ROSNEFT
OIL COMPANY
OPEN JOINT STOCK COMPANY

OJSC Rosneft Oil Company

Consolidated Financial Statements

as of December 31, 2006 and 2005 and
for the years ended December 31, 2006, 2005 and 2004
With Report of Independent Auditors

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Contents

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Report of Independent Auditors

Shareholders and the Board of Directors
of OJSC Rosneft Oil Company

We have audited the accompanying consolidated balance sheets of OJSC Rosneft Oil Company, an open joint stock company ("the Company"), as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. 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 consolidated financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our report dated May 15, 2006, we expressed an opinion that the 2005 consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company, consolidated results of its operations and its cash flows in conformity with accounting principles generally accepted in the United States of America except for three departures from such principles, including the classification of certain debt in default as non-current. As described in Note 17 to the consolidated financial statements, the Company has subsequently obtained satisfactory waivers and/or amended loan agreements to support non-current classification of such debt as of December 31, 2005. Accordingly, our present opinion on the 2005 financial statements, as presented herein, is not qualified related to this matter, but remains qualified related to the other matters described below.

Ernst & Young

As discussed in Note 3 to the consolidated financial statements, the Company has not presented pro-forma results of operations for the year 2004 as though its OJSC Yuganskneftegaz acquisition had been completed as of January 1, 2004. These disclosures are required by SFAS No. 141 *"Business Combinations"*.

As discussed in Note 3 to the consolidated financial statements, as of December 31, 2005 the value of property, plant and equipment pertaining to non-controlling shareholders in the accounting for minority interests resulting from acquisition of OJSC Yuganskneftegaz has been recorded at appraised values rather than at historical cost as required by SFAS No. 141 *"Business Combinations"*.

In our opinion, except for the effects of the matters described in the preceding paragraphs, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

Ernst & Young LLC

May 3, 2007

OJSC Rosneft Oil Company

Consolidated Balance Sheets

(in millions of US dollars, except share amounts)

	Notes	As of December 31, 2006	As of December 31, 2005
ASSETS			
Current assets:			
Cash and cash equivalents	**4**	**$ 505**	$ 1,173
Restricted cash	**4**	**29**	23
Short-term investments	**5**	**460**	165
Accounts receivable, net	**6**	**4,839**	2,858
Inventories	**7**	**905**	814
Deferred tax assets	**22**	**1,135**	48
Prepayments and other current assets	**8**	**1,589**	882
Total current assets		**9,462**	5,963
Non-current assets:			
Long-term investments	**9**	**568**	436
Long-term bank loans granted, net of allowance of US$ 6 and US$ 12, respectively		**110**	63
Oil and gas properties, net	**10, 13**	**32,959**	20,939
Property, plant and equipment, net	**11, 13**	**2,598**	2,030
Construction-in-progress	**12**	**388**	509
Goodwill	**14**	**161**	35
Deferred tax assets	**22**	**110**	8
Other non-current assets	**15**	**434**	33
Total non-current assets		**37,328**	24,053
Total assets		**$ 46,790**	$ 30,016
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Accounts payable and accrued liabilities	**16**	**$ 1,998**	$ 1,358
Short-term loans and current portion of long-term debt	**17**	**6,427**	4,005
Income and other tax liabilities	**19**	**2,472**	2,810
Deferred tax liabilities	**22**	**17**	40
Other current liabilities		**20**	32
Total current liabilities		**10,934**	8,245
Asset retirement obligations	**23**	**748**	566
Long-term debt	**17**	**7,402**	8,198
Deferred tax liabilities	**22**	**5,446**	3,696
Other non-current liabilities		**160**	18
Total non-current liabilities		**13,756**	12,478
Minority interest	**20**	**225**	1,860
Shareholders' equity:			
Common stock par value 0.01 RUB (shares issued and outstanding: 10,598 million and 9,092 million as of December 31, 2006 and 2005, respectively)	**18**	**20**	20
Additional paid-in capital	**18**	**11,352**	19
Retained earnings		**10,503**	7,394
Total shareholders' equity		**21,875**	7,433
Total liabilities and shareholders' equity		**$ 46,790**	$ 30,016

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

OJSC Rosneft Oil Company

Consolidated Statements of Income

(in millions of US dollars, except earnings per share data)

	Notes	For the years ended December 31, 2006	2005	2004
Revenues				
Oil and gas sales	**26**	**$ 23,499**	$ 16,152	$ 2,735
Petroleum products and processing fees	**26**	**9,250**	7,374	2,233
Support services and other revenues		**350**	337	294
Total		**33,099**	23,863	5,262
Costs and expenses				
Production and operating expenses		**2,197**	1,623	595
Cost of purchased oil, petroleum products and refining costs		**1,320**	637	547
Selling, general and administrative expenses		**757**	589	257
Pipeline tariffs and transportation costs		**3,226**	2,231	574
Exploration expenses		**193**	164	51
Depreciation, depletion and amortization		**1,638**	1,472	307
Accretion expense	**23**	**34**	35	8
Taxes other than income tax	**22**	**6,990**	5,326	1,011
Export customs duty	**21**	**11,140**	6,264	706
Total		**27,495**	18,341	4,056
Operating income		**5,604**	5,522	1,206
Other income/(expenses)				
Interest income		**135**	81	65
Interest expense		**(724)**	(775)	(159)
(Loss)/gain on disposal of property, plant and equipment		**(95)**	(74)	121
Gain/(loss) on disposal of investments		**3**	(13)	(30)
Gain on sale of shares in CJSC Sevmorneftegaz		**–**	1,303	–
Equity share in affiliates' profits	**9**	**17**	51	52
Dividends and income from joint ventures		**15**	10	46
Other expenses, net		**(320)**	(136)	(196)
Foreign exchange (loss)/gain		**(470)**	245	96
Total other (expenses)/income		**(1,439)**	692	(5)
Income before income tax and minority interest		**4,165**	6,214	1,201
Income tax expense	**22**	**(540)**	(1,609)	(298)
Income before minority interest		**3,625**	4,605	903
Minority interest in subsidiaries' earnings	**20**	**(92)**	(446)	(66)
Net income		**$ 3,533**	$ 4,159	$ 837
Earnings per share (in US$) – basic and diluted		**$ 0.37**	$ 0.46	$ 0.09
Weighted average number of shares outstanding (millions)	**18**	**9,527**	9,092	9,092

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

OJSC Rosneft Oil Company

Consolidated Statements of Changes in Shareholders’ Equity

for the years ended December 31, 2006, 2005 and 2004

(in millions of US dollars, except share amounts)

	Number of shares (millions)	Common stock	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Shareholder’s equity
Balance at December 31, 2003	9,092	$ 20	$ 19	$ 13	$ 2,510	$ 2,562
Realized gains on available-for-sale securities		–	–	(13)	–	(13)
Net income for the year		–	–	–	837	837
Comprehensive income for the year						824
Dividends declared on common stock		–	–	–	(51)	(51)
Balance at December 31, 2004	9,092	$ 20	$ 19	$ –	$ 3,296	$ 3,335
Net and comprehensive income for the year		–	–	–	4,159	4,159
Dividends declared on common stock		–	–	–	(61)	(61)
Balance at December 31, 2005	**9,092**	**$ 20**	**$ 19**	**$ –**	**$ 7,394**	**$ 7,433**
Net and comprehensive income for the year		**–**	**–**	**–**	**3,533**	**3,533**
Ordinary shares issued during Initial Public Offering (see Note 1)	**285**	**–**	**2,115**	**–**	**–**	**2,115**
Ordinary shares issued during Share Swap (see Note 1)	**1,221**	**–**	**9,218**	**–**	**–**	**9,218**
Dividends declared on common stock		**–**	**–**	**–**	**(424)**	**(424)**
Balance at December 31, 2006	**10,598**	**$ 20**	**$ 11,352**	**$ –**	**$ 10,503**	**$ 21,875**

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

OJSC Rosneft Oil Company

Consolidated Statements of Cash Flows

(in millions of US dollars)

	Notes	For the years ended December 31, 2006	2005	2004
Operating activities				
Net income		**$ 3,533**	$ 4,159	$ 837
Reconciliation of net income to net cash provided by operating activities:				
Effect of foreign exchange		**392**	(115)	(24)
Gain on sale of shares in CJSC Sevmorneftegaz		**–**	(1,303)	–
Depreciation, depletion and amortization		**1,638**	1,472	307
Dry well expenses		**20**	17	7
Loss/(gain) on disposal of property, plant and equipment		**95**	74	(121)
Deferred income tax	**22**	**(1,845)**	(79)	(11)
Accretion expense	**23**	**34**	35	8
Equity share in affiliates' profits	**9**	**(17)**	(51)	(52)
(Decrease)/increase in allowance for doubtful accounts and bank loans granted		**(10)**	4	11
Minority interests in subsidiaries' earnings		**92**	446	66
Acquisition of trading securities		**(181)**	(71)	(27)
Proceeds from sale of trading securities		**9**	75	44
Changes in operating assets and liabilities net of acquisitions:				
Increase in accounts receivable		**(1,181)**	(1,353)	(146)
Increase in inventories		**(91)**	(297)	(92)
(Increase)/decrease in restricted cash		**(6)**	2	(4)
Increase in prepayments and other current assets		**(231)**	(626)	(90)
(Increase)/decrease in other non-current assets		**(124)**	6	(60)
Increase in long-term bank loans granted		**(41)**	(23)	(16)
Increase in interest payable		**36**	158	35
Increase/(decrease) in accounts payable and accrued liabilities		**678**	(8)	(44)
(Decrease)/increase in income and other tax liabilities		**(338)**	414	34
Increase in other current and non-current liabilities		**131**	5	38
Net cash provided by operating activities		**2,593**	2,941	700
Cash flows from investing activities				
Capital expenditures		**(3,462)**	(1,944)	(829)
Acquisition of licences		**(916)**	(146)	–
Repayment of Sakhalin-1 carried costs	**10**	**(1,339)**	–	–
Proceeds from disposals of property, plant and equipment		**27**	30	206
Acquisition of short-term investments		**(277)**	(622)	(61)
Proceeds from sale of short-term investments		**136**	632	209
Acquisition of entities and additional shares in subsidiaries, net of cash acquired		**(194)**	(366)	(270)
Acquisition of OJSC Yuganskneftegaz	**3**	**–**	–	(9,398)
Proceeds from sale of long-term investments		**33**	147	248
Acquisition of debt receivable	**5**	**(463)**	(20)	–
Acquisition of long-term investments		**(61)**	(33)	(267)
Net cash used in investing activities		**$ (6,516)**	$ (2,322)	$ (10,162)

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

OJSC Rosneft Oil Company

Consolidated Statements of Cash Flows (continued)

(in millions of US dollars)

	Notes	2006	2005	2004
		For the years ended December 31,		
Cash flows from financing activities				
Proceeds from short-term debt		**$ 2,768**	$ 977	$ 3,211
Repayment of short-term debt		**(796)**	(2,018)	(132)
Proceeds from long-term debt		**2,887**	2,547	8,092
Repayment of long-term debt		**(3,250)**	(1,829)	(867)
Proceeds from share issue, net of commission	**18**	**2,115**	–	–
Dividends paid		**(424)**	(61)	(51)
Dividends paid to minority shareholders in subsidiaries		**(75)**	(74)	(10)
Net cash, provided by/(used in) financing activities		**3,225**	(458)	10,243
(Decrease)/increase in cash and cash equivalents		**(698)**	161	781
Cash and cash equivalents at beginning of year		**1,173**	1,033	228
Effect of foreign exchange on cash and cash equivalents		**30**	(21)	24
Cash and cash equivalents at end of year		**$ 505**	$ 1,173	$ 1,033
Supplementary disclosures of cash flow information				
Cash paid for interest (net of amount capitalized)		**$ 610**	$ 617	$ 124
Cash paid for income taxes		**$ 2,157**	$ 1,636	$ 309
Supplementary disclosure of non-cash activities				
Net assets of subsidiaries contributed by minority shareholders in exchange for shares issued by Rosneft	**3**	**$ 9,218**	$ –	$ –
Income tax offsets		**$ 1**	$ 41	$ 6
Non-cash capital expenditures		**$ –**	$ (32)	$ (50)

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

1. General

Nature of Operations

Open Joint Stock Company ("OJSC") Rosneft Oil Company ("Rosneft") and its subsidiaries, (collectively the "Company" or the "Group"), are principally engaged in exploration, development, production and sale of crude oil and gas and refining, transportation and sale of petroleum products in the Russian Federation and in certain international markets.

Rosneft State Enterprise was incorporated as an open joint stock company on December 7, 1995. All assets and liabilities previously managed by Rosneft State Enterprise were transferred to the Company at their book value effective on that date together with the Government of the Russian Federation ("State") ownership in other privatized oil and gas companies. The transfer of assets and liabilities was made in accordance with Resolution No. 971, "On the Transformation of Rosneft State Enterprise into an Open Joint Stock Company "Rosneft Oil Company", dated September 29, 1995. Such transfers represented a reorganization of assets under the common control of the State and, accordingly, were accounted for at their book value. In 2005, the State contributed the shares of Rosneft to the share capital of OJSC Rosneftegaz (see Note 18). As of December 31, 2005, 100% of the shares of Rosneft less one share were owned by OJSC Rosneftegaz and one share was owned by the Russian Federation Federal Agency for the Management of Federal Property. As of December 31, 2006, OJSC Rosneftegaz maintains a 75.16% interest in Rosneft. The decrease in interest is attributable to sales of shares during Initial Public Offering ("IPO") in Russia, sales of Global Depository Receipts ("GDR") for the shares on London Stock Exchange and share swap realized during the merger of Rosneft and certain subsidiaries (see Note 1, Note 3 and Note 18).

Under Russian legislation, natural resources, including oil, gas, precious metals and minerals and other commercial minerals situated within the territory of the Russian Federation are the property of the State until they are extracted. The Law of the Russian Federation No. 2395-1, *On Subsurface Resources*, regulates relations arising in connection with the geological study, use and protection of subsurface resources within the territory of the Russian Federation. Pursuant to the Law, subsurface resources may be developed only on the basis of a licence. The licence is issued by the regional governmental body and contains information on the site to be developed, the period of activity, financial and other conditions. The Company holds licences issued by regional authorities for geological studies, exploration and development of oil and gas blocks and fields in areas where its subsidiaries are located.

Due to the limited capacity of OJSC Transneft's pipeline system, the State Pipeline Commission sets export quotas for each oil company based on the legislation on equal access to the oil pipeline system. In addition, the Company exports certain quantities of crude oil bypassing the Transneft system thus enabling it to increase its export capacities. In 2006, 2005 and 2004, the Company's export sales were approximately 70%, 62% and 57% of produced crude oil, respectively. The remaining production was processed at the Company's refineries and other Russian refineries for further sales on domestic and international markets. Generally, export crude oil sales result in a higher netback than Russian domestic sales after considering related transportation and export duties and other charges.

1. General (continued)

Nature of Operations (continued)

On October 1, 2006, the Company undertook a legal reorganization whereby a number of subsidiaries were merged with OJSC Rosneft Oil Company via an exchange of shares, as approved by the respective shareholders (“Share Swap”) of: OJSC Yuganskneftegaz, OJSC Rosneft-Purneftegaz, OJSC Selkupneftegaz, OJSC Severnaya Neft (Northern Oil), OJSC Rosneft-Krasnodarneftegaz, OJSC Rosneft-Stavropolneftegaz, OJSC Rosneft-Sakhalinmorneftegaz, OJSC Rosneft-Komsomolsky Refinery, OJSC Rosneft-Tuapse Refinery, OJSC Rosneft-Arkhangelsknefteproduct, OJSC Rosneft-Nakhodkanefteproduct, and OJSC Rosneft-Tuapsenefteproduct (each, a “Merging Subsidiary” and collectively, the “Merging Subsidiaries”). The primary purpose of the merger was to create a more efficient corporate and management structure with a single profit center. The Merging Subsidiaries were delisted from Unified State Register of Legal Entities from October 1, 2006. As a result of the Share Swap, OJSC Rosneft Oil Company issued its ordinary shares to the minority shareholders of the Merging Subsidiaries in exchange for ordinary and preferred shares owned by them. The shares of each Merging Subsidiary were exchanged at an agreed conversion ratio (see Note 3).

