Draft

Accounting Regulation

(Petroleum Accounting Regulation)

One. Background

1.1 This regulation aims to bring exploration and extraction operations in line with the International Accounting Standards, commencing from the date a petroleum company (hereinafter referred to as "Contractor") signs the Production Sharing Agreement (hereinafter referred to as "PSA") with the Government of Mongolia.

1.2 A petroleum entity, carrying out petroleum exploration and extraction operations, shall comply with this regulation when accounting and reporting license ownership, exploration, exploitation, extraction and dismantling costs.

1.3 A petroleum entity shall develop its accounting policy, which will be approved by the Central State administrative body in charge of financial matters.

1.4 As an entity which recognized and registered as exploration and evaluation assets, impairment of the assets and values shall be complied with "IAS 36 – Impairment of Assets".

Scope of the Regulation:

This regulation shall apply to entities carrying out the petroleum exploration and extraction operations within the territory of Mongolia.

Terminologies:

PSAs – Production Sharing Agreements

Acc. – Accounting

IAS – International Accounting Standards

IFRS – International Financial Reporting Standards

FC – Full Cost

SE – Successful effecting

Ownership Costs – Costs related to obtaining a special license and costs during preparation prior to obtaining special licenses.

Dismantling Costs – Costs stipulated in Clause 4.1.30 of the Mongolian Law on Petroleum.

Two. Preparation period prior to exploration operation and registration of special license

2.1 Depending on whether it is related to special license of exploration or special license of exploitation, the ownership costs shall be registered into the "*Special License of Exploration"* or "*Special License of Exploitation"* account and the balance should be accounted in the section of non-current assets, according to the "IAS 38 – Intangible Assets".

2.2 Costs of the "Special License of Exploration" account - include prospecting costs and other expenses related to obtaining the special license of exploration since the PSA was signed.

2.3 Costs of the "Special License of Exploitation" account – include the costs related to obtaining the special license of exploitation.

2.4 The petroleum entity shall accumulatively register its costs or expenses by each special license during the reporting period.

Version 1

2.5 The expenses related to the special license since it was obtained are categorized as “cost recoverable expenses” and “non-recoverable expenses”, according to the PSA.

2.6 The cost recoverable expenses related to the special license since it was obtained shall not be accounted into the cost of the special license account and instead be deemed as expenses during the reporting period and registered into the cost recoverable expenses report.

2.7 The cost non-recoverable expenses related to the special license since it was obtained shall be recorded into the special license account.

(Conditions favorable for the Contractor)

Version 2

2.8 The expenses related to the special license since it was obtained shall be accounted into the costs of the special license account. (More in line with the IAS)

2.9 The expenses for registering the special license account shall not be cost recovered.

Three. Accounts during Exploration

Exploration work costs – include the costs stipulated in Clause 4.1.27 of the Mongolian Law on Petroleum.

3.1 Exploration costs will be capitalized in compliance with “IFRS 6 – Mineral Resources Exploration and Evaluation“.

3.2 The petroleum entity shall determine and regularly implement the accounting policy that identifies which expenditures will be recognized as exploration and evaluation assets.

3.3 Exploration and evaluation assets shall be accounted for in terms of its costs and in the balance it is classified by non-current assets. By each special license, the expenses shall be accumulatively registered.

3.4 The expenses at the stage of petroleum development and extraction as well as general management expenses shall not be recognized as exploration and evaluation assets.

3.5 Borrowing costs: The borrowing costs borne in the process of petroleum exploration work shall be accounted according to the “IAS – Borrowing Costs”. The borrowing costs directly related to preparatory operations and time-consuming exploration and evaluation assets shall be capitalized.

3.6 The cost of exploration work done by the state budget: The compensation cost paid to the government, by the deposit whose exploration work was done and reserves were determined by the state budget, shall be registered into the exploration and evaluation assets.

3.7 Allocating consolidated costs: Entities owning several petroleum exploration and exploitation special licenses shall reflect the issues of allocating and capitalizing the expenses with common purposes in its accounting policy and comply with accordingly.

3.8 When allocating these consolidated costs, petroleum entities shall follow the bases suitable to their characteristics. For example, by the size of the area permitted by the special license, by the length of meters drilled for the purpose of exploration, accounting other expenses related to the special license in terms of equivalent percentage, etc.

