

**LUBEL COAL COMPANY
LIMITED
(Registered in British Virgin
Islands – No.1056038)**

Independent Auditor's Report

**Consolidated Financial Statements
for the Year Ended 31 December 2012**

LUBEL COAL COMPANY LIMITED

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LUBEL COAL COMPANY LIMITED

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of Lubel Coal Company Limited (the "Company") and its subsidiaries (the "Group") as at 31 December 2012, and the results of its operations, cash flows and changes in shareholders' equity for the year then ended, in compliance with International Financial Reporting Standards ("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;
- 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 statutory accounting records in compliance with legislation and accounting standards of the countries where entities of the Group are incorporated;
- 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 2012 were approved by management on 26 June 2013.

On behalf of the management:


Boris Pokrass, Chairman


Igor Frantskevych, Chief Financial Officer

INDEPENDENT AUDITOR'S REPORT

To Shareholders and Board of Directors of Lubel Coal Company Limited:

We have audited the accompanying consolidated financial statements of Lubel Coal Company Limited and its subsidiaries (collectively the "Group"), which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated statement of comprehensive loss, statement of changes in equity and cash flow statement 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, 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 about 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 judgment, 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 entity'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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the 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 consolidated financial position of the Group as at 31 December 2012, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.




26 June 2013

LUBEL COAL COMPANY LIMITED

CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US Dollars)

	Notes	Year ended 31 December 2012	Year ended 31 December 2011
Administrative expenses	5	(2,194,086)	(2,771,598)
Operating loss		(2,194,086)	(2,771,598)
Interest income		941,521	908,790
Other income		15,361	60,490
Foreign exchange (loss)/gain		(182,307)	77,762
Loss before income tax		(1,419,511)	(1,724,556)
Income tax expense	6	-	-
Loss for the year		(1,419,511)	(1,724,556)
Other comprehensive income/(loss)			
Foreign currency translation reserve		179,539	(377,856)
Total comprehensive loss for the year		(1,239,972)	(2,102,412)
Loss per share:			
Basic (cents per share)		(0.64)	(0.78)
Diluted (cents per share)		(0.63)	(0.77)

On behalf of the management:


Boris Pokrass, Chairman


Igor Frantskevych, Chief Financial Officer

The notes on pages 7 to 27 form an integral part of these consolidated financial statements.

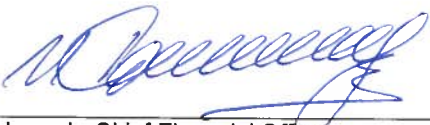
LUBEL COAL COMPANY LIMITED

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2012 (in US Dollars)

	Notes	31 December 2012	31 December 2011
ASSETS			
Non-current assets			
Exploration and evaluation assets	7	1,145,112	587,464
Mining rights and development assets	8	16,630,434	13,794,486
Property, plant and equipment		868,569	278,350
Prepayments to suppliers for exploration, evaluation and development expenditures		165,145	850,123
Total non-current assets		18,809,260	15,510,423
Current assets			
Other receivables	9	98,537	31,595
Cash and cash equivalents	10	18,105,350	22,514,645
Total current assets		18,203,887	22,546,240
Total assets		37,013,147	38,056,663
EQUITY AND LIABILITIES			
Equity			
Issued capital	12	61,580,561	61,580,561
Reserves	13	1,603,419	1,239,889
Accumulated losses		(26,232,649)	(24,813,138)
Total equity		36,951,331	38,007,312
Current liabilities			
Trade and other payables	11	61,816	49,351
Total current liabilities		61,816	49,351
Total liabilities		61,816	49,351
Total equity and liabilities		37,013,147	38,056,663

On behalf of the management:


Boris Pokrass, Chairman


Igor Frantskevych, Chief Financial Officer

The notes on pages 7 to 27 form an integral part of these consolidated financial statements.

LUBEL COAL COMPANY LIMITED

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

	Notes	Year ended 31 December 2012	Year ended 31 December 2011
CASH FLOWS FROM OPERATING ACTIVITIES:			
Loss before income tax		(1,419,511)	(1,724,556)
Adjustments for:			
Interest income		(941,521)	(908,790)
Depreciation of property, plant and equipment	5	-	61,197
Change in allowance for VAT irrecoverable	5	416,445	373,963
Change in allowance for irrecoverable prepayments	5	49,897	281,065
Unrealized foreign exchange loss/(gain)		183,155	(367,350)
Operating loss before changes in operating assets and liabilities		(1,711,535)	(2,284,471)
Increase in other receivables		(473,857)	(70,987)
Increase/(decrease) in trade and other payables		12,465	(731,892)
Net cash used in operating activities		(2,172,927)	(3,087,350)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Exploration and evaluation expenditures		(326,866)	(543,938)
Mining rights and development expenditures		(2,802,075)	(1,869,088)
Purchase of property, plant and equipment		(10,074)	(84,190)
Interest received		941,521	908,790
Net cash used in investing activities		(2,197,494)	(1,588,426)
Net decrease in cash and cash equivalents		(4,370,421)	(4,675,776)
Effect of exchange rate changes		(38,874)	49,425
CASH AND CASH EQUIVALENTS at the beginning of year	10	22,514,645	27,140,996
CASH AND CASH EQUIVALENTS at the end of year	10	18,105,350	22,514,645

On behalf of the management:


Boris Pokrass, Chairman


Igor Frantskevych, Chief Financial Officer

The notes on pages 7 to 27 form an integral part of these consolidated financial statements.

