

AUDIT COMMITTEE



Members:

1. Philip John Dayer (Chair) –Chair since May 2018;
2. Stephen James Whyte - Member since August 2017;
3. Luis Maria Viana Palha Da Silva - Member since June 2019.

CHAIRMAN'S INTRODUCTION

The Audit Committee continued to monitor the Company's system of internal control, risk management and the work of key functions as well as reviewing and challenging as appropriate the disclosures and key judgements made by management. The Audit Committee fully met the expectations and functional responsibilities set for the Audit Committee by the KMG Corporate Governance Code and Audit Committee Terms of reference, as well as decisions of the KMG Board of Directors.

We received reports from management and the external auditor each quarter highlighting significant accounting issues and judgements and have used these to inform our debate on whether KMG's financial reporting is fair, balanced and understandable.

I would like to thank each member of the Audit Committee for their contribution and believe that their expertise will be valuable to the work of the Audit Committee in driving KMG's performance and financial stability.

Philip John Dayer
Chairman of the Audit Committee, Independent Director

ROLE AND KEY RESPONSIBILITIES OF THE COMMITTEE

The Audit Committee assists the Board of Directors by:

- Monitoring the Company's internal control and risk management;
- Overseeing the internal and external audit arrangements; and
- Reviewing the Company's quarterly and annual financial statements.

MEETINGS AND ATTENDANCE

The Audit Committee holds regular meetings, including conference call meetings. There were nine committee meetings in 2019. During the year, the Audit Committee reviewed 110 issues, of which 39 were related to an internal audit, 12 related to external audit, 13 related to risks, and the remaining 46 were of other reviews.

Attendance by members at Audit Committee meetings in 2019

Committee members	Meeting No. and date									Attendance %
	1/19 28.01.2019	2/19 05.03.2019	3/19 01.04.2019	4/19 06.05.2019	5/19 02.07.2019	6/19 02.09.2019	7/19 27.09.2019	8/19 06.11.2019	9/19 19.12.2019	
P. J. Dayer	+	+	+	+	+	+	+	+	+	100
L. M. Palha ¹					+	+	+	+	+	100
S. J. Whyte	+	+	+	+	+	+	+	+	+	100

¹ Elected to the Board of Directors of KMG as a member /an independent director of KMG on April 29, 2019.

ACTIVITIES DURING THE YEAR

FINANCIAL DISCLOSURE

The Audit Committee reviewed the quarterly and annual consolidated financial statements with interim management reports, focusing on:

- Integrity of Group's financial reporting process;
- Clarity of disclosure;
- Application of accounting policies and judgements

As part of this review, the Audit Committee received updates from management and the external auditor in relation to accounting judgements, financial statements and taxation.

EXTERNAL AUDIT

The external auditor set out its audit strategy for 2019, identifying significant audit risks to be addressed during the course of the audit. These included:

- Impairment of non-current assets
- Compliance with debt covenants
- Estimation of oil and gas reserves and resources.

As part of the annual audit of the Company's consolidated financial statements, the Audit Committee requested EY to conduct additional procedures over the Group's process of payroll accrual and payment in some subsidiaries. At the date of this report, the results of those additional procedures have not yet been finalized.

The Audit Committee approved the level of materiality adopted by the external auditor for the 2019 audit and also reviewed uncorrected audit adjustments.

FINANCIAL REPORTING

The Audit Committee considered, among other things, a number of significant issues related to KMG's financial reporting including:

- Key judgements and estimates
- Audit Committee activity
- Conclusion / Outcomes

Key judgements and estimates

Oil and gas accounting (see notes 4, 13, 15 and 16 to the Consolidated Financial Statements)

KMG uses technical and commercial judgements to account for: exploration; appraisal and development expenditure; and, determining estimated oil and gas reserves.

Management's assumptions for future commodity prices impact the recoverability of asset carrying values.

Judgement is required to decide whether it is appropriate to continue to carry intangible assets relating to exploration and evaluation (E&E) assets.

Recoverability of assets' carrying values (see notes 4, 13 and 15 to the Consolidated Financial Statements)

Management judgement and estimates on uncertain matters such as product mix, loss ratios, discount rates, production profiles and the impact of inflation on operating expenses, are required to assess the carrying value of KMG's refinery cash generating units and other long-lived assets.

