OAO AK TRANSNEFT
IAS CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 1999

CONTENTS

STATEMENT OF DIRECTORS' RESPONSIBILITIES
To the Shareholders of OAO AK Transneft

1. We have prepared consolidated financial statements for the year ended 31 December 1999 which give a true and fair view of the financial position of the Group at the end of the financial year and of the results of operations and cash flows for the year then ended. Management is responsible for ensuring that the Group entities keep accounting records which disclose with reasonable accuracy the financial position of each entity and which enable them to ensure that the consolidated financial statements comply with International Accounting Standards and that their statutory accounting reports comply with Russian laws and regulations. Management also has a general responsibility for taking such steps as are reasonably available to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

2. Management considers that, in preparing the consolidated financial statements set out on pages 6 to 31, the Group has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that appropriate International Accounting Standards have been followed.

3. The names of the directors during the year ended 31 December 1999, and their other positions in Group companies or government were as follows:

Name	**Position in Group companies or Government**
Current Board Members	
Alexandrov V.N.	General Director of OAO Verkhnevolzhskye MN
Arakelian E.M.	Deputy Chief of Department in the Ministry of Fuel and Energy
Danilov-Danialian A.V.	Chief of Economics Department in the Presidential Administration
Gref G.O.	First Deputy Minister of State Property Committee
Kutovoi G.P.	Deputy Chairman of the Federal Energy Commission
Morozov E.S.	Deputy Minister of Fuel and Energy
Rybak O.P.	Chief of Department in the State Property Committee
Shamraev N.G.	Deputy Minister of Economics
Stanev V.S.	Deputy Minister of Fuel and Energy
Tsyganov A.G.	Deputy Minister of the State Anti-Monopoly Policy and Business Support
Vainstock S.M.	President OAO AK Transneft
Vorobiev V.A.	Chief of Department in the Ministry of Fuel and Energy
Zhirov A.I.	General Director of OAO Chernomortransneft MN
Former Board Members	
Chizhov S.D.	First Deputy Minister of Fuel and Energy
Galkin I.V.	Chief of Department in the Ministry of Fuel and Energy
Novikov S.G.	Deputy Minister of Fuel and Energy
Prushak S.F.	Assistant Deputy Chairman of the Government
Saveliev D.V.	President OAO AK Transneft
Vladimirov A.E.	Chief of Department in the Ministry of Fuel and Energy

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STATEMENT OF DIRECTORS' RESPONSIBILITIES
To the Shareholders of OAO AK Transneft (continuation)

4. None of the directors held any shares in Group companies during the year ended 31 December 1999.

5. The consolidated financial statements, which are based on the statutory consolidated accounting reports issued in May 2000, have been restated in accordance with International Accounting Standards.

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S.M. Vainstock
President
25 May 2000

OAO AK Transneft
ul. Bolshaya Polyanka 57
109180 Moscow
Russian Federation

ZAO PricewaterhouseCoopers Audit
Kosmodamianskaya Nab. 52, Bld. 5
113054 Moscow
Russia
Telephone +7 (095) 967 6000
Facsimile +7 (095) 967 6001

AUDITORS' REPORT
To the Shareholders and Board of Directors of OAO AK Transneft

1. We have audited the accompanying consolidated balance sheet of OAO AK Transneft (the "Company") and its subsidiaries (the "Group") as at 31 December 1999 and the related consolidated statements of income, of cash flows and of changes in shareholders' equity for the year then ended. These consolidated financial statements set out on pages 6 to 31 are the responsibility of the Group's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audit.

2. We conducted our audit in accordance with International Standards on Auditing. 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 1999, and of the results of its operations and its cash flows for the year then ended in accordance with International Accounting Standards.

4. Without qualifying our opinion, we draw your attention to the following matters:

   4.1 As disclosed in Note 20.1, all transactions in the preferred share capital of the Company have been suspended until the rightful owners of the shares are determined through legal process. These consolidated financial statements include the amount of RR 115 million declared as dividends in 1999 and 1998 relating to the financial years 1999 (interim dividends) and 1997 under current liabilities on the basis of the shareholders' resolutions, but it is not certain when these amounts will be paid.

   4.2 As disclosed in Note 20.6, the operations of the Group, and those of similar enterprises operating in the Russian Federation, have been affected and may continue to be affected for the foreseeable future by the continuing regulatory, political and economic uncertainties existing for enterprises operating in the Russian Federation.

PricewaterhouseCoopers

Moscow, Russia
25 May 2000

(in millions of Russian roubles except amounts per share)

Consolidated Balance Sheets

	Notes	31 December 1999	31 December 1998
ASSETS			
Non-current assets			
Intangible assets		73	110
Property, plant and equipment	9	104,540	104,609
Investments and other long-term assets	10	459	349
Total non-current assets		**105,072**	**105,068**
Current assets			
Inventories	8	2,457	1,821
Receivables and prepayments	7	9,993	5,539
Profit tax assets		1,454	441
Other current assets	6	2,077	102
Cash and cash equivalents	5	2,142	3,099
Total current assets		**18,123**	**11,002**
Total assets		**123,195**	**116,070**
EQUITY AND LIABILITIES			
Shareholders' equity			
Share capital	15	187	187
Retained earnings	15	85,793	82,650
Total shareholders' equity		**85,980**	**82,837**
Minority interests	16	**4,560**	**5,149**
Non-current liabilities			
Borrowings	12	134	120
Deferred taxes	14	19,893	21,272
Provisions for liabilities and charges	13	1,270	1,672
Total non-current liabilities		**21,297**	**23,064**
Current liabilities			
Trade and other payables	11	10,356	4,858
Profit tax liabilities		402	112
Borrowings	12	600	50
Total current liabilities		**11,358**	**5,020**
Total liabilities		**32,655**	**28,084**
Total shareholders' equity, minority interests and liabilities		**123,195**	**116,070**

S.M. Vainstock — President

E.I. Astafiev — Vice-President, Finance

The accounting policies and the accompanying notes set out on pages 10 to 31 are an integral part of these financial statements. See Auditors' Report on page 5.

(in millions of Russian roubles except amounts per share)

Consolidated Statements of Income

	Notes	Year ended 31 December 1999	Year ended 31 December 1998
Sales	17	34,797	35,970
Operating expenses	18	(26,458)	(29,099)
Other operating costs	18	(1,505)	(3,821)
Net other operating income		379	198
Operating income		**7,213**	**3,248**
Financial items (net):			
Exchange gains		738	4,681
Monetary gain/(loss)		(2,644)	(3,446)
Interest income	12	410	36
Interest income arising from changes in discount rate on provisions	13	-	1,157
Total financial items		**(1,496)**	**2,428**
Income before profit tax		**5,717**	**5,676**
Profit tax expense	14	(2,362)	(2,676)
Income after profit tax and before minority interest		**3,355**	**3,000**
Minority interest	16	(57)	(5)
Net income		**3,298**	**2,995**
Basic and diluted earnings per ordinary share	15	707	572

The accounting policies and the accompanying notes set out on pages 10 to 31 are an integral part of these financial statements. See Auditors' Report on page 5.