LUBEL COAL COMPANY LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

	Share capital	Share premium reserve	Accumulated losses	Equity settled employee benefit reserve	Foreign currency translation reserve	Total
As at 1 January 2011	4,527,142	57,053,419	(23,088,582)	2,659,837	(1,391,443)	39,760,373
Share based payment charge (Note 14)	-	-	-	349,351	-	349,351
Loss for the year	-	-	(1,724,556)	-	-	(1,724,556)
Other comprehensive loss	-	-	-	-	(377,856)	(377,856)
Total comprehensive loss for the year	-	-	(1,724,556)	-	(377,856)	(2,102,412)
As at 31 December 2011	4,527,142	57,053,419	(24,813,138)	3,009,188	(1,769,299)	38,007,312
Share based payment charge (Note 14)	-	-	-	183,991	-	183,991
Loss for the year	-	-	(1,419,511)	-	-	(1,419,511)
Other comprehensive income	-	-	-	-	179,539	179,539
Total comprehensive (loss)/income for the year	-	-	(1,419,511)	-	179,539	(1,239,972)
As at 31 December 2012	4,527,142	57,053,419	(26,232,649)	3,193,179	(1,589,760)	36,951,331

On behalf of the management:


Boris Pokrass, Chairman


Igor Frantskevych, Chief Financial Officer

The notes on pages 7 to 27 form an integral part of these consolidated financial statements.

LUBEL COAL COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

1. GENERAL INFORMATION

Lubel Coal Company Limited ("the Company") is a private company incorporated in the British Virgin Islands (Company number 1056038). These consolidated financial statements include the financial statements of the Company and its subsidiaries which together are referred to as the "Group". The registered address of the Company is Geneva Place, Waterford Drive, PO Box 3469, Road Town, Tortola, British Virgin Islands.

The principal activity of the Group is the development of a mine in Western Ukraine through its Ukrainian-based subsidiary CCI Lubelia. In 2006 the Group obtained a license for operation of minefield Lubelska # 1-2 of Lviv-Volyn coalfield for 20 years. A feasibility study to bankable standard is finalised and the outstanding permits were received in June 2009, following which development of certain infrastructure works commenced. The mine construction is dependent upon obtaining of appropriate financing.

In 2011 the Group acquired exploration licenses for minefield Lubelska # 3 and 4 and exploration and evaluation activities started from that date. In September 2011 the Group obtained a special permit for geological exploration for minefield Lubelska # 3. The Group also received positive conclusions of appointed state experts addressed to the state geological committee on reasonable to attach part of field 4 to field 3.

As at 31 December 2012 and 2011 the Company was owned by the following shareholders:

	<u>2012</u>	<u>2011</u>
Pokrass, Boris	27%	27%
The Severinovskyi 2008 Family Trust/(previously Severinovsky, Mark)	18%	18%
Palant, Vladimir	12%	12%
Malavasia Enterprises Inc (BVI)	14%	14%
Agrera Investments Limited	11%	11%
Zdanov, Alex	4%	4%
Other	14%	14%
	<u>100%</u>	<u>100%</u>

The Company is the parent company of the Group which includes the following subsidiaries in the consolidated financial statements:

Name	Country of incorporation	Percentage controlled as at 31 December 2012	Percentage controlled as at 31 December 2011	Principal activity	Consolidation method
CCI Lubelia	Ukraine	100%	100%	Coal mining	Full
Lubel Coal Company (UK) Limited	UK	-	100%	Service company	Full
Lakehold Limited	Cyprus	100%	100%	Dormant company	Full
Lubel Assets Limited	Cyprus	100%	100%	Dormant company	Full

In June 2011 there was decision taken by shareholders to liquidate Lubel Coal Company (UK) Limited. As at 31 December 2011 all operations were ceased and in June 2012 this entity was liquidated.

LUBEL COAL COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

2. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

In the current year ended 31 December 2012, the Group adopted the following new and revised Standards and Interpretations:

- Amendments to IFRS 1 "First-time Adoption of International Financial Reporting Standards" – Replacement of "fixed dates" for certain exceptions with "the date of transition to IFRS" and Additional exemption for entities ceasing to suffer from severe hyperinflation;
- Amendments to IFRS 7 "Financial Instruments: Disclosures" – Transfer of Financial Assets – The amendments increase the disclosure requirements for transactions involving the transfer of financial assets in order to provide greater transparency around risk exposures when financial assets are transferred;
- Amendments to IAS 12 "Income Taxes" – Deferred Tax: Recovery of Underlying Assets – Under the amendments, investment properties that are measured using the fair value model are presumed to be recovered entirely through sale for the purposes of measuring deferred taxes unless the presumption is rebutted;
- Amendments to IAS 1 "Presentation of Financial Statements" – Amendment revises the way other comprehensive income is presented.

The adoption of the new or revised standards did not have any effect on the consolidated financial position or performance reported in the consolidated financial statements and did not result in any changes to the Group's accounting policies and the amounts reported for the current or prior years.

New and revised IFRS in issue but not yet effective – At the date of authorization of these consolidated financial statements, the following Standards and Interpretations, as well as amendments to the Standards were in issue but not yet effective:

Standards and Interpretations	Effective for annual period beginning on or after
Amendments to IAS 19 "Employee Benefits" (as revised in 2011)	1 January 2013
IAS 27 "Separate Financial Statements" (as revised in 2011)	1 January 2013
IAS 28 "Investments in Associates and Joint Ventures" (as revised in 2011)	1 January 2013
IFRS 10 "Consolidated Financial Statements"	1 January 2013
IFRS 11 "Joint Arrangements"	1 January 2013
IFRS 12 "Disclosure of Interests in Other Entities"	1 January 2013
IFRS 13 "Fair Value Measurement"	1 January 2013
IFRIC 20 "Stripping costs in the Production of a Surface Mine"	1 January 2013
Amendments to IFRS 7 "Financial instruments: Disclosures" – Offsetting of financial assets and financial liabilities	1 January 2013
Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements" and IFRS 12 "Disclosure of Interests in Other Entities: Transition Guidance"	1 January 2013
Amendments to IFRS 1 "First-time Adoption of International Financial Reporting Standards" – Accounting for government loan below-market rate when transitioning to IFRS	1 January 2013
Amendments to IFRSs "Annual Improvements to IFRSs 2009-2011"	1 January 2013
Amendments to IAS 32 "Financial instruments: Presentation" – Application guidance on the offsetting of financial assets and financial liabilities	1 January 2014
Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)	1 January 2014
Amendments to IFRS 7 "Financial instruments: Disclosures" – Disclosures about the initial application of IFRS 9	1 January 2015
IFRS 9 "Financial Instruments: Classification and Measurement and Accounting for financial liabilities and derecognition"	1 January 2015

