, environmental laws and regulations continue to evolve. The Group is unable to predict the timing or extent to which those laws and regulations may change. Such change, if it occurs, may require that the Group modernise technology to meet more stringent standards.

The Group is obliged in terms of various laws, mining licenses and ‘use of mineral rights’ agreements to decommission mine facilities on cessation of its mining operations and to restore and rehabilitate the environment. Management of the Group regularly reassesses environmental obligations for its operations. Estimations are based on management’s understanding of the current legal requirements and the terms of the license agreements. Should the requirements of applicable environmental legislation change or be clarified, the Group may incur additional environmental obligations. Provision for site restoration and decommissioning are presented in Note 18.

### **Republic of Kazakhstan risk**

Although in recent years there has been a general improvement in economic conditions in the Republic of Kazakhstan, the country continues to display certain characteristics of an emerging market. These include, but are not limited to, currency controls and convertibility restrictions, relatively high level of inflation and continuing efforts by the Government to implement structural reforms.

As a result, laws and regulations affecting businesses in the Republic of Kazakhstan continue to change rapidly. Tax, currency and customs legislation within the Republic of Kazakhstan is subject to varying interpretations, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Republic of Kazakhstan. The future economic direction of the Republic of Kazakhstan is largely dependent upon the effectiveness of economic, fiscal and monetary measures undertaken by the Government, together with legal, regulatory, and political developments.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

### 23. RISK MANAGEMENT ACTIVITIES

#### Capital risk management

The Group manages its capital through financing from parent company to ensure that entities of the Group will be able to continue as a going concern. The capital structure of the Group consists of net debt (borrowings as described in Note 17 offset by cash and cash equivalents (disclosed in Note 15) and equity attributable to the parent (comprising issued share capital, reserves and accumulated losses).

#### Major categories of financial instruments

The Group's principal financial liabilities comprise borrowings, trade and other payables and other non-current liabilities. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group financial assets represent mainly trade and other receivables, and cash and cash equivalents.

	<u>2010</u>	<u>2009</u>
<b>Financial assets</b>		
Cash and cash equivalents	8,162	3,531
Trade and other receivables	1,812	2,124
Other non-current assets	862	-
<b>Total financial assets</b>	<b><u>10,836</u></b>	<b><u>5,655</u></b>
<b>Financial liabilities</b>		
Guaranteed senior notes	200,000	200,000
Other borrowings	73,465	78,628
Trade payables	1,778	1,771
Other payables	23,752	15,851
Other non-current liabilities	4,458	15,526
<b>Total financial liabilities</b>	<b><u>303,453</u></b>	<b><u>311,776</u></b>

The main risks arising from the Group's financial instruments are interest rate, foreign currency, credit and liquidity risks.

#### Fair value of financial instruments

Management believes that the carrying values of trade and other receivables, borrowings, trade payables, other payables and other non-current liabilities recorded at amortised cost in the consolidated financial statements approximate their fair values due to their short-term nature, variable interest rates, or recently negotiated terms except for the Company's Notes the fair value which, at the reporting date, was USD 197,174 thousand (2009: USD 201,000 thousand) based on the mid market price as quoted on the Luxembourg Stock Exchange.

#### Interest rate risk

Interest rate risk is the risk that changes in interest rates will adversely impact the financial results of the Group. The Group's interest rate risk arises from borrowings at floating rates.

If interest rates had been 50 basis points higher/lower and all other variables were held constant, the Group's loss for the year ended 31 December 2010 would decrease/increase by USD 250 thousand (2009: decrease/increase by USD 85 thousand). The change of 50 basis points would have the same impact on equity.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

### Foreign currency risk

Foreign currency risk is the risk that the financial results of the Group will be adversely affected by changes in exchange rates to which the Group is exposed. The Group undertakes certain transactions denominated in foreign currencies. All revenues are denominated in USD, whereas the majority of the Group's expenditures are denominated in KZT. Accordingly, operating profits are adversely impacted by appreciation of KZT against USD.

The carrying amounts of monetary assets and liabilities denominated in foreign currencies other than functional currencies of the individual Group entities at 31 December 2010 and 2009 were as follows:

	Assets		Liabilities	
	2010	2009	2010	2009
USD	3,834	4,274	287,693	281,286
<b>Total</b>	<b>3,834</b>	<b>4,274</b>	<b>287,693</b>	<b>281,286</b>

Currency risk is monitored by performing sensitivity analysis in order to verify that the potential loss is at an acceptable level.

The table below details the Group's sensitivity to changes of exchange rates of the KZT to USD by 10% which is the sensitivity rate used by the Group for internal reporting purposes. The analysis was applied to monetary items at the reporting dates denominated in respective currencies.

	2010	2009
Profit or loss (KZT to USD)	28,386	27,701

Equity would be impacted by the same amount as shown for profit or loss above.