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(in millions of Russian roubles except amounts per share)

Consolidated Statements of Cash Flows

	Notes	Year ended 31 December 1999	Year ended 31 December 1998
Cash flows from operating activities			
Cash receipts from customers		39,478	40,917
Cash paid to suppliers and employees, and taxes other than profit tax		(26,518)	(30,140)
Cash generated from operations		12,960	10,777
Interest paid		(188)	(229)
Profit tax paid		(4,816)	(2,017)
Net cash from operating activities		**7,956**	**8,531**
Cash flows from investing activities			
Purchase of property, plant and equipment		(8,237)	(7,227)
Interest received		141	258
Acquisition of subsidiary	19	(582)	-
Net cash used in investing activities		**(8,678)**	**(6,969)**
Cash flows from financing activities			
Proceeds from long and short term borrowing		10,165	2,972
Repayment of long and short term borrowing		(9,885)	(3,742)
Dividends paid		(148)	(145)
Net cash from/(used in) financing activities		**132**	**(915)**
(Decrease)/Increase in cash and cash equivalents		**(590)**	**647**
Effects of exchange rate changes on cash and cash equivalents		**516**	**-**
Effect of inflation on holding cash		**(883)**	**(1,705)**
Net decrease in cash and cash equivalents		**(957)**	**(1,058)**
Provision due to insolvency of banks	5	-	(306)
Cash and cash equivalents at the beginning of the year		3,099	4,463
Cash and cash equivalents at the end of the year		**2,142**	**3,099**

The accounting policies and the accompanying notes set out on pages 10 to 31 are an integral part of these financial statements. See Auditors' Report on page 5..

(in millions of Russian roubles except amounts per share)

Consolidated Statements of Changes in Shareholders' Equity

	Notes	Share capital	Retained earnings	Total shareholders' equity
Balance at 1 January 1998		**187**	**80,148**	**80,335**
Net income for the year		-	2,995	2,995
Dividends - preferred	15	-	(328)	(328)
- ordinary	15	-	(165)	(165)
Balance at 31 December 1998		**187**	**82,650**	**82,837**
Net income for the year		-	3,298	3,298
Dividends - preferred	15	-	(1)	(1)
- ordinary	15	-	(154)	(154)
Balance at 31 December 1999		**187**	**85,793**	**85,980**

The accounting policies and the accompanying notes set out on pages 10 to 31 are an integral part of these financial statements. See Auditors' Report on page 5.

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1 NATURE OF OPERATIONS

OAO AK Transneft ("the Company") was established as an open joint stock company and incorporated on 14 August 1993 in the Russian Federation by the Russian Government Resolution No 810 under Presidential Decree No 1403 dated 17 November 1992. The Company's registered office is at 109180 Moscow, ul. Bolshaya Polyanka 57, Russian Federation.

The Company and its subsidiaries (the "Group") operate one of the largest crude oil pipeline systems in the world totalling approximately 46,700 km (1998 – 46,600 km) and are responsible for transportation to refineries and export markets of substantially all the crude oil produced in the territory of the Russian Federation, which amounted to 298.9 million tonnes in the year ended 31 December 1999 (1998 – 295.9 million tonnes).

The Group, which had 52,107 employees as at 31 December 1999 (31 December 1998 – 54,200 employees), is considered by management to have a single main activity and all its activities comprise one industry and geographic segment.

2 BALTIC PIPELINE SYSTEM

The Group commenced construction of the “Baltic Pipeline System”, which is expected to cost in excess of RR 12,420 million, on behalf of the Government of the Russian Federation in March 2000. Construction is presently being financed through an investment tariff invoiced up to the date of its suspension on 31 December 1999 totalling RR 2,373 million. This amount is shown in trade and other payables in these consolidated financial statements. Of this latter amount, RR 1,949 million had been collected by the balance sheet date and is shown as other current assets, since it can only be spent on this construction project. At 31 December 1999, the Group had spent RR 94 million of its own funds on planning and design of the project, included in assets under construction.

Although plans were announced in 1999 for the Government to allow oil producers to invest in the OAO Baltic Pipeline System (“BPS”) which was established as a Group company on 18 August 1999, it is not clear at present how the funds already paid by the oil producers as investment tariff will be converted into shares.

3 BASIS OF PRESENTATION

Those Group companies incorporated in Russia maintain their statutory accounting records and prepare statutory financial reports in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR") and their functional currency is the Russian rouble ("RR"). Group companies incorporated in other countries maintain their statutory accounting records in accordance with relevant legislation and in the appropriate functional currency. The accompanying consolidated financial statements are based on the statutory accounting records, which are maintained under the historical cost convention, with adjustments and reclassifications for the purpose of presentation in accordance with International Accounting Standards ("IAS") issued by the International Accounting Standards Committee ("IASC").

The Group companies were all incorporated at approximately the same time and the consolidated financial statements have been prepared on the basis that there was no acquisition of shares at the time of incorporation of the Group companies in the context of IAS 22, “Business Combinations”. Subsequent acquisitions have been accounted for in accordance with the relevant accounting policy.

The adjustments and reclassifications made to the statutory accounts for IAS presentation include the restatement for changes in the general purchasing power of the Russian rouble based on IAS 29, "Financial Reporting in Hyperinflationary Economies". IAS 29 requires that financial statements in the currency of a hyperinflationary economy are stated in terms of the measuring unit current at the latest balance sheet date. The restatement was calculated from the conversion factors derived from the Russian Federation Consumer Price Index, published by the Russian State Committee on Statistics, and from indices obtained from other sources for years prior to 1992, which management believes represent the most appropriate measure of inflation in the economy.
The indices and the respective conversion factors used to restate the consolidated financial statements, based on 1988 prices (1988=100) for the five years ended 31 December 1999, are:

(in millions of Russian roubles except amounts per share)

Year	Index	Conversion Factors
1995	487,575	3.4
1996	594,110	2.8
1997	659,403	2.5
1998	1,216,401	1.4
1999	1,661,481	1.0

The significant guidelines followed in restating the consolidated financial statements are:

- all amounts including corresponding figures are stated in terms of the measuring unit current at the latest balance sheet date;

- monetary assets and liabilities are not restated because they are already expressed in terms of the monetary unit current at the latest balance sheet date;

- non-monetary assets and liabilities (items which are not expressed in the monetary unit current at the balance sheet date) and components of shareholders' equity are restated by applying a conversion factor based on the age of the underlying asset, liability or component of shareholders' equity;

- most items in the consolidated statements of income and cash flows are restated by applying the conversion factors for the period between the approximate date of the transaction and the balance sheet date. Depreciation, amortisation, and loss on disposal of property, plant and equipment are restated based on the restated balances of property, plant and equipment at each year end. Bad and doubtful debts expense represents the movement between the indexed opening and closing provision adjusted for amounts written off during the year. The cash flow statement contains an adjustment to reflect the effect of inflation on holding cash; and

- the effect of inflation on the Group's net monetary position is included in the consolidated statement of income as a net monetary gain or loss.

