OAO LUKOIL

CONSOLIDATED FINANCIAL STATEMENTS

(prepared in accordance with US GAAP)

As of December 31, 2005 and 2004
and for each of the years in the three year period
ended December 31, 2005

Independent Auditors' Report

To the Board of Directors of OAO LUKOIL:

We have audited the accompanying consolidated balance sheets of OAO LUKOIL and its subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2005. These consolidated financial statements are the responsibility of the management of OAO LUKOIL. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO LUKOIL and its subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

KPMG Limited

KPMG Limited
Moscow, Russian Federation
May 15, 2006

OAO LUKOIL
Consolidated Balance Sheets
As of December 31, 2005 and 2004
(Millions of US dollars, unless otherwise noted)

	Note	2005	2004
Assets			
Current assets			
Cash and cash equivalents	3	1,650	1,257
Short-term investments		111	149
Accounts and notes receivable, net	5	5,533	3,867
Inventories	6	2,619	1,759
Prepaid taxes and other expenses		2,107	1,242
Other current assets		287	300
Assets held for sale	10	190	-
Total current assets		**12,497**	**8,574**
Investments	7	1,110	779
Property, plant and equipment	8	25,464	19,329
Deferred income tax assets	13	181	138
Goodwill and other intangible assets	9	680	610
Other non-current assets		413	331
Total assets		**40,345**	**29,761**
Liabilities and Stockholders' equity			
Current liabilities			
Accounts payable		2,167	1,787
Short-term borrowings and current portion of long-term debt	11	853	1,265
Taxes payable		2,087	1,238
Other current liabilities		729	255
Total current liabilities		**5,836**	**4,545**
Long-term debt	12, 16	4,137	2,609
Deferred income tax liabilities	13	1,830	698
Asset retirement obligations	8	387	307
Other long-term liabilities		332	338
Minority interest in subsidiary companies		1,019	453
Total liabilities		**13,541**	**8,950**
Stockholders' equity	15		
Common stock		15	15
Treasury stock, at cost		(527)	(706)
Additional paid-in capital		3,730	3,564
Retained earnings		23,586	17,938
Total stockholders' equity		**26,804**	**20,811**
Total liabilities and stockholders' equity		**40,345**	**29,761**

President of OAO LUKOIL
Alekperov V.Y.

Deputy Chief accountant of OAO LUKOIL
Kozyrev I.A.

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

Consolidated Statements of Income
For the years ended December 31, 2005, 2004 and 2003
(Millions of US dollars, unless otherwise noted)

	Note	2005	2004	2003
Revenues				
Sales (including excise and export tariffs)	23	55,774	33,845	22,118
Equity share in income of affiliates	7	441	213	181
Total revenues		**56,215**	**34,058**	**22,299**
Costs and other deductions				
Operating expenses		(3,487)	(2,880)	(2,546)
Cost of purchased crude oil, petroleum and chemical products		(19,398)	(10,124)	(5,909)
Transportation expenses		(3,519)	(2,784)	(2,052)
Selling, general and administrative expenses		(2,578)	(2,024)	(1,800)
Depreciation, depletion and amortization		(1,315)	(1,075)	(920)
Taxes other than income taxes	13	(6,334)	(3,505)	(2,456)
Excise and export tariffs		(9,931)	(5,248)	(2,954)
Exploration expenses		(317)	(171)	(136)
Gain from sale of interest in Azeri Chirag Guneshli	10	-	-	1,130
Gain (loss) on disposals and impairments of assets		52	(213)	(69)
Income from operating activities		**9,388**	**6,034**	**4,587**
Interest expense		(275)	(300)	(273)
Interest and dividend income		96	180	139
Currency translation (loss) gain		(134)	135	148
Other non-operating (expense) income		(44)	21	11
Minority interest		(121)	(62)	(36)
Income before income taxes		**8,910**	**6,008**	**4,576**
Current income taxes		(2,301)	(1,614)	(939)
Deferred income taxes		(166)	(146)	(68)
Total income tax expense	13	**(2,467)**	**(1,760)**	**(1,007)**
Income before cumulative effect of change in accounting principle		**6,443**	**4,248**	**3,569**
Cumulative effect of change in accounting principle, net of tax	2	-	-	132
Net income		**6,443**	**4,248**	**3,701**
Per share of common stock (US dollars):				
Income before cumulative effect of change in accounting principle				
Basic	15	7.91	5.20	4.36
Diluted	15	7.79	5.13	4.30
Net Income				
Basic	15	7.91	5.20	4.52
Diluted	15	7.79	5.13	4.45

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

OAO LUKOIL
Consolidated Statements of Stockholders' Equity and Comprehensive Income
For the years ended December 31, 2005, 2004 and 2003
(Millions of US dollars, unless otherwise noted)

	2005		**2004**		**2003**	
	Stockholders' equity	**Comprehensive income**	**Stockholders' equity**	**Comprehensive income**	**Stockholders' equity**	**Comprehensive income**
Common stock						
Balance as of January 1	15		15		15	
Outstanding as of December 31	**15**		**15**		**15**	
Treasury stock						
Balance as of January 1	(706)		(435)		(428)	
Stock purchased	-		(502)		(368)	
Stock sold	179		231		361	
Balance as of December 31	**(527)**		**(706)**		**(435)**	
Additional paid-in capital						
Balance as of January 1	3,564		3,522		3,229	
Premium on non-outstanding shares issued	47		-		38	
Proceeds from sale of treasury stock in excess of carrying amount	119		42		255	
Balance as of December 31	**3,730**		**3,564**		**3,522**	
Retained earnings						
Balance as of January 1	17,938	-	14,371	-	11,186	-
Net income	6,443	6,443	4,248	4,248	3,701	3,701
Dividends on common stock	(795)	-	(681)	-	(516)	-
Balance as of December 31	**23,586**		**17,938**		**14,371**	
Accumulated other comprehensive loss, net of tax						
Balance as of January 1	-	-	(1)	-	(2)	-
Foreign currency translation adjustment	-	-	1	1	1	1
Balance as of December 31	**-**		**-**		**(1)**	
Total comprehensive income for the year		6,443		4,249		3,702
Total stockholders' equity as of December 31	**26,804**		**20,811**		**17,472**	

	Share activity		
	2005	**2004**	**2003**
	(millions of shares)	**(millions of shares)**	**(millions of shares)**
Common stock, issued			
Balance as of January 1	850	850	850
Balance as of December 31	**850**	**850**	**850**
Treasury stock			
Balance as of January 1	(34)	(26)	(27)
Purchase of treasury stock	-	(18)	(19)
Sales of treasury stock	12	10	20
Balance as of December 31	**(22)**	**(34)**	**(26)**

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

OAO LUKOIL
Consolidated Statements of Cash Flows
For the years ended December 31, 2005, 2004 and 2003
(Millions of US dollars)

	Note	2005	2004	2003
Cash flows from operating activities				
Net income		**6,443**	**4,248**	**3,701**
Adjustments for non-cash items:				
Cumulative effect of change in accounting principle		-	-	(132)
Depreciation, depletion and amortization		1,315	1,075	920
Equity share in income of affiliates		(397)	(169)	(122)
Gain from sale of interest in Azeri Chirag Guneshli	10	-	-	(1,130)
Dry hole costs		170	42	48
(Gain) loss on disposals and impairments of assets		(52)	213	69
Deferred income taxes		166	146	68
Non-cash currency translation (gain) loss		(26)	(4)	17
Non-cash investing activities		(133)	(123)	(64)
All other items – net		151	97	32
Changes in operating assets and liabilities:				
Accounts and notes receivable		(1,314)	(694)	(797)
Short-term loans receivable of a banking subsidiary		(23)	(101)	(223)
Customer deposits placed in a banking subsidiary		49	(90)	341
Inventories		(735)	(571)	(153)
Accounts payable		245	306	186
Taxes payable		705	310	284
Other current assets and liabilities		(467)	(505)	(109)
Net cash provided by operating activities		**6,097**	**4,180**	**2,936**
Cash flows from investing activities				
Capital expenditures		(3,982)	(3,248)	(2,881)
Proceeds from sale of property, plant and equipment		51	99	62
Purchases of investments		(242)	(540)	(459)
Proceeds from sale of investments		234	242	374
Proceeds from sale of interest in Azeri Chirag Guneshli	10	-	-	1,337
Sale of interests in subsidiaries and affiliated companies		588	183	-
Acquisitions of subsidiaries and minority shareholding interest (including advances related to these acquisitions), net of cash acquired		(2,874)	(477)	(1,225)
Net cash used in investing activities		**(6,225)**	**(3,741)**	**(2,792)**
Cash flows from financing activities				
Net movements of short-term borrowings		(638)	(170)	220
Proceeds from issuance of long-term debt		2,474	1,191	1,445
Principal repayments of long-term debt		(704)	(778)	(1,124)
Dividends paid		(746)	(661)	(467)
Financing from related party		101	-	-
Purchase of treasury stock		-	(502)	(368)
Proceeds from sale of treasury stock		46	273	290
Other – net		6	(3)	-
Net cash provided by (used in) financing activities		**539**	**(650)**	**(4)**
Effect of exchange rate changes on cash and cash equivalents		(18)	33	43
Net increase (decrease) in cash and cash equivalents		**393**	**(178)**	**183**
Cash and cash equivalents at beginning of year		1,257	1,435	1,252
Cash and cash equivalents at end of year	3	**1,650**	**1,257**	**1,435**

Supplemental disclosures of cash flow information			
Interest paid	296	291	320
Income taxes paid	2,402	1,803	895

The accompanying notes are an integral part of these 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 which, on April 5, 1993, the Government of the Russian Federation transferred to the Company 51% of the voting shares of fifteen enterprises, and Government Resolution 861 issued on September 1, 1995 under which, during 1995, a further nine enterprises were transferred to the Group. 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 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

These consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

Note 2. Summary of significant accounting policies

Principles of consolidation

The financial position and results of subsidiaries of which the Company directly or indirectly owns more than 50% of the voting interest and which the Company controls, are included with the financial position and results of the Company in these consolidated financial statements unless minority interest holders have substantive participating rights. The Group applies the same principles of consolidation for variable interest entities where it 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 the Company 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. Investments in other companies are recorded at cost. Equity investments and investments in other companies are included in "Investments" in the consolidated balance sheets.

