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CHAPARRAL RESOURCES INC  
Form 10-K  
March 29, 2004

FORM 10-K

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the fiscal year ended December 31, 2003.

Commission file number: 0-7261

CHAPARRAL RESOURCES, INC.  
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(Exact Name of Registrant as Specified in Its Charter)

Delaware  
-----

84-0630863  
-----

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

2 Gannett Drive, Suite 418  
White Plains, New York 10604  
-----

(Address of Principal Executive Offices)

Registrant's telephone number, including area code: (866) 559-3822

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, Par Value \$.0001 Per Share  
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(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer.

YES  NO

As of June 30, 2003, the aggregate market value of registrant's voting common stock, par value \$.0001 per share, held by non-affiliates was \$15,426,505.

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As of March 15, 2004, registrant had 38,209,502 shares of its common stock, par value \$.0001 per share, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None

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## PART I

### ITEM 1. BUSINESS

#### Our Business

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Chaparral Resources, Inc. is an independent oil and gas exploration and production company. Our strategy is to acquire and develop oil and gas projects in emerging markets, specifically targeting fields with previously discovered reserves, which have never been commercially produced or could be materially enhanced by our management team and technical expertise.

Through intermediate holding companies, Central Asian Petroleum (Guernsey), Ltd., a Guernsey company ("CAP-G"), Korporatsiya Mangistau Terra International Limited ("MTI"), a Kazakhstan company, and Central Asian Petroleum, Inc., a Delaware company ("CAP-D"), we own a 60% interest in Closed Type JSC Karakudukmunay ("KKM"), a Kazakh joint stock company that holds a governmental license to develop the Karakuduk Oil Field. All references to "Chaparral," "we," "us," and "our" refer to Chaparral Resources, Inc., and Chaparral's greater than 50% owned subsidiaries, unless indicated otherwise.

Since 1995, the business of Chaparral has been the development of the Karakuduk Field, a 16,900-acre oil field in the Republic of Kazakhstan. The U.S. based oil and gas assets of Chaparral were divested during 1996 and 1997 to help fund the development of the Karakuduk Field. The Government of the former Soviet Union discovered the Karakuduk Field in 1972 and drilled 22 exploratory and development wells, none of which were produced commercially. KKM began to aggressively develop the Karakuduk Field in early 2000, re-establishing oil production from a majority of the existing wells and drilling a total of 23 new wells through to September 2001. On February 12, 2003, KKM commenced a new drilling campaign to further develop and commercially produce the oil reserves in the Karakuduk Field. By the end of 2003 the well stock had risen to 45 producing wells, 4 water injection wells and 3 water supply wells (one of which was under completion at year end). The drilling campaign is to be continued throughout 2004 when it is anticipated that a further 12 production wells, 4 water injection wells and 3 water supply wells will be drilled.

The other stockholder of KKM is KazMunayGaz JSC, the state owned national petroleum and transportation company of the Republic of Kazakhstan, which owns a 40% interest.

Currently, the Karakuduk Field is our only oil field. We are continuing to identify and evaluate other oil fields for possible acquisition and development. We have no other significant subsidiaries besides CAP-G, MTI, and CAP-D.

During 2002, Chaparral obtained a controlling interest in KKM. Consequently, Chaparral's financial statements have been consolidated with KKM on a retroactive basis to January 1, 2002. Chaparral previously accounted for its 50% investment in KKM using the equity method of accounting, which is reflected in Chaparral's financial statements for periods prior to 2002. The consolidated financial statements for Chaparral for the three years ending December 31, 2003 and separate financial statements for KKM for the two years ended December 31, 2001 are included as part of this Annual Report on Form 10-K.

#### Available Information

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Chaparral files Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and registration statements and other items with the Securities and Exchange Commission (SEC). Chaparral provides access free of charge to all of these SEC filings, as soon as reasonably practicable after filing, on its Internet site located at [www.chaparralresources.com](http://www.chaparralresources.com). Chaparral will also make available to any stockholder, for a nominal fee, copies of its Annual Report on Form 10-K as filed with the SEC. For copies of this, or any other filing, please contact: Chaparral Resources, Inc., 2 Gannett Drive, Suite 418, White Plains, New York 10604 or call (866) 559-3822.

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In addition, the public may read and copy any materials Chaparral files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site ([www.sec.gov](http://www.sec.gov)) that contains reports, proxy and information statements and other information regarding issuers, like Chaparral, that file electronically with the SEC.

### Crude Oil Sales

-----

We derive all of our revenue through the production and sale of crude oil from the Karakuduk Field. We remain in the early stages of development of the Karakuduk Field and only began generating revenue from the sale of crude oil during 2000. KKM recognized \$57.61 million in revenue in 2003 from the sale of approximately 2.69 million barrels of crude oil, net of royalty. In 2002, KKM recorded \$45.13 million in revenue based upon sales of approximately 2.47 million barrels of crude oil, net of royalty.

KKM sells the majority of its crude oil on the "far" abroad export market. Sales at world market prices were responsible for approximately 96% of KKM's oil sales revenue in 2003. Currently, KKM has a month to month crude oil sales agreement in place with Vitol Central Asia S.A. ("Vitol") for the sale of KKM's oil production quota for the export market. KKM is responsible for obtaining export quotas and all other permissions from Kazakhstan, Russia, or other relevant jurisdictions necessary to transport and deliver KKM's oil production to the off-taker. The off-taker is responsible for nominating and coordinating oil tankers, if necessary, and arranging for the resale/marketing of the crude oil purchased.

In 2003, KKM sold crude oil to the following major customers: Vitol Central Asia S.A., Naftex Oil and Shipping Corporation ("Naftex"), and Euro-Asian Oil Company Inc ("Euro-Asian"), accounting for 61%, 13% and 12% of total annual deliveries, respectively.

The majority of our sales prices at the export port locations are based upon quoted Urals crude oil prices from the Platt's Crude Oil Marketwire average for the three banking days following the bill of lading. The price is net of deductions that include freight charges published in both Platt's Dirty Tanker Wire and the Worldscale Tanker Nominal Freight Scale. As of January 1, 2003, additional deductions of approximately \$1 per barrel have been implemented due to increased regulatory pressure on owners/charter companies to improve safety requirements. Recently, we have also witnessed a rise in both deductions and demurrage costs, which is largely attributable to shipping delays at the entrance to the Black Sea. Under contract terms, payment is made by the offtaker within 30 days of receipt of the final bill of lading and KKM's invoice for the sale, unless otherwise agreed by both parties. There are six delivery points for export sales, including three preferred port facilities (Novorossiisk, Odessa,

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and Ventspills) and three onshore pipeline facilities (Budkovce, Feyeshlitke, and Adamovo). KKM must use its best efforts to deliver crude oil to one of the three preferred port locations. To date, the majority of KKM's export oil sales have been delivered to the Ukrainian port of Odessa. KKM has a contractual right to deliver undersized cargoes to the port facilities, subject to additional freight charges if a tanker is loaded below its tonnage capacity. Third-party sellers, however, may offset capacity shortages in the tanker.

Under the terms of the Agreement with the Government of the republic of Kazakhstan, we have a right to export, and receive export quota for, 100% of the production from the Karakuduk Field. However, oil producers within Kazakhstan are required to supply a portion of their crude oil production to the local market to meet domestic energy needs. The domestic market does not permit world market prices to be obtained, resulting in approximately \$10 to \$12 lower cash flow per barrel. Furthermore, the Government of Kazakhstan has not allocated sufficient export quota to allow us to sell all of our available crude oil production on the world market. We are taking steps to reduce our local market obligations and to obtain an export quota that will enable us to sell all of our crude oil production on the export market. On July 17, 2003, we took the first step towards the commencement of arbitration proceedings in Switzerland for the breach of the Agreement by the Government of Kazakhstan by initiating a required three-month period of consultation with the Government. Although the consultation period has expired, we continue to seek an amicable resolution with the Government on this matter rather than proceeding with arbitration. If the matter can not be resolved in a satisfactory manner, we have, however, reserved our right to commence formal arbitration proceedings pursuant to our contractual arrangements with the Government. See Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

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### Risks of Oil and Gas Activities

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The current market for oil is characterized by instability. This instability has caused fluctuations in world oil prices in recent years and there is no assurance of any price stability in the future. The production and sale of oil from the Karakuduk Field may not be commercially feasible under market conditions prevailing in the future. The price we receive for our oil may not be sufficient to generate revenues in excess of our costs of production or provide sufficient cash flow to meet our investment and working capital requirements.

We make no assurance that we will be able to sell oil that we produce nor the price at which such sales will be made. Our estimated future net revenue from oil sales is highly dependent on the price of oil, as well as the quantity of oil produced. The volatility of the energy market makes it difficult to estimate future prices of oil. Various factors beyond our control affect these prices. These factors include:

- o domestic and worldwide supplies of oil;
- o the ability of the members of the Organization of Petroleum Exporting Countries, or OPEC, to agree to and maintain oil price and production controls;
- o political instability or armed conflict in oil-producing regions;
- o the price of foreign imports;
- o the level of consumer demand;

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- o the price and availability of alternative fuels;
- o the availability of pipeline capacity and;
- o changes in existing federal regulation and price controls.

It is likely that oil prices will continue to fluctuate as they have in the past. Current oil prices are not representative of oil prices in either the near- or long-term. We do not expect oil prices to maintain current price levels and do not base our capital spending decisions on current market prices.

No assurances can be given that we will be able to successfully develop, produce, and market the oil reserves underlying the Karakuduk Field. The development of oil reserves inherently involves a high degree of risk, even though the reserves are proved. Our risks are increased because our activities are concentrated in areas where political or other unknown circumstances could adversely affect commercial development of the reserves. Costs necessary to acquire, explore, and develop oil reserves are substantial. No assurances can be given that we will recover the costs incurred to acquire and develop the Karakuduk Field. If we fail to generate sufficient cash flow from operations to meet our working capital requirements or other long-term debt obligations, we may lose our entire investment in the Karakuduk Field, which is currently pledged as collateral to JSC Kazkommertsbank ("Kazkommertsbank") under the terms of the loan with Kazkommertsbank (the "KKM Credit Facility").

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The development of oil reserves is a high risk endeavor and is frequently marked by unprofitable efforts, such as:

- o drilling unproductive wells;
- o drilling productive wells which do not produce commercial quantities and;
- o production of developed oil reserves which cannot be marketed or achieve an adequate market price.

There are many additional risks associated with drilling for and producing oil and gas. These risks include blowouts, cratering, fires, equipment failure and accidents. Any of these events could result in personal injury, loss of life and environmental and/or property damage. If such an event does occur, we may be held liable and we are not fully insured against all of these risks. In fact, many of these risks cannot be insured against. The occurrence of such events that are not fully covered by insurance may require us to pay damages, which would reduce our profits. As of February 24, 2004, we have not experienced any material losses due to these events.

### Risks of Foreign Operations

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Our ability to develop the Karakuduk Field is dependent on fundamental contracts with governmental agencies in Kazakhstan, including KKM's Agreement with the Ministry of Energy and Natural Resources for Exploration, Development, and Production of Oil in the Karakuduk Oil Field (the "Agreement") and KKM's petroleum license with the government allowing KKM to operate and develop the Karakuduk Field. Kazakhstan is a relatively new country and, as is inherent in such developing markets, there is some uncertainty as to the interpretation and application of Kazakh law and the stability of the region.

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The laws of the Republic of Kazakhstan govern our operations and a number of our significant agreements. As a result, we may be subject to arbitration in Kazakhstan or to the jurisdiction of the Kazakh courts. Even if we seek relief in foreign territories such as the courts of the United States or Switzerland, we may not be successful in subjecting foreign persons to the jurisdiction of those courts.

The export of oil from Kazakhstan depends on access to transportation routes, particularly the Russian pipeline system. Transportation routes are limited in number, and access to them is regulated and restricted. If any of our agreements relating to oil transportation or marketing are breached, or if we are unable to renew such agreements upon their expiration, we may be unable to transport or market our oil. Also, a breakdown of the Kazakhstan or Russian pipeline systems could delay or even halt our ability to sell oil. Any such event would result in reduced revenues.

Obtaining the necessary quotas and permissions to export production through the Russian pipeline system can be extremely difficult, if not impossible in some circumstances. Our agreements with the government of the Republic of Kazakhstan grant us the right to export, and to receive export quota. We cannot, however, provide any assurances that we will receive export quota or any other approvals required to export and deliver our production in the future.

### Environmental Regulations

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We must comply with laws of the Republic of Kazakhstan and international requirements that regulate the discharge of materials into the environment. Furthermore, KKM's Credit Facility requires that we comply with the World Bank's environment, health, and safety guidelines for onshore oil and gas development. Environmental protection and pollution control could, in the future, become so restrictive as to make production unprofitable. Furthermore, we may be exposed to potential claims and lawsuits involving such environmental matters as soil and water contamination and air pollution. We are currently in compliance with all local and international environmental requirements and are closely monitored by the environmental authorities of the Republic of Kazakhstan. We have not made any material capital expenditures for environmental control facilities to date, but we are currently performing a feasibility study, the results of which may require capital expenditures to ensure environmental compliance for the utilization of associated gas.

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### Competition

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We compete in all areas of the exploration and production segment of the oil and gas industry with a number of other companies. These companies include large multinational oil and gas companies and other independent operators, many of which possess greater financial resources and more experience than Chaparral. We do not hold a significant competitive position in the oil industry given that we compete both with major oil and gas companies and with independent producers for, among other things, rights to develop oil and gas properties, access to limited pipeline capacity, procurement of available materials and resources, and hiring qualified local and international personnel.

### Employees

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As of February 24, 2004, Chaparral had 4 full-time employees. KKM had 209 employees and retains independent consultants on an as needed basis. We believe

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that our relationship with our employees and consultants is good.

### Corporate Information

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Chaparral was incorporated under the laws of the State of Colorado in 1972. In 1999, Chaparral reincorporated under the laws of the State of Delaware.

Our address is 2 Gannett Drive, Suite 418, White Plains, New York 10604, and our telephone number is (866) 559-3822.

### Special Note Regarding Forward-Looking Statements

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Some of the statements in this Annual Report on Form 10-K constitute "forward-looking statements." Forward-looking statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "estimates," "believes," "predicts," "potential," "likely," or "continue," or by the negative of such terms or comparable terminology. Forward-looking statements are predictions based on current expectations that involve a number of risks and uncertainties. Actual events may differ materially. In evaluating forward-looking statements, you should consider various factors, including the risks discussed above in "Risks of Oil and Gas Activities" and "Risks of Foreign Operations." These factors may cause our actual results to differ materially from any forward-looking statement.

Although we believe that these statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements, and you are encouraged to exercise caution in considering such forward-looking statements. Unless otherwise required by law, we are not under any duty to update any of the forward-looking statements after the date of this Annual Report on Form 10-K to conform these statements to actual results.

## ITEM 2. PROPERTIES

### Properties

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The Karakuduk Field is located in the Mangistau Region of the Republic of Kazakhstan. The license to develop the Karakuduk Field covers an area of approximately 16,900 acres and is effective for a 25-year period, which may be extended if the productive life of the field exceeds this term. In 1995, KKM entered into an agreement with Kazakhstan's Ministry of Energy and Natural Resources to develop the Karakuduk Field.

The Karakuduk Field is geographically located approximately 227 miles northeast of the regional capital city of Aktau, on the Ust-Yurt Plateau. The closest settlement is the Say-Utes Railway Station approximately 51 miles southeast of the field. The ground elevation varies between 590 and 656 feet above sea level. The region has a dry, continental climate, with fewer than 10 inches of rainfall per year. Mean temperatures range from minus 25 degrees Fahrenheit in January to 100 degrees Fahrenheit in July. The operating environment is similar to that found in northern Arizona and New Mexico in the United States.

The Karakuduk Field structure is an asymmetrical anticline located on the Aristan Uplift in the North Ustyurt Basin. Oil was discovered in the structure in 1972, when Kazakhstan was a republic of the former Soviet Union, from



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Jurassic age sediments between 8,500 and 10,000 feet. The former Soviet Union drilled 22 exploratory and development wells to delineate the Karakuduk Field, discovering the presence of recoverable oil reserves. The productive area of the Karakuduk Field is estimated to contain a minimum of 8 separate productive horizons present in the Jurassic formation. None of the original wells were ever placed on commercial production prior to KKM obtaining the rights to the Karakuduk Field.

The Karakuduk Field is approximately 18 miles north of the main utility corridor, which includes the Makat-Mangishlak railroad, the Mangishlak-Astrakhan water pipeline, the Beyneu-Uzen high voltage utility lines, and the Uzen-Atrau-Samara oil and gas pipelines. KKM, according to its agreements with the Republic of Kazakhstan, has a right to use the existing oil export pipeline and related utilities. KKM also has a contract with CJSC Kaztransoil ("KTO"), a 100% subsidiary of KMG, granting KKM the right to use the export pipeline for transportation of crude oil to local and export markets, subject to transit quota restrictions, and as a temporary storage facility until the produced hydrocarbons are sold by KKM.

As of February 24, 2004, KKM had 47 productive wells in the Karakuduk Field, including 34 new wells and 13 re-completions of previously existing delineation wells. The 47 wells include 40 wells currently producing over 8,500 barrels of oil per day collectively and 7 which are shut-in for various reasons that include completion, installation of additional gathering lines, equipment and additional workover operations, water injection and stimulation activities to bring wells on to primary production. KKM implemented an aggressive drilling program during 2000, drilling a total of 12 development wells and re-completing 4 delineation wells using a combination of two drilling rigs and a workover rig. KKM drilled an additional exploratory well and performed two re-completions prior to 2000. During 2001, KKM drilled an additional 10 development wells and re-completed seven delineation wells. In 2002, KKM did not have any drilling activity. During 2003, KKM drilled 13 wells (12 producers and one injector), completing all of these wells prior to the year-end. Two water supply wells were also drilled and 2 redundant producing wells were converted to injectors as part of KKM's reservoir pressure maintenance program. The drilling program has continued into 2004 and it is anticipated that a further 12 producers, 4 injectors and 3 water source wells will be drilled during the year. Oil has been recovered from the originally identified J-1, J-2, J-4, J-6a, J-8, and J-9 formations, along with new discoveries in the J-6b, J-7 and J-10 horizons.

In the past, KKM's daily oil production has been limited due to various facility constraints and lack of working capital to fund field operations. KKM remains committed to improving efficiency of field facilities through continued expansion of its oil storage capacity, installation of additional gathering and processing facilities, and the full implementation of the central processing facility.

In June 2002, KKM commissioned an 18-mile crude oil pipeline from the Karakuduk Field capable of transporting up to 18,000 barrels of oil per day to the export pipeline terminal. To maximize efficiency of line and guarantee throughput, KKM continues improvements at the facilities on mid pipeline, where there are situated tanks, pumps, booster pumps and mid line heaters. The pipeline runs from the central processing unit to the pump station, which lies adjacent to the main export pipeline. While this has reduced the requirement for trucking oil to the pump station, KKM does, however, continue to haul oil to the central processing unit from remote wells and those awaiting flowline installation.

In 2003, KKM further expanded the central processing unit in order to improve its produced water processing capability in the field, to enable reservoir pressure maintenance through water injection.

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Having commissioned the field high line (providing electricity for the field from the 110kv main grid) KKM continued the installation of 6kv power lines to well sites during 2003. This project also included providing power to a third gathering unit (GU3) commissioned July in 2003, which is capable of handling the throughput of up to 24 wells.

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KKM currently has 2 drilling rigs and 2 workover rigs operating in the Karakuduk Field. While the main rig continues the drilling of development wells, the second rig is used for the drilling of water supply wells. The workover rigs are expected to continue operations, performing standard well maintenance, completions of new wells, re-completions of existing wells, and down-hole pump installations. As of February 24, 2004 we estimate that up to 63 additional new wells will be required to fully develop the Karakuduk Field together with a further 6 water supply wells. We estimate that some 32 producing wells will eventually be converted into water injection wells. The planned development program includes a pressure maintenance operation involving water injection that management believes will substantially enhance ultimate recovery.

The artificial lift program, while encompassing water injection, also includes the ongoing installation of pumps at well sites. In 2003, 10 electrical submersible pumps, 10 sucker rod ("nodding donkey") pumps and 1 screw pump were installed in the Karakuduk field.

As part of the artificial lift program to improve well productivity, KKM also performed hydraulic fracturing on 11 wells. As of year end 2003, 9 of these wells were completed with 2 in the process of completion. Hydraulic fracturing has proven reasonably successful. KKM has achieved marked increases in post frac production rates on 5 wells and has witnessed production increases on a further 3 wells. Of the remaining 3 wells, 2 are awaiting completion while 1 requires remedial work.

During 2002, Chaparral completed a simulation study, which we have used to optimize the location of wells (both producers and injectors) and further define the possible total productive capacity of the Karakuduk Field. We have a contract in place with Ryder Scott Company ("Ryder Scott"), a petroleum engineering firm, for the monitoring and analysis of reservoir performance on a monthly basis.

### Reserves -----

As of December 31, 2003, the Karakuduk Field has total estimated proved reserves of approximately 25.62 million barrels (compared with 21.86 million barrels for prior year), net of government royalty, of which we have a proportional interest in approximately 15.37 million barrels, based upon our 60% interest in KKM. The reserve disclosure is based on a reserve study of the Karakuduk Field conducted by Ryder Scott, including data available subsequent to December 31, 2003.

No reserve estimates have been filed with any Federal authority or other agency since January 1, 2003.

### Net Quantities of Oil and Gas Produced -----

The following table summarized sales volumes, sales prices and production cost information for our oil and gas production for each of the three years ended December 31, 2003:

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	As of the Year Ended December 31,		
	2001	2002	2003
Net sales volumes			
Oil (bbls)	1,092,000	2,467,000	2,694,000
Gas (mcf)	--	--	--
Average sales price			
Oil (per bbl)	\$ 16.75	\$ 18.29	\$ 21.39
Gas (per mcf)	\$ --	\$ --	\$ --
Average production cost (per bbl)	\$ 2.40	\$ 3.11	\$ 2.20

The average sales revenue, net of transportation costs, was approximately \$17.13 and \$14.47 per barrel for the years ended December 31, 2003 and 2002, respectively. For the same periods, the average transportation costs per barrel were approximately \$4.26 and \$3.82, respectively.

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Net sales volume for the year 2001 represents our 50% equity interest in KKM's production, but does not reflect our right under the agreement with the government of the Republic of Kazakhstan to receive 65% of KKM's cash flow from oil sales, net of royalty, on a quarterly basis until our loan to KKM has been fully repaid. The remaining 35% of net cash flows is used by KKM to meet capital and operating expenditures. We may waive receipt of quarterly loan repayments, in whole or in part, to provide KKM with additional working capital.

#### Productive Wells and Acreage

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As of December 31, 2003, we had interests in 45 gross productive oil wells, and no producing gas wells. There were no multiple completion wells. Production was from 16,900 gross acres, of which 5,000 acres are productive developed.

#### Undeveloped Acreage

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As of December 31, 2003, 5,000 acres in the Karakuduk Field are productive undeveloped.

#### Drilling Activity

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During the three years ended December 31, 2003, our net interests in exploratory and development wells drilled were as follows:

Year Ended December 31,	Exploratory Wells, Net		Development Wells, Net	
	Productive	Dry	Productive	Dry
2001	.5	--	8.0	--
2002	--	--	--	--
2003	--	--	7.8	--

All wells are located in the Republic of Kazakhstan.

#### Present Activities

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As of February 24, 2004, KKM has successfully completed an additional two development wells (No. 195 and 190) and another development well (No. 143) is expected to be completed in March 2004. Well No. 143 was spudded on February 19, 2004 and is expected to be drilled to a depth of approximately 10,700 feet (3,250 meters). The Karakuduk Field is currently producing approximately 8,500 barrels of oil per day from 40 flowing wells. KKM has also successfully completed 2 water supply wells and is currently drilling a third water supply well. See Item 7 - Management's Discussion and Financial Condition and Results of Operations for additional information on Chaparral's ongoing activities.

### ITEM 3. LEGAL PROCEEDINGS

In December 2002, KKM received a claim from the Ministry of State Revenues of the Republic of Kazakhstan for \$9.1 million (the "Tax Claim") relating to taxes and penalties covering the three years from 1999 to 2001. KKM appealed the claim through the courts in Kazakhstan, which eventually ruled in favor of KKM with the exception of \$255,000 which was upheld. As a result KKM reversed \$899,000 for income taxes accrued during 2002 for the Tax Claim net of the \$255,000 which was settled in January 2004.

The Ministry of State Revenues of the Republic of Kazakhstan is currently considering penalties with respect to the Tax Claim in the amount of \$970,000. Due to the success of the appeal on the Tax Claim, we expect that the liability with regards to penalties will be reduced to approximately \$55,000. The date for the court hearing in respect of this claim is anticipated to be decided in March 2004, with the actual hearing to be conducted at a subsequent date. It is our opinion that the ultimate resolution of this claim will not have a material adverse effect on the financial position and operating results of Chaparral.

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### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On October 16, 2003, Chaparral held its Annual Meeting of Stockholders. Our stockholders elected the following six persons as directors, each to serve until the next Annual Meeting of Stockholders or until his successor is elected or appointed: Askar Alshinbayev, Ian Connor, Nikolai D. Klinchev, Alan D. Berlin, Peter G. Dilling, and John Duthie. Chaparral's stockholders also voted to ratify selection by the board of directors of Ernst & Young as Chaparral's independent auditors for the fiscal year ended December 31, 2003.

The number of shares voted and withheld with respect to each director was as follows:

Election of Directors -----	For ---	Withheld -----
Askar Alshinbayev	-	36,406,860
Ian Connor	-	16,993
Nikolai D. Klinchev	-	36,407,878
Alan D. Berlin	-	36,406,862
Peter G. Dilling	-	16,991
John Duthie	-	36,407,796
		16,057
		36,403,402
		20,811
		36,408,842
		15,811

The number of shares voted with respect to the approval of Ernst & Young as Chaparral's independent auditors was as follows:

For ---	Against -----	Abstained -----
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36,416,928

1,278

5,647

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is currently quoted on the OTC Bulletin Board under the symbol "CHAR". As of March 15, 2004, we have 1,373 stockholders of record of our common stock. No dividend has been paid on our common stock, and there are no plans to pay dividends in the foreseeable future.

The following table shows the range of high and low bid prices for each quarter during our last two calendar years ended December 31, 2003 and 2002, as reported by the National Association of Securities Dealers, Inc.:

Fiscal Quarter Ended	Price Range	
	High	Low
March 31, 2002	1.75	1.30
June 30, 2002	3.05	1.40
September 30, 2002	2.20	1.25
December 31, 2002	1.50	0.82
March 31, 2003	1.05	0.60
June 30, 2003	1.50	0.88
September 30, 2003	2.20	1.00
December 31, 2003	1.45	1.00

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In August 2001, our common stock was delisted from the Nasdaq SmallCap Market for failure to comply with Nasdaq Marketplace Rules 4350(i)(1)(A), 4350(i)(1)(B) and 4350(i)(1)(D)(ii), which required Chaparral obtain stockholder approval prior to the conversion of its 8% Non-Negotiable Subordinated Convertible Promissory Notes into 11,690,259 shares of its common stock on September 21, 2000 and the issuance of 1,612,903 shares of common stock on October 30, 2000. Nasdaq also cited a violation of its annual meeting requirement. The Nasdaq Listing Qualifications Panel did not, however, cite any public interest concerns as a basis for its determination.