Option of choosing the international petroleum accounting methods of Full Cost (FC) and Successful Efforts (SE)

[1] According to the International Petroleum Accounting Standards, either one of the petroleum accounting methods – Full Cost (FC) and Successful Efforts (SE) is allowed to use. The selected petroleum accounting approach shall be followed consistently in the future.

[2] When using the FC approach, exploration costs shall be categorized as tangible and intangible, both of which shall be capitalized.

[3] When using the SE approach, exploration costs shall be categorized as tangible and intangible costs and:

- Intangible costs shall be deemed as expenses during the reporting period and accounted for in the income report as expenditure.
- If proved to be commercial discovery as a result of the exploration work, tangible costs shall be accounted for as long-term asset and recognized as exploration and evaluation assets in the balance. In other words, it will be capitalized.
- If proved to be not commercial discovery as a result of the exploration work, tangible costs shall be deemed as expenses during the reporting period and accounted for in the income report as expenditure.
- If doubtful to be commercial discovery as a result of the exploration work, intangible costs of exploration shall be capitalized as asset for the next (one) year.
- If the well is still uncertain as to whether it is commercial discovery or not, as a result of the additional research and exploration following the year, and satisfying the following conditions, it shall be capitalized as asset continuously. Otherwise, intangible costs of the exploration work shall be immediately accounted as expenses in that year of reporting.

➢ If additional exploration work is necessary in order to determine whether the well is commercial discovery, despite the fact that it has reserves,
➢ If proved to be commercial discovery as a result of the additional exploration work.

Four. Accounts during the petroleum Development period

Development costs related to the extraction area are comprised of:

4.1 Asset and operational costs directly related to development activities prior to regular extraction in the area; and,

4.2 Asset costs related to continuing development and petroleum extraction since the area was subject to regular extraction.

4.3 Development costs shall be spent according to the approved development plan, action plan of the year and relevant budget.

4.4 Development expenses shall be capitalized as the relevant development costs.

Five. Accounts during Extraction

The extraction costs include the following costs:

5.1 Expenses related to petroleum extraction, apart from the expenses related to development and dismantling of the exploitation area.

5.2 Depreciation cost of exploration and exploitation special license.

5.3 Amortization cost added into the expenses during the reporting period from capitalized exploration and development costs related to extraction work.

5.4 Expenses during extraction shall be added and reflected as expense in the income report.

Six. Accounts during Dismantling

6.1 Dismantling costs shall be soaked into the expenses during the reporting.

6.2 Cost recoverable expenses will increase by the amount of assets centralized in the dismantling reserve fund accumulated before the dismantling work starts and during the reporting period.

6.3 Costs centralized in the reserve fund before the dismantling work commences shall not be soaked into the expenses. It shall be accounted as non-current assets in the balance.

6.4 When dismantling starts and assets of dismantling reserve fund are spent, it shall be accounted as dismantling costs and deemed as expense. Expenses during the reporting of dismantling period are not cost recoverable expenses.

6.5 At the end of the dismantling, remainder from the dismantling reserve fund is transferred to the Government of Mongolia.

6.6 Assets of the dismantling reserve fund should only be spent on the dismantling work.

6.7 In case of having insufficient assets for dismantling in the dismantling reserve fund, the Contactor company shall carry out this work by their own assets. This cost borne by their own assets are not cost recoverable expenses.

Seven. Cost Recoverable Expenses

7.1 When capitalized expenses include cost recoverable expenses during the reporting period, while the expenses capitalized not during the reporting period are calculated as depreciation cost, it is accounted as cost recoverable expenses accumulatively in the cost recovery report.

7.2 If capitalized expenses include cost recoverable expenses, classification of the expenses shall be recorded in great details and when expenses are added taking depreciation into account, the cost recoverable expenses shall be added and accumulatively accounted into the cost recovery report.

7.3 Cost recoverable expenses during the reporting period shall be accumulatively accounted for in the cost recovery report.

7.4 The following items shall be added into the cost recovery report:

- Cost recoverable expenses shall be accounted for in terms of each expense accumulatively since the time of the PSA.
- If the capitalized expenses include cost recoverable expenses, the expenses related to the capitalized cost recoverable expenses shall be reflected in the detailed report on cost recoverable expenses.
- Depreciation costs related to the capitalized cost recoverable expenses shall be accumulatively accounted for in the report.