The Group has adopted the following new and revised standards approved by the IASC in the preparation of the consolidated financial statements for the years ended 31 December 1999 and 1998, notwithstanding the fact that they only became mandatory in future accounting periods, and all the interpretations approved by the Standing Interpretation Committee ("SIC") up to each balance sheet date:

31 December 1998

IAS 1 (revised)	Presentation of Financial Statements
IAS 14 (revised)	Segment Reporting
IAS 17 (revised)	Leases
IAS 19 (revised)	Employee Benefits
IAS 35	Discontinuing Operations
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Assets and Liabilities
IAS 38	Intangible Assets
IAS 22 (revised 1998)	Business Combinations
IAS 16 (revised 1998)	Property, Plant and Equipment
IAS 28 (revised 1998)	Accounting for Investments in Associates
IAS 31 (revised 1998)	Financial Reporting of Interests in Joint Ventures

31 December 1999

IAS 10 (revised 1999) Events After the Balance Sheet Date

There are no changes in accounting policy that affect the results of operations arising from the adoption of these standards in either 1999 or 1998.

In December 1998, the IASC issued IAS 39, Financial Instruments – Recognition and Measurement. IAS 39 is effective for accounting periods beginning on or after 1 January 2001. Management is currently studying the effect of this standard on the consolidated financial statements.

The preparation of consolidated financial statements in conformity with IAS requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies followed by the Group are set out below.

Consolidation

Those business undertakings in which the Group, directly or indirectly, has an interest of usually more than one half of the voting rights or otherwise has power to exercise control over the operations, are defined as subsidiary undertakings ("subsidiaries") and have been consolidated. Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date when such control ceases.

All transactions, balances and unrealised surpluses and deficits on transactions within the Group have been eliminated in the consolidation. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group. The financial statements of all subsidiaries are prepared up to 31 December for the purposes of consolidation, or their audited results for a period ended not more than three months earlier are adjusted for significant events and transactions in the intervening period.

For subsidiaries that are not wholly owned, the minority's interest is measured as the proportion of the fair value at the acquisition date of the assets and liabilities of the subsidiary, amended for the minority's share of subsequent profits and losses.

Goodwill and intangible assets

Goodwill represents the difference between the fair value of the purchase consideration and the fair value of the proportion of the net assets at the date of acquisition of the subsidiary.

Goodwill is amortised on a straight line basis over a maximum period of twenty years. Negative goodwill is amortised on a straight line basis over a maximum period of five years.

The carrying amount of goodwill is reviewed annually and written down for permanent impairment where necessary. A similar annual review is carried out for negative goodwill which is written down if there is no economic justification for its continued deferral.

Intangible assets are amortised on a straight line basis over their estimated useful life, which is usually a maximum of ten years.

Foreign currencies

The financial statements of foreign subsidiaries whose operations are integral to those of the Group are translated into the reporting currency as if the transactions had been undertaken directly by the Company. Foreign currency transactions in Group companies are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Receivables, payables and cash denominated in foreign currencies are translated at year end exchange rates.

Property, plant and equipment

All property, plant and equipment is initially recorded at historical cost, including, where appropriate, the net present value of the estimated dismantlement or removal cost of the asset at the end of its estimated useful life, less accumulated depreciation. Assets under construction are carried at historical cost and depreciated from the time the asset is brought into use.

Depreciation is calculated on the straight line basis to write down the cost of each asset to its estimated residual value over its estimated useful life as follows:

	Years
Buildings	50
Pipelines	33
Plant and equipment	10 - 20

Crude oil held in storage and in the pipeline network ("linefill") owned by the Group companies is treated as a separate class of asset, which is not depreciated as it is not physically consumed in the process of providing services to customers.

Management approves specific plans for prospective dismantlement or decommissioning of sections of pipeline and related facilities on an annual basis, and at this time, the estimated useful life of the related asset is revised and the annual depreciation charge is amended accordingly.

At each balance sheet date an assessment is made as to whether there is any indication that the recoverable amount of the Group's property, plant and equipment is less than the carrying amount. When there is such an indication an impairment provision is made which is charged in full to the results of operations in the year in which the impairment occurred. Linefill is assessed for impairment by reference to net realisable value, which is calculated based on the export price of Russian Urals Blend crude oil (FOB Novorossiysk) at each balance sheet date. The remainder of the Group's pipeline network and associated buildings and plant and equipment are assessed by reference to their value in use, based on future cash flow forecasts from continuing use of the asset discounted to net present value. The discount rates used are those considered appropriate to the Group in the economic environment in the Russian Federation at each balance sheet date. In the event that a decision is made to abandon a construction project in progress or to significantly postpone its planned completion date, the carrying value of the asset is reviewed for potential impairment.

Major renewals and improvements are capitalised and the assets replaced are retired. Maintenance and repairs and minor renewals are expensed as incurred. Minor renewals include all expenditures which do not result in a technical enhancement of the asset beyond its original capability, or which represent the replacement of sections of pipeline which are less than ten kilometers in length and do not constitute phased replacements of a longer section of pipeline over an extended period. Gains and losses arising from the retirement or other disposal of property, plant and equipment are included in the consolidated statement of income.

Interest costs on borrowings to finance the construction of property, plant and equipment are expensed.

Consulting fees related to the acquisition of property, plant and equipment are expensed at the time of concluding the agreement to purchase the relevant assets.

Investments and other long-term assets

Long-term investments, excluding marketable securities, are stated at cost. Provision for impairment is made where, in the opinion of the Group's management, there is a diminution in value which is other than temporary and such provisions are recognised as an expense in the period in which they are identified.

Marketable securities are valued at market value, and changes in market value are charged or credited to the consolidated statement of income.

On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to the consolidated statement of income.

Accounts receivable

Accounts receivable are presented at net realisable value. An estimate is made for doubtful receivables based on a review of all outstanding amounts at the year end, and the movement in the estimate is charged or credited to the consolidated statement of income. Bad debts are written off in the year in which they are identified.

Inventories

Inventories are valued at the lower of cost, calculated on a first in, first out basis, and net realisable value.

Revenue recognition

Revenues are recognised for financial reporting purposes when transportation services have been provided as evidenced by delivery of crude oil to the owner or customer in accordance with the contract.