Provisions (see notes 4, 26 and 34 to the Consolidated Financial Statements)

KMG's significant provisions relate to: decommissioning; environmental matters; and, dispute resolution.

Decommissioning will occur many years in the future and there is significant uncertainty surrounding precise requirements.

KMG is a party to various legal actions. Management judgement and estimates are required on the merits of any case, the uncertainty surrounding the result of judicial proceedings and the timing of appeal processes.

In addition to the above key judgements and estimates, the Audit Committee reviewed the Group's compliance with its financing covenants given that compliance has a major impact on the going concern assumption used in the preparation of the financial statements.

AUDIT AND NON-AUDIT FEES

The Audit Committee reviews the fee structure, resourcing and terms of engagement for the external auditor annually. In addition, it reviews the non-audit services that the auditor provides to the Company on an annual basis.

Fees¹ payable to the external auditor for the year were USD 5.3 mln (2018: USD 5.8 mln), including USD 0.4 mln (2018: USD 0.95 mln) for non-audit services. Non-audit or non-audit related services consisted of other assurance services.

EXTERNAL AUDITOR

The external audit of KMG's consolidated financial statements for 2019 was conducted by an independent audit company, EY, with effect from 19 April 2019, in accordance with the decision of shareholders dated 4 March 2019.

¹ Excluding VAT.

Audit Committee activity	Conclusion / Outcomes
<p>Reviewed KMG's commodity price assumptions.</p> <p>Reviewed KMG's discount rates used for impairment.</p> <p>Reviewed the external expert's assessment of oil and gas volumes.</p> <p>Reviewed brown fields write offs.</p> <p>Reviewed E&E write offs.</p> <p>Satisfied itself with the impairment testing performed and the impairment charges recognized.</p>	<p>Oil and gas assets totaled KZT 1,049.8 bln at 31 December 2019.</p> <p>E&E assets totaled KZT 179.9 bln at 31 December 2019.</p> <p>KMG's long term oil price assumptions were unchanged from 2018.</p> <p>E&E impairment of KZT 57.2 bln recognized during 2019. This represents 100 per cent write-offs of E&E assets where the contract areas were returned to the Government.</p>
<p>Reviewed the management's assessment of impairment indicators.</p> <p>Satisfied itself with the impairment testing performed and the impairment charges recognised.</p>	<p>Refinery assets totaled KZT 1,381.7 bln at 31 December 2019.</p> <p>During 2019 an impairment charge attributable to property, plant and equipment of KZT 144.4 bln was recognised mainly attributable to cash generating units of KMG International, the Satti jackup rig and the Batumi Oil Terminal.</p>
<p>Reviewed KMG's decommissioning assumptions.</p> <p>Reviewed KMG's discount rates.</p> <p>Received a briefing on current significant disputes involving KMG.</p> <p>Satisfied itself with the level of provisions.</p>	<p>The decommissioning provision totaled KZT 154.4 bln at 31 December 2019.</p> <p>The discount rates used to calculate the decommissioning provision were changed from 2018. In monetary terms, the change was not significant.</p> <p>Following a decision to resolve a dispute involving KMG Drilling and Services by negotiation, a settlement provision of KZT 34.1 bln was made during 2019.</p>

Audit appointment and independence

The commission, consisting of the Audit Committee of KMG and Samruk-Kazyna JSC, considers the reappointment of the external auditor once in every three years before making a recommendation to the shareholders of KMG. The Audit Committee assesses the independence of the external auditor on an ongoing basis and the Audit Partner is required to rotate every five years. No partner or senior staff associated with the KMG audit may transfer to the Company.

Non-audit services by the external auditor

Provision of any non-audit advisory services by the external auditor is subject to prior approval by the Audit Committee. In addition, the external auditor annually submits a report showing the proportion of non-audit services in the total amount of services provided to KMG. In accordance with the policy of engaging audit organizations, the proportion of non-audit services must not exceed 50% of the total amount. The proportion of non-audit services for 2019 accounted for 8.09% of the total accrued amount for audit and non-audit services (see "Audit and non-audit fees").