LUBEL COAL COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

Management is currently evaluating the impact of the adoption of IFRS 9 "Financial Instruments", IFRS 13 "Fair Value Measurement", amendment to IFRS 7 "Financial instruments: Disclosures", Amendments to IAS 1 "Presentation of Financial Statements", amendments to IAS 12 "Income Taxes", amendments to IAS 19 "Employee benefits" and IFRIC 20 "Stripping costs in the Production of a Surface Mine". For other Standards and Interpretations management anticipates that their adoption in future periods will not have material effect on the financial statements of the Company.

3. SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

(b) Basis of preparation

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

(c) Going concern

In order to complete the mine development and ensure sufficient working capital until coal sales commences, management has estimated that the Group needs to raise additional funds of approximately USD 1 billion. With the support of its financial advisor, the Company is currently negotiating with potential strategic investors about their acquiring an ownership interest in the Group.

Should these negotiations be unsuccessful, management will seek a private placement of the Company's shares among potential portfolio investors to raise approximately USD 120 million. Together with the Group's existing cash reserves, these funds should be sufficient to commence the mine construction and lower the main working shaft to the lower mining level. The sourcing of funding for further mine development would then be considered by the Company's shareholders.

At 31 December 2012, the Group had available cash balances of USD 18,105,350. Management considers that these funds are sufficient to allow the Group to continue operations for the foreseeable future, being a period of 12 months from 31 December 2012.

(d) Basis of consolidation

The consolidated financial statements incorporate the financial statements of Lubel Coal Company Limited (the "Company") and entities controlled by the Company (its subsidiaries). 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.

Income and expenses of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive loss from the effective date of acquisition and up to the effective date of disposal, as appropriate. Total comprehensive loss of subsidiaries is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

LUBEL COAL COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated in full on consolidation.

(e) Employee leave benefits

Liabilities for wages and salaries, including non-monetary benefits and accrued but unused annual leave are recognized in respect of employees' services up to the reporting date. They are measured at the amounts expected to be paid when the liabilities are settled.

(f) Financial instruments

Financial assets and financial liabilities are recognized in the Group's consolidated statement of financial position when the Group becomes a party to the contractual provisions of the instrument. Management of the Group considers that the carrying amounts of financial assets and financial liabilities recorded in the consolidated financial statements approximate their fair values.

Trade and other receivables – Trade and other receivables are measured at initial recognition at fair value, and are subsequently carried at cost. Appropriate allowances for estimated irrecoverable amounts are recognized in the statement of comprehensive loss when there is objective evidence that the asset is impaired.

Cash and cash equivalents – Cash and cash equivalents comprise cash at banks and in hand and short-term deposits with an original maturity of three months or less.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

The Group derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when 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 recognizes 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 recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

Financial liabilities and equity instruments – Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

Trade payables – Trade payables are initially measured at fair value, and are subsequently measured at amortized cost, using the effective interest rate method.

The Group derecognizes trade payables when, and only when, the Group's obligations are discharged, cancelled or they expire.

LUBEL COAL COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

(g) Foreign currencies

The individual financial statements of each Group entity are prepared in the currency of the primary economic environment in which the entity operates (its functional currency). The functional currency of the Company is the United States Dollar ("USD"). The functional currency for the Ukrainian subsidiary is Ukrainian Hryvnia ("UAH"), for Cypriot subsidiary is USD, and for the English subsidiary (which was liquidated during 2012) is GB Pound ("GBP"). The Group presents its consolidated financial statements in USD. .

The translation of the financial statements of the Group entities from their functional currencies to the presentation currency is done as follows:

- All assets and liabilities, both monetary and non-monetary, are translated at closing exchange rates existing at each reporting date;
- All income and expenses are translated at the average exchange rates for the years presented, except for significant transactions that are translated at rates on the dates of such transactions;
- Resulting exchange differences are recognized directly in other comprehensive income as foreign currency reserve and accumulated in equity; and
- In the statement of cash flows, cash balances at the 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 dates of such transactions.

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing at the dates of the transactions. At each reporting date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at the reporting date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences are recognized in profit or loss in the consolidated statement of comprehensive loss in the period in which they arise.

The relevant exchange rates are as follows:

	<u>As at 31 December 2012</u>	<u>Average for the year ended 31 December 2012</u>	<u>As at 31 December 2011</u>	<u>Average for the year ended 31 December 2011</u>
UAH/USD	0.124	0.122	0.123	0.124
EUR/USD	1.320	1.285	1.295	1.393
GBP/USD	1.614	1.584	1.545	1.604

(h) Exploration and evaluation assets

The costs related to exploration properties, which include the cost of acquiring properties and exploration rights and costs incurred in exploration and evaluation activities, are capitalized as part of exploration and evaluation assets.

LUBEL COAL COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

Exploration and evaluation assets are carried forward during the exploration and evaluation stage and are assessed for impairment in accordance with the indicators of impairment as set out in IFRS 6 "Exploration for and Evaluation of Mineral Resources". In circumstances where a property is abandoned, the cumulative capitalized costs relating to the property are written off in the period. No amortization is charged prior to the commencement of production.

In circumstances where a property is identified as containing economically recoverable resources then the accumulated exploration and evaluation costs associated with that property are transferred to Mining Rights and Development Assets.