Value Added Tax

In the consolidated balance sheet and the consolidated statement of cash flows, transactions and balances are presented inclusive of the associated Value Added Tax ("VAT") applicable under the legislation of the relevant jurisdiction in which the transaction occurred. These taxes are excluded from the consolidated statement of income since the payment and collection of VAT generally has no effect on the results of operations.

Deferred taxes

Deferred tax is calculated at currently enacted rates, using the liability method, for all temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. The principal temporary differences arise from depreciation on property, plant and equipment; revaluations of certain non-current assets; and provisions and expenses which are charged to the consolidated statement of income before they become deductible for tax purposes.

Deferred tax liabilities are recognised in respect of all taxable temporary differences relating to investments in subsidiaries, unless the Company is able to control the timing of the reversal of the temporary difference and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax assets attributable to temporary differences and to unused tax losses and credits are recognised only to the extent that it is probable that future taxable profit or temporary differences will be available against which they can be utilised.

Retirement benefit obligations and other employee benefits

The Group makes the statutory contributions, which are calculated as a percentage of current gross salary payments, in respect of its employees to the State Pension Scheme of the Russian Federation and such expense is charged to the consolidated statement of income.
Short-term employee benefits, provided under the conditions of legal agreements with employees' organisations, expected to be paid within one year of the balance sheet date are included in expenses on the accruals basis.

Other expenditures for the benefit of employees, former employees and their dependants which are discretionary are expensed at the time when they are approved by management.

The Group's contractual liability for long service benefits, such as lump sum payments at the point of retirement, is estimated annually and included in the consolidated financial statements at the expected net present value using discount rates appropriate to the Group in the economic environment in the Russian Federation at each balance sheet date.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions are reassessed annually, and are included in the consolidated financial statements at their expected net present values using discount rates appropriate to the Group in the economic environment in the Russian Federation at each balance sheet date.

Changes in the provisions resulting from the passage of time or changes in the discount rates are reflected in the consolidated statement of income each year under financial items. Other changes in provisions, related to a change in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in an accounting estimate in the period of the change.

The Group recognises the estimated cost of crude oil spillages, including the cost of the obligations to restore the environment (air, land, water and other resources) net of estimated recoveries under applicable insurance policies, at the date of the spillage. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised immediately, if no current or future benefit is discernible. Expenditures which extend the life of the related property or mitigate or prevent future environmental contamination are capitalised.

Financial assets and liabilities

Financial assets and liabilities carried on the consolidated balance sheet include cash and cash equivalents, investments, receivables and trade and other payables. The particular recognition methods adopted are disclosed in the individual accounting policies contained in this report associated with each item.

Cash received as restricted purpose investment tariff is excluded from the consolidated statements of income and cashflow and is accumulated in current liabilities in the consolidated balance sheet until its disposition is clarified, and the restricted bank accounts representing those funds which have not yet been disbursed are classified as other current assets.

Cash and cash equivalents

Cash and cash equivalents consist of cash, bank balances and highly liquid investments with maturities of three months or less at the date of acquisition.

(in millions of Russian roubles except amounts per share)

5 CASH AND CASH EQUIVALENTS

The Group's cash and cash equivalents at 31 December 1999, including cash received as restricted purpose investment tariff, were held in the following banks:

	1999	**1998**
State Savings Bank (Sberbank Russia)	754	222
Federal Industrial Bank (Russia)	-	112
Vneshtorgbank (Russia)	49	456
SDM Bank (Russia)	14	68
Mezhprombank (Russia)	1,188	-
Barclays Bank (UK)	417	1,753
Alfa Bank (Russia)	523	-
MDM Bank (Russia)	501	-
Other Russian banks	645	488
	4,091	3,099
Restricted bank balances	(1,949)	-
	2,142	3,099

Cash and cash equivalents is shown net of a provision of RR 306 million at 31 December 1999 (1998 – RR 306 million) for balances held in banks which are under administrative supervision or are technically insolvent and are unable to release the Group's funds.

6 OTHER CURRENT ASSETS

	Year ended 31 December 1999	**Year ended 31 December 1998**
Restricted bank balances	1,949	-
Other financial assets	128	102
	2,077	102

Restricted bank balances are funds collected from oil producers which may only be spent on the construction of the "Baltic Pipeline Project".

(in millions of Russian roubles except amounts per share)

7 RECEIVABLES AND PREPAYMENTS

	31 December 1999	31 December 1998
Trade receivables (net of a provision for doubtful accounts of RR 108 million at 31 December 1999 (1998 – RR 334 million)) (1)	2,072	2,280
Prepayments and advances paid for assets under construction and equipment (net of a provision for doubtful accounts of RR 64 million at 31 December 1999 (1998 – RR 96 million))	4,478	1,118
VAT input tax recoverable	1,111	781
Other taxes recoverable	35	47
Other prepayments and advances	641	676
Other receivables (net of a provision for doubtful accounts of RR 1,035 million at 31 December 1999 (1998 – RR 1,264 million))	888	619
Notes receivable (net of a provision for doubtful accounts of RR 97 million at 31 December 1999 (1998 - RR nil)) (2)	768	18
	9,993	5,539

(1) Trade receivables include amounts due more than twelve months from the balance sheet date of RR 64 million (1998 – RR 74 million).

(2) Notes receivable are generally unsecured, non-interest bearing and are due within six to twelve months from the date of issuance.

8 INVENTORIES

	31 December 1999	31 December 1998
Materials and supplies at net realisable value	1,731	1,604
Sundry goods for resale	680	180
Other items at net realisable value	46	37
	2,457	1,821

Inventories are presented net of provisions of RR 376 million at 31 December 1999 (1998 – RR 419 million) for obsolescence and to reduce cost to net realisable value.

(in millions of Russian roubles except amounts per share)

9 PROPERTY, PLANT AND EQUIPMENT

	Buildings	Pipelines	Plant and equipment	Linefill	Assets under construction	Total
At 1 January 1999						
Cost	20,011	98,201	53,717	30,632	3,404	205,965
Accumulated depreciation	(7,736)	(65,691)	(27,929)	-	-	(101,356)
Net book value at 1 January 1999	12,275	32,510	25,788	30,632	3,404	104,609
Depreciation	(392)	(2,896)	(2,787)	-	-	(6,075)
Additions	-	-	61	202	7,168	7,431
Transfers from assets under construction to fixed assets	1,095	2,546	2,971	-	(6,612)	-
Disposals at cost	(1,060)	(331)	(1,515)	(561)	-	(3,467)
Accumulated depreciation on disposals	360	290	1,392	-	-	2,042
Net book value at 31 December 1999	12,278	32,119	25,910	30,273	3,960	104,540
At 31 December 1999						
Cost	20,046	100,416	55,234	30,273	3,960	209,929
Accumulated depreciation	(7,768)	(68,297)	(29,324)	-	-	(105,389)
Net book value	12,278	32,119	25,910	30,273	3,960	104,540

Linefill represents 26,383 thousand tonnes of crude oil (1998 – 26,668 thousand tonnes).

