OAO LUKOIL

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(prepared in accordance with US GAAP)

As of and for the three-month period ended March 31, 2008

(unaudited)

These interim consolidated financial statements were prepared by OAO LUKOIL in accordance with US GAAP and have not been audited by our independent auditor. If these financial statements are audited in the future, the audit could reveal differences in our consolidated financial results and we can not assure that any such differences would not be material.

Independent Accountants' Review Report

The Board of Directors of OAO LUKOIL:

We have reviewed the accompanying consolidated balance sheet of OAO LUKOIL and its subsidiaries as of March 31, 2008, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for the three-month periods ended March 31, 2008 and 2007 in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of OAO LUKOIL.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim consolidated financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

ZAO KPMG

ZAO KPMG
Moscow, Russian Federation
June 2, 2008

OAO LUKOIL
Consolidated Balance Sheets
(Millions of US dollars, unless otherwise noted)

	Note	As of March 31, 2008 (unaudited)	As of December 31, 2007
Assets			
Current assets			
Cash and cash equivalents	4	1,146	841
Short-term investments		70	48
Accounts and notes receivable, net	6	7,997	7,467
Inventories		5,206	4,609
Prepaid taxes and other expenses		4,230	4,109
Other current assets		731	625
Assets held for sale	10	204	204
Total current assets		**19,584**	**17,903**
Investments	7	1,245	1,086
Property, plant and equipment	8	40,344	37,930
Deferred income tax assets		574	490
Goodwill and other intangible assets	9	959	934
Other non-current assets		1,309	1,289
Total assets		**64,015**	**59,632**
Liabilities and Stockholders' equity			
Current liabilities			
Accounts payable		4,517	4,554
Short-term borrowings and current portion of long-term debt	11	2,015	2,214
Taxes payable		3,052	2,042
Other current liabilities		924	918
Total current liabilities		**10,508**	**9,728**
Long-term debt	12, 15	5,060	4,829
Deferred income tax liabilities		2,155	2,079
Asset retirement obligations	8	972	811
Other long-term liabilities		372	395
Minority interest in subsidiary companies		582	577
Total liabilities		**19,649**	**18,419**
Stockholders' equity	14		
Common stock		15	15
Treasury stock, at cost		(1,630)	(1,591)
Additional paid-in capital		4,525	4,499
Retained earnings		41,512	38,349
Accumulated other comprehensive loss		(56)	(59)
Total stockholders' equity		**44,366**	**41,213**
Total liabilities and stockholders' equity		**64,015**	**59,632**

President of OAO LUKOIL
Alekperov V.Y.

Chief accountant of OAO LUKOIL
Khoba L.N.

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

OAO LUKOIL
Consolidated Statements of Income
(Millions of US dollars, unless otherwise noted)

	Note	For the three months ended March 31, 2008 (unaudited)	For the three months ended March 31, 2007 (unaudited)
Revenues			
Sales (including excise and export tariffs)	22	24,955	15,652
Equity share in income of affiliates	7	129	84
Total revenues		**25,084**	**15,736**
Costs and other deductions			
Operating expenses		(1,908)	(1,443)
Cost of purchased crude oil, gas and products		(8,608)	(5,050)
Transportation expenses		(1,195)	(987)
Selling, general and administrative expenses		(796)	(663)
Depreciation, depletion and amortization		(624)	(547)
Taxes other than income taxes		(3,129)	(1,829)
Excise and export tariffs		(4,585)	(3,268)
Exploration expenses		(34)	(75)
Net (loss) gain on disposals and impairments of assets		(5)	2
Income from operating activities		**4,200**	**1,876**
Interest expense		(72)	(77)
Interest and dividend income		25	29
Currency translation gain		110	42
Other non-operating expense		(48)	(19)
Minority interest		(40)	(14)
Income before income taxes		**4,175**	**1,837**
Current income taxes		(1,064)	(630)
Deferred income taxes		52	92
Total income tax expense	3	**(1,012)**	**(538)**
Net income		**3,163**	**1,299**
Basic earning per share of common stock (US dollars):	14	3.83	1.56

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

OAO LUKOIL
Consolidated Statements of Stockholders' Equity and Comprehensive Income (unaudited)
(Millions of US dollars, unless otherwise noted)

	Common stock	Treasury stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total Stockholders' equity
Three months ended March 31, 2008						
Balance as of December 31, 2007	15	(1,591)	4,499	38,349	(59)	**41,213**
Net income	-	-	-	3,163	-	**3,163**
Prior service cost	-	-	-	-	3	**3**
Comprehensive income						**3,166**
Effect of stock compensation plan	-	-	26	-	-	**26**
Stock purchased	-	(39)	-	-	-	**(39)**
Balance as of March 31, 2008	**15**	**(1,630)**	**4,525**	**41,512**	**(56)**	**44,366**

	Common stock	Treasury stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total Stockholders' equity
Three months ended March 31, 2007						
Balance as of December 31, 2006	15	(1,098)	3,943	30,061	(21)	**32,900**
Net income	-	-	-	1,299	-	**1,299**
Prior service cost	-	-	-	-	2	**2**
Actuarial gain	-	-	-	-	(1)	**(1)**
Comprehensive income						**1,300**
Effect of stock compensation plan	-	-	25	-	-	**25**
Stock purchased	-	(212)	-	-	-	**(212)**
Stock disposed	-	215	451	-	-	**666**
Balance as of March 31, 2007	**15**	**(1,095)**	**4,419**	**31,360**	**(20)**	**34,679**

	Share activity (thousands of shares)	
	Common stock	**Treasury stock**
Three months ended March 31, 2008		
Balance as of December 31, 2007	850,563	(23,321)
Stock purchased	-	(550)
Balance as of March 31, 2008	**850,653**	**(23,871)**
Three months ended March 31, 2007		
Balance as of December 31, 2006	850,563	(23,632)
Stock purchased	-	(2,466)
Stock disposed	-	8,841
Balance as of March 31, 2007	**850,563**	**(17,257)**

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

OAO LUKOIL
Consolidated Statements of Cash Flows
(Millions of US dollars)

	Note	For the three months ended March 31, 2008 (unaudited)	For the three months ended March 31, 2007 (unaudited)
Cash flows from operating activities			
Net income		**3,163**	**1,299**
Adjustments for non-cash items:			
Depreciation, depletion and amortization		624	547
Equity share in income of affiliates, net of dividends received		(98)	-
Dry hole write-offs		8	48
Loss (gain) on disposals and impairments of assets		5	(2)
Deferred income taxes		(52)	(92)
Non-cash currency translation loss		132	25
Non-cash investing activities		(6)	(7)
All other items – net		264	(35)
Changes in operating assets and liabilities:			
Accounts and notes receivable		(560)	(174)
Inventories		(578)	(277)
Accounts payable		(61)	361
Taxes payable		1,010	47
Other current assets and liabilities		(193)	280
Net cash provided by operating activities		**3,658**	**2,020**
Cash flows from investing activities			
Acquisition of licenses		(10)	(246)
Capital expenditures		(2,362)	(1,899)
Proceeds from sale of property, plant and equipment		27	14
Purchases of investments		(60)	(46)
Proceeds from sale of investments		14	14
Sale of subsidiaries, net of cash disposed		1	3
Acquisitions of subsidiaries and minority shareholding interest (including advances related to acquisitions), net of cash acquired		(771)	(24)
Net cash used in investing activities		**(3,161)**	**(2,184)**
Cash flows from financing activities			
Net movements of short-term borrowings		(197)	(32)
Proceeds from issuance of long-term debt		151	207
Principal repayments of long-term debt		(112)	(55)
Dividends paid to minority		(21)	(29)
Financing received from related and third party minority shareholders		10	45
Purchase of Company’s stock (including advances)		(39)	(212)
Proceeds from sale of Company’s stock under compensation plan		-	129
Other – net		-	(10)
Net cash (used in) provided by financing activities		**(208)**	**43**
Effect of exchange rate changes on cash and cash equivalents		16	2
Net increase (decrease) in cash and cash equivalents		**305**	**(119)**
Cash and cash equivalents at beginning of year		841	752
Cash and cash equivalents at end of period	4	**1,146**	**633**