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 recognition

Revenues from the production and sale of crude oil and petroleum products are recognized when title passes to customers.

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 or 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 December 31, 2005, 2004 and 2003, exchange rates of 28.78, 27.75 and 29.45 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. Interest bearing security deposits with credit institutions that do not reduce the balance on long-term loan accounts are accounted for within long-term investments.

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.

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.

Note 2. Summary of significant accounting policies (continued)

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.

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.

Deferred income taxes

Deferred income tax assets and liabilities are recognized in respect of future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purposes of the consolidated financial statements and their respective tax bases and in respect of operating loss and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse and the assets be recovered and liabilities settled. 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 which includes the enactment date.

Note 2. Summary of significant accounting policies (continued)

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income in the reporting periods in which the originating expenditure becomes deductible. In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that the deferred income tax assets will be realized. In making this assessment, management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies.

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 determined by an independent actuary. Obligations in respect of each employee are accrued over the reporting periods during which the employee renders service in 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 December 2004, the FASB issued SFAS No. 123(R) *"Share-Based Payment"*, which revises SFAS No. 123 and supersedes Accounting Principles Board (APB) Opinion No. 25 regarding stock-based employee compensation plans. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. The Group will adopt the provisions of SFAS No. 123(R) in the first quarter 2006 and is currently assessing the effect of adoption.

In April 2005, the FASB staff issued FASB Staff Position ("FSP") No. FAS 19-1 "*Accounting for Suspended Well Costs*". FSP No. 19-1 amends SFAS No. 19 *"Financial Accounting and Reporting by Oil and Gas Producing Companies"* to revise the criteria for continued capitalization of costs in relation to exploratory wells and exploratory-type stratigraphic wells. As amended, SFAS No. 19 allows continued capitalization of such costs for more than one year, provided (a) the well has found a sufficient quantity of reserves to justify its completion as a producing well and (b) the company is making sufficient progress assessing the reserves and the economic and operating viability of the project. If either condition is not met or if a company obtains information that raises substantial doubt about the economic or operational viability of the project, the exploratory well would be assumed impaired, and its costs, net of any salvage value, would be charged to expense. Following adoption of the changes, certain exploration costs which would have been charged to the income statement will remain capitalized and will instead be subject to depreciation, depletion and amortization in future periods. FSP No. 19-1 also requires certain additional disclosures in relation to suspended well costs. The adoption of the provisions of FSP No. 19-1 during 2005 did not have a material impact on the Group's results of operations, financial position or cash flows.

Cumulative effect of change in accounting principle

Effective January 1, 2003, the Group adopted SFAS No. 143, "*Accounting for Asset Retirement Obligations.*" This accounting standard applies to legal obligations associated with the retirement of tangible long-lived assets. SFAS No. 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 liability is accreted for the passage of time and the related asset is depreciated over its estimated useful life.

(Millions of US dollars, except as indicated)

Note 2. Summary of significant accounting policies (continued)

Upon adoption of SFAS No. 143, the Group recorded a cumulative-effect adjustment resulting in an increase to net income of $132 million (net of income tax of $46 million), including the Group's share of the effect of adoption by its equity affiliates. The effect of adoption also included an increase of net property, plant and equipment of $330 million, minority interest of $12 million, non-current deferred income tax assets and liabilities of a net $46 million and an increase in the asset retirement obligation of $140 million.

In March 2005, the FASB issued FASB Interpretation No. 47, *"Accounting for Conditional Asset Retirement Obligations — an interpretation of FASB Statement No. 143"* (FIN 47). This Interpretation clarifies that an entity is required to recognize a liability for a legal obligation to perform asset retirement activities when the retirement is conditional on a future event and if the liability's fair value can be reasonably estimated. The adoption of the provisions of FIN 47 in the fourth quarter of 2005 did not have a material impact on the Group's results of operations, financial position or cash flows.

Comparative amounts

Certain prior period amounts have been reclassified to conform with current period presentation.

Note 3. Cash and cash equivalents

	As of December 31, 2005	As of December 31, 2004
Cash held in Russian rubles	346	218
Cash held in other currencies	905	557
Cash of a banking subsidiary in other currencies	102	176
Cash held in affiliated banks in Russian rubles	173	255
Cash held in affiliated banks in other currencies	124	51
Total cash and cash equivalents	**1,650**	**1,257**

Note 4. Non-cash transactions

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

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Non-cash investing activity	133	123	64
Settlement of bond liability with the Company's common stock	300	-	395
Total non-cash transactions	**433**	**123**	**459**

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

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Net cash used in investing activity	6,225	3,741	2,792
Non-cash investing activity	133	123	64
Total investing activity	**6,358**	**3,864**	**2,856**

(Millions of US dollars, except as indicated)

Note 5. Accounts and notes receivable, net

	As of December 31, 2005	As of December 31, 2004
Trade accounts and notes receivable (net of provisions of $80 million and $85 million as of December 31, 2005 and 2004, respectively)	3,410	2,316
Current VAT and excise recoverable	1,772	1,302
Short-term loans receivable of a banking subsidiary	48	25
Other current accounts receivable (net of provisions of $46 million and $66 million as of December 31, 2005 and 2004, respectively)	303	224
Total accounts and notes receivable	**5,533**	**3,867**

Note 6. Inventories

	As of December 31, 2005	As of December 31, 2004
Crude oil and petroleum products	1,975	1,310
Materials for extraction and drilling	250	162
Materials and supplies for refining	29	49
Other goods, materials and supplies	365	238
Total inventories	**2,619**	**1,759**

Note 7. Investments

	As of December 31, 2005	As of December 31, 2004
Investments in equity method affiliates and joint ventures	934	559
Long-term loans given by non-banking subsidiaries	165	197
Other long-term investments	11	23
Total long-term investments	**1,110**	**779**

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, refining and distribution operations in the Russian Federation and crude oil production and marketing in Kazakhstan.

	Year ended December 31, 2005		Year ended December 31, 2004		Year ended December 31, 2003	
	Total	Group's share	Total	Group's share	Total	Group's share
Revenues	2,972	1,383	2,885	1,313	1,676	757
Income before income taxes	1,214	605	761	392	444	235
Less income taxes	(338)	(164)	(362)	(179)	(106)	(54)
Net income	**876**	**441**	**399**	**213**	**338**	**181**

(Millions of US dollars, except as indicated)

Note 7. Investments (continued)

	As of December 31, 2005		As of December 31, 2004	
	Total	Group's share	Total	Group's share
Current assets	2,650	859	2,727	832
Property, plant and equipment	2,171	1,129	2,073	1,081
Other non-current assets	71	32	457	77
Total assets	4,892	2,020	5,257	1,990
Short-term debt	1,599	347	1,803	396
Other current liabilities	590	249	692	320
Long-term debt	904	487	1,455	705
Other non-current liabilities	6	3	23	10
Net assets	**1,793**	**934**	**1,284**	**559**

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

	At cost		Net	
	As of December 31, 2005	As of December 31, 2004	As of December 31, 2005	As of December 31, 2004
Exploration and Production:				
Western Siberia	14,237	13,421	6,669	6,063
European Russia	13,245	11,237	8,122	6,434
International	4,527	1,459	4,150	1,305
Total	32,009	26,117	18,941	13,802
Refining, Marketing, Distribution and Chemicals:				
Western Siberia	27	28	22	23
European Russia	6,374	5,765	3,921	3,489
International	3,537	2,824	2,254	1,734
Total	9,938	8,617	6,197	5,246
Other:				
Western Siberia	159	154	78	77
European Russia	215	195	190	158
International	73	62	58	46
Total	447	411	326	281
Total property, plant and equipment	**42,394**	**35,145**	**25,464**	**19,329**

As described in Note 2, effective January 1, 2003, the Group adopted SFAS No. 143 and began recording asset retirement obligations for estimated dismantlement, abandonment and restoration costs of property, plant and equipment in which a legal obligation exists. In accordance with SFAS No. 143, property, plant and equipment listed above include asset retirement costs associated with these asset retirement obligations.

(Millions of US dollars, except as indicated)

Note 8. Property, plant and equipment and asset retirement obligations (continued)

As of December 31, 2005 and 2004, the asset retirement obligation amounted to $397 million and $317 million, respectively, of which $10 million was included in "Other current liabilities" in the consolidated balance sheets as of each balance sheet date. During 2005 and 2004, asset retirement obligations changed as follows:

	2005	**2004**
Asset retirement obligations as of January 1	317	221
Accretion expense	30	8
New obligations and changes in estimates of existing obligations	66	88
Spending on existing obligations	(7)	(8)
Property dispositions	(4)	(7)
Foreign currency translation and other adjustments	(5)	15
Asset retirement obligations as of December 31	**397**	**317**

Note 9. Goodwill and other intangible assets

The carrying value of goodwill and other intangible assets as of December 31, 2005 and 2004 was as follows:

	As of December 31, 2005	**As of December 31, 2004**
Amortized intangible assets		
Software	205	127
Licenses and other assets	58	66
Goodwill	417	417
Total goodwill and other intangible assets	**680**	**610**

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

Note 10. Dispositions of subsidiaries and assets

In December 2005, the Company made a decision to sell ten tankers. A Group company finalized the sale of eight tankers for a price that approximates the carrying value of $190 million in May 2006. As of December 31, 2005, the Group classified these tankers as assets held for sale in the consolidated balance sheet. The sale of the remaining two tankers is expected to be finalized by July 2007. The Group will use these tankers until that date and they continue to be accounted for as property, plant and equipment. These tankers are included in the "Refining, marketing and distribution" operating segment and "European Russia" geographical segment in Note 23 "Segment information."