### Credit risk

Credit risk is the risk that a counterparty may default or not meet its obligations to the Group on a timely basis, leading to financial losses to the Group. Credit risk arises from cash and cash equivalents, trade and other receivables and advances paid to suppliers.

Prior to dealing with a new counterparty, management assesses the credit worthiness and liquidity of the counterparty.

Although the Group sells substantially all the gold produced to two major customers, the Group is not economically dependant on these customers because of the high level of liquidity in the gold commodity market. Buyers of gold are required to make advance payments, therefore credit risk related to trade receivables is minimal. At 31 December 2010 the Group had USD 1,004 thousand of outstanding trade receivables from gold sales (31 December 2009: USD 1,359 thousand). Gold sales to the Group's two major customers, exceeding 90% of the Group's gold sales, amounted to USD 105,928 thousand and comprise (2009: USD 57,402 thousand).

The procedures of accepting a new customer include check by a security department and responsible on-site management for a business reputation, licenses and certification, credit worthiness and liquidity.

Management of the Group believes that there is no other significant concentration of credit risk.

### Liquidity risk

Liquidity risk is the risk that the Group will not be able to settle all liabilities as they are due. The Group's liquidity position is carefully monitored and managed by treasury department. The Group manages liquidity risk by maintaining detailed budgeting, cash forecasting process and matching the maturity profiles of financial assets and liabilities to help ensure that it has adequate cash available to meet its payment obligations.

# KAZAKHGOLD GROUP LIMITED

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010 (in thousands of US Dollars)

The maturity profile of the Group's financial liabilities at 31 December 2010 and 2009 based on contractual payments is presented below:

	Total	Due within three months	Due from three to six months	Due from six to twelve months	Due in the second year	Due in the third year	Due in the fourth year	Due in the fifth year	Due in thereafter
<b>2010</b>									
<i>Borrowings, including:</i>									
Principal	<b>280,335</b>	249,310	-	-	-	-	31,025	-	-
Interest	<b>27,785</b>	3,940	2,865	-	-	-	20,980	-	-
<i>Other non-current liabilities, including:</i>									
Principal	<b>8,392</b>	-	-	-	1,199	899	899	899	4,496
<i>Trade and other payables, including:</i>									
Principal	<b>18,725</b>	11,834	-	6,891	-	-	-	-	-
<b>Total</b>	<b>335,237</b>	<b>265,084</b>	<b>2,865</b>	<b>6,891</b>	<b>1,199</b>	<b>899</b>	<b>52,904</b>	<b>899</b>	<b>4,496</b>
<b>2009</b>									
<i>Borrowings, including:</i>									
Principal	<b>289,870</b>	200,206	48,098	9,512	823	206	-	31,025	-
Interest	<b>24,105</b>	1,105	1,105	565	297	53	-	20,980	-
<i>Other non-current liabilities, including:</i>									
Principal	<b>20,005</b>	-	-	-	11,583	1,229	899	899	5,395
<i>Trade and other payables, including:</i>									
Principal	<b>17,622</b>	4,316	8,018	5,288	-	-	-	-	-
<b>Total</b>	<b>351,602</b>	<b>205,627</b>	<b>57,221</b>	<b>15,365</b>	<b>12,703</b>	<b>1,488</b>	<b>899</b>	<b>52,904</b>	<b>5,395</b>

## 24. SUBSEQUENT EVENTS

On 8 December 2010, KazakhGold and AltynGroup entered into a binding agreement (the "Original Principal Agreement") for the sale of KazakhGold's operating subsidiaries in Kazakhstan, Romania and Kyrgyzstan and the withdrawal of claims against former shareholders, and cessation of claims by Kazakh Authorities. The Original Principal Agreement was terminated by KazakhGold on 14 March 2011.

Following termination of the Original Principal Agreement, the parties have continued with negotiations regarding the sale of the operating subsidiaries to AltynGroup, resolution of the Claims and other disputes between the parties. These continued negotiations have now resulted in the entry into a Restated and Amended Principal Agreement (the "RAPA"), and a Settlement Deed in respect of the Claims which provides for a conditional settlement and release of the orders, judgments and claims, whether in litigation, arbitration or otherwise, initiated, inter alia, in the UK, Jersey, the BVI, or elsewhere, between KazakhGold, Jenington and KazakhAltyn, on the one hand, and the Assaubayev family, on the other hand, and all of their respective subsidiaries and affiliates, howsoever relating to the matters referred to in those proceedings or otherwise arising in respect of the original acquisition of 65 percent of KazakhGold by Jenington, without any admission of liability on either part (the "Settlement Deed").

Pursuant to the RAPA, AltynGroup will acquire KazakhGold's operating subsidiaries in Kazakhstan, Romania and Kyrgyzstan in two tranches. The aggregate transaction price for all the shares is USD509,000,000, as well as the provision of funds required to be repay the Jenington Loan.

There can be no assurance that the conditions to the transactions contemplated by the RAPA and the conditions to the Settlement Deed will be satisfied, or that the transactions will be completed.