7.5 The order of cost recovery expenses during the reporting period:

1) Operation cost during the reporting period
2) Unrecovered exploration cost
3) Unrecovered development cost
4) Dismantling reserve fund.

Eight. Escrow Account

8.1 Establishing the account

8.1.1 When selecting a bank to accommodate an escrow account, the Central State administrative body in charge of petroleum shall select a bank and establish the escrow account from more than 3 commercial banks operating in Mongolia, recommended by the Central State administrative body in charge of financial and accounting matters.

8.1.2 The selected bank shall hereinafter be referred to as “Escrow Bank”.

8.1.3 The escrow account shall be established within ..... days upon signing the PSA.

8.2 Calculating the amount

8.2.1 The Contractor shall deposit its assets in the escrow account, as stipulated in 11.2.9 of the Mongolian Law on Petroleum, within 60 days upon approval of annual action plan and budget.

8.2.2 The escrow account shall be adjusted at the end of the fiscal year. This adjustment is:

I. During exploration

- If the exploration cost upon performance is lower than the planned exploration cost and as in the following cases, the escrow account will not be adjusted. This includes:
  - If the exploration work of the Contractor is affected by the Force Majeure (and this includes: earthquake, flood, fire, hurricane, typhoon, spread of epidemic diseases and other natural disasters and dangerous phenomena, strike, state decision, intervention, etc.) and if the Contractor was unable to carry out the duties and responsibilities bound by the agreement. The evidence of the above Force Majeure shall be certified by the National Chambers of Commerce and Industry of the country.
  - In the above-mentioned cases, the remaining amount of the escrow account shall be adjusted and the over-deposited assets shall be returned to the Contractor.

- If the exploration cost upon performance is higher than the planned exploration cost, the assets to deposit in the escrow account shall be equal to 3% of the exploration cost estimated upon performance. Therefore, the final remaining amount of the escrow account shall be adjusted.

II. During exploitation

- If the profit oil for the Contractor upon performance is higher than the profit oil for the Contractor by the approved plan, the remaining amount of the escrow account will be estimated by 1% of the profit oil for the Contractor upon performance and the remainder of the escrow account will be adjusted.
- If the profit oil for the Contractor upon performance is lower than the profit oil for the Contractor by the approved plan, the adjustment will not be made except for the following cases:
  - If the exploration work of the Contractor is affected by the Force Majeure (and this includes: earthquake, flood, fire, hurricane, typhoon, spread of epidemic diseases and other natural disasters and dangerous phenomena, strike, state decision, intervention, etc.) and if the Contractor was unable to carry out the duties and responsibilities bound by the agreement. The evidence of the above Force Majeure shall be certified by the National Chambers of Commerce and Industry of the country.
  - In the above-mentioned cases, the remaining amount of the escrow account shall be adjusted and the over-deposited assets shall be returned to the Contractor.
- In case of carrying out the exploration work during exploitation: the higher amount between the assets equal to 3% of the exploration work by the approved plan and 1% of the profit oil for the Contractor shall be deposited into the escrow account.

8.2.3 The under-deposit in the escrow account shall be re-deposited by the Contractor within 60 days after the fiscal year, based on the adjustment made to the remainder of the escrow account at the end of the fiscal year.

8.2.4 As stated in 8.2.2 of this regulation, the over-deposit of the escrow account shall be returned to the account of the Contractor by the escrow bank from its escrow account based on the mutual agreement between the Government and the Contractor and within 3 days of the agreement.

8.3 Making a contract

8.3.1 The Government and the Contractor shall make a contract for the escrow account as stated in 8.1.3 of this regulation.

8.3.2 Other matters except for the ones stated in this regulation shall be reflected in the escrow account contract based on mutual negotiations by the Parties.

8.4 Spending from the account

8.4.1 When depositing assets in the escrow account, they shall not be viewed as cost recovery expenses.

8.4.2 Based on mutual agreements between the Government of Mongolia and the Contractor, expenditure can be made from the escrow account as stipulated in 11.2.9 of the Mongolian Law on Petroleum.