Assets under construction at 31 December 1999 and 1998 are presented net of a provision of RR 418 million for a project which is unlikely to be completed.

Included in property, plant and equipment above at 31 December 1999 are fully depreciated assets still in service whose cost is RR 28,652 million (1998 – RR 27,666 million), and temporarily idle assets whose net book value is RR 1,093 million (1998 – RR 1,243 million).

Social assets which were part of the assets transferred to the Group companies at the time of their privatisation have been excluded from these consolidated financial statements if the privatisation plan provided for them to be transferred to municipal authorities or other organisations without consideration.

The carrying value of the Group's property, plant and equipment was reduced by an impairment provision of RR 1,147 million in the year ended 31 December 1998, which resulted from the increase in the discount rate considered appropriate to the Group's future cash flows, triggered by the economic crisis of August 1998. The real discount rate used in calculating the impairment of assets was 17.5% at 31 December 1999 (1998 – 17.5%).

Property, plant and equipment pledged as security for borrowings totalled RR 434 million at 31 December 1999 (31 December 1998 – RR 109 million).

(in millions of Russian roubles except amounts per share)

10 INVESTMENTS AND OTHER LONG-TERM ASSETS

	31 December 1999	31 December 1998
Non-consolidated subsidiaries:		
Diana Insurance Company	60	60
Pyatnitskaya Department Store	-	95
Transneft Insurance Company	14	14
Other	9	-
Marketable securities	270	82
Other investments	106	98
		-
	459	349

Subsidiaries whose total assets, net assets, revenues, costs and net income are not material, either individually or in the aggregate, are not consolidated but are included in investments.

Other investments are carried net of provisions for impairment of RR 1,405 million (1998 – RR 1,704 million).

11 TRADE AND OTHER PAYABLES

	31 December 1999	31 December 1998
Trade payables	2,657	1,694
Notes payable	891	361
Accruals and deferred income	42	32
VAT output tax payable (including deferred amounts of RR 502 million at 31 December 1999 (1998 – RR 789 million)	1,011	927
Advances received	1,698	252
Other taxes payable	609	532
Advances related to the Baltic Pipeline System	2,373	-
Dividends payable (Note 15)	115	156
Other payables	960	904
	10,356	4,858

Notes payable are generally unsecured, non-interest bearing and are due within six months of the date of issuance.

VAT input and output taxes can only be offset under tax regulations to the extent that they relate to the same subsidiary; deferred VAT output tax liabilities become payable when the value of the underlying invoice has been received.

(in millions of Russian roubles except amounts per share)

12 BORROWINGS

	31 December 1999	31 December 1998
Total borrowings	734	170
Less: current portion of borrowings	(600)	(50)
	134	120
Maturity of non-current borrowings		
Due for repayment:		
Between one and two years	48	51
Between two and five years	45	-
After five years	41	69
	134	120

The majority of borrowings are in Russian roubles and bear variable market rates of interest which range from 32% to 42% annually. Typical assets pledged as security for these loans are sections of pipe awaiting installation and crude oil in storage reservoirs, and the total value of property, plant and equipment pledged as security at 31 December 1999 was RR 434 million (31 December 1998 – RR 109 million).

Interest expense on borrowings which is netted against interest income in the consolidated statement of income amounted to RR 155 million in the year ended 31 December 1999 (1998 – RR 175 million).

13 PROVISIONS FOR LIABILITIES AND CHARGES

	Dismantlement (1)	Preferred shares (2)	Employment benefits (3)	Total
Balance 1 January 1999	1,453	63	156	1,672
Additional provisions made/released	(233)	38	47	(148)
Amounts used	(194)	(28)	(32)	(254)
Balance 31 December 1999	1,026	73	171	1,270

(1) Dismantlement

A provision is established for the expected cost of dismantling the existing pipeline network based on the average current cost per kilometer of removal according to an estimated plan of replacement over the long term and discounted to net present value using a rate of 17.5% per year (1998 - 17.5% per year). The replacement program is expected to cover the same number of kilometers each year over the useful life of the network, and this plan could change over the course of time. The provision is added to the cost of fixed assets and depreciated over the useful economic life of the pipeline network. Additional provisions are therefore made when the total length of the network increases, and reductions occur when sections of the pipeline are decommissioned. Other changes are made when the expected pattern or unit cost of dismantlement is changed. Actual costs of individual removals are not generally significant and are therefore not identified separately.

(2) Preferred shares

Certain subsidiaries entered into contracts with the original holders of the preferred shares of the Company under which commitments were made to pay annual rents based on a percentage of the profits of the subsidiary calculated in accordance with RAR. Payments are made in May and November each year based on the results of operations of the relevant subsidiaries for the six months ended on the previous 31 December and 30 June, respectively. A provision is made for the net present value of the estimated future payments under such contracts assuming that the relevant subsidiaries continue to make profits of the same average amount as in the last three most recently completed financial years. The net present value is calculated using a discount rate of 17.5% per year (1998 - 17.5% per year).

(in millions of Russian roubles except amounts per share)

(3) Employment benefits

Under collective agreements with the employees, an amount ranging from one to ten months' final salary is payable upon retirement to those who have worked for the Group for more than five years. Management has carried out an exercise, in accordance with the provisions of IAS 19, to assess the net present value of these obligations. Under this method an assessment has been made of an employee's service period with the Group, and the expected salary and number of months' salary payable under these agreements having regard to staff turnover statistics, retirement age, and salaries at retirement. The expected liabilities at the date of retirement have been discounted to net present value using a rate of 17.5% per year (1998 – 17.5% per year).

In view of the relative insignificance of the expense recognised in the income statement for the year, the further disclosures required by IAS 19 have not been made.

14 PROFIT TAX AND DEFERRED TAXES

	Year ended 31 December 1999	Year ended 31 December 1998
Profit tax expense consists of:		
Current tax expense	3,740	3,294
Effect of change in tax rate on deferred tax liabilities and assets	(3,039)	-
Deferred tax expense/(benefit)	1,661	(618)
	2,362	2,676

Deferred tax liabilities and assets consist of the following:

	31 December 1999	31 December 1998
Deferred tax liabilities:		
revenue recognition	(163)	(462)
carrying value of property, plant and equipment in excess of tax base	(20,351)	(21,626)
	(20,514)	(22,088)
Deferred tax assets:		
provisions against inventories and receivables	172	302
provisions for environmental costs	449	514
	621	816
Net deferred tax liability	(19,893)	(21,272)

With effect from 1 April 1999, the standard rate of profit tax payable by companies in the Russian Federation was reduced from 35% to 30%. The effective tax rate for 1999 is therefore 31.25% (1998 - 35%).