Expenditures related to the following activities are initially measured at cost and capitalized as Exploration and Evaluation assets:

- Acquisition of rights to explore;
- Topographical, geological, geochemical and geophysical studies;
- Exploratory drilling;
- Trenching, sampling; and
- Activities in relation to evaluating technical feasibility and commercial viability of extracting a mineral resource.

(i) Mining Rights and Development Assets

Once a development decision has been taken, all costs related to development of the relevant area of interest are capitalized. Such costs include those directly attributable to the construction of a mine and the related infrastructure including an appropriate allocation of attributable overheads.

Mining Rights and Development Assets are held at cost and reclassified as Mining Assets at the end of the commissioning phase of the mine. Mining Assets are amortized on a unit of production basis from the end of the commissioning phase.

Mining Rights and Development Assets are reclassified as Mining Assets at the end of the commissioning phase, when the mine is capable of operating in the manner intended by management. No depreciation is recognized in respect of Development Expenditure costs until they are reclassified as Mining Rights.

(j) Property, plant and equipment

Prior to 1 January 2001, the Ukrainian economy was considered to be hyperinflationary in accordance with IAS 29 "Financial Reporting in Hyperinflationary Economies". Accordingly, the consolidated financial statements were adjusted to reflect the effects of the diminution of the purchasing power of Ukrainian Hryvnia. Property, plant and equipment, acquired by CCI Lubelia before 1 January 2001 are carried at historical cost adjusted for the effect of hyperinflation under IAS 29 less accumulated depreciation and recognised impairment loss, if any. All other property, plant and equipment are carried at historical cost less accumulated depreciation and recognised impairment loss, if any.

Cost includes professional fees and, for qualifying assets, borrowing costs capitalised in accordance with the Group's accounting policy.

LUBEL COAL COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

Depreciation on assets under construction and those not placed in service commences from the date the assets are ready for their intended use.

Depreciation of property, plant and equipment is designed to write off assets over their useful economic lives. The Group estimates the useful economic lives of property, plant and equipment as follows for the years ended 31 December 2012 and 2011:

	<u>Years</u>
Vehicles	8
Office equipment, furniture and fixtures	3-5
Other	5-25
	Lower of useful life of improvement or length of lease
Leasehold improvements	

The cost of maintenance, repairs and replacement of minor items of property, plant and equipment are charged to the consolidated statement of comprehensive loss as incurred.

An item of property, plant and equipment is derecognised upon disposal or when no further economic benefits are expected from its use or disposal. Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the consolidated financial statements. Any resulting gains or losses are included in the consolidated statement of comprehensive loss.

(k) Impairment of non-current assets

At each reporting date, the Group reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

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 (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized as an expense immediately.

The Group considers the whole of Ukraine to be one cash-generating unit and therefore aggregates all Ukraine assets for the purpose of determining whether impairment has occurred.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognized as income immediately.

LUBEL COAL COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

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. One or more of the following facts and circumstances may indicate that exploration and evaluation assets should be assessed for impairment:

- The period for which the Group has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed;
- Substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned;
- Exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area;
- Sufficient data exist 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.

(l) Interest income and interest expense recognition

Interest income and expense are recorded in the consolidated statement of comprehensive loss for all interest bearing instruments on an accrual basis using the effective interest method, except for interest expenses directly attributable to the acquisition, construction or production of qualifying assets which are accounted for in accordance with borrowing costs policy.

(m) Issued capital

Issued capital is comprised of share capital and share premium reserve. Issued capital is recognised at the fair value of the contributions received by the Group.

(n) Operating leases

Leases of assets under which the risks and rewards of ownership are effectively retained with the lessor are classified as operating leases.

Rentals payable under operating leases are charged to statement of comprehensive loss on a straight-line basis over the term of the relevant lease.

(o) Other income and other expenses recognition

Other income is credited to the consolidated statement of comprehensive loss when the related transactions are completed. Operating and other expenses are generally recorded on an accrual basis when the product has been received or the service has been provided.

(p) Prepayments to suppliers

Prepayments to suppliers represent amounts paid to suppliers and contractors for goods/services which have not been yet delivered/rendered. Prepayments to suppliers are stated at nominal value less an allowance for estimated irrecoverable amounts.

Prepayments to suppliers made to acquire long-lived assets are presented as long-term assets.

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(q) Provisions

Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made. The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, 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.

(r) Retirement benefit costs

In Ukraine, the Group does not operate a pension scheme for the benefit of its employees but instead makes contributions to their personal pension policies. The contributions due for the period are charged to the consolidated statement of comprehensive loss.

(s) Share-based payment transactions

The Group issues equity-settled share-based payments to certain directors. Equity settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date for each tranche of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. At the end of each reporting period, the Group revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the equity-settled employee benefits reserve.

Failure by an employee to meet a service condition (whether due to voluntary departure or involuntary redundancy) is accounted as forfeiture. Previously recognized expenses in respect of forfeited share-based payments are reversed through profit or loss.

The fair value of equity share-based payments is measured by use of the Monte Carlo Simulation Model and the Binomial Model. The expected life of equity share-based payments used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

(t) Taxation

Deferred tax is the tax expected to be payable or recoverable 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 is accounted for using the balance sheet liability method. Deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are generally recognized for all deductible temporary differences and carried forward unused tax losses to the extent that it is probable that taxable profits will be available against which those deductible temporary differences and tax losses can be utilized.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date. Deferred tax is charged or credited in the consolidated statement of comprehensive loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

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Deferred tax assets are not recognized in respect of temporary differences and unutilized tax losses where there is insufficient evidence that the asset will be recovered. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

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.

Ukraine also has various other taxes, which are assessed on the subsidiary's activities. These taxes are included as a component of operating expenses in the consolidated statement of comprehensive loss.

4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Group's accounting policies, which are described in Note 3, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

The following are the critical judgments and estimations 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 recognized in the consolidated financial statements.