In December 2006, the Federal Tax Agency of the Russian Federation registered the increase in the Company’s Share Capital resulting from the Share Swap.

Principal subsidiary companies included in the consolidated financial statements and respective ownership interests of the Company as of December 31, 2006 are as follows:

Name	Nature of Business	Preferred and Common Shares	Voting Shares
		%	%
Exploration and production			
RN-Yuganskneftegaz LLC	Oil and gas production operator services	100.00	100.00
RN-Purneftegaz LLC	Oil and gas production operator services	100.00	100.00
RN-Sakhalinmorneftegaz LLC	Oil and gas production operator services	100.00	100.00
RN-Krasnodarneftegaz LLC	Oil and gas production operator services	100.00	100.00
RN-Stavropolneftegaz LLC	Oil and gas production operator services	100.00	100.00
Rosneft Severnaya Neft LLC (Northern Oil)	Oil and gas production operator services	100.00	100.00
CJSC RN-Astra	Oil and gas development and production	100.00	100.00
CJSC Sakhalinmorneftegaz Shelf	Oil and gas development and production	100.00	100.00
CJSC Komsomolskneft	Oil and gas development and production	100.00	100.00
OJSC Dagneftegaz	Oil and gas development and production	81.22	94.96
OJSC Rosneft-Dagneft	Oil and gas development and production	68.70	91.60
OJSC Grozneftegaz	Oil and gas production operator services	51.00	51.00
Caspoil LLC	Oil and gas development and production	75.10	75.10
CJSC Vostokshelf	Field survey and exploration	100.00	100.00
RN-Kazakhstan LLC	Field survey and exploration	100.00	100.00
RN-Kaiganneftegaz LLC	Field survey and exploration	100.00	100.00
CJSC Vostok-Smidt Neftegaz	Field survey and exploration	100.00	100.00
CJSC Zapad-Smidt Neftegaz	Field survey and exploration	100.00	100.00
Veninneft LLC	Field survey and exploration	100.00	100.00
CJSC Vankorneft	Field survey and exploration	100.00	100.00
Taymyrneft LLC	Investment activities	60.00	60.00
Anglo-Siberian Oil Company Limited	Holding company	100.00	100.00
Vostok Smidt Invest LLC	Investment activities	100.00	100.00
Zapad Smidt Invest LLC	Investment activities	100.00	100.00
Vostok-Energy LLC	Investment activities	51.00	51.00

1. General (continued)

Nature of Operations (continued)

Name	Nature of Business	Preferred and Common Shares	Voting Shares
		%	%
Refining, marketing and distribution			
RN-Tuapse Refinery LLC	Petroleum refining	100.00	100.00
RN-Komsomolsky Refinery LLC	Petroleum refining	100.00	100.00
OJSC Rosneft-MZ Nefteproduct	Petroleum refining	65.42	87.23
OJSC Rosneft-ARTAG	Marketing and distribution	38.00	50.67
OJSC Rosneft-Altainefteproduct	Marketing and distribution	64.18	78.59
RN-Arkhangelsknefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Kabardino-Balkarskaya Toplivnaya Company	Marketing and distribution	88.66	92.91
OJSC Rosneft-Kubannefteproduct	Marketing and distribution	89.50	96.61
OJSC Rosneft-Karachaevo-Cherkessknefteproduct	Marketing and distribution	85.99	87.46
OJSC Rosneft-Kurgannefteproduct	Marketing and distribution	83.32	90.33
OJSC Rosneft-Murmansknefteproduct	Marketing and distribution	45.38	60.51
RN-Nakhodkanefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Smolensknefteproduct	Marketing and distribution	66.67	86.97
RN-Tuapsenefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Yamalnefteproduct	Marketing and distribution	49.52	66.03
RN-Vostoknefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Stavropolye	Marketing and distribution	99.49	99.49
RN-Trade LLC	Marketing and distribution	100.00	100.00
OJSC Nakhodka Oil Seatrade Port	Transshipment	97.51	97.51
CJSC Exponeft	Marketing and distribution	45.38	60.51
Other			
Rosneft International Limited	Holding company	100.00	100.00
CJSC Rosnefteflot	Transportation services	100.00	100.00
OJSC All-Russian Bank for Reconstruction and Development of Russian Regions (VBRR)	Banking	76.47	76.47
CJSC Sakhalinskie Proekty	Corporate planning	100.00	100.00
CJSC Vostochny Neftenalivnoy Terminal	Services	100.00	100.00
RN-Burenie LLC	Service company	100,00	100,00
NK Rosneft NTC LLC	Research & development activities	64.22	64.22

All of the above subsidiaries, except for Rosneft International Ltd. and Anglo-Siberian Oil Company Limited, are incorporated in the Russian Federation. Rosneft International Ltd. is registered in Ireland, and Anglo-Siberian Oil Company Limited is registered in Cyprus.

Currency Exchange and Control

Foreign currencies, in particular the US dollar and the Euro, play a significant role in the underlying economics of many business transactions in Russia. For the oil and gas sector in particular, substantial export arrangements as well as investing and financing activities are conducted in foreign currencies, primarily the US dollar.

2. Significant Accounting Policies

Form and Content of the Consolidated Financial Statements

The Company maintains its books and records in accordance with accounting and taxation principles and practices mandated by the Russian legislation. The accompanying consolidated financial statements were derived from the Company's Russian statutory books and records with adjustments made to present them in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

The accompanying consolidated financial statements differ from the financial statements issued for statutory purposes in Russia in that they reflect certain adjustments, not recorded in the Company's statutory books, which are appropriate to present the financial position, results of operations and cash flows in accordance with US GAAP. The principal adjustments relate to: (1) recognition of certain expenses; (2) valuation and depreciation of property, plant and equipment; (3) foreign currency translation; (4) deferred income taxes; (5) valuation allowances for unrecoverable assets; (6) accounting for the time value of money; (7) accounting for investments in oil and gas property and conveyances; (8) consolidation principles; (9) recognition and disclosure of guarantees, contingencies, commitments and certain assets and liabilities; (10) accounting for asset retirement obligations; (11) business combinations and goodwill/negative goodwill.

Certain items in consolidated statements of income and cash flows for 2005 and 2004 were reclassified to conform to the current year presentation.

As discussed in the Note 3 below, the Company acquired OJSC Yuganskneftegaz on December 31, 2004, thus the results of operations of OJSC Yuganskneftegaz are included in consolidated statements of income starting January 1, 2005. As a result, the results of operations of the Company for 2004 are not comparable with the results for 2006 and 2005 without considering this matter. The share of sales of oil, extracted from OJSC Yuganskneftegaz's oil fields, and petroleum products produced from this oil for 2006 and 2005 in the total revenue of the Company is approximately 70% and 69%, respectively.

Management Estimates

The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheet as well as the amounts of revenues and expenses recognized during the reporting periods. Certain significant estimates and assumptions for the Company include: estimation of economically recoverable oil and gas reserves; rights to and recoverability and useful lives of long-term assets and investments; impairment of goodwill; allowances for doubtful accounts receivable; asset retirement obligations; legal and tax contingencies; environmental remediation obligations; recognition and disclosure of guarantees and other commitments; fair value measurements; ability to renew operating leases and to enter into new lease agreements; classification of certain debt amounts. Some of the most significant estimates were made in connection with the acquisition of OJSC Yuganskneftegaz. Management believes it has a reasonable and appropriate basis for its judgment pertaining to its estimates and assumptions. However, actual results could differ from those estimates.

Foreign Currency Translation

The management of the Company has determined the US Dollar as the functional and reporting currency for the purpose of financial reporting under US GAAP. Monetary assets and liabilities have been translated into US dollars using the official exchange rate as of the balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows are translated into US dollars at average exchange rates for the period or exchange rates prevailing on transaction dates where practicable.

2. Significant Accounting Policies (continued)

Foreign Currency Translation (continued)

Gains and losses resulting from the re-measurement into US dollars are included in the "Foreign exchange (loss)/gain" in the consolidated statements of income.

As of December 31, 2006 and 2005, the Central Bank of the Russian Federation ("CBR") official rates of exchange were 26.33 rubles and 28.78 rubles per US dollar, respectively. As of May 3, 2007, the official rate of exchange was 25.76 rubles ('RUB') per US dollar.

The translation of local currency denominated assets and liabilities into US dollars for the purposes of these financial statements does not indicate that the Company could realize or settle, in US dollars, the reported values of these assets and liabilities. Likewise, it does not indicate that the Company could return or distribute the reported US dollar value of capital to its shareholders.

Principles of Consolidation

The consolidated financial statements include the accounts of majority-owned, controlled subsidiaries and variable interest entities where the Company is a primary beneficiary. All intercompany transactions and balances have been eliminated. The equity method is used to account for investments in affiliates in which the Company has the ability to exert significant influence over the affiliates' operating and financial policies. The investments in entities where the Company holds the majority of shares, but the minority shareholders have significant influence, are also accounted for using the equity method. The Company's share in net profit or loss of equity investees also includes any other-than-temporary declines in fair value recognized during the period. Investments in other companies are accounted for at cost and adjusted for estimated impairment.

Minority Interest

Minority interests in the net assets and net results of consolidated subsidiaries are shown under "Minority interest" in the accompanying consolidated balance sheets and statements of income. For majority-owned subsidiaries that incur losses, the Company recognizes 100% of the losses, after first reducing the related minority interests' balances to zero, unless minority shareholders committed to fund the losses. Further, when a majority-owned subsidiary becomes profitable, the Company recognizes 100% of profits until such time as the excess losses previously recorded have been recovered. Thereafter, the Company recognizes profits in accordance with the underlying ownership percentage. The actual ruble-denominated balances attributable to minority interests may differ from these amounts presented in these consolidated financial statements.

Cash and Cash Equivalents

Cash represents cash on hand and in the Company's bank accounts and interest bearing deposits which can be effectively withdrawn at any time without prior notice or penalties reducing the principal amount of the deposit. Cash equivalents are highly liquid, short-term investments that are readily convertible to known amounts of cash and have original maturities of three months or less from their date of purchase. They are carried at cost plus accrued interest, which approximates fair value.

Accounts Receivable

Trade accounts receivable are stated at their principal amounts outstanding net of allowances for doubtful debts. Specific allowances are recorded against trade receivables whose recovery or collection has been identified as doubtful. Estimates of allowances require the exercise of judgment and the use of assumptions.

2. Significant Accounting Policies (continued)

Earnings per Share

Basic earnings per share is calculated by dividing net earnings attributable to common shares by the weighted average number of common shares outstanding during the corresponding period. In the absence of any securities-to-shares conversion transactions, the amount of basic earnings per share stated in these financial statements is equal to the amount of diluted earnings per share.

Inventories

Inventories, consisting primarily of crude oil, petroleum products and materials and supplies, are stated at the lower of weighted average cost of acquisition or market value. Market value shall not exceed net realizable value (i.e. the price at which inventories can be sold after allowing for the cost of completion and sale), and shall not be lower than net realizable values less the amount of margin.

Financial Investments

All debt and equity securities held by the Company are classified into one of the following three categories: trading securities; available-for-sale securities; held-to-maturity securities.

Trading securities are purchased and held principally for the purpose of sale in the nearest future. Held-to-maturity securities represent financial instruments that the Company has both the intent and the ability to hold to maturity.

All other securities, which do not fall into these two categories, are classified as available-for-sale securities.

Trading securities and available-for-sale securities are carried at fair (market) value. Held-to-maturity securities are stated at amortized cost. Unrealized gains or losses on trading securities are included in the consolidated statements of income. Unrealized gains and losses on available-for-sale securities less related tax effects are recorded as a separate component of comprehensive income until the date of disposal.

Realized gains and losses from the sale of available-for-sale securities are reported separately for each type of security. Dividends and interest income are recognized in the consolidated statements of income on an accrual basis.

Investments in shares or interests of companies where the Company has less than 20% equity interest and no significant influence, which are not publicly traded, and whose market value is not readily available, are carried at cost.

If the decline in fair value of an investment below its carrying value is other than temporary, the carrying value of the investment is reduced and a loss in the amount of any such decline is recorded. Cost method investments are evaluated for impairment when events or changes in circumstances occur which may have a significant effect on the fair value of these investments.

Sale and Repurchase Agreements and Securities Lending

Sale and repurchase agreements are treated as secured financing transactions. Securities sold under sale and repurchase agreements are included in trading securities. The corresponding liability is presented within short-term debt. The difference between the sale and repurchase price is treated as interest and is accrued over the life of repurchased agreements using the effective interest method.

2. Significant Accounting Policies (continued)

Oil and Gas Properties

In accordance with Statement of Financial Accounting Standard ("SFAS") 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies,* oil and gas properties and the related expenses are recognized under the successful efforts method. This method prescribes that exploration costs, including geological and geophysical costs and the costs of dry holes, are charged to expense when incurred.

Exploratory well costs (including costs associated with stratigraphic test wells) are temporarily capitalized pending determination of whether commercial oil and gas reserves have been discovered by the drilling effort. The length of time necessary for this determination depends on the specific technical or economic difficulties in assessing the recoverability of the reserves. If a determination is made that the well did not encounter oil and gas in economically viable quantities, the well costs are expensed and are reported in "exploration expenses".

Exploratory drilling costs are temporarily capitalized pending determination of whether the well has found proved reserves if both of the following conditions are met:

- The well has found a sufficient quantity of reserves to justify, if appropriate, its completion as a producing well, assuming that the required capital expenditure is made; and
- Satisfactory progress toward ultimate development of the reserves is being achieved, with the Company making sufficient progress assessing the reserves and the economic and operating viability of the project.

The Company evaluates the progress made on the basis of regular project reviews which take into account the following factors:

- First, if additional exploratory drilling or other exploratory activities (such as seismic work or other significant studies) are either underway or firmly planned, the Company deems there to be satisfactory progress. For these purposes, exploratory activities are considered firmly planned only if they are included in the Company's three-year exploration plan/budget. At December 31, 2006, exploratory drilling costs capitalized on this basis were not material.
- In cases where exploratory activity has been completed, the evaluation of satisfactory progress takes into account indicators such as the fact that costs for development studies are incurred in the current period, or that governmental or other third-party authorizations are pending or that the availability of capacity on an existing transport or processing facility awaits confirmation. At December 31, 2006, exploratory drilling costs capitalized on this basis were not material.

Should the project be deemed commercially viable, it is then transferred to the development stage, otherwise the costs are expensed.

Costs, including "internal" costs relating to drilling and equipping of development wells, including development dry holes, as well as costs required for drilling and equipping of injection wells in the process of oil and gas reserves development, are capitalized. These costs are included in oil and gas properties in the consolidated balance sheet.

Property, Plant and Equipment

Property, plant and equipment are stated at historical cost, net of accumulated depreciation. The cost of maintenance, repairs, and replacement of minor items of property is charged to operating expenses. Renewals and betterments of assets are capitalized.

Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are included in the statement of income.

2. Significant Accounting Policies (continued)

Depreciation, Depletion and Amortization

Depletion expense of acquisition costs of proved oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalized costs related to oil and gas production is calculated using the unit-of production method based on proved developed reserves. Management of the Company considers each extraction division as the appropriate level for these calculations.

Acquisition costs of unproved properties are not amortized. These costs are reclassified as proved properties when the relevant reserve reclassification is made. Acquisition costs of unproved properties are reviewed for impairment. In case of impairment these costs are expensed when incurred.

Depreciation and amortization charges with respect to property, plant and equipment other than oil and gas properties is computed using the straight-line method and based on their useful lives.