(in millions of Russian roubles except amounts per share)

The following is a reconciliation of theoretical profit tax expense computed at the statutory tax rate to the actual profit tax expense:

	Year ended 31 December 1999	Year ended 31 December 1998
Income before profit tax	5,717	5,676
Theoretical profit tax expense at 31.25% (1998 – 35%)	1,786	1,985
Increase (reduction) due to:		
Allowance for capital expenditure	(2,227)	(688)
Expenses not deductible for profit tax purposes	1,227	1,992
Income not assessable for profit tax purposes	-	(1,637)
Non-temporary elements of net monetary loss	12,408	11,151
Tax penalties and interest	27	63
Lower tax rates in other countries	-	(4)
Temporary difference on revaluation of tax base	(37)	(201)
Effect of change in tax rates	(3,039)	-
Inflation effect on deferred tax balance at the beginning of the year	(7,783)	(9,985)
Actual profit tax expense	2,362	2,676

The maximum potential deferred tax liability, not provided in these consolidated financial statements, which would materialise in the event that the subsidiaries paid all available amounts as dividends is RR 6,659 million (1998 – RR 8,040 million).

15 SHARE CAPITAL, RETAINED EARNINGS AND EARNINGS PER SHARE

	Nominal amounts	31 December 1999 and 1998
Authorised, issued and fully paid shares of RR 1 each		
Ordinary: 4,664,627 shares	5	140
Preferred: 1,554,875 shares	1	47
	6	187

The subsidiaries own a total of 3,179 preferred shares of the Company.

Earnings per share have been calculated on the average number of ordinary shares outstanding during the year (4,664,627 shares):

	Year ended 31 December 1999	Year ended 31 December 1998
Net income	3,298	2,995
Less dividends declared during the year on preferred shares	(1)	(328)
Amounts available for ordinary shareholders	3,297	2,667
Basic and diluted earnings per ordinary share	707	572

(in millions of Russian roubles except amounts per share)

There is no separate diluted earnings per share computation since there are no circumstances in which the preferred shares can be converted to ordinary shares.

The Group's largest shareholders are:

State Property Committee of Russian Federation	100% of ordinary shares
OOO Benevent	43% of preferred shares
Smeralco Investment Ltd.	13% of preferred shares

Rights attributable to preferred shares

Preferred shareholders may only vote at meetings on the following issues:

- the amendment of their rights to income;
- the issue of additional shares with rights greater than or equal to their rights in terms of income or assets on liquidation; and
- the liquidation or reorganisation of the Group.

Holders of preferred shares acquire the same voting rights as holders of ordinary shares in the event that dividends are either not declared, or are declared but not paid. As a result of the freezing of all transactions and dividends on preferred shares, explained in more detail in note 20.1, the preferred shareholders acquired voting rights equivalent to those attributable to ordinary shares during 1999, and this situation is expected to continue until such time as the outcome of the Court case is determined. The preferred shareholders did not, however, acquire the right to receive dividends which may be declared on ordinary shares during the period of their entitlement to vote, and therefore the calculation of earnings per share in these consolidated financial statements is not affected by the change.

Preferred shares earned dividends amounting to 10% of the consolidated net income of the Group according to RAR for the year, if any, and the dividend per share on preferred shares was not permitted to be less than that paid on each ordinary share until these rights were amended based on a resolution of the Annual General Meeting dated 25 June 1999, after which the annual dividend on preferred shares was fixed at RR 0.5 per share. The necessary amendments to the charter document were registered on 30 August 1999. On liquidation, the preferred shareholders are entitled to receive distribution of net assets equal to the par value of the shares, prior to any distribution to ordinary shareholders.

Dividends

Dividends of RR 210.69 (RR 85.91 in historic terms) on each preferred share were approved in the shareholders' annual general meeting held on 30 June 1998 in respect of the financial year ended 31 December 1997 and interim dividends of RR 0.52 (RR 0.5 in historic terms) in the meeting held on 26 August 1999 in respect of the year ended 31 December 1999. The amounts remaining unpaid are included in trade and other payables. Payment of these dividends has been delayed and all transactions in the preferred shares of the Company have been suspended pending resolution of an investigation ordered by decisions of the Prosecutor General's Office of the Russian Federation dated 22 January 1999 and 17 December 1999 to determine the rightful owners of the shares.

Dividends of RR 35.12 (RR 14.32 in historic terms) on each ordinary share were approved in the shareholders' annual general meeting held on 30 June 1998 in respect of the financial year ended 31 December 1997, and were paid in 1998. Interim dividends of RR 28.36 (RR 27.02 in historic terms) on each ordinary share were approved in the Board of Directors' meeting held on 26 August 1999 in respect of the financial year ending 31 December 1999, and were paid in November 1999.

The Board of Directors has made the following proposals for final dividends in respect of the year ended 31 December 1999, which will be considered by the shareholders in their annual general meeting in June 2000:

(in millions of Russian roubles except amounts per share)

Preferred shares	RR 0.5 per share
Ordinary shares	RR 55.74 per share.

In accordance with IAS 10 (revised 1999), these amounts have not been included as liabilities in these consolidated financial statements.

Distributable retained earnings

The statutory accounting reports of the parent Company and each subsidiary are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net profit. For 1999, the statutory consolidated profit for the Group as reported in the published annual statutory reporting forms was RR 8,570 million (1998 – RR 7,817 million). However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and accordingly management believes at present it would not be appropriate to disclose an amount as “distributable retained earnings” in these consolidated financial statements.

16 MINORITY INTERESTS

	Year ended 31 December 1999	Year ended 31 December 1998
At 1 January	5,149	5,144
Effect of acquisition	(646)	-
Share of net income for the year	57	5
Balance at 31 December	4,560	5,149

As a result of the acquisition by the Group of the minority interest in OAO Severniye MN during the year ended 31 December 1999, the minority interest in this subsidiary has been eliminated in the calculation of goodwill.

The remaining minority interests at 31 December 1999 represent the shares in consolidated subsidiaries held by the Regional State Property Committees of the Republics of Tatarstan (36% of OAO Severo-Zapadny MN) and Bashkortostan (24.5% of OAO Uralsibnefteprovod).

17 SALES

	Year ended 31 December 1999	Year ended 31 December 1998
Revenues for oil transportation services		
Domestic tariff	17,355	26,518
Export tariff	11,244	4,717
Total revenues from oil transportation services	28,599	31,235
Net other revenues	6,198	4,735
Total sales	34,797	35,970

Tariff structure in 1999

The revenues of the Group for oil transportation services comprise:

- distance related tariffs, set in RR and revised periodically after approval by the Federal Energy Commission (“domestic tariffs”), for transportation of crude oil on the domestic pipeline network. These are calculated based on total operating costs calculated in accordance with RAR (with certain exclusions) based on normal levels of activity and a monetary profit margin;

(in millions of Russian roubles except amounts per share)

- a fixed “export tariff”, set in US dollars ("US$") and revised periodically by the Federal Energy Commission at its discretion, until 1 May 1999 when it was replaced by a distance-related tariff, denominated in US$ but payable in RR, which is designed to provide revenues for the reconstruction of the existing network; and

- a fixed tariff, set in US$ under intergovernmental agreements for the transportation of crude oil from Azerbaijan, for export at Novorossiysk and other outlets.