(a) Recoverability of Value Added Tax ("VAT")

Significant input VAT was incurred by CCI Lubelia during exploration, evaluation and development of the coal mine reserves. According to the Ukrainian legislation, input VAT can be refunded or netted off against output VAT. The estimation of the allowance for the amount of input VAT which will not be recovered through refund or setting off against future output VAT on sales, involves an exercise of judgment. Management believes that due to uncertainties inherent in the Ukrainian tax legislation, the timing of commercial mining commencement, and future prices on coal, the amount receivable related to input VAT should be provided in full.

(b) Deferred tax for unused tax losses

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

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(c) Allowance for irrecoverable amounts for prepayments to suppliers for exploration, evaluation and development expenditures

Prepayments to suppliers for exploration, evaluation and development expenditures are stated at their net realizable value after deducting the Group's best estimate of probable credit losses related to these assets.

In estimating the level of probable credit losses, management considers a number of factors, including current overall economic conditions, industry-specific economic conditions and historical and anticipated customer performance. Uncertainties regarding changes in the financial condition of suppliers, either adverse or positive, could impact the amount and timing of any additional allowances for irrecoverable amounts that may be required. This may have a negative impact on the financial results if additional losses occur that were not anticipated in prior periods.

(d) Compliance with Tax and Currency Legislation

Ukraine's tax and currency legislation is subject to frequent changes and varying interpretations. Management's interpretation of such legislation in applying it to business transactions of the Group may be challenged by the relevant regional and federal authorities enabled by law to impose fines and penalties. It is possible that the tax treatment of transactions that have not been challenged in the past may be challenged. Fiscal periods remain open to review by the tax authorities in respect of taxes for the three calendar years preceding the year of tax review. Under certain circumstances reviews may cover longer periods. While the Group believes it has provided adequately for all tax liabilities based on its understanding of the tax legislation, the above facts may create additional financial risks for the Group.

(e) Share-based payments

The Group has an equity-settled share option scheme available to one of the directors. In accordance with IFRS 2 *Share-based payment*, in determining the fair value of options granted, the Group has applied the Monte Carlo Simulation Model and Binomial Model. As a result, the Group makes assumptions for expected volatility, expected life, risk free rate and expected dividend yield (Note 14).

During the year ended 31 December 2012, the Board approved a revision of the vesting period for the Company's issued share options from 31 December 2013 to 30 September 2015. The revised estimate was based on the current condition of capital markets and the progress in negotiations with strategic investors. As a result of the change in the vesting period, the amortization charge for the year ended 31 December 2012 decreased by USD 160,992.

5. ADMINISTRATIVE EXPENSES

Administrative expenses for the years ended 31 December 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Employment costs	1,101,854	1,115,585
Professional and consulting costs	442,354	451,021
Change in allowance for VAT recoverable	416,445	373,963
Rent expenses and other office costs	149,143	340,118
Change in allowance for irrecoverable prepayments	49,897	281,065
Depreciation of property, plant and equipment	-	61,197
Business trip expenses	9,021	47,373
Other expenses	25,372	101,276
Total	<u>2,194,086</u>	<u>2,771,598</u>

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6. TAXATION

The Group provides for taxes based on the statutory tax accounts maintained and prepared in accordance with the respective countries tax legislation.

The current tax expense calculations of the companies within the Group are based on taxable profits for the year and are computed in accordance with the legislation of the respective countries of incorporation.

During the years ended 31 December 2012 and 2011, the holding company which is incorporated in the British Virgin Islands was tax exempt, the subsidiaries incorporated in the Republic of Cyprus and Ukraine are subject to 10% and 21% tax rates respectively. Additionally, the new Tax Code of Ukraine, which was enacted in December 2010, introduced gradual decreases in income tax rates over future years (from 23% effective from 1 April 2011 to 16% effective from 1 January 2014), as well as certain changes to the rules of income tax assessment starting from 1 April 2011.

The deferred tax assets and liabilities as at 31 December 2012 and 2011 were measured based upon the tax rates expected to be applied to the period when the temporary differences are expected to be realized.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Temporary differences as at 31 December 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Deductible temporary differences:		
Mining rights and development assets	2,114,730	1,942,856
Trade and other payables	2,267	77,568
Total	<u>2,116,997</u>	<u>2,020,424</u>
Taxable temporary differences:		
Property, plant and equipment	(102,018)	(78,534)
Exploration and evaluation assets	(31,975)	-
Total	<u>(133,993)</u>	<u>(78,534)</u>
Net deductible temporary differences	<u>1,983,004</u>	<u>1,941,890</u>
Deferred tax assets at the statutory rate of 21% (2011: 23%)	416,431	446,635
Less valuation allowance	(416,431)	(446,635)
Net deferred tax assets	<u><u>-</u></u>	<u><u>-</u></u>

A valuation allowance was provided for deferred tax assets as at 31 December 2012 and 2011 due to the uncertainty that sufficient taxable profits will be available in the future to allow the assets to be recovered.

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As at 31 December 2012 and 2011, the Ukrainian subsidiary had tax losses carried forward of USD 4,614,345 and USD 4,374,221, respectively. A deferred tax asset for tax losses carried forward was not recognised due to the uncertainty that sufficient taxable profits will be available to allow the assets to be recovered. According to current Ukrainian legislation, tax losses can be carried forward for an indefinite period of time.