Chaparral's common stock is also subject to the rules and regulations of the SEC concerning "penny stocks." The SEC's rules and regulations generally define a penny stock to be an equity security that is not listed on Nasdaq or a national securities exchange and that has a market price of less than \$5.00 per share, subject to certain exceptions. The SEC's rules and regulations require broker-dealers to deliver to a purchaser of penny stock a disclosure schedule explaining the penny stock market and the risks associated with it. Various sales practice requirements are also imposed on broker-dealers who sell penny stocks to persons other than established customers and accredited investors (generally institutions). In addition, broker-dealers must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction and monthly account statements showing the market value of each penny stock held in the customer's account.

#### 1998 Incentive and Non-statutory Stock Option Plan

On June 26, 1998, the stockholders approved the 1998 Incentive and Non-statutory Stock Option Plan (the "1998 Plan"), pursuant to which up to

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50,000 options to acquire Chaparral's common stock may be granted to officers, directors, employees, or consultants of Chaparral and its subsidiaries. The stock options granted under the 1998 Plan may be either incentive stock options or nonstatutory stock options. The 1998 Plan has an effective term of ten years, commencing on May 20, 1998. Chaparral has not granted any options under the 1998 Plan as of December 31, 2003.

### 2001 Stock Incentive Plan

In June 2001, Chaparral's stockholders approved the 2001 Stock Incentive Plan, which sets aside a total of 2.14 million shares of Chaparral's common stock for issuance to Chaparral's officers, directors, employees, and consultants. Chaparral has not made any grants under the 2001 Stock Incentive Plan as of December 31, 2003.

We did not sell any securities since October 1, 2001, which were not registered under the Securities Act of 1933, as amended.

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### ITEM 6. SELECTED FINANCIAL DATA

	As of or for the Year Ended December 31, (In Thousands of U.S. Dollars)				
	2003(1)	2002(1)	2001	2000	1999
Oil and gas sales .....	\$ 57,615	45,133	--	--	--
Total revenues .....	\$ 57,615	45,133	--	--	--
Equity in income (loss) from investment .....	\$ --	--	4,616	2,827	(1,800)
Net income/(loss) .....	\$ 2,061	4,117	(16,215)	(26,803)	(5,100)
Net income (loss) per common share .....	\$ 0.05	0.14	(1.16)	(6.01)	(5.00)
Working capital (deficit) .....	\$ (12,487)	(2,366)	(39,357)	(601)	(2,900)
Total assets .....	\$ 98,668	87,308	69,037	70,156	41,300
Long-term obligations and Redeemable preferred stock .....	\$ 30,470	29,542	3,900	26,528	14,700
Stockholders' equity .....	\$ 46,170	44,109	25,361	41,926	22,800
Other Data -----					
Present value of proved reserves(2)	\$ 167,182	128,739	40,344	70,281	61,300
Minority interest present value of proved reserves .....	\$ 66,873	51,496	--	--	--
Proved oil reserves (bbls) .....	25,616	21,855	14,961	16,523	10,000
Minority interest of proved oil reserves (bbls) .....	10,246	8,742	--	--	--
Proved gas reserves (mcf) .....	--	--	--	--	--

(1) In 2002, Chaparral obtained a controlling interest in KKM. Consequently, our financial statements have been consolidated with KKM on a retroactive basis to January 1, 2002. Chaparral accounted for its 50% investment in KKM

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using the equity method of accounting, which is reflected in our selected financial data for periods prior to 2002.

- (2) Present value of proved reserves for the years prior to 2002 represent our 50% equity interest in KKM. Present value of proved reserves for the years 2003 and 2002 are presented at 100%. Discount rate applied was 10%.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### 1. Liquidity and Capital Resources

##### General Liquidity Considerations

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##### Going Concern

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Our financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. Chaparral has a working capital deficiency as of December 31, 2003. In addition, we have experienced limitations in obtaining 100% export quota for the sale of our hydrocarbons. These conditions create uncertainties relating to our ability to meet all expenditure and cash flow requirements through the next twelve months.

These conditions raise substantial doubt about our ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

Chaparral has been successful in 2003 in increasing its export sales and reducing its local market deliveries. As of December 31, 2003, Chaparral has sold approximately 2,694,000 barrels of its current year production, of which approximately 2,591,000 barrels, or 96%, have been sold at world market prices and 103,000 barrels, or 4%, have been sold at domestic market prices. This represents a significant increase in sales at world market prices and corresponding decrease in local market price sales from the year 2002.

In addition, we are continuing with our efforts to obtain additional financing to cover any short-term working capital deficiencies and to refinance our loan with Kazkommertsbank on more favorable terms. If we are successful in these efforts, we plan to use the resulting capital infusion to restructure the loan with Kazkommertsbank and eliminate or significantly reduce our current working capital deficiencies.

##### Liquidity and Capital Resources

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We are presently engaged in the development of the Karakuduk Field, which requires substantial cash expenditures for drilling costs, well completions, workovers, oil storage and processing facilities, pipelines, gathering systems, water injection facilities, plant and equipment (pumps, transformer sub-stations etc.) and other field facilities. We have invested approximately \$121.3 million in the development of the Karakuduk Field and have drilled or re-completed 45 productive wells by the end of 2003, including 12 wells in the year 2003. Total

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capital expenditures for 2003 were approximately \$27.7 million compared to total capital expenditures of \$11.5 million incurred in 2002. Capital expenditures are estimated to be at least \$80 million from 2004 through 2008, including the drilling of approximately 65 more wells over this period. We anticipate 2004 capital expenditures of approximately \$28.4 million.

We expect to finance the continued development of the Karakuduk Field primarily through cash flows from the sale of crude oil. During 2003, KKM sold approximately 2.69 million barrels of crude oil for \$57.61 million. In addition, from May 2003 KKM has requested and received prepayment for approximately 90% of the majority of crude sales in order to accelerate these cash flows, at a cost in prepayment interest of \$187,000. As of February 24, 2004, the daily oil production is approximately 8,500 barrels per day from 40 of the 47 productive wells in the field. The remaining 7 wells are shut-in for various reasons including, completion, installation of additional gathering lines/ equipment and additional workover, water injection and stimulation operations to bring wells on production.

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In 2004, KKM plans to increase its daily production by commissioning the water injection facilities, installing further pumps, and drilling 16 additional wells. Accordingly, management expects the Karakuduk Field production to increase from approximately 8,500 to approximately 13,000 barrels of oil per day by year-end 2004.

KKM successfully initiated a "pilot" reservoir pressure maintenance program during 2003 by the injection of water into one well. KKM witnessed a favorable increase in the reservoir pressure on surrounding well production performance.

In December 2003, KKM production peaked at over 12,000 barrels of oil per day and daily production averaged over 11,000 barrels of oil per day for the month. For the full implementation of the reservoir pressure maintenance program and to ensure that gasification of the reservoir and reservoir pressure decline is not accelerated due to delays in the implementation of this program, KKM has taken a number of preventative measures in this regard so that ultimate reservoir recovery will not be negatively affected. KKM has reduced choke sizes and shut in a number of wells for pressure monitoring and analysis purposes. Until the reservoir pressure maintenance program has been fully implemented, KKM cannot fully maximize well productivity. As a result, oil production decreased from 11,000 barrels per day average during December 2003 to our current level of 8,500 barrels per day.

While we expect the reservoir pressure maintenance program to be commissioned by the end of March 2004, we do not anticipate a tangible benefit in terms of increased production levels until the third quarter of 2004.

In addition, our short and long-term liquidity is impacted by local oil sales obligations imposed on oil and gas producers within Kazakhstan to supply local energy needs, and our ability to obtain export quota necessary to sell our crude oil production on the international market. Under the terms of the Agreement, we have a right to export, and receive export quota for, 100% of the production from the Karakuduk Field. The domestic market does not permit world market prices to be obtained, resulting in approximately \$10 to \$12 lower cash flow per barrel. Furthermore, the Government has not allocated sufficient export quota to allow us to sell all of our available crude oil production on the world market. We are taking steps to reduce our local market obligations and to obtain an export quota that will enable us to sell all of our crude oil production. On July 17, 2003, we took the first step towards the commencement of arbitration proceedings in Switzerland for the breach of the Agreement by the Government of



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Kazakhstan by initiating a required three-month period of consultation with the Government. Although the consultation period has expired, we continue to seek an amicable resolution with the Government on this matter rather than proceeding with arbitration. If the matter can not be resolved in a satisfactory manner, we have, however, reserved our right to commence formal arbitration proceedings pursuant to our contractual arrangements with the Government.

No assurances can be provided, however, that if arbitration is instituted, it will be successful or that if successful, Chaparral will be able to enforce the award in Kazakhstan, or that we will be able to export 100% or a significant portion of its production and that we will be able to obtain additional financing and cash flow from operations to meet working capital requirements in the future.

### Obligations and Commitments

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The following table is a summary of Chaparral's future payments on obligations as of December 31, 2003.

Obligations by Period (In Thousands)					
	1 Year	2-3 Years	4-5 Years	Later Years	Total
Debt	\$12,000	\$18,000	\$4,000	\$--	\$34,000
Interest on debt	\$ 4,314	\$ 3,774	\$ 212	\$--	\$ 8,300
Drilling contract	\$ 5,520	\$ --	\$ --	\$--	\$ 5,520
Operating leases	\$ 29	\$ --	\$ --	\$--	\$ 29

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In May 2002, Chaparral received a total equity and debt capital infusion of \$45 million. Chaparral received a total investment of \$12 million from Central Asian Industrial Holdings, N.V. ("CAIH"), including \$8 million in exchange for 22,925,701 shares, or 60%, of Chaparral's outstanding common stock, and \$4 million in exchange for a three year note bearing interest at 12% per annum of which \$2 million was repaid during 2002. Additionally, Kazkommertsbank provided KKM with a credit facility totaling \$33 million bearing interest at 14% per annum. As of December 31, 2003 the outstanding principal balance on the KKM Credit Facility was \$32 million. The terms and conditions of the CAIH Note and the KKM Credit facility are more fully described in Note 11 of our consolidated financial statements for the year ended December 31, 2003.

The financing costs of the KKM Credit Facility and the CAIH Note represent significant future cash flow requirements. A substantial portion of our future cash flow from operations will be required for debt service and may not be available for other purposes. We expect up to \$42.3 million of our future available net cash flows from the Karakuduk Field will be utilized to service the loan, depending upon excess cash flows available from operations, if any, to repay the loan prior to its stated maturity date. The availability of future cash flows is contingent upon many factors beyond our control, including successful development of the underlying oil reserves from the Karakuduk Field, production rates, production and development costs, oil prices, access to oil transportation routes, and political stability in the region. In addition under the KKM Credit Facility, our ability to obtain additional debt or equity financing in the future for working capital, capital expenditures, or acquisitions is also restricted, as well as our ability to acquire or dispose of significant assets or investments. These restrictions may make us more vulnerable and less able to react to adverse economic conditions.

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The failure of Chaparral to meet the terms of the KKM Credit Facility could result in an event of default and the loss of our shares in KKM, currently pledge as collateral under the KKM Credit Facility. We are currently in compliance with all the terms of the KKM Credit Facility. We had made all principal and interest payment due under the KKM Credit Facility and CAIH Note as of December 31, 2003. A payment of principal of \$1 million and interest of \$983,000 was due on the KKM Credit Facility on February 6, 2004. KKM paid the \$983,000 interest on February 6, 2004, and KKM and Kazkommertsbank have agreed to defer the repayment of \$1 million in principal until March 31, 2004.

As of December 31, 2003, Chaparral has a drilling contract with KazMunayGas-Drilling, an affiliate of KMG, for one development drilling rig currently operating in the Karakuduk Field. The rig is contracted through December 31, 2004. Our other drilling and operations related contracts are either cancelable within 30 days or are on a call-off (as required) basis.

### Related Party Transactions

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KKM has a contract to transport 100% of its oil sales through the pipeline owned and operated by KTO, a wholly owned subsidiary of KMG, the 40% minority shareholder in KKM. The rates for transportation are in accordance with those approved by the government of the Republic of Kazakhstan. Currently, the use of the KTO pipeline system is the only viable method of exporting KKM's production. As KTO notifies KKM of the export sales allocated to KKM on a monthly basis, KTO controls both the volume and transportation cost of export sales.

KKM makes a prepayment for crude transportation based upon the allocation of export sales received from KTO. This prepayment includes pipeline costs charged by the operators of the Russian and Ukrainian pipeline systems and are dependent upon the point of sale of KKM's exports. During 2003, KKM paid \$12 million to KTO of which \$11.29 million were recognized as transportation costs for sales during 2003. At December 31, 2003, KKM had a prepayment balance of \$1.30 million with KTO in respect of sales to be made in January 2004. Comparably during 2002, KKM paid \$8.93 million to KTO of which \$9.30 million were recognized as transportation costs for sales during 2002. At December 31, 2002, KKM had a prepayment balance of \$584,000 with KTO in respect of sales to be made in January 2003.

KTO charges KKM for associated costs of oil storage within their pipeline system, sales commission, and customs clearance fees in respect to export sales. KTO also provides KKM with water through the Volga Water pipeline. Amounts recognized for these services during 2003 and 2002 were \$267,000 and \$169,000 of which \$97,000 and 37,000 remained outstanding as of the end of the respective period.

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As mentioned above, KKM has a drilling contract with KazMunayGas-Drilling, an affiliate of KMG, for one development drilling rig currently operating in the Karakuduk Field. The rig is contracted through December 31, 2004.

All other related party transactions are disclosed in the notes to our consolidated financial statements for December 31, 2003. The loans with Kazkommertsbank and CAIH are disclosed in Note 11 and the drilling contract with KMGD is described in Note 17 and 18, the lease with Nasikhat is described in Note 14, prepaid transportation to KTO in Note 4 and Insurance policy with Kazkommerts Policy in Note 18.

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### Legal Proceedings

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In December 2002, KKM received a claim from the Ministry of State Revenues of the Republic of Kazakhstan for \$9.1 million (the "Tax Claim") relating to taxes and penalties covering the three years from 1999 to 2001. KKM appealed the claim through the courts in Kazakhstan, which eventually ruled in favor of KKM with the exception of \$255,000 which was upheld. As a result KKM reversed \$899,000 for income taxes accrued during 2002 for the Tax Claim net of the \$255,000 which was settled January 2004.

The Ministry of State Revenues of the Republic of Kazakhstan is currently considering penalties with respect to the Tax Claim in the amount of \$970,000. Due to the success of the appeal on the Tax Claim, we expect that the liability with regards to penalties will be reduced to approximately \$55,000. The date for the court hearing in respect of this claim is anticipated to be decided in March 2004, with the actual hearing to be conducted at a subsequent date. It is our opinion that the ultimate resolution of this claim will not have a material adverse effect on the financial position and operating results of Chaparral.

### Capital Commitments and Other Contingencies

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Our operations may be subject to other regulations by the government of the Republic of Kazakhstan or other regulatory bodies responsible for the area in which the Karakuduk Field is located. In addition to taxation, customs declarations and environmental controls, regulations may govern such things as drilling permits and production rates. Drilling permits could become difficult to obtain or prohibitively expensive. Production rates could be set so low that they would make production unprofitable. These regulations may substantially increase the costs of doing business and may prevent or delay the starting or continuation of any given exploration or development project.

All regulations are subject to future changes by legislative and administrative action and by judicial decisions. Such changes could adversely affect the petroleum industry in general, and us in particular. It is impossible to predict the effect that any current or future proposals or changes in existing laws or regulations may have on our operations.

### Commodity Prices for Oil

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Our revenues, profitability, growth and value are highly dependent upon the price of oil. Market conditions make it difficult to estimate prices of oil or the impact of inflation on such prices. Oil prices have been volatile, and it is likely they will continue to fluctuate in the future. Various factors beyond our control affect prices for oil, including supplies of oil available worldwide and in Kazakhstan, the ability of OPEC to agree to maintain oil prices and production controls, political instability or armed conflict in Kazakhstan or other oil producing regions, the price of foreign imports, the level of consumer demand, the price and availability of alternative fuels, the availability of transportation routes and pipeline capacity, and changes in applicable laws and regulations.

### Inflation

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We cannot control prices received from our oil sales and to the extent we are unable to pass on increases in operating costs, we may be affected by inflation. The devaluation of the Tenge, the currency of the Republic of Kazakhstan, can significantly decrease the value of the monetary assets that we

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hold in Kazakhstan as well as our assets in that country that are based on the Tenge. KKM retains the majority of cash and cash equivalents in U.S. Dollars, but KKM's statutory tax basis for its assets, tax loss carryforwards, and VAT receivables are all denominated in Tenge and subject to the effects of devaluation. Local tax laws allow basis adjustments to offset the impact of inflation on statutory tax basis assets, but there is no assurance that any adjustments will be sufficient to offset the effects of inflation in whole or in

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part. If not, KKM may be subject to much higher income tax liabilities within Kazakhstan due to inflation and or devaluation of the local currency. Additionally, devaluation may create uncertainty with respect to the future business climate in Kazakhstan and to our investment in that country. During 2003, however, the Tenge has appreciated against the U.S. Dollar by 7.31%. There remains no guarantee that this appreciation is either sustainable or permanent in the foreseeable future. As of December 31, 2003, the exchange rate was 144.22 Tenge per U.S. Dollar compared to 155.60 as of December 31, 2002. It should be noted that 96% of our crude oil sales in 2003 were denominated in U.S. Dollars, while the majority of our capital expenditures, operating costs and general and administrative expenses are denominated in Tenge.

### Critical Accounting Policies

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Application of generally accepted accounting principles requires the use of estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and revenues and expenses during the reporting period. In addition, alternatives can exist among various accounting methods. In such cases, the choice of accounting method can also have a significant impact on reported amounts.

Our determination of proved oil and gas reserve quantities, the application of the full cost method of accounting for KKM's exploration and production activities, and the application of standards of accounting for derivative instruments and hedging activities require management to make numerous estimates and judgments.

Oil and Gas properties (Full Cost Method). Chaparral follows the full cost method of accounting for oil and gas properties. Accordingly, all costs associated with the acquisition, exploration, and development of oil and gas reserves, including directly related overhead costs, are capitalized. Effective with the adoption of SFAS No. 143 in 2003, the carrying amount of oil and gas properties also includes estimated asset retirement costs recorded based on the fair value of the asset retirement obligation when incurred. The application of the full cost method of accounting for oil and gas properties generally results in higher capitalized costs and higher DD&A rates compared to the successful efforts method of accounting for oil and gas properties

All capitalized costs of proved oil and gas properties, including the estimated future costs to develop proved reserves, are amortized on the unit-of-production method using estimated proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized cost to be amortized.

Sales of proved and unproved properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved

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reserves of oil and gas, in which case the gain or loss is recognized in income. Abandonments of properties are accounted for as adjustments of capitalized costs with no loss recognized.

**Cost Excluded.** Oil and gas properties include costs that are excluded from capitalized costs being amortized. These amounts represent costs of investments in unproved properties and major development projects. Chaparral excludes these costs on a country-by-country basis until proved reserves are found or until it is determined that the costs are impaired. All costs excluded are reviewed quarterly to determine if impairment has occurred. Any impairment is transferred to the costs to be amortized or a charge is made against earnings for those international operations where a reserve base has not yet been established. For operations where a reserve base has not yet been established, an impairment requiring a charge to earnings may be indicated through evaluation of drilling results or relinquishing drilling rights.

**Capitalized Interest.** Statement of Financial Accounting Standards ("SFAS") 34, Capitalization of Interest Costs, provides standards for the capitalization of interest costs as part of the historical cost of acquiring assets. FASB-Interpretation ("FIN") 33 provides guidance for the application of SFAS 34 to the full cost method of accounting for oil and gas properties. Under FIN 33, costs of investments in unproved properties and major development projects, on which depreciation, depletion, and amortization ("DD&A") expense is not currently taken and on which exploration or development activities are in progress, qualify for capitalization of interest. Capitalized interest is calculated by multiplying the weighted-average interest rate on debt by the amount of costs excluded. Capitalized interest cannot exceed gross interest expense.

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**Ceiling Test.** Companies that use the full cost method of accounting for oil and gas exploration and development activities are required to perform a ceiling test each quarter. The full cost ceiling test is an impairment test prescribed by SEC Regulation S-X Rule 4-10. The ceiling test is performed on a country-by-country basis. The test determines a limit, or ceiling, on the book value of oil and gas properties. That limit is basically the after tax present value of the future net cash flows from proved crude oil and natural gas reserves. This ceiling is compared to the net book value of the oil and gas properties reduced by any related deferred income tax liability. If the net book value reduced by the related deferred income taxes exceeds the ceiling, an impairment or non-cash write down is required. A ceiling test impairment can give Chaparral a significant loss for a particular period; however, future DD&A expense would be reduced.

**Reserves.** Estimates of our proved oil and gas reserves are prepared by Ryder Scott Company in accordance with guidelines established by the SEC. Those guidelines require that reserve estimates be prepared under existing economic and operating conditions with no provisions for increases in commodity prices, except by contractual arrangement. Estimation of oil and gas reserve quantities is inherently difficult and is subject to numerous uncertainties. Such uncertainties include the projection of future rates of production, export allocation, and the timing of development expenditures. The accuracy of the estimates depends on the quality of available geological and geophysical data and requires interpretation and judgment. Estimates may be revised either upward or downward by results of future drilling, testing or production. In addition, estimates of volumes considered to be commercially recoverable fluctuate with changes in commodity prices and operating costs. Our estimates of reserves are expected to change as additional information becomes available. A material change in the estimated volumes of reserves could have an impact on the DD&A rate calculation and the financial statements.

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Derivative Financial Instruments and Hedging Activities. We account for our investment in derivative financial instruments in accordance with SFAS 133, Accounting for Derivative Financial Instruments and Hedging Activities, as amended. As a result, we recognize all derivative financial instruments in our financial statements at fair value, regardless of the purpose or intent for holding the instrument. Changes in the fair value of derivative financial instruments are recognized periodically in income or in shareholders' equity as a component of comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in fair values of derivatives accounted for as fair value hedges are recorded in income along with the portions of the changes in the fair values of the hedged items that relate to the hedged risks. Changes in fair values of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income net of deferred taxes. Changes in fair values of derivatives not qualifying as hedges are reported in income.

Accounting for Asset Retirement Obligations. SFAS 143, Accounting for Asset Retirement Obligations, requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Subsequently, the asset retirement cost should be allocated to expense using a systematic and rational method. SFAS 143 is effective for fiscal years beginning after June 15, 2002. As a result of the adoption of FASB 143, Chaparral has increased its assets and liabilities by \$516,000 as of January 1, 2003 to reflect the net present value of its retirement obligations. See Note 10 to our consolidated financial statements for the year ended December 31, 2003 for results on the adoption of SFAS 143.

Legal, Environmental and Other Contingencies. A provision for legal, environmental and other contingencies is charged to expense when the loss is probable and the cost can be reasonably estimated. Determining when expenses should be recorded for these contingencies and the appropriate amounts for accrual is a complex estimation process that includes the subjective judgment of management. In many cases, management's judgment is based on interpretation of laws and regulations, which can be interpreted differently by regulators and/or courts of law. Chaparral's management closely monitors known and potential legal, environmental and other contingencies and periodically determines when Chaparral should record losses for these items based on information available to us.

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Income Taxes. As part of the process of preparing our consolidated financial statements, we are required to estimate our taxes in each of the jurisdictions of operation. This process involves management estimating the actual current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes in accordance with the provisions of SFAS No. 109, Accounting for Income Taxes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheets. We then must assess the likelihood that the deferred tax assets will be recovered from future taxable income and, to the extent recovery is not likely, we must establish a valuation allowance. Future taxable income depends on the ability to generate income in excess of allowable deductions. To the extent we establish a valuation allowance or increase this allowance in a period, an expense is recorded within the tax provision in the consolidated statement of operations. Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. In the event that actual results differ from these estimates or we

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adjust these estimates in future periods, we may need to establish a valuation allowance that could materially impact our financial condition and results of operations.

Change in Estimates. Chaparral has not materially changed the use of its methodology for the estimates described above for the years presented and actual results compared to estimates made have not had a material effect on Chaparral's financial condition and results of operations. There are currently no known trends, demands, commitments, events or uncertainties that are reasonably likely to occur that could materially affect the methodology or assumptions described above.

### Recent Accounting Pronouncements

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In December 2003, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 104 Revenue Recognition ("SAB 104"), which codifies, revises and rescinds certain sections of SAB No. 101, Revenue Recognition, in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB 104 did not have a material effect on our consolidated results of operations, consolidated financial position or consolidated cash flows.

In April 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts and hedging activities under SFAS No. 133. The amendments set forth in SFAS No. 149 require that contracts with comparable characteristics be accounted for similarly. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003 (with a few exceptions) and for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively only. The adoption of SFAS No. 149 as of July 1, 2003 has had no effect on our consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This statement establishes standards for how an issuer classifies and measures on its balance sheet certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 was effective for financial instruments entered into or modified after May 31, 2003, and was otherwise effective for us as of July 1, 2003. The adoption of the applicable provisions of this statement as of the indicated dates has had no effect on our consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an interpretation of ARB 51." The primary objectives of this interpretation are to provide guidance on the identification of entities for which control is achieved through means other than through voting rights ("variable interest entities") and how to determine when and which business enterprise (the "primary beneficiary") should consolidate the variable interest entity. This new model for consolidation applies to an entity in which either (i) the equity investors (if any) do not have a controlling financial interest; or (ii) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, FIN 46 requires that the primary beneficiary, as well as all other enterprises with a significant variable interest in a variable interest entity, make additional disclosures. Certain disclosure requirements of FIN 46 were effective for

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financial statements issued after January 31, 2003.

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In December 2003, the FASB issued FIN No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" ("FIN 46-R") to address certain FIN 46 implementation issues. The effective dates and impact of FIN 46 and FIN 46-R are as follows:

(i) Special purpose entities ("SPEs") created prior to February 1, 2003. Chaparral must apply either the provisions of FIN 46 or early adopt the provisions of FIN 46-R at the end of the first interim or annual reporting period ending after December 15, 2003.

(ii) Non-SPEs created prior to February 1, 2003. Chaparral is required to adopt FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

(iii) All entities, regardless of whether a SPE, that were created subsequent to January 31, 2003. The provisions of FIN 46 were applicable for variable interests in entities obtained after January 31, 2003. Chaparral is required to adopt FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

The adoption of the provisions applicable to SPEs and all other variable interests obtained after January 31, 2003 did not have a material impact on Chaparral's financial statements. Chaparral is currently evaluating the impact of adopting FIN 46-R applicable to Non-SPEs created prior to February 1, 2003 but does not expect a material impact on Chaparral's results of operations, financial position and cash flows.

In June 2001, the FASB issued SFAS 143, Accounting for Asset Retirement Obligations. SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Subsequently, the asset retirement cost should be allocated to expense using a systematic and rational method. SFAS 143 is effective for fiscal years beginning after June 15, 2002. Chaparral adopted SFAS 143 on January 1, 2003. See Note 10 to our consolidated financial statements for the year ended December 31, 2003 for results of the adoption of SFAS 143.