8.4.3 If the assets of the escrow account are spent on the activities viewed as cost recovery expenses, the expenses for the performance shall be deemed as cost recovery expenses during that reporting period.

Nine. Classifying expenses by each of its expense centers

9.1 With the purpose of ensuring a possibility of conducting effective monitoring on cost recoverable expenses according to the contract, all expenses are classified by their purposes and divided into expense centers and their sub-categories based on predefined classification and they are submitted to the Petroleum Authority of Mongolia (PAM) for monitoring and supervision.

9.2 The following classifications shall be necessarily made:

- Ownership costs spent for preparatory work prior to exploration and for matters related to special license.
- Exploration costs for the exploration work.
- Development costs for development work.
- Operational costs for production work.
- Costs impossible to identify for particular sites.
- Closure costs for the closure.

1. Petroleum costs for petroleum operations are distributed by its area in the following manner:

- Exploration costs of all Contract areas. Evaluation costs which are exploration costs directly related to evaluation itself are distributed to each area of evaluation.
- Development costs and operational costs are distributed to each extraction area.
- In the development and operational costs, expenses related to external activities outside the Contract area such as isolated transmission pipelines are distributed by each extraction area.
- Closure costs are distributed by each extraction area.
- Petroleum costs not belonging to particular areas are distributed by each classification and management costs are done according to the approved methodology.

2. Expenses for each petroleum operation are distributed in the following manner:

2.1 Exploration work is sub-divided even further:

- Aerial, geological, geochemical, paleontological, topographic and other researches.
- Each seismological research.
- Each exploration and evaluation well.
- Infrastructure (road, airport).

- Auxiliary facilities (storage, etc.). These include cost and distribution of regular services. (Cost related to petroleum operations).
- Distribution of general costs and management costs.
- Other costs.

2.2 Development work to the delivery point is sub-divided:

- Aerial, geological, geochemical, geophysical and other researches.
- Each extraction well.
- Accumulation lines.
- Site facilities.
- Storage facilities.
- Transmission pipelines and transport tanks.
- Infrastructure.
- Auxiliary facilities (storage, etc.). These include cost and distribution of regular services. (Cost related to petroleum operations).
- Distribution of general costs and management costs.
- Costs of other development work such as engineering and invention researches.

2.3 Extraction operation is classified as same as the development operation.

2.4 Closure operation is classified as same as the extraction operation.

3. Costs related to the extracted and stored raw oil and natural gas are distributed in the following manner:

- If the majority of expenses has to do with either raw crude oil or natural gas, the whole expense will be distributed to the one of the two.

- In case of being able to distribute the expenses to both raw oil and natural gas, it will be distributed based on the mutually agreed methodology and according to best international practice on petroleum industry.

Ten. Revenue and Expenditure

10.1 Cost Recoverable Expenses

The Contractor shall fully and directly cover the following expenses according to the contract and these expenses shall be other expenses than the ones not for cost recovery related to the petroleum operations carried out by the Contractor and duly accounted for in the joint account according to the approved annual action plan and budget.

a) Land Rights

Direct costs related to constructing and installing buildings and facilities and obtaining land rights, necessary to carry out petroleum operations by the Contractor only on the contract area and those parts according to the Contract, without those stated in the PSA such as promotions, all awards, special license fee for the area and service fees.

b) Employment

1. Salaries, additional wages, bonuses, awards, promotions, holiday pays, per diems, temporary disability and disability compensations for the staff working in Mongolia for the Contractor (except for those working in formal offices for the Contractor in Mongolia and abroad),

2. Livelihood, accommodation and other benefits for the foreign citizens appointed to work in Mongolia by the Contractor (except for those working in formal offices for the Contractor in Mongolia and abroad),

3. Expenses related to fees imposed on salaries of Contractor's staff (except for those working in formal offices for the Contractor in Mongolia and abroad) by governmental organizations according to the law.

c) Benefits, pensions and social welfare for workers

1. Expenses related to covering life and social insurances in regards to salary as well as pension and social welfare for Mongolian and foreign staff working in Mongolia employed by the Contractor (except for those working in formal offices for the Contractor in Mongolia and abroad).