Supplemental disclosures of cash flow information

Interest paid	49	111
Income taxes paid	988	582

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

Note 1. Organization and environment

The primary activities of OAO LUKOIL (the "Company") and its subsidiaries (together, the "Group") are oil exploration, production, refining, marketing and distribution. The Company is the ultimate parent entity of this vertically integrated group of companies.

The Group was established in accordance with Presidential Decree 1403, issued on November 17, 1992. Under this decree, on April 5, 1993, the Government of the Russian Federation transferred to the Company 51% of the voting shares of fifteen enterprises. Under Government Resolution 861 issued on September 1, 1995, a further nine enterprises were transferred to the Group during 1995. Since 1995, the Group has carried out a share exchange program to increase its shareholding in each of the twenty-four founding subsidiaries to 100%.

From formation, the Group has expanded substantially through consolidation of its interests, acquisition of new companies and establishment of new businesses.

Business and economic environment

The Russian Federation has been experiencing political and economic change, which has affected and will continue to affect the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks, which do not typically exist in other markets.

The accompanying interim financial statements reflect management's assessment of the impact of the business environment in the countries in which the Group operates on the operations and the financial position of the Group. The future business environments may differ from management's assessment.

Basis of preparation

The accompanying interim consolidated financial statements and notes thereto have not been audited by independent accountants, except for the balance sheet as of December 31, 2007. In the opinion of the Company's management, the interim consolidated financial statements include all adjustments and disclosures necessary to present fairly the Group's financial position, results of operations and cash flows for the interim periods reported herein. These adjustments were of a normal recurring nature.

These interim consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("US GAAP") as applicable to interim financial statements. These financial statements should be read in conjunction with the Group's December 31, 2007 annual consolidated financial statements.

The results for the three-month period ended March 31, 2008 are not necessarily indicative of the results expected for the full year.

Note 2. Summary of significant accounting policies

Principles of consolidation

These interim consolidated financial statements include the financial position and results of the Company, controlled subsidiaries of which the Company directly or indirectly owns more than 50% of the voting interest, unless minority interest shareholders have substantive participating rights, and variable interest entities where the Group is determined to be the primary beneficiary. Other significant investments in companies of which the Company directly or indirectly owns between 20% and 50% of the voting interest and over which it exercises significant influence but not control, are accounted for using the equity method of accounting. Investments in companies of which the Company directly or indirectly owns more than 50% of the voting interest but where minority interest shareholders have substantive participating rights are accounted for using the equity method of accounting. Undivided interests in oil and gas joint ventures are accounted for using the proportionate consolidation method. Investments in other companies are recorded at cost. Equity investments and investments in other companies are included in "Investments" in the consolidated balance sheet.

Note 2. Summary of significant accounting policies (continued)

Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying value of oil and gas properties and other property, plant and equipment, goodwill impairment assessment, asset retirement obligations, deferred income taxes, valuation of financial instruments, and obligations related to employee benefits. Eventual actual amounts could differ from those estimates.

Revenue

Revenues from the production and sale of crude oil and petroleum products are recognized when title passes to customers. Revenues include excise on petroleum products sales and duties on export sales of crude oil and petroleum products.

Revenues from non-cash sales are recognized at the fair market value of the crude oil and petroleum products sold.

Foreign currency translation

The Company maintains its accounting records in Russian rubles. The Company's functional currency is the US dollar and the Group's reporting currency is the US dollar.

For operations in the Russian Federation, hyperinflationary economies and other operations where the US dollar is the functional currency, monetary assets and liabilities have been translated into US dollars at the rate prevailing at each balance sheet date. Non-monetary assets and liabilities have been translated into US dollars at historical rates. Revenues, expenses and cash flows have been translated into US dollars at rates, which approximate actual rates at the date of the transaction. Translation differences resulting from the use of these rates are included in the consolidated statement of income.

For the majority of operations outside the Russian Federation, the US dollar is the functional currency. For certain other operations outside the Russian Federation, where the US dollar is not the functional currency and the economy is not hyperinflationary, assets and liabilities are translated into US dollars at year-end exchange rates and revenues and expenses are translated at average exchange rates for the year. Resulting translation adjustments are reflected as a separate component of comprehensive income.

Foreign currency transaction gains and losses are included in the consolidated statement of income.

As of March 31, 2008 and December 31, 2007, exchange rates of 23.52 and 24.55 Russian rubles to the US dollar, respectively, have been used for translation purposes.

The Russian ruble and other currencies of republics of the former Soviet Union are not readily convertible outside of their countries. Accordingly, the translation of amounts recorded in these currencies into US dollars should not be construed as a representation that such currency amounts have been, could be or will in the future be converted into US dollars at the exchange rate shown or at any other exchange rate.

Cash and cash equivalents

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less.

Note 2. Summary of significant accounting policies (continued)

Cash with restrictions on immediate use

Cash funds for which restrictions on immediate use exist are accounted for within other non-current assets.

Accounts and notes receivable

Accounts and notes receivable are recorded at their transaction amounts less provisions for doubtful debts. Provisions for doubtful debts are recorded to the extent that there is a likelihood that any of the amounts due will not be obtained. Non-current receivables are discounted to the present value of expected cash flows in future periods using the original discount rate.

Inventories

Inventories, consisting primarily of stocks of crude oil, petroleum products and materials and supplies, are stated at the lower of cost or market value. Cost is determined using an "average cost" method.

Investments

Debt and equity securities are classified into one of three categories: trading, available-for-sale, or held-to-maturity.

Trading securities are bought and held principally for the purpose of selling in the near term. Held-to-maturity securities are those securities in which a Group company has the ability and intent to hold until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are included in the consolidated statement of income. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are reported as a separate component of comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis. Dividends and interest income are recognized in the consolidated statement of income when earned.

A permanent decline in the market value of any available-for-sale or held-to-maturity security below cost is accounted for as a reduction in the carrying amount to fair value. The impairment is charged to the consolidated statement of income and a new cost base for the security is established. Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective interest method and such amortization and accretion is recorded in the consolidated statement of income.

Property, plant and equipment

Oil and gas properties are accounted for using the successful efforts method of accounting whereby property acquisitions, successful exploratory wells, all development costs, and support equipment and facilities are capitalized. Unsuccessful exploratory wells are expensed when a well is determined to be non-productive. Other exploratory expenditures, including geological and geophysical costs are expensed as incurred.

The Group continues to capitalize costs of exploratory wells and exploratory-type stratigraphic wells for more than one year after the completion of drilling if the well has found a sufficient quantity of reserves to justify its completion as a producing well and the company is making sufficient progress assessing the reserves and the economic and operating viability of the project. If these conditions are not met or if information that raises substantial doubt about the economic or operational viability of the project is obtained, the well would be assumed impaired, and its costs, net of any salvage value, would be charged to expense.