The EITF currently is deliberating on EITF No. 04-2 "Whether Mineral Rights Are Tangible or Intangible Assets" and EITF No. 03-S "Application of FASB Statement No. 142, Goodwill and Other Intangible Assets, to Oil and Gas Companies." These proposed statements will determine whether contract-based oil and gas mineral rights are classified as tangible or intangible assets based on the EITF's interpretation of SFAS No. 141 and SFAS No. 142. Historically, Chaparral has classified all of its contract-based mineral rights within property, plant, and equipment and has generally not identified these amounts separately. If the EITF determines that these mineral rights should be presented as intangible assets, Chaparral would have to reclassify its contract-based oil and gas mineral rights acquired after June 30, 2001 to intangible assets and make additional disclosures in accordance with SFAS No. 142. Chaparral has not acquired any contract-based mineral rights after June 30, 2001. Therefore, the adoption of this change will not have a material effect on Chaparral's results from operations.

### 2. Results of Operations

Results of Operations for the Year Ended December 31, 2003 Compared to the Year Ended December 31, 2002



Our operations for the year ended December 31, 2003 resulted in a net income of \$2.06 million compared to a net income of \$4.12 million for the year ended December 31, 2002. The \$2.06 million decrease in our net income is the result of (i) higher transportation, depletion, general and administrative, income tax, and minority interest costs for the year ended December 31, 2003, (ii) a \$5.34 million extraordinary gain recognized as a result of the restructuring of our indebtedness during 2002, offset by (iii) higher revenues recognized during 2003, (iv) the recognition of a \$1.02 million gain as a result of the adoption of SFAS 143 on January 1, 2003 and (v) lower interest costs for 2003.

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Revenue. Revenues were \$57.61 million for the year ended December 31, 2003 compared with \$45.13 million for the year ended December 31, 2002. The \$12.48 million increase is the result of higher volumes sold and higher oil prices received during the year ended December 31, 2003. The increase in volumes sold during 2003 was the result of increased production and sales quotas obtained for the year. During 2003 we sold approximately 2,694,000 barrels of crude oil, recognizing \$57.61 million, or \$21.39 per barrel, in revenue. In comparison, we sold approximately 2,467,000 barrels of crude oil, recognizing \$45.13 million in revenue, or \$18.29 per barrel, for the year ended December 31, 2002.

Transportation and Operating expenses. Transportation costs for the year ended December 31, 2003 were \$11.47 million, or \$4.26 per barrel, and operating costs associated with sales were \$5.92 million, or \$2.20 per barrel. In comparison, transportation costs for the year ended December 31, 2002 were \$9.43 million, or \$3.82 per barrel, and operating costs associated with sales were \$7.68 million, or \$3.11 per barrel. The increase in transportation costs per barrel is mainly due to higher tariffs imposed on Chaparral and greater sales to the export market during 2003. The decrease in operating cost per barrel is mainly due to (i) economies of scale achieved by higher throughput during the period, (ii) significantly lower transportation costs from the wellhead to entry point of the KTO export pipeline, following the commission of the KKM pipeline, and (iii) lower work-over cost for the current year due to the increase in capital activities during the year 2003.

Depreciation and Depletion. Depreciation and depletion expense was \$18.04 million for the year ended December 31, 2003 compared to \$12.80 million for the year ended December 31, 2002. The \$5.24 million increase is the result of higher effective depletion rates and higher volumes of oil sold during the year ended December 31, 2003. During the year 2003, Chaparral recognized a total depletion expense of \$17.30 million or \$6.42 per barrel, compared with \$9.48 million or \$4.90 per barrel in depletion expense for the year 2002. The increase in the effective depletion rate of \$1.52 per barrel is due to increased estimated capital expenditures for the development of the field for future years and reductions to Chaparral's proved reserves, based on December 31, 2002 reserve report.

Interest Expense. Interest expense for the year ended December 31, 2003, decreased by \$1.08 million from \$5.61 million in 2002 to \$4.53 million in 2003, as a result of lower financing costs and the restructuring of our indebtedness in 2002.

General and Administrative Expense. General and administrative costs for the year ended December 31, 2003, increased by \$950,000 from \$6.81 million for the year 2002 to \$7.76 million for the year 2003. The \$950,000 increase is largely due to higher salaries accrued during 2003 and consultant payments, comprising of \$673,000 accrued 2003 year end bonus and a \$278,000 production

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bonus paid in the year to employees and consultants of Chaparral for achieving the milestone of 1 million tons (approximately 8 million barrels) of cumulative production. In addition, salaries increase at the KKM level by \$304,000 due to increase in personnel and salary adjustments performed during 2003.

Income Taxes. Income Tax expense for the year ended December 31, 2003, increased by \$1.43 million from \$2.69 million for the year 2002 to \$4.12 million for the year 2003. The \$1.43 million increase is largely due to KKM generating higher taxable income in the Republic of Kazakhstan. (Net income at the KKM level for the year ended December 31, 2003 was \$10.76 million compared with \$4.88 million for the year ended December 31, 2002). All income taxes provided for relate to our operations in Kazakhstan. Chaparral currently has no U.S. income tax liability due to Chaparral's estimated USA domestic tax loss carryforwards of \$24.7 million as of December 31, 2003. These carryforwards will expire at various times between 2004 and 2021. See Note 13 to our consolidated financial statements for the year ended December 31, 2003.

Cumulative effect of change in accounting principle. As a result of the adoption of SFAS 143, Chaparral recognized a gain of \$1.02 million as a cumulative effect of change in accounting principle for the year ended December 31, 2003. In addition, Chaparral recognized \$73,000 in accretion expense to account for changes in the ARO liability. See Note 10 of our consolidated financial statements.

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### Results of Operations Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

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In May 2002, Chaparral increased its ownership in KKM from 50% to 60% through the acquisition of 100% of the outstanding stock of MTI. As a result of the acquisition, Chaparral obtained a controlling interest in KKM. Consequently, its financial statements have been consolidated with KKM on a retroactive basis to January 1, 2002. We previously accounted for our 50% investment in KKM using the equity method of accounting, which is reflected in our financial results for periods prior to 2002.

Our operations for the year ended December 31, 2002 resulted in net income of \$4.12 million compared to a net loss of \$16.22 million for the year ended December 31, 2001. The \$20.34 million increase in our net income relates to the recognition of a \$5.34 million extraordinary gain resulting from the May 2002 restructuring of our loan with Shell Capital, decreased interest charges resulting from the refinancing of its debt obligations, and improved operational results from the Karakuduk Field.

Interest expense decreased from \$14.45 million for the year ended December 31, 2001 to \$5.61 million for the year ended December 31, 2002, due to the lower financing costs and the restructuring of our indebtedness. Chaparral's cost of financing the development of the Karakuduk Field has improved from a pre-restructuring annual interest rate of LIBOR plus 19.75% compounded daily, to a simple fixed annual interest rate of 14%, generating a saving of approximately \$3 million per year. Interest expense for the year ended December 31, 2001 reflects an additional loan discount of \$4.37 million recorded and fully amortized as of September 30, 2001 due to the transfer of a 40% interest in the distributable profits of CAP-G to Shell Capital for our failure to repay a \$3.15 million bridge loan to Shell Capital on or before September 30, 2001. See Notes 10 and 11 to our consolidated financial statements for the year ended December 31, 2002.

As a result of the adoption of SFAS 133, we recognized a loss of \$2.52

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million as a cumulative effect of change in accounting principle and an additional loss of \$237,000 for the year ended December 31, 2001 to record the hedges at their fair value as of the end of the period. Comparatively, Chaparral recognized a loss of \$762,000 to record the hedges at their fair value during the year ended December 31, 2002. As of December 31, 2002, the hedge agreement expired. See Note 7 to our consolidated financial statements for the year ended December 31, 2002.

For the year ended December 31, 2002, Chaparral's financial results have been consolidated with the financial results of its operating subsidiary, KKM. During 2002, we sold approximately 2.47 million barrels of crude oil, recognizing \$45.13 million, or \$18.29 per barrel, in revenue. Transportation costs were \$9.43 million, or \$3.82 per barrel and operating costs associated with sales were \$7.68 million, or \$3.11 per barrel. Comparatively, Chaparral recognized \$4.62 million in equity income from investment for the year ended December 31, 2001, which represents our 50% share of KKM's results during the period. During the year ended December 31, 2001, KKM sold approximately 2.18 million barrels of crude oil, recognizing \$36.58 million in revenue, or \$16.75 per barrel. Associated operating costs were \$5.25 million, or \$2.40 per barrel, and associated transportation costs were \$8.30 million, or \$3.80 per barrel. The increase in operating costs per barrel relates to increased utilization of a workover rig in the Karakuduk Field to maintain production rates. During the year ended December 31, 2001, our equity income from investment also reflects the elimination of \$1.45 million of inter-company interest income on our loan to KKM. See Notes 5 and 19 to our consolidated financial statements for the year ended December 31, 2002.

General and administrative costs increased from \$4.33 million as of December 31, 2001, to \$6.81 million as of December 31, 2002. The \$2.52 million change was principally due to the consolidation of KKM financial results during 2002 as a result of the MTI acquisition. Comparably, general and administrative expenses reported by Chaparral and KKM during the year ended December 31, 2001 were \$4.33 million and \$3.75 million, respectively. The \$2.21 million decrease was mainly due to lower insurance and lower professional services expenses. During 2002, Chaparral canceled its Overseas Private Investment Corporation ("OPIC") political risk insurance as part of the restructuring of Chaparral creating a savings of \$650,000. In addition, expenses for professional services decreased by \$1.52 million from 2001 to 2002.

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Depreciation and depletion expense increased \$12.05 million from \$753,000 in 2001 to \$12.80 million in 2002, due to the consolidation of KKM's financial results during 2002. Comparably, depreciation and depletion expense reported by Chaparral and KKM during the year ended December 31, 2001 were \$753,000 and \$9.48 million, respectively. Effectively, depreciation and depletion expense increased by \$2.57 million due to additional depletion of our investment in oil and gas assets resulting from increased production from the Karakuduk Field and an increase in the effective depletion rate from \$3.97 per barrel during 2001 to \$4.59 per barrel during 2002. The increase in the effective depletion rate was due to higher estimated development costs to produce proved reserve estimates.

Income taxes increased by \$2.69 million from \$0 in 2001 to \$2.69 million in 2002, due to the consolidation of KKM financial results during 2002. All income taxes payable relate to our operations in Kazakhstan. Chaparral has no U.S. income taxes due to Chaparral's estimated domestic tax loss carryforwards of \$26.37 million as of December 31, 2002. These carryforwards will expire at various times between 2003 and 2020. See Note 14 to our consolidated financial statements for the year ended December 31, 2002.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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### Foreign Currency

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Chaparral's functional currency is the U.S. Dollar. All transactions arising in currencies other than U.S. Dollars, including assets, liabilities, revenue, expenses, gains, or losses are measured and recorded in U.S. Dollars using the exchange rate in effect on the date of the transaction.

Cash and other monetary assets held and liabilities denominated in currencies other than U.S. Dollars are translated at exchange rates prevailing as of the balance sheet date (144.22 and 155.60 Kazakh Tenge per U.S. Dollar as of December 31, 2003 and 2002, respectively). Non-monetary assets and liabilities denominated in currencies other than U.S. Dollars have been translated at the estimated historical exchange rate prevailing on the date of the transaction. Exchange gains and losses arising from translation of non-U.S. Dollar amounts at the balance sheet date are recognized as an increase or decrease in income for the period.

The devaluation of the Tenge, the currency of the Republic of Kazakhstan, can significantly decrease the value of the monetary assets that we hold in Kazakhstan as well as our assets in that country that are based on the Tenge. During 2003, however, the Tenge has appreciated against the U.S. Dollar by 7.31%. There remains no guarantee that this appreciation is either sustainable or permanent in the foreseeable future. KKM retains the majority of cash and cash equivalents in U.S. Dollars in bank accounts within Kazakhstan, but KKM's statutory tax basis in its assets, tax loss carryforwards, and VAT receivables are all denominated in Tenge and subject to the effects of devaluation. Local tax laws allow basis adjustments to offset the impact of inflation on statutory tax basis assets, but there is no assurance that any adjustments will be sufficient to offset the effects of inflation in whole or in part. If not, KKM may be subject to much higher income tax liabilities within Kazakhstan due to inflation and/ or devaluation of the local currency. Additionally, devaluation may create uncertainty with respect to the future business climate in Kazakhstan and to our investment in that country. It should be noted that 96% of our crude oil sales in 2003 were denominated in U.S. Dollars, while the majority of our capital expenditures, operating costs and general and administrative expenses are denominated in Tenge.

The Tenge is not a convertible currency outside of the Republic of Kazakhstan. The translation of Tenge denominated assets and liabilities in these financial statements does not indicate that Chaparral could realize or settle these assets and liabilities in U.S. Dollars.

We had \$3.70 million of net monetary liabilities denominated in Tenge as of December 31, 2003.

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### Commodity Prices for Oil

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During 2003 we sold approximately 2,694,000 barrels of crude oil, recognizing \$57.61 million, or \$21.39 per barrel, in revenue. In comparison, we sold approximately 2,467,000 barrels of crude oil, recognizing \$45.13 million in revenue, or \$18.29 per barrel, for the year ended December 31, 2002.

Under the terms of the Agreement, we have a right to export, and receive export quota for, 100% of the production from the Karakuduk Field. The domestic market does not permit world market prices to be obtained, resulting in approximately \$10 to \$12 lower cash flow per barrel. Furthermore, the Government

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has not allocated sufficient export quota to allow us to sell all of our available crude oil production on the world market. We are taking steps to reduce our local market obligations and to obtain an export quota that will enable us to sell all of our crude oil production. On July 17, 2003, we took the first step towards the commencement of arbitration proceedings in Switzerland for the breach of the Agreement by the Government of Kazakhstan by initiating a required three-month period of consultation with the Government. Although the consultation period has expired, we continue to seek an amicable resolution with the Government on this matter rather than proceeding with arbitration. If the matter can not be resolved in a satisfactory manner we have, however, reserved our right to commence formal arbitration proceedings pursuant to our contractual arrangements with the Government.

Chaparral has been successful in 2003 in increasing its export sales and reducing its local market deliveries. As of December 31, 2003, Chaparral has sold approximately 2,694,000 barrels of its current year production, of which approximately 2,591,000 barrels, or 96%, have been sold at world market prices and 103,000 barrels, or 4%, have been sold at domestic market prices. This represents a significant increase in sales at world market prices and corresponding decrease in local market price sales from the year 2002.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Item 15(a) for a list of the Financial Statements and the supplementary financial information included in this report following the signature page.

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not Applicable.

### ITEM 9A. Controls and Procedures.

- a) Evaluation of Disclosure Controls and Procedures. We maintain disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in the periodic reports we file with the SEC is recorded, processed, summarized and reported within the time periods specified in the rules of the SEC. We carried out an evaluation as of December 31, 2003, under the supervision and the participation of our management, including our chief executive officer and chief financial officer, of the design and operation of these disclosure controls and procedures pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC filings.
- (b) Changes in internal controls over financial reporting. There have been no significant changes in internal controls over financial reporting or other factors subsequent to December 31, 2003.

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## PART III

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

As of March 15, 2004, the following table sets forth the names and ages of our directors and executive officers of Chaparral, the principal offices and positions with Chaparral held by each person and the date such person became a

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director or executive officer. The executive officers are elected annually by the board of directors. Executive officers serve terms of one year or until their death, resignation or removal by the board of directors. The present term of office of each director will expire at the next annual meeting of stockholders. Each executive officer will hold office until his successor duly is elected and qualified, until his resignation or until he is removed in the manner provided by our bylaws.

Name of Director or Officer and Position in Chaparral -----	Since -----	Age ---	Principal Occupation During the La -----
Ian Connor Chairman of the Board	2002	38	Mr. Connor has served as the Chairman of Chaparral since November 2002. Mr. Connor has served as Chairman of Kazkommerts Securities, the investment company; as Chairman of Kazkommertsbank; is a Managing Director of an investment company; and Chairman of a registered oil and gas company. Formerly, Mr. Connor served as a Managing Director of Open Joint Stock Company Kazkommertsbank, a commercial bank in Kazakhstan. Prior to joining Kazkommertsbank, Mr. Connor held several senior executive positions, including Executive Officer at Global Menkul Değerler A.Ş., an Istanbul-based brokerage and investment company, from March 2001 to March 2001.
Nikolai D. Klinchev Director and Chief Executive Officer	2002	46	Mr. Klinchev has been the Chief Executive Officer of Chaparral since November 2002. From July 2002, he served as Vice President - Business Development of Chaparral. Mr. Klinchev has served as a board member of KKM since 1998 and as a board member of KKM since 1998. Mr. Klinchev graduated from the Institute of Energy Engineering in Kazakhstan, as a power engineer and specialist in management in St. Petersburg (formerly Leningrad).
Askar Alshinbayev Director	2002	39	Mr. Alshinbayev has served as Managing Director and Executive Officer of Central Asian International Bank since May 2002. Since 1998, Mr. Alshinbayev has served as Managing Director of Open Joint Stock Company Kazkommertsbank, a commercial bank in Kazakhstan. From 1994 to 1998, he served as a member of the Management Board of Kazkommertsbank. Mr. Alshinbayev also serves on the Board of Directors of Chaparral Resources Inc. and Nelson Resources, Ltd.

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Name of Director or Officer and Position in Chaparral -----	Since -----	Age ---	Principal Occupation During the La -----
Peter G. Dilling * Director	2002	54	From 1995 to 1997, Mr. Dilling held various positions with Chaparral, including Vice Chairman of the Board. Mr. Dilling has served as President and Chief Executive Officer and as a director of Trinidad and Tobago Development, Ltd., an oil and gas exploration and production company. Mr. Dilling has served as President and Chief Executive Officer of a Director of Anglo-African Energy, Inc.

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John Duthie * Director	2002	61	production company, since 1999. Prior Anglo-African, Mr. Dilling was President M-D International Petroleum, Inc., an production company, from 1994 to 1997  Since December 2002, Mr. Duthie has owned Bowler Hat Ltd., a H.K. based company in the Black Sea region. He also serves as a consultant to a major corporate finance house, and provides investment advice to various Turkish corporations and institutions. Prior to 2002, he served as General Manager for Westdeutsche Bank, Turkey, a commercial bank headquartered in Turkey, from 1994 to 1997. He previously held various positions at Lynch & Co., a stock brokerage house and Deutsche Bank, a commercial bank and investment institution.
Alan D. Berlin * Director and Corporate Secretary	2002	64	Since 1995, Mr. Berlin has been a partner in Aitken Irvin Berlin & Vrooman, LLP. He has been in private practice of law for over five years with Aitken Irvin. Mr. Berlin served as a Director of the Company in 1997 and was the Secretary of Chaparral from August 1997 to August 1998. Since June 1998, he has held the same position. From 1985 to 1987, he was President of the International Division of Shell International Corp. and held various other positions with Shell Corp. and Belco Oil and Gas Corp. from 1980 to 1985. Mr. Berlin has been appointed an Honorary Fellow of the Centre for Petroleum and Mineral Law at the University of Dundee, Scotland, and is a member of the Association of International Petroleum
Jonathan S. Wood VP-Finance and Chief Financial Officer	2004	40	Mr. Wood, currently the Finance Director of the Stock Company Karakudukmunai ("KKM"), an operating subsidiary in the Republic of Azerbaijan, has held the title of Vice President-Finance and Chief Financial Officer of the Company in January 2004. He has worked with KKM since 1998 when he was appointed as the Controller of KKM. He has over 18 years of experience in the international petroleum industry, including experience in the Former Soviet Union.
Name of Director or Officer and Position in Chaparral -----	Since -----	Age -----	Principal Occupation During the Last
Miguel C. Soto Treasurer and Controller	2002	32	Mr. Soto has served as Treasurer and Controller of Chaparral since November 2002. Since November 2002, he has been the Financial Controller of KKM. Prior to joining Chaparral in November 2002, he served as the Financial Controller of Chaparral. Prior to joining Chaparral, he was a Tax Accountant for Arthur Andersen and as a Staff Accountant for a technology company. He is a Committee member.

Audit Committee Financial Expert

The Board of Directors has determined that all audit committee members are financially literate under the current listing standards of the New York Stock Exchange. The Board also determined that John Duthie qualifies as an "audit committee financial expert" as defined by the SEC rules adopted pursuant to the Sarbanes-Oxley Act of 2002.

Code of Ethics

Chaparral has adopted a code of ethics that applies to all of its directors, officers (including its chief executive officer, chief financial officer, chief accounting officer, controller and any person performing similar functions) and its employees. Chaparral has filed a copy of this Code of Ethics as Exhibit 99.2 to this form 10-K.

Shareholder Nomination Procedures

There had been none material changes, during the fourth fiscal quarter, to the procedures disclosed in the Proxy statement filed on September 9, 2003 with the SEC.

Committees of the Board of Directors and Meeting Attendance

During the fiscal year 2003, Chaparral held six Board meetings. The Board had several committees, including the Compensation Committee, the Audit Committee, the Nominations Committee, and the Corporate Governance Committee.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based solely upon a review of Forms 3 and 4 and any amendments furnished to Chaparral during our fiscal year ended December 31, 2003, and Form 5 and any amendments furnished to Chaparral with respect to the same fiscal year, we believe that our directors, officers, and greater than 10% beneficial owners complied with all applicable Section 16 filing requirements.

ITEM 11. EXECUTIVE COMPENSATION

The following table shows the compensation paid by Chaparral for services



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rendered by Mr. Moore, who was the Vice President - Finance, and Chief Financial Officer of Chaparral, Mr. Klinchev, who is the Chief Executive Officer of Chaparral, Mr. Wood, who is currently the Vice President - Finance and Chief Financial Officer of Chaparral, and Mr. Soto, who is currently the Treasurer and Controller of Chaparral. There were no other executive officers of Chaparral whose annual salary and bonus exceeded \$100,000 during the fiscal year 2003.

### Summary Compensation Table.

Name and Principal Position -----	Year ----	Annual Compensation -----			Long-Term Comp -----	
		Salary -----	Bonus -----	Other Annual Compensation -----	Restricted Stock Awards (\$) -----	Securities Options/S -----
Nikolai D. Klinchev Chief Executive Officer (11/02 to Present)	2003	\$282,000	\$290,000	--	--	--
	2002	\$164,500 (1)		--	--	--
Jonathan S. Wood VP-Finance and Chief Financial Officer (01/04 to Present)	2003	\$235,000 (2)	\$136,000 (2)	--	--	--
Richard J. Moore Former VP-Finance and Chief Financial Officer (11/02 to 12/03)	2003	\$282,000	\$40,000	--	--	--
	2002	\$164,500 (3)	\$90,000	--	--	--
Miguel C. Soto Treasurer and Controller (11/02 to present)	2003	\$172,000	\$67,000	--	--	--
	2002	\$116,933	\$35,000	--	--	--

1. Represents compensation paid to Mr. Klinchev from June 2002 to December 31, 2002. In addition, \$28,000 was paid by Chaparral for the education for Mr. Klinchev's daughter during 2003.
2. Mr. Wood served as Financial Director of KKM during 2003 for which he received salary of \$235,000 and bonuses in the amount \$136,000.
3. Represents compensation paid to Mr. Moore from June 2002 to December 31, 2002.

### Options/SAR Grants.

For the fiscal year ended December 31, 2003, we did not grant any options.

### Aggregated Option/SAR Exercises and Year-End Option/SAR Value.

As of December 31, 2003, there were no unexercised options/SARs and additionally, no options were exercised in fiscal year 2003.

### Director Interlocks.

Mr. Alshinbayev is a Managing Director of Kazkommertsbank and the Chief Executive Officer of CAIH. Mr. Connor, Chaparral's current Chairman, is also a Chairman of Kazkommerts Securities. Mr. Klinchev, Chaparral's current Chief Executive Officer, has acted as a Director of KKM since 1996.

Compensation of Directors.

During the fiscal year ended December 31, 2002, Chaparral implemented a standard compensation arrangement for its directors, including providing (i) \$700 in compensation to each director for each board or committee meeting attended via teleconference, (ii) \$1,000 in compensation to each director for each board or committee meeting attended in person, (iii) \$2,000 in compensation per day while traveling on Chaparral related business, including board meetings, and (iv) \$2,500 in quarterly compensation for serving on Chaparral's Board.

Stock Performance Graph.

Comparison of Five Year Cumulative Total Return

The following line graph compares the total returns (assuming reinvestment of dividends) of common stock, the Nasdaq Market Index and the SIC Code Index for the five year period ending December 31, 2003.

	1998	1999	2000	2001	2002	2003
CHAPARRAL RESOURCES, INC.	100	38.02	17.50	7.29	4.83	4.88
SIC CODE INDEX	100	129.77	146.37	130.66	130.71	201.17
NASDAQ MARKET INDEX	100	185.46	111.65	88.57	61.09	92.15

Board Compensation Committee Report on Executive Compensation

Insider Participation In Compensation Decisions  
And Compensation Committee  
Report On Executive Compensation

The Compensation Committee of our board of directors determines the compensation of the executive officers named in the Summary Compensation Table included as part of "Item 11 - Executive Compensation." The Compensation Committee will furnish the following report on executive compensation in connection with the Annual Meeting:

Compensation Philosophy.

As members of the Compensation Committee, it is our duty to administer the executive compensation program for Chaparral. The Compensation Committee is responsible for establishing appropriate compensation goals for the executive officers of Chaparral, evaluating the performance of such executive officers in meeting such goals and making recommendations to the Board with regard to executive compensation. Chaparral's compensation philosophy is to ensure that executive compensation be directly linked to continuous improvements in corporate performance, achievement of specific operation, financial and strategic objectives, and increases in shareholder value. The Compensation Committee regularly reviews the compensation packages of Chaparral's executive officers, taking into account factors which it considers relevant, such as business conditions within and outside the industry, Chaparral's financial performance, the market composition for executives of similar background and

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experience, and the performance of the executive officer under consideration. The particular elements of Chaparral's compensation programs for executive officers are described below.

### Compensation Structure.

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The base compensation for the executive officers of Chaparral named in the Summary Compensation Table is intended to be competitive with that paid in comparable situated industries, taking into account the scope of responsibilities. The goals of the Compensation Committee in establishing Chaparral's executive compensation program are:

- o to compensate the executive officers of Chaparral fairly for their contributions to Chaparral's short, medium and long-term performance; and
- o to allow Chaparral to attract, motivate and retain the management personnel necessary to Chaparral's success by providing an executive compensation program comparable to that offered by companies with which Chaparral competes for management personnel.

The elements of Chaparral's executive compensation program are annual base salaries, annual bonuses and equity incentives. The Compensation Committee bases its decisions on the scope of the executive's responsibilities, a subjective evaluation of the executive's performance and the length of time the executive has been in the position.

In June 2001, Chaparral's stockholders approved the 2001 Stock Incentive Plan, which sets aside 2.14 million shares of Chaparral's common stock for issuance to Chaparral's officers, directors, employees, and consultants. Chaparral has not made any grants under the 2001 Stock Incentive Plan as of December 31, 2003.