2. Employment termination benefits for both Mongolian and foreign staff (except for those working in formal offices for the Contractor in Mongolia and abroad) are the same and the benefits are regulated according to the Mongolian Law on Labor.

d) Materials, equipment and spare parts

Materials, equipment and spare parts acquired, rented or supplied by the Contractor.

1) *Acquired materials*

When calculating the materials, equipment and spare parts acquired by the Contractor, all benefits given to the Contractor shall be deducted and its net cost shall be estimated.

2) *Materials supplied by the Contractor or subsidiary*

In other cases than supplying any materials, equipment and spare parts to be used for the petroleum operations from reserves of its own organizations or of its subsidiaries, the Contractor shall directly acquire them from individuals and entities. However, the price of the materials supplied from the above reserves shall not be higher than that of similar items purchased from the third party in the same insurance and supply conditions. Evaluation of the materials, equipment and spare parts will be determined by distributing the development and operational costs to each extraction area.

3) *Guarantee*

The Contractor shall not provide additional guarantees except for manufacturer's or salesperson's quality guarantee for the materials, equipment and spare parts it supplied and if the supplied material has defects, it will not be accounted for as income until the manufacturer or salesperson compensates the Contractor for the difference.

4) *Rent*

Prices of the rented materials, equipment and spare parts will be estimated at the actually paid prices.

e) *Transportation*

Costs for transporting the equipment, materials and spare parts necessary for carrying out petroleum-related operations

f) *Services*

1) The Contractor shall get the permission for expenses related to consultant and contract services as well as supply services by the third party for the petroleum operations from the PAM in advance in a written form. If the estimated amount is higher than the permitted amount, permission should be obtained as per each contract. These expenses shall be more or less equal to expenses for similar work and services provided by both foreign and Mongolian organizations.

2) Fees of services such as laboratory testing, mapping, geological and geophysical processing and deciphering as well as engineering and information processing in Mongolia and overseas, provided by the Contractor and its subsidiaries, shall be compatible with the evaluation being followed in the international petroleum industry of the time.

3) Services provided by the Contractor or its subsidiary shall be estimated at the actual expense, without adding profits. The expense shall not be higher than the regular expense for the same services provided by its subsidiary or third party in the same condition.

4) If necessary, the auditor shall request the Contractor, its subsidiary, or the PAM to produce an evidence or proof of the expenses including documents proving the amount of direct expenses for the services and the amount of allocated management expenses.

5) If the service fees provided by the Contractor or its subsidiary are higher than the fees of similar services of petroleum companies for their subsidiaries in the international petroleum industry, the PAM shall be entitled to subtract the expenses from cost recovery.

g) *Ecological and environmental costs*

Expenses made on the contract areas according to environmental protection laws, including expenses to conduct environmental and ecological studies, expenses to have conservation devices, expenses to clean and control oil leakage and donations contributing to the environmental preservation.

h) *Damage and Loss*

All the expenses for reclaiming damages and losses due to earthquake, fire, flood, storm, theft, accident of other reasons that do not depend on the Contractor, and except for the cases mentioned in (i). Once the Contractor is aware of damage or loss, it shall inform the PAM immediately.

i) *Insurance fee*

As stipulated in the PSA, insurance is mandatory and contract payment fee of any insurance whose insurance fee is not higher than the competitive amount shall be estimated as cost recovery expenses.

j) *Field units, storage and other facilities and systems*

Direct expenses within the territory of Mongolia related to maintaining, protecting, equipping and operating field units to the delivery point, storages, transportation and communications systems, water supply, road and other facilities.

k) *Legal Fee*

Expenses for protecting operations and equipment related to the contract area and petroleum; for court procedures and legal assistance, particularly attorney fee and certain percentage of consultant's salary; costs related to the decision against one or both of the Parties on petroleum operations according to the contract; and expenses to take preventive measures by one or both of the Parties to the contract to protect from any action, complaint or claim which is against the petroleum operations. If the above mentioned measures were carried out by the Parties or lawyers of either party, adequate amount of payment for their services shall be borne as that of the petroleum operations.

l) *Administrative Costs*

(As Clause 11.1.6 of the Mongolian Law on Petroleum has logical flaws, creating a great deal of controversies, the following international standard is suggested)

1) Administrative costs other than direct costs allocated to petroleum operations ("Administrative costs") shall be set by a thorough study and approved by the PAM, keeping a separate record and using a suitable methodology with stability each year. In any case, overall expenses of the Contractor to support its head organization outside Mongolia and other organizations as well as staff costs shall be no higher than:

- 3 percent of exploration costs; and,
- 2 percent of development, operational and closure costs.