Note 2. Summary of significant accounting policies (continued)

Depreciation, depletion and amortization of capitalized costs of oil and gas properties is calculated using the unit-of-production method based upon proved reserves for the cost of property acquisitions and proved developed reserves for exploration and development costs.

Production and related overhead costs are expensed as incurred.

Depreciation of assets not directly associated with oil production is calculated on a straight-line basis over the economic lives of such assets, estimated to be in the following ranges:

Buildings and constructions	5 – 40	Years
Machinery and equipment	5 – 20	Years

In addition to production assets, certain Group companies also maintain and construct social assets for the use of local communities. Such assets are capitalized only to the extent that they are expected to result in future economic benefits to the Group. If capitalized, they are depreciated over their estimated economic lives.

Asset retirement obligations

The Group records the fair value of liabilities related to its legal obligations to abandon, dismantle or otherwise retire tangible long-lived assets in the period in which the liability is incurred. A corresponding increase in the carrying amount of the related long-lived asset is also recorded. Subsequently, the liability is accreted for the passage of time and the related asset is depreciated using the unit-of-production method.

Goodwill and other intangible assets

Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. It is assigned to reporting units as of the acquisition date. Goodwill is not amortized, but is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The impairment test requires estimating the fair value of a reporting unit and comparing it with its carrying amount, including goodwill assigned to the reporting unit. If the estimated fair value of the reporting unit is less than its net carrying amount, including goodwill, then the goodwill is written down to its implied fair value.

Intangible assets with indefinite useful lives are tested for impairment at least annually. Intangible assets that have limited useful lives are amortized on a straight-line basis over the shorter of their useful or legal lives.

Impairment of long-lived assets

Long-lived assets, such as oil and gas properties, other property, plant, and equipment, and purchased intangibles subject to amortization, are assessed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future cash flows expected to be generated by that group. If the carrying amount of an asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by writing down the carrying amount to the estimated fair value of the asset group, generally determined as discounted future net cash flows. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale are presented separately in the appropriate asset and liability sections of the balance sheet.

Note 2. Summary of significant accounting policies (continued)

Deferred income taxes

The estimated effective income tax rate expected to be applicable for the full fiscal year is used in providing for income taxes on a current year-to-date basis. The estimated effective tax rate reflects statutory tax rates for each jurisdiction, the deductibility of expenses and taxability of income, anticipated tax credits and other available tax planning alternatives. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of income in the reporting period that includes the enactment date and is not accounted for as an adjustment of the annual effective tax rate.

Interest-bearing borrowings

Interest-bearing borrowings are initially recorded at the value of net proceeds received. Any difference between the net proceeds and the redemption value is amortized at a constant rate over the term of the borrowing. Amortization is included in the consolidated statement of income each year and the carrying amounts are adjusted as amortization accumulates.

If borrowings are repurchased or settled before maturity, any difference between the amount paid and the carrying amount is recognized in the consolidated statement of income in the period in which the repurchase or settlement occurs.

Pension benefits

The expected costs in respect of pension obligations of Group companies are estimated by management based on pension obligations as of the most recent annual period, which are determined by an independent actuary. Obligations in respect of each employee are accrued over the reporting periods during which the employee renders service to the Group.

Treasury stock

Purchases by Group companies of the Company’s outstanding stock are recorded at cost and classified as treasury stock within Stockholders’ equity. Shares shown as Authorized and Issued include treasury stock. Shares shown as Outstanding do not include treasury stock.

Earnings per share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the reporting period. A calculation is carried out to establish if there is potential dilution in earnings per share if convertible securities were to be converted into shares of common stock or contracts to issue shares of common stock were to be exercised. If there is such dilution, diluted earnings per share is presented.

Contingencies

Certain conditions may exist as of the balance sheet date, which may result in losses to the Group but the impact of which will only be resolved when one or more future events occur or fail to occur.

If a Group company’s assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability is accrued and charged to the consolidated statement of income. If the assessment indicates that a potentially material loss is not probable, but is reasonably possible, or is probable, but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, is disclosed in the notes to the consolidated financial statements. Loss contingencies considered remote or related to unasserted claims are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

Note 2. Summary of significant accounting policies (continued)

Environmental expenditures

Estimated losses from environmental remediation obligations are generally recognized no later than completion of remedial feasibility studies. Group companies accrue for losses associated with environmental remediation obligations when such losses are probable and reasonably estimable. Such accruals are adjusted as further information becomes available or circumstances change. Costs of expected future expenditures for environmental remediation obligations are not discounted to their present value.

Use of derivative instruments

The Group's derivative activity is limited to certain petroleum products marketing and trading outside of its physical crude oil and petroleum products businesses and hedging of commodity price risks. Currently this activity involves the use of futures and swaps contracts together with purchase and sale contracts that qualify as derivative instruments. The Group accounts for these activities under the mark-to-market methodology in which the derivatives are revalued each accounting period. Resulting realized and unrealized gains or losses are presented in the consolidated statement of income on a net basis. Unrealized gains and losses are carried as assets or liabilities on the consolidated balance sheet.

Recent accounting pronouncements

In March 2008, the FASB issued SFAS No. 161, *"Disclosures about Derivative Instruments and Hedging Activities."* This Statement improves financial reporting about derivative instruments and hedging activities by enhanced disclosures of their effects on entity's financial position, financial performance and cash flows. The Group is required to adopt the provisions of SFAS No. 161 no later than the first quarter 2009 and does not expect any material impact on its results of operations, financial position or cash flows upon adoption.

In December 2007, the FASB issued SFAS No. 141 (Revised), *"Business combinations."* This Statement will apply to all transactions in which an entity obtains control of one or more businesses. SFAS No. 141 (Revised) requires an entity to recognize the fair value of assets acquired and liabilities assumed in a business combination; to recognize and measure the goodwill acquired in the business combination or gain from a bargain purchase and modifies the disclosure requirements. The Group is required to prospectively adopt the provisions of SFAS No. 141 (Revised) for business combinations for which the acquisition date is on or after January 1, 2009. Early adoption of SFAS No. 141 (Revised) is prohibited.

In December 2007, the FASB issued SFAS No. 160, *"Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51."* This Statement will apply to all entities that prepare consolidated financial statements (except not-for-profit organizations) and will affect those which have an outstanding noncontrolling interest (or minority interest) in their subsidiaries or which have to deconsolidate a subsidiary. This Statement changes the classification of a non-controlling interest; establishing a single method of accounting for changes in the parent company's ownership interest that does not result in deconsolidation and requires a parent company to recognize a gain or loss when a subsidiary is deconsolidated. The Group is required to prospectively adopt the provisions of SFAS No. 160 in the first quarter 2009, except for the presentation and disclosure requirements which shall be applied retrospectively. Early adoption of SFAS No. 160 is prohibited.

(Millions of US dollars, unless otherwise noted)

Note 2. Summary of significant accounting policies (continued)

In February 2007, the FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities."* This Statement expands the possibility of using fair value measurements and permits enterprises to choose to measure certain financial assets and financial liabilities at fair value. Enterprises shall report unrealized gains and losses on items for which the fair value option has been elected in earnings in each subsequent period. The Group adopted the provisions of SFAS No. 159 in the first quarter 2008. The Group elected not to use the fair value option for its financial assets and financial liabilities not already carried at fair value in accordance with other standards. Therefore the adoption of SFAS No. 159 did not have any impact on the Group's results of operations, financial position or cash flows.