Risk and internal control reviews

Improvement of the internal control system and risk management is one of the key tasks for KMG.

The Audit Committee held regular meetings with the Head of the risk management department to review significant risks and internal control issues.

The Audit Committee reviewed and evaluated: the quarterly risk report; the statement of risk appetite; the risk register and the risk management action plan; the risk map; risk tolerance level; key risk indicators; internal controls; and, insurance issues.

INTERNAL AUDITS

Internal audits are carried out by KMG's Internal Audit Service (the "IAS").

The activities of the IAS are governed by: Kazakhstan's laws; KMG's Charter; decisions of KMG's governing bodies; internal documents regulating the IAS activities; Regulations on KMG's Internal Audit Service; and, Guidelines for KMG's Internal Audits.

The annual Internal Audit Plan is developed from a consideration of the principal risks confronting KMG, the audit testing cycle and management requests. The Internal Audit Plan also accommodates ad hoc requests from the Audit Committee and Management.

The Audit Committee not only monitors the IAS's performance but also facilitates professional development of the IAS employees and the management of its talent pool. These issues are covered by the IAS reports and reviewed by the Audit Committee on a quarterly basis. The quarterly reports detail the progress made by the IAS against a number of objectives including obtaining certificates, completing trainings/seminars budgeted within the IAS training and upskilling programme.

The high professional level of the IAS employees is a key performance driver for KMG's internal audit function; therefore training and upskilling are prioritised.

Internal audit issues reviewed by the Audit Committee in 2019 included:

1. IAS 2018 annual performance report;
2. IAS 2019 annual audit plan;
3. 2018 KPI scorecards of the IAS head and staff shifted to a pay grade system;
4. KMG Internal Audit Service's quarterly reports, including reviews of any material findings identified in audit reports and follow-up on the implementation of internal audit recommendations;
5. Independence confirmation forms for the IAS employees;
6. IAS Strategic Plan for 2019–2021;
7. IAS 2019 budget;
8. 2019 KPIs for the IAS head and staff;
9. Appointments and terminations within the IAS;
10. Amendments to the IAS 2019 annual audit plan.

During the year, as part of the Audit Committee's oversight of the reports prepared by the company's IAS, the Audit Committee decided to engage the forensic accounting services of a major independent international audit firm to investigate internal control failings disclosed at one of the group's subsidiaries. That firm's investigations confirmed the existence of internal control failings and it produced a number of recommendations to remediate those deficiencies. The management of the company is currently reviewing those recommendations with the objective of devising an effective remediation plan.

ASSESSMENTS OF THE EXTERNAL AND INTERNAL AUDIT PROCESS PERFORMANCE

In 2019, surveys were run among members of the Audit Committee and units of KMG interacting with the external

auditor, to facilitate an assessment of the external auditor's performance. The assessment was based on the results of a completed questionnaire and a specific discussion between members of the Audit Committee with input from the relevant senior management. The assessment results were reviewed at an Audit Committee meeting and communicated to the external auditor.

As required by the quality assurance and improvement programme for KMG's Internal Audit Service, following each audit, the audited entity is required to complete a form evaluating the IAS' performance. Results of these assessments are consolidated into the IAS annual performance reports approved by the Audit Committee. It is pleasing to note that the IAS role and value is appreciated by Management.

COMPLIANCE

The Compliance Department engaged an independent international firm of auditors to assist with the work of carrying out a compliance risk assessment, gap analysis and remediation plan. Good progress was made during 2019 to implement and embed that plan. In 2020, the Audit Committee reviewed the following compliance policies: Code of conduct; Anti-bribery policy; Conflict of interest; Third party due diligence procedure; and Whistleblowing policy.

To support the work of the newly established compliance department, the Audit Committee appointed an independent international audit firm to carry out a specific due diligence exercise.

The Audit Committee monitors the whistle blowing procedures and other channels of communication. All whistle blowing notifications are investigated.

OTHER ISSUES

The Audit Committee reviewed the implementation of the Detailed Action Plan to Improve Corporate Governance at KMG.

As instructed by the Audit Committee, the IAS runs regular anonymous surveys on health and safety at each audited entity. The surveys provide valuable insights to KMG's management, including insights into employee expectations regarding health and safety.