Depreciation rates are applied to similar types of buildings, machinery and equipment having similar economic characteristics, as shown below:

Asset Group	Average Useful Life
Buildings and constructions	30-35 years
Plant and machinery	15 years
Vehicles and other equipment	6 years
Service vessels	20 years
Offshore drilling assets	20 years

Interests in Joint Operations

A joint operation is a contractual arrangement whereby two or more parties (participants) undertake an economic activity that is subject to joint control. Joint control is only exercised when strategic, financial and operating decisions relating to the joint activity are made unanimously by all the parties. A joint venture is a registered company, partnership or any other legal form for the purposes of handling joint operations.

Financial results, assets and liabilities arising from interests in incorporated joint ventures are recognized in these consolidated financial statements using the equity method of accounting. Under the equity method, investments in joint ventures are recognized at the cost of financial investments increased by any change to the share of net assets from the date of inception of a joint venture, less distributed earnings and impairment of financial investments. The consolidated statements of income include the Company's share in gains and losses arising from joint ventures.

The Company discontinues the use of the equity method of accounting from the date on which it ceases to have joint control over, or have significant influence in, a jointly-controlled entity, or when its interest in a jointly-controlled entity is reclassified to assets held for sale.

Undivided interests in unincorporated oil and gas joint ventures are consolidated on a proportionate basis.

2. Significant Accounting Policies (continued)

Interests in Joint Operations (continued)

A part of an interest in a jointly-controlled oil and gas exploration and production entity may be assigned to other participants or third parties. In which case, in accordance with SFAS 19, such assignment is performed and accounted for under an arrangement called a "carried interest" whereby the assignee agrees to carry all costs of drilling, developing, and operating the property. The assignee is also entitled to all of the revenue from hydrocarbon production from the property, excluding any third party interest, until all of the assignee's costs, including the contractual rate of return, have been recovered, at such time the assignor will resume its participation in operating expenses and income.

Impairment of Long-Lived Assets

Long-lived assets, including blocks with proved oil and gas reserves, are assessed for potential impairment in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

Oil and gas properties are assessed whenever events or circumstances indicate potential impairment. If the carrying value of oil and gas properties is not recoverable through undiscounted cash flows, an impairment is recognized. The impairment is determined on the basis of the estimated fair value of oil and gas properties which, in turn, is measured by discounting future net cash flows or with reference to current market prices of oil and gas properties, if available. Discounted future cash flows from oil and gas fields are based on the most reliable management estimates of future prices that rely on recent actual prices and published prices for forward transactions; such prices are applied to forecast production volumes at particular fields with further discounting for the expected risk level.

Forecast production volumes shall be understood as reserves, including probable reserves that are proposed to be extracted using a known amount of capital expenditures. Production volumes and prices correspond to the internal plans and forecasts, as well as other data in the published financial statements. Assumptions regarding future prices and costs used to assess oil and gas properties for impairment differ from those used in the standard procedure for discounting net cash flows from proved oil and gas reserves.

Grouping of assets for the purpose of depreciation is performed on the basis of the lowest level of identifiable cash flows that are largely independent of the cash flows from other groups of assets – as a rule, for oil and gas properties such level is represented by the field, for refining assets – by the whole refining unit, for service stations – by the facilities. Long-lived assets intended by management for use during a period not exceeding one year are recorded at the lower of depreciated value or fair value, less selling expenses.

Acquisition costs of unproved oil and gas properties are assessed for impairment on a regular basis and any estimated impairment is charged to expenses.

Recoverability of oil and gas properties attributable to the refining, marketing and distribution segment is generally assessed on the basis of expected future cash flows from key operating units, usually entire legal entities. Since assets of this segment (particularly refining units) represent an integrated set of operations, this condition is taken into account in measuring the value of particular units or the extent of their utilization to generate other cash flows.

2. Significant Accounting Policies (continued)

Business Combinations

The Company accounts for its business acquisitions under the purchase method of accounting. The total cost of acquisitions is allocated to the underlying assets, including intangible assets, and liabilities based on their respective estimated fair values. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, licence and other asset lives and market multiples, among other items.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the acquisition cost over the fair value of net assets acquired. The excess of the fair value of the acquired share of net assets over their acquisition cost represents negative goodwill and is allocated among the non-current assets acquired, excluding investments and deferred tax assets, which may result in their value being reduced to zero.

For investees accounted for under the equity method, the excess of the cost to acquire a share in those entities over the fair value of the acquired share of net assets as of the acquisition date is treated as embedded goodwill and is considered in computing the Company's equity share in income/loss of equity investees.

In accordance with requirements of SFAS 142, *Goodwill and Other Intangible Assets*, goodwill and intangible assets with indefinite useful lives are not amortized. Instead, they are tested at least annually for impairment.

Intangible assets that have a finite useful life are amortized using the straight-line method over the shorter of their useful life or the term established by legislation.

Capitalized Interest

Interest expense related to the use of borrowed funds used for capital construction projects and acquisition of properties, plant and equipment is capitalized provided such interest expense could have been avoided if the Company had not made capital investments. Interest is capitalized only during the period when construction activities are actually in progress and until the resulting properties are put into operation. The Company capitalized US$ 109 million, US$ 79 million and US$ 22 million of interest expenses on loans and borrowings in 2006, 2005 and 2004, respectively.

Leasing Agreements

Capital leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the interest charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liabilities. Interest charges are charged directly to the consolidated statements of income.

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term unless leased assets are capitalized because the terms of the lease agreement grant the Company ownership rights over the leased assets by the end of the lease term or containing a bargain purchase option. In the latter cases capitalized assets are depreciated over the estimated useful life of the asset regardless of the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statements of income on a straight-line basis over the lease term.

2. Significant Accounting Policies (continued)

Asset Retirement Obligations

The Company has asset retirement obligations associated with its core business activities. The nature of the assets and potential obligations are as follows:

Exploration and Production – The Company's exploration, development and production activities involve the use of the following assets: wells, related equipment and operating sites, oil gathering and treatment facilities, tank farms and in-field pipelines. Generally, licences and other regulatory acts require that such assets be decommissioned upon the completion of production. According to these requirements, the Company is obliged to decommission wells, dismantle equipment, restore the sites and perform other related activities. The Company's estimates of these obligations are based on current regulatory or licence requirements, as well as actual dismantling and other related costs. Asset retirement obligations are calculated in accordance with the provisions of SFAS 143, *Accounting for Asset Retirement Obligations*.

Refining, Marketing and Distribution – This business segment covers refining operations, marine and other distribution terminals, and retail sales. The Company's refining operations consist of major petrochemical operations and industrial complexes. These industrial complexes have been in operation for several decades. The Company's management believes that given the nature of the operations, the useful lives of these industrial complexes are indeterminable, while certain of their operating components and equipment have definite useful lives. Legal or contractual asset retirement obligations related to petrochemical, oil refining, marketing and distribution activities are not recognized due to the limited history of such activities in these segments, the lack of clear legal requirements as to the recognition of obligations, as well as the fact that useful lives of such assets are not determinable.

The Company's marine and other distribution terminals, including its retail network, operate under the regulatory requirements of local authorities and lease arrangements. These requirements generally provide for elimination of the consequences of the use of those assets, including dismantling of equipment, restoration of land, etc. The Company's estimate of asset retirement obligations takes into account the above requirements.

SFAS 143 calls for measurements of asset retirement obligations to include, as a component of expected costs, an estimate of the price that a third party would demand, and could expect to receive, for bearing the uncertainties and unforeseeable circumstances inherent in the obligations, sometimes referred to as a market-risk premium.

To date, the oil and gas industry has few examples of credit-worthy third parties which are willing to assume this type of risk, for a determinable price, on major oil and gas production facilities and pipelines. Therefore, because determining such a market-risk premium would be an arbitrary process, it has been excluded from the SFAS 143 estimates.

Due to continuous changes in the Russian regulatory and legal environment, there could be future changes to the requirements and contingencies associated with the retirement of long-lived assets.

Fair Value of Financial Instruments

SFAS 107, *Disclosures about Fair Value of Financial Instruments,* defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

2. Summary of Significant Accounting Policies (continued)

Fair Value of Financial Instruments (continued)

Financial assets and financial liabilities recognized in the accompanying consolidated balance sheets include cash and cash equivalents, short-term and long-term investments, accounts receivable and payable, short-term and long-term debt and other current and non-current assets and liabilities.

The Company, using available market information, management's estimates and appropriate valuation methodologies, has determined the approximate fair values of financial instruments.

Income Taxes

Russian legislation does not contain the concept of a ‘consolidated tax payer’ and, accordingly, the Company is not subject to Russian taxation on a consolidated basis but rather on an individual company basis. Income taxes are provided on taxable profit as determined under the Russian Federation Tax Code. Deferred income tax assets and liabilities are recognized in the accompanying consolidated financial statements in the amount determined by the Company using the liability method in accordance with SFAS 109, *Accounting for Income Taxes*. This method takes into account future tax consequences, based on the effective tax rate, associated with differences between the carrying values of assets and liabilities and their taxable base, which gives immediate income statement effect to changes in income tax laws, including changes in the tax rates. A valuation allowance for a deferred tax asset is recorded when management believes that it is more likely than not that this tax asset will not be realized.

Recognition of Revenues

Revenues are recognized when title passes from the seller to the customer, the contract price is fixed or determinable and collectability of the receivable is reasonably assured. Specifically, domestic sales of crude oil and gas, as well as petroleum products and materials are recognized when title passes. For export sales, title generally passes at the border of the Russian Federation and the Company covers transportation expenses (except freight), duties and taxes on those sales. Revenues include excise taxes and custom duties (see Note 21).

Sales of support services are recognized as services are performed provided that the service price can be determined and no significant uncertainties regarding the receipt of revenues exist.

Transportation Expenses

Transportation expenses recognized in the consolidated statements of income represent all expenses incurred in the transportation of crude oil and petroleum products via the Transneft pipeline network, as well as by railway and other transport means. Transportation expenses also include all other shipping and handling costs.

Refinery Maintenance Costs

The Company recognizes the costs of overhauls and preventive maintenance performed with respect to oil refining assets as expenses when incurred.

Environmental Liabilities

Environmental expenditures are expensed or capitalized, depending upon their future economic benefit. Expenditures that relate to an existing condition caused by past operations, and do not have a future economic benefit, are expensed. Liabilities for these expenditures are recorded on an undiscounted basis when environmental assessments or clean-ups are probable and the costs can be reasonably estimated.

2. Summary of Significant Accounting Policies (continued)

Guarantees

The fair value of a guarantee is determined and recorded as a liability at the time when the guarantee is issued. The initial guarantee amount is subsequently remeasured to reflect the changes in the underlying liability. The expense is included in the related line items of the consolidated statements of income, based on the nature of the guarantee. When the likelihood of performing on a guarantee becomes probable, a liability is accrued, provided it is reasonably determinable on the basis of the facts and circumstances at that time.

Comprehensive Income

The Company applies SFAS 130, *Reporting Comprehensive Income,* which establishes standards for the calculation and reporting of the Company's comprehensive income (net income plus all other changes in net assets from non-owner sources) and its components in consolidated financial statements.

As of December 31, 2006, 2005 and 2004, there are no material comprehensive income items and, therefore, comprehensive income for 2006, 2005 and 2004 equals net income.

Accounting for Contingencies

Certain conditions may exist as of the date of these consolidated financial statements which may further result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company's management makes an assessment of such contingent liabilities which is based on assumptions and is a matter of opinion. In assessing loss contingencies relating to legal or tax proceedings that involve the Company or unasserted claims that may result in such proceedings, the Company, after consultation with legal or tax advisors, evaluates the perceived merits of any legal or tax proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a loss will be incurred and the amount of the liability can be estimated, then the estimated liability is accrued in the Company's consolidated financial statements. If the assessment indicates that a potentially material loss contingency 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 if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed. However, in some instances in which disclosure is not otherwise required, the Company may disclose contingent liabilities or other uncertainties of an unusual nature which, in the judgment of management after consultation with its legal or tax counsel, may be of interest to shareholders or others.

Taxes Collected from Customers and Remitted to Governmental Authorities

Excise taxes are reported gross within sales and other operating revenues and taxes other than income taxes, while other sales and value-added taxes are recorded net in taxes other than income taxes.

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Standards

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation ("FIN") 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS 109. FIN 48, which is the most significant change to accounting for income taxes since the adoption of the liability approach, creates a single model to address uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The interpretation also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 clearly scopes out income taxes from SFAS 5, *Accounting for Contingencies*.

FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the consolidated balance sheets prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The cumulative effect adjustment would not apply to those items that would not have been recognized in earnings, such as the effect of adopting FIN 48 on tax positions related to business combinations. The Company evaluated the impact of FIN 48 on the Company's financial statements and concluded that it would not be significant.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements*. The standard defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, this standard does not require any new fair value measurements. The guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company will apply this standard for financial statements issued for fiscal year beginning from January 1, 2008. The Company has not identified the impact this standard will have on the Company’s financial position and results of operations.

In September 2006, the FASB issued SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. The standard will require employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. The standard will make it easier for investors, employees, retirees and others to understand and assess an employer’s financial position and its ability to fulfill the obligations under its benefit plans. SFAS 158 applies to plan sponsors that are public and private companies and nongovernmental not-for-profit organizations. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006, for entities with publicly traded equity securities. The requirement to measure plan assets and benefit obligations as of the date of the employer’s fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Since the Company has no defined benefit pension plans, this standard will have no impact to the Company’s financial position and results of operations.

In June 2006, the FASB Emerging Issues Task Force (“EITF”) ratified EITF Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation).*Issue No. 06-3 requires disclosure of either the gross or net method of presentation for taxes assessed by a governmental authority resulting from specific revenue-producing transactions between a customer and a seller. For any such taxes reported on a gross basis, the entity must also disclose the amount of the tax reported in revenue in the interim and annual financial statements. The Company adopted the Issue effective December 31, 2006. See Note 2, Summary of Significant Accounting Policies (Taxes Collected from Customers and Remitted to Governmental Authorities) for additional information.

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Standards (continued)

The Company expects that EITF 06-3 will not have a material impact to the Company's financial statements.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The standard permits all entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company will apply this standard for financial statements issued for fiscal year beginning from January 1, 2008. The Company has not identified the impact this standard will have on the Company's financial position and results of operations.

3. Significant Acquisitions

Share Swap

In June 2006, the shareholders of Rosneft and of the Merging Subsidiaries (see Note 1) approved the conversion of their shares into the Company's shares at an agreed conversion ratio. Subsequent to this, the Merging Subsidiaries were merged with the Company. 1,220,939,458 shares of Rosneft were issued to acquire the shares of minority shareholders of these subsidiaries (11.52% of the Rosneft's share capital).

This acquisition of minority interest was accounted for as a purchase, in accordance with SFAS 141, *Business Combinations.* The fair value of purchase consideration, that is Rosneft shares, issued for the Share Swap, was determined based on the market value of the shares as of the date nearest to the date of all the terms of the deal were agreed to and amounted to US$ 9,218 million. The excess of the fair value of the shares issued over the fair value of minority interests acquired in the amount of US$ 69 million has been reflected as goodwill and relates to refining and marketing segment. The Company attributes this goodwill to the synergy effects from the merger. The majority of the purchase price was allocated to oil and gas properties, property, plant and equipment and mineral rights. Where the fair value of the net assets acquired exceeded the purchase price, negative goodwill existed which has reduced, on a pro rata basis, amounts assigned to the long-term assets acquired.

OJSC Yuganskneftegaz

In late December 2004, the Company acquired a 76.79% interest in OJSC Yuganskneftegaz, which represented 100% of the common shares of OJSC Yuganskneftegaz. The purpose of the transaction was to acquire the oil and gas properties held by OJSC Yuganskneftegaz and the purchase price was RUR 260,782 million (US$ 9,398 million at the CBR exchange rate in effect on the settlement date).

As discussed in Note 25 the Company's acquisition of OJSC Yuganskneftegaz is currently subject to court challenges in the Russian Federation and in the USA.

The Company consolidated the balance sheet of OJSC Yuganskneftegaz as of December 31, 2004 and the results of operations of OJSC Yuganskneftegaz from January 1, 2005. No results of operations are consolidated during the year ended December 31, 2004 given that the acquisition occurred on December 31, 2004.