In September 2006, the FASB issued SFAS No. 157, *"Fair Value Measurements,"* which establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair value measurements. In February 2008, the FASB issued Staff Position FSP No. 157-2, "*Effective date of FASB Statement No. 157,"* which defers the effective date of SFAS No. 157 for certain nonfinancial assets and nonfinancial liabilities to the first quarter 2009. The Group elected to adopt SFAS No. 157 with deferral permitted by FSP No. 157-2. The deferral applies to nonfinancial assets and liabilities measured in a business combination; long-lived assets, intangible assets and goodwill measured at fair value upon impairment and liabilities for asset retirement obligations. The Group does not expect any material impact on its results of operations, financial position or cash flows on adoption of SFAS No. 157 for these assets and liabilities. The initial adoption of SFAS No. 157 is limited to commodity derivative instruments (refer to Note 15. Financial and derivative instruments).

The initial adoption of the provisions of SFAS No. 157 did not have a material impact on the Group's results of operations, financial position or cash flows.

In June 2006, the FASB issued FASB Interpretation No. 48, *"Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109."* This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *"Accounting for Income Taxes."* The Group adopted the provisions of FIN No. 48 in the first quarter 2007. The adoption of the provisions of FIN No. 48 did not have a material impact on the Group's results of operations, financial position or cash flows.

Note 3. Taxes

Operations in the Russian Federation are subject to Federal income tax rate of 6.5% and a regional income tax rate that varies from 13.5% to 17.5% at the discretion of the individual regional administration. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

The Group's effective income tax rate for the periods presented differs from the statutory income tax rate primarily due to domestic and foreign rate differences and the incurrence of costs that are either not tax deductible or only deductible to a certain limit.

The Group's accounting policy is to record penalties and interest related to unrecognized tax benefits as components of income tax expense.

Note 4. Cash and cash equivalents

	As of March 31, 2008	As of December 31, 2007
Cash held in Russian rubles	209	285
Cash held in other currencies	665	417
Cash of a banking subsidiary in other currencies	60	47
Cash held in related party banks in Russian rubles	162	80
Cash held in related party banks in other currencies	50	12
Total cash and cash equivalents	**1,146**	**841**

(Millions of US dollars, unless otherwise noted)

Note 5. Non-cash transactions

The consolidated statement of cash flows excludes the effect of non-cash transactions, which are described in the following table:

	For the three months ended March 31, 2008	For the three months ended March 31, 2007
Non-cash investing activity	6	7
Settlement of stock-based compensation plan liability	-	537
Total non-cash transactions	**6**	**544**

The following table shows the effect of non-cash transactions on investing activity:

	For the three months ended March 31, 2008	For the three months ended March 31, 2007
Net cash used in investing activity	3,161	2,184
Non-cash investing activity	6	7
Total investing activity	**3,167**	**2,191**

Note 6. Accounts and notes receivable, net

	As of March 31, 2008	As of December 31, 2007
Trade accounts and notes receivable (net of provisions of $82 million and $69 million as of March 31, 2008 and December 31, 2007, respectively)	6,373	5,962
Current VAT and excise recoverable	1,335	1,196
Other current accounts receivable (net of provisions of $65 million and $48 million as of March 31, 2008 and December 31, 2007, respectively)	289	309
Total accounts and notes receivable, net	**7,997**	**7,467**

Note 7. Investments

	As of March 31, 2008	As of December 31, 2007
Investments in equity method affiliates and joint ventures	971	836
Long-term loans given by non-banking subsidiaries	256	232
Other long-term investments	18	18
Total long-term investments	**1,245**	**1,086**

Investments in "equity method" affiliates and joint ventures

The summarized financial information below is in respect of equity method affiliates and corporate joint ventures. The companies are primarily engaged in crude oil exploration, production, marketing and distribution operations in the Russian Federation and crude oil production and marketing in Kazakhstan.

	For the three months ended March 31, 2008		For the three months ended March 31, 2007	
	Total	Group's share	Total	Group's share
Revenues	999	473	646	303
Income before income taxes	440	213	284	140
Less income taxes	(169)	(84)	(112)	(56)
Net income	**271**	**129**	**172**	**84**

(Millions of US dollars, unless otherwise noted)

Note 7. Investments (continued)

	As of March 31, 2008		As of December 31, 2007	
	Total	Group's share	Total	Group's share
Current assets	1,657	784	1,320	618
Property, plant and equipment	2,168	1,120	2,082	1,082
Other non-current assets	289	142	181	88
Total assets	4,114	2,046	3,583	1,788
Short-term debt	112	46	204	89
Other current liabilities	899	430	682	329
Long-term debt	1,076	537	1,005	511
Other non-current liabilities	124	62	47	23
Net assets	**1,903**	**971**	**1,645**	**836**

Note 8. Property, plant and equipment and asset retirement obligations

	At cost		Net	
	As of March 31, 2008	As of December 31, 2007	As of March 31, 2008	As of December 31, 2007
Exploration and Production:				
Western Siberia	20,109	19,424	11,353	10,811
European Russia	19,563	18,776	14,048	13,303
International	5,187	4,360	4,474	3,716
Total	44,859	42,560	29,875	27,830
Refining, Marketing, Distribution and Chemicals:				
Western Siberia	22	22	16	16
European Russia	9,524	9,216	6,482	6,292
International	5,129	4,855	3,440	3,241
Total	14,675	14,093	9,938	9,549
Other:				
Western Siberia	157	156	69	69
European Russia	385	399	321	338
International	181	181	141	144
Total	723	736	531	551
Total property, plant and equipment	**60,257**	**57,389**	**40,344**	**37,930**

As of March 31, 2008 and December 31, 2007, the asset retirement obligation amounted to $982 million and $821 million, respectively, of which $10 million was included in "Other current liabilities" in the consolidated balance sheets as of each balance sheet date. During the three-month periods ended March 31, 2008 and 2007, asset retirement obligations changed as follows:

	For the three months ended March 31, 2008	For the three months ended March 31, 2007
Asset retirement obligations as of January 1	821	618
Accretion expense	23	16
New obligations	42	13
Changes in estimates of existing obligations	60	17
Spending on existing obligations	(1)	(1)
Foreign currency translation and other adjustments	37	7
Asset retirement obligations as of March 31	**982**	**670**

(Millions of US dollars, unless otherwise noted)

Note 9. Goodwill and other intangible assets

The carrying value of goodwill and other intangible assets as of March 31, 2008 and December 31, 2007 was as follows:

	As of March 31, 2008	As of December 31, 2007
Amortized intangible assets		
Software	444	410
Licenses and other assets	47	56
Goodwill	468	468
Total goodwill and other intangible assets	**959**	**934**

All goodwill amounts relate to the refining, marketing and distribution segment.

Note 10. Dispositions of assets

In December 2007, a Group company committed to a plan to sell 162 petrol stations, located in Pennsylvania and southern New Jersey, USA, previously acquired from ConocoPhillips in 2004. In February 2008, this company entered into an agreement to sell these petrol stations to a third party investor for $138 million, less estimated amounts to extinguish environmental remediation liabilities of approximately $19 million. The Group will continue to supply petroleum products to these petrol stations under a 15 year supply contract with the new owners. The transaction is expected to be finalized in the second quarter 2008. As of March 31, 2008 and December 31, 2007, the Group classified these petrol stations with the carrying value of $134 million as assets held for sale in the consolidated balance sheet, additionally the Group had a liability related to assets held for sale with the carrying value of $15 million included in “Other current liabilities” of the consolidated balance sheet.