In November, 2004, the Company entered into a contract to sell its 100% interest in OOO LUKOIL-Burenie and its subsidiaries ("LUKOIL-Burenie") for $69 million. The terms of the contract required signing a five-year contract for drilling services (refer to Note 20 "Commitments and contingencies") to be provided to the Group and revising the terms of Group financing previously provided to LUKOIL-Burenie. The transaction was completed at the end of December 2004. The Group recognized an impairment loss of $70 million in relation to this transaction during 2004.

(Millions of US dollars, except as indicated)

Note 10. Dispositions of subsidiaries and assets (continued)

In August 2004, the Company entered into contracts to sell its 99% ownership interest in OAO Bank Petrocommerce (the “Bank”) for $214 million to a group of companies of a related party, whose management and directors include members of the Group’s management and Board of Directors. The Company used an independent valuation in the determination of the selling price. The transaction was structured to be completed in two phases. The first phase, representing the sale of 78% of the Group’s ownership interest for $169 million was completed on September 22, 2004. The second phase, in which the Group was to sell its remaining 21% ownership interest in the Bank for $45 million, was expected to be completed by the end of June 2007. The Group recognized an impairment loss of $35 million in relation to this transaction during 2004. In December 2005 the Group and the buyer cancelled the contract related to the second phase. Subsequently, in December 2005, the Group made a public auction for the sale of its remaining 21% ownership interest in the Bank and entered into a contract with the bidder, the same related party, at a selling price of $33 million. This transaction is expected to be completed by the end of June 2006. The Group recognized an additional impairment loss of $12 million during 2005.

As of December 31, 2005 the carrying value of the Group’s investment in the Bank is $33 million and is included in “Investments” in the consolidated balance sheet.

In April 2003 a Group company completed the sale of its 10% interest in the production sharing agreement operated by the Azerbaijan International Operating Company for net $1,337 million cash, resulting in the recognition of a net gain of $1,130 million during 2003. This gain is included in the “Exploration and production” operating segment and “International” geographical segment in Note 23 “Segment information.”

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

	As of December 31, 2005	As of December 31, 2004
Short-term borrowings from third parties	315	875
Short-term borrowings from related parties	1	18
Current portion of long-term debt	537	372
Total short-term borrowings and current portion of long-term debt	**853**	**1,265**

Short-term borrowings are primarily payable in US dollars and are unsecured. The weighted-average interest rate on short-term borrowings from third parties was 5.6% and 5.0% per annum as of December 31, 2005 and 2004, respectively.

Note 12. Long-term debt

	As of December 31, 2005	As of December 31, 2004
Long-term loans and borrowings from third parties (including loans from banks in the amount of $4,107 million and $1,878 million as of December 31, 2005 and 2004, respectively)	4,233	2,276
Long-term loans and borrowings from related parties	65	14
3.5% Convertible US dollar bonds, maturing 2007	94	380
7.25% Russian ruble bonds, maturing 2008	208	216
Capital lease obligation	74	95
Total long-term debt	4,674	2,981
Current portion of long-term debt	(537)	(372)
Total non-current portion of long-term debt	**4,137**	**2,609**

Note 12. Long-term debt (continued)

Long-term loans and borrowings

Long-term loans and borrowings are primarily repayable in US dollars, maturing from 2006 through 2017. About one third 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 5.8% and 5.6% per annum as of December 31, 2005 and 2004, respectively.

A Group company has an unsecured syndicated loan agreement, arranged by Citibank, ABN AMRO Bank, BNP Paribas, Sumitomo Banking Corporation and Societe Generale with an outstanding amount of $1,934 million as of December 31, 2005, maturing in 2008. Borrowings under this agreement bear interest at LIBOR plus 0.7% per annum. This loan facility was used for financing the acquisition of Nelson Resources Limited ("Nelson") (refer to Note 17 "Business combinations").

The Company has a secured syndicated loan agreement, arranged by ABN AMRO Bank and Citibank, with an outstanding amount of $715 million as of December 31, 2005. Borrowings of $429 million under this agreement bear interest at LIBOR plus 1.35% per annum and have maturity dates up to 2008. The balance of $286 million bears interest at LIBOR plus 2.5% per annum and has maturity dates up to 2010.

A Group company has an unsecured syndicated loan agreement with CALYON and ABN AMRO with an outstanding amount of $251 million as of December 31, 2005. Borrowings under this agreement bear interest at LIBOR plus 1.2% per annum and have maturity dates up to 2010.

A Group company has a secured loan agreement, arranged by Credit Swiss First Boston, with an outstanding amount of $222 million as of December 31, 2005. Borrowings under this agreement bear interest at LIBOR plus 4.8% per annum and have maturity dates up to 2015.

A Group company has a number of loan agreements with Natexis bank with a total outstanding amount of $211 million as of December 31, 2005. These agreements have maturity dates up to 2009. Borrowings under these agreements bear interest at a range from LIBOR plus 0.9% to LIBOR plus 2.5% per annum.

A Group company has a loan agreement with Vnesheconombank with an outstanding amount of $129 million as of December 31, 2005. Borrowings under this agreement bear interest at a fixed rate of 3% per annum and have maturity dates up to 2011.

A Group company has a loan agreement with the European Bank of Reconstruction and Development with an outstanding amount of $125 million as of December 31, 2005. Borrowings under this agreement bear interest at LIBOR plus 3.0% per annum and have maturity dates up to 2008.

A Group company has a number of loan agreements with International Finance Corporation with a total outstanding amount of $109 million as of December 31, 2005. These agreements have maturity dates up to 2011. Borrowings under these agreements bear interest at a range from LIBOR plus 2.0% to LIBOR plus 2.5% per annum.

As of December 31, 2005 the Group has a number of other fixed rate loan agreements with a number of banks and organizations totaling $299 million, maturing from 2006 to 2017. The weighted average interest rate under these loans was 5.6% per annum.

As of December 31, 2005 the Group has a number of floating rate loan agreements with a number of banks and organizations totaling $238 million, maturing from 2006 to 2015. The weighted average interest rate under these loans was 7.1% per annum.

Note 12. Long-term debt (continued)

A Group company has a loan agreement with ConocoPhillips, the Group’s related party, with outstanding amount of $61 million as of December 31, 2005. Borrowings under this agreement bear interest at a fixed rate of 10% per annum and have maturity dates up to 2017. This agreement is a part of the Company’s broad-based strategic alliance with ConocoPhillips and this financing is used to develop the distribution infrastructure in the Timan-Pechora region of the Russian Federation.

Convertible US dollar bonds

On November 29, 2002, a Group company issued 350,000 3.5% convertible bonds with a face value of $1,000 each, maturing on November 29, 2007, and exchangeable for 12.112 (previously 11.948) global depository receipts (“GDRs”) of the Company per bond. The bonds are convertible into GDRs on or after January 9, 2003 up to the maturity dates. The GDRs are exchangeable into four shares of common stock of the Company. Bonds not converted by the maturity date must be redeemed for cash. The redemption price at maturity will be 120.53% of the face value in respect of these bonds. A Group company may redeem the bonds for cash prior to maturity, subject to certain restrictions and early redemption charges. The carrying amount of the bonds is being accreted to their redemption value with the accreted amount being charged to the consolidated statement of income.

As of December 31, 2005, bondholders had converted 266,821 bonds into 12.9 million shares of common stock of the Company. Subsequent to year end, as of May 15, 2006, bondholders had converted an additional 28,295 bonds into 1.4 million shares of common stock of the Company.

Group companies held sufficient treasury stock to permit the full conversion of the bonds to GDRs.

Russian ruble bonds

In November 2004, the Company issued 6 million Russian ruble bonds with a nominal value of 1,000 Russian rubles each, maturing on November 23, 2009. For a period of 7 days commencing on November 13, 2007 the bonds holders have the right to demand the Company repurchase the bonds. The bonds have a half year coupon period and bear interest at 7.25% per annum.

Maturities of long-term debt

Annual maturities of total long-term debt during the next five years, including the portion classified as current, are $537 million in 2006, $600 million in 2007, $2,414 million in 2008, $467 million in 2009, $346 million in 2010 and $310 million thereafter.

Note 13. Taxes

The Group is taxable in a number of jurisdictions within and outside of the Russian Federation and, as a result, is subject to a variety of taxes as established under the statutory provisions of each jurisdiction.

The total cost of taxation to the Group is reported in the consolidated statement of income as “Total income tax expense” for income taxes, as “Excise and export tariffs” for excise taxes, export tariffs and petroleum products sales taxes and as “Taxes other than income taxes” for other types of taxation. In each category taxation is made up of taxes levied at various rates in different jurisdictions.

Operations in the Russian Federation are subject to Federal and city tax rates that total 9.5% and a regional tax rate that varies from 10.5% to 14.5% at the discretion of the individual regional administration. The majority of the Group's operations in Russia were subject to a combined statutory tax rate of 24%.