Reconciliation between loss before income tax multiplied by the statutory tax rate and the tax benefit for the years ended 31 December 2012 and 2011 was as follows:

	<u>2012</u>	<u>2011</u>
Loss before income tax	(1,419,511)	(1,724,556)
Theoretical income tax benefit at tax rate applicable to profits in the country of the Parent domicile (zero tax rate)	-	-
Tax effect of:		
Effect of different tax rates of subsidiaries operating in other jurisdictions	(393,853)	(203,900)
Effect of expenses that are not deductible in determining tax loss	297,464	137,640
Effect of unused tax losses not recognized as deferred tax assets	66,185	13,494
Change in deferred tax assets valuation allowance	30,204	52,766
Income tax expense	-	-

7. EXPLORATION AND EVALUATION ASSETS

During 2012 and 2011, additions to exploration and evaluation assets relate to minefields Lubelska # 3 and 4. The following table presents the movement in exploration and evaluation assets for the years ended 31 December 2012 and 2011:

	<u>2012</u>	<u>2011</u>
At cost		
At the beginning of the year	587,464	43,526
Additions	547,513	549,743
Differences arising on foreign exchange translation	10,135	(5,805)
At the end of the year	1,145,112	587,464

8. MINING RIGHTS AND DEVELOPMENT ASSETS

The following table presents the movement in mining rights and development assets for the years ended 31 December 2012 and 2011:

	<u>2012</u>	<u>2011</u>
At cost		
At the beginning of the year	13,794,486	10,509,205
Additions	3,450,397	3,330,852
Transfer to property, plant and equipment	(616,059)	-
Differences arising on foreign exchange translation	1,610	(45,571)
At the end of the year	16,630,434	13,794,486

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9. OTHER RECEIVABLES

Other receivables as at 31 December 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Value added tax ("VAT")	2,124,387	1,717,472
Other receivables	<u>98,537</u>	<u>31,595</u>
	<u>2,222,924</u>	<u>1,749,067</u>
Less: Allowance for irrecoverable VAT	<u>(2,124,387)</u>	<u>(1,717,472)</u>
Total	<u>98,537</u>	<u>31,595</u>

The Group has accumulated significant input VAT during exploration and evaluation and mine development activities. According to Ukrainian legislation, VAT receivables can be refunded from or netted off against output VAT from future sales. As at 31 December 2012 and 2011, from VAT receivable balances USD 570,437 and USD 570,105, respectively, were claimed for refund and the balance would be recoverable against future VAT liabilities (Note 15). The Group did not receive VAT refunds in prior years and as at 31 December 2012 and 2011 the amount of VAT claimed for refund was under legal proceedings with tax authorities. Management believes that due to uncertainties inherent in the Ukrainian tax legislation, the Group's ability to receive VAT refund, the timing of commercial mining commencement and future prices on coal, an allowance should be provided against the full amount of input VAT receivable.

10. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as at 31 December 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Short-term deposits with banks	15,222,490	20,390,000
Cash with banks	<u>2,882,860</u>	<u>2,124,645</u>
Total	<u>18,105,350</u>	<u>22,514,645</u>

As at 31 December 2012 and 2011, short-term deposits with banks consisted of deposits with original maturity of less than three months. For the year ended 31 December 2012, deposits with banks bore an annual average interest rate of 5.64% (2011: 4.60%).

As at 31 December 2012 from cash and cash equivalents USD 15,000,000 were placed as call deposits with five banks in Ukraine: PJSC "UKRSOTSBANK", PJSC "VTB", CJSC "BANK FORUM", JSC "SBERBANK OF RUSSIA" and OJSC "OTP".

As at 31 December 2011 from cash and cash equivalents USD 20,000,000 were placed as call deposit with PJSC "UKRSOTSBANK" in Ukraine.

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11. TRADE AND OTHER PAYABLES

As at 31 December 2012 and 2011, trade and other payables of the Group were as follows:

	<u>2012</u>	<u>2011</u>
Trade and other creditors	52,911	49,339
Other taxes and social security	<u>8,905</u>	<u>12</u>
Total	<u>61,816</u>	<u>49,351</u>

The average credit period on purchases of goods and services is 30 days. No interest is charged on the outstanding balance of trade payables.

12. ISSUED CAPITAL

	<u>Share Capital</u>		<u>Share Premium Reserve</u>		<u>Total</u>	<u>Total</u>
	<u>2012</u> No.	<u>2011</u> No.	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Authorized: 300,000,000 ordinary shares 1p each	300,000,000	300,000,000	-	-	-	-
Issued and fully paid: 221,810,000 ordinary shares 1p each	221,810,000	221,810,000	-	-	-	-
At the beginning of the year	<u>4,527,142</u>	<u>4,527,142</u>	<u>57,053,419</u>	<u>57,053,419</u>	<u>61,580,561</u>	<u>61,580,561</u>
At the end of the year	<u>4,527,142</u>	<u>4,527,142</u>	<u>57,053,419</u>	<u>57,053,419</u>	<u>61,580,561</u>	<u>61,580,561</u>

Basic and diluted loss per share

The loss and weighted average number of ordinary shares used in the calculation of basic loss per share are as follows:

	<u>2012</u>	<u>2011</u>
Loss for the year	<u>(1,419,511)</u>	<u>(1,724,556)</u>
Loss used in the calculation of basic loss per share	<u>(1,419,511)</u>	<u>(1,724,556)</u>
Weighted average number of ordinary shares for the purposes of basic loss per share	<u>221,810,000</u>	<u>221,810,000</u>
Basic loss per share, cents per share	<u>(0.64)</u>	<u>(0.78)</u>

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The loss used in the calculation of diluted loss per share is as follows:

	<u>2012</u>	<u>2011</u>
Loss used in the calculation of basic loss per share	(1,419,511)	(1,724,556)
Loss used in the calculation of diluted loss per share	<u>(1,419,511)</u>	<u>(1,724,556)</u>

The weighted average number of ordinary shares for the purpose of diluted loss per share reconciles to the weighted average number of ordinary shares used in the calculation of basic loss per share as follows:

Weighted average number of ordinary shares used in the calculation of basic loss per share	221,810,000	221,810,000
Shares deemed to be issued for no consideration in respect of employee options (Note 14)	<u>2,218,100</u>	<u>2,218,100</u>
Weighted average number of ordinary shares used in the calculation of diluted loss per share	<u>224,028,100</u>	<u>224,028,100</u>
Diluted loss per share, cents per share	<u>(0.63)</u>	<u>(0.77)</u>