Administrative costs include costs related to administrative officers mandated to supervise, serve and advise the Contractor and major administrative tasks in Mongolia and abroad (it includes shareholders). In other words, these include salaries, holiday pays, bonuses, taxes imposed by the government by law, procurement of furniture and equipment for office use, rent, fuel and training expenses.

2) The above mentioned administrative costs shall not be overlapped with other costs or expenses.

1. Income

The Contractor shall account for the income from the operation process related to petroleum in a proper account with the purpose of estimating cost recovery. This income is comprised of the following work or transaction:

a) Income coming from complaints and claims

Claims, insurance income or assets on activities related to petroleum.

b) Income from the third party

Income coming from the third party in the form of payment for services or information provided by the Contractor or letting the third party use property

c) Adjustment

Compensations paid by the supplier or manufacturer to the Contractor for the defect materials or equipment, which were previously registered in the account.

d) Reimbursed payment

Rent, compensation or other income reimbursed to the Contractor from the expenses which were previously registered in the account.

f) Selling and exporting materials, equipment and spare parts

Unless specifically stated in this contract, when selling, exporting or transferring any materials, equipment and spare parts previously registered in the Contractor's account to subsidiaries, or other organizations or individuals, the amount of transferal shall be reflected in the accounting.

2. Evaluation of materials, equipment and spare parts

Evaluation of the materials, equipment and spare parts reflected in the accounting shall be carried out based on the following principles:

1. Prices of the materials, equipment and spare parts acquired by the Contractor shall be consistent with the international market prices of goods with similar quality and the price standards of the same supply conditions which dominated the international market at the time of acquisition negotiations. Prices to acquire the materials, equipment and spare parts depend on whether they took account of the following into different estimates in particular cases – trading and cash crises, supply payments, transportation and delivery fees, insurance, taxation, custom fee, consular fee and other payment imposed on import goods.

2. The materials, equipment and spare parts acquired from or sold to subsidiaries shall be evaluated as stated in (a) and (b) as follows.

a) New materials, equipment and spare parts (A classification) shall be consistent with the international market price of the same quality goods and the price standards of the same supply condition at the time of the contract made by the Contractor.

b) Used materials, equipment and spare parts (B, C classifications).

i) Raw materials, equipment and spare parts, without any damage or defect, which are being used for production and services and which do not require repairs, are categorized as B classification and are evaluated by 75% of the price at the time of new materials, equipment and spare parts defined in (a) as above.

ii) Materials, equipment and spare parts which cannot be categorized as B classification, but:

- After repairing, it was being used as before as B classification, but just as any good materials, equipment and spare parts,
- It can be used again; or,
- Materials, equipment and spare parts, which could be used for its original functions, but generally could not be repaired, are categorized as C classification and are evaluated by 50% of the price at the time of new materials, equipment and spare parts defined

in (a) as above. In case of the total amount of prices of materials, equipment and spare parts of C classification together with its repairing costs does not exceed the total amount of materials, equipment and spare parts of B classification together with its repairing costs, the cost of repairing is included in the repaired materials, equipment and spare parts.

iii) Materials, equipment and spare parts which are not in the B and C classifications are evaluated in terms of their use.

iv) In case the materials, equipment and spare parts cannot be written down as a result of being used temporarily for the petroleum operation, these materials, equipment and spare parts will be evaluated based on the amount of net estimate of the account compatible with the amount of service fee that was provided.