(Millions of US dollars, except as indicated)

Note 13. Taxes (continued)

There are not currently, and have not been during the three years ended December 31, 2005, any provisions in the taxation legislation of the Russian Federation to permit the Group to reduce taxable profits in a Group company by offsetting tax losses in another Group company against such profits. Tax losses of a Group company in the Russian Federation may, however, be used fully or partially to offset taxable profits in the same company in any of the ten years following the year of loss, subject to the restriction that no more than 50% of the taxable profit in 2006 can be reduced by loss relief. Starting from January 1, 2007 this restriction will no longer apply.

Domestic and foreign components of income before income taxes were:

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Domestic	7,992	5,167	3,298
Foreign	918	841	1,278
Income before income taxes	**8,910**	**6,008**	**4,576**

Domestic and foreign components of income taxes were:

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Current			
Domestic	2,194	1,511	883
Foreign	107	103	56
Current income tax expense	2,301	1,614	939
Deferred			
Domestic	61	76	49
Foreign	105	70	19
Deferred income tax expense	166	146	68
Total income tax expense	**2,467**	**1,760**	**1,007**

The following table is a reconciliation of the amount of income tax expense that would result from applying the Russian statutory tax rate to income before income taxes to total income taxes:

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Income before income taxes	8,910	6,008	4,576
Notional income tax at Russian statutory rates	2,138	1,442	1,098
Increase (reduction) in income tax due to:			
Non-deductible items, net	407	301	168
Foreign rate differences	(12)	4	(11)
Domestic rate differences	(125)	(23)	(7)
Non-taxable gain on sale of interest in Azeri Chirag Guneshli	-	-	(271)
Foreign currency effect	(5)	6	3
Change in valuation allowance	64	30	(1)
Other	-	-	28
Total income tax expense	**2,467**	**1,760**	**1,007**

(Millions of US dollars, except as indicated)

Note 13. Taxes (continued)

Taxes other than income taxes were:

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Mineral extraction tax	5,590	2,971	1,966
Social taxes and contributions	324	330	257
Property tax	233	111	139
Other taxes and contributions	187	93	94
Taxes other than income taxes	**6,334**	**3,505**	**2,456**

Deferred income taxes are included in the consolidated balance sheets as follows:

	As of December 31, 2005	As of December 31, 2004
Other current assets	52	69
Deferred income tax assets – non-current	181	138
Other current liabilities	(18)	(16)
Deferred income tax liabilities – non-current	(1,830)	(698)
Net deferred income tax liability	**(1,615)**	**(507)**

The following table sets out the tax effects of each type of temporary differences which give rise to deferred income tax assets and liabilities:

	As of December 31, 2005	As of December 31, 2004
Accounts receivable	15	18
Long-term liabilities	145	111
Inventories	5	29
Property, plant and equipment	131	115
Accounts payable	27	19
Long-term investments	3	5
Operating loss carry forwards	121	131
Other	69	51
Total gross deferred income tax assets	516	479
Less valuation allowance	(134)	(70)
Deferred income tax assets	**382**	**409**
Property, plant and equipment	(1,747)	(714)
Accounts payable	(8)	(5)
Accounts receivable	(9)	(8)
Long-term liabilities	(117)	(72)
Inventories	(30)	(17)
Long-term investments	(66)	(83)
Other	(20)	(17)
Deferred income tax liabilities	**(1,997)**	**(916)**
Net deferred income tax liability	**(1,615)**	**(507)**

As a result of business combinations, during 2005 the Group recognised a net deferred tax liability of $923 million.

Note 13. Taxes (continued)

As of December 31, 2005, retained earnings of foreign subsidiaries included $7,066 million for which deferred taxation has not been provided because remittance of the earnings has been indefinitely postponed through reinvestment and, as a result, such amounts are considered to be permanently invested. The amount of deferred tax liability on this amount is not practicable to calculate.

In accordance with SFAS No. 52 "*Foreign currency translation*" and SFAS No. 109, "*Accounting for Income Taxes,*" deferred tax assets and liabilities are not recognized for exchange rate effects resulting from the translation of transactions and balances from the Russian ruble to the US dollar using historical exchange rates. Also, in accordance with SFAS No. 109, no deferred tax assets or liabilities are recognized for the effects of the related statutory indexation of property, plant and equipment.

Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred income tax assets are deductible, management believes it is more likely than not that Group companies will realize the benefits of the deductible temporary differences and loss carry forwards, net of existing valuation allowances as of December 31, 2005 and 2004.

As of December 31, 2005, the Group had operating loss carry forwards of $475 million of which $1 million expire during 2010, $36 million expire during 2013, $38 million expire during 2014, $21 million expire during 2015, and $379 million have indefinite carry forward.

Note 14. Pension benefits

The Company sponsors a post employment and post retirement benefits program. The primary component of the post employment and postretirement benefits program is a defined benefit pension plan that covers the majority of the Group's employees. 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.

In December 2003, the Company took the decision to replace its existing pension plan with a new plan. The new 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. Employees also have the right to receive upon retirement the benefits accumulated under the previous pension plan. These benefits have been fixed and included in the benefit obligation as of December 31, 2005 and 2004. The amount was determined primarily based on a formula including past pensionable service and relative salaries as of December 31, 2003. The Company recorded a gain of $53 million during 2003 as a result of this curtailment.

The Company uses December 31 as the measurement date for its post employment and post retirement benefits program. An independent actuary has assessed the benefit obligations as of December 31, 2005 and 2004.

(Millions of US dollars, except as indicated)

Note 14. Pension benefits (continued)

The following table provides information about the benefit obligations, plan assets and actuarial assumptions used as of December 31, 2005 and 2004. The benefit obligations below represent the projected benefit obligation of the pension plan.

	2005	2004
Benefit obligations		
Benefit obligations as of January 1	198	156
Effect of exchange rate changes	(8)	11
Service cost	9	7
Interest cost	17	14
Plan amendments	4	7
Actuarial loss	2	29
Benefits paid	(20)	(12)
Curtailment gain	-	(14)
Benefit obligations as of December 31	**202**	**198**
Plan assets		
Fair value of plan assets as of January 1	63	55
Effect of exchange rate changes	(3)	4
Return on plan assets	9	8
Employer contributions	24	14
Benefits paid	(20)	(12)
Assets transferred as a result of settlement	-	(6)
Fair value of plan assets as of December 31	**73**	**63**
Funded status	(129)	(135)
Unamortized prior service cost	53	54
Unrecognized actuarial gain	(45)	(47)
Net amount recognized	**(121)**	**(128)**
Amounts recorded in the consolidated balance sheets were:		
Accrued benefit liabilities included in “Other long-term liabilities”	(121)	(128)
Assumptions:		
Discount rate	9.2%	9.2%
Expected return on plan assets	10.0%	10.0%

The real returns on bonds and equities are based on what is observed in the international markets over extended periods of time. In the calculation of the expected return on assets no use is made of the historical returns LUKOIL-GARANT has achieved.

In addition to the plan assets, LUKOIL-GARANT holds assets in the form of an insurance reserve. The purpose of this insurance reserve is to satisfy pension obligations should the plan assets not be sufficient to meet pension obligations. The Group’s contributions to the pension plan are determined without considering the assets in the insurance reserve.

The plans are funded on a discretionary basis through a solidarity account, which is held in trust with LUKOIL-GARANT. LUKOIL-GARANT does not allocate separately identifiable assets to the Group or its other third party clients. All funds of plan assets and other individual pension accounts are managed as a pool of investments.

(Millions of US dollars, except as indicated)

Note 14. Pension benefits (continued)

The asset allocation of the investment portfolio maintained by LUKOIL-GARANT for the Group and its clients was as follows:

Type of assets	As of December 31, 2005	As of December 31, 2004
Promissory notes of Russian issuers	30%	6%
Russian corporate bonds	20%	23%
Bank deposits	16%	8%
Equity securities of Russian issuers	10%	19%
Russian state bonds	9%	-
Shares of OAO LUKOIL	5%	8%
Shares in investment funds	5%	-
Russian municipal bonds	3%	6%
Accounts receivable from investment companies	-	28%
Other assets	2%	2%
	100%	100%

The investment strategy employed by LUKOIL-GARANT includes an overall goal to attain a maximum investment return, while guaranteeing the principal amount invested. The strategy is to invest with a medium-term perspective while maintaining a level of liquidity through proper allocation of investment assets. Investment policies include rules and limitations to avoid concentrations of investments.

The investment portfolio is primarily comprised of two types of investments: securities with fixed yield and equity securities. The securities with fixed yield include mainly high yield corporate bonds and promissory notes of banks with low and medium risk ratings. Maturities range from one to three years.

The following table details the targeted investment mix for 2006 and the maximum limits on investment type.

Type of investment	2006 Target Allocation	Maximum Allocation Allowed
Russian corporate bonds	31%	50%
Promissory notes of Russian issuers	5%	50%
Equity securities of Russian issuers	28%	50%
Russian municipal bonds	31%	50%
Other, including bank deposits	5%	50%
	100%	

Components of net periodic benefit cost were as follows:

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Service cost	9	7	5
Interest cost	17	14	34
Less expected return on plan assets	(6)	(5)	(7)
Amortization of prior service cost	5	5	19
Actuarial gain	(3)	(5)	(4)
Curtailment gain	-	(8)	(53)
Total net periodic benefit cost (income)	**22**	**8**	**(6)**

Total employer contributions for 2006 are expected to be $18 million.