- a distance related tariff, set in US$ by the Federal Energy Commission, for transit of Kazakhstan crude oil over the territory of Russian Federation.

A separate investment tariff payable on all crude exports of US$ 1.43 per tonne was introduced on 1 May 1999 and suspended on 31 December 1999 to raise money for the construction of the Baltic Pipeline System.

During 1999 domestic tariffs were increased by 30% compared to 1998 levels while the inflation rate in the Russian Federation was approximately 36%.

Tariff changes in 2000

Tariffs were increased on 11 January 2000 by approximately 17% for domestic transportation and 11% for exported crude, and again on 1 April 2000 by approximately 12%.

18 OPERATING EXPENSES AND OTHER OPERATING COSTS

	Year ended 31 December 1999	Year ended 31 December 1998
Operating expenses		
Depreciation	6,075	6,071
Staff costs	4,992	5,941
Electricity	2,210	3,805
Maintenance and repairs and minor renewals	2,652	3,663
Materials	2,778	3,363
Usage of oil	421	74
Taxes other than profit tax:		
Road use and housing fund tax	1,739	1,537
Oil transportation tax	-	1,253
Property tax	265	366
Other taxes	286	592
Cost of goods for resale	2,295	1,070
Social expenditures and discretionary employee benefits	611	786
Research and development	316	113
Tax penalties and interest	116	181
Other	1,702	284
Total operating expenses	26,458	29,099

Staff costs include RR 1,073 million of contributions to the State Pension Scheme of the Russian Federation (1998 – RR 1,208 million).

Taxes included in operating expenses, which are calculated on figures prepared in accordance with RAR, are computed as follows:

(in millions of Russian roubles except amounts per share)

- Road use and housing fund tax vary by region and locality but generally do not exceed 2.5 percent and 1.5 percent, respectively, of revenues invoiced in the respective region.

- Property tax is assessed at a maximum of 2.0 percent on the average annual net book value of fixed assets, intangible assets and inventory. Specific legislation provides for the exclusion of trunk pipelines from the taxable base.

The following non-recurring or significant items are included in other operating costs:

	Year ended 31 December 1999	Year ended 31 December 1998
Other operating costs		
(Increase)/decrease in provisions against investments in and amounts due from related parties (note 21)	(210)	674
Provisions due to insolvency of banks (note 5)	-	306
Usage and losses of linefill	704	-
Provisions against investments and doubtful debts	96	640
Provisions for impairment of assets (note 9)	-	1,147
Losses on disposal of property, plant and equipment and social assets	915	1,054
Total other operating costs	1,505	3,821

(in millions of Russian roubles except amounts per share)

19 CONSOLIDATED SUBSIDIARIES AND ACQUISITIONS

	Percent (%) of voting share capital held at 31 December 1999
Regional pipeline operators	
OAO Sibnefteprovod	100
OAO Chernomortransneft	100
OAO Druzhba	100
OAO Privolzhsknefteprovod	100
OAO Transsibneft	100
OAO Verkhnevolzhskye MN	100
OAO Tsentrsib MN	100
OAO Uralsibnefteprovod	75.5
OAO Severniye MN	100
OAO Severo-Zapadnye MN	64
Other services	
OAO Giprotruboprovod	100
OAO Svyaztransneft	100
OAO Stroineft	100
OAO Technical Diagnostics Centre	100
OAO Volzhsky Podvodnik	100
OAO Metrological Ensuring Centre	100
OAO Transneft Insurance Company	90
Transneft UK Limited	100
OOO Trade House Transneft	100
OAO Baltic Pipeline System	100
OOO Transneftburservice	100

All of the consolidated subsidiaries are incorporated in the Russian Federation, with the exception of Transneft UK Limited, which is incorporated in the United Kingdom. There were no material changes in the structure of the Group during the year ended 31 December 1999, except for the acquisition of the remaining 24.5% of the ordinary shares of OAO Severniye MN on 31 August 1999, previously held by the Regional State Property Committee of the Komi Republic. Information regarding this transaction is as follows:

Purchase consideration (RR 563 million in historic terms)	582
Fair value of net assets acquired (RR 625 million in historic terms)	(646)
Negative goodwill arising on acquisition	(64)

The negative goodwill has been included in the results of the current year, as there is no economic reason for its deferral. The net assets acquired, stated in accordance with RAR, were adjusted for the most significant different accounting policies used in preparing financial statements in accordance with IAS to derive the above figure.

The acquisition of the shares in OAO Severniye MN had no significant effect on the Group's financial position or on its results of operations in the current year, nor would it have had a significant effect on the corresponding amounts for the previous period.

There were no acquisitions in 1998.

20 CONTINGENT LIABILITIES, COMMITMENTS AND OTHER RISKS

CONTINGENT LIABILITIES

Legal proceedings

20.1 The Group is a party to certain legal proceedings arising in the ordinary course of business. Also, the Group is subject to various environmental laws regarding handling, storage, and disposal of certain products and is subject to regulation by various governmental authorities. In the opinion of management, there are no current legal proceedings or other claims outstanding which could have a material adverse effect on the results of operations or financial position of the Group.

In accordance with decisions of the Office of the Prosecutor General of the Russian Federation dated 22 January and 17 December 1999, all transactions in the preferred share capital of the Company have been suspended (including all types of sales and purchases of those shares and paying and receiving dividends thereon) until the Court decides on the rightful owners of the shares. These consolidated financial statements include the amount of RR 115 million declared as dividends in 1999 and 1998 relating to the financial years 1999 (interim dividends) and 1997 under current liabilities on the basis of the shareholders' resolutions, but it is not certain when these amounts will be paid.

Taxation

20.2 Russian tax legislation is subject to varying interpretations and frequent changes. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activities of the Group may not coincide with that of management. As a result, tax authorities may assert violations of the tax legislation in transactions, and the Group may be assessed additional taxes, penalties and interest, which can be significant. The tax returns which have been submitted remain open for review by the tax authorities for three years. It is not practical to quantify the value of such contingent liabilities.

Financial guarantees

20.3 The Company had issued a guarantee valued at up to the equivalent of US$ 100 million in respect of the outstanding debt and interest obligations of FSUC All-Russian Television and Broadcasting Company which is valid until 31 December 2002. The guarantee was fully utilised at 31 December 1999, but those debt and interest obligations had been fulfilled by the borrower by 22 March 2000.