4. Non-recoverable expenses

With the purpose of determining cost oil and gas, the following expenses are deemed as non-recoverable expenses:

a) Flawed expenses with insufficient documentation, in terms of tangible items for which the initial or first documents were not produced.

b) Expenses made before the contract took effect

c) Expenses that were not spent according to the relevant action plan, budget or acknowledgement of expenditure, or expenses that are not in the category permitted by the Contract.

d) Other expenses than the ones due to accidents and disasters and the expenses surrounding the goods acquired by the Contractor or service fees ordered or sub-contracted which exceed the international market price of same quality goods and the price standards of the same supply condition dominating the international market of the time.

e) Payments for goods and services incompatible with the Contract made with subcontractor and supplier.

f) Extra costs related to conflicts due to the fact that the state of the material is not compatible with its price, as stated in “d” above.

g) Unnecessary expenses for the petroleum operations. This includes all expenses related to marketing beyond delivery points surpassing supply point and expenses to do with risk protection, transportation and activities. Also it includes expenses to prevent from the risks of foreign currency rates.

h) Taxes paid according to Mongolian laws and other taxes paid for newfound benefits or any gains.

i) Awards and promotions, fees to use the site and other payments as well as fees to use the reserves by the Contract, apart from the payments made for donations contributing to the environmental preservation, according to the PSA.

j) Court, arbitration and expert fees borne by disputes as a result of the Contract.

к) Interests, fines and penalties from the court of Mongolia or authorities, or imposed by the law.

l) Work, services or donation and aid which are not permitted in a written form by the PAM.

m) Expenses related to conducting researches in order to introduce new equipment, materials and methodologies designed to explore, extract and exploit petroleum into production.

o) Any expenses related to financing interest and petroleum operations.

p) Payment to support delegation of the PAM.

q) Expenses made locally to support local areas.

r) Operational and service costs, of which relevant information, reports and documents have not been submitted to the PAM, even though the operation was carried out on the Contract area.

s) Any expenses due to misconduct or neglect of the Contractor, its agency or sub-contractor, including any payments of damages and compensations according to the Contract.

t) Any payments, commissions, or acquisition costs related to transferring the rights to percentage and participation stated in the PSA, particularly, payments for net profit percentage, selling the rights or its equivalent.

u) Closure costs funded from the closure cost fund - If assets accumulated in the fund are included in the cost recovery.

Eleven. Regular Inventories and Inventory Report

11.1 Conducting, Informing and Planning of Inventories

The Contractor conducts inventories of all materials, tangible assets and construction projects within an adequate period of time based on the mutual agreement between the PAM and the Contractor. In order to ensure that the PAM participates in the inventory process, the Contractor shall inform the PAM about the inventories in a written form at least 30 days before the inventories start. The Contractor shall conduct inventories at least once a year and when the Contract is terminated.

11.2 On cross-examining and regulating inventory accounting

The Contractor and the PAM shall double-check the inventory account of assets collaboratively, coming up with the list of excess and shortage and the Contractor shall correct the difference.

11.3 Inventory report

a) The Contractor shall conduct the detailed accounting of assets and properties being used for the petroleum operation, according to the accounting system recognized by international petroleum industry.

b) The Contractor shall submit the inventory report to the PAM on a quarterly basis containing the following:

1. Definitions and codes of all controllable assets and materials.
2. Price amount of each asset as registered in the account.
3. Date of registering the assets into the account.
4. Whether these assets were cost-recovered or not.

Twelve. Extraction Report

12.1 Extraction report shall be produced following the principles as below:

a) Profit oil or gas and cost oil or gas shall be determined based on the amount of overall raw oil and gas which were extracted from the contract area stated in the PSA and stored accordingly.

b) Total amount of the extracted and reserved raw oil and gas is taken to delivery point of each extraction area based on mutual agreement every day. Raw oil of various categories is drained at certain points and loading points of the delivery area and the category of such raw oil shall be classified and determined one by one if it has not been negotiated between the PAM and the Contractor.

c) Daily extracted raw oil will be determined by barrel. If raw oil of different qualities is arriving in delivery points, quality and category of each oil shall be determined separately.

d) The amount of raw oil shall be determined at a regular temperature and pressure and it shall be fixed depending on the amount of water content and clear moraine. Density of raw oil, sulphur content and other quality definitions shall be regularly examined and accounted.

e) The amount of natural gas shall be determined at a regular temperature and pressure. Heat emittance, sulphur content and other quality definitions shall be regularly examined and accounted for.

f) The amount of raw oil used for the petroleum operations is measured and accounted for on a daily basis. This was for energy use of the site operation to:

I. Re-compress;

II. Re-process; and,

III. Compress into exploration, extraction and transmission pipelines.

g) Raw oil and natural gas which were combusted and evaporated shall be accounted for on a daily basis.

h) Amount of available reserves of raw oil is determined at the minimum level in the beginning and end of each calendar month.