### Compensation of the Chief Executive Officer.

-----

During fiscal year 2003, Mr. Klinchev served as Chief Executive Officer of Chaparral. In establishing Mr. Klinchev's base salary, the Compensation Committee considered the factors set forth above, including the level of CEO compensation in other publicly owned/similar sized exploration and production companies in the oil and gas industry and Mr. Klinchev's level of involvement in the day-to-day operations of Chaparral.

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### Executive Compensation Deductibility.

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Chaparral intends that amounts paid under Chaparral's compensation plans generally will be deductible compensation expenses. The Compensation Committee does not currently anticipate that the amount of compensation paid to executive officers will exceed the amounts specified as deductible according to Section 162(m) of the Internal Revenue Code of 1986.

### Compensation Committee Interlocks and Insider Participation.

-----

No executive officer or director of Chaparral serves as an executive officer, director, or member of a compensation committee of any other entity, for which an executive officer, director, or member of such entity is a member

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of the Board or the Compensation Committee of the Board. There are no other interlocks.

Compensation Committee of the Board of Directors,  
 Ian Connor, Chairman  
 Askar Alshinbayev  
 Nikolai D. Klinchev

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### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information as of March 15, 2004, with respect to our directors, named executive officers and each person who is known by us to own beneficially more than 5% of our common stock, and with respect to shares owned beneficially by all of our directors and executive officers as a group. The address for all of our directors and executive officers of Chaparral is 2 Gannett Drive, Suite 418, White Plains, New York 10604.

Name of Beneficial Owner -----	Position -----	Amount and Nature of Beneficial Ownership (1) -----
Central Asian Industrial Holdings, N.V. 81 Scharlooweg, Curacao, Netherlands Antilles	--	26,002,624 (2)
Allen & Company Incorporated 711 Fifth Avenue New York, New York 10022	--	5,642,578 (3)
Whittier Ventures, LLC 1600 Huntington Drive South Pasadena, California 91030	--	4,113,122
Ian Connor	Chairman of the Board	--
Nikolai D. Klinchev	Director and Chief Executive Officer	500,084 (4)
Askar Alshinbayev	Director	26,002,624 (5)
Peter G. Dilling	Director	--
John Duthie	Director	--
Alan D. Berlin	Director and Corporate Secretary	167 (6)
Jonathan S. Wood	VP - Finance and Chief Financial Officer	--
Richard J. Moore	Former VP - Finance and Chief Financial Officer	--
Miguel C. Soto	Treasurer and Controller	--

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All current directors, nominees, and executive officers as a group (eight persons)

--

26,502,875

-----

\* Represents less than 1% of the shares of Common Stock outstanding.

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- (1) Beneficial ownership of Common Stock has been determined for this purpose in accordance with Rule 13d-3 under the Exchange Act, under which a person is deemed to be the beneficial owner of securities if such person has or shares voting power or investment power with respect to such securities, has the right to acquire beneficial ownership within 60 days or acquires such securities with the purpose or effect of changing or influencing the control of Chaparral.
- (2) In accordance with Rule 13d-3(d) (1) (i) (A), includes 3,076,923 shares underlying warrants to purchase shares of Common Stock. Does not include shares owned directly by officers and stockholders of CAIH with respect to which CAIH disclaim beneficial ownership. Officers and stockholders of CAIH may be deemed to beneficially own shares of the Common Stock reported to be beneficially owned directly by CAIH.
- (3) Does not include shares owned directly by officers and stockholders of Allen Holding and Allen & Company with respect to which Allen Holding and Allen & Company disclaim beneficial ownership. Officers and stockholders of Allen Holding and Allen & Company may be deemed to beneficially own shares of the Common Stock reported to be beneficially owned directly by Allen Holding and Allen & Company.
- (4) In accordance with Rule 13d-3(d) (1) (i) (A), includes 500,000 shares beneficially owned by NK Cayman Limited.
- (5) In accordance with Rule 13d-3(d) (1) (i) (A), includes 3,076,923 shares underlying warrants to purchase shares of Common Stock. Mr. Alshinbayev has a pecuniary interest in the shares beneficially owned by CAIH and has voting power and investment power over such shares and, thus, may be deemed to beneficially own such shares.
- (6) Includes 167 shares owned by Mr. Berlin.

### 1998 Incentive and Non-statutory Stock Option Plan

On June 26, 1998, the stockholders approved the 1998 Incentive and Non-statutory Stock Option Plan (the "1998 Plan"), pursuant to which up to 50,000 options to acquire Chaparral's common stock may be granted to officers, directors, employees, or consultants of Chaparral and its subsidiaries. The stock options granted under the 1998 Plan may be either incentive stock options or nonstatutory stock options. The 1998 Plan has an effective term of ten years, commencing on May 20, 1998. Chaparral has not granted any options under the 1998 Plan as of December 31, 2003.

### 2001 Stock Incentive Plan

In June 2001, Chaparral's stockholders approved the 2001 Stock Incentive Plan, which sets aside a total of 2.14 million shares of Chaparral's common stock for issuance to Chaparral's officers, directors, employees, and

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consultants. Chaparral has not made any grants under the 2001 Stock Incentive Plan as of December 31, 2003.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In May 2002, Chaparral received a total equity and debt capital infusion of \$45 million, which was partially utilized to repay a substantial portion of Chaparral's loan agreement with Shell Capital. Chaparral received a total investment of \$12 million from CAIH, including \$8 million in exchange for 22,925,701 shares, or 60%, of Chaparral's outstanding common stock, and \$4 million in exchange for a three year note bearing interest at 12% per annum (the "CAIH Note"). Along with the CAIH Note, CAIH received a warrant to purchase 3,076,923 shares of Chaparral's common stock at \$1.30 per share (the "CAIH Warrant"). Additionally, Kazkommertsbank, an affiliate of CAIH, provided KKM with a credit facility totaling \$33 million, consisting of \$28 million that was used to repay a portion of the Shell Capital Loan and \$5 million that was made available for KKM's working capital requirements. Chaparral paid CAIH \$1.79 million as a related restructuring fee. See Note 11 to our consolidated financial statements for the year ended December 31, 2003 for additional disclosure on loans with affiliates.

In 2003, Chaparral approved a one-year agreement with OJSC Kazkommerts Securities ("KKS"), an affiliate of Kazkommertsbank, The agreement is effective as of January 7, 2003 and provides for KKS to assist the Chaparral's senior management with financial advisory and investment banking services. In consideration for the services, KKS received a monthly fee of \$25,000 (the "Advisory Fee").

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### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The following table shows the fees paid or accrued (in thousands) by Chaparral for the audit and other services provided by Ernst & Young and affiliated entities for the years ended December 31, 2003 and 2002.

Description	2003	2002
-----	-----	-----
Audit Fees	\$ 261	\$ 240
Tax Fees	12	9
Audit Related Fees	--	--
All other fees	--	--
	-----	-----
Total	\$ 273	\$ 249
	=====	=====

The Audit Committee must pre-approve audit-related and non-audit services not prohibited by law to be performed by Chaparral's independent auditors. The Audit Committee pre-approved all audit-related and non-audit services in 2003.

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## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

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## (a) (1) Financial Statements

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## (a) (2) Financial Statement Schedules

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All schedules for which a provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and, therefore, have been omitted.

## (b) Current Reports on Form 8-K

-----

We filed a Current Report on Form 8-K, dated January 9, 2004 to report that Richard J. Moore had resigned as Chaparral's Vice President-Finance and Chief Financial Officer. Mr. Moore was replaced by Jonathan S. Wood, currently the Finance Director of KKM, who assumed the title of Vice President-Finance and Chief Financial Officer of Chaparral.

## (c) Exhibits.

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Exhibit No.	Description and Method of Filing
-----	
*2.1	Stock Acquisition Agreement and Plan of Reorganization dated April 12, 1995 between Chaparral Resources, Inc., and the Shareholders of Central Asian Petroleum, Inc.
*2.2	Escrow Agreement dated April 12, 1995 between Chaparral Resources, Inc., the Shareholders of Central Asian Petroleum, Inc. and Barry W. Spector.
*2.3	Amendment to Stock Acquisition Agreement and Plan of Reorganization dated March 10, 1996 between Chaparral Resources, Inc., and the Shareholders of Central Asian Petroleum, Inc.

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- 3.1 Certificate of Incorporation, dated April 21, 1999, incorporated by reference to Chaparral Resources, Inc.'s Notice and Definitive Schedule 14A dated April 21, 1999.

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Exhibit No.	Description and Method of Filing
3.2	Bylaws, dated April 21, 1999, incorporated by reference to Annex IV to our Notice and Definitive Schedule 14A dated April 21, 1999.
4.1	Written Resolutions of the Shareholders of Central Asian Petroleum (Guernsey) Limited dated May 30, 2001, authorizing the issuance of Series A Preferred Shares in Central Asian Petroleum (Guernsey) Limited, incorporated by reference to Exhibit 4.1 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, filed with Securities and Exchange Commission on August 14, 2001.
*10.1	Agreement dated August 30, 1995 for Exploration Development and Production of Oil in Karakuduk Oil Field in Mangistan Oblast of the Republic of Kazakhstan between Ministry of Oil and Gas Industries of the Republic of Kazakhstan for and on Behalf of the Government of the Republic of Kazakhstan and Joint Stock Company of Closed Type Karakuduk Munay Joint Venture.
*10.2	License for the Right to Use the Subsurface in the Republic of Kazakhstan.
*10.3	Amendment dated September 11, 1997, to License for Right to Use the Subsurface in the Republic of Kazakhstan.
10.4	Amendment to License for the Right to Use the Subsurface in the Republic of Kazakhstan, dated December 31, 1998, incorporated by reference to Exhibit 10.25 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1998, filed with the Securities and Exchange Commission on April 15, 1999.
10.5	Letter from the Agency of the Republic of Kazakhstan on Investments to Central Asian Petroleum (Guernsey) Limited dated July 28, 1999 regarding License for Right to Use the Subsurface in the Republic of Kazakhstan, incorporated by reference to Exhibit 10.5 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1999, filed with the Securities and Exchange Commission on March 30, 2000.
10.6	1998 Incentive and Non-statutory Stock Option Plan, incorporated by reference to Exhibit 10.24 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1998, filed with the Securities and Exchange Commission on April 15, 1999.
10.7	CRI-CAP(G) Loan Agreement, dated February 7, 2000, between Chaparral Resources, Inc. and Central Asian Petroleum (Guernsey) Limited, incorporated by reference to Exhibit



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- 10.13 to Chaparral Resources, Inc.'s Current Report on 8-K dated February 14, 2000, filed with the Securities and Exchange Commission on March 22, 2000.
- 10.8 CAP(G)-KKM Loan Agreement, dated February 7, 2000, between Closed Type JSC Karakudukmunay and Central Asian Petroleum (Guernsey) Limited, incorporated by reference to Exhibit 10.16 to Chaparral Resources, Inc.'s Current Report on 8-K dated February 14, 2000, filed with the Securities and Exchange Commission on March 22, 2000.
- 10.9 2001 Stock Incentive Plan approved by the stockholders of Chaparral Resources, Inc. on June 21, 2001, incorporated by reference to Exhibit 10.43 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 2001, filed with the Securities and Exchange Commission on April 15, 2000.
- 10.10 Master Agreement, dated May 9, 2002, between Chaparral Resources, Inc. and Central Asian Industrial Holdings, N.V., incorporated by reference to Exhibit 10.1 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the Securities and Exchange Commission on May 20, 2002.

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Exhibit No.	Description and Method of Filing
10.11	Mutual Release Agreement, dated May 7, 2002, among Chaparral Resources, Inc., Central Asian Petroleum (Guernsey) Limited, Central Asian Petroleum, Inc. and Closed Type JSC Karakudukmunay, and Shell Capital Inc., Shell Capital Services Limited and Shell Capital Limited, incorporated by reference to Exhibit 10.2 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the Securities and Exchange Commission on May 20, 2002.
10.12	Promissory Note, dated May 10, 2002, jointly and severally between Chaparral Resources, Inc. and Central Asian Petroleum (Guernsey) Limited and Central Asian Industrial Holdings, N.V., incorporated by reference to Exhibit 10.3 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the Securities and Exchange Commission on May 20, 2002.
10.13	Stock Purchase Warrant, dated May 10, 2002, between Chaparral Resources, Inc. and Central Asian Industrial Holdings, N.V., incorporated by reference to Exhibit 10.4 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the Securities and Exchange Commission on May 20, 2002.
10.14	Registration Agreement, dated May 10, 2002, between Chaparral Resources, Inc. and Central Asian Industrial Holdings, N.V., incorporated by reference to Exhibit 10.5 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the Securities and Exchange Commission on May 20, 2002.

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- 10.15 Agreement, dated May 8, 2002, between Chaparral Resources, Inc. and Exeter Finance Group, Inc., incorporated by reference to Exhibit 10.6 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the Securities and Exchange Commission on May 20, 2002.
- 10.16 Stock Purchase Agreement, dated May 9, 2002, between Chaparral Resources, Inc. and Dardana Limited, incorporated by reference to Exhibit 10.7 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the Securities and Exchange Commission on May 20, 2002.
- 10.17 Loan Agreement #250, dated May 6, 2002, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.1 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 19, 2002.
- 10.18 Additional Agreement, dated May 6, 2002, to Loan Agreement #250, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.2 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 19, 2002.
- 10.19 Additional Agreement, dated June 6, 2002, to Loan Agreement #250, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.3 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 19, 2002.
- 10.20 Accessorial Agreement #5382A, dated May 6, 2002, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.4 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 19, 2002.

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Exhibit No.	Description and Method of Filing
-----	-----
10.21	Additional Agreement, dated May 7, 2002, to Accessorial Agreement #5382A, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.5 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 19, 2002.
10.22	Accessorial Agreement #5896A, dated July 31, 2002, among Closed Joint Stock Company Karakudukmunai and Open Joint

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Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.6 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 19, 2002.

- 10.23 Open Joint Stock Company Kazkommertsbank letter dated August 16, 2002, to Closed Joint Stock Company Karakudukmunai, incorporated by reference to Exhibit 10.7 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 19, 2002, incorporated by reference to Exhibit 10.7 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 19, 2002.
- 10.24 Amendment to License dated December 11, 2002, to provide for the stabilization of taxes and clarification on tax laws applicable to KKK, incorporated by reference to Exhibit 10.58 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2002, filed with the Securities and Exchange Commission on March 31, 2003.
- 10.25 Service Agreement, dated January 7, 2003, between Chaparral Resources, Inc. and OJSC Kazkommerts Securities, incorporated by reference to Exhibit 10.1 to Chaparral Resources, Inc.'s Quaterly Report on Form 10-Q for the period ended June 30, 2003, filed with the Securities and Exchange Commission on August 14, 2003.
- 21 Subsidiaries of the Registrant, incorporated by reference to Exhibit 21 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1997, filed with the Securities and Exchange Commission on April 6, 1998.
- \*\*23 Consent of Ryder Scott Company dated March 10, 2004.
- \*\*31.2 Certification Pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- \*\*32.1 Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished pursuant to Item 601(b)(32) of Regulation S-K).
- \*\*32.2 Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished pursuant to Item 601(b)(32) of Regulation S-K).
- \*\*99.1 Letter from Ryder Scott Company to Chaparral Resources, Inc. regarding reserve estimates of the Karakuduk Field as of December 31, 2003, dated March 5, 2004.
- \*\*99.2 Chaparral's Code of Ethics

\* These exhibits, previously incorporated by reference to Chaparral's reports under file number 0-7261, have now been on file with the Commission for more

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than 5 years and are not filed with this Annual Report. We agree to furnish these documents to the Commission upon request.

\*\* Filed herewith.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHAPARRAL RESOURCES, INC.,  
a Delaware corporation

By /s/ Nikolai D. Klinchev

-----  
Nikolai D. Klinchev  
Chief Executive Officer  
(Principal Executive Officer)

By /s/ Jonathan S. Wood

-----  
Jonathan S. Wood  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

By /s/ Miguel C. Soto

-----  
Miguel C. Soto  
Treasurer and Financial Controller  
(Financial Controller)

Dated: March 15, 2003

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Date	Name and Title	Signature
----	-----	-----
March 15, 2003	Askar Alshinbayev, Director	/s/ Askar Alshinbayev -----
March 15, 2003	Alan D. Berlin, Director and Corporate Secretary	/s/ Alan D. Berlin -----
March 15, 2003	Ian Connor, Chairman of the Board	/s/ Ian Connor -----
March 15, 2003	Peter G. Dilling, Director	/s/ Peter G. Dilling -----
March 15, 2003	John Duthie, Director	/s/ John Duthie -----

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March 15, 2003

Nikolai D. Klinchev, Chief  
Executive Officer

/s/ Nikolai D. Klinchev  
-----

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Consolidated Financial Statements

Chaparral Resources, Inc.

As of December 31, 2003 and 2002 and for the Three Years ended  
December 31, 2003 with  
Report of Independent Auditors

Chaparral Resources, Inc.

Consolidated Financial Statements

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Chaparral Resources, Inc.

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Report of Independent Auditors

The Board of Directors and Stockholders  
Chaparral Resources, Inc.

We have audited the accompanying consolidated balance sheets of Chaparral Resources, Inc. as of December 31, 2003 and 2002, and the related consolidated statements of operations, cash flows, and changes in stockholders' equity for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our

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responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Chaparral Resources, Inc. at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the consolidated financial statements, in 2003 Chaparral Resources, Inc. adopted Statement of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations".

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As more fully described in Note 2, the Company has a working capital deficiency as of December 31, 2003, and there are uncertainties relating to the Company's ability to meet projected cash flow requirements through 2004. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans and other factors in regard to these matters are also described in Note 2. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

/s/ Ernst & Young Kazakhstan  
-----  
Ernst & Young Kazakhstan

March 17, 2004  
Almaty, Kazakhstan

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### CHAPARRAL RESOURCES, INC. CONSOLIDATED BALANCE SHEETS (In Thousands)

	December 31,	
	2003	2002
	-----	-----
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,639	\$ 4,295

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Accounts receivable:		
Oil sales receivable	215	1,993
VAT receivable (Note 3)	2,907	1,999
Prepaid expenses (Note 4)	1,940	1,872
Prepaid expenses to affiliates (Note 4)	1,296	584
Crude oil inventory	544	548
	-----	-----
Total current assets	9,541	11,291
Materials and supplies	3,188	2,457
Other	--	5
Property, plant and equipment:		
Oil and gas properties, full cost: (Note 5)		
Properties subject to depletion	118,347	84,833
Properties not subject to depletion	2,942	8,814
	-----	-----
	121,289	93,647
Other property, plant and equipment (Note 6)	9,408	8,210
	-----	-----
	130,697	101,857
Less - accumulated depreciation, depletion, and amortization	(44,758)	(28,302)
	-----	-----
Property, plant and equipment, net	85,939	73,555
Total assets	\$ 98,668	\$ 87,308
	=====	=====

See accompanying notes.

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CHAPARRAL RESOURCES, INC.  
CONSOLIDATED BALANCE SHEETS  
(In Thousands)

	December 31,	
	2003	2002
	-----	-----
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 6,086	\$ 2,772
Accounts payable to affiliates (Note 18)	1,143	37
Accrued liabilities:		
Accrued compensation	949	227
Other accrued liabilities (Note 8)	1,571	2,432
Accrued interest payable (Note 11)	776	250
Current income tax liability (Note 13)	3	1,939
Current portion of loans payable to affiliates (Note 11)	12,000	6,000
	-----	-----
Total current liabilities	22,528	13,657
Accrued production bonus (Note 9)	190	477
Loans payable to affiliates (Note 11)	21,284	27,998
Deferred tax liability (Note 13)	3,057	746
Minority interest	4,635	321
Asset Retirement Obligation (Note 10)	804	--
Commitments and contingencies (Note 16)	--	--
Stockholders' equity:		
Common stock (Note 12) - authorized, 100,000,000		

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shares of \$0.0001 par value; issued and outstanding, 38,209,502 and 38,209,502 shares as of December 31, 2003 and December 31, 2002, respectively	4	4
Capital in excess of par value	107,226	107,226
Preferred stock - 1,000,000 shares authorized, 925,000 shares undesignated. Issued and outstanding - none	--	--
Accumulated deficit	(61,060)	(63,121)
Total stockholders' equity	46,170	44,109
Total liabilities and stockholders' equity	\$ 98,668	\$ 87,308

See accompanying notes.

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CHAPARRAL RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In Thousands, Except Share Data)

	Year Ended December 31,		
	2003	2002	2001
Revenue	\$ 57,615	\$ 45,133	\$ --
Costs and expenses:			
Transportation costs	11,474	9,427	--
Operating expenses	5,915	7,678	--
Impairment of materials inventory	--	203	--
Depreciation, depletion, and amortization	18,038	12,804	753
Advisory fee (Note 18)	300	--	--
Hedge losses (Note 7)	--	762	237
General and administrative	7,762	6,811	4,330
	43,489	37,685	5,320
Income/(loss) from operations	14,126	7,448	(5,320)
Other income (expense):			
Interest income	24	8	1,454
Interest expense	(4,526)	(5,605)	(14,446)
Equity income from investment (Note 20)	--	--	4,616
Accretion expense	(73)	--	--
Currency exchange gain/(loss)	(62)	(131)	--
Minority interest	(4,314)	(241)	--
Other	(11)	(15)	--
	(8,962)	(5,984)	(8,376)
Income/(loss) before income taxes, extraordinary gain, and cumulative effect of change in accounting principle	5,164	1,464	(13,696)
Income tax expense (Note 13)	(4,121)	(2,685)	--
Income/(loss) before extraordinary gain and cumulative effect of change in accounting principle	\$ 1,043	\$ (1,221)	\$ (13,696)
Extraordinary gain (Note 11)	--	5,338	--
Cumulative effect of change in accounting			



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principle, net of taxes of \$436,000 for 2003 and \$0 for 2001 (Notes 7 & 10)	1,018	--	(2,519)
	-----	-----	-----
Net income/(loss)	\$ 2,061	\$ 4,117	\$ (16,215)
	=====	=====	=====

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CHAPARRAL RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In Thousands, Except Share Data)

	Year Ended December 31,		
	2003	2002	2001
	-----	-----	-----
Net income/(loss)	\$ 2,061	\$ 4,117	\$ (16,215)
Cumulative annual dividend accrued			
Series A Redeemable Preferred Stock	--	--	(250)
Discount accretion			
Series A Redeemable Preferred Stock	--	--	(100)
	-----	-----	-----
Net income/(loss) available to common Stockholders	\$ 2,061	\$ 4,117	\$ (16,565)
	=====	=====	=====
Basic and diluted earnings per share:			
Income/(loss) per share before extraordinary gain and cumulative effect of change in accounting principle	\$ 0.03	\$ (0.04)	\$ (0.98)
Extraordinary gain	\$ --	\$ 0.18	\$ --
Cumulative effect of change in accounting principle	\$ 0.02	\$ --	\$ (0.18)
Net income/(loss) per share	\$ 0.05	\$ 0.14	\$ (1.16)
Weighted average number of shares outstanding (basic and diluted)	38,209,502	29,753,569	14,283,788

See accompanying notes.

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CHAPARRAL RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands)

	Year Ended December 31,		
	2003	2002	2001
	-----	-----	-----
Cash flows from operating activities			
Net income/(loss)	\$ 2,061	\$ 4,117	\$ (16,215)
Adjustments to reconcile net income/(loss) to			

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net cash provided in operating activities:			
Equity income from investment	--	--	(4,616)
Depreciation, depletion, and amortization	18,038	12,804	1,333
Loss on disposition of assets	11	15	--
Deferred Income taxes	2,311	746	--
Cumulative effect of change in accounting principal	(1,018)	--	2,519
Hedge losses	--	762	237
Accretion expense on ARO	73	--	--
Amortization of debt issuance cost	--	--	3,102
Amortization of note discount	286	234	--
Extraordinary gain on restructuring of debt	--	(5,338)	--
Interest expense from transfer of net profits interest	--	--	4,369
Non-cash interest expense	--	2,753	--
Minority interest	4,314	241	--
Changes in assets and liabilities:			
(Increase) decrease in:			
Accounts receivable	870	(1,960)	295
Prepaid expenses	(775)	(614)	(43)
Crude oil inventory	55	(240)	--
Accrued interest income on advances to KKM	--	--	(1,452)
Interest payments from KKM	--	--	5,799
Increase (decrease) in:			
Accounts payable and accrued liabilities	(2,094)	(5,560)	396
Accrued interest payable	526	261	1,676
Other liabilities	213	288	--
Interest expense reclassified as principal on the Shell Capital loan	--	--	4,272
Net cash provided by operating activities	24,871	8,509	1,672

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CHAPARRAL RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands)

	Year Ended December 31,		
	2003	2002	2001
Cash flows from investing activities			
Additions to property, plant, and equipment	\$ (24,800)	\$ (11,834)	\$ (18)
Investment in and advances to KKM	--	--	(7,734)
Acquisition of 10% interest in KKM, net of cash acquired	--	(644)	--
Materials and supplies inventory	(732)	353	--
Proceeds from disposition of assets	5	5	--
Net cash used in investing activities	(25,527)	(12,120)	(7,752)
Cash flows from financing activities			
Net proceeds from Shell Capital loan	\$ --	\$ --	\$ 5,650
Proceeds from sale of stock	--	8,000	--
Proceeds from loans from affiliates	6,500	40,000	--
Payments on Shell Capital loan	--	(30,450)	--
Debt restructuring and issuance costs	--	(2,518)	--
Payments on loans from affiliates	(7,500)	(5,000)	--
Redemption of Series A Preferred Stock	--	(2,300)	--

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Net cash provided/(used) by financing activities	(1,000)	7,732	5,650
	-----	-----	-----
Net increase (decrease) in cash and cash equivalents	(1,656)	4,121	(430)
Cash and cash equivalents at beginning of year	4,295	174	604
	-----	-----	-----
Cash and cash equivalents at end of year	\$ 2,639	\$ 4,295	\$ 174
	=====	=====	=====
Supplemental cash flow disclosure			
Interest paid	\$ 4,282	\$ 3,019	\$ 986
Income taxes paid	\$ 5,019	\$ --	\$ --
Supplemental schedule of non-cash investing and financing activities			
Non-cash additions to oil and gas properties	\$ 3,939	\$ --	\$ --
Common stock issued for 10% interest in KKM	\$ --	\$ 2,701	\$ --
Discount recognized for note issued with stock warrants	\$ --	\$ 2,466	\$ --

See accompanying notes.