Note 14. Pension benefits (continued)

The following benefit payments, which reflect expected future services, as appropriate, are expected to be paid:

	2006	2007	2008	2009	2010	5-year period 2006-2010	5-year period 2011-2015
Pension benefits	23	9	12	12	13	69	54
Other long-term employee benefits	15	9	10	11	11	56	62
Total expected benefits to be paid	**38**	**18**	**22**	**23**	**24**	**125**	**116**

Note 15. Stockholders’ equity

Common stock

	As of December 31, 2005 (millions of shares)	As of December 31, 2004 (millions of shares)
Authorized and issued common stock, par value of 0.025 Russian rubles each	850	850
Common stock held by subsidiaries, not considered as outstanding	(2)	(5)
Treasury stock	(22)	(34)
Outstanding common stock	**826**	**811**

Dividends and dividend limitations

Profits available for distribution to common stockholders in respect of any reporting period are determined by reference to the statutory financial statements of the Company prepared in accordance with the laws of the Russian Federation and denominated in Russian rubles. Under Russian Law, dividends are limited to the net profits of the reporting year as set out in the statutory financial statements of the Company. These laws and other legislative acts governing the rights of shareholders to receive dividends are subject to various interpretations.

The Company’s net profits were 66,327 million Russian rubles, 78,028 million Russian rubles and 48,042 million Russian rubles, respectively for 2005, 2004 and 2003, pursuant to the statutory financial statements, which at the US dollar exchange rates as of December 31, 2005, 2004 and 2003 amounted to $2,304 million, $2,812 million and $1,631 million, respectively.

At the annual stockholders’ meeting on June 28, 2005, dividends were declared for 2004 in the amount of 28.00 Russian rubles per common share, which at the date of the decision was equivalent to $0.98.

At the annual stockholders’ meeting on June 24, 2004, dividends were declared for 2003 in the amount of 24.00 Russian rubles per common share, which at the date of the meeting was equivalent to $0.83.

At the annual stockholders’ meeting on June 26, 2003, dividends were declared for 2002 in the amount of 19.50 Russian rubles per common share, which at the date of the decision was equivalent to $0.64.

Note 15. Stockholders' equity (continued)

Earnings per share

The calculation of diluted earnings per share for these years was as follows:

	Year ended December 31, 2005	Year ended December 31, 2004	Year ended December 31, 2003
Income before cumulative effect of change in accounting principle	6,443	4,248	3,569
Cumulative effect of change in accounting principle	-	-	132
Net income	6,443	4,248	3,701
Add back convertible debt interest (net of tax at effective rate)			
1% Convertible US dollar bonds, maturing 2003	-	-	13
3.5% Convertible US dollar bonds, maturing 2007	26	27	27
Total diluted income before cumulative effect of change in accounting principle	6,469	4,275	3,609
Total diluted net income	6,469	4,275	3,741
Weighted average number of outstanding common shares (thousands of shares)	814,417	817,294	819,169
Add back treasury shares held in respect of convertible debt (thousands of shares)	15,957	16,847	20,977
Weighted average number of outstanding common shares, after dilution (thousands of shares)	830,374	834,141	840,146

Note 16. 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. The Group recognized an expense from the use of derivative instruments of $171 million, $55 million and $37 million during 2005, 2004 and 2003, respectively. The expense is included in "Cost of purchased crude oil, petroleum and chemical products" in the consolidated statements of income. The fair value of derivative contracts outstanding and recorded on the consolidated balance sheets was a net liability of $26 million and a net asset of $28 million as of December 31, 2005 and 2004, respectively.

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 December 31, 2005 and 2004 was $5,081 million and $3,124 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.

(Millions of US dollars, except as indicated)

Note 17. Business combinations

During the period from November to December 2005, a Group company acquired 51% of the share capital of OAO Primorieneftegaz for $261 million. OAO Primorieneftegaz is a Russian oil and gas exploration company operating in the European Russia.

During the period from October 14 to December 5, 2005, a Group company acquired 100% of the share capital of Nelson for $1,951 million. Nelson is an exploration and production company operating in western Kazakhstan. Nelson owns an effective 76% interest in the Karakuduk field, 50% interest in Alibekmola, Kozhasai, North Buzachi and Arman fields. In addition, Nelson holds an option to acquire a 25% interest in two exploration blocks in the Kazakhstan sector of the Caspian Sea – South Zhambai and South Zaburunye. The purpose of the acquisition was to increase the Group's presence in the Kazakhstan oil and gas sector and its international oil and gas reserves.

Nelson's results of operations are included in the Group's consolidated statement of income from October 14, 2005.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

Current assets	170
Property, plant and equipment	2,794
Other non-current assets	55
Total assets acquired	3,019
Current liabilities	(166)
Non-current deferred tax liabilities	(769)
Long-term debt	(87)
Minority interest	(31)
Other non-current liabilities	(15)
Total liabilities assumed	(1,068)
Net assets acquired	**1,951**

In November 2005, a Group company acquired the remaining 50% of the share capital of ZAO SeverTEK for $318 million from Neste Oil Corporation (including $98 million repayment of ZAO SeverTEK debt). The acquisition increased the Group's ownership stake in ZAO SeverTEK to 100%. ZAO SeverTEK is an exploration and production company operating within the Komi Republic of the Russian Federation.

In July 2005, a Group company acquired 66.0% of the share capital of OOO Geoilbent for $180 million. OOO Geoilbent is an exploration and production company operating in the West Siberian region of the Russian Federation. All decisions over OOO Geoilbent's financing and operating activities require approval by at least a 66.7% majority of the voting rights. Because the minority shareholder of OOO Geoilbent holds substantive participating rights, the Group accounts for its investment in OOO Geoilbent using the equity method of accounting.

In March 2005, a Group company acquired a 100% interest in Oy Teboil Ab and Suomen Petrooli Oy for $160 million. Oy Teboil Ab and Suomen Petrooli Oy are marketing and distribution companies mainly engaged in operating a chain of retail petrol stations, wholesale of refined products and production and sale of lubricants in Finland.

Note 17. Business combinations (continued)

In January 2005, a Group company acquired an additional 22% interest in LUKOIL Neftochim Bourgas AD for $56 million (20.7% interest was acquired from a related party for $52 million). The acquisition increased the Group's ownership stake in LUKOIL Neftochim Bourgas AD to 93.2%. In August 2005, a Group company acquired an additional 4% interest in LUKOIL Neftochim Bourgas AD for $10 million, thereby increasing the Group's ownership stake in LUKOIL Neftochim Bourgas AD to 97.2%.

In December 2004, a Group company acquired the remaining 50% interest in LUKAgip N.V. ("LUKAgip") for $143 million from Eni Group (of which $111 million represents repayment of debt to the Eni Group). The acquisition increased the Group's ownership in LUKAgip to 100%. LUKAgip owns a 24% interest in the Meleiha Hydrocarbon License Concession Agreement located onshore in Egypt. It also owns a 10% interest in the Shakh Deniz Exploration, Development and Production Sharing Agreement, 8% of the midstream gas marketing entity, the Azerbaijan Gas Supply Company, and 100% of LUKAgip Midstream B.V., which holds LUKAgip's 10% interest in the South Caucasus Pipeline Company.

On January 26, 2004, a Group company entered into an agreement with ConocoPhillips to purchase 308 gas stations and contracts to supply petroleum products to an additional 471 gas stations in the Northeast of the United States of America for $270 million. The transaction was finalized in May 2004.

Purchases of interests in OAO Primorieneftegaz, Nelson, ZAO SeverTEK, Oy Teboil Ab, Suomen Petrooli Oy and LUKOIL Neftochim Bourgas AD did not have a material impact on the Group's consolidated operations for the period ended December 31, 2005. Therefore, no pro-forma income statement information has been provided in these consolidated financial statements.

Note 18. Consolidation of Variable Interest Entity

On June 30, 2005, the Company completed the formation of a joint venture with ConocoPhillips within the framework of their broad-based strategic alliance. This joint venture was created by selling ConocoPhillips an interest in the Company's wholly owned subsidiary OOO Narianmarneftegaz ("NMNG") for $529 million. This joint venture is to develop 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. As of June 30, 2005, NMNG's total assets were approximately $1.6 billion.

The Group has 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 has also determined that it is the primary beneficiary and has consolidated NMNG.

As a result of the transaction, the Group recognized a gain of $152 million, which is included in "Gain (loss) on disposals and impairments of assets" in the consolidated statement of income.

Note 19. Financial guarantees

The Group has entered into various guarantee arrangements. These arrangements arose in transactions related to enhancing the credit standing of an affiliated company LUKARCO and borrowings of the Group's suppliers.

(Millions of US dollars, except as indicated)

Note 19. Financial guarantees (continued)

The following table provides the undiscounted maximum amount of potential future payments for each major group of guarantees:

	As of December 31, 2005	As of December 31, 2004
Guarantees of equity investees' debt	454	629
Guarantees of third parties' debt	19	13
Total	**473**	**642**

Guarantees on debt

LUKARCO, an investee recorded under the equity method of accounting has a loan facility on which $709 million was drawn as of December 31, 2005. Borrowings under this loan bear interest at LIBOR plus 2.5% and are partly payable by February 7, 2007 with the remaining outstanding balance repayable 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 December 31, 2005, the total amount of the Company's guarantee was $447 million, which includes $64 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. No collateral secures LUKARCO's obligation or the Company's guarantee. There are no material amounts being carried as liabilities for the Group's obligations under this guarantee.