Because the fair value of the net assets acquired exceeded the purchase price, negative goodwill existed which has reduced, on a pro rata basis, amounts assigned to the long-term assets acquired.

3. Significant Acquisitions (continued)

OJSC Yuganskneftegaz (continued)

The following table summarizes the Company's allocation of the assets acquired and liabilities assumed:

ASSETS		
Current assets:		
Restricted cash	$	14
Short–term investments		22
Accounts receivable		606
Inventories		94
Prepaid expenses		1
Total current assets		**737**
Oil and gas properties, net		7,276
Mineral rights		9,786
Property, plant and equipment, net		370
Construction–in–progress		41
Deferred tax assets		3
Leased equipment		175
Other non–current assets		4
Total non–current assets		**17,655**
Total assets	**$**	**18,392**
LIABILITIES		
Accounts payable	$	(760)
Short-term loans and borrowings and current portion long-term debt		(385)
Income and other tax liabilities		(2,231)
Other current liabilities		(6)
Total current liabilities		(3,382)
Long-term loans and borrowings net of current liabilities		(625)
Asset retirement obligations		(387)
Deferred tax liability		(3,834)
Total non-current liabilities		**(4,846)**
Total liabilities	**$**	**(8,228)**
Total net assets	**$**	**10,164**
Minority interest	**$**	**(766)**
Purchase price	**$**	**9,398**

Pro forma financial information assuming that the acquisition of OJSC Yuganskneftegaz had occurred as of the beginning of 2004 has not been presented herein as is required by SFAS 141. This information is not presented as the Company does not have access to reliable US GAAP financial information for OJSC Yuganskneftegaz for periods prior to acquisition.

For the purposes of valuation of oil and gas properties, property, plant and equipment, and construction-in-progress which relate to minority interest in OJSC Yuganskneftegaz, the Company used their appraised fair values as the previous controlling shareholder did not provide the records of the historical cost of these non-current assets. Minority interest which relates to other assets and liabilities was determined on the basis of historical cost.

3. Significant Acquisitions (continued)

CJSC Exponeft

In December 2006, the Company, through one of its subsidiaries, acquired a 100% equity interest in CJSC Exponeft, which owns a network of gasoline stations in the Murmansk region. The purchase price amounted to US$ 12.5 million and was paid in cash. The excess of the purchase price over the fair value of the net assets acquired was US$ 14 million and is accounted for as goodwill. The Company explains the existence of the goodwill by the potential increase in the market volume in the Murmansk region.

OJSC Nakhodka Oil Seatrade Port

In June 2006, the Company acquired 97.51% equity interest in OJSC Nakhodka Oil Seatrade Port. The purchase price amounted to US$ 19.5 million and was paid in cash. The purchase price was allocated to the fair value of assets acquired and liabilities assumed, the resulting goodwill amounted to US$ 9.5 million, which the Company attributes to synergy effect from the future integration with the operations of the Company's subsidiary LLC Rosneft-Nakhodkanefteprodukt.

The results of operations of the two aforementioned acquisitions are not significant and therefore do not warrant pro-forma presentation.

OJSC Daltransgaz

In February 2006, the Company purchased 25% of the additional issue of shares by OJSC Daltransgaz, an equity investee, for RUB 722 million (US$ 26 million at the CBR exchange rate as of date of settlement).

In August 2006, the Company again purchased 25% of the additional issue of shares by OJSC Daltransgaz for RUB 525 million (US$ 19 million at the CBR exchange rate as of the date of settlement). Through these purchases the Company maintained and continues to maintain its interest in OJSC Daltransgaz of 25% plus one share.

Taihu Ltd/OJSC Udmurtneft

In November 2006, the Company acquired a 51% equity share in Taihu Ltd, a joint venture created with the intention of managing the activity of OJSC Udmurtneft. The Company paid 5,100 Cyprus Pounds (approximately US$ 11 thousand) for this investment and is included within equity method investments - Other. The other party to the joint venture is China Petrochemical Corporation ("Sinopec") with a respective share of 49%. The Shareholder Agreement in respect of this joint venture stipulates that key decisions regarding its business shall be subject to unanimous approval by both participants and none of the participants has a preferential voting right. The Company accounts for this investment using the equity method of accounting (see Note 9).

In December 2006, Taihu Ltd, through its wholly owned subsidiary, acquired a 96.86% equity interest in OJSC Udmurtneft for US$ 3,541 million. The credit facility for financing the purchase of 96.86% shares of OJSC Udmurtneft was provided to Taihu Ltd by Bank of China and principally secured by OJSC Udmurtneft's shares, without recourse to the Company.

OJSC Udmurtneft is located in the Volga-Ural region of the Russian Federation and holds the licences for the development of 24 productive oil and gas condensate deposits. OJSC Udmurtneft is a group of 21 companies.

3. Significant Acquisitions (continued)

OJSC Verkhnechonskneftegaz

In the fourth quarter of 2005, the Company acquired 7,781,449 common shares (25.94% of the total number of common shares) of OJSC Verkhnechonskneftegaz. OJSC Verkhnechonskneftegaz holds the licence for the development of the Verkhnechonskoye oil and gas condensate deposit, which is the largest oil deposit in the Irkutsk region.

The purchase price amounted to US$ 230 million (RUB 6,637 million at the CBR exchange rate as at the date of the transaction) and was paid in cash. The acquisition price was fully allocated to the fair values of the acquired assets and liabilities. In these consolidated financial statements, the Company's interest in OJSC Verkhnechonskneftegaz shares is accounted for using the equity method (see Note 9).

Other Acquisitions of Additional Interests

OJSC Vserossiysky Bank Razvitiya Regionov

In July 2006, the Company won an auction and purchased 25.49% ordinary shares of OJSC Vserossiysky Bank Razvitiya Regionov ("VBRR") for RUB 333 million (US$ 12 million at the CBR exchange rate as of the date of settlement), thus increasing its interest in VBRR to 76.47%. The settlement was made in cash. The purchase price was fully allocated to the fair value of assets acquired and liabilities assumed.

OJSC Rosneft – Tuapsenefteprodukt (a Merging Subsidiary)

In January 2006, the Company, through one of its subsidiaries, purchased an additional 39.26% of the voting stock (30.24% of the share capital) of OJSC Rosneft – Tuapsenefteprodukt, a consolidated subsidiary. The purchase price amounted to US$ 100 million and was paid in cash. After the purchase, the Company's share in OJSC Rosneft – Tuapsenefteprodukt increased from 50.67% to 89.93% of voting shares (from 38.00% to 68.24% of the share capital).

The excess of purchase price over the fair value of the net assets acquired was US$ 34 million and is accounted for as goodwill. The Company explains the existence of the goodwill by expected additional positive effects arising from risk optimization which became possible after obtaining more than 75% of voting power.

OJSC Rosneft-Krasnodarneftegaz (a Merging Subsidiary)

In the first half of 2005, the Company acquired 33,337,187 common shares (38.66% of the total number of common shares) and 17,633,509 preferred shares (61.63% of the total number of preferred shares) in OJSC Rosneft-Krasnodarneftegaz, thus increasing its share in the share capital of OJSC Rosneft-Krasnodarneftegaz to 95.46%. The purchase price of the above shares amounted to US$ 110 million and was paid in cash.

The preliminary evaluation of the fair value of net assets acquired amounted to US$ 239 million based on a report of an independent appraiser. Because the fair value of the net assets acquired exceeded the purchase price, negative goodwill reduced, on a pro rata basis, amounts assigned to the long-term assets acquired, primarily oil and gas properties and mineral rights. The final purchase price allocation did not have a material effect on the carrying values of assets acquired and liabilities assumed.

3. Significant Acquisitions (continued)

Other Acquisitions of Additional Interests (continued)

OJSC Selkupneftegaz (a Merging Subsidiary)

In July 2005, the Company acquired 34 common shares (34% of the total number of common shares) in OJSC Selkupneftegaz, thus increasing its share in the share capital of OJSC Selkupneftegaz to 100%. The purchase price of the above shares amounted to US$ 20 million and was paid in cash.

The preliminary evaluation of the fair value of net assets acquired amounted to US$ 215 million based on a report of an independent appraiser. Because the fair value of the net assets acquired exceeded the purchase price, negative goodwill reduced, on a pro rata basis, amounts assigned to the long-term assets acquired, primarily mineral rights. The final purchase price allocation did not have a material effect on the carrying values of assets acquired and liabilities assumed.

4. Cash and Cash Equivalents

Cash and cash equivalents as of December 31 comprise the following:

		2006		2005
Cash at hand and cash in bank in RUB	**$**	**244**	$	414
Cash at hand and cash in bank – foreign currencies		**192**		394
Deposits and cash in transit		**69**		365
Total cash and cash equivalents	**$**	**505**	$	1,173

Restricted cash as of December 31 comprises the following:

		2006		2005
Obligatory reserve with the CBR	**$**	**18**	$	13
Other restricted cash		**11**		10
Total restricted cash	**$**	**29**	$	23

The obligatory reserve with the CBR represents the amounts deposited by the Company's subsidiary bank, VBRR with the CBR for securing the current operating activity of the bank. Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBR, the amount of which depends on the level of funds attracted by the credit institution and this amount has certain restrictions for use.

Cash accounts denominated in foreign currencies represent primarily cash in US$.

Deposits and other represent primarily bank deposits denominated in RUB that may be readily convertible into cash and may be withdrawn by the Company at any time without prior notice or penalties.

As part of its cash management and credit risk function, the Company regularly evaluates the creditworthiness of financial and banking institutions where it deposits cash. Banking relationships are primarily with Russian subsidiaries of international banking institutions and certain large Russian banks.

5. Short-Term Investments

Short-term investments as of December 31 comprise the following:

		2006		2005
Short-term loans granted	**$**	**2**	$	27
Loans to related parties		**34**		32
Trading securities				
Promissory notes		**91**		7
Corporate and state bonds		**170**		74
Other		**39**		10
Available-for-sale securities		**120**		–
Other		**4**		15
Total short-term investments	**$**	**460**	$	165

State bonds primarily represent federal loan bonds issued by the Ministry of Finance of the Russian Federation with maturities ranging from June 2007 to February 2036, coupon yields in 2006 ranging from 3.0% to 12.5% p.a. and yields to maturity ranging from 5.0% to 6.8% p.a., depending on the issue.

Corporate bonds represent bonds issued by large Russian corporations with maturities ranging from May 2008 to July 2014 and interest rates ranging from 7.4% to 13.8% p.a.

Short-term promissory notes mature in March and October 2007 and are interest free.

Available-for-sale securities represent promissory notes and loans maturing in March and December 2007 and bear interest rates of 7-14%.

Unrealized gains and losses on available-for-sale securities are not significant.

6. Accounts Receivable, Net

Accounts receivable as of December 31 comprise the following:

		2006		2005
Trade receivables	**$**	**1,176**	$	935
Value added tax receivable		**2,092**		1,536
Other taxes		**117**		88
Banking loans to customers		**580**		305
Accounts receivable from Yukos Oil Company		**810**		–
Other		**129**		63
Less: allowance for doubtful accounts		**(65)**		(69)
Total accounts receivable, net	**$**	**4,839**	$	2,858

The Company's trade accounts receivable are denominated primarily in US dollars. Credit risk is managed through the use of letters of credit, and requesting advance payments from customers for the majority of sales.

Value added tax receivable (VAT) primarily includes input VAT associated with export sales, which is reimbursed from the budget in accordance with Russian tax legislation.

Accounts receivable from Yukos Oil Company represent the fair value of 23.21% of the trade receivables of OJSC Yuganskneftegas which are due from the Yukos Oil Company, and were acquired as part of the Share Swap (see Note 3). The total value of the receivables (US$ 3,430 million at 100%) has been included in Yukos Oil Company's creditors register. The Company believes that US$ 3,430 million will be fully recovered as part of the ongoing Yukos Oil Company bankruptcy proceedings.

7. Inventories

Inventories as of December 31 comprise the following:

	2006	2005
Materials and supplies	**$ 348**	$ 332
Crude oil and gas	**329**	300
Petroleum products	**228**	182
Total inventories	**$ 905**	$ 814

Materials and supplies mostly include spare parts. Petroleum products also include those designated for sale as well as for own use.

8. Prepayments and Other Current Assets

Prepayments and other current assets as of December 31 comprise the following:

	2006	2005
Prepayments to suppliers	**$ 599**	$ 366
Insurance prepayments	**27**	46
Customs	**442**	451
Acquired debt receivable	**483**	–
Other	**38**	19
Total prepayments and other current assets	**$ 1,589**	$ 882

Customs primarily represent export duty prepayments related to the export of crude oil and petroleum products (see Note 21).

The Company and a group of banks led by Societe Generale S.A. entered into an agreement granting the Company the right to claim the outstanding balance due from Yukos Oil Company under a syndicated loan of US$ 1,000 million. Under this agreement, the right to claim the debt and other rights and benefits per the original loan agreement between the bank syndicate and Yukos Oil Company were transferred from the banks to the Company in March 2006 upon the payment of the outstanding loan principal, accumulated interest (up to the date of repayment), legal and other fees in the amount of US$ 483 million, of which US$ 20 million was advanced in 2005.

The amount of the debt has been included in Yukos Oil Company's creditors register. No interest is being accrued on this balance. As of December 31, 2006, the amount due from Yukos Oil Company is recognized as a current asset since it is anticipated that it will be recovered in full during the bankruptcy proceedings of Yukos Oil Company in 2007.

9. Long-Term Investments

Long-term investments as of December 31 comprise the following:

	2006	2005
Equity method investments		
Polar Lights Company LLC	**$ 132**	$ 94
CJSC Kaspiy-1	**–**	29
JV Rosneft-Shell Caspian Ventures Limited	**26**	21
OJSC Daltransgaz	**57**	11
OJSC Verkhnechonskneftegaz	**225**	231
Taihu Limited (see Note 3)	**–**	–
OT Belokamenka LLC	**2**	1
Other	**4**	3
Total	**446**	390
Available-for-sale securities		
Russian government bonds	**1**	2
Long-term promissory notes	**14**	7
Held-to-maturity		
Long-term loans granted	**9**	2
Long-term loans to equity investees	**80**	21
Investments in joint operations	**1**	4
Cost method investments	**17**	10
Total long-term investments	**$ 568**	$ 436

Equity share in income/(loss) of material investments recorded using the equity method:

	Participation interest (percentage) as of December 31, 2006	Share in income/(loss) of equity investees 2006	2005	2004
Polar Lights Company LLC	**50.00**	**$ 47**	$ 42	$ 50
CJSC Kaspiy-1	**41.22**	**(29)**	–	(1)
OJSC Verkhnechonskneftegaz	**25.94**	**(6)**	1	–
Taihu Limited (see Note 3)	**51.00**	**–**	–	–
Other	**various**	**5**	8	3
Total equity share		**$ 17**	$ 51	$ 52

Polar Lights Company LLC ("PLC")

PLC is a limited liability company owned 50% by Conoco Phillips Timan-Pechora Inc., and 50% by the Company. PLC is primarily engaged in the development of the Ardalin and satellite fields in the Timan-Pechora Basin located 125 kilometers south of the Barents Sea above the Arctic Circle. Development of the Ardalin field commenced in late 1992 and the first oil was produced in 1994.

9. Long-Term Investments (continued)

CJSC Kaspiy-1

In 1997, a subsidiary of the Company made a contribution to the share capital of CJSC Kaspiy-1 which was founded to construct an oil refinery in Makhachkala (Dagestan Republic). The refinery has been commissioned. Due to significant and continuous capacity underutilization, the Company considered that decline in fair value is other-than temporary and the carrying amount of this investment was fully written-down in the amount of US$ 29 million.

JV Rosneft-Shell Caspian Ventures Limited

JV Rosneft-Shell Caspian Ventures Limited ("JV") is a joint venture in which the Company holds a 51% interest. The Articles of Incorporation of this joint venture stipulate, however, that key decisions regarding its business shall be subject to unanimous approval by both participants and none of the participants has a preferential voting right.