One of the Group companies issued a floating guarantee with no expiry date in respect of the loan obligations of a company outside the Group. The value of the guarantee at 31 December 1999 was approximately RR 400 million, and this amount had not changed significantly by the date of approval of these consolidated financial statements.

COMMITMENTS

20.4 In the normal course of business, the Group has entered into contracts for the purchase of property, plant and equipment and amounts contracted for but not reflected in the consolidated financial statements as at 31 December 1999 were approximately RR 2,649 million. In addition to these contractual commitments, the Board of Directors of the Group has approved a capital expenditure budget of approximately RR 11,658 million for 2000 (1999 – RR 3,406 million).

OTHER RISKS

Government and tariffs

20.5 The Government of the Russian Federation, through the State Property Committee, owns 100% of the issued ordinary shares of the Company and controls most of its operations through the Ministry of Fuel and Energy. The Government also appoints the members of the Federal Energy Commission, which is charged inter alia with the periodic review of tariff rates and structures which affect capital expenditure programs.

Economic instability

20.6 The Russian Federation continues to experience economic difficulties following the financial crisis of August 1998. Consequently, the country's currency continues to devalue, there is continued volatility in the debt and equity market, hyperinflation persists, and confidence in the banking sector has yet to be restored, and there continues to be general lack of liquidity in the economy. In addition, laws and regulations affecting businesses operating within the Russian Federation continue to evolve.

The Russian Federation's return to economic stability is dependent to a large extent on the effectiveness of the measures taken by the government and other actions, including regulatory and political developments, which are beyond the Group's control.

The Group's assets and operations could be of risk if there are any further significant adverse changes in the political and business environment. Management is unable to predict what effect those uncertainties might have on the future financial position of the Group. No adjustments related to these uncertainties have been included in the accompanying consolidated financial statements.

Operations, environmental and legislative matters

20.7 The operations and earnings of the Group continue, from time to time and in varying degrees, to be affected by legislative, fiscal and regulatory developments, including those related to environmental protection. Due to the capital intensive nature of the industry, the Group is also subject to physical risks of various kinds. The nature and frequency of these developments and events associated with these risks as well as their effect on future operations and earnings are not predictable.

20.8 Potential liabilities which might arise as a result of stricter enforcement of existing environmental regulations, civil litigation or changes in legislation or regulation cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that all significant liabilities for environmental restoration have been accrued in the consolidated financial statements.

Insurance risks

20.9 The Group insures the majority of its fire and environmental risks with Russian reinsurers through its subsidiary, Transneft Insurance Company.

21 RELATED PARTIES AND DIRECTORS' COMPENSATION

As IAS 24 ("Related Party Disclosures") specifically excludes government-controlled entities from the definition of related parties, transactions between, and balances due to or from, entities under government or other state control and Group companies are not detailed in this note.

Related party transactions

21.1 National Reinsurance Company JSC ("NRC") has been treated as an investment, rather than a subsidiary, since NRC management unilaterally cancelled reinsurance treaties placed outside the Group in October 1998 and Group management has not been able to regain control of NRC and has no access to its assets. The Group's share of the capital in this company was 82% at 31 December 1998, and this was diluted by a share issue to other parties which effectively reduced the Group's holding to 49% during 1999. Management is disputing the legality of this share issue. During 1997, the preference shares whose ownership is presently the subject of investigation by the Office of the Prosecutor General of the Russian Federation were accumulated in NRC before being sold outside the Group. In the circumstances, management has made full provision against the Group's investment in NRC.

21.2 The Group advanced RR 228 million to the President's Administration during 1998 and subsequently this has been treated as a nonrecoverable contribution.

(in millions of Russian roubles except amounts per share)

21.3 One of the subsidiaries has a contract with another related party which provides for a commission payable of 4.75% of the value of capital equipment purchased from overseas suppliers. There were no payments under this contract in the years ended 31 December 1999 and 1998.

21.4 An amount of RR 337 million due from one of the Group's main customers was assigned to International Industrial Company and this amount was provided for in full in the consolidated statement of income for the year ended 31 December 1998, but subsequently recovered and therefore reversed in 1999.

21.5 An amount of RR 107 million has been provided for in the consolidated statement of income for the year ended 31 December 1998 as a result of a court decision relating to a note payable which was endorsed on behalf of the Group by one of its former vice-presidents.

The amount included in the consolidated statement of income in respect of provisions against investments in, and amounts due from, related parties is as follows:

	Reference	Year ended 31 December 1999	Year ended 31 December 1998
National Reinsurance Company	21.1	-	2
President's Administration	21.2	-	228
International Industrial Company	21.4	(210)	337
Notes payable	21.5	-	107
		(210)	674

Directors' compensation

Compensation paid to directors and senior management for their services in full or part time executive management positions is made up of a contractual salary, non-cash benefits, and a performance bonus depending on results for the year according to Russian statutory financial statements.

Discretionary bonuses are also payable to board members, which are approved by the President and distributed by him according to his perception of the value of the individual's contribution based on criteria other than performance.

22 FINANCIAL INSTRUMENTS

Foreign exchange

The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble or the US dollar, and it does not use foreign exchange or forward contracts. At 31 December 1999 prepayments and advances paid for imported equipment in US dollars amounted to RR 3,991 million (1998 – RR 903 million) translated at the official rouble exchange rate used by Central Bank of Russian Federation.

Interest rates

The Group obtains funds from and deposits surpluses with banks at current market interest rates, and does not use any hedging instruments to manage its exposure to changes in interest rates.

Credit risk

Cash and cash equivalents are deposited only with banks which are considered by the Group at the time of deposit to have minimal risk of default.

The Group does not hold or issue financial instruments for trading purposes. Its trade accounts receivable are unsecured, and the largest single exposure (based on combined figures of accounts receivable, notes receivable and advances due from the same group of entities) at 31 December 1999 was RR 2,812 million (1998 – RR 853 million) due from an equipment manufacturer and RR 422 million (1998 – RR 322 million) due from an oil producer.

Activities involving notes receivable and payable

The Group companies issued notes payable with a total value of RR 13,626 million during the year (1998 - RR 1,393 million) to provide short term working capital, usually in the form of cash, or in settlement of current liabilities. These notes were generally unsecured, non-interest bearing and were repayable six months from the date of issuance.

Included in the above figure for 1999 are notes payable issued without receiving cash at the time of their issue, and which effectively represent loans to the beneficiaries supported by corresponding notes receivable. The corresponding notes receivable were generally unsecured, non-interest bearing and were due in twelve equal monthly instalments from the date of their issuance. The outstanding amounts of such notes receivable at 31 December 1999 was RR 414 million (1998 – RR nil).

Fair values of financial assets and liabilities

The fair values of the financial assets and liabilities at 31 December 1999 were approximately equal to their carrying values.