Note 20. Commitments and contingencies

Capital expenditure, exploration and investment programs

The Group owns and operates refineries in Bulgaria (LUKOIL Neftochim Bourgas AD) and Romania (Petrotel-LUKOIL). As a result of Bulgaria and Romania joining the European Union in 2007, LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL are required to upgrade their refining plants to comply with the requirements of European Union legislation in relation to the quality of produced petroleum products and environmental protection. These requirements are stricter than existing Bulgarian and Romanian legislation. The Group estimates the amount of future capital commitment required to upgrade LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL to be approximately $607 million and $60 million, respectively.

Group companies have commitments under the terms of existing license agreements in the Russian Federation of $1,380 million over the next 5 years and of $115 million thereafter. Management believes that a significant portion of these commitments will be fulfilled by the services to be performed by Eurasia Drilling Company and ZAO Globalstroy-Engineering as discussed below.

In connection with the sale of LUKOIL-Burenie (refer to Note 10 "Dispositions of subsidiaries and assets") the Group signed a five year contract for drilling services. Under the terms of the contract, drilling services of $378 million, $571 million, $661 million, and $666 million will be provided by LUKOIL-Burenie (now Eurasia Drilling Company) during 2006, 2007, 2008, and 2009, respectively.

The Company has signed a four-year agreement for the provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for 2006 to be approximately $850 million.

Group companies have commitments for capital expenditure contributions in the amount of $479 million related to various production sharing agreements over the next 32 years.

(Millions of US dollars, except as indicated)

Note 20. Commitments and contingencies (continued)

Group companies have investment commitments relating to oil deposits in Iraq of $495 million to be spent within 3 years from when exploitation becomes possible. Due to significant changes in the political and economic situation in Iraq the future of this contract is not clear, however, the Group is actively pursuing its legal right to this contract in Iraq in alliance with ConocoPhillips.

Operating lease obligations

A Group company has commitments of $1,140 million primarily for the lease of vessels and petroleum distribution outlets over the next 9 years. Commitments for minimum rentals under these leases as of December 31, 2005 are as follows:

	As of December 31, 2005
2006	316
2007	180
2008	108
2009	88
2010	88
beyond	360

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. The Group has limited business interruption insurance coverage. Management does not believe that it is appropriate to have full insurance coverage against business interruption given the Group’s geographical diversity and the limited impact it considers likely to occur from a single event.

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 over the estimated remaining lives of the related assets or recognized immediately depending on their nature. 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.

Note 20. Commitments and contingencies (continued)

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.

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 regional organizational structure of the Russian Federation tax authorities and the regional judicial system can mean that taxation issues successfully defended in one region may be unsuccessful in another region. The tax authorities in each region may have a different interpretation of similar taxation issues. There is however some degree of 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.

"Income tax expense" and "Taxes other than income taxes" in the consolidated statement of income include $163 million in relation to the results of tax audits of the Group companies for periods prior to the 2004 financial year.

Note 20. Commitments and contingencies (continued)

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 claims, among other things, that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. The total damages claimed by ADC are 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 of Denver, Colorado dismissed ADC's action against the Defendants based on lack of personal jurisdiction. On November 22, 2002, the Denver District Court denied ADC's request for reconsideration of the Court's October 15th order dismissing the case. ADC subsequently filed an appeal on November 27, 2002 with the Court of Appeals in the State of Colorado. On March 25, 2004, the Court of Appeals upheld the October 15, 2002 decision of the District Court. On April 17, 2004, ADC filed a motion for rehearing that was denied on June 17, 2004. ADC then filed a petition for writ of certiorari with the Colorado Supreme Court on July 16, 2004. On January 10, 2005, the Colorado Supreme Court granted certiorari on a narrow issue: whether the Court of Appeals erred by concluding that a trial court may decide a motion to dismiss for lack of personal jurisdiction by weighing and resolving factual issues without an evidentiary hearing. The Colorado Supreme Court declined to review ADC's other requested issue concerning jurisdiction. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts' findings 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 erred by not holding an evidentiary hearing concerning the existence of general jurisdiction, which is whether the Company had systematic and continuous contacts in the State of Colorado at the time the lawsuit was filed. Therefore, the lawsuit was initially remanded to the trial court to hold an evidentiary hearing on the issue of general jurisdiction. However, in response to a petition for rehearing filed by the Company, the Supreme Court issued a modified opinion on December 19, 2005 remanding this case to the Court of Appeals to consider any remaining issues that were not addressed by the Court of Appeals' previous decision. On March 2, 2006, the Court of Appeals granted the Company's motion to permit supplemental briefing on the issue of forum non convenience. Briefs on this issue were filed by the Company and ADC on March 27, 2006. The Company has filed a motion requesting oral argument on forum non convenience; the Court of Appeals has not ruled on this request. No other timetable has been established for the proceedings in the Court of Appeals. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

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 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 of the Arbitration Institute of the Stockholm Chamber of Commerce 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. The decision of the Swedish Supreme Court is expected to be issued during 2006. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

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 21. 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. Purchases of construction services were primarily from affiliated companies.

Below are related party transactions not disclosed elsewhere in the financial statements. Refer also to Notes 3, 10, 11, 12, 14, 17, 18, 19 and 22 for other transactions with related parties.

Sales of oil and oil products to related parties were $605 million, $153 million and $124 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Other sales to related parties were $58 million, $63 million and $76 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Purchases of oil and oil products from related parties were $2,248 million, $770 million and $270 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Purchases of construction services from related parties were $378 million, $648 million and $451 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Other purchases from related parties were $54 million, $71 million and $99 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Purchases of insurance services from related parties, whose management and directors include members of the Group’s management, were $133 million, $138 million and $200 million during the years ended December 31, 2005, 2004 and 2003, respectively.

Amounts receivable from related parties, including loans and advances, were $160 million and $225 million as of December 31, 2005 and 2004, respectively. Amounts payable to related parties were $127 million and $150 million as of December 31, 2005 and 2004, respectively.

Note 22. Compensation plan

During 2003, the Company introduced a compensation plan available to certain members of management, which provides compensation based upon share appreciation rights on the Company’s common stock. The number of shares, or rights, allocated to the plan is approximately 11 million shares. These rights vest in December 2006. The Group has accrued a liability of $283 million, included in “Other current liabilities”, and $68 million, included in “Other long-term liabilities”, as of December 31, 2005 and 2004, respectively and recorded $263 million and $65 million of compensation expense during the year ended December 31, 2005 and 2004, respectively. The Group also recorded compensation of $26 million during the year ended December 31, 2003 in relation to this and a previous plan that expired in 2003.

Note 23. Segment information

Presented below is information about the Group’s operating and geographical segments for the years ended December 31, 2005, 2004 and 2003 in accordance with SFAS No. 131, *“Disclosures about Segments of an Enterprise and Related Information.”*

(Millions of US dollars, except as indicated)

Note 23. Segment information (continued)

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

2005	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
Sales						
Third parties	1,047	53,064	1,628	35	-	55,774
Inter-segment	14,821	1,041	22	138	(16,022)	-
Total sales	15,868	54,105	1,650	173	(16,022)	55,774
Operating expenses and total cost of purchases	2,602	34,652	1,314	126	(15,809)	22,885
Depreciation, depletion and amortization	824	464	15	12	-	1,315
Interest expense	73	335	2	50	(185)	275
Income tax expense	1,111	1,317	35	4	-	2,467
Net income	3,362	3,059	122	52	(152)	6,443
Total assets	25,480	23,682	586	5,130	(14,533)	40,345
Capital expenditures	2,918	1,129	77	53	-	4,177

2004	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
Sales						
Third parties	1,614	30,807	1,384	40	-	33,845
Inter-segment	8,379	822	13	103	(9,317)	-
Total sales	9,993	31,629	1,397	143	(9,317)	33,845
Operating expenses and total cost of purchases	2,610	18,469	1,119	89	(9,283)	13,004
Depreciation, depletion and amortization	676	377	8	14	-	1,075
Interest expense	76	272	2	93	(143)	300
Income tax expense	568	1,159	20	13	-	1,760
Net income	1,221	2,908	175	117	(173)	4,248
Total assets	17,827	17,029	462	3,143	(8,700)	29,761
Capital expenditures	2,289	1,070	71	17	-	3,447

(Millions of US dollars, except as indicated)

Note 23. Segment information (continued)

2003	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
Sales						
Third parties	1,580	19,542	963	33	-	22,118
Inter-segment	5,702	285	8	46	(6,041)	-
Total sales	7,282	19,827	971	79	(6,041)	22,118
Operating expenses and total cost of purchases	2,349	11,323	808	25	(6,050)	8,455
Depreciation, depletion and amortization	606	304	4	6	-	920
Interest expense	66	199	3	84	(79)	273
Income tax expense	381	605	11	10	-	1,007
Net income	1,995	1,573	72	99	(38)	3,701
Total assets	15,851	13,479	282	3,789	(6,827)	26,574
Capital expenditures	1,784	1,175	39	20	-	3,018

Geographical segments

	2005	2004	2003
Sales of crude oil within Russia	120	181	374
Export of crude oil and sales of crude oil by foreign subsidiaries	16,367	10,940	6,844
Sales of petroleum products within Russia	6,725	4,665	3,450
Export of petroleum products and sales of petroleum products by foreign subsidiaries	29,216	15,317	9,480
Sales of chemicals within Russia	469	332	251
Export of chemicals and sales of chemicals by foreign subsidiaries	1,134	1,021	671
Other sales within Russia	821	713	568
Other export sales and other sales of foreign subsidiaries	922	676	480
Total sales	55,774	33,845	22,118