On February 6, 1997, the Company, through the JV, signed an agreement with eight oil and gas companies and government agencies of the Russian Federation and the Republic of Kazakhstan for the establishment of Caspian Pipeline Consortium ("CPC"). The purpose of the consortium is to design, finance, construct and operate a pipeline from the oil fields located in Western Kazakhstan through Russia to the port of Novorossiysk. The interest of the JV in the CPC is 7.5%. In October 2001, the CPC pipeline was put in operation.

OJSC Daltransgaz

OJSC Daltransgaz is an operator for the program to supply gas to the Sakhalin Region and the Khabarovsk and Primorye Territories. See also Note 3.

OJSC Verkhnechonskneftegaz

OJSC Verkhnechonskneftegaz holds the licence for the development of the Verkhnechonskoye oil and gas condensate deposit, which is the largest oil deposit in the Irkutsk region.

Oil Terminal (OT) Belokamenka LLC

OT Belokamenka LLC is a floating storage facility constructed in 2004 in the nearby ice-free Kola Bay.

10. Oil and Gas Properties, Net

Oil and gas properties as of December 31 comprise the following:

		2006		2005
Wells and related facilities	**$**	**17,128**	$	12,606
Mineral rights		**19,356**		10,723
Pipelines		**1,627**		1,057
Equipment under capital lease (Note 13)		**26**		214
Total cost		**38,137**		24,600
Less: accumulated depletion		**(5,178)**		(3,661)
Total oil and gas properties, net	**$**	**32,959**	$	20,939

10. Oil and Gas Properties, Net (continued)

Mineral rights include costs to acquire unproved properties in the amount of US$ 3,878 million as of December 31, 2006, and US$ 1,382 million as of December 31, 2005. The Company plans to explore and develop the respective fields. The Company's management believes these costs are recoverable.

For the purposes of evaluation of the reserves as of December 31, 2006 and 2005 the Company used oil and gas reserves data prepared by DeGolyer and MacNaughton, independent reservoir engineers. The Company used the reserve report to calculate depreciation, depletion and amortization relating to oil and gas properties for 2006 and 2005. The reserve report was also used for the assessment of impairment of oil and gas assets and for the required supplemental disclosure for oil and gas activities (see supplementary oil and gas disclosure).

As described in the "Depreciation, depletion and amortization" section of Note 2, the Company calculates depletion using the unit-of-production method over proved or proved developed oil and gas reserves depending on the nature of the costs involved. The proved or proved developed reserves used in the unit of production method assume the extension of the Company’s production licences beyond their current expiration dates until the end of the economic lives of the fields as discussed below in further detail.

The Company’s oil and gas fields are located principally in the territory of the Russian Federation. The Company obtains licences from the governmental authorities to explore and produce oil and gas from these fields. The Company’s existing production licences generally expire during the period 2009 to 2031. Expiration dates of licences for the most significant fields are between 2013 and 2019, and the licence for the largest field, Priobskoye, expires in 2019. The economic lives of the major licenced fields extend significantly beyond these dates. Under Russian law, the Company is entitled to renew the licences to the end of the economic lives of the fields, provided certain conditions are met. Article 10 of the Subsoil Law, *Concerning Subsurface Resources,* provides that a licence to use a field “shall be” extended at its scheduled termination at the initiative of the subsoil user if necessary to finish production of the field, provided that there are no violations of the conditions of the licence.

The legislative history of Article 10 indicates that the term "shall" replaced the term "may" in August 2004, clarifying that the subsoil user has an absolute right to extend the licence term so long as it has not violated the conditions of the licence. In 2006, no licences came up for renewal. In 2005, the Company extended the terms of 39 of its production licences for the period equivalent to the expected life of the fields. There were no unsuccessful licence renewal applications.

The Company’s current production plans are based on the assumption, which management considers to be reasonably certain, that the Company will be able to extend all other existing licences. These plans have been designed on the basis that the Company will be producing crude oil through the economic lives of the fields and not with a view to exploiting the Company’s reserves to maximum effect only through the licence expiration dates. Accordingly, management has included in proved reserves in the supplementary information on oil and gas exploration and production activities of the consolidated financial statements as of and for the year ended December 31, 2006 all reserves that otherwise meet the standards for being characterized as "proved" and that the Company estimates the Company can produce through the economic lives of Company’s licensed fields.

Proved reserves should generally be limited to those that can be produced through the licence expiration date unless there is a long and clear track record which supports the conclusion that extension of the licence will be granted as a matter of course. The Company believes that extension of the licences will occur as a matter of course as fully described above.

10. Oil and Gas Properties, Net (continued)

RN-Yuganskneftegaz LLC (previously OJSC Yuganskneftegaz) in its operating activities enters into short-term lease contracts for a significant number of wells and related equipment and facilities. These agreements are entered into with the owners of the wells, equipment and facilities, which are certain subsidiaries of Yukos Oil Company. All of the lease agreements are cancellable in nature and most expire within one year. During 2005 and 2006, all the expired lease contracts were extended for a period of up to one year. The Company's management plans to attempt to further extend the above leases. Following a claim brought by OJSC Yuganskneftegaz in March 2006, the Moscow Arbitration Court ruled that the 100% ownership interest in one of the subsidiaries, which is by far the most significant lessor, should be transferred from Yukos Oil Company to OJSC Yuganskneftegaz (and following the Share Swap described in Note 3, was transferred directly to Rosneft). This ruling was upheld in the appeal hearings on June 1, 2006, which made it legally binding and enforceable. This ruling was also upheld in cassational hearing on July 26, 2006. Transfer of the ownership interest was made in the beginning of April, 2007 (see Note 28).

Sakhalin-1

The Company's primary investment in production sharing agreements ("PSA") is through the Sakhalin-1 project (PSA 1), which is operated by ExxonMobil, one of the PSA participants. In February 2001, the Company signed an agreement with Oil and Natural Gas Corporation ("ONGC") in relation to its interest in the PSA 1 which reduced the Company's interest to 20%. The Company recorded the investment in its retained share under the "carried interest" method. Commercial hydrocarbon production under PSA 1 commenced in October 2005. Accordingly, the Company's share in hydrocarbon reserves was reclassified as proved developed reserves.

On July 31, 2006, the Company repaid US$ 1.34 billion (including accumulated interest) to ONGC with respect to the costs of the Company carried by ONGC in previous years. Following this settlement the Company recovered the right to receive the income equivalent to its interest in the project. As of December 31, 2006, US$ 1.33 billion of the US$ 1.34 billion paid was recorded as oil and gas properties and the remaining amount was reflected in the appropriate lines of the balance sheet and the statements of income based on the nature of the cost originally incurred.

Sakhalin-5

The participants of the project are subsidiaries of the Company and BP p.l.c. In March 2004, the licence for geological study of the Kaigansko-Vasyukansky block held by the Company was transferred to CJSC Elvari Neftegaz, which is a 100% subsidiary of Elvary Neftegaz Holdings B.V., an entity jointly established by the participants of the project.

The Shareholders and Operating Agreement was signed between the participants and the operator in June 2004. In accordance with the terms of the agreement, during the exploration stage project funding will be fully provided by BP p.l.c., while during the development stage BP p.l.c. will carry a portion of payments due from the Company and will provide credit support to obtain project funding.

The Company recognizes this investment as an equity interest in a related company under the equity method of accounting.

10. Oil and Gas Properties, Net (continued)

Other Projects

The Company is a party to other projects associated with the development of the Sakhalin shelf (Zapadno-Shmidtovsky and Vostochno-Shmidtovsky blocks). Under those arrangements, the other participant (BP p.l.c.) has agreed to pay for exploration costs on behalf of the Company. Exploration and development of these projects is at an early stage. The Company's costs (currently insignificant) associated with these projects were capitalized.

In July 2005, the Company entered into a PSA agreement with the Kazakhstan Government for the joint development of the Kurmangazy oil and gas field. The participants of the project are a subsidiary of the Company, RN Kazakhstan LLC, and a subsidiary of Kazakhstan State JSC KazMunaiGaz, JSC "NK KazMunaiGaz – KazMunaiTeniz" ("KazMunaiTeniz"), with equal shares of 50%. The agreement provided for a signing bonus in the amount of US$ 50 million. The Company's share of US$ 25 million is recognized within mineral rights. In accordance with the terms of the agreement, upon a commercial discovery the Russian Federation has an option to buy a 25% share in the project at a future market price, by reducing the share of RN-Kazakhstan LLC in the project. If the Russian Federation does not exercise its option, this share shall be sold to third parties at a market price or redistributed between the participants in equal parts. If the share is sold, the proceeds from the sale shall cover the expenses already incurred, including those suffered by RN Kazakhstan LLC and related to the sold share. Any excess of the proceeds from the sale of share over the expenses shall be equally distributed between RN Kazakhstan LLC and KazMunaiTeniz.

11. Property, Plant and Equipment, Net

Property, plant and equipment as of December 31 comprise the following:

	2006	2005
Buildings and constructions	**$ 2,293**	$ 1,941
Plant and machinery	**1,214**	1,096
Vehicles and other equipment	**430**	356
Service vessels	**101**	8
Assets under capital lease (Note 13)	**6**	12
Total	**4,044**	3,413
Less: accumulated depreciation	**(1,446)**	(1,383)
Property, plant and equipment, net	**$ 2,598**	$ 2,030

12. Construction-in-Progress

Construction-in-progress as of December 31 comprises the following:

	2006	2005
Equipment to be installed	**$ 98**	$ 100
Buildings and constructions	**225**	303
Plant and machinery	**65**	106
Total construction-in-progress	**$ 388**	$ 509

Construction-in-progress includes various construction projects as well as machinery and equipment delivered but not yet installed.

13. Leased Property, Plant and Equipment

The following is the analysis of the property, plant and equipment under capital leases as of December 31:

	2006	2005
Oil and gas properties	**$ 26**	$ 214
Less: accumulated depletion	**(1)**	(10)
Oil and gas properties, net	**25**	204
Other property, plant and equipment		
Buildings and constructions	**–**	1
Plant and machinery	**3**	5
Vehicles	**3**	6
Total	**6**	12
Less: accumulated depreciation	**(2)**	(3)
Property, plant and equipment, net	**4**	9
Total net book value of leased assets	**$ 29**	$ 213

Below is the analysis of the repayment of capital lease obligations as of December 31:

	2006
2007	**$ 11**
2008	**3**
2009	**–**
2010	**–**
Imputed interest	**(1)**
Present value of capital lease payments	**$ 13**

Operating Lease

The Company has obligations which are primarily related to the operating lease for oil and gas facilities in the amount of US$ 62 million for 2007.

The total amount of operating lease expenses was as follows:

	2006	2005	2004
Total lease expenses	**$ 115**	$ 120	$ 16
Total sublease revenues	**$ 15**	$ 3	$ –

14. Goodwill

Goodwill in the amount of US$ 161 million represents the excess of the purchase price of additional shares in various entities in the refining, marketing and distribution segment acquired during 2005 and 2006, over the fair value of the corresponding share in net assets (See Note 3). As of December 31, 2006 and 2005, no impairment of goodwill was identified.

15. Other Non-Current Assets

Other non-current assets consist of advances given to Factorias Vulcano S.A for construction of three twin-hull shuttle oil tankers. As of December 31, 2006 the vessels were in the early stage of construction. The amount of the advance paid is US$ 145 million; the remaining part of the advance to be paid in 2007 is approximately US$ 95 million.

Advances paid for capital construction in the amount of US$ 142 million and US$ 15 million as of December 31, 2006 and 2005, respectively, are also included in other non-current assets.

16. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities as of December 31 comprise the following:

		2006		2005
Trade accounts payable	$	**851**	$	649
Salary and other benefits payable		**130**		157
Advances received		**350**		192
Dividends payable		**2**		60
Banking customer accounts		**386**		252
Promissory notes payable		**2**		2
Obligations under Total E&P Vankor claim (Note 25)		**134**		–
Other		**143**		46
Total Accounts payable and accrued liabilities	**$**	**1,998**	$	1,358

The Company's accounts payable are denominated primarily in RUB.

17. Short-Term Loans and Long-Term Debt

Short-term loans and borrowings as of December 31 comprise the following:

		2006		2005
Bank loans – US$ denominated	$	**79**	$	794
Bank loans – RUB denominated		**2,517**		9
Customer deposits – US$ denominated		**29**		42
Customer deposits – RUB denominated		**164**		96
Promissory notes payable		**771**		657
Other		**505**		456
		4,065		2,054
Current portion of long-term debt		**2,362**		1,951
Total short-term loans and current portion of long-term debt	**$**	**6,427**	$	4,005

US$ denominated bank loans bear interest rates from LIBOR plus 0.75% p.a. to LIBOR plus 3.02% p.a., mostly represent interbank loans raised by the Company's subsidiary bank. The RUB denominated loans generally bear an annual interest rate ranging from 4% to 8% p.a.

17. Short-Term Loans and Long-Term Debt (continued)

In December 2006, the Company opened a short-term credit line in Russian rubles with a state owned bank with a variable interest rate, dependent on the timing of the repayment period, ranging from 6.0% to 6.8% p.a.

Customer deposits represent fixed-term deposits placed by customers with the Company's subsidiary bank, denominated in RUB and foreign currencies. Customer deposits denominated in RUB bear an interest rate ranging from 3% to 12.6% p.a. Customer deposits denominated in foreign currencies bear an interest rate ranging from 1.75% to 8% p.a.

Promissory notes are primarily payable on demand with interest rates ranging from 0% to 18% p.a. The promissory notes are recorded at amortized cost.

Other borrowings primarily include four RUB-denominated loans provided to OJSC Yuganskneftegaz by Yukos Capital S.a.r.l., which bear interest of 9% p.a. and mature in 2007. As of December 31, 2006 and December 31, 2005, these loans are classified as current since the creditor demanded early repayment of these loans due to non-compliance with the terms of the loan agreements.

Long-term debt as of December 31 comprises the following:

	2006	2005
Bank loans – foreign currencies	**$ 4,826**	$ 4,220
Bank loans raised for funding the acquisition of OJSC Yuganskneftegaz – US$ denominated	**4,780**	5,743
Borrowings – US$ denominated	**30**	49
Customer deposits – foreign currencies	**15**	8
Borrowings – RUB denominated	**2**	9
Customer deposits – RUB denominated	**85**	60
Bonds of the subsidiary bank – RUB denominated	**4**	20
Other long-term liabilities – RUB denominated	**22**	40
	9,764	10,149
Current portion of long-term debt	**(2,362)**	(1,951)
Total long-term debt	**$ 7,402**	$ 8,198

The rates of interest on the Company's long-term bank loans denominated in US$ ranged from 4.35% to 5.97% p.a. Weighted average interest rates on these loans were 5.96% and 6.58% (LIBOR plus 0.64%, LIBOR plus 2.19%) as of December 31, 2006 and 2005, respectively. These bank loans are primarily secured by contracts for the export of crude oil.

In January 2006, a subsidiary of the Company registered in Cyprus signed a loan agreement with a major international bank for an amount of EUR 188 million or US$ 247.7 million at the CBR exchange rate as of December 31, 2006. The loan bears an interest rate of EURIBOR plus 0.35% p.a. The first drawdown was made during 2006 in the amount of EUR 115.88 million or US$ 152.69 million using the CBR exchange rate as of December 31, 2006. Funds borrowed are to be invested in the construction of ice-reinforced tankers for crude oil transportation purposes in north-western regions of the Russian Federation (see also Note 15). The loan is scheduled to be repaid within the twelve years following the completion of tanker construction.

In February 2006, the Company signed a loan agreement with a syndicate of Western banks for US$ 2,000 million with a term of 5 years. The loan bears interest at LIBOR plus 0.65% p.a. The loan funds were used to repay other loans with less favorable terms.

17. Short-Term Loans and Long-Term Debt (continued)

As of December 31, 2006 the bank loans raised for funding the acquisition of OJSC Yuganskneftegaz represent a long-term loan obtained through a government-owned bank at a rate of LIBOR plus 0.7% p.a. repayable in equal monthly installments. It is scheduled for repayment in 2011 and is secured by the Company's receivables under a long-term contract for the supply of crude oil (see Note 25).