In December 2005, the Company made a decision to sell ten tankers. A Group company finalized the sale of eight tankers in May 2006, for a price that approximated their carrying value of $190 million. The sale of the remaining two tankers was finalized in April 2008, for a price that approximates their carrying value of $70 million. As of March 31, 2008 and December 31, 2007, the Group classified these tankers as assets held for sale in the consolidated balance sheets.

Note 11. Short-term borrowings and current portion of long-term debt

	As of March 31, 2008	As of December 31, 2007
Short-term borrowings from third parties	693	938
Short-term borrowings from related parties	61	-
Current portion of long-term debt	1,261	1,276
Total short-term borrowings and current portion of long-term debt	**2,015**	**2,214**

Short-term borrowings are unsecured and primarily payable in US dollars. The weighted-average interest rate on short-term borrowings from third parties was 5.93% and 5.97% per annum as of March 31, 2008 and December 31, 2007, respectively.

Note 12. Long-term debt

(Millions of US dollars, unless otherwise noted)

	As of March 31, 2008	As of December 31, 2007
Long-term loans and borrowings from third parties	2,438	2,439
Long-term loans and borrowings from related parties	1,936	1,745
6.356% US dollar bonds, maturing 2017	500	500
6.656% US dollar bonds, maturing 2022	500	500
7.25% Russian ruble bonds, maturing 2009	255	244
7.10% Russian ruble bonds, maturing 2011	340	326
7.40% Russian ruble bonds, maturing 2013	255	244
Capital lease obligations	97	107
Total long-term debt	6,321	6,105
Current portion of long-term debt	(1,261)	(1,276)
Total non-current portion of long-term debt	**5,060**	**4,829**

Long-term loans and borrowings

Long-term loans and borrowings are primarily repayable in US dollars, maturing from 2008 through 2037. Approximately 6% of this debt is secured by export sales and property, plant and equipment. The weighted-average interest rate on long-term loans and borrowings from third parties was 4.17% and 5.77% per annum as of March 31, 2008 and December 31, 2007, respectively.

US dollar bonds

In June 2007, a Group company issued non-convertible bonds totaling $1 billion. $500 million were placed with a maturity of 10 years and a coupon yield of 6.356% per annum. Another $500 million were placed with a maturity of 15 years and a coupon yield of 6.656% per annum. All bonds were placed at nominal value and have a half year coupon period.

Russian ruble bonds

In December 2006, the Company issued 14 million non-convertible bonds with a face value of 1,000 Russian rubles each. Eight million bonds were placed with a maturity of 5 years and a coupon yield of 7.10% per annum and six million bonds were placed with a maturity of 7 years and a coupon yield of 7.40% per annum. All bonds were placed at the face value and have a half year coupon period.

In November 2004, the Company issued 6 million non-convertible bonds with a face value of 1,000 Russian rubles each, maturing on November 23, 2009. The bonds have a half year coupon period and bear interest at 7.25% per annum.

Note 13. Pension benefits

The Company sponsors a post employment and post retirement benefits program that covers the majority of the Group’s employees. The plan primarily consists of a defined benefit plan enabling employees to contribute a portion of their salary to the plan and at retirement to receive a lump sum amount from the Company equal to all past contributions made by the employee up to 7% of their annual salary. This plan is administered by a non-state pension fund, LUKOIL-GARANT, and provides pension benefits primarily based on years of service and final remuneration levels. The Company also provides several long-term employee benefits such as death-in-service benefit and lump-sum payments upon retirement of a defined benefit nature and other defined benefits to certain old age and disabled pensioners who have not vested any pensions under the pension plan.

(Millions of US dollars, unless otherwise noted)

Note 13. Pension benefits (continued)

Components of net periodic benefit cost were as follows:

	For the three months ended March 31, 2008	For the three months ended March 31, 2007
Service cost	6	3
Interest cost	5	4
Less expected return on plan assets	(3)	(2)
Amortization of prior service cost	3	2
Actuarial gain	-	(1)
Total net periodic benefit cost	**11**	**6**

Note 14. Stockholders' equity

Weighted average number of outstanding common shares was 825,707 thousand shares and 830,671 thousand shares for the three months ended March 31, 2008 and 2007, respectively. There is no potential dilution in earnings available to common stockholders and as such diluted earnings per share are not disclosed.

Note 15. Financial and derivative instruments

Commodity derivative instruments

The Group uses derivative instruments in its international petroleum products marketing and trading operations. The types of derivative instruments used include futures and swap contracts, used for hedging purposes, and purchase and sale contracts that qualify as derivative instruments. The Group maintains a system of controls over these activities that includes policies covering the authorization, reporting and monitoring of derivative activity.

In the first quarter 2008, the Group adopted SFAS No. 157, *"Fair Value Measurements"* with deferral permitted by FSP No. 157-2, *"Effective date of FASB Statement No. 157."* SFAS No. 157 requires disclosures that categorize assets and liabilities measured at fair value into one of the three different levels depending on the observability of the inputs employed in the measurement.

Level 1 inputs are quoted prices in active markets for identical assets or liabilities.

Level 2 inputs are observable inputs other then quoted prices included within Level 1 for the asset or liability, either directly or indirectly through market-corroborated inputs.

Level 3 inputs are unobservable inputs for the asset of liability reflecting assumptions about pricing by market participants.

Commodity purchase and sale contracts are generally valued using quotations provided by brokers and price index developers such as Platts and Oil price Information Service. These are classified as Level 2.

Futures and swap contracts are valued using industry standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors and contractual prices for the underlying instruments, as well as other relevant economic measures. The degree to which these inputs are observable in the forward markets determines whether the option is classified as Level 1 or Level 2.

(Millions of US dollars, unless otherwise noted)

Note 15. Financial and derivative instruments (continued)

The Group recognized net loss from the use of derivative instruments of $98 million and $153 million during the three months ended March 31, 2008 and 2007, respectively. The result is included in “Cost of purchased crude oil, gas and products” in the consolidated statements of income. The fair value of derivative contracts outstanding and recorded on the consolidated balance sheets was net liability of $78 million and $50 million as of March 31, 2008 and December 31, 2007, respectively.

The fair value hierarchy of commodity derivative instruments accounted for at fair value on a recurring basis as of March 31, 2008, was:

	Level 1	**Level 2**	**Level 3**	**Total**
Assets	-	43	-	43
Liabilities	-	(121)	-	(121)
Net liabilities	-	**(78)**	-	**(78)**

Fair value

The fair values of cash and cash equivalents, current accounts and notes receivable, and liquid securities are approximately equal to their value as disclosed in the consolidated financial statements.

The fair value of long-term receivables included in other non-current assets approximates the amounts disclosed in the consolidated financial statements as a result of discounting using estimated market interest rates for similar financing arrangements. The fair value of long-term debt differs from the amount disclosed in the consolidated financial statements. The estimated fair value of long-term debt as of March 31, 2008 and December 31, 2007 was $6,517 million and $6,250 million, respectively, as a result of discounting using estimated market interest rates for similar financing arrangements. These amounts include all future cash outflows associated with the long-term debt repayments, including the current portion, and interest.