2005	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	250	8,656	46,868	-	55,774
Inter-segment	8,947	21,098	31	(30,076)	-
Total sales	9,197	29,754	46,899	(30,076)	55,774
Operating expenses and total cost of purchases	1,372	10,829	40,590	(29,906)	22,885
Depletion, depreciation and amortization	389	618	308	-	1,315
Interest expense	17	160	133	(35)	275
Income taxes	539	1,716	212	-	2,467
Net income	2,116	4,015	925	(613)	6,443
Total assets	9,301	21,207	14,361	(4,524)	40,345
Capital expenditures	1,100	2,146	931	-	4,177

(Millions of US dollars, except as indicated)

Note 23. Segment information (continued)

2004	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	698	6,739	26,408	-	33,845
Inter-segment	4,780	12,081	20	(16,881)	-
Total sales	5,478	18,820	26,428	(16,881)	33,845
Operating expenses and total cost of purchases	1,457	6,334	22,045	(16,832)	13,004
Depletion, depreciation and amortization	366	533	176	-	1,075
Interest expense	33	234	92	(59)	300
Income taxes	236	1,351	173	-	1,760
Net income	607	3,295	682	(336)	4,248
Total assets	5,625	16,796	10,579	(3,239)	29,761
Capital expenditures	1,082	1,767	598	-	3,447

2003	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	512	5,346	16,260	-	22,118
Inter-segment	3,212	7,572	22	(10,806)	-
Total sales	3,724	12,918	16,282	(10,806)	22,118
Operating expenses and total cost of purchases	1,023	4,836	13,414	(10,818)	8,455
Depletion, depreciation and amortization	314	476	130	-	920
Interest expense	13	233	70	(43)	273
Income taxes	172	773	62	-	1,007
Net income	584	1,761	1,376	(20)	3,701
Total assets	6,721	15,912	7,247	(3,306)	26,574
Capital expenditures	543	1,953	522	-	3,018

(Millions of US dollars, except as indicated)

This section provides unaudited supplemental information on oil and gas exploration and production activities in accordance with SFAS No. 69, *"Disclosures About Oil and Gas Producing Activities"* in six separate tables:

I. Capitalized costs relating to oil and gas producing activities
II. Costs incurred in oil and gas property acquisition, exploration, and development activities
III. Results of operations for oil and gas producing activities
IV. Reserve quantity information
V. Standardized measure of discounted future net cash flows
VI. Principal sources of changes in the standardized measure of discounted future net cash flows

Amounts shown for equity companies represent the Group's share in its exploration and production affiliates, which are accounted for using the equity method of accounting.

I. Capitalized costs relating to oil and gas producing activities

As of December 31, 2005	International	Russia	Total consolidated companies	Group's share in equity companies	Total
Unproved oil and gas properties	196	531	727	17	744
Proved oil and gas properties	4,331	26,785	31,116	782	31,898
Accumulated depreciation, depletion, and amortization	(377)	(12,672)	(13,049)	(173)	(13,222)
Capitalized cost related to asset retirement obligation	-	166	166	4	170
Accumulated depreciation of capitalized cost related to asset retirement obligation	-	(19)	(19)	-	(19)
Net capitalized costs	4 ,150	14,791	18,941	630	19,571

As of December 31, 2004	International	Russia	Total consolidated companies	Group's share in equity companies	Total
Unproved oil and gas properties	202	666	868	23	891
Proved oil and gas properties	1,256	23,922	25,178	735	25,913
Accumulated depreciation, depletion, and amortization	(154)	(12,154)	(12,308)	(174)	(12,482)
Capitalized cost related to asset retirement obligation	1	70	71	1	72
Accumulated depreciation of capitalized cost related to asset retirement obligation	-	(7)	(7)	-	(7)
Net capitalized costs	1,305	12,497	13,802	585	14,387

As of December 31, 2003	International	Russia	Total consolidated companies	Group's share in equity companies	Total
Unproved oil and gas properties	127	508	635	23	658
Proved oil and gas properties	906	22,730	23,636	680	24,316
Accumulated depreciation, depletion, and amortization	(71)	(12,071)	(12,142)	(103)	(12,245)
Capitalized cost related to asset retirement obligation	2	36	38	1	39
Accumulated depreciation of capitalized cost related to asset retirement obligation	-	(5)	(5)	-	(5)
Net capitalized costs	964	11,198	12,162	601	12,763

(Millions of US dollars, except as indicated)

II. Costs incurred in oil and gas property acquisition, exploration, and development activities

Year ended December 31, 2005	International	Russia	Total consolidated companies	Group's share in equity companies	Total
Acquisition of properties - proved	1,726	183	1,909	80	1,989
Acquisition of properties - unproved	690	370	1,060	100	1,160
Exploration costs	171	252	423	3	426
Development costs	260	2,235	2,495	124	2,619
Total costs incurred	2,847	3,040	5,887	307	6,194

Year ended December 31, 2004	International	Russia	Total consolidated companies	Group's share in equity companies	Total
Acquisition of properties - proved	224	16	240	-	240
Acquisition of properties - unproved	22	49	71	-	71
Exploration costs	81	225	306	3	309
Development costs	108	1,875	1,983	117	2,100
Total costs incurred	435	2,165	2,600	120	2,720

Year ended December 31, 2003	International	Russia	Total consolidated companies	Group's share in equity companies	Total
Acquisition of properties - proved	-	485	485	2	487
Acquisition of properties - unproved	2	311	313	1	314
Exploration costs	121	135	256	3	259
Development costs	128	1,400	1,528	249	1,777
Total costs incurred	251	2,331	2,582	255	2,837

$21 million relating to the cumulative effect of the adoption of SFAS No.143 is excluded from costs incurred in 2003.

(Millions of US dollars, except as indicated)

III. Results of operations for oil and gas producing activities

The Group's results of operations for oil and gas producing activities are presented below. In accordance with SFAS No. 69, sales and transfers to Group companies are based on market prices. Income taxes are based on statutory rates. The results of operations exclude corporate overhead and interest costs.

Year ended December 31, 2005	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**	**Total**
Revenue					
Sales	620	12,327	12,947	720	13,667
Transfers	-	8,072	8,072	268	8,340
Total revenues	620	20,399	21,019	988	22,007
Production costs (excluding production taxes)	(93)	(1,672)	(1,765)	(137)	(1,902)
Exploration expense	(192)	(125)	(317)	(1)	(318)
Depreciation, depletion, and amortization	(106)	(718)	(824)	(60)	(884)
Accretion expense	-	(30)	(30)	-	(30)
Taxes other than income taxes	(6)	(11,160)	(11,166)	(285)	(11,451)
Related income taxes	(160)	(1,548)	(1,708)	(181)	(1,889)
Total results of operations for producing activities	63	5,146	5,209	324	5,533

Year ended December 31, 2004	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**	**Total**
Revenue					
Sales	243	8,841	9,084	754	9,838
Transfers	-	4,456	4,456	47	4,503
Total revenues	243	13,297	13,540	801	14,341
Production costs (excluding production taxes)	(54)	(1,509)	(1,563)	(62)	(1,625)
Exploration expense	(40)	(131)	(171)	(5)	(176)
Depreciation, depletion, and amortization	(28)	(648)	(676)	(39)	(715)
Accretion expense	-	(8)	(8)	-	(8)
Taxes other than income taxes	(2)	(5,544)	(5,546)	(172)	(5,718)
Related income taxes	(3)	(1,310)	(1,313)	(315)	(1,628)
Total results of operations for producing activities	116	4,147	4,263	208	4,471

Year ended December 31, 2003	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**	**Total**
Revenue					
Sales	102	5,606	5,708	339	6,047
Transfers	3	2,638	2,641	28	2,669
Total revenues	105	8,244	8,349	367	8,716
Production costs (excluding production taxes)	(26)	(1,432)	(1,458)	(69)	(1,527)
Exploration expense	(15)	(121)	(136)	(4)	(140)
Depreciation, depletion, and amortization	(16)	(590)	(606)	(31)	(637)
Accretion expense	-	(11)	(11)	-	(11)
Taxes other than income taxes	-	(3,230)	(3,230)	(69)	(3,299)
Related income taxes	(8)	(686)	(694)	(53)	(747)
Total results of operations for producing activities	40	2,174	2,214	141	2,355

IV. Reserve quantity information

Proved reserves are the estimated quantities of oil and gas reserves which geological and engineering data demonstrate will be recoverable with reasonable certainty in future years from known reservoirs under existing economic and operating conditions. Proved reserves do not include additional quantities of oil and gas reserves that may result from extensions of currently proved areas or from applying secondary or tertiary recovery techniques not yet tested and determined to be economic.

Proved developed reserves are the quantities of reserves expected to be recovered through existing wells with existing equipment and operating methods.

Due to the inherent uncertainties and the necessarily limited nature of reservoir data, estimates of reserves are subject to change as additional information becomes available.

Management has included within proved reserves quantities which the Group expects to produce after the expiry dates of its current production licenses. These licenses expire between 2011 and 2026, with the most significant expiring between 2011 and 2014. Management believes the licenses will be extended to produce subsequent to their current expiry dates. The Group is in the process of extending all of its production licenses in the Russian Federation. The Group has already extended a portion of these licenses and expects to extend the remaining licenses for indefinite periods. To date there have been no unsuccessful license renewal applications.

Estimated net proved oil and gas reserves and changes thereto for the years 2005, 2004 and 2003 are shown in the tables set out below.