Weighted average interest rates on US$ denominated borrowings were 8.85% and 8.67% as of December 31, 2006 and 2005, respectively.

Customer deposits include fixed-term RUB and foreign currency denominated customer deposits placed with the Company's subsidiary bank which mature primarily during 2007 and are included in the current portion of long-term debt. The RUB-denominated deposits bear an interest rate ranging from 5% to 12% p.a. Deposits denominated in foreign currencies bear an interest rate of 9% p.a.

As of December 31, 2006 other long-term liabilities include promissory notes with interest rates ranging from 0% to 4.75% which mature mostly in 2007. The promissory notes are recorded at amortized cost and are included in the current portion of long-term debt.

Generally, long-term loans are secured by oil export contracts. Usually, under the terms of such contracts, the lender is provided with an express right of claim for contractual revenue which must be remitted directly to transit currency (US$ denominated) accounts with those banks, should the Company fail to repay its debt in time.

The Company is obliged to comply with a number of restrictive financial and other covenants contained within its loan agreements. Restrictive covenants include maintaining certain financial ratios. As a result of the Company's acquisition of OJSC Yuganskneftegaz in December 2004, and the resulting debt incurred and assets and liabilities, including contingent liabilities, consolidated, the Company was not in compliance with various financial and other covenants of existing loan agreements as of that date.

In July 2005, the creditors waived violations related to restrictive financial ratios and agreed to amend the financial ratio covenants in line with the Company's new structure and new scope of activities. The creditors also waived other events of default arising from the breach of other covenant provisions. Effective January 1, 2007, the creditors granted amendments to the loan agreements which remove these provisions and have included new waivers which state that the Company must:

- redeem, secure, discharge in full or restructure (and comply with any restructuring plans once it is agreed upon) all OJSC Yuganskneftegaz's tax liabilities by January 3, 2008;
- pay any arbitration award relating to Moravel Litigation (see Note 25) or the Yukos Capital S.a.r.l. Litigation (see Note 17 above) if any such arbitration award is granted by a court of the Russian Federation, within the time frame provided for such payment under Russian Law.

These conditions also apply to certain new borrowings obtained throughout 2005 and 2006. Thus, as of December 31, 2005, long-term borrowings, for which creditors either waived events of default arising from the breach of certain covenant provisions amounted to US$ 2,831 million. This debt continued to be reflected as long-term in nature as of December 31, 2005. As of December 31, 2006, the Company was in compliance with all of the restrictive financial covenants. Following the amendments granted effective 1 January 2007, the Company is in compliance with all restrictive financial and other covenants contained within its loan agreements.

17. Short-Term Loans and Long-Term Debt (continued)

The aggregate maturity of long-term debt outstanding as of December 31, 2006 is as follows (assuming the debt will not be called by creditors ahead of scheduled maturities):

		2006
2007	$	**2,362**
2008		**2,468**
2009		**2,449**
2010		**2,114**
2011		**250**
2012 and after		**121**
Total long-term debt	**$**	**9,764**

To finance its current operations, acquisitions and to refinance its short-term loans, the Company continues to raise external funding. Operating income depends heavily on oil prices and oil export quotas available to the Company. In the event of a long-term drop in crude oil prices and a failure to raise external funding, the Company may be compelled to reduce its capital expenditures thus limiting its ability to maintain or increase the current level of oil production.

18. Shareholders' Equity

In June 2005, the Company contributed all of its shares to the share capital of OJSC Rosneftegaz, wholly owned by the State as represented by the Federal Agency for Federal Property Management.

In the third quarter of 2005, 1 share of Rosneft was transferred to the Federal Agency of Federal Property Management.

In the third quarter of 2005, Rosneft increased the number of common shares by splitting one common share with par value of RUB 1 into 100 common shares with par value of RUB 0.01. As a result the total number of shares issued and outstanding became 9,092 million. Net earnings per share for 2006 and the comparable data for 2005 and 2004 were calculated retrospectively based on the new number of outstanding shares.

In July 2006, the shareholders of Rosneft undertook an initial public offering of ordinary shares of Rosneft in Russia, as well as GDRs for these shares on the London Stock Exchange. 1,126 million of the Company’s ordinary shares were sold by the Company’s shareholders. Additionally, the Company issued 285 million new ordinary shares. As a result of the offering, the Company’s proceeds from sales of new shares amounted to US$ 2,115 million (net of commissions and expenses). The difference between the nominal value of the shares issued (US$ 105 thousand) and the amount received for shares (US$ 2,115,408 thousand) was recognized as additional paid-in capital.

In December 2006, the Federal Tax Service of the Russian Federation registered the change in the Company’s share capital, which was increased due to an additional share issue for the purposes of the Share Swap and consolidation of the Merging Subsidiaries (see Notes 1 and 3). The Company’s issued ordinary share capital was increased by 1,221 million shares to 10,598 million shares. The fair value of the shares issued was determined to be US$ 9,218 million (see Note 3). The difference between the par value (US$ 456 thousand) and the fair value (US$ 9,218,093 thousand) of the issued shares was recognized as additional paid-in capital of the Company.

The number of common shares authorized (in addition to shares issued) was 6,333 million and 7,839 million as of December 31, 2006 and 2005, respectively.

18. Shareholders' Equity (continued)

Amounts Available for Distribution to Shareholders

Amounts available for distribution to shareholders are based on the Company's unconsolidated statutory accounts prepared in accordance with Russian accounting standards, which differ significantly from US GAAP (see Note 2). Russian legislation identifies the basis of distribution as the current period consolidated net profit calculated in accordance with statutory accounting standards. According to Russian legislation, dividends cannot exceed the accounting income for the reporting year. However, this legislation and other statutory laws and regulations dealing with distribution rights are open to different legal interpretations.

In June 2006, the annual general shareholders' meeting approved dividends on the Company's common shares for 2005 in the amount of RUB 11.3 billion or US$ 424 million at the CBR exchange rate as at the date of decision, which corresponds to US$ 0.05 per share.

19. Income and Other Tax Liabilities

Income and other tax liabilities as of December 31 comprise the following:

	2006	2005
Mineral extraction tax	**$ 1,156**	$ 1,158
Value added tax	**615**	776
Excise tax	**73**	62
Personal income tax	**15**	19
Property tax	**36**	18
Income tax	**454**	644
Other	**123**	133
Total income and other tax liabilities	**$ 2,472**	$ 2,810

20. Minority Interest

As a result of the Share Swap (see Notes 1 and 3) minority owners' interests in Merging Subsidiaries with a carrying value of US$ 1,711 million were acquired.

21. Revenue Related Taxes

Revenues include the following:

	2006	2005	2004
Oil and gas sales			
Export customs duty	**$ 9,763**	$ 5,322	$ 535
Petroleum products sales and processing fees			
Export customs duty	**1,377**	942	171
Total revenue related taxes	**$ 11,140**	$ 6,264	$ 706

Petroleum products sales also include excise taxes which are presented in Note 22.

22. Income and Other Taxes

Income tax expenses for the years ended December 31 comprise the following:

	2006	2005	2004
Current income tax expense	**$ 2,385**	$ 1,688	$ 309
Deferred income tax benefit	**(1,845)**	(79)	(11)
Total income tax expense	**$ 540**	$ 1,609	$ 298

The Company does not file a consolidated tax return, rather each legal entity files separate tax returns with various authorities, primarily in the Russian Federation.

Temporary differences between these consolidated financial statements and tax records gave rise to the following deferred income tax assets and liabilities as of December 31:

	2006	2005
Deferred income tax asset arising from tax effect of:		
Tax loss carry-forward	**$ 100**	$ 101
Asset retirement obligations	**60**	54
Property, plant and equipment	**70**	75
Prepayments and other current assets	**9**	14
Accounts receivable	**1,135**	9
Accounts payable and accruals	**8**	32
Inventories	**9**	12
Long-term investments	**6**	5
Short-term investments	**–**	3
Other	**25**	22
Total	**1,422**	327
Valuation allowance for deferred income tax asset	**(177)**	(271)
Deferred income tax asset	**1,245**	56
Deferred income tax liability arising from tax effect of:		
Mineral rights	**(3,720)**	(2,172)
Other oil and gas properties, plant and equipment, and other	**(1,743)**	(1,564)
Deferred income tax liability	**(5,463)**	(3,736)
Net deferred income tax liability	**$ (4,218)**	$ (3,680)

The deferred income tax liability related to mineral rights, other oil and gas properties, plant and equipment, and other includes the deferred tax liability assumed as a result of the Share Swap (see Note 3) in the amount of US$ 1,961 million.

Deferred income tax asset related to accounts receivable primarily relates to the deferred tax asset recorded as a result of the favorable court decision on the Company's claim against Yukos Oil Company received at the end of 2006, whereby taxable non-operating income was recognized in tax records relating to the expected reimbursement of "lost profits" to the Company.

22. Income and Other Taxes (continued)

Classification of deferred taxes:

		2006		2005
Current deferred tax assets	**$**	**1,135**	$	48
Long-term deferred tax assets	**$**	**110**	$	8
Current deferred tax liabilities	**$**	**(17)**	$	(40)
Long-term deferred tax liabilities	**$**	**(5,446)**	$	(3,696)

Although the Company does not pay tax on a consolidated basis, a reconciliation of expected income tax expense to the actual tax expense for the years ended December 31 is as follows:

		2006		2005		2004
Income before income taxes	**$**	**4,165**	$	6,214	$	1,201
Statutory income tax rate		**24.00%**		24.00%		24.00%
Theoretical income tax expense		**1,000**		1,491		288
Add / (deduct) tax effect of:						
Change in valuation allowance		**(94)**		155		44
Effect of income tax preferences		**(77)**		(128)		–
Previously unrecognized deferred tax asset		**(539)**		(24)		–
Adjustments of income tax for prior periods		**(30)**		–		–
Permanent accounting differences arising from:						
Non-deductible items, net		**86**		45		4
Foreign exchange effects, net		**113**		(59)		(23)
Other permanent differences		**81**		129		(15)
Income taxes	**$**	**540**	$	1,609	$	298

During 2005, OJSC Yuganskneftegaz and OJSC Rosneft-Purneftegaz and during 2006 OJSC Yuganskneftegaz paid income tax at lower rates subject to a 3.5% - 4% income tax exemption under the regional laws. These laws provide that the income tax exemptions are granted to the oil and gas producing companies, which make capital investments, agreed with regional administrations, within the respective region and participate in various social projects, therefore increasing benefits to the regional budget. These exemptions are granted on an annual basis and are shown in the table above as 'Effect of income tax preferences'.

In addition to income tax, the Company accrued other taxes as follows:

		2006		2005		2004
Mineral extraction tax	**$**	**6,342**	$	4,716	$	739
Excise tax		**329**		286		88
Social security		**154**		118		98
Property tax		**107**		73		40
Land tax		**7**		14		13
Transport tax		**2**		2		1
Other taxes and payments		**49**		117		32
Taxes, other than income tax	**$**	**6,990**	$	5,326	$	1,011

23. Asset Retirement Obligations

The movement of asset retirement obligations is as follows:

	2006	2005
Asset retirement obligations as of the beginning of the reporting period	**$ 566**	$ 555
Recognition of additional obligations for new wells	**16**	5
Accretion expense	**34**	35
Increase/(decrease) as a result of changes in estimates	**132**	(27)
Spending on existing obligations	**–**	(2)
Asset retirement obligations as of the end of the reporting period	**$ 748**	$ 566

Asset retirement obligations represent an estimate of costs of wells liquidation, recultivation of sand pits, slurry ponds, disturbed lands and dismantling pipelines and power transmission lines.

Russian legislation does not stipulate any funds reservation for purposes of settling asset retirement obligations.

24. Related Party Transactions

In the course of its usual activity, the Company regularly enters into transactions with other enterprises which are directly or indirectly controlled by the Russian Government. Such enterprises are business units of RAO UES, OJSC Gazprom, OJSC Russian Railways, OJSC Sberbank, Vnesheconombank, OJSC Bank VTB, CJSC Gazprombank, OJSC Transneft and federal agencies including tax authorities. Management considers these business relations as part of regular activities in the Russian Federation and believes that they will remain unchanged in the foreseeable future.

Total amounts of transactions with companies controlled by the Government of the Russian Federation for each of the reporting periods ending December 31, as well as related party balances are provided in the table below:

	2006	2005	2004
Revenues			
Oil and gas sales	**$ 27**	$ 19	$ 12
Sales of petroleum products and processing fees	**148**	195	78
Support services and other revenues	**8**	2	1
	$ 183	$ 216	$ 91
Costs and expenses			
Pipeline tariffs and transportation costs	**$ 2,032**	$ 1,305	$ 430
Other expenses	**22**	1	–
	$ 2,054	$ 1,306	$ 430

24. Related Party Transactions (continued)

	2006	2005	2004
Other operations			
Purchases of property, plant and equipment	**$ 87**	$ 9	$ 1
Sale of short-term and long-term investments	**4**	38	725
Acquisition of short-term and long-term investments	**14**	38	294
Sale of shares in CJSC Sevmorneftegaz	**–**	1,303	–
Proceeds from short-term and long term debt	**2,463**	1,527	9,479
Repayment of short-term and long term debt	**2,104**	3,458	192
Deposits placed	**374**	1,945	226
Deposits paid	**499**	1,762	226
Borrowings issued	**131**	574	–
Repayment of borrowings issued	**134**	574	–
Interest expense	**384**	487	56
Interest income	**25**	–	1
Banking fees	**13**	12	2
Assets			
Cash and cash equivalents	**$ 69**	$ 376	$ 702
Accounts receivable and other current assets	**20**	23	2
Prepayments	**137**	154	14
Short-term and long-term investments	**172**	180	–
	$ 398	$ 733	$ 718
Liabilities			
Accounts payable	**$ 24**	$ 4	$ 2
Short-term and long-term debt (including interest)	**7,282**	6,890	10,506
	$ 7,306	$ 6,894	$ 10,508

Total amounts of transactions with other related parties, excluding the companies controlled by the Government of the Russian Federation, primarily equity investees and joint ventures, for each of the reporting periods ending December 31, as well as related party balances are provided in the table below:

	2006	2005	2004
Revenues			
Oil and gas sales	**$ 31**	$ 27	$ 2
Sales of petroleum products and processing fees	**84**	50	4
Support services and other revenues	**26**	60	36
	$ 141	$ 137	$ 42
Costs and expenses			
Purchase of oil and petroleum products	**$ 103**	$ 1	$ 6
Other expenses	**74**	64	26
	$ 177	$ 65	$ 32

24. Related Party Transactions (continued)

	2006	2005	2004
Other operations			
Acquisitions of property, plant and equipment	**$ 2**	$ 73	$ 21
Lease payments	**–**	29	14
Sales of short-term and long-term investments	**–**	514	809
Acquisition of short-term and long-term investments	**48**	345	756
Proceeds from short-term and long term debt	**33**	–	612
Repayment of short-term and long term debt	**51**	8	664
Borrowings issued	**88**	61	63
Repayment of borrowings issued	**22**	46	52
Interest expense	**4**	–	–
Interest income	**8**	–	–
Dividends received	**13**	19	13
Assets			
Accounts receivables and other current assets	**$ 33**	$ 13	$ 15
Prepayments	**42**	–	4
Short-term and long-term investments	**121**	128	232
	$ 196	$ 141	$ 251
Liabilities			
Accounts payable	**$ 193**	$ 24	$ 30
Short-term and long-term debt (including interest)	**9**	2	23
	$ 202	$ 26	$ 53

25. Commitments and Contingencies

Russian Business Environment

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government. In addition laws and regulations, including interpretations, enforcement and judicial processes, continue to evolve in Russia. Other laws and regulations and certain other restrictions producing a significant effect on the Company's industry, including, but not limited to the following issues: rights to use subsurface resources, environmental matters, site restoration, transportation and export, corporate governance, taxation, etc.