12.2 Once the first extraction starts in the well and the site (experimentally and economically profitable), the Contractor shall produce the extraction report with the following information as per each extraction area:

a) Amount of raw oil extracted and stored

b) Amount of natural gas extracted and stored

c) Amount of raw oil and natural gas used for drilling, extracting and compressing into the container

d) Amount of evaporated natural gas

e) Amount of raw oil reserves at the beginning of the month

f) Amount of raw oil reserves at the end of the month

g) Amount of raw oil and natural gas sold

Thirteen. Extraction Evaluation Report

13.1 The Contractor shall produce a quarterly report estimating the evaluation of raw oil and natural gas extracted and sold at the supply point, according to the Contract. Evaluation of the extraction report shall include the following:

a) Amount and price of raw oil sold to the third party during the quarter of the calendar, documented by the PAM and the Contractor,

b) Amount and price of raw oil sold to other parties than the third party during the quarter of the calendar, documented by the PAM and the Contractor,

c) Contractor’s information on raw oil evaluation by major oil exporting countries with the purpose of determining the evaluation of raw oil, in particular the information on prices, benefits and promotions of the contract and the market price of the day,

d) Amount and price of natural gas sold, documented by the PAM and the Contractor.

Fourteen. Cost Recovery Report

14.1 The Contractor shall produce the cost recovery report containing the following on a quarterly basis according to its obligations:

a) Recoverable expenses throughout the quarterly period;

b) Overall recoverable expenses in the quarter of the calendar;

c) Amount and price of cost oil and cost natural gas allocated for the Contractor throughout the quarterly period of the calendar;

d) Amount of recovered expenses during the quarterly period;

e) If available, recoverable expenses to be transferred to the following quarter;

2. The Contractor shall open a cost recovery account and a negative balancing account and control the remaining amount of cost recovery expenses and recovered amount. Information on the account shall be submitted to the PAM on a quarterly basis.

Fifteen. Income and Expenditure Report

15.1 The Contractor shall produce the income and expenditure report on a quarterly basis according to its obligations. The report includes the following:

a) Annual expense and income to be reflected in the annual action plan and budget, based on expense classifications and centers agreed by this accounting and estimate regulation;

b) Accumulated expense and income in the particular quarter of the calendar;

c) Accumulated expense and income that are not yet resolved in the calendar year;

d) Agreed changes to be made to the annual budget according to the contract;

e) Latest version of preliminary estimate of accumulated income and expense towards the end of the year;

f) Difference between the annual budget with changes made as stated in (d) and the actual estimate of advanced budget with comments.

Sixteen. Cost Oil and Profit Oil Reporting

The Contractor shall submit the following report and newsletter to the PAM on a quarterly basis, which includes the following:

a) Raw oil extracted throughout the quarterly period;

b) Amount of raw oil extracted and accumulated towards the end of the quarter;

c) Profit oil allocated to the PAM and the Contractor in that quarter;

d) Total amount of accumulated profit oil allocated to the PAM and the Contractor at the end of the quarter;

e) Amount of cost oil used by the Contractor in that quarter;

f) Amount of accumulated cost oil used by the Contractor at the end of the quarter;

Seventeen. Cost Gas and Profit Gas Reporting

17.1 The Contractor shall produce natural gas quarterly report on a quarterly basis.

Eighteen. Reserves Reporting

18.1 If the PAM deemed it necessary, the Contractor shall produce and submit the Reserve Recognition Accounting (RRA) report approved by Securities and Exchange Commission (SEC).

Nineteen. Dispute Resolution

19.1 The Parties shall seek to resolve any dispute or claim arising in relation to this accounting and estimate regulation through negotiations and if the dispute cannot be settled, a suit shall be filed in court.

19.2 Any matter that is not directly stated in this accounting and estimate regulation shall be resolved by the Accounting Law of Mongolia, Mongolian Law on Petroleum and other national legislations.

19.3 If the dispute cannot be settled through negotiations or court procedures, any dispute related to the accounting and estimate regulation shall be ultimately resolved in Mongolia at the Mongolian National Arbitration by its dispute resolution charter, under the Mongolian National Chambers of Commerce and Industry.