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CHAPARRAL RESOURCES, INC.  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
(In Thousands, Except Share Data)

	Common Stock		Capital in Excess of Par Value	Unearned Restricted Stock Awards	Accumulated Deficit
	Shares	Amount	Value	Stock Awards	Deficit
	-----	-----	-----	-----	-----
Balance at December 31, 2000	14,283,634	\$ 1	\$ 94,061	\$ --	\$ (52,136)
Capital stock issued for services	167	--	--	--	--
Cumulative dividend Series A Redeemable Preferred Stock	--	--	--	--	(250)
Discount accretion on redeemable preferred stock	--	--	--	--	(100)
Net loss for the year 2001	--	--	--	--	(16,215)
	-----	-----	-----	-----	-----
Balance at December 31, 2001	14,283,801	\$ 1	\$ 94,061	\$ --	\$ (68,701)
	-----	-----	-----	-----	-----
Capital stock issued in private placement	22,925,701	3	7,998	--	--
Capital stock issued for 10% interest in KKM	1,000,000	--	2,701	--	--
CAIH warrants issued	--	--	2,466	--	--
Discount accretion on redeemable preferred stock	--	--	--	--	(36)
Cumulative dividend Series A Redeemable Preferred Stock	--	--	--	--	(90)
Redemption of Series A Redeemable Preferred Stock	--	--	--	--	3,726
Adjustment due to full consolidation of KKM	--	--	--	--	(2,137)
Net income for the year 2002	--	--	--	--	4,117
	-----	-----	-----	-----	-----

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Balance at December 31, 2002	38,209,502	\$ 4	\$ 107,226	\$ --	\$ (63,121)
	-----	-----	-----	-----	-----
Net income for the year 2003	--	--	--	--	2,061
	-----	-----	-----	-----	-----
Balance at December 31, 2003	38,209,502	\$ 4	\$ 107,226	\$ --	\$ (61,060)
	=====	=====	=====	=====	=====

See accompanying notes.

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### CHAPARRAL RESOURCES, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

##### 1. Summary of Significant Accounting Policies and Organization

###### Organization, Principles of Consolidation, and Basis of Presentation

Chaparral Resources, Inc. ("Chaparral") was incorporated in the state of Colorado on January 13, 1972, principally to engage in the exploration, development and production of oil and gas properties. Chaparral focuses substantially all of its efforts on the exploration and development of the Karakuduk Field, an oilfield located in the Central Asian Republic of Kazakhstan. In 1999, Chaparral reincorporated from Colorado to Delaware.

The consolidated financial statements include the accounts of Chaparral and its greater than 50% owned subsidiaries, Closed Type JSC Karakudukmunay ("KKM"), Central Asian Petroleum (Guernsey) Limited ("CAP-G"), Korporatsiya Mangistau Terra International ("MTI"), Road Runner Services Company ("RRSC"), Chaparral Acquisition Corporation ("CAC"), and Central Asian Petroleum, Inc. ("CAP-D"). Chaparral owns 80% of the common stock of CAP-G directly and 20% indirectly through CAP-D. Hereinafter, Chaparral and its subsidiaries are collectively referred to as the "Company." All significant intercompany transactions have been eliminated.

As of December 31, 2003, Chaparral owns a 60% interest in KKM, a Kazakhstan Joint Stock Company of Closed Type. KKM was formed to engage in the exploration, development, and production of oil and gas properties in the Republic of Kazakhstan. KKM's only significant investment is in the Karakuduk Field, an onshore oil field in the Mangistau Region of the Republic of Kazakhstan. On August 30, 1995, KKM entered into an agreement with the Ministry of Oil and Gas Industry for Exploration, Development and Production of Oil in the Karakuduk Oil Field in the Mangistau Region of the Republic of Kazakhstan (the "Agreement"). KKM's rights and obligations regarding the exploration, development, and production of underlying hydrocarbons in the Karakuduk Field are determined by the Agreement.

KKM's rights to the Karakuduk Field may be terminated under certain conditions specified in the Agreement. The term of the Agreement is 25 years commencing from the date of KKM's registration. The Agreement can be extended to a date agreed between the Ministry of Energy and Mineral Resources and KKM as long as production of petroleum and/or gas is continued in the Karakuduk Field.

KKM is owned jointly by CAP-G (50%), MTI (10%), and KazMunayGaz JSC ("KMG") (40%). In May 2002, Chaparral increased its ownership in KKM from 50% to 60% through the acquisition of 100% of the outstanding stock of MTI, a Kazakhstan company. KMG, the national petroleum company of Kazakhstan, is owned by the government of the Republic of Kazakhstan.

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As a result of the acquisition of MTI during 2002, the Company obtained a controlling interest in KKM. Consequently, the Company's financial statements have been consolidated with KKM on a retroactive basis to January 1, 2002. The Company previously accounted for its 50% investment in KKM using the equity method of accounting, which is reflected in the Company's financial statements for periods prior to 2002.

Certain reclassifications have been made in the periods presented for the 2002 financial statements to conform to the 2003 presentation. The following reclassifications have been made; (i) Prepaid transportation to KTO as of December 31, 2002 is now shown separately, (ii) Accounts payable to affiliates is shown separately for 2002, and (iii) \$938,000 originally presented as Management service fees during 2002 has been netted against general and administrative expenses.

### Acquisition

In May 2002, the Company acquired 100% of the outstanding shares of MTI from Dardana Limited. MTI's only asset was its 10% ownership interest in KKM. The Company acquired MTI to obtain a controlling interest in KKM as well as to increase the Company's ownership interest in the Karakuduk Field. The aggregate purchase price was \$3.9 million, including \$1.2 million of cash and common stock valued at \$2.7 million. The value of the 1 million common shares issued was determined based on the average market price of the Company's common shares over the 3-day period before and after the terms of the acquisition were agreed to and announced. As a result, the total purchase price of \$3.9 million was recorded as an addition to the Company's oil and gas properties.

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## CHAPARRAL RESOURCES, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 1. Summary of Significant Accounting Policies and Organization (continued)

##### Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments purchased with an original maturity of three months or less.

##### Revenue Recognition

Revenue and related costs are recognized upon delivery of commercial quantities of oil production produced from proved reserves, in accordance with the accrual method of accounting. Losses, if any, are provided for in the period in which the loss is determined to occur.

Revenue is presented gross of transportation expenses in accordance with EITF 00-10, Accounting for Shipping and Handling Fees and Costs.

##### Foreign Currency Translation

The Company's functional currency is the U.S. Dollar. All transactions arising in currencies other than U.S. Dollars, including assets, liabilities, revenue, expenses, gains, or losses are measured and recorded in U.S. Dollars using the exchange rate in effect on the date of the transaction.

Cash and other monetary assets held and liabilities denominated in currencies other than U.S. Dollars are translated at exchange rates prevailing as of the

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balance sheet date (144.22 and 155.60 Kazakh Tenge per U.S. Dollar as of December 31, 2003 and 2002, respectively). Non-monetary assets and liabilities denominated in currencies other than U.S. Dollars have been translated at the estimated historical exchange rate prevailing on the date of the transaction. Exchange gains and losses arising from translation of non-U.S. Dollar amounts at the balance sheet date are recognized as an increase or decrease in income for the period.

The Tenge is not a convertible currency outside of the Republic of Kazakhstan. The translation of Tenge denominated assets and liabilities in these financial statements does not indicate that the Company could realize or settle these assets and liabilities in U.S. Dollars.

The Company had \$3.7 million of net monetary liabilities denominated in Tenge as of December 31, 2003.

### Interest Capitalization

The Company capitalizes interest on significant construction projects. Statement of Financial Accounting Standards ("SFAS") 34, Capitalization of Interest Costs, provides standards for the capitalization of interest costs as part of the historical cost of acquiring assets. FASB-Interpretation (FIN) 33 provides guidance for the application of SFAS 34 to the full cost method of accounting for oil and gas properties. Under FIN 33, costs of investments in unproved properties and major development projects, on which depreciation, depletion, and amortization (DD&A) expense is not currently taken and on which exploration or development activities are in progress, qualify for capitalization of interest. Capitalized interest is calculated by multiplying the weighted-average interest rate on debt by the amount of costs excluded. Capitalized interest cannot exceed gross interest expense. The Company incurred interest costs of \$5.19 million and \$6.24 million for the years ended December 31, 2003 and 2002, respectively. For the same periods, the Company capitalized interest totaling \$662,000, and \$631,000, respectively.

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## CHAPARRAL RESOURCES, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 1. Summary of Significant Accounting Policies and Organization (continued)

##### Oil and Gas Properties - Full Cost Method

The Company follows the full cost method of accounting for oil and gas properties. Accordingly, all costs associated with the acquisition, exploration, and development of oil and gas reserves, including directly related overhead costs, are capitalized.

All capitalized costs of proved oil and gas properties, including the estimated future costs to develop proved reserves, are amortized on the unit-of-production method using estimated proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized cost to be amortized.

In addition, the capitalized costs are subject to a "ceiling test." The full cost ceiling test is an impairment test prescribed by SEC Regulation S-X Rule 4-10. The ceiling test is performed on a country-by-country basis. The test determines a limit, or ceiling, on the book value of oil and gas properties.

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That limit is basically the after tax present value of the future net cash flows from proved crude oil and natural gas reserves. This ceiling is compared to the net book value of the oil and gas properties reduced by any related deferred income tax liability. If the net book value reduced by the related deferred income taxes exceeds the ceiling, an impairment or non-cash write down is required. A ceiling test impairment can give the Company a significant loss for a particular period; however, future DD&A expense would be reduced.

Sales of proved and unproved properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil and gas, in which case the gain or loss is recognized in income. Abandonment of properties is accounted for as adjustments of capitalized costs with no loss recognized.

### Other Property, Plant and Equipment

Other property, plant and equipment are valued at historical cost and are depreciated on a straight line basis over the estimated useful lives of the assets as follows:

Description -----	Period -----
Office buildings and apartments	20 years
Office equipment	3 years
Vehicles	5 years
Field buildings	15 years
Field equipment	Up to 10 years

### Inventory

Crude oil inventory is valued using the first-in, first-out method, at the lower of cost or net realizable value. Crude oil inventory represents production costs associated with lifting and transporting crude oil from the Karakuduk Field to the KazTransOil pipeline. Crude oil placed into the KazTransOil Pipeline is held as inventory until formally nominated and delivered for sale. Crude oil inventory as of December 31, 2003 and 2002 represented approximately 74,000 barrels and 87,000 barrels of crude oil, respectively.

Materials and supplies inventory is valued using the first-in, first-out method and is recorded at the lower of cost or net realizable value. Certain unique items, such as drilling equipment, are valued using the specific identification method. Materials and supplies represent plant and equipment for development activities, tangible drilling costs (drill bits, tubing, casing, wellheads, etc.) required for development drilling operations, spare parts, diesel fuel, and various materials for use in oil field operations.

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CHAPARRAL RESOURCES, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 1. Summary of Significant Accounting Policies and Organization (continued)

##### Earnings Per Common Share

Basic Earnings Per Share ("EPS") is computed by dividing income (loss) available to common stockholders by the weighted-average number of common shares outstanding during the period. The computation of diluted EPS is similar to the

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computation of basic EPS except that the numerator is increased to exclude certain charges which would not have been incurred, and the denominator is increased to include the number of additional common shares that would have been outstanding (using the if-converted and treasury stock methods), if securities containing potentially dilutive common shares (warrants, convertible notes payable, and options) had been converted to such common shares, and if such assumed conversion is dilutive. The Company's basic and diluted EPS for the years ended December 31, 2003, 2002 and 2001 are the same, as the assumed conversion of all potentially dilutive securities would be anti-dilutive.

### New Accounting Standards

In December 2003, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 104 Revenue Recognition ("SAB 104"), which codifies, revises and rescinds certain sections of SAB No. 101, Revenue Recognition, in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB 104 did not have a material effect on the Company's consolidated results of operations, consolidated financial position or consolidated cash flows.

In April 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts and hedging activities under SFAS No. 133. The amendments set forth in SFAS No. 149 require that contracts with comparable characteristics be accounted for similarly. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003 (with a few exceptions) and for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively only. The adoption of SFAS No. 149 as of July 1, 2003 had no effect on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This statement establishes standards for how an issuer classifies and measures on its balance sheet certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 was effective for financial instruments entered into or modified after May 31, 2003, and was otherwise effective for the Company as of July 1, 2003. The adoption of the applicable provisions of this statement as of the indicated dates has no effect on the Company's financial statements.

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CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 1. Summary of Significant Accounting Policies and Organization (continued)

##### New Accounting Standards (continued)

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an interpretation of ARB 51." The primary objectives of this interpretation are to provide guidance on the identification of entities for which control is achieved through means other than through voting rights ("variable interest entities") and how to determine when and which business enterprise (the "primary beneficiary") should consolidate the variable interest entity. This new model for consolidation



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applies to an entity in which either (i) the equity investors (if any) do not have a controlling financial interest; or (ii) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, FIN 46 requires that the primary beneficiary, as well as all other enterprises with a significant variable interest in a variable interest entity, make additional disclosures. Certain disclosure requirements of FIN 46 were effective for financial statements issued after January 31, 2003.

In December 2003, the FASB issued FIN No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" ("FIN 46-R") to address certain FIN 46 implementation issues. The effective dates and impact of FIN 46 and FIN 46-R are as follows:

(i) Special purpose entities ("SPEs") created prior to February 1, 2003. The company must apply either the provisions of FIN 46 or early adopt the provisions of FIN 46-R at the end of the first interim or annual reporting period ending after December 15, 2003.

(ii) Non-SPEs created prior to February 1, 2003. The company is required to adopt FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

(iii) All entities, regardless of whether a SPE, that were created subsequent to January 31, 2003. The provisions of FIN 46 were applicable for variable interests in entities obtained after January 31, 2003. The company is required to adopt FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

The adoption of the provisions applicable to SPEs and all other variable interests obtained after January 31, 2003 did not have a material impact on the Company's financial statements. The Company is currently evaluating the impact of adopting FIN 46-R applicable to Non-SPEs created prior to February 1, 2003 but does not expect a material impact on the Company's results of operations, financial position and cash flows.

In June 2001, the FASB issued SFAS 143, Accounting for Asset Retirement Obligations. SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Subsequently, the asset retirement cost should be allocated to expense using a systematic and rational method. SFAS 143 is effective for fiscal years beginning after June 15, 2002. The Company adopted SFAS 143 on January 1, 2003. See Note 10 for the effect of the adoption of SFAS 143.

The EITF currently is deliberating on EITF No. 04-2 "Whether Mineral Rights Are Tangible or Intangible Assets" and EITF No. 03-S "Application of FASB Statement No. 142, Goodwill and Other Intangible Assets, to Oil and Gas Companies." These proposed statements will determine whether contract-based oil and gas mineral rights are classified as tangible or intangible assets based on the EITF's interpretation of SFAS No. 141 and SFAS No. 142. Historically, the Company has classified all of its contract-based mineral rights within property, plant, and equipment and has generally not identified these amounts separately. If the EITF determines that these mineral rights should be presented as intangible assets, Chaparral would have to reclassify its contract-based oil and gas mineral rights acquired after June 30, 2001 to intangible assets and make additional disclosures in accordance with SFAS No. 142. The Company has not acquired any contract-based mineral rights after June 30, 2001. Therefore, the adoption of this change will not have an effect on the Company's financial position or results from operations.

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CHAPARRAL RESOURCES, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 1. Summary of Significant Accounting Policies and Organization (continued)

#### Fair Value of Financial Instruments

All of the Company's financial instruments, including cash and cash equivalents, accounts receivable, notes receivable, and loans payable, have fair values which approximate their recorded values as they are either short-term in nature or carry interest rates which approximate market rates.

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Risks and Uncertainties

The ability of the Company to realize the carrying value of its assets is dependent on being able to develop, transport and market hydrocarbons. Currently, exports from the Republic of Kazakhstan are restricted since they are dependent on limited transport routes and, in particular, access to the Russian pipeline system. Domestic markets in the Republic of Kazakhstan do not permit world market prices to be obtained. Management believes, however, that over the life of the project, transportation restrictions will be alleviated by additional pipeline capacity being planned or currently under construction and prices will be achievable for hydrocarbons extracted to allow full recovery of the carrying value of its assets.

### 2. Going Concern

The Company's financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has a working capital deficiency as of December 31, 2003. In addition, the Company has experienced limitations in obtaining 100% export quota for the sale of its hydrocarbons. These conditions create uncertainties relating to the Company's ability to meet all expenditure and cash flow requirements through the next twelve months. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

The Company is seeking to alleviate these conditions by obtaining 100% export of all hydrocarbons produced from the Karakuduk Field through discussions with the Government of Kazakhstan. On July 17, 2003, the Company took the first step towards the commencement of arbitration proceedings in Switzerland for the breach of the Agreement by the Government of Kazakhstan by initiating a required three-month period of consultation with the Government. The Government indicated an interest in trying to resolve this matter during the consultation period. Although the consultation period has expired, the Company continues to seek an amicable resolution with the Government on this matter rather than proceeding with arbitration. If the matter cannot be resolved in a satisfactory manner, the

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Company has, however, reserved the right to commence formal arbitration proceedings pursuant to its contractual arrangements with the Government.

In addition, the Company is attempting to obtain additional financing to cover any cash flow deficiencies that may occur and refinance the Company's loan with JSC Kazkommertsbank ("Kazkommertsbank") in order to reduce the Company's current interest rate of 14% and alleviate the Company's current working capital deficiency.

No assurances can be provided, however, that if arbitration is instituted, it will be successful or that if successful, the Company will be able to enforce the award in Kazakhstan, or that the Company will be able to export 100% or a significant portion of its production and that the Company will be able to obtain additional financing and cash flow from operations to meet working capital requirements in the future.

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### CHAPARRAL RESOURCES, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 3. VAT Receivable

The value added tax (VAT) receivable is a Tenge denominated asset due from the Republic of Kazakhstan. The VAT receivable consists of VAT paid on local expenditures and imported goods. Under the Company's Agreement, VAT charged to the Company is recoverable in future periods as either cash refunds or offsets against the Company's fiscal obligations, including future income tax liabilities. Periodically, the Company reviews its outstanding VAT receivable for possible impairment. During the years ended December 31, 2003 and 2002, the Company utilized its VAT receivable to offset fiscal obligations for approximately \$2.58 million and \$1.6 million against other fiscal obligations respectively.

#### 4. Prepaid Expenses

The breakdown of Prepaid expenses is as follows:

Description -----	December 31, 2003 (Thousands) -----	December 31, 2002 (Thousands) -----
Prepaid transportation costs to KTO	\$1,296	\$ 584
Advanced payments for materials and supplies	1,616	1,352
Prepaid insurance	210	104
Other prepaid expenses	114	416
	-----	-----
Total prepaid expenses	\$3,236 =====	\$2,456 =====

Prepaid transportation costs represent prepayments to CJSC KazTransOil ("KTO"), a 100% subsidiary of KMG, for export tariffs necessary to sell oil on the export market, which is expensed in the period the related oil revenue is recognized. Advanced payments for materials and supplies represent prepayments for general materials and supplies to be used in the development of the Karakuduk Field.

#### 5. Oil and Gas Properties - Full Cost

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The Company has capitalized all direct costs associated with acquisition, exploration, and development of the Karakuduk Field. These costs include geological and geophysical expenditures, license acquisition costs, tangible and intangible drilling costs, production facilities, pipelines and related equipment, access roads, gathering systems, management fees related to the salary costs of individuals directly associated with exploration and development activities, related interest costs associated with unproved properties, and other capitalizable costs allowed under the full cost method of accounting. Overhead and general and administrative costs have been expensed as incurred.

The Company calculates depreciation, depletion, and amortization of oil and gas properties using the units-of-production method. The provision is computed by multiplying the unamortized costs of proved oil and gas properties by a production rate calculated by dividing the physical units of oil and gas produced during the relevant period by the total estimated proved reserves. The unamortized costs of proved oil and gas properties include all capitalized costs net of accumulated amortization, estimated future costs to develop proved reserves, and estimated dismantlement and abandonment costs. Estimates of proved oil and gas reserves are prepared in accordance with guidelines established by the SEC. Those guidelines require that reserve estimates be prepared under existing economic and operating conditions with no provisions for increases in commodity prices, except by contractual arrangement. Estimation of oil and gas reserve quantities is inherently difficult and is subject to numerous uncertainties. Such uncertainties include the projection of future rates of production, export allocation, and the timing of development expenditures. The accuracy of the estimates depends on the quality of available geological and geophysical data and requires interpretation and judgment. Estimates may be

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CHAPARRAL RESOURCES, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 5. Oil and Gas Properties - Full Cost (continued)

revised either upward or downward by results of future drilling, testing or production. In addition, estimates of volumes considered to be commercially recoverable fluctuate with changes in commodity prices and operating costs. The Company's estimates of reserves are expected to change as additional information becomes available. A material change in the estimated volumes of reserves could have an impact on the DD&A rate calculation and the financial statements.

The Company recognized total amortization expense of \$17.30 million and \$12.08 million for the years ended December 31, 2003 and 2002, respectively. For the same periods, the Company has an effective amortization rate of \$6.42 and \$4.90 per barrel, respectively. The Company's amortization expense during 2001 was \$730,000. Amortization expense from KKM of \$8.67 million during 2001 was accounted under the equity method.

In accordance with SFAS 19, Financial Accounting and Reporting by Oil and Gas Producing Companies, the Company accounts for amortization of crude oil production as a component of crude oil inventory until the related crude oil is sold. For the years ended December 31, 2003 and 2002, the Company had \$423,000 and \$372,000 of amortization expense allocated to crude oil inventory, respectively.

Costs capitalized to oil and gas properties consist of:

Description	December 31,	December 31,
-------------	--------------	--------------

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-----	2003 (Thousands)	2002 (Thousands)
	-----	-----
Acquisition costs	\$ 10,633	\$ 10,633
Exploration and appraisal costs	22,277	22,277
Development cost	81,366	54,920
Other capitalized cost	1,097	1,097
Capitalized interest	5,275	4,720
Asset Retirement Obligation	641	--
	-----	-----
Total oil and gas properties at cost	\$ 121,289	\$ 93,647
	=====	=====
Total costs not subject to amortization	\$ 2,942	\$ 8,814
	=====	=====
Total costs subject to amortization	\$ 118,347	\$ 84,833
Accumulated amortization	(40,915)	(25,105)
	-----	-----
Net properties subject to amortization	\$ 77,432	\$ 59,728
	=====	=====

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CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

5. Oil and Gas Properties - Full Cost (continued)

The condensed financial statements of KKM are as follows:

	December 31, 2003	2002
	(Thousands)	(Thousands)
	-----	-----
Condensed balance sheet		
Current assets	\$ 9,109	\$ 10,874
Non-current assets (primarily oil and gas properties, full cost method)	81,551	66,949
Current liabilities	24,544	15,834
Non-current liabilities		
Loan payable to related party	29,977	31,809
Loans payable to affiliates	20,000	27,000
Other non-current liabilities	4,551	2,376
Charter capital	200	200
Retained earnings/ (accumulated deficit)	11,388	604
Condensed income statement		
Revenues	\$ 57,615	\$ 45,133
Other costs and expenses	(46,830)	(40,255)
	-----	-----
Net income	\$ 10,785	\$ 4,878
	=====	=====

6. Other Property, Plant and Equipment

A summary of other property, plant and equipment is provided in the table below:

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Description -----	December 31, 2003 (Thousands) -----	December 31, 2002 (Thousands) -----
Office buildings and apartments	\$ 879	\$ 326
Office equipment and furniture	1,026	917
Vehicles	1,435	1,419
Land	25	25
Field buildings	5,413	4,948
Field equipment and furniture	630	575
	-----	-----
Total cost	9,408	8,210
	-----	-----
Accumulated depreciation	(3,843)	(3,197)
	-----	-----
Property, plant and equipment, net	\$ 5,565 =====	\$ 5,013 =====

Depreciation expense for property, plant, and equipment was \$734,000, \$724,000, and \$23,000 for the years ending December 31, 2003, 2002 and 2001, respectively.

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CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

7. Hedge Agreement

During 2000, the Company paid \$4 million for put contracts to sell approximately 1.56 million barrels of North Sea Brent crude (the "Hedge Agreement") to hedge price risk of future sales of oil production from the Karakuduk Field. The exercise prices of the various put contracts in the Hedge Agreement range from \$22.35 to \$17.25 per barrel, with monthly expiration dates beginning in October 2000 and ending in December 2002. The contracts were evenly spread between October 2000 to December 2001 (62,750 barrels per month) and between January 2002 to December 2002 (51,750 barrels per month).

In June 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This standard provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. This statement, as amended by SFAS No. 137, 138, and 149, is effective for years beginning after June 15, 2000. The Company adopted SFAS 133 on January 1, 2001. As a result of adoption of SFAS 133, the Company recognizes all derivative financial instruments in the consolidated financial statements at fair value regardless of the purpose or intent for holding the instrument. Changes in the fair value of derivative financial instruments are recognized periodically in income or in shareholders' equity as a component of comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in fair values of derivatives accounted for as fair value hedges are recorded in income along with the portions of the changes in the fair values of the hedged items that relate to the hedged risks. Changes in fair values of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income net of deferred taxes. Changes in fair values of derivatives not qualifying as hedges are reported in income, which require derivative financial instruments to be recorded at their fair value. Accordingly, the Company recognized a \$2.52 million loss from the cumulative

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effect of change in accounting principle upon adoption. In addition and in accordance with SFAS 133, the Company recognized \$762,000 loss for the year ended December 31, 2002 to record the Hedge Agreement at its fair value as of that date. The Hedge Agreement expired in December 2002 and the Company did not enter into any hedge agreements during 2003.

### 8. Other Accrued Liabilities

Description	December 31, 2003 (Thousands)	December 31, 2002 (Thousands)
Accrued taxes payable	\$ 910	\$2,238
Production bonus	500	--
Other accrued liabilities	161	194
	-----	-----
Total accrued liabilities	\$1,571 =====	\$2,432 =====

### 9. Accrued Production Bonus

Accrued production bonus represents production based bonuses, which will be payable to the Government of Kazakhstan, amounting to \$500,000 when cumulative production reaches 10 million barrels and \$1.2 million when cumulative production reaches 50 million barrels. Under current Kazakhstan tax law, the production bonuses will be considered tax deductible expenditures in the calculation of income taxes. The Company accrues the production bonuses in relation to cumulative oil production. The Company accrued \$213,000 and \$201,000 in production bonuses for the years ended December 31, 2003 and 2002, respectively. In addition, the first production bonus is expected to be paid during the second quarter 2004.

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CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 10. Asset Retirement Obligation

As discussed in Note 1, effective January 1, 2003, the Company changed its method of accounting for asset retirement obligations in accordance with SFAS 143, Accounting for Asset Retirement Obligations. Previously, the Company used an amount equal to the undiscounted cash flows associated with the asset retirement obligation ("ARO") in determining depreciation, depletion, and amortization ("DD&A") rates. Under the new accounting method, the Company now recognizes AROs in the period in which they are incurred if a reasonable estimate of a fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset.

The cumulative effect of the change on prior years resulted in a gain of \$1.02 million, net of tax of \$436,000, or \$0.02 per share, which is included in income for the year ended December 31, 2003.

Since 1995, the core business of the Company has been the development of the Karakuduk Field. The Company is still in the early stages of development and continues to develop the field by drilling additional wells, expansion of its oil storage capacity, installation of additional gathering and processing

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facilities, and the full implementation of the central processing facility. The Company is legally required under the Agreement to restore the field to its original condition. The Company recognized the fair value of its liability for an ARO as of January 1, 2003 in the amount of \$516,000 and capitalized that cost as part of the cost basis of its oil and gas properties and depletes it using the units of production method over proved reserves.