Taxation

Legislation and regulations regarding taxation in Russia continue to evolve. The various legislation and regulations are not always clearly written and their interpretation is subject to the opinions of the local, regional and national tax authorities. Instances of inconsistent opinions are not unusual.

The current regime of penalties and interest related to reported and discovered violations of Russia's laws, decrees and related regulations is severe. Interest and penalties are levied when an understatement of a tax liability is discovered. As a result, the amounts of penalties and interest can be significant in relation to the amounts of unreported taxes.

25. Commitments and Contingencies (continued)

Taxation (continued)

In Russia tax declarations remain open and subject to inspection for a period of up to three years. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review during the three-year period.

Russian transfer pricing rules were introduced in 1999, giving Russian tax authorities the right to make transfer pricing adjustments and impose additional tax liabilities in respect of all "controlled" transactions, provided that the transaction price deviates from the market price by more than 20%. Controlled transactions include transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions with significant (by more than 20%) price fluctuations.

The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and courts. Due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge the Group's prices and propose an adjustment. If such price adjustments are upheld by the Russian courts and implemented, the Group's future financial results could be adversely affected. In addition, the Group could face significant losses associated with the assessment of prior tax underpaid and related interest and penalties, which could have an adverse effect on the Group's financial condition and results of operations. The Company's management believes that such transfer pricing related tax contingencies are possible but will not have any significant impact on the Company's financial statements.

During 2005, tax audits of several subsidiaries for the years 2002-2003 took place. The results of these tax audits are currently being appealed with the tax authorities. The Company's management believes that the resolution of these matters will not have any significant impact on the Company's financial statements.

The Company and its certain subsidiaries are currently being audited by tax authorities for the years 2004-2006 (for the period up to September 30, 2006). The Company's management believes that the outcome of these tax audits will not have any significant impact on the Company's financial statements.

The Company provides finance for operations of its subsidiaries by various means which may lead to certain tax risks. The Company's management believes that the related tax contingencies are remote rather than possible and will not have any significant impact on the Company's financial statements.

The Company is currently appealing a number of decisions made by the tax authorities not to reimburse VAT paid by the Company. The Company's related claims in the amount of RUB 324 million (US$ 12 million at the CBR exchange rate as of the balance sheet date) have been upheld by various courts. The remaining claims in the amount of RUB 1,420 million (US$ 54 million at the CBR exchange rate as of the balance sheet date) are still being heard in the courts.

Overall, management believes that the Company has paid or accrued all taxes that are applicable. Where uncertainty exists, the Company has accrued tax liabilities based on management's best estimate of the probable outflow of resources embodying economic benefits, which will be required to settle these liabilities. Possible liabilities which were identified by management at the balance sheet date as those that can be subject to different interpretations of the tax laws and regulations are not accrued in the consolidated financial statements.

25. Commitments and Contingencies (continued)

Capital Commitments

The Company and its subsidiaries are engaged in ongoing capital projects for exploration and development of production facilities and modernization of refineries and the distribution network. The budgets for these projects are generally set on an annual basis. Depending on the current market situation, actual expenditures may vary from the budgeted amounts.

It is planned that future costs will be primarily self-financed. In addition, the Company is seeking external sources of financing. Management believes that the Company will receive all the financing required to complete both existing and scheduled projects.

Environmental Matters

Due to the nature of its business, Rosneft and its subsidiaries are subject to federal legislation regulating environmental protection. The majority of environmental liabilities arise as a result of accidental oil spills and leaks that pollute land, and air pollution. The Company considers fines paid and other environmental liabilities as immaterial, given the scale of its operations.

In the course of its operations, the Company seeks to comply with international environmental standards and monitors compliance therewith on a regular basis. With a view to improve environmental activities, the Company takes specific measures to mitigate the adverse impact of its current operations on the environment.

Legislation that regulates environmental protection in the Russian Federation is evolving, and the Company evaluates its liabilities in accordance therewith. Currently it is not possible to reasonably estimate the liabilities of the Company which may be incurred should the legislation be amended.

The management believes that, based on the existing legislation, the Company is unlikely to have liabilities that need to be accrued in addition to the amounts already recognized in the consolidated financial statements and that may have a material adverse effect on the operating results or financial position of the Company.

Social Commitments

The Company is required to maintain certain social infrastructure assets (not owned by the Company and not recorded in the consolidated financial statements) for use by its employees.

The Company incurred US$ 64 million, US$ 66 million and US$ 81 million in social infrastructure and similar expenses in 2006, 2005 and 2004, respectively. These expenses are presented as other expenses in the consolidated statement of income.

Charity and Sponsorship

During 2006, 2005 and 2004, the Company made donations of US$ 41 million, US$ 25 million and US$ 44 million, respectively, for charity and sponsorship in various regions of Russia where the Company operates. These expenses are presented as other expenses in the consolidated statements of income.

25. Commitments and Contingencies (continued)

Pension Benefits

The Company and its subsidiaries make payments to State Pension Fund of Russian Federation. These payments are calculated by the employer as percentage from the salary expense and are expensed as they are accrued.

The Company contributes to corporate pension fund to finance non-state pensions of its employees. These payments are done based on the defined contribution plan. In 2006, 2005 and 2004, the Company made contributions to non-state corporate pension fund amounting to US$ 41 million, US$ 16 million and US$ 13 million, respectively.

In 2006, the Company paid special termination benefits to the retiring employees in the amount of US$ 4.5 million.

Insurance

The Company insured its assets through the insurance company SK Neftepolis LLC.

As of December 31, 2006 and 2005, the amount of coverage on assets for such insurance was US$ 2,209 million and US$ 1,420 million, respectively.

Russian insurance providers do not offer business interruption insurance. Currently, it is not a common practice in Russia to obtain such insurance.

Guarantees and Indemnity

As of December 31, 2006, the Company has provided guarantees for certain debt agreements primarily of its subsidiaries. In accordance with the debt agreements, the Company is obliged to perform on the guarantee and to pay the bank all amounts of outstanding guaranteed liabilities, including interest.

The Company cannot substitute guarantees issued by any novation agreement or mutual offset. The Company’s obligations under guarantees issued are valid in case of any change in loan agreements.

After the full payment and settlement of all obligations under the guarantees, the Company has the right to subrogate its respective part of all bank claims against the debtor in accordance with the loan agreements. In the event the Company makes payments under guarantees issued, it has a right to claim the amounts paid from the debtor.

In December 2006, the Company signed a guarantee agreement in respect of all the obligations of CJSC Vankorneft per an irrevocable uncovered documentary letter of credit for the amount of EUR 30 million (US$ 40 million at the CBR exchange rate as of December 31, 2006) for a period of up to 730 days. In the event of default, specified in the agreement, the bank may request the Company to place a deposit with the issuing bank in the amount and for the period of validity of such letter of credit.

25. Commitments and Contingencies (continued)

Guarantees and Indemnity (continued)

The Company's outstanding guarantees as of December 31, 2006 are as follows:

Beneficiary Bank	Loan debtor	Maturity date	Contractual principal amount	Maximum guarantee amount as of December 31, 2006
Societe Generale S.A (as Facility Agent)	Yukos Oil Company	May 29, 2009	$ 1,600	$ 662

In May 2005, Moravel Investments Limited, an affiliate of Yukos Oil Company, filed an arbitral claim against OJSC Yuganskneftegaz in the London Court of International Arbitration for the recovery of US$ 662 million pertaining to the loan of US$ 1,600 million from Societe Generale S.A. The case was heard in July 2006. On April 16, 2007, the London Court of International Arbitration made an intermediate ruling to dismiss Moravel's claim to OJSC Yuganskneftegaz. On April 26, 2007, Moravel informed the Company that in its view the intermediate ruling was a nullity and accused the Company of a repudiatory breach of the arbitration clause contained in the guarantee under which the London Court of International Arbitration was brought. Moravel reserved its rights to challenge the interim ruling. The Company expects to receive the final ruling in May, 2007. The Company believes that the probability of any payments under the above guarantee is remote. On March 17, 2006, the Moscow Arbitration Court ruled that the guarantee agreement signed by OJSC Yuganskneftegaz with respect to Yukos Oil Company loan received from Societe Generale S.A. in the amount of US$ 1,600 million was invalid. This ruling was upheld on May 15, 2006 by the 9th Appeal Arbitration Court in appeal hearings, which made it legally binding and enforceable. This ruling was also upheld in cassational instance on August 31, 2006.

Litigation, Claims and Assessments

In 2002, an option agreement was entered into between Total E&P Vankor (Total) and Anglo-Siberian Oil Company Limited (ASOC) under which Total had a conditional option to buy the latter's 60% stake in Taimyrneft LLC which ASOC held through Anglo-Siberian Oil Company Limited (Cyprus) (ASOC Cyprus) for US$ 1 million. ASOC and ASOC Cyprus belong to the Rosneft International Group.

During 2004, Total E&P Vankor issued a claim against ASOC Cyprus for US$ 640 million under the sale and purchase agreement for a 52% share in Eniseineft LLC. Total alleged that under the terms of a sale agreement, the shareholding in Eniseineft LLC should have been sold to them. The Company contested this on the grounds that the relevant conditions precedent to the sale had not been met. The arbitration proceedings were completed in 2006 and the final decision was made in late 2006 in the Company's favor. Apart from the court expenses, which are not significant for the Company, there are no additional liabilities related to this claim. No additional actions have been taken by any of the parties regarding this case.

Total obtained injunctions in various jurisdictions to prevent ASOC Cyprus from trading in the shares of Taimyrneft LLC. In 2005 Total E&P Vankor filed an arbitration claim, asking to exercise the option or cover the losses amounting to above US$ 700 million. In the early 2007 the court decision was made to collect US$ 116 million from ASOC Cyprus in favor of Total including interest at 6.5% p.a. from December 31, 2004 to the date of payment and to compensate Total for the related court expenses of US$ 2.8 million. The amounts to be paid are recognized in full in these financial statements.

25. Commitments and Contingencies (continued)

Litigation, Claims and Assessments (continued)

The Company is a co-defendant in the litigation in the USA in respect of the acquisition of OJSC Yuganskneftegaz. This litigation was brought by certain holders of American Depository Receipts ("ADRs") of Yukos Oil Company seeking unspecified damages due to the fall in market value of the ADRs. On July 13, 2006, plaintiffs filed an amended complaint. The amended complaint seeks to recover from alleged loss resulting from events surrounding Yukos Oil Company, including levying of taxes upon Yukos Oil Company by the Russian Federation, the arrest of certain assets of Yukos Oil Company to pay owed taxes. Defendants filed motions to dismiss on numerous grounds. The Company believes that this claim is without merit.

The Company is also a co-defendant in litigation in the Moscow Arbitration Court with respect to the auction for the common shares of OJSC Yuganskneftegaz. This litigation was brought by Yukos Oil Company. The claimant is seeking to recover all the common shares of OJSC Yuganskneftegaz and also damages in the total amount of RUB 388 billion (approximately US$ 14.7 billion at the CBR exchange rate as of December 31, 2006). In February 2007, the Moscow Arbitration Court dismissed Yukos Oil Company's claim. Yukos Oil Company subsequently filed an appeal which is scheduled to be heard on May 7, 2006.

The Company's subsidiaries are involved in other litigations which arise from time to time in the course of their business activities. The Company's management believes that the ultimate result of these litigations will not significantly affect the operating results or financial position of the Company.

Licence Agreements

In accordance with certain licence agreements or separate agreements concluded from time to time with the local and regional authorities the Company is required to maintain certain levels of expenditures for health, safety and environmental protection, as well as maintain certain level of capital expenditures. Generally these expenditures are within the normal operating and capital budgets and are accounted for when incurred in accordance with existing accounting policies for respective costs and expenses.

Oil Supplies

In January 2005, the Company entered into a long-term contract until 2010 with China National United Oil Corporation for export supplies of crude oil in the total amount of 48.4 million tonnes to be delivered in equal annual amounts. The prices are determined based on usual commercial terms for crude oil deliveries.

26. Segment Information

Presented below is information about the Company's operating segments in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information.* The Company determines its operating segments based on the nature of their operations. The performance of these operating segments is assessed by management on a regular basis. The exploration and production segment is engaged in field exploration and development and production of crude oil and natural gas. The refinery, marketing and distribution segment is engaged in processing crude oil and other hydrocarbons into petroleum products, as well as purchasing, sale and transportation of crude oil and petroleum products. The other activities segment consists of banking, finance services, drilling services, construction services and other activities. Substantially all of the Company's operations are conducted in the Russian Federation. Further, the geographical regions within the Russian Federation have substantially similar economic and regulatory conditions. Therefore, the Company has not presented any separate geographical disclosure.

26. Segment Information (continued)

The significant accounting policies applied to each operating segment are consistent with those applied to the consolidated financial statements. Sales transactions for goods and services between the operating segments are carried out using prices agreed upon between Rosneft and its subsidiaries.

Operating segments in 2006:

	Exploration and production	Refining, marketing and distribution	Other activities	Total elimination	Consolidated
Revenues from external customers	**$ 442**	**$ 32,460**	**$ 197**	**$ –**	**$ 33,099**
Intersegmental revenues	**10,465**	**1,287**	**903**	**(12,655)**	**–**
Total revenues	**$ 10,907**	**$ 33,747**	**$ 1,100**	**$ (12,655)**	**$ 33,099**
Operating expenses and cost of purchased oil and petroleum products	**$ 1,670**	**$ 1,635**	**$ 212**	**$ –**	**$ 3,517**
Depreciation, depletion and amortization	**$ 1,420**	**$ 201**	**$ 17**	**$ –**	**$ 1,638**
Operating income	**$ 2,126**	**$ 15,367**	**$ 766**	**$ (12,655)**	**$ 5,604**
Total other income, net					**(1,439)**
Income before income tax					**$ 4,165**
Total assets	**$ 33,934**	**$ 10,757**	**$ 2,099**	**$ –**	**$ 46,790**

Operating segments in 2005:

	Exploration and production	Refining, marketing and distribution	Other activities	Total elimination	Consolidated
Revenues from external customers	$ 378	$ 23,151	$ 334	$ –	$ 23,863
Intersegmental revenues	9,534	797	297	(10,628)	–
Total revenues	$ 9,912	$ 23,948	$ 631	$ (10,628)	$ 23,863
Operating expenses and cost of purchased oil and petroleum products	$ 1,333	$ 863	$ 64	$ –	$ 2,260
Depreciation, depletion and amortization	$ 1,320	$ 143	$ 9	$ –	$ 1,472
Operating income	$ 1,781	$ 13,902	$ 467	$ (10,628)	$ 5,522
Total other income, net					692
Income before income tax					$ 6,214
Total assets	$ 23,005	$ 5,841	$ 1,170	$ –	$ 30,016

26. Segment Information (continued)

Operating segments in 2004:

	Exploration and production	Refining, marketing and distribution	Other activities	Total elimination	Consolidated
Revenues from external customers	$ 226	$ 4,805	$ 231	$ –	$ 5,262
Intersegmental revenues	1,899	317	275	(2,491)	–
Total revenues	$ 2,125	$ 5,122	$ 506	$ (2,491)	$ 5,262
Operating expenses and cost of purchased oil and petroleum products	$ 344	$ 669	$ 129	$ –	$ 1,142
Depreciation, depletion and amortization	$ 193	$ 103	$ 11	$ –	$ 307
Operating income	$ 590	$ 2,818	$ 289	$ (2,491)	$ 1,206
Total other expenses, net					(5)
Income before income tax					$ 1,201
Total assets	$ 21,282	$ 3,653	$ 1,077	$ –	$ 26,012

Below is a breakdown of revenues by domestic and export sales, with a classification of export sales based on the country of incorporation of the foreign customer.