(Millions of US dollars, except as indicated)

Millions of barrels	**Consolidated subsidiaries**			**Group's share in equity companies**	**Total**
	International	Russia	Total		
Crude oil					
January 1, 2003	327	14,386	14,713	545	15,258
Revisions of previous estimates	15	493	508	97	605
Purchase of hydrocarbons in place*	-	571	571	(206)	365
Extensions and discoveries	-	420	420	-	420
Production	(8)	(552)	(560)	(32)	(592)
Sales of reserves	(79)	-	(79)	-	(79)
December 31, 2003	255	15,318	15,573	404	15,977
Revisions of previous estimates	8	(63)	(55)	65	10
Purchase of hydrocarbons in place*	12	22	34	(1)	33
Extensions and discoveries	-	606	606	18	624
Production	(11)	(596)	(607)	(28)	(635)
Sales of reserves	-	(35)	(35)	(2)	(37)
December 31, 2004	264	15,252	15,516	456	15,972
Revisions of previous estimates	(43)	29	(14)	(6)	(20)
Purchase of hydrocarbons in place*	174	266	440	(86)	354
Extensions and discoveries	28	472	500	6	506
Production	(15)	(619)	(634)	(30)	(664)
Sales of reserves	-	(34)	(34)	-	(34)
December 31, 2005	**408**	**15,366**	**15,774**	**340**	**16,114**
Proved developed reserves					
December 31, 2003	143	9,792	9,935	272	10,207
December 31, 2004	124	10,205	10,329	322	10,651
December 31, 2005	**255**	**10,070**	**10,325**	**258**	**10,583**

* Purchase of hydrocarbons in place for equity companies includes transfers of reserves to the consolidated group upon those equity companies becoming subject to consolidation.

The minority interest share included in the above total proved reserves was 580 million barrels, 259 million barrels and 256 million barrels as of December 31, 2005, 2004 and 2003, respectively. The minority interest share included in the above proved developed reserves was 172 million barrels, 125 million barrels and 133 million barrels as of December 31, 2005, 2004 and 2003, respectively. Substantially all minority interests relate to the reserves in the Russian Federation.

(Millions of US dollars, except as indicated)

Billions of cubic feet	**Consolidated subsidiaries**			**Group's share in equity companies**	**Total**
	International	Russia	Total		
Natural gas					
January 1, 2003	1,581	22,362	23,943	221	24,164
Revisions of previous estimates	602	(269)	333	13	346
Purchase of hydrocarbons in place*	-	98	98	(59)	39
Extensions and discoveries	-	57	57	-	57
Production	(28)	(96)	(124)	(9)	(133)
December 31, 2003	2,155	22,152	24,307	166	24,473
Revisions of previous estimates	(268)	(754)	(1,022)	55	(967)
Purchase of hydrocarbons in place	1,174	2	1,176	-	1,176
Extensions and discoveries	-	93	93	2	95
Production	(32)	(133)	(165)	(9)	(174)
Sales of reserves	-	(4)	(4)	(1)	(5)
December 31, 2004	3,029	21,356	24,385	213	24,598
Revisions of previous estimates	402	(520)	(118)	(4)	(122)
Purchase of hydrocarbons in place*	-	8	8	(6)	2
Extensions and discoveries	273	742	1 015	5	1 020
Production	(35)	(155)	(190)	(10)	(200)
Sales of reserves	-	-	-	-	-
December 31, 2005	**3,669**	**21,431**	**25,100**	**198**	**25,298**
Proved developed reserves:					
December 31, 2003	1,070	1,722	2,792	122	2,914
December 31, 2004	1,363	3,420	4,783	175	4,958
December 31, 2005	**1,102**	**4,834**	**5,936**	153	**6,089**

* Purchase of hydrocarbons in place for equity companies includes transfers of reserves to the consolidated group upon those equity companies becoming subject to consolidation.

The minority interest share included in the above total proved reserves was 23 billion cubic feet, 20 billion cubic feet and 21 billion cubic feet as of December 31, 2005, 2004 and 2003, respectively. The minority interest share included in the above proved developed reserves was 15 billion cubic feet, 15 billion cubic feet and 16 billion cubic feet as of December 31, 2005, 2004 and 2003, respectively. Substantially all minority interests relate to the reserves in the Russian Federation.

(Millions of US dollars, except as indicated)

V. Standardized measure of discounted future net cash flows

The standardized measure of discounted future net cash flows, related to the above oil and gas reserves, is calculated in accordance with the requirements of SFAS No. 69. Estimated future cash inflows from production are computed by applying year-end prices for oil and gas to year-end quantities of estimated net proved reserves. Adjustment in this calculation for future price changes is limited to those required by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future pre-tax net cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a ten percent discount factor. Discounting requires a year-by-year estimate of when future expenditures will be incurred and when reserves will be produced.

The information provided in the tables set out below does not represent management's estimate of the Group's expected future cash flows or of the value of the Group's proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations. The arbitrary valuation prescribed under SFAS No. 69 requires assumptions as to the timing and amount of future development and production costs. The calculations should not be relied upon as an indication of the Group's future cash flows or of the value of its oil and gas reserves.

	International	Russia	Total consolidated companies	Group's share in equity	Total
As of December 31, 2005					
Future cash inflows	21,028	375,279	396,307	12,290	408,597
Future production and development costs	(9,471)	(200,288)	(209,759)	(4,513)	(214,272)
Future income tax expenses	(3,563)	(40,135)	(43,698)	(2,220)	(45,918)
Future net cash flows	7,994	134,856	142,850	5,557	148,407
Discount for estimated timing of cash flows (10% p.a.)	(4,140)	(86,622)	(90,762)	(2,898)	(93,660)
Discounted future net cash flows	3,854	48,234	52,088	2,659	54,747
Minority share in discounted future net cash flows	-	1,730	1,730	-	1,730

Included as a part of the $214 billion of future production and development costs are $5.6 billion of future dismantlement, abandonment and rehabilitation costs.

(Millions of US dollars, except as indicated)

	International	Russia	Total consolidated companies	Group's share in equity	Total
As of December 31, 2004					
Future cash inflows	8,290	290,189	298,479	9,630	308,109
Future production and development costs	(4,507)	(162,246)	(166,753)	(4,434)	(171,187)
Future income tax expenses	(537)	(29,268)	(29,805)	(1,276)	(31,081)
Future net cash flows	3,246	98,675	101,921	3,920	105,841
Discount for estimated timing of cash flows (10% p.a.)	(1,919)	(64,896)	(66,815)	(1,980)	(68,795)
Discounted future net cash flows	1,327	33,779	35,106	1,940	37,046
Minority share in discounted future net cash flows	-	531	531	-	531

Included as a part of the $171 billion of future production and development costs are $4.4 billion of future dismantlement, abandonment and rehabilitation costs.

	International	Russia	Total consolidated companies	Group's share in equity	Total
As of December 31, 2003					
Future cash inflows	6,376	261,575	267,951	6,445	274,396
Future production and development costs	(3,476)	(149,526)	(153,002)	(3,117)	(156,119)
Future income tax expenses	(586)	(26,071)	(26,657)	(824)	(27,481)
Future net cash flows	2,314	85,978	88,292	2,504	90,796
Discount for estimated timing of cash flows (10% p.a.)	(1,392)	(55,642)	(57,034)	(1,389)	(58,423)
Discounted future net cash flows	922	30,336	31,258	1,115	32,373
Minority share in discounted future net cash flows	-	537	537	-	537

Included as a part of the $156 billion of future production and development costs are $3.6 billion of future dismantlement, abandonment and rehabilitation costs.

(Millions of US dollars, except as indicated)

VI. Principal sources of changes in the standardized measure of discounted future net cash flows

Consolidated companies	**2005**	**2004**	**2003**
Discounted present value as at January 1	35,106	31,258	22,082
Net changes due to purchases and sales of minerals in place	1,761	31	16
Sales and transfers of oil and gas produced, net of production costs	(7,771)	(6,260)	(3,525)
Net changes in prices and production costs estimates	18,786	5,881	8,978
Extensions, discoveries, and improved recovery, less related costs	2,619	1,548	1,049
Development costs incurred during the period	2,495	1,983	1,528
Revisions of previous quantity estimates	(320)	(416)	1,163
Net change in income taxes	(5,346)	(1,084)	(2,867)
Other changes	149	8	(115)
Accretion of discount	4,609	2,157	2,949
Discounted present value at December 31	**52,088**	**35,106**	**31,258**

Group's share in equity companies	**2005**	**2004**	**2003**
Discounted present value as at January 1	1,940	1,115	1,365
Net changes due to purchases and sales of minerals in place	(473)	(20)	(457)
Sales and transfers of oil and gas produced, net of production costs	(565)	(562)	(225)
Net changes in prices and production costs estimates	1,934	787	158
Extensions, discoveries, and improved recovery, less related costs	62	64	-
Development costs incurred during the period	124	117	127
Revisions of previous quantity estimates	(82)	388	218
Net change in income taxes	(432)	(224)	(121)
Other changes	(88)	143	(67)
Accretion of discount	239	132	117
Discounted present value at December 31	**2,659**	**1,940**	**1,115**

Total	**2005**	**2004**	**2003**
Discounted present value as at January 1	37,046	32,373	23,447
Net changes due to purchases and sales of minerals in place	1,288	11	(441)
Sales and transfers of oil and gas produced, net of production costs	(8,336)	(6,822)	(3,750)
Net changes in prices and production costs estimates	20,720	6,668	9,136
Extensions, discoveries, and improved recovery, less related costs	2,681	1,612	1,049
Development costs incurred during the period	2,619	2,100	1,655
Revisions of previous quantity estimates	(402)	(28)	1,381
Net change in income taxes	(5,778)	(1,308)	(2,988)
Other changes	61	151	(182)
Accretion of discount	4,848	2,289	3,066
Discounted present value at December 31	**54,747**	**37,046**	**32,373**