On February 12, 2003, the Company commenced a new drilling campaign to further develop and commercially produce the oil reserves in the Karakuduk Field. As a result of the new drilling campaign, the Company revised its estimate of retirement costs to include expected additions to the Karakuduk Field during 2003. This change in estimate did not result in a direct charge to income for the year ended December 31, 2003. The following table describes all changes to the Company's asset retirement obligation liability:

	December 31, 2003 (In Thousands)
-----	
Asset retirement obligation at beginning of year	\$ --
Liability recognized in transition	516
Accretion expense	73
Revision in estimated cash flows	215
-----	
Asset retirement obligation at end of year	\$ 804
=====	

The pro forma effects of the application of SFAS 143 as if the Statement had been adopted for periods prior to January 1, 2003 are presented below:

- The pro forma asset retirement obligation liability balances as if Statement 143 had been adopted on January 1, 2001 (rather than January 1, 2003) are as follows (In Thousands);

	December 31,		
	-----	-----	-----
	2003	2002	2001
	----	----	----
Pro forma amounts of liability for asset retirement obligation at beginning of year	\$516	\$467	\$426
Pro forma amounts of liability for asset retirement obligation at end of year	\$804	\$516	\$467

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CHAPARRAL RESOURCES, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 10. Asset Retirement Obligation (continued)

- The Pro forma amounts assuming the accounting change is applied retroactively (In Thousands, Except Share Data);

Pro forma amounts assuming the accounting change is applied retroactively net-of-tax:



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	2003 -----	2002 -----	2001 -----
Income/(loss) before extraordinary gain and cumulative effect of change in accounting principle	\$ 1,043	\$ (708)	\$ (13,643)
Net income/(loss)	\$ 2,061	\$ 4,630	\$ (16,162)
Income/(loss) per share before extraordinary gain and cumulative effect of change in accounting principle	\$ 0.03	\$ (0.02)	\$ (0.96)
Net income/(loss) per share	\$ 0.05	\$ 0.16	\$ (1.13)

11. Loans Payable to Affiliates

CAIH Note

-----

In May 2002, the Company received a total equity and debt capital infusion of \$45 million, which was partially utilized to repay a substantial portion of the Company's loan agreement with Shell Capital, Inc. (the "Shell Capital Loan"). The Company received a total investment of \$12 million from Central Asian Industrial Holdings, N.V. ("CAIH"), including \$8 million in exchange for 22,925,701 shares, or 60%, of the Company's outstanding common stock, and \$4 million in exchange for a three year note bearing interest at 12% per annum (the "CAIH Note"). Along with the CAIH Note, CAIH received a warrant to purchase 3,076,923 shares of the Company's common stock at \$1.30 per share (the "CAIH Warrant"). Additionally, JSC Kazkommertsbank ("Kazkommertsbank"), an affiliate of CAIH, provided KKM with a credit facility totaling \$33 million (the "KKM Credit Facility"), consisting of \$28 million that was used to repay a portion of the Shell Capital Loan and \$5 million that was made available for KKM's working capital requirements. The Company paid CAIH \$1.79 million as a related restructuring fee.

The CAIH Note was recorded net of a \$2.47 million discount, based on the fair market value of the CAIH Warrant issued in conjunction with the CAIH Note. The discount is amortized using the effective interest rate over the life of the CAIH Note. The principal balance of the CAIH Note is due on May 10, 2005 and accrued interest is payable quarterly. The CAIH Warrant is fully discussed in Note 12.

In June 2002, the Company prepaid \$2 million of the \$4 million outstanding principal balance of the CAIH Note. As a result, the Company recognized an extraordinary loss on the early extinguishment of debt of \$1.22 million from the write-off of 50% of the unamortized discount on the CAIH Note. The extraordinary loss was netted against the extraordinary gain from the restructuring of the Shell Capital Loan. The Company recognized \$423,000 in interest expense on the CAIH Note for the year ended December 31, 2002 and \$526,000 for the year ended December 31, 2003. The CAIH Note is presented net of \$716,000 remaining discount as of December 31, 2003.

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CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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### 11. Loans Payable to Affiliates (continued)

In addition, as a result of the restructuring of the Shell Capital Loan, the Company recognized a \$6.56 million extraordinary gain on the extinguishment of debt due to the restructuring of the Shell Capital Loan. The extraordinary gain reflects the forgiveness of \$9.07 million in principal, interest, and fees previously owed to Shell Capital, less \$1.79 million in restructuring fees paid to CAIH, \$509,000 in professional fees, and \$220,000 in other costs and expenses. The Company recognized \$2.75 million and \$10.01 million in interest expense on the Shell Capital loan during 2002 and 2001, respectively. As of May 2002, the Company has no further commitments or obligation under the Shell Capital Loan.

#### KKM Credit Facility

In May 2002, KKM established a five-year, \$33 million credit line with Kazkommertsbank. The KKM Credit Facility consists of a \$30 million non-revolving line and a \$3 million revolving line, both of which were fully borrowed by KKM in May 2002. The Company recognized \$4.0 million and \$3.08 million of interest expense on the KKM Credit Facility for the years ended December 31, 2003 and 2002, respectively. Accrued interest payable as of December 31, 2003 on the KKM Credit Facility amounts to \$776,000.

The non-revolving portion of the KKM Credit Facility accrues simple interest at an annual rate of 14% and is repayable over a five-year period with final maturity in May 2007. Accrued interest is payable quarterly, beginning in December 2002; KKM started making quarterly principal payments in May 2003. As of December 31, 2003, the Company has repaid \$3 million in principal and is in compliance with all the terms of the KKM Credit Facility.

The revolving portion of the KKM Credit Facility accrues simple interest at an annual rate of 14%. The revolver is loaned to KKM for short-term periods of up to one year, but KKM has the right to re-borrow the funds through May 2006 with final repayment due in May 2007. The initial \$3 million revolving loan to KKM was subject to a three-month term. The principal balance was repaid in July 2002 and KKM immediately re-borrowed another \$3 million with a maturity date of July 31, 2003. KKM repaid the \$3 million due on July 31, 2003 and exercised its right to re-borrow another \$3 million with a maturity date of July 31, 2004. In addition, on December 30, 2003, Kazkommertsbank increased the revolving portion of the KKM Credit Facility from \$3 million to \$5 million. On the same date, KKM borrowed the additional \$2 million to finance ongoing operations. The additional \$2 million accrued interest at 14% and principal and interest is due in full on June 30, 2004. All amounts due in 2004 under the revolving portion of the KKM Credit Facility are classified as current as of December 31, 2003.

The original KKM Credit Facility included repayment terms of three years and four years for the non-revolving and revolving portions of the KKM Credit Facility, respectively, with an option to extend the final maturity date for repayment of the entire KKM Credit Facility to five years. In May 2002, KKM exercised the option to extend the repayment term to five years with final maturity in May 2007 for the entire KKM Credit Facility.

The Company is subject to certain pledges, covenants, and other restrictions under the KKM Credit Facility, including, but not limited to, the following:

- (i) CAP-G pledged its 50% interest in KKM to Kazkommertsbank as collateral for the KKM Credit Facility;
- (ii) The Company provided a written guarantee to Kazkommertsbank that it will repay the KKM Credit Facility in the event KKM fails to do so;
- (iii) KKM may not incur additional indebtedness or pledge its assets to another party without the written consent of Kazkommertsbank; and

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(iv) KKM may not pay dividends without the written consent of Kazkommertsbank.

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### CHAPARRAL RESOURCES, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 11. Loans Payable to Affiliates (continued)

The KKM Credit Facility stipulates certain events of default, including, but not limited to, KKM's inability to meet the terms of the KKM Credit Facility, KKM's failure to meet its obligations to third parties in excess of \$100,000, and the Company's involvement in legal proceedings in excess of \$100,000 where an adverse judgment against the Company occurs or is expected to occur. If an event of default does occur and is not waived by the lender, Kazkommertsbank has a right to call the KKM Credit Facility immediately due and payable and/or exercise its security interest on the Company's shares in KKM pledged as collateral. Furthermore, in the event of a material adverse change in the financial or credit markets, Kazkommertsbank has a right to unilaterally alter any terms and conditions of the KKM Credit Facility, including the rate of interest, by written request. KKM may either agree to the amended terms or repay the outstanding KKM Credit Facility within 10 days of notification.

The maturity schedule of the Company's indebtedness as of December 31, 2003 is as follows:

Date ----	Principal Amount Due -----
2004	\$ 12,000,000
2005	10,000,000
2006	8,000,000
2007	4,000,000
Total principal due	\$ 34,000,000
Less:	
Principal due within one year	(12,000,000)
Unamortized debt issue cost	(716,000)
Net long-term principal due	\$21,284,000

#### Line of Credit

On April 29, 2003, Kazkommertsbank provided a line of credit for \$2.5 million to the Company to cover necessary operating expenditures ("Line of Credit"). On the same day, the Company accessed \$1.5 million from the line of credit to cover the required transportation costs for oil sales. The \$1.5 million was due on May 29, 2003 and accrued simple interest at an annual rate of 14%. The company repaid the \$1.5 million and all accrued interest on May 22, 2003 and the credit line was cancelled.

#### 12. Common Stock

##### General

1998 Incentive and Non-statutory Stock Option Plan

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On June 26, 1998, the stockholders approved the 1998 Incentive and Non-statutory Stock Option Plan (the "1998 Plan"), pursuant to which up to 50,000 options to acquire the Company's common stock may be granted to officers, directors, employees, or consultants of the Company and its subsidiaries. The stock options granted under the 1998 Plan may be either incentive stock options or nonstatutory stock options. The 1998 Plan has an effective term of ten years, commencing on May 20, 1998. The Company has not granted any options under the 1998 Plan as of December 31, 2003.

### 2001 Stock Incentive Plan

In June 2001, the Company's stockholders approved the 2001 Stock Incentive Plan, which sets aside a total of 2.14 million shares of the Company's common stock for issuance to the Company's officers, directors, employees, and consultants. The Company has not made any grants under the 2001 Stock Incentive Plan as of December 31, 2003.

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### CHAPARRAL RESOURCES, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

#### 12. Common Stock (continued)

##### Non-Qualified Stock Options

During 2003, stock options to purchase 2,817 shares of the Company's common stock granted in 1997 to various employees and consultants of the Company expired. The expired options had exercise prices ranging between \$43.20 and \$142.50 per share.

##### Common Stock Offerings and Common Stock Warrant Issuances

In 1996, the Company sold 233,334 shares of common stock in a private placement at a price of \$30 per share. In connection with the private placement, the Company issued warrants to purchase 17,033 shares of the Company's common stock for a total of \$10 to the sales agent as a commission. In April 2002, the 17,033 warrants expired.

During February 1997, the Company entered into a severance agreement with Paul V. Hoovler, a former Chief Executive Officer and President of the Company, pursuant to which Mr. Hoovler received warrants to purchase 1,667 shares of the Company's common stock at an exercise price of \$51 per share and warrants to purchase 1,667 shares of the Company's common stock at an exercise price of \$75 per share. The 3,334 warrants expired in February 2001.

In January 1998, the Company granted 500 shares of the Company's common stock to an employee of the Company, which vested ratably on January 30, 1999, 2000, and 2001, respectively. The Company recognized \$45,000 as compensation expense, amortized over the vesting period of the grants.

As discussed in Note 11, Shell Capital's warrant for 1,785,455 shares of the Company's common stock was canceled on May 2002 as part of the restructuring of the Shell Capital Loan. The warrants had an exercise price of \$9.79.

In November 1997, the Company entered into a subscription agreement with an unaffiliated investor to purchase 225,000 shares of the Company's designated Series A, B, and C Redeemable Preferred Stock, for \$100 per share. As of December 31, 1997, the investor had purchased 50,000 shares of the Company's

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Series A Redeemable Preferred Stock for \$5 million. The Company issued a warrant for 15,000 shares at an exercise price of \$0.60 per share as compensation to the placement agent in connection with the subscription agreement. On November 24, 2002, the 15,000 share warrant expired.

In August 5, 1998, the Company retired two outstanding loans, totaling \$1,000,000. The Company borrowed the \$1,000,000 on June 3, 1998, subject to a 7% interest rate. In conjunction with the loans, the Company issued warrants to purchase 16,667 shares of the Company's common stock, at an exercise price of \$210 per share. On November 25, 2002, the 16,667 warrants expired.

In May 2002, the Company issued 1 million shares of its outstanding common stock valued at \$2.7 million and \$1.2 million in cash to Dardana Limited, in exchange for 100% of the stock of MTI, which owns a 10% interest in KKM.

As discussed in Note 11, the Company issued to CAIH a warrant to purchase 3,076,923 shares of the Company's common stock at an exercise price of \$1.30 per share, subject to certain anti-dilution provisions. The CAIH Warrant is exercisable for five years from May 10, 2002, the date of grant. The fair market value of the CAIH Warrant of \$2.47 million was recorded as a discount on the CAIH Note. The fair market value of the CAIH Warrant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: risk free interest rate of 4.09%, dividend yield of 0%, volatility factor of the expected market price of the Company's common stock of 0.624, and a weighted average life expectancy of 3.5 years.

As discussed in Note 11, the Company received a total investment of \$12 million from CAIH, including \$8 million in exchange for 22,925,701 shares, or 60%, of the Company's outstanding common stock.

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### CHAPARRAL RESOURCES, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

##### 12. Common Stock (continued)

In May 2002, the Company repurchased 50,000 shares of its Series A Redeemable Preferred Stock from an unrelated party for \$2.3 million. The Series A Redeemable Preferred Stock had a carrying value of approximately \$6 million, including \$1.1 million in accrued dividends. The \$3.7 million difference between the redemption price and the carrying value was recorded directly to retained earnings.

SFAS 123 Disclosure. SFAS 123 requires that pro forma information regarding net income and earnings per share are determined as if the Company had accounted for its employee stock options under the fair value method as defined in SFAS 123. The fair value for the options issued is estimated at the date of grant using the Black-Scholes option pricing model by using weighted average assumptions, volatility factors of the expected market price of the Company's common stock, and the weighted average life expectancy of the options. The Company did not issue any options during 2000, 2001, 2002 and 2003 and all outstanding options were fully vested as of December 31, 1999, therefore pro-forma information is not presented.

A summary of the Company's stock option activity and related information for the periods ended follows:

Shares Under	Weighted Average Exercise	Weighted Average
-----------------	------------------------------	---------------------

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	Option	Price	Fair Value
Unexercised options outstanding - December 31, 2000	57,516	\$67.73	-
Options Cancelled	-	-	-
Unexercised options outstanding - December 31, 2001	57,516	\$67.73	-
Options Cancelled	(54,700)	\$66.32	-
Unexercised options outstanding - December 31, 2002	2,816	\$95.10	-
Options Cancelled	(2,816)	\$95.10	-
Unexercised options outstanding - December 31, 2003	-	\$ -	-
Exercisable options December 31, 2001	57,516	\$67.73	
December 31, 2002	2,816	\$95.10	
December 31, 2003	0	\$ -	

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CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

12. Common Stock (continued)

The following table summarizes all common stock purchase warrant activity:

	Number of Stock Warrants	Exercise Price Range
Outstanding, December 31, 2000	1,837,822	\$0.0006 - \$210
Expired	(3,334)	\$ 51 - \$75
Outstanding, December 31, 2001	1,834,488	\$0.0006 - \$210
Granted	3,076,923	\$ 1.30
Expired	(48,700)	\$ 0 - \$210
Cancelled	(1,785,455)	\$ 9.79
Outstanding as of December 31, 2002	3,077,256	\$ 0.60 - \$1.30
Expired	(333)	\$ 0.60
Outstanding as of December 31, 2003	3,076,923	\$ 1.30

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CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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### 13. Income Taxes

The Company accounts for income taxes under FASB 109, Accounting for Income Taxes. Deferred income tax assets and liabilities are determined based upon differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

For financial reporting purposes, income before income taxes, extraordinary gain, and cumulative effect of change in accounting principle includes the following components:

	Year ended December 31,		
	2003 (Thousands)	2002 (Thousands)	2001 (Thousands)
	-----	-----	-----
Domestic	\$ (3,883)	\$ (5,923)	\$ (13,696)
Foreign	9,047	7,387	--
	-----	-----	-----
	\$ 5,164	\$ 1,464	\$ (13,696)
	=====	=====	=====

The components of the income tax provision (benefit) are as follows:

	Year ended December 31,		
	2003 (Thousands)	2002 (Thousands)	2001 (Thousands)
	-----	-----	-----
Income tax provision:			
Current			
Domestic	\$ --	\$ --	\$ --
Foreign	2,246	1,939	--
	-----	-----	-----
Total current	2,246	1,939	--
	-----	-----	-----
Deferred			
Domestic	--	--	--
Foreign	1,875	746	--
	-----	-----	-----
Total deferred	1,875	746	--
	-----	-----	-----
Total provision for income taxes	\$ 4,121	\$ 2,685	\$ --
	=====	=====	=====

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CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 13. Income Taxes (continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred income taxes are as follows:

Year Ended December 31,

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	2003 (Thousands)	2002 (Thousands)
Deferred tax assets:		
Oil and gas assets	\$ 983	\$ 660
Sales of assets	23	28
Obsolete inventory	52	48
Amortization of derivatives	1,400	1,400
Compensation and accrued expenses	1,022	41
Capital loss on transfer of net profits interest	1,529	1,529
Net operating loss carry-forwards	8,645	9,231
Deferred tax assets	13,654	12,937
Valuation allowance	(13,046)	(12,751)
Total deferred tax assets	608	186
Deferred tax liabilities:		
Depreciation and other basis Differences	(3,665)	(932)
Net deferred tax liabilities	\$ (3,057)	\$ (746)

SFAS 109 requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all the evidence, both positive and negative, management has determined that a \$13,046 valuation allowance at December 31, 2003 is necessary to reduce the deferred tax assets to the amount that will more likely than not be realized. The change in the valuation allowance for the current year is \$295,000. The increase in valuation allowance is mainly due to domestic operating losses realized during 2003 less expiration of net operating losses from prior years and prior year return to provision adjustments.

As of December 31, 2003, the Company has estimated domestic tax loss carry-forwards of \$24.7 million. These carry-forwards will expire at various times between 2004 and 2021.

Expiration of domestic tax loss carry-forward  
(In Thousands)

	1 Year	2-3 Years	4-5 Years	Later Years	Total
Tax loss carry-forward	\$ 913	\$ 704	\$ 741	\$ 22,342	\$ 24,700

During 2000 and 2002, the Company had an ownership change under ss.382 of the Internal Revenue Code, which significantly limits the Company's use of its net operating tax loss carry-forwards. During 2003 no such ownership change took place.

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CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)



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### 13. Income Taxes (continued)

Undistributed earnings associated with the Company's interest in KKM amounted to approximately \$6.83 million at December 31, 2003. Those earnings are considered to be indefinitely reinvested and, accordingly, no provision for U.S. federal income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the Republic of Kazakhstan. Determination of the amount of unrecognized deferred U.S. income tax liability is not practical because of the complexities associated with the hypothetical calculation; however, unrecognized foreign tax credit forwards would be available to reduce some portion of the U.S. liability. Withholding taxes of approximately \$1.02 million would be payable upon remittance of all previously unremitted earnings at December 31, 2003.

The following table summarizes the significant differences between the statutory tax rate and the Company's effective tax rate for financial statement purposes:

	Year ended December 31, (In Thousands)		
	2003	2002	2001
	-----	-----	-----
Income/(loss) before minority interest, income taxes, extraordinary gain, and cumulative effect of change in accounting principle	\$ 9,478	\$ 1,705	\$ (13,696)
Statutory tax rate	35%	35%	35%
Income taxes (benefit) computed at statutory rate	\$ 3,317	\$ 597	\$ (4,794)
Losses and expenses with no tax benefit	1,919	840	7
Expiration of NOL carry forwards	320	597	663
Difference in foreign tax rate	(694)	(378)	--
Valuation allowance	295	221	4,124
Reversal of provision for tax claim	(899)	--	--
Additional foreign taxes/(benefit)	(137)	808	--
	-----	-----	-----
Income tax provision	\$ 4,121	\$ 2,685	\$ --
	=====	=====	=====

Foreign taxes applicable to the Company are specified under the Agreement with the Government of the Republic of Kazakhstan. As of December 31, 2003, the Company has utilized all available foreign tax loss carry forwards.

In December 2002, KKM received a claim from the Ministry of State Revenues of the Republic of Kazakhstan for \$9.1 million (the "Tax Claim") relating to taxes and penalties covering the three years from 1999 to 2001. KKM appealed the claim through the courts in Kazakhstan, which eventually ruled in favor of KKM with the exception of \$255,000 which was upheld. As a result, KKM reversed \$899,000 of income taxes accrued during 2002 for the Tax Claim net of \$255,000 which was settled in January 2004.

The Company has used the best estimates available to determine the Company's deferred tax assets and liabilities. Refer to Note 15 regarding the uncertainties of taxation in the Republic of Kazakhstan.

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CHAPARRAL RESOURCES, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 14. Operating Leases

The Company entered into a sublease agreement extending from March 2000 through November 2003. At the expiration date of the lease, the Company moved its registered office from Houston to New York. In addition, the Company entered into a new 6 month lease agreement for reduced office space at a new location in Houston. The Company also maintains an executive office in Almaty, Kazakhstan. The Almaty office is subleased from Nasikhat, an affiliate of Kazkommertsbank, for approximately \$3,000 per month renewable at the Company's option on September 1, 2004. As of December 31, 2003, the Company's future minimum annual lease payments through the contractual term of these leases are \$29,000, all due in 2004.

The Company's rental expense for 2003, 2002 and 2001, was approximately \$144,000, \$83,000 and \$77,000, respectively.

### 15. Commitments and Contingencies

#### Taxation

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As part of the process of preparing the Company's consolidated financial statements, the Company is required to estimate our taxes in each of the jurisdictions of operation. This process involves management estimating the actual current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes in accordance with the provisions of SFAS No. 109, "Accounting for Income Taxes". These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheets. Management then must assess the likelihood that the deferred tax assets will be recovered from future taxable income and, to the extent recovery is not likely; management must establish a valuation allowance. Future taxable income depends on the ability to generate income in excess of allowable deductions. To the extent the Company establishes a valuation allowance or increase this allowance in a period, an expense is recorded within the tax provision in the consolidated statement of operations. Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, the Company may need to establish a valuation allowance that could materially impact the Company's financial condition and results of operations.

In addition, the existing legislation with regard to taxation in the Republic of Kazakhstan is constantly evolving as the Government manages the transition from a command to a market economy. Tax and other laws applicable to the Company are not always clearly written and their interpretation is often subject to the opinions of the local or Central Tax Authorities. Instances of inconsistent opinions between local, regional and national tax authorities are not unusual.

In December 2002, KKM received an amendment to the Agreement to provide for the stabilization of taxes and clarification on tax laws applicable to KKM. The amendment increased the KKM royalty rate from 8% to 8.14% and allowed KKM to use the lower current tax rates for payroll taxes, social taxes and pension taxes. In addition, during 2003 the royalty rate was increased to 8.4% from 8.14%. The effect of these changes is reflected on the Company's financial statements as of December 31, 2003.

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The Ministry of State Revenues of the Republic of Kazakhstan is currently considering penalties with respect to the Tax Claim in the amount of \$970,000 (see Note 13). Due to the success of the appeal on the Tax Claim, we expect that the liability with regards to penalties will be reduced to approximately \$55,000. The date for the court hearing in respect of this claim is anticipated to be decided in March 2004, with the actual hearing to be conducted at a subsequent date. It is our opinion that the ultimate resolution of this claim will not have a material adverse effect on the financial position and operating results of Chaparral.

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### CHAPARRAL RESOURCES, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

##### 15. Commitments and Contingencies (continued)

###### Basis of Accounting

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KKM maintains its statutory books and records in accordance with U.S. generally accepted accounting principles and calculates taxable income or loss using the existing Kazakh tax legislation in effect on August 30, 1995, the date the Agreement was signed. The Company considers these accounting methods correct under the terms of the Agreement. The Republic of Kazakhstan currently requires companies to comply with Kazakh accounting regulations and to calculate tax profits or losses in accordance with these regulations as well as the prevailing tax law.

##### 16. Local Oil Sales Requirements and Export Quotas

The ability of the Company to realize the carrying value of its assets is dependent on being able to transport hydrocarbons and finding appropriate markets for their sale. Domestic markets in the Republic of Kazakhstan currently do not permit world market prices to be obtained.

The Company is responsible for obtaining export quotas and finalizing access routes through the KazTransOil pipeline and onward through the Russian pipeline system. The Company has a right to export and receive export quota for 100% of the production from the Karakuduk Field under the terms of the Agreement.

During 2003, the Company sold crude oil to the following major customers: Vitol Central Asia S.A., Naftex Oil and Shipping Corporation, and Euro-Asian Oil Company Inc, accounting for 61%, 13% and 12% of total annual deliveries, respectively.

Oil and gas producers within Kazakhstan are required to sell a certain portion of their crude oil production to the local market to supply local energy needs. During 2002, the Company sold approximately 363,000 barrels of crude oil on the local market for approximately \$3.3 million and 2.1 million barrels at world market prices for approximately \$41.83 million. During 2003 the Company sold approximately 103,000 barrels of crude oil on the local market for approximately \$947,000 and 2.59 million barrels on the export market for approximately \$56.67 million. Oil sales at world market prices represent 98% and 92% of the Company's oil sales revenues during 2003 and 2002, respectively.

The Company continues to seek an amicable resolution with the Government to eliminate local market requirements. If this matter can not be resolved in a satisfactory manner, the Company has, however, reserved the right to commence formal arbitration proceedings pursuant to its contractual arrangements with the

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Government (See Note 2).

### 17. Capital Commitments

As of December 31, 2003, the Company has a drilling contract with KazMunayGas-Drilling ("KMGD"), an affiliate of KMG, for one development drilling rig currently operating in the Karakuduk Field. The rig is contracted through December 31, 2004. The minimum payments under the drilling contract with KMGD for 2004 are \$5.52 million. The Company's other drilling and operations related contracts can either be cancelable within 30 days or are on a call-off (as required) basis.

The Company has no other significant commitments other than those incurred during the normal performance of the work program to develop the Karakuduk field.

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CHAPARRAL RESOURCES, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 18. Related Party Transactions

In 2003, the Company approved a one-year agreement with OJSC Kazkommerts Securities ("KKS"), an affiliate of Kazkommertsbank. The agreement is effective as of January 7, 2003 and provides for KKS to assist the Company's senior management with financial advisory and investment banking services. In consideration for the services KKS received a monthly fee of \$25,000 (the "Advisory Fee").

Kazkommerts Policy, an affiliate of Kazkommertsbank, is the major insurer of KKM oil and gas activities. The current insurance policy expires in November 2004.

KKM has a contract to transport 100% of its oil sales through the pipeline owned and operated by KTO, a wholly owned subsidiary of KMG, the 40% minority shareholder in KKM. The rates for transportation are in accordance with those approved by the government of the Republic of Kazakhstan. Currently, the use of the KTO pipeline system is the only viable method of exporting KKM's production. As KTO notifies KKM of the export sales allocated to the company on a monthly basis, KTO controls both the volume and transportation cost of export sales.

KKM makes a prepayment for crude transportation based upon the allocation of export sales received from KTO. This prepayment includes pipeline costs charged by the operators of the Russian and Ukrainian pipeline systems and are dependent upon the point of sale of KKM's exports. During 2003, KKM paid \$12 million to KTO, of which \$11.29 million were recognized as transportation costs for sales during 2003. Comparably during 2002, KKM paid \$8.93 million to KTO, of which \$9.30 million were recognized as transportation costs for sales during 2002. See Note 4 for prepaid transportation as of December 31, 2003 and 2002.