Oil and gas sales	**2006**	2005	2004
Export sales of crude oil – Europe	**$ 15,888**	$ 11,489	$ 1,689
Export sales of crude oil –Asia	**5,145**	2,303	353
Export sales of crude oil – CIS	**1,620**	1,491	411
Export sales of crude oil – other directions	**435**	94	60
Domestic sales of crude oil	**214**	600	104
Domestic sales of gas	**197**	175	118
Total oil and gas sales	**$ 23,499**	$ 16,152	$ 2,735

Petroleum products and processing fees	**2006**	2005	2004
Export sales of petroleum products – Europe	**$ 3,152**	$ 2,827	$ 344
Export sales of petroleum products – Asia	**1,941**	1,618	640
Export sales of petroleum products – CIS	**202**	64	–
Domestic sales of petroleum products and processing fees	**3,955**	2,865	1,249
Total petroleum products and processing fees	**$ 9,250**	$ 7,374	$ 2,233

During the reporting periods, different three customers in 2006 and different single customers in 2005 and 2004, whom are international oil traders accounted for revenues of US$ 18,001 million, US$ 5,041 million and US$ 831 million or 54%, 21% and 16% of gross revenues, respectively. These revenues are recognized mainly under the Refining, Marketing and Distribution segment. Management does not believe that the Company is dependent on any particular customer.

27. Fair Value of Financial Instruments and Risk Management

The Company, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks. The Company manages these risks and monitors its exposure on a regular basis.

The fair value of cash and cash equivalents, accounts receivable and accounts payable, other current assets, asset retirement obligations, promissory notes receivable approximates their carrying value recognized in these financial statements. The Company's management believes that accounts receivable recorded net of allowance for doubtful accounts will be recovered in full during an acceptable time period. The fair value of long-term debt differs from amounts recognized in the consolidated financial statements. The estimated fair value of long-term debt discounted using the estimated market interest rate for similar financial liabilities amounted to US$ 9,710 million, US$ 10,026 million and US$ 10,012 million as of December 31, 2006, 2005 and 2004, respectively. These amounts include all future cash outflows related to the repayment of long-term loans, including their current portion and interest expenses.

A substantial portion of the Company's sales revenues is received in US dollars. In addition, substantial financing and investing activities, obligations and commitments are also undertaken in US dollars. However, significant operating and investing expenditures, other obligations and commitments as well as tax liabilities are undertaken in rubles. As a result of any decline of the US dollar against the ruble, the Company is exposed to the corresponding currency risk. Starting from January 2007, the Company entered into agreements for forward sale of currency denominated revenue at fixed exchange rate in order to hedge currency risk.

28. Subsequent Events

In January 2007, a new company, Truboprovodny Consortium Burgas-Alexandroupolis LLC was registered with Equity of RUB 9.1 million (0.4 US$ million at the CBR exchange rate as of the registration date). This company was created by three companies – OJSC Transneft, OJSC Gazprom and the Company with equal equity participation.

In January 2007, the Company paid RUB 629 million (US$ 24 million at the CBR exchange rate as of the transaction date) to acquire 55,331,951 ordinary shares of OJSC Ohinskaya TETS, which represents 85.61% of its equity. This acquisition is not material.

In January 2007, the Company bought 339,582 ordinary shares of additional share issue of OJSC Verhnechonskneftegaz paying RUB 201 million (US$ 7.6 million at the CBR exchange rate as of the transaction date). Through this purchase the Company maintained its previous share of 25.94% in this investment.

In January 2007, the Company entered into a long-term contract until 2009 with a Russian producer of steel pipes for the supply of various types of pipes used in the oil and gas industry. The purchase price of the products will be fixed twice a year and depends on the product mix.

In January 2007, the Company signed a guarantee agreement in respect of all the obligations of Vankorneft per the irrevocable uncovered documentary letter of credit for the amount of US$ 62 million and the period of up to 730 days. In the event of default, as specified in the agreement, the bank may request the Company to place a deposit in the amount necessary to ensure all of the Company's existing and potential obligations are payable for the period of validity of such letter of credit.

28. Subsequent Events (continued)

In February 2007, the Company signed and drew down a six month bridge-loan from a consortium of international banks in the amount of US$ 2.5 billion at LIBOR plus 0.25-0.30% p.a, depending on the final settlement date. These funds are to be used for temporary refinancing (until other long-term loans are received) of short term loans obtained from the Russian banks in the fourth quarter of 2006, with less favorable terms.

In March 2007, two companies of the Group signed loan agreements with a consortium of international banks which assume the following terms: part of loan for the amount of US$ 9,5 billion is for 6 months, US$ 6 billion is for 12 months and US$ 6,5 billion is for 18 months. These loan agreements are at LIBOR plus 0.25-0.50% annual interest rate depending on the final settlement date. These loans were drawn to finance the planned acquisition of assets during the auctions for sales of the assets of Yukos Oil Company. The total amount drawn down up to May 3, 2007 was US$ 11,555 million.

On March 27, 2007, RN-Razvitie LLC, the Company's wholly owned subsidiary, won the auction for the acquisition of 1 billion ordinary shares of Rosneft (9.44% of share capital) and promissory notes of OJSC Yuganskneftegaz from Yukos Oil Company. RN-Razvitie LLC offered RUB 197.84 billion (US$ 7.59 billion at the CBR exchange rate as of the date of the auction), or RUB 194.28 for 1 share (US$ 7.45 at the CBR exchange rate as of the date of the auction). The face value of the promissory notes amounted to RUB 3,558 million (US$ 136 million at the CBR exchange rate as of the date of the auction), for which RUB 3,601 million was paid (US$ 138 million at the CBR exchange rate as of the date of the auction). Title to the shares and promissory notes was transferred to RN-Razvitie LLC on April 17, 2007.

Rosneft and Sinopec have signed a Shareholder and Operating Agreement related to their joint work in exploring and developing the Veninsky block of fields on the shelf of Sakhalin Island (Sakhalin-3 project). According to the document, which was signed on March 26, 2007 in Moscow, the wholly owned subsidiaries of Rosneft and Sinopec – Rosneft International Limited and Sinopec Overseas Oil and Gas Limited – will become the owners of Venin Holding Ltd., which was established in October 2006. Venin Holding Ltd. will in turn be the sole shareholder of Venineft LLC, the licence holder and operator of the Sakhalin-3 project. Rosneft will have a 74.9% stake in the project, with the remaining 25.1% owned by Sinopec. The Company considers Venin Holding Ltd. to be a joint venture under the joint control of Rosneft and Sinopec and will account for this investment using the equity method of accounting.

On April 3, 2007, the Company acquired 100% interest in CJSC Yukos-Mamontovo for no consideration. Transfer of rights of ownership was made by the Moscow Arbitration Court. CJSC Yukos-Mamontovo is an owner of wells and related facilities leased by RN-Yuganskneftegas (see Note 10). This acquisition is not expected to have a significant impact on the Company's financial statements.

On May 3, 2007, Neft-Aktiv LLC, the Company's wholly owned subsidiary, won the auction for the sale of certain assets of Yukos Oil Company. These assets comprise shares in various exploration and production and refining and marketing companies in Eastern Siberia. Neft-Aktiv LLC offered RUB 175.7 billion (US$ 6.82 billion at the CBR exchange rate as of the date of the auction).

Supplementary Oil and Gas Disclosure (unaudited)

In accordance with SFAS 69, *Disclosures about Oil and Gas Producing Activities*, the Company makes certain supplemental disclosures about its oil and gas exploration and production operations. While this information was developed with reasonable care and disclosed in good faith, it is emphasized that the data represents management's best estimates. Accordingly, this information may not necessarily represent the current financial condition of the Company and its expected future financial results.

All of the Company's activities are conducted in Russia, which is considered as one geographic area.

Capitalized Costs Relating to Oil and Gas Producing Activities

	As of December 31,	
	2006	**2005**
Oil and gas properties related to proved reserves	**$ 34,259**	$ 23,218
Oil and gas properties related to unproved reserves	**3,878**	1,382
Total	**38,137**	24,600
Accumulated depreciation, depletion and amortization, and valuation allowances	**(5,178)**	(3,661)
Net capitalized costs	**$ 32,959**	$ 20,939

The share of the Company in the capitalized costs of equity investees on December 31, 2006 was US$ 388 million. On December 31, 2005, the share of the Company was immaterial.

Cost Incurred in Oil and Gas Property Acquisition, Exploration and Development Activities

	2006	**2005**	**2004**
Acquisition of proved oil and gas properties	**$ 8,392**	$ 3,475	$ 11,877
Acquisition of unproved oil and gas properties	**2,350**	487	775
Exploration costs	**193**	164	51
Development costs	**2,795**	1,606	568
Total costs incurred	**$ 13,730**	$ 5,732	$ 13,271

The share of the Company in acquisition, exploration and development expenditures of its equity investees was US$ 46 million in 2006, and was immaterial during 2005 and 2004.

Results of Operations for Oil & Gas Producing Activities

	2006	**2005**	**2004**
Revenues:			
External sales	**$ 11,246**	$ 9,313	$ 1,909
Transfers to other operations	**5,216**	4,416	935
Total revenues	**16,462**	13,729	2,844
Production costs (excluding production taxes)	**1,632**	1,333	344
Selling, general and administrative expenses	**480**	229	81
Exploration expense	**193**	164	51
Accretion expense	**34**	35	8
Depreciation, depletion and amortization	**1,420**	1,426	250
Taxes other than income tax	**6,636**	4,735	853
Income tax	**1,384**	1,274	174
Results of operation for producing activities	**$ 4,683**	$ 4,533	$ 1,083

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Results of Operations for Oil & Gas Producing Activities (continued)

In prior periods the Company presented revenues within results of operations for oil and gas producing activities consistent with those presented in the Company's operating segment disclosure. In 2006, the Company changed the presentation of results of operations for oil and gas producing activities for all periods presented to include revenues based on market prices determined at the point of delivery from production units.

The Company's share in the results of operations for oil and gas production of equity investees in 2006, 2005 and 2004 was US$ 59 million, US$ 35 million and US$ 41 million, respectively.

Reserve Quantity Information

For the purposes of evaluation of reserves as of December 31, 2006, 2005 and 2004 the Company used the oil and gas reserve information prepared by DeGolyer and MacNaughton, independent reservoir engineers, prepared in accordance with United States Securities and Exchange Commission definitions. Proved reserves are those estimated quantities of crude oil and gas which, by analysis of geological and engineering data, demonstrate with reasonable certainty to be recoverable in the future from existing reservoirs under the existing economic and operating conditions. In certain cases, recovery of such reserves may require considerable investments in wells and related equipment. Proved reserves also include additional oil and gas reserves that will be extracted after the expiry date of licence agreements or may be discovered as a result of secondary and tertiary extraction which have been successfully tested and checked for commercial benefit. Proved developed reserves are the quantities of crude oil and gas expected to be recovered from existing wells using existing equipment and operating methods.

Proved undeveloped oil and gas reserves are reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Under no circumstances are estimates of proved undeveloped reserves attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless those techniques have been proved effective by actual tests in the area and in the same reservoir.

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

The Company included in proved reserves those reserves which the Company intends to extract after the expiry of the current licences. The licences for the development and production of hydrocarbons currently held by the Company generally expire between 2009 and 2031, and the licences for the most important deposits expire between 2013 and 2019. In accordance with the effective version of the law of the Russian Federation, *On Subsurface Resources* (the "Law"), licences are currently granted for a production period determined on the basis of technological and economic criteria applied to the development of a mineral deposit which guarantee rational use of subsurface resources and necessary environmental protection. In accordance with the Law and upon gradual expiration of old licences issued under the previous version of the Law, the Company extends its hydrocarbon production licences for the whole productive life of the fields. Extension of the licences depends on both current and future compliance with the terms set forth in the licence agreements. As of the date of these financial statements, the Company is generally in compliance with all the terms of the licence agreements and intends to continue complying with such terms in the future (see Note 10).

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Reserve Quantity Information (continued)

The Company's estimates of net proved oil and gas reserves and changes thereto for the years ended December 31, 2006, 2005 and 2004 are shown in the table below and expressed in million barrels of oil equivalent (oil production data was recalculated from tonnes to barrels using a ratio of 7.3 barrels per tonne, gas production data was recalculated from cubic meters to barrels of oil equivalent using a ratio of 35.3/6 cubic meters per barrel):

	2006	2005	2004
	mln. boe.	*mln. boe.*	*mln.boe.*
Beginning of year reserves	**11,813**	12,744	3,346
Revisions of previous estimates	**1,142**	(373)	330
Increase and discovery of new reserves	**297**	63	–
Acquisitions of new properties	**74**	–	9,216
Production	**(655)**	(621)	(148)
End of year reserves	**12,671**	11,813	12,744
Of which:			
Proved reserves under PSA Sakhalin 1	**71**	–	–
Proved developed reserves	**9,891**	8,507	8,355
Minority interest in total proved reserves	**15**	2,393	2,728
Minority interest in proved developed reserves	**15**	1,732	1,847

The Company's share in the proved reserves of equity investees in 2006, 2005 and 2004 was 330 million barrels of oil equivalent, 46 million barrels of oil equivalent and 37 million barrels of oil equivalent, respectively.

The Company's share in the proved developed reserves of equity investees in 2006, 2005 and 2004 was 281 million barrels of oil equivalent, 45 million barrels of oil equivalent and 22 million barrels of oil equivalent, respectively.

The minority interest in proved developed and total proved reserves in 2005 and 2004 mainly relates to OJSC Yuganskneftegaz. The increase in acquisition of new properties in 2004 primarily relates to proved reserves of OJSC Yuganskneftegaz.

Standardized Measure of Discounted Future Net Cash Flows and Changes therein Relating to Proved Oil and Gas Reserves

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 69. Estimated future cash inflows from oil and gas 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 period. Future development and production costs are those estimated future expenditures necessary to develop and produce estimated proved reserves as of year-end based on year-end cost indices and 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 net pre-tax cash flows, net of the tax bases of related assets.

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Standardized Measure of Discounted Future Net Cash Flows and Changes therein Relating to Proved Oil and Gas Reserves (continued)

Discounted future net cash flows are calculated using a 10% discount factor. Discounting requires a year-by-year estimates of future expenditures to be incurred in the periods when the reserves will be extracted.

The information provided in the tables below does not represent management's estimates of the Company's expected future cash flows or of the value of its proved oil and gas reserves. Estimates of proved reserves 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 69 requires assumptions as to the timing and the amount of future development and production costs. The calculations should not be relied upon as an indication of the Company's future cash flows or of the value of its oil and gas reserves.

	2006	2005	2004
Future cash inflows	**$ 308,051**	$ 274,619	$ 214,887
Future development costs	**(16,426)**	(12,507)	(22,170)
Future production costs	**(154,045)**	(80,564)	(79,302)
Future income tax expenses	**(31,991)**	(43,291)	(27,740)
Future net cash flows	**105,589**	138,257	85,675
Discount of estimated timing of cash flows	**(64,019)**	(87,100)	(56,499)
Discounted value of future cash flows as of the end of year	**$ 41,570**	$ 51,157	$ 29,176

	2006	2005	2004
Discounted value of future cash flows as of the beginning of year	**$ 51,157**	$ 29,176	$ 7,068
Sales and transfers of oil and gas produced, net of production costs and taxes other than income taxes	**(7,714)**	(7,432)	(1,566)
Changes in price estimates, net	**(22,018)**	26,798	3,808
Changes in future development costs	**(4,084)**	3,471	(2,751)
Development costs incurred during the period	**2,795**	1,752	568
Revisions of previous reserves estimates	**4,034**	1,097	415
Discovery of new reserves, less respective expenses	**1,177**	115	–
Net change in income taxes	**3,580**	(5,743)	(454)
Accretion of discount	**5,116**	2,918	707
Purchase of new oil and gas fields	**1,464**	–	22,143
Other	**6,063**	(995)	(762)
Discounted value of future cash flows as of the end of year	**$ 41,570**	$ 51,157	$ 29,176

The Company's share in the discounted value of future cash flows related to the oil and gas reserves of equity investees in 2006, 2005 and 2004 was US$ 1,086 million, US$ 549 million and US$ 147 million, respectively.

Discounted value of future cash flows as of December 31, 2006, 2005 and 2004 includes the interest of other (minority) shareholders in the amount of US$ 25 million, US$ 10,574 million and US$ 6,431 million, respectively.