Note 16. Business combinations and acquisitions of assets

In March 2008, a Group company acquired 100% of the share capital of the SNG Holdings Ltd. Group for $578 million. The purchase agreement provides for an additional two components of contingent purchase consideration.

- An amount of $100 million payable if an agreed level of proved and probable hydrocarbon reserves are verified by an independent petroleum engineer by June 15, 2008.
- An amount of $100 million payable upon approval of the agreed development program by the Uzbekistan authorities and an agreed minimum production volume of crude oil is achieved by March 2009.

The SNG Holdings Ltd. Group holds a 100% interest in a production sharing agreement in oil and gas condensate fields located in the South-Western Gissar and Ustyurt regions of Uzbekistan. The purpose of the acquisition was to increase the Group’s presence in the Uzbekistan oil and gas sector.

In January 2007, a Group company acquired the remaining 34% of the share capital of OOO Geoilbent for $300 million. The acquisition increased the Group’s ownership to 100%. Prior to this acquisition the Group accounted for its investment using the equity method of accounting due to the fact that minority shareholder held substantive participating rights. OOO Geoilbent was an exploration and production company operating in the West Siberian region of the Russian Federation.

The acquisition of interests in the SNG Holdings Ltd. Group and Geoilbent did not have a material impact on the Group’s consolidated operations for the period ended March 31, 2008 and 2007. Therefore, no pro-forma income statement information has been provided.

Note 17. Consolidation of Variable Interest Entity

The Group and ConocoPhillips have a joint venture Narianmarneftegaz ("NMNG") which develops oil reserves in the Timan-Pechora region of the Russian Federation. The Group and ConocoPhillips have equal voting rights over the joint venture's activity and effective ownership interests of 70% and 30%, respectively.

The Group determined that NMNG is a variable interest entity as the Group's voting rights are not proportionate to its ownership rights and all of NMNG's activities are conducted on behalf of the Group and ConocoPhillips, its related party. The Group is considered to be the primary beneficiary and has consolidated NMNG.

NMNG's total assets were approximately $5.8 billion and $5.1 billion as of March 31, 2008 and December 31, 2007, respectively.

The Group and ConocoPhillips agreed to provide financing to NMNG by means of long-term loans in proportion to their effective ownership interests. These loans mature in 2037, with the option to be extended for a further 35 years with the agreement of both parties. As of March 31, 2008, borrowings under these agreements bear fixed interest in the range of 6.8% to 8.2% per annum.

As of March 31, 2008, the amount outstanding to ConocoPhillips from NMNG was $1,563 million, which consists of a number of loans with a weighted-average interest rate of 7.81% per annum. This amount is presented within "Long-term loans and borrowings from related parties."

Note 18. Financial guarantees

The Group has entered into various guarantee arrangements. These arrangements arose in transactions related to enhancing the credit standing of an affiliated companies. Undiscounted maximum amount of potential future payments for the guarantees issued in favour of equity companies was $309 million and $361 million as of March 31, 2008 and December 31, 2007, respectively.

Guarantees on debt

LUKARCO, an investee recorded under the equity method of accounting has a loan facility on which $542 million was drawn as of March 31, 2008. Borrowings under this loan bear interest at LIBOR plus 2.5% per annum, maturing by May 1, 2012. To enhance the credit standing of LUKARCO, the Company guarantees 54% of the interest payment as well as the repayment of 54% of the loan at maturity. As of March 31, 2008, the total amount of the Company's guarantee was $296 million, which includes $4 million related to accrued interest on the outstanding amount. Payments are due if the Company is notified that LUKARCO is not able to fulfill its obligations at maturity date. The Company's guarantee is secured by its 54% interest in LUKARCO with the carrying value of $493 million and $462 million as of March 31, 2008 and December 31, 2007, respectively. There are no material amounts being carried as liabilities for the Group's obligations under this guarantee.

Note 19. Commitments and contingencies

Capital expenditure, exploration and investment programs

The Group owns and operates a number of assets under which it has commitments for capital expenditure in relation to its exploration and investment programs. They mainly relate to existing license agreements in the Russian Federation, production sharing agreements and long-term service contracts. In addition to these, the Group has commitments to comply with the requirements of European Union legislation in relation to the quality of produced petroleum products and environmental protection which require it to upgrade its Bulgarian and Romanian refineries.

(Millions of US dollars, unless otherwise noted)

Note 19. Commitments and contingencies (continued)

During the three-months period ended March 31, 2008, there were no significant changes in these commitments from those disclosed in the Group’s consolidated financial statements for the year ended December 31, 2007.

Operating lease obligations

A Group company has commitments of $1,685 million primarily for the lease of vessels and petroleum distribution outlets. Commitments for minimum rentals under these leases as of March 31, 2008 are as follows:

	As of March 31, 2008
For the nine-months ending December 31, 2008	387
2009 fiscal year	433
2010 fiscal year	239
2011 fiscal year	157
2012 fiscal year	134
beyond	335

Insurance

The insurance industry in the Russian Federation and certain other areas where the Group has operations is in the course of development. Management believes that the Group has adequate property damage coverage for its main production assets. In respect of third party liability for property and environmental damage arising from accidents on Group property or relating to Group operations, the Group has insurance coverage that is generally higher than insurance limits set by the local legal requirements. Management believes that the Group has adequate insurance coverage of the risks, which could have a material effect on the Group’s operations and financial position.

Environmental liabilities

Group companies and their predecessor entities have operated in the Russian Federation and other countries for many years and, within certain parts of the operations, environmental related problems have developed. Environmental regulations are currently under consideration in the Russian Federation and other areas where the Group has operations. Group companies routinely assess and evaluate their obligations in response to new and changing legislation.

As liabilities in respect of the Group’s environmental obligations are able to be determined, they are charged against income. The likelihood and amount of liabilities relating to environmental obligations under proposed or any future legislation cannot be reasonably estimated at present and could become material. Under existing legislation, however, management believes that there are no significant unrecorded liabilities or contingencies, which could have a materially adverse effect on the operating results or financial position of the Group.

Social assets

Certain Group companies contribute to Government sponsored programs, the maintenance of local infrastructure and the welfare of their employees within the Russian Federation and elsewhere. Such contributions include assistance with the construction, development and maintenance of housing, hospitals and transport services, recreation and other social needs. The funding of such assistance is periodically determined by management and is appropriately capitalized or expensed as incurred.

Note 19. Commitments and contingencies (continued)

Taxation environment

The taxation systems in the Russian Federation and other emerging markets where Group companies operate are relatively new and are characterized by numerous taxes and frequently changing legislation, which is often unclear, contradictory, and subject to interpretation. Often, differing interpretations exist among different tax authorities within the same jurisdictions and among taxing authorities in different jurisdictions. Taxes are subject to review and investigation by a number of authorities, which are enabled by law to impose severe fines, penalties and interest charges. In the Russian Federation a tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation. Such factors may create taxation risks in the Russian Federation and other emerging markets where Group companies operate substantially more significant than those in other countries where taxation regimes have been subject to development and clarification over long periods.

The tax authorities in each region may have a different interpretation of similar taxation issues which may result in taxation issues successfully defended by the Group in one region being unsuccessful in another region. There is some direction provided from the central authority based in Moscow on particular taxation issues.