13. RESERVES

As at 31 December 2012 and 2011 the Group's reserves were as follows:

	<u>2012</u>	<u>2011</u>
Equity-settled employee benefit reserve	3,193,179	3,009,188
Foreign currency translation reserve	<u>(1,589,760)</u>	<u>(1,769,299)</u>
	<u>1,603,419</u>	<u>1,239,889</u>
Equity-settled employee benefit reserve		
At the beginning of the year	3,009,188	2,659,837
Share based payment charge (Note 14)	<u>183,991</u>	<u>349,351</u>
At the end of the year	<u>3,193,179</u>	<u>3,009,188</u>
	<u>2012</u>	<u>2011</u>
Foreign currency translation reserve		
At the beginning of the year	(1,769,299)	(1,391,443)
Foreign currency exchange for the year	<u>179,539</u>	<u>(377,856)</u>
At the end of the year	<u>(1,589,760)</u>	<u>(1,769,299)</u>

The translation reserve arises from monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur and which form part of the net investment in a foreign operation and from retranslation of individual entities' accounts for presentational purposes.

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14. SHARE BASED PAYMENT TRANSACTIONS

Equity settled share based payments – In 2008, the Group issued 2,218,100 share options to one of the directors under terms of its Employee Share Option Scheme (the “Scheme”). These options were to vest on completion of an Initial Public Offering (“IPO”) or at sale of the Company. The fair value of these options was estimated at the grant date using a Monte Carlo Simulation Model combined with a Binomial Model, taking into account the terms and conditions upon which the instruments were granted. The Monte Carlo Simulation Model generates an estimate of the offer share price which is then input into a Binomial Model. The contractual life of these options was 10 years and there were no cash settlement alternatives. The fair value of these options was estimated at the grant date to be GBP 1.05 per option. The exercise price of these options was nil.

The following table illustrates the number and movements in share options:

	<u>2012</u> Number of share options	<u>2011</u> Number of share options
Outstanding at the beginning of year	2,218,100	2,218,100
Outstanding at the end of the year	2,218,100	2,218,100
Weighted average contractual life	5.58 years	6.68 years

The valuation assumptions utilized in the Binomial Model are as follows:

Weighted average share price	GBP 1.05
Weighted average exercise price	GBP nil
Expected volatility	42%
Expected life	5.25 years
Risk-free rate	4.95%

As the Company is unlisted, expected volatility was determined by considering the historical volatility of similar listed entities over the most recent period that is commensurate with the expected term of the option and as at the time of grant.

During the year ended 31 December 2012, the Group revised the vesting period for its share options from 31 December 2013 to 30 September 2015. The revised estimate was based on the current condition of capital markets and the progress in negotiations with strategic investors. As a result of the change in the vesting period, the amortization charge for the year ended 31 December 2012 decreased by USD 160,992.

For the year ended 31 December 2012, the Group recognised a total charge of GBP 116,450 (equivalent to USD 183,991) (2011: GBP 218,344 (equivalent to USD 349,351) in respect of equity settled share based payment transactions which was capitalized in “Mining rights and development assets”.

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15. CONTINGENCIES AND CONTRACTUAL COMMITMENTS

Operating environment – Emerging markets such as Ukraine are subject to different risks than more developed markets, including economic, political, social, legal and legislative risks. Laws and regulations affecting businesses in Ukraine continue to change rapidly; tax and regulatory frameworks are subject to varying interpretations. The future economic direction of Ukraine is heavily influenced by the fiscal and monetary policies adopted by the government, together with developments in the legal, regulatory and political environment.

Taxation – Ukrainian tax authorities are increasingly directing their attention to the business community as a result of the overall Ukrainian economic environment. In this respect, the local and national tax environment in Ukraine is constantly changing and subject to inconsistent application, interpretation and enforcement. Non-compliance with Ukrainian laws and regulations can lead to the imposition of severe penalties and interest. Future tax examinations could raise issues or assessments, which are contrary to the Ukrainian subsidiary's tax filings. Such assessments could include taxes, penalties and interest, and these amounts could be material. While the Group management believes it has complied with local tax legislation, there are regular new tax and foreign currency laws and related regulations, which are not always clearly written.

The management believes that it has adequately provided for tax liabilities based on its interpretation of tax legislation and, therefore, no additional provisions are to be made in these consolidated financial statements, except for those already accrued in these consolidated financial statements.

Legal proceedings with tax authorities – As at 31 December 2012, the Group had a VAT receivable balance (before allowance for non-recoverability) of USD 2,124,387 (2011: USD 1,717,472), of which USD 570,437 (2011: USD 570,105) were claimed for refund and the balance would be recoverable against future VAT liabilities. The Ukrainian tax authorities have rejected the VAT refund claim based on the argument that the Group is not entitled for VAT refund as it was accumulated from non-business transactions. The Group disagreed with the tax authorities' decision and has commenced legal action for recovery of the total amount of USD 570,437 (2011: USD 570,105). The Group was able to win some of them in the courts of first and second instances, but final decision remains with Higher Administrative court of Ukraine. As a result of court wins insignificant amounts of VAT were refunded to the Group making a precedent.

Following a full-scope tax audit conducted by Ukrainian tax authorities in 2011 covering the period from 1 April 2009 to 30 June 2011, tax assessments were issued disallowing USD 4,440,199 of tax losses carried forward and USD 194,406 of deductible expenses and accruing USD 59,702 of additional income tax liabilities. The Group filed a lawsuit against these assessments and as at 31 December 2012 the case was under consideration of the second instance court. In January 2013 there was a decision on this case made by the second instance court in favour of the Group (Note 20). Regional tax administration has put forward cassations to Supreme administrative Court.

Operating lease commitments – Starting from October 2009 the Group leases land on which the Group plans to locate its mining facilities through operating lease agreements, which expire in various years through 2061. The Group does not have an option to purchase the leased land at the expiry of the lease periods, but it has preferential right to renew the lease.