KTO charges KKM for associated costs of oil storage within their pipeline system, sales commission, and customs clearance fees in respect to export sales. KTO also provides KKM with water through the Volga Water pipeline. Amounts recognized for these services during 2003 and 2002 were \$267,000 and \$169,000, respectively.

KMGD, a subsidiary of KMG, provided a drilling rig for the drilling campaign, which commenced February 12, 2003 and is contracted to provide the services of a drilling rig throughout 2004.

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The total amounts of the transactions with the above related companies are as follows:

	2003 (Thousands)	2002 (Thousands)
Kazkommerts Policy	\$ 524	\$ 82
KTO	\$11,561	\$ 9,476
KMGD	\$ 5,999	\$ 66

Accounts Payable Balance to affiliates as of December 31,

	2003 (Thousands)	2002 (Thousands)
Kazkommerts Policy	\$ 48	\$ --
KTO	97	37
KMGD	998	--
	\$1,143	\$ 37
	=====	=====

All other related party transactions are disclosed on the face of the balance sheet and in the notes to the financial statements. The loans with Kazkommertsbank and CAIH are disclosed in Note 11 and the drilling contract with KMGD is described in Note 17 and 18, the lease with Nasikhat is described in Note 14, and prepaid transportation to KTO in Note 4.

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### CHAPARRAL RESOURCES, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

##### 19. Subsequent Events

A payment of principal of \$1 million and interest of \$983,000 on the KKM Credit Facility was due on February 6, 2004. The Company paid the \$983,000 interest on February 6, 2004, and the Company and Kazkommertsbank have agreed to defer the repayment of \$1 million in principal until March 31, 2004.

##### 20. KKM Financial Statements

As a result of the acquisition of MTI in May 2002, the Company obtained a controlling interest in KKM. Consequently, the Company's financial statements have been consolidated with KKM on a retroactive basis to January 1, 2002. The Company previously accounted for its 50% investment in KKM using the equity method of accounting, which is reflected in the Company's financial statements for periods prior to 2002.

Due to the significance of the Company's equity investee, the Company has attached audited financial statements for KKM for the years ended December 31, 2001 and 2000. Reflected in the financial statements are management fees of \$2.04 million charged by the Company to KKM for each of the two years ended December 31, 2001. These amounts are exclusive of any local withholding tax, which may be accrued by KKM. Also, the financial statements include interest on the note payable to the Company from KKM in the amounts \$2.90 million and \$3.35 million for the years ended December 31, 2001 and 2000, respectively.

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SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS  
PRODUCING ACTIVITIES-UNAUDITED  
(IN THOUSANDS)

The following supplemental information regarding the oil and gas activities of the Company is presented pursuant to the disclosure requirements promulgated by the Securities and Exchange Commission (the "SEC") and SFAS 69, Disclosures About Oil and Gas Producing Activities.

The following estimates of reserve quantities and related standardized measure of discounted net cash flows are estimates only, and are not intended to reflect realizable values or fair market values of the Company's reserves. The Company emphasizes that reserve estimates are inherently imprecise and that estimates of new discoveries are more imprecise than producing oil and gas properties. Additionally, the price of oil has been very volatile and downward changes in prices can significantly affect quantities that are economically recoverable. Accordingly, these estimates are expected to change as future information becomes available and these changes may be significant.

KKM sold 2.69 million barrels of crude oil in 2003, of which 103,000 barrels, or approximately 4%, were sold to the local market. Comparatively, the Company sold 2.47 million barrels of crude oil in 2002, of which 363,000, or approximately 15%, was sold to the local market. KKM has an existing Agreement to sell 100% of its production on the export market for world market prices and a right to export 100% of its production under the terms of its Agreement with the government. Although the Company expects to sell 100% of its production on the export market in future years, the year-end prices used for the standardized measure of discounted net cash flows for 2003 reflects the assumption that 5% of KKM's production will be sold on the local market for a substantially lower net oil price. Year-end prices used for the standardized measure of discounted net cash flows for 2002 and 2001 reflect the assumption that 15% and 20% of KKM's production would have been sold on the local market for a substantially lower net oil price, respectively.

Proved reserves are estimated reserves of crude oil and natural gas that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are those expected to be recovered through existing wells, equipment and operating methods.

The standardized measure of discounted future net cash flows is computed by applying year-end prices of oil and gas (with consideration of price changes only to the extent provided by contractual arrangements) to the estimated future production of proved oil and gas reserves, less estimated future expenditures (based on year-end costs) to be incurred in developing and producing the proved reserves, less estimated future income tax expenses. The estimated future net cash flows are then discounted using a rate of 10% a year to reflect the estimated timing of the future cash flows.

As a result of the acquisition of an additional 10% interest in KKM through the acquisition of 100% of the stock in MTI during 2002, the Company's SFAS 69 is presented in full for the years 2003 and 2002. For the year 2001 the Company had a 50% proportionate equity interest in KKM's oil and gas producing activities. The Company has attached the audited financial statements of KKM for the years 2001 and 2000. Those financial statements should be reviewed in conjunction with the following disclosures with respect to the Company's proportionate equity

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interest in KKM's oil and gas producing activities for the years 2001 and 2000.

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SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS  
PRODUCING ACTIVITIES-UNAUDITED  
(IN THOUSANDS)

Proved Oil and Gas Reserve Quantities  
(All within the Republic of Kazakhstan)

	Year Ended December 31,					
	2003		2002		2001	
	Oil Reserves (bbls.)	Gas Reserves (Mcf.)	Oil Reserves (bbls.)	Gas Reserves (Mcf.)	Oil Reserves (bbls.)	Gas Reserves (Mcf.)
Proved developed and undeveloped reserves:						
Beginning Balance	21,855	--	29,921	--	--	--
Revision of previous estimates	6,455	--	(5,348)	--	--	--
Extensions, discoveries and other additions	--	--	--	--	--	--
Production	(2,694)	--	(2,718)	--	--	--
Ending Balance December 31,	25,616	--	21,855	--	--	--
Company's proportional interest in KKM's Proved developed and undeveloped Reserves	--	--	--	--	14,961	--
Minority interest in KKM's Proved developed and undeveloped Reserves	10,246	--	8,742	--	--	--
Proved Developed Reserves	15,107	--	9,321	--	--	--
Minority interest in KKM's Proved Developed Reserves	6,043	--	3,728	--	--	--

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SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS  
PRODUCING ACTIVITIES-UNAUDITED  
(IN THOUSANDS)

Capitalized Costs Relating to Oil and Gas Producing Activities  
(All within the Republic of Kazakhstan)

Year Ended December 31,

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	2003 -----	2002 -----	2001 -----
Unproved oil and gas properties	\$ 6,131	\$ 11,270	\$ --
Proved oil and gas properties	118,347	84,853	--
	-----	-----	-----
	124,478	96,123	
Accumulated depreciation and depletion	(40,915)	(25,105)	--
	-----	-----	-----
Net capitalized cost	\$ 83,563 =====	\$ 71,018 =====	\$ -- =====
Company's share of equity method investee's net capitalized cost	\$ -- =====	\$ -- =====	\$ 33,530 =====

Cost Incurred in Oil and Gas Property Acquisition, Exploration, and Development  
Activities  
(All within the Republic of Kazakhstan)

	Year Ended December 31,		
	2003 -----	2002 -----	2001 -----
Acquisition costs (1)	\$ --	\$ 3,881	\$ --
Exploration and appraisal costs	--	--	--
Development costs	27,642	10,287	--
	-----	-----	-----
	\$27,642	\$14,168	\$ --
	=====	=====	=====
Company's share of equity method investee's costs of property acquisition, Exploration, and development	\$ -- =====	\$ -- =====	\$12,446 =====

- (1) Acquisition cost for the year 2002 represents the cost for acquiring an additional 10% interest in KKM through the acquisition of 100% of the outstanding stock in MTI .

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SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS  
PRODUCING ACTIVITIES-UNAUDITED  
(IN THOUSANDS)

Results of Operations for Producing Activities  
(All within the Republic of Kazakhstan)

	Year Ended December 31,		
	2003 -----	2002 -----	2001 -----
Oil revenue	\$ 57,615	\$ 45,133	\$ --
Transportation costs	(11,474)	(9,427)	--
Operating expenses	(5,915)	(7,678)	--
Depreciation, depletion, and amortization	(18,038)	(12,804)	--
	-----	-----	-----



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	22,188	15,224	--
Provision for income taxes(1)	(6,986)	(3,633)	--
	-----	-----	-----
	\$ 15,202	\$ 11,591	\$ --
	=====	=====	=====
Company's share of equity method investee's results from operations for producing activities			
	\$ --	\$ --	\$ 6,090
	=====	=====	=====

(1) Income tax expense is calculated by applying the statutory tax rate to operating profit, adjusted for applicable net operating loss carry forwards.

Standardized Measure of Discounted Future Net Cash Flows and Changes Therein Relating to Proven Oil and Gas Reserves (All within the Republic of Kazakhstan)

	Year Ended December 31,		
	2003	2002	2001
	-----	-----	-----
Future cash inflows	\$ 476,969	\$ 377,660	\$ --
Future development costs	(73,642)	(83,189)	--
Future production costs	(53,338)	(50,952)	--
Future income tax expenses	(90,699)	(55,699)	--
	-----	-----	-----
Future net cash flows	259,290	187,820	--
10% annual discount for estimated timing of cash flows	(92,108)	(59,081)	--
	-----	-----	-----
Standardized measure of discounted net cash flows	\$ 167,182	\$ 128,739	\$ --
	=====	=====	=====
Minority interest	\$ 66,873	\$ 51,496	\$ --
	=====	=====	=====
Company's share of equity method investee's standardized measure of discounted future net cash flows			
	\$ --	\$ --	\$ 40,344
	=====	=====	=====

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SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS PRODUCING ACTIVITIES-UNAUDITED (IN THOUSANDS)

Principal Sources of Change in the Standardized Measure of Discounted Future Net Cash Flows

	Year Ended December 31,		
	2003	2002	2001
	-----	-----	-----
Beginning balance	\$ 128,739	\$ 80,688	\$ --
Sales of oil produced, net of production			

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and transportation costs	(40,226)	(28,028)	--
Extensions and discoveries	--	--	--
Net changes in prices, production cost and future development cost	(3,377)	129,412	--
Net changes due to revisions of previous quantity estimates	79,054	(63,344)	--
Development cost incurred	27,642	10,287	--
Accretion of discount	463	10,393	--
Net change in income taxes	(25,113)	(10,669)	--
Ending balance	\$ 167,182	\$ 128,739	\$ --
	=====	=====	=====

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SUPPLEMENTAL INFORMATION  
SELECTED QUARTERLY FINANCIAL DATA - UNAUDITED  
(All Amounts in Thousands, Except Share Data)

2003 Quarterly Information

	For the Three Months Ended		
	March 31, 2003	June 30, 2003	September 30, 2003
Revenue (1)	\$ 7,813	\$ 8,472	\$ 23,308
Transportation and operating costs	2,785	3,048	6,288
Depreciation and depletion	2,438	3,319	7,140
Operating income	2,590	2,105	9,880
Income/(loss) before taxes and cumulative effect of change in accounting principle	(617)	(779)	4,550
Income taxes	352	330	2,479
Income/(loss) before extraordinary gains	(969)	(1,109)	2,071
Cumulative effect of change in accounting principle	1,018	--	--
Net income/(loss) available to common Stockholders	\$ 49	\$ (1,109)	\$ 2,071
Diluted earnings per share:			
Income/(loss) per share before cumulative effect of change in accounting principle	\$ (0.03)	\$ (0.03)	\$ 0.05
Cumulative effect of change in accounting principle	\$ 0.03	\$ 0.00	\$ --
Net loss per share	\$ (0.00)	\$ (0.03)	\$ 0.05
Basic Weighted average number of shares Outstanding (basic)	38,209,502	38,209,502	38,209,502
Diluted earnings per share:			
Loss per share before cumulative effect of change in accounting principle	\$ (0.03)	\$ (0.03)	\$ 0.05
Cumulative effect of change in accounting principle	\$ 0.03	\$ 0.00	\$ --

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Net loss per share	\$ (0.00)	\$ (0.03)	\$ 0.05
Diluted Weighted average number of shares			
Outstanding (basic and diluted)	38,209,502	38,209,635	38,408,726

(1) Revenue is presented gross of transportation and marketing cost in accordance with EITF 00-1 and Handling Fees and Costs

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SUPPLEMENTAL INFORMATION  
SELECTED QUARTERLY FINANCIAL DATA - UNAUDITED  
(All Amounts in Thousands, Except Share Data)

2002 Quarterly Information

	For the Three Months Ended			
	March 31, 2002	June 30, 2002	September 30, 2002	December 31, 2002
Revenue (1)	\$ 8,379	\$ 10,646	\$ 13,446	\$ 13,446
Transportation and operating costs	4,123	4,248	4,609	4,609
Depreciation and depletion	2,932	3,067	3,709	3,709
Operating income (loss)	1,324	3,331	5,128	5,128
Income/(loss) before taxes and extraordinary gains	(2,893)	3	2,465	2,465
Income taxes	233	287	352	352
Income/(loss) before extraordinary gains	(3,126)	(284)	2,113	2,113
Extraordinary gains	--	5,338	--	--
Net income/(loss) available to common Stockholders	\$ (3,126)	\$ 5,054	\$ 2,113	\$ 2,113
Basic earnings per share:				
Loss per share before cumulative Extraordinary gain	\$ (0.22)	\$ (0.01)	\$ 0.06	\$ 0.06
Extraordinary gain	\$ --	\$ 0.19	\$ --	\$ --
Net loss per share	\$ (0.22)	\$ 0.18	\$ --	\$ --
Basic weighted average number of shares outstanding (basic)	14,283,801	27,955,630	38,209,501	38,209,501
Diluted earnings per share:				
Loss per share before cumulative Extraordinary gain	\$ (0.22)	\$ (0.01)	\$ 0.05	\$ 0.05
Extraordinary gain	\$ --	\$ 0.19	\$ --	\$ --

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Net loss per share	\$	(0.22)	\$	0.18	\$	0.05	\$
Diluted weighted average number of shares outstanding (basic and diluted)		14,283,801		28,488,711		39,134,622	38,2

- (1) Revenue is presented gross of transportation and marketing cost in accordance with EITF 00-1 Shipping and Handling Fees and Costs

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Financial Statements

Closed Type JSC Karakudukmunay

For the Two Years ended December 31, 2001 with  
Reports of Independent Auditors

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### Report of Independent Auditors

The Board of Directors and Stockholders  
Closed Type JSC Karakudukmunay

We have audited the accompanying balance sheets of Closed Type JSC Karakudukmunay ("the Company") as of December 31, 2001 and 2000, and the related statements of operations, cash flows and stockholders' deficit for each of the two years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Closed Type JSC Karakudukmunay at December 31, 2001 and 2000, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As more fully described in Note 3, the Company has a working capital deficiency as of December 31, 2001 and there are uncertainties relating to the Company's ability to meet its expenditure/cash flow requirements through 2002. In addition, the Company's principal investor has been notified that it is in default of its loan agreement with its primary creditor and the primary creditor has initiated legal proceedings for purposes of obtaining control of the principal investor's interest in the Company. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans and other factors in regard to these matters are also described in Note 3. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties.

/s/ Ernst & Young Kazakhstan

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Ernst & Young Kazakhstan

April 2, 2002  
Almaty, Kazakhstan

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Closed Type JSC Karakudukmunay  
Balance Sheets as of  
December 31,  
(In Thousands of U.S. Dollars)

	2001	2000
	-----	-----
ASSETS		
Current assets:		
Cash	\$ 556	\$ 51
Trade receivables	--	680
Prepaid and other receivables (Note 4)	1,705	1,251
Crude oil inventory	145	155
Current VAT receivable (Note 5)	1,925	3,100
	-----	-----
Total current assets	4,331	5,237
Deferred tax assets (Note 11)	58	--
Long term VAT receivable (Note 5)	--	985
Materials and supplies	2,809	3,800
Property, plant and equipment, net (Note 6)	4,741	4,682
Oil and gas properties, full cost (Note 7)		

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Properties subject to depletion	42,336	22,779
Properties not subject to depletion	17,173	20,527
	-----	-----
	59,509	43,306
	-----	-----
TOTAL ASSETS	\$ 71,448	\$ 58,010
	=====	=====
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	\$ 9,914	\$ 8,926
Accrued liabilities (Note 8)	675	795
Current portion of loans payable to partner (Note 10)	5,000	--
	-----	-----
Total current liabilities	15,589	9,721
Long-term debt (Note 10)	58,438	58,605
Other long-term liabilities (Note 9)	276	86
Deferred tax liability (Note 11)	1,220	--
Stockholders' deficit:		
Charter capital (Note 12)	200	200
Accumulated deficit	(4,275)	(10,602)
	-----	-----
	(4,075)	(10,402)
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 71,448	\$ 58,010
	=====	=====

See accompanying notes.

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Closed Type JSC Karakudukmunay  
Statements of Operations for the years ended December 31,  
(In Thousands of U.S. Dollars)

	2001	2000
	-----	-----
Revenues:		
Oil sales	\$ 36,575	\$ 16,968
Costs and expenses:		
Transportation costs	8,297	3,213
Operating expenses	5,246	3,676
Depreciation and depletion	9,479	3,598
Management service fee	620	454
General and administrative	3,753	2,316
	-----	-----
Total cost and expenses	27,395	13,257
	-----	-----
Income (loss) from operations	9,180	3,711

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Other (income) expense:		
Interest income	(14)	(51)
Interest expense	1,847	2,245
Currency exchange (gain)/loss	(258)	54
Other	116	58
	-----	-----
Income (loss) before income taxes	\$ 7,489	\$ 1,405
	=====	=====
Income tax expense	1,162	--
	-----	-----
Net income / (loss)	\$ 6,327	\$ 1,405
	=====	=====

See accompanying notes.

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Closed Type JSC Karakudukmunay  
Statements of Cash Flows for the years ended December 31,  
(In Thousands of U.S. Dollars)

	2001	2000
	-----	-----
Cash flows from operating activities:		
Net income (loss)	\$ 6,327	\$ 1,405
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation and depletion	9,479	3,598
Loss from sale and disposition of fixed assets	116	58
Management service fees	362	--
Accrued production bonus	190	86
Deferred income taxes	1,162	--
Changes in working capital:		
(Increase)/decrease in prepaid and other receivables	227	(1,862)
(Increase)/decrease in crude oil inventory	(3)	272
(Increase)/decrease in materials and supplies inventory	991	(2,664)
(Increase)/decrease in VAT receivable	2,160	(3,414)
Increase in accounts payable and accrued liabilities	868	5,710
Increase/(decrease) in accrued interest payable to partner	(2,897)	3,346
	-----	-----
Net cash provided by operating activities	18,982	6,535
Cash flows from investing activities:		
Purchase of property, plant and equipment	(980)	(1,178)
Investments in oil and gas properties	(23,911)	(27,205)
Proceeds from sale of fixed assets	45	3
Net proceeds from sales of non-commercial crude oil	--	--
	-----	-----
Net cash used in investing activities	(24,846)	(28,380)
Cash flows from financing activities:		

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Increase in loan payable to bank	1,600	--
Principal payments on bank loan	(1,600)	(578)
Increase in loan payable to partner due to cash contributions and other contributions	6,369	22,388
	-----	-----
Net cash provided by financing activities	6,369	21,810
Net increase/(decrease) in cash	505	(35)
Cash at beginning of year	51	86
	-----	-----
Cash at end of year	\$ 556	\$ 51
	=====	=====
Supplemental cash flow disclosure:		
Interest paid to non-related parties	\$ 14	\$ 33
Supplemental schedule of non-cash investing and financing activities:		
Increase in accrued management service fees	\$ 1,360	\$ --

See accompanying notes.

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Closed Type JSC Karakudukmunay  
Statement of Stockholders' Deficit  
(In Thousands of U.S. Dollars)

	Authorized Charter Capital	Accumulated Deficit	Total
	-----	-----	-----
As of December 31,1999	200	(12,007)	(11,807)
Net income for the year 2000	--	1,405	1,405
	-----	-----	-----
As of December 31, 2000	200	(10,602)	(10,402)
Net income for the year 2001	--	6,327	6,327
	-----	-----	-----
As of December 31, 2001	\$ 200	\$ (4,275)	\$ (4,075)
	=====	=====	=====

See accompanying notes.

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements  
(Amounts in thousands of U.S. dollars unless otherwise stated)



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### 1. Organization and Background Information

Closed Type JSC Karakudukmunay. (the "Company"), a Kazakhstan Joint Stock Company of Closed Type, was formed to engage in the exploration, development, and production of oil and gas properties in the Republic of Kazakhstan. The Company's only significant investment is in the Karakuduk Field, an onshore oil field in the Mangistau Oblast region of the Republic of Kazakhstan. On August 30, 1995, the Company entered into an agreement with the Ministry of Oil and Gas Industry for Exploration, Development and Production of Oil in the Karakuduk Oil Field in the Mangistau Oblast of the Republic of Kazakhstan (the "Agreement"). The Company's rights and obligations regarding the exploration, development, and production of underlying hydrocarbons in the Karakuduk Field are determined by the Agreement.

The Company's rights to the Karakuduk Field may be terminated under certain conditions specified in the Agreement. The term of the Agreement is 25 years commencing from the date of the Company's registration. The Agreement can be extended to a date agreed between the Ministry of Energy and Mineral Resources and the Company as long as production of petroleum and/or gas is continued in the Karakuduk Field.

### 2. Basis of Presentation

The Company maintains its accounting records and prepares its financial statements in U.S. dollars in accordance with the terms of the Agreement. Certain reclassifications have been made in the financial statements for 2000 to conform to the 2001 presentation.

The material accounting principles adopted by the Company are described below:

#### Foreign Currency Translation

-----

The Company's functional currency is the U.S. dollar. All transactions arising in currencies other than U.S. dollars, including assets, liabilities, revenue, expenses, gains, or losses are measured and recorded into U.S. dollars using the exchange rate in effect on the date of the transaction.

Cash and other monetary assets held and liabilities denominated in currencies other than U.S. dollars are translated at exchange rates prevailing as of the balance sheet date (150.20 and 144.50 Kazakh Tenge per U.S. dollar as of December 31, 2001 and 2000, respectively). Non-monetary assets and liabilities denominated in currencies other than U.S. dollars have been translated at the estimated historical exchange rate prevailing on the date of the transaction. Exchange gains and losses arising from translation of non-U.S. dollar amounts at the balance sheet date are recognized as an increase or decrease in income for the period.

The Tenge is not a convertible currency outside of the Republic of Kazakhstan. The translation of Tenge denominated assets and liabilities in these financial statements does not indicate the Company could realize or settle these assets and liabilities in U.S. dollars.

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

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### 2. Basis of Presentation (continued)

The Company had \$6.57 million of net monetary liabilities denominated in Tenge as of December 31, 2001 and \$1.67 million net monetary liabilities denominated in Tenge as of December 31, 2000.

#### Interest Capitalization

-----

The Company capitalizes interest on significant construction projects. Assets qualifying for interest capitalization include significant investments in unproved properties and other major development projects that are not being depreciated, depleted, or amortized, provided that work is in progress at that time. The Company had interest expense of \$2.92 million and \$3.38 million for the years ended December 2001 and 2000, respectively. For the same periods, the Company capitalized interest totaling \$1.07 million and \$1.13 million, respectively.

#### Oil and Gas Properties - Full Cost Method

-----

The Company follows the full cost method of accounting for oil and gas properties. Accordingly, all costs associated with the acquisition, exploration, and development of oil and gas reserves, including directly related overhead costs, are capitalized.

All capitalized costs of proved oil and gas properties, including the estimated future costs to develop proved reserves, are amortized on the unit-of-production method using estimated proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized cost to be amortized.

In addition, the capitalized costs are subject to a "ceiling test," which basically limits such costs to the aggregate of the "estimated present value," discounted at a 10-percent interest rate of the future net revenues from proved reserves, based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties.

Sales of proved and unproved properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil and gas, in which case the gain or loss is recognized in income. Abandonments of properties are accounted for as adjustments of capitalized costs with no loss recognized.

#### Property, Plant and Equipment

-----

Property, plant and equipment are valued at historical cost and are depreciated on a straight line basis over the estimated useful lives of the assets as follows:

Description	Period
-----	-----
Office buildings and apartments	20 years
Office equipment	3 years
Vehicles	5 years
Field buildings	15 years

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Field equipment

Up to 10 years

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

## 2. Basis of Presentation (continued)

### Inventory

-----

Crude oil inventory is valued using the first-in, first-out method, at the lower of cost or net realizable value. Crude oil inventory represents production costs associated with lifting and transporting crude oil from the Karakuduk Field to the KazTransOil pipeline. Crude oil placed into the KazTransOil Pipeline is held as inventory until formally nominated and delivered for sale. Crude oil inventory as of December 31, 2001 and 2000 represented approximately 24,000 and 19,000 barrels of crude oil, respectively.

Materials and supplies inventory is valued using the first-in, first-out method and is recorded at the lower of cost or net realizable value. Certain unique items, such as drilling equipment, are valued using the specific identification method. Materials and supplies represent plant and equipment for development activities, tangible drilling costs (drill bits, tubing, casing, wellheads, etc.) required for development drilling operations, spare parts, diesel fuel, and various materials for use in oil field operations.

### Revenue Recognition

-----

Revenues and their related costs are recognized upon delivery of commercial quantities of oil production produced from proved reserves, in accordance with the accrual method of accounting. Losses, if any, are provided for in the period in which the loss is determined to occur.

Revenue is presented gross of transportation expenses in accordance with EITF 00-10, Accounting for Shipping and Handling Fees and Costs.

### Earnings Per Common Share

-----

Basic earnings (loss) and diluted earnings (loss) are not presented due to the Company being of a "closed" nature, and having no underlying shares outstanding.

### New Accounting Standards

-----

In June 1998, the FASB issued SFAS 133, Accounting for Derivative Instruments and Hedging Activities. This standard provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. SFAS 133, as amended by SFAS 137 and 138, is effective for years beginning after June 15, 2000. The Company adopted SFAS 133 on January 1, 2001. As a result of adoption of SFAS 133, the Company recognizes all derivative financial instruments in the financial statements at fair value regardless of the purpose or intent for holding the instrument. Changes in the fair value of derivative financial instruments are recognized periodically in income or in stockholders' equity as a component of comprehensive income depending on whether

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the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in fair values of derivatives accounted for as fair value hedges are recorded in income along with the portions of the changes in the fair values of the hedged items that relate to the hedged risks. Changes in fair values of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income net of deferred taxes. Changes in fair values of derivatives not qualifying as hedges are reported in income. The Company has not identified any derivative financial instruments, which could be designated as fair value or cash flow hedges under SFAS 133 as of December 31, 2001.

During 2001, the FASB issued the following pronouncements, which have potential future accounting implications for the Company:

SFAS 141, Accounting for Business Combinations, requires the use of the purchase method of accounting for all business combinations and provides new criteria to determine whether an acquired intangible asset should be recognized. SFAS 141 applies to all business combinations initiated after June 30, 2001 and to all business combinations accounted for by the purchase method that are completed after June 30, 2001.