The Group has implemented tax planning and management strategies based on existing legislation at the time of implementation. The Group is subject to tax authority audits on an ongoing basis, as is normal in the Russian environment and other republics of the former Soviet Union, and, at times, the authorities have attempted to impose additional significant taxes on the Group. Management believes that it has adequately met and provided for tax liabilities based on its interpretation of existing tax legislation. However, the relevant tax authorities may have differing interpretations and the effects on the financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

Litigation and claims

On November 27, 2001, Archangel Diamond Corporation (“ADC”), a Canadian diamond development company, filed a lawsuit in the District Court of Denver, Colorado against OAO Arkhangelskgeoldobycha (“AGD”), a Group company, and the Company (together the “Defendants”). ADC alleged that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. ADC claimed total damages of approximately $4.8 billion, including compensatory damages of $1.2 billion and punitive damages of $3.6 billion. On October 15, 2002, the District Court dismissed the lawsuit for lack of personal jurisdiction. This ruling was upheld by the Colorado Court of Appeals on March 25, 2004. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts’ ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was dismissed from the lawsuit. The Supreme Court found, however, that the trial court made a procedural error by not holding an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company, which is whether the Company had systematic and continuous contacts in the State of Colorado at the time the lawsuit was filed. In a modified opinion dated December 19, 2005, the Colorado Supreme Court remanded the case to the Colorado Court of Appeals (instead of the District Court) to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). On June 29, 2006, the Colorado Court of Appeals declined to dismiss the case based on forum non conveniens. The Company filed a petition for certiorari on August 28, 2006, asking the Colorado Supreme Court to review this decision. This petition has been rejected. On March 5, 2007, the Colorado Supreme Court remanded the case to the District Court. On June 11, 2007, the District Court ruled it would conduct an evidentiary hearing on the issue of whether the Company is subject to general personal jurisdiction in the State of Colorado. A meeting to discuss the status of the hearing with the Court is scheduled for June 13, 2008. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group’s financial condition.

Note 19. Commitments and contingencies (continued)

On February 20, 2004, the Stockholm District Court overturned the decision of the Arbitral Tribunal of the Arbitration Institute of the Stockholm Chamber of Commerce (“Arbitration Tribunal”), made on June 25, 2001, dismissing ADC’s action against AGD based on lack of jurisdiction. ADC’s lawsuit against AGD was initially filed with the Arbitral Tribunal claiming alleged non-performance under an agreement between the parties and its obligation to transfer the diamond exploration license to Almazny Bereg. This lawsuit claimed compensation of damages amounting to $492 million. In March 2004, AGD filed an appeal against the Stockholm District Court decision with the Swedish Court of Appeals. On November 15, 2005, the Swedish Court of Appeals denied AGD’s appeal and affirmed the Stockholm District Court decision. On December 13, 2005, AGD filed an appeal against the Swedish Court of Appeals decision with the Swedish Supreme Court. On April 13, 2006, the Swedish Supreme Court denied the application of AGD for appeal against the Swedish Court of Appeal’s decision dated November 15, 2005. On May 6, 2006, a Notice of Arbitration was received on behalf of ADC. On December 20, 2006, the first session of the Arbitration Tribunal with participation of both parties took place in order to define procedural issues related to the tribunal. As a result of the hearing the Arbitration Tribunal issued a detailed procedural order setting out the rules and timetable for the conduct of the arbitration. In May 2007, ADC filed a statement of claim that requested the Tribunal to require AGD to transfer the diamond exploration license to Almazny Bereg. On October 22, 2007, AGD submitted a statement of defense. On December 21, 2007, the Arbitration Tribunal issued a procedural order on suspension of the arbitration for four months. On March 10, 2008, the Arbitration Tribunal issued a procedural order to suspend the arbitration until May 31, 2008. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group’s financial condition.

In April 2008, the Company entered into an agreement to sell 49.99% of the share capital of AGD to De Beers and ADC (Refer to Note 23. Subsequent events). In accordance with this agreement, upon completion the litigation and arbitration proceedings described above between ADC and the Group will be terminated.

The Group is involved in various other claims and legal proceedings arising in the normal course of business. While these claims may seek substantial damages against the Group and are subject to uncertainty inherent in any litigation, management does not believe that the ultimate resolution of such matters will have a material adverse impact on the Group’s operating results or financial condition.

Note 20. Related party transactions

In the rapidly developing business environment in the Russian Federation, companies and individuals have frequently used nominees and other forms of intermediary companies in transactions. The senior management of the Company considers that the Group has appropriate procedures in place to identify and properly disclose transactions with related parties in this environment and has disclosed all of the relationships identified which it deemed to be significant. Related party sales and purchases of oil and oil products were primarily to and from affiliated companies and the Company’s shareholder ConocoPhillips. Insurance services are provided by the related parties, whose management and directors include members of the Group’s management.

Below are related party transactions not disclosed elsewhere in the financial statements. Refer also to Notes 4, 5, 7, 11, 12, 13, 17, 18, 21 and 23 for other transactions with related parties.

Sales of oil and oil products to related parties were $48 million and $175 million for the three months ended March 31, 2008 and 2007, respectively.

Note 20. Related party transactions (continued)

Other sales to related parties were $21 million and $16 million for the three moths ended March 31, 2008 and 2007, respectively.

Purchases of oil and oil products from related parties were $440 million and $293 million for the three moths ended March 31, 2008 and 2007, respectively.

Purchases of insurance services from related parties were $42 million and $40 million for the three months ended March 31, 2008 and 2007, respectively.

Other purchases from related parties were $8 million and $6 million for the years ended March 31, 2008 and 2007, respectively.

Amounts receivable from related parties, including loans and advances, were $179 million and $563 million as of March 31, 2008 and December 31, 2007, respectively. Amounts payable to related parties were $180 million and $139 million as of March 31, 2008 and December 31, 2007, respectively.

Note 21. Compensation plan

During the period from 2003 to 2006, the Company had a compensation plan available to certain members of management, which provided compensation based upon share appreciation rights on the Company’s common stock. The number of shares or rights allocated to individuals under the plan was 8.8 million shares. These rights vested in December 2006. In February 2007, the Group settled the plan. As a result of this settlement employees purchased 8.8 million shares held by the Group as treasury stock at the grant price for $129 million and resold 1.5 million shares back to the Group for $134 million. The accrued liability in relation to this plan of $537 million was extinguished through the issuance of 7.3 million shares.

In December 2006, the Company introduced a new compensation plan to certain members of management for the period from 2007 to 2009, which is based on assigned phantom shares and provides compensation consisting of two parts (the “Phantom share plan”). The first part represents annual bonuses that are based on the number of assigned phantom shares and amount of dividend per share. The payment of these bonuses is contingent on the Group meeting certain financial KPIs in each financial year. The second is based upon the Company’s common stock appreciation from 2007 to 2009, with rights vesting after the date of the compensation plan’s termination. The number of assigned phantom shares is approximately 15.5 million shares.

For the first part of the Phantom share plan the Group recognizes a liability based on expected dividends and number of assigned phantom shares.

The second part of the Phantom share plan is classified as equity. The grant date fair value of the plan is estimated at $289 million. The fair value was estimated using the Black-Sholes-Merton option-pricing model, assuming a risk-free interest rate of 6.00% per annum, an expected dividend yield 1.59% per annum, expected term of three years and a volatility factor of 30.07%. The expected volatility factor was estimated based on the historical volatility of the Company’s shares for the previous three year period up to January 2007.