During the years 2012 and 2011 the Group also leased administrative offices through operating lease agreements, which expire in various years through 2015. The Group does not have an option to purchase the leased offices at the expiry of the lease periods, but it has preferential right to renew the lease.

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As at 31 December 2012 and 2011 the Group had outstanding minimum commitments under non-cancellable operating leases, which fall due as follows:

	<u>2012</u>	<u>2011</u>
Within one year	129,329	105,086
In the second to fifth year inclusive	517,315	420,344
After five years	<u>2,341,712</u>	<u>1,398,932</u>
Total	<u>2,988,356</u>	<u>1,924,362</u>

Capital Commitments – As at 31 December 2012 the Group had outstanding contracts with third party engineering companies for project development works for the total amount of USD 397,089 (2011: USD 1,834,109).

16. RELATED PARTY TRANSACTIONS

Related parties include shareholders and members of key management personnel.

The Group entered into the following transactions with related parties:

During the year ended 31 December 2012 and 2011, the Group received professional and consulting services from its shareholders in the amount of USD 140,004 and 110,004, respectively.

During the year ended 31 December 2012 and 2011, a loan to a key management employee was provided and fully repaid in the amount of USD 158,600 and USD nil, respectively.

Remuneration of key management personnel – The remuneration of directors and other key management personnel of the Group is set out below, in aggregate, for each of the categories specified in IAS 24 "Related Party Disclosures":

	<u>2012</u>	<u>2011</u>
Employment costs	1,093,410	1,007,289
Share-based payments charge (Note 14)	<u>183,991</u>	<u>349,351</u>
Total	<u>1,277,401</u>	<u>1,356,640</u>

17. EMPLOYEE BENEFITS AND RETIREMENT BENEFITS

Employees of CCI Lubelia receive pension benefits from the Government in accordance with the laws and regulations of Ukraine. Contributions to State Pension Fund are recorded in profit or loss in the consolidated statement of comprehensive loss on the accrual basis. Total expenses on contributions to the State Pension Fund of Ukraine reflected in the consolidated statement of comprehensive loss for the years ended 31 December 2012 and 2011 amounted to USD 149,513 and USD 127,287, respectively.

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18. FINANCIAL RISK MANAGEMENT

Capital risk management – The Group manages its capital to ensure that entities of the Group will be able to continue as a going concern while maximising the return to the equity holder through the optimisation of the debt and equity balance. The management of the Group reviews the capital structure on a regular basis. Based on the results of this review, the Group takes steps to balance its overall capital structure through new share issues as well as taking of new loans and borrowings or redemption of existing loans and borrowings.

Major categories of financial instruments

	<u>2012</u>	<u>2011</u>
Financial assets		
Cash and cash equivalents	18,105,350	22,514,645
Other receivables	44,942	31,595
Total financial assets	<u>18,150,292</u>	<u>22,546,240</u>
Financial liabilities		
Trade and other payables	52,911	49,339
Total financial liabilities	<u>52,911</u>	<u>49,339</u>

The main risks arising from the Group's financial instruments are foreign currency risks since at 31 December 2012 and 2011 some of the cash balances and financial liabilities were denominated in GBP, EUR and USD.

Foreign currency risk – Currency risk is the risk that the financial results of the Group will be adversely impacted by changes in exchange rates to which the Group is exposed. The Group undertakes certain transactions denominated in foreign currencies. The Group does not use any derivatives to manage foreign currency risk exposure, at the same time the management of the Group is trying to mitigate such risk by managing monetary assets and liabilities in foreign currency at the same (more or less stable) level.

The carrying amounts of the Group companies' monetary assets and liabilities denominated in foreign currency as at 31 December 2012 and 2011 were as follows:

2012	<u>USD</u>	<u>GBP</u>	<u>EUR</u>
Financial assets			
Cash and cash equivalents	15,313,954	1,122	1,236
Total financial assets	<u>15,313,954</u>	<u>1,122</u>	<u>1,236</u>
Financial liabilities			
Trade and other payables	-	-	(19,294)
Total financial liabilities	<u>-</u>	<u>-</u>	<u>(19,294)</u>
Total net position	<u>15,313,954</u>	<u>1,122</u>	<u>(18,058)</u>

LUBEL COAL COMPANY LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (in US dollars)

2011	USD	GBP	EUR
Financial assets			
Cash and cash equivalents	20,441,447	199,309	17,532
Total financial assets	20,441,447	199,309	17,532
Total net position	20,441,447	199,309	17,532

The table below details the sensitivity to strengthening of functional currency of Group companies against foreign currencies by 10% as at 31 December 2012 and 2011. There would be an equal or negative impact on the profit and the balances below will have opposite showings. The analysis was applied to monetary items at the reporting date denominated in respective currencies.

	USD impact 2012/2011	GBP impact 2012/2011	EUR impact 2012/2011
Profit/(loss)	1,531,395/ 2,044,145	112/19,931	(1,806)/1,753

19. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial assets and liabilities is determined as follows:

- The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices; and
- The fair value of other financial assets and financial liabilities (excluding derivatives) are determined in accordance with generally accepted pricing model based on discounted cash flow analysis using prices from observable current market transactions.

Management believes that the carrying values of financial assets and financial liabilities recorded at amortised cost in the consolidated financial statements approximate their fair values.

20. EVENTS AFTER THE REPORTING PERIOD

In January 2013, the Group received a positive decision ruled by the court of second instance in regard to its appeal to cancel tax losses carried forward in the amount of USD 4,440,199, taxable expenses in the amount of USD 194,406, and the accrual of income tax liabilities in the amount of USD 59,702. Regional tax administration has submitted cassation appeals to the Supreme Administrative Court.

21. APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS

These consolidated financial statements were approved by Group management and authorised for issue on 26 June 2013.