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

### 2. Basis of Presentation (continued)

SFAS 142, Accounting for Goodwill and Intangible Assets, requires that goodwill as well as other intangible assets with indefinite lives be tested annually for impairment. SFAS 142 is effective for fiscal years beginning after December 15, 2001.

SFAS 143, Accounting for Asset Retirement Obligations, requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. SFAS 143 is effective for fiscal years beginning after June 15, 2002.

SFAS 141 and 142 will not apply to the Company unless it enters into a future business combination. The Company is currently assessing the impact of SFAS 143 on its financial condition and results of operations and is unsure if the effect of the future adoption of SFAS 143, if any, will be material to the Company's financial results.

#### Fair Value of Financial Instruments

-----

All of the Company's financial instruments, including loans payable to partner, cash and trade receivables have fair values which approximate their recorded values as they are either short-term in nature or carry interest rates which approximate market rates.

#### Use of Estimates

-----

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that

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affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### 3. Going Concern

The Company's financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has a working capital deficiency as of December 31, 2001 and there are uncertainties relating to the Company's ability to meet all expenditure and cash flow requirements through fiscal year 2002. In addition, Chaparral Resources, Inc. ("Chaparral"), the parent company of the Company's principal investor, Central Asian Petroleum (Guernsey) Limited ("CAP-G"), has been notified by Shell Capital Services Limited, acting as facility agent, that it is in default of its loan agreement (the "Loan") with Shell Capital Inc. ("Shell Capital"), and Shell Capital Services Limited has initiated legal proceedings against both Chaparral and CAP-G. See Note 13 regarding the status of the Loan.

These conditions raise doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of these uncertainties. The Company is seeking to alleviate these conditions through increased production and related sale of oil from the Karakuduk Field and elimination or minimization of local oil sales requirements imposed upon the Company by the Government. See Note 14 regarding the Company's local market requirements.

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

### 4. Prepaid and Other Receivables

The breakdown of Prepaid and Other Receivables is as follows:

Description	December 31, 2001	December 31, 2000
-----	-----	-----
Advanced payment for oil and gas assets	\$ --	\$ 189
Advanced payments for materials and supplies	588	--
VAT receivable from drilling contractor	--	651
Prepaid transportation costs	959	291
Other prepaid expenses	158	120
	-----	-----
Total	\$1,705	\$1,251
	=====	=====

Advanced payment for materials and supplies represents prepayments for general materials and supplies to be used in the development of the Karakuduk Field. Advanced payments for oil and gas assets represents prepaid drilling costs, which were fully recovered during 2001 through reduction of monthly charges from the Company's drilling contractor, KazakhOil Drilling Services Company ("KODS"), an affiliate of KazakhOil JSC. The VAT receivable from the drilling contractor represents import VAT paid by the Company on behalf of KODS, which was offset

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against drilling invoices charged to the Company in 2001. Prepaid transportation costs represent the prepayment of export tariffs necessary to sell oil on the export market, which is expensed in the period the related oil revenue is recognized.

### 5. VAT Receivable

The VAT receivable is a Tenge denominated asset due from the Republic of Kazakhstan. The VAT receivable consists of VAT paid on local expenditures and imported goods. Under the Company's Agreement, VAT charged to the Company is recoverable in future periods as either cash refunds or offsets against the Company's fiscal obligations, including future income tax liabilities. Periodically, the Company reviews its outstanding VAT receivable for possible impairment. During 2001, the Company received VAT refunds of approximately \$5.94 million.

### 6. Property, Plant and Equipment

Upon full amortization of tangible assets, the right of ownership of the tangible assets shall be transferred to the Republic of Kazakhstan in accordance with the Agreement. The Company is entitled to the use of the fully amortized tangible assets during the whole term of the Agreement. A summary of property, plant and equipment is provided in the table below:

Description -----	December 31, 2001 -----	December 31, 2000 -----
Office buildings and apartments	\$ 326	\$ 312
Office equipment and furniture	770	552
Vehicles	1,376	1,758
Field buildings	4,304	3,652
Field equipment and furniture	492	479
	-----	-----
Total cost	7,268	6,753
	-----	-----
Accumulated depreciation	(2,527)	(2,071)
	-----	-----
Property, plant and equipment, net	\$ 4,741 =====	\$ 4,682 =====

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

### 6. Property, Plant and Equipment (continued)

Depreciation expense for property, plant, and equipment was \$803,000 and \$755,000 for years ending December 31, 2001 and 2000, respectively.

### 7. Oil and Gas Properties

The Company has capitalized all direct costs associated with acquisition, exploration, and development of the Karakuduk Field. These costs include geological and geophysical expenditures, license acquisition costs, tangible and intangible drilling costs, production facilities, pipelines and related equipment, access roads, gathering systems, management fees related to the

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salary costs of individuals directly associated with exploration and development activities, and related interest costs associated with unproved properties. Overhead and general and administrative costs have been expensed as incurred.

The Company calculates depreciation, depletion, and amortization of oil and gas properties using the units-of-production method. The provision is computed by multiplying the unamortized costs of proved oil and gas properties by a production rate calculated by dividing the physical units of oil and gas produced during the relevant period by the total estimated proved reserves. The unamortized costs of proved oil and gas properties includes all capitalized costs net of accumulated amortization, estimated future costs to develop proved reserves, and estimated dismantlement and abandonment costs.

The Company recognized total amortization expense of \$8.67 million and \$2.77 million for the years ended December 31, 2001 and 2000, respectively. For the same periods, the effective amortization rate was \$3.97 and \$3.70 per barrel, respectively.

In accordance with SFAS 19, Financial Accounting and Reporting by Oil and Gas Producing Companies, the Company accounts for amortization of crude oil production as a component of crude oil inventory until the related crude oil is sold. As of December 31, 2001 and 2000, \$96,000 and \$76,000 of amortization expense was capitalized to crude oil inventory, respectively.

The composition of Oil and Gas Properties is as follows:

Description -----	December 31, 2001 -----	December 31, 2000 -----
Acquisition costs	\$ 508	\$ 508
Exploration and appraisal costs	22,277	22,077
Development cost	44,633	21,012
Capitalized interest	3,699	2,628
	-----	-----
Total oil and gas properties at cost	\$ 71,117	\$ 46,225
	=====	=====
Total costs not subject to amortization	\$ 17,173	\$ 20,527
	=====	=====
Total costs subject to amortization	53,944	25,698
Accumulated amortization	(11,608)	(2,919)
	-----	-----
Net properties subject to amortization	\$ 42,336	\$ 22,779
	=====	=====

The full cost ceiling test results as of December 31, 2001 support the carrying amount of the assets disclosed above. Therefore, no impairment provision has been made.

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

### 8. Accrued Liabilities

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Description	December 31, 2001	December 31, 2000
-----	----	----
Accrued management service fee	\$574	\$574
Accrued taxes payable	36	156
Other accrued liabilities	65	65
	----	----
Total accrued liabilities	\$675	\$795
	=====	=====

9. Other Long-Term Liabilities

Other long-term liabilities represent production based bonuses, which will be payable to the Government of Kazakhstan amounting to \$500,000 when cumulative production reaches ten million barrels and \$1.2 million when cumulative production reaches 50 million barrels. Under current Kazakhstan tax law, the production bonuses will be considered tax deductible expenditures in the calculation of profits taxes. The Company accrues the production bonuses in relation to cumulative oil production. The Company accrued \$190,000 and \$86,000 in production bonuses for the years ended December 31, 2001 and December 31, 2000, respectively.

10. Long-term Debt

Description	December 31, 2001	December 31, 2000
-----	-----	-----
Loans payable to partner		
Cash funding	\$ 47,317	\$ 42,477
Management service fee	7,675	6,315
Other expenditures	4,715	3,186
Accrued interest payable	3,731	6,627
	-----	-----
	63,438	58,605
Less current portion	(5,000)	--
	-----	-----
Total long-term debt	\$ 58,438	\$ 58,605
	=====	=====

Loans Payable to Partner

-----

One of the Company's founders, CAP-G, bears sole financial responsibility for providing all funding for the Company, which is not otherwise generated by the Company's operations or borrowed from third party sources. The various forms of funding from CAP-G are treated as long-term loans to the Company and bear interest at the rate of LIBOR plus 1%. The Agreement requires installment payments on the loan to be paid quarterly in an amount equal to 65% of gross revenues after deduction of royalties payable to the Government of Kazakhstan. CAP-G, at its own discretion, may waive receipt of quarterly repayments to maintain working capital within the Company. During 2001, the Company paid \$5.79 million to CAP-G as investment recovery.

The management service fee element of loans payable to partners relates to management services provided by a subsidiary of Chaparral from 1996 through 1999 and directly by Chaparral, thereafter. Chaparral is CAP-G's parent company. The accrued management fees were paid by CAP-G on the Company's behalf and made part of the loan.



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Loans Payable to Banks  
-----

In September 2001, the Company borrowed \$1.60 million from a local Kazakhstan financial institution. The Company fully repaid the loan in October, 2001.

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

11. Taxes

The Company is subject to corporate income tax at the prevailing statutory rate of 30%. Income (loss) from continuing operations before provision for income taxes consists of:

	Year ended December 31,	
	2001	2000
	-----	-----
Income/(Loss) before income taxes	\$ 7,489	\$ 1,405
	=====	=====

The provision for income taxes consists of:

	Year ended December 31,	
	2001	2000
	-----	-----
Income tax provision:		
Current	--	--
Deferred	1,162	--
	-----	-----
Total provision for income taxes	\$1,162	\$ --
	=====	=====

The following table summarizes the significant differences between the statutory tax rate and the Company's effective tax rate for financial statement purposes:

	Year ended December 31,	
	2001	2000
	-----	-----
Statutory tax rate	30%	30%
Income taxes (benefit) computed at statutory rate	\$ 2,247	\$ 422
Losses and expenses with no tax benefit	1,608	487
Utilization of net operating loss carryforwards	--	--
Change in asset valuation allowance	(2,693)	(909)
	-----	-----
Income tax provision	\$ 1,162	\$ --
	=====	=====

Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

## 11. Taxes (continued)

The components of the Company's deferred tax assets and liabilities are as follows:

	Year ended December 31, 2001	2000
	-----	-----
Deferred tax assets:		
Oil and gas properties	\$ 24	\$ 253
Net operating loss carryforwards	34	908
	-----	-----
Total deferred tax assets before valuation allowance	58	1,161
Valuation allowance	--	(1,161)
	-----	-----
Net deferred tax assets	58	--
Deferred tax liabilities		
Oil and gas properties and other book/tax differences	1,220	--
	-----	-----
Total deferred tax liabilities	1,220	--
	-----	-----
Net deferred tax liabilities (assets)	\$ 1,162	\$ --
	=====	=====

The Company recognized a net deferred tax liability of \$1.16 million as of December 31, 2001, primarily related to deductible temporary differences for cost recovery adjusted for net operating loss carryforwards expected to be utilized in future years. The Company did not record a valuation allowance for the year ended December 31, 2001, due to the Company's determination that net operating loss carryforwards would be fully utilized to offset taxable income in 2001 and future periods. Additionally, the Company increased its valuation allowance by \$1.53 million applied against 2001 taxable income to reflect the impact of depreciation for basis adjustments allowed for statutory tax reporting purposes. The adjustment did not impact the provision for prior years as the Company recognized a 100% valuation allowance on its deferred tax assets due to recurring operating losses from prior periods.

The Agreement specifies the income taxes and other taxes applicable to the Company, which is subject to the tax laws of the Republic of Kazakhstan. At December 31, 2001, the Company has tax loss carryforwards of approximately \$115,000 available to offset against future taxable income, in accordance with the terms of the Agreement and legislation existing as of the date the Agreement was signed. The tax loss carryforwards are Tenge denominated and expire in 2004.

The Company has used the best estimates available to determine the Company's deferred tax assets and liabilities before consideration of the valuation allowance. Refer to Note 13 regarding the uncertainties of taxation in the Republic of Kazakhstan.

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Closed Type JSC Karakudukmunay  
 Notes to the Financial Statements (continued)  
 (Amounts in thousands of U.S. dollars unless otherwise stated)

12. Charter Capital

The total Charter Fund contribution specified in the Founders Agreement of the Company is \$200,000. Each of the founders' portion of the Charter Fund and their respective participating interest in the Company is:

	December 31, 2001		December 31, 2000	
	Charter Contribution	Percent	Charter Contribution	Percent
KazakhOil	\$ 80	40%	\$ 80	40%
Korporatsiya Mangistau Terra International	20	10%	20	10%
Central Asian Petroleum (Guernsey) Limited - CAP-G	100	50%	100	50%
	----	----	----	----
Total charter capital	\$200	100%	\$200	100%
	====		====	

KazakhOil JSC ("KazakhOil") is the national petroleum company of the Republic of Kazakhstan.

13. Contingencies

Shell Capital Loan

In November 1999, Chaparral entered into the Loan with Shell Capital to provide up to \$24 million to partially fund the development of the Karakuduk Field. In May 2001, the Loan was amended to provide Chaparral with up to \$8 million in uncommitted working capital (the "Bridge Loan"), repayable on or before September 30, 2001. The Company and CAP-G both signed the Loan and Bridge Loan as "co-obligors," assuming certain obligations and commitments to Shell Capital and to Chaparral, as the borrower. The Company, however, continues to borrow funds directly from CAP-G in accordance with the terms of the Agreement.

As of December 31, 2001, Chaparral was notified by Shell Capital Services Limited, acting as facility agent, that it was in default of the Loan for failure to pay outstanding principal and interest due on the Bridge Loan totaling \$3.34 million on or before September 30, 2001, failure to pay principal and interest due on the Loan totaling \$2.68 million on or before December 31, 2001, failure to achieve project completion by September 30, 2001, failure to settle certain accounts payable within 90 days, the Company's failure to obtain Shell Capital's approval prior to entering certain short-term debt arrangements, and failure to maintain the listing of Chaparral's common stock on one of the major stock exchanges (i.e. Nasdaq, NYSE, or AMEX). In January 2002, Chaparral received a notice from Shell Capital Services Limited accelerating the payment of the outstanding principal, interest, and other fees and expenses due under the Loan. Additionally, Shell Capital Services Limited initiated legal

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proceedings against Chaparral in the United Kingdom and against CAP-G in the Isle of Guernsey to enforce Shell Capital's rights under the Loan. Chaparral and CAP-G are contesting Shell Capital Services Limited's respective actions, but there are no assurances that either CAP-G or Chaparral will be successful. Shell Capital has not initiated legal action against the Company itself, but there can be no assurance that Shell Capital will not do so in the future.

As a co-obligor of the Loan, the Company is subject to the following pledges, covenants, and other restrictions:

- (v) A pledge of the Company's receivables, including proceeds from the sale of crude oil, to Shell Capital in the event of default of the Loan;
- (vi) A pledge of the Company's right to insurance proceeds to Shell Capital in the event of default of the Loan;

As a condition of the Loan, the Company entered into a crude oil sales agreement with Shell Trading International Limited ("STASCO"), an affiliate of Shell Capital, for the purchase of 100% of the Company's oil production from the Karakuduk Field on the export market. The Loan requires the Company to sell all of its net oil production to STASCO, unless otherwise agreed. The Company sold approximately 1.81 million barrels of oil to STASCO during 2001, and

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

### 13. Contingencies (continued)

approximately 604,000 barrels during 2000. Furthermore, the Government of the Republic of Kazakhstan required the Company to sell approximately 375,000 and 161,000 barrels of oil to the local market for the years ended December 31, 2001 and December 31, 2000, respectively. Although the Loan has been called in default by Shell Capital Services Limited, the Company has continued to sell its crude oil to STASCO on the export market in accordance with the Loan and the STASCO agreement.

### Taxation -----

The existing legislation with regard to taxation in the Republic of Kazakhstan is constantly evolving as the Government manages the transition from a command to a market economy. Tax and other laws applicable to the Company are not always clearly written and their interpretation is often subject to the opinions of the local or main State Tax Service. Instances of inconsistent opinions between local, regional and national tax authorities are not unusual.

### Basis of Accounting -----

The Company maintains its statutory books and records in accordance with U.S. generally accepted accounting principles and calculates taxable income or loss using the existing Kazakh tax legislation in effect on August 30, 1995, the date the Agreement was signed. The Company considers these accounting methods correct under the terms of the Agreement. The Republic of Kazakhstan currently requires companies to comply with Kazakh accounting regulations and to calculate tax profits or losses in accordance with these regulations as well as the prevailing tax law. There is currently uncertainty as to the extent of tax losses available

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to the Company. The potential effect of the uncertainty is not quantifiable.

### 14. Local Oil Sales Requirements

The ability of the Company to realize the carrying value of its assets is dependent on being able to transport hydrocarbons and finding appropriate markets for their sale. Domestic markets in the Republic of Kazakhstan currently do not permit world market prices to be obtained.

The Company's crude oil sales agreement with STASCO, discussed in Note 13, requires the Company to sell 100% of its oil production to STASCO on the export market. The Company is not allowed to sell to other parties, on either the export or local markets, without the approval of STASCO and Shell Capital. While the Company is responsible for obtaining export quotas and finalizing access routes through the KazTransOil pipeline and onward through the Russian pipeline system, the Company has a right to export, and receive export quota for, 100% of the production from the Karakuduk Field under the terms of the Agreement.

The Government of Kazakhstan, however, has required the Company, along with other oil and gas producers within Kazakhstan, to sell a certain portion of their crude oil production to the local market to supply local energy needs. During 2001, the Company sold approximately 375,000 barrels of crude oil on the local market for approximately \$3.38 million and 1.81 million barrels to STASCO on the export market for approximately \$33.20 million. During 2000, the Company sold approximately 161,000 barrels of crude oil on the local market for approximately \$1.69 million and sold 604,000 barrels to STASCO on the export market for approximately \$15.28 million.

The Company has and is continuing to work with the Government to effect the export of 100% of hydrocarbons produced. It is uncertain, however, whether the Company will be successful in doing so, as the Government is expected to require additional local sales from oil and gas producers in the future.

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Closed Type JSC Karakudukmunay  
Notes to the Financial Statements (continued)  
(Amounts in thousands of U.S. dollars unless otherwise stated)

### 15. Related Party Transactions

The Company entered into a marketing services agreement with KazakhOil on January 31, 2000, whereby KazakhOil will assist the Company in expediting export oil sales under the crude oil sales agreement with STASCO.

In January 2000, the Company canceled its management service contract with Chaparral's subsidiary and entered into a similar contract directly with Chaparral. The contract is for \$170,000 per month, plus reimbursable expenses, or \$2.04 million per year.

Other related party transactions are disclosed on the face of the balance sheet. Stockholders and their respective holdings in the Company are disclosed in Note 12, CAP-G related party transactions are referenced in Note 10.

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### SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS PRODUCING ACTIVITIES-UNAUDITED

The following supplemental information regarding the oil and gas activities of the Company is presented pursuant to the disclosure requirements promulgated by the SEC and Statement of Financial Accounting Standards ("SFAS") 69, Disclosures About Oil and Gas Producing Activities.

The following estimates of reserve quantities and related standardized measure of discounted net cash flows are estimates only, and are not intended to reflect realizable values or fair market values of the Company's reserves. The Company emphasizes that reserve estimates are inherently imprecise and that estimates of new discoveries are more imprecise than producing oil and gas properties. Additionally, the price of oil has been very volatile and downward changes in prices can significantly affect quantities that are economically recoverable. Accordingly, these estimates are expected to change as future information becomes available and these changes may be significant.

The Company sold 2.18 million barrels of crude oil in 2001, of which 375,000 barrels, or approximately 17%, were sold to the local market. Comparatively, the Company sold 765,000 barrels of crude oil in 2000, of which 161,000, or approximately 21%, was sold to the local market. Prices received on local market sales were substantially lower than world market prices prevailing at that time. The Company has an existing crude oil sales agreement with STASCO to sell 100% of its production on the export market for world market prices and a right to export 100% of its production under the terms of its Agreement with the government. The Company, however, expects the government to continue to require the Company to sell a portion of its future crude oil production to the local market. Therefore, year-end prices used for the standardized measure of discounted net cash flows for the three years ended December 31, 2001 reflect the assumption that 20% of the Company's production will be sold to the local market for a substantially lower net oil price per barrel.

Proved reserves are estimated reserves of crude oil and natural gas that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are those expected to be recovered through existing wells, equipment and operating methods.

The standardized measure of discounted future net cash flows is computed by applying year-end prices of oil and gas (with consideration of price changes only to the extent provided by contractual arrangements) to the estimated future production of proved oil and gas reserves, less estimated future expenditures (based on year-end costs) to be incurred in developing and producing the proved reserves, less estimated future income tax expenses. The estimated future net cash flows are then discounted using a rate of 10% a year to reflect the estimated timing of the future cash flows.

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### SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS PRODUCING ACTIVITIES-UNAUDITED (All Amounts in Thousands)

Proved Oil and Gas Reserve Quantities  
(All within the Republic of Kazakhstan)

Oil

Gas

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	Reserves (bbls.) -----	Reserves (Mcf.) -----
Proved developed and undeveloped reserves:		
Balance December 31, 1999	20,142	--
Revision of previous estimates	--	--
Extensions, discoveries and other additions	13,633	--
Production	(730)	--
Balance December 31, 2000	33,045	--
Revision of previous estimates	(1,978)	--
Extensions, discoveries and other additions	1,043	--
Production	(2,189)	--
	-----	-----
Balance December 31, 2001	29,921	--
	=====	=====
Proved Developed Reserves:		
Balance December 31, 2000	10,414	--
	=====	=====
Balance December 31, 2001	13,520	--
	=====	=====

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SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS  
PRODUCING ACTIVITIES-UNAUDITED  
(All Amounts in Thousands)

Capitalized Costs Relating to Oil and Gas Producing Activities  
(All within the Republic of Kazakhstan)

	Year Ended December 31, 2001 -----	Year Ended December 31, 2000 -----
Unproved oil and gas properties	\$ 23,179	\$ 29,892
Proved oil and gas properties	58,015	26,886
	-----	-----
Accumulated depreciation and depletion	(14,135)	(4,990)
	-----	-----
Net capitalized cost	\$ 67,059	\$ 51,788
	=====	=====

Cost Incurred in Oil and Gas Property Acquisition, Exploration, and Development Activities  
(All within the Republic of Kazakhstan)

	Year Ended December 31, 2001 -----	Year Ended December 31, 2000 -----
Acquisition costs	\$ --	\$ --
Exploration and appraisal costs	200	5,060
Development costs	24,692	22,144

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-----	-----
\$24,892	\$27,204
=====	=====

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SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS  
PRODUCING ACTIVITIES-UNAUDITED  
(All Amounts in Thousands)

Results of operations for producing activities  
(All within the Republic of Kazakhstan)

	Year Ended December 31,	
	2001	2000
	-----	-----
Oil revenue	\$ 36,575	\$ 16,968
Transportation costs	(8,297)	(3,213)
Operating expenses	(5,246)	(3,676)
Depreciation, depletion, and amortization	(9,479)	(3,598)
	-----	-----
	13,553	6,481
Provision for income taxes(1)	(1,373)	--
	-----	-----
	\$ 12,180	\$ 6,481
	=====	=====

(1) Income tax expense is calculated by applying the statutory tax rate to operating profit, adjusted for applicable net operating loss carryforwards.

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SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS  
PRODUCING ACTIVITIES-UNAUDITED  
(All Amounts in Thousands)

Standardized Measure of Discounted Future Net Cash Flows and Changes Therein  
Relating to Proven Oil and Gas Reserves (All within the Republic of Kazakhstan)

	Year Ended December 31,	
	2001	2000
	-----	-----
Future cash inflows	\$ 305,579	\$ 430,082
Future development costs	(92,433)	(92,685)
Future production costs	(57,945)	(46,477)
Future income tax expenses	(34,132)	(71,000)
	-----	-----
Future net cash flows	121,069	219,920
10% annual discount for estimated timing of cash flows	(40,381)	(79,358)
	-----	-----



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Standardized measure of discounted net cash flows	\$ 80,688	\$ 140,562
	=====	=====

Principal sources of change in the standardized measure of discounted future net cash flows

	Year Ended December 31,	
	2001	2000 (1)
	-----	-----
Beginning balance	\$ 140,562	\$ 122,623
Sales of oil produced, net of production and transportation costs	(23,032)	(10,079)
Extensions and discoveries	7,094	69,464
Net changes in prices, production cost and future development cost	(93,058)	(75,990)
Net changes due to revisions of previous quantity estimates	(13,459)	--
Development cost incurred	24,692	22,144
Accretion of discount	18,519	16,496
Net change in income taxes	21,387	(2,296)
Other	(2,017)	(1,800)
	-----	-----
Ending balance	\$ 80,688	\$ 140,562
	=====	=====

(1) Certain reclassifications have been made in the 2000 presentation for principal sources of change in the standardized measure of discounted future net cash flows to conform to the 2001 presentation.

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SUPPLEMENTAL INFORMATION - SELECTED QUARTERLY FINANCIAL DATA - UNAUDITED  
(All Amounts in Thousands)

2001 Quarterly Information

	For the Three Months Ended (In Thousands of U.S. Dollars)			
	March 31, 2001	June 30, 2001	September 30, 2001	December 31, 2001
	-----	-----	-----	-----
Revenue (1)	\$ 8,436	\$ 9,559	\$ 6,916	\$ 10,000
Transportation and operating costs	(3,082)	(3,198)	(2,046)	(2,046)
Depreciation and depletion	(1,931)	(2,132)	(1,828)	(1,828)
	-----	-----	-----	-----
Operating income (loss)	3,423	4,229	3,042	(4,902)
	=====	=====	=====	=====
Income (loss) before income taxes	\$ 1,667	\$ 2,712	\$ 1,677	\$ 1,677

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Income tax provision	--	--	--	--
	-----	-----	-----	-----
Net income (loss)	\$ 1,667	\$ 2,712	\$ 1,677	\$
	=====	=====	=====	=====

- (1) Revenue is presented gross of transportation and marketing cost in accordance with EITF 00-1 Shipping and Handling Fees and Costs.

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SUPPLEMENTAL INFORMATION - SELECTED QUARTERLY FINANCIAL DATA - UNAUDITED  
(All Amounts in Thousands)

2000 Quarterly Information

	For the Three Months Ended (In Thousands of U.S. Dollars)			
	March 31, 2000	June 30, 2000	September 30, 2000	December 2000
	-----	-----	-----	-----
Revenue (1)	\$ --	\$ 4,552	\$ 4,341	\$ 8,0
Transportation and operating costs	--	(1,863)	(2,235)	(2,7
Depreciation and depletion	(180)	(828)	(884)	(1,7
	-----	-----	-----	-----
Operating income (loss)	(180)	1,861	1,222	3,5
	=====	=====	=====	=====
Income (loss) before income taxes	\$ (1,209)	\$ 625	\$ (148)	\$ 2,1
Income tax provision	--	--	--	--
	-----	-----	-----	-----
Net income (loss)	\$ (1,209)	\$ 625	\$ (148)	\$ 2,1
	=====	=====	=====	=====

- (1) Revenue is presented gross of transportation and marketing cost in accordance with EITF 00-1 Shipping and Handling Fees and Costs.

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