(Millions of US dollars, unless otherwise noted)

Note 21. Compensation plan (continued)

Related to this plan the Group recorded $32 million and $30 million of compensation expense during the three months ended March 31, 2008 and 2007, respectively, of which $26 million and $25 million, respectively, are recognized as an increase in additional paid-in capital. As of March 31, 2008 and December 31, 2007, $28 million and $22 million related to this plan are included in "Other current liabilities" of the consolidated balance sheets, respectively. The total recognized tax benefit related to these accruals during the three months ended March 31, 2008 and 2007, is $8 million and $7 million, respectively.

As of March 31, 2007, there was $160 million of total unrecognized compensation cost related to unvested benefits. This cost is expected to be recognized periodically by the Group up to December 2009.

Note 22. Segment information

Presented below is information about the Group's operating and geographical segments for the three months ended March 31, 2008 and 2007, in accordance with SFAS No. 131, *"Disclosures about Segments of an Enterprise and Related Information."*

The Group has four operating segments – exploration and production; refining, marketing and distribution; chemicals and other business segments. These segments have been determined based on the nature of their operations. Management on a regular basis assesses the performance of these operating segments. The exploration and production segment explores for, develops and produces primarily crude oil. The refining, marketing and distribution segment processes crude oil into refined products and purchases, sells and transports crude oil and refined petroleum products. The chemicals segment refines and sells chemical products. Activities of the other business operating segment include the development of businesses beyond the Group's traditional operations.

Geographical segments have been determined based on the area of operations and include three segments. They are Western Siberia, European Russia and International.

Operating segments

For the three months ended March 31, 2008

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
Sales						
Third parties	402	23,843	641	69	-	24,955
Inter-segment	7,194	420	7	361	(7,982)	-
Total sales	7,596	24,263	648	430	(7,982)	24,955
Operating expenses and total cost of purchases	1,105	16,252	552	348	(7,741)	10,516
Depreciation, depletion and amortization	401	194	9	20	-	624
Interest expense	192	147	-	56	(323)	72
Income tax expense	570	427	8	7	-	1,012
Net income	1,449	1,702	7	129	(124)	3,163
Total assets	46,827	41,343	1,070	10,844	(36,069)	64,015
Capital expenditures	1,981	356	27	48	-	2,412

(Millions of US dollars, unless otherwise noted)

Note 22. Segment information (continued)

For the three months ended March 31, 2007

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
Sales						
Third parties	480	14,653	508	11	-	15,652
Inter-segment	3,699	456	5	58	(4,218)	-
Total sales	4,179	15,109	513	69	(4,218)	15,652
Operating expenses and total cost of purchases	843	9,324	400	33	(4,107)	6,493
Depreciation, depletion and amortization expense	377	155	6	9	-	547
Interest expense	113	151	1	42	(230)	77
Income tax expense	226	303	6	3	-	538
Net income	397	843	36	55	(32)	1,299
Total assets	36,319	32,954	878	6,836	(26,832)	50,155
Capital expenditures	1,716	277	44	25	-	2,062

Geographical segments

	For the three months ended March 31, 2008	For the three months ended March 31, 2007
Sales of crude oil within Russia	248	82
Export of crude oil and sales of crude oil by foreign subsidiaries	5,867	4,009
Sales of petroleum products within Russia	3,029	1,922
Export of petroleum products and sales of petroleum products by foreign subsidiaries	14,277	8,517
Sales of chemicals within Russia	225	156
Export of chemicals and sales of chemicals by foreign subsidiaries	403	347
Other sales within Russia	477	356
Other export sales and other sales of foreign subsidiaries	429	263
Total sales	24,955	15,652

For the three months ended March 31, 2008

	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	39	4,436	20,480	-	24,955
Inter-segment	4,384	9,653	8	(14,045)	-
Total sales	4,423	14,089	20,488	(14,045)	24,955
Operating expenses and total cost of purchases	549	5,527	18,253	(13,813)	10,516
Depletion, depreciation and amortization	179	289	156	-	624
Interest expense	7	49	48	(32)	72
Income taxes	322	579	111	-	1,012
Net income	1,151	1,842	293	(123)	3,163
Total assets	17,979	34,927	21,588	(10,479)	64,015
Capital expenditures	680	1,361	371	-	2,412

(Millions of US dollars, unless otherwise noted)

Note 22. Segment information (continued)

For the three months ended March 31, 2007

	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	34	2,623	12,995	-	15,652
Inter-segment	2,432	6,268	8	(8,708)	-
Total sales	2,466	8,891	13,003	(8,708)	15,652
Operating expenses and total cost of purchases	464	3,239	11,392	(8,602)	6,493
Depreciation, depletion and amortization expense	175	224	148	-	547
Interest expense	5	59	61	(48)	77
Income tax expense	105	356	77	-	538
Net income	334	938	58	(31)	1,299
Total assets	13,109	26,021	18,550	(7,525)	50,155
Capital expenditures	583	1,173	306	-	2,062

Group's international sales to third parties include sales in Switzerland and USA of $11,431 million and $3,202 million during the three months ended March 31, 2008 and $8,302 million and $1,547 million during the three months ended March 31, 2007, respectively. These amounts are attributed to individual countries based on the jurisdiction of subsidiaries making the sale.

Note 23. Subsequent events

In March 2008, a Group company entered into agreement to acquire 75 petrol stations and storage facilities in Bulgaria for approximately $367 million. The transaction is expected to be finalised in the second quarter 2008.

In April 2008, the Company entered into an agreement to sell 49.99% of the share capital of AGD to De Beers and ADC for $100 million, which is subject to the finalization of a working capital adjustment. The agreement provides for an additional two components of contingent purchase consideration.

- An amount of $75 million payable when both the signing of the mining protocol by the AGD shareholders and the decision to mine have been passed by the AGD board of directors.
- An amount of $50 million payable at the commencement of commercial production. The amount will only be payable if the first contingent event has occurred.

The agreement contains a put option in favour of ADC whereby ADC can require the Company to repurchase ADC's 49.99% interest in AGD at the purchase price and adjusted for amounts invested in AGD as defined by the agreement. The option is exercisable within 18 months after completion date where losses relating to tax, environmental or restructuring individually or in aggregate equal or exceed $50 million.

It is expected the transaction will be finalized by the end of 2008. In accordance with this agreement, upon completion the litigation and arbitration proceedings described in Note 19 between ADC and the Group will be terminated. AGD is a company which owns a diamond exploration license in the Timan-Pechora region of the Russian Federation.

Note 23. Subsequent events (continued)

In April 2008, the Group sold 7,449 LPG and oil tank-wagons for $256 million and leased them back. These tank-wagons had a carrying value which approximated $93 million and were sold in line with the Group's strategy to dispose non-core assets.

In March 2008, a Group company entered into an agreement with a related party, whose management and directors include members of the Group's management and Board of Directors, to acquire a 64.3% interest in OAO UGK TGK-8 for approximately $2,117 million. Purchase consideration consists of 23.55 million shares of common stock of the Company (at a market value of approximately $1,620 million) and a cash payment of approximately $497 million. The transaction was finalized in May 2008. OAO UGK TGK-8 is a power generation company which owns power plants located in Astrakhan, Volgograd and Rostov regions, Krasnodar and Stavropol Districts, and the Republic of Dagestan of the Russian Federation. This acquisition is made in accordance with the Company's plans to develop its electric power business.