OAO GAZPROM
IAS CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 1998

AUDITORS’ REPORT

To the Shareholders of OAO Gazprom

1. We have audited the accompanying consolidated balance sheet of OAO Gazprom and its subsidiaries (the “Group”) as at 31 December 1998 and the related consolidated statements of income, of cash flows and of changes in shareholders’ equity for the year then ended. These financial statements are the responsibility of the Group’s management. Our responsibility is to express an opinion on the 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 1998, and 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 Note 2 to the financial statements. The operations of the Group have been significantly affected by instability in the Russian Federation’s economy, caused in part by its currency volatility, and may continue to be so for the foreseeable future.

5. Further, we draw your attention to Note 23 to the financial statements. The Government of the Russian Federation is a significant shareholder of the Group and governmental economic and social policies affect the Group’s financial position, results of operations and cash flows.

5 August 1999

Moscow, Russia

OAO GAZPROM
IAS CONSOLIDATED BALANCE SHEET
(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

Notes		31 December 1998	31 December 1997
	Assets		
	Current assets		
13	Cash and cash equivalents	19,885	16,916
	Marketable securities	1,746	9,812
6	Accounts receivable and prepayments	183,880	201,854
7	Inventories	44,823	48,160
	Other current assets	3,937	1,659
		254,271	278,401
	Long-term assets		
8	Property, plant and equipment	754,121	770,771
9	Investments	46,147	47,717
14	Deferred profit tax	-	13,374
23	Other long-term assets	25,425	5,256
		825,693	837,118
5	Total assets	1,079,964	1,115,519
	Liabilities and equity		
	Current liabilities		
10	Accounts payable and accrued charges	69,908	90,838
11	Taxes payable	99,100	116,024
12	Short-term loans and current portion of long-term borrowings	26,044	16,236
		195,052	223,098
	Long-term liabilities		
13	Long-term borrowings	184,742	83,585
14	Deferred profit tax	9,119	-
15	Provisions for liabilities and charges	34,698	5,619
		228,559	89,204
5	Total liabilities	423,611	312,302
	Minority interest in subsidiaries	3,469	6,887
16	**Shareholders' equity**		
	Share capital (23.7 billion shares issued; nominal value of RR 118,368 and RR 237 as at 31 December 1998 and 31 December 1997, respectively)	144,888	26,757
	Treasury shares (at cost, 2.3 billion shares and 2.6 billion shares as at 31 December 1998 and 31 December 1997, respectively)	(3,736)	(5,053)
	Retained earnings and other reserves	511,732	774,626
		652,884	796,330
	Total liabilities and equity	1,079,964	1,115,519

R.I. Vyakhirev
Chairman of the Management Committee

I.N. Bogatyriova
Chief Accountant

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

OAO GAZPROM
IAS CONSOLIDATED STATEMENT OF INCOME
(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

Notes		Year ended 31 December 1998	1997
5, 17	Sales	252,802	252,454
5, 18	Operating expenses	(294,563)	(242,076)
	Operating (loss) income	(41,761)	10,378
9	Share of net losses of associated undertakings	(158)	(78)
	(Loss) income before monetary effects and profit tax	(41,919)	10,300
	Monetary effects:		
2	Exchange loss	(118,731)	(299)
	Monetary gain	62,921	3,230
	Interest income	6,509	6,193
11	Interest (expense) income on taxes payable	(12,389)	4,600
	Other interest expense	(10,990)	(4,639)
	Total monetary effects	(72,680)	9,085
	(Loss) income before profit tax	(114,599)	19,385
14	Profit tax (expense) benefit	(36,185)	1,474
	(Loss) income after profit tax	(150,784)	20,859
	Minority interest	3,562	(853)
5, 19	**Net (loss) income**	(147,222)	20,006
20	**(Loss) earnings per share (in Roubles)**	(6.88)	0.94

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OAO GAZPROM
IAS CONSOLIDATED STATEMENT OF CASH FLOWS
(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

	Year ended 31 December	
	1998	**1997**
Operating activities		
(Loss) income before profit tax	(114,599)	19,385
Adjustments:		
Depreciation, depletion and amortisation	37,189	38,991
Unrealised foreign exchange losses (gains)	127,377	(84)
Interest expense	10,990	4,639
Loss on disposal of property, plant and equipment	6,476	16,567
Non-cash additions to property, plant and equipment	(26,577)	(30,964)
Non-cash additions to investments	(1,890)	(1,771)
Increase in provisions for liabilities and charges	29,079	59
Increase in provision for doubtful accounts	20,587	20,225
Impairment provisions for investments, property, plant and equipment and inventories	36,090	11,657
Increase in other long-term assets	(20,169)	(2,501)
Monetary effects on non-operating balances	(112,652)	(4,551)
Changes in working capital:		
Decrease (increase) in marketable securities	8,066	(3,669)
Decrease (increase) in accounts receivable and prepayments	24,108	(56,309)
Decrease (increase) in inventories	3,253	(5,648)
(Increase) decrease in other current assets	(2,278)	160
(Decrease) increase in accounts payable and accrued charges, excluding interest, dividends and capital construction	(1,738)	7,333
(Decrease) increase in taxes payable (other than profit tax)	(14,694)	2,262
Profit tax paid	(13,254)	(24,180)
Net cash used for operating activities	(4,636)	(8,399)
Investing activities		
Capital expenditures	(23,576)	(38,195)
Interest paid	(3,001)	(2,993)
Purchase of investments	(6,719)	(6,670)
Net cash used for investing activities	(33,296)	(47,858)

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

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

	Year ended 31 December	
	1998	**1997**
Financing activities		
Proceeds from long-term borrowings (including short-term portion)	30,317	61,512
Repayments of long-term borrowings (including short-term portion)	(4,976)	(3,094)
Net increase in short-term loans	19,170	5,709
Dividends paid	(979)	(996)
Interest paid	(9,979)	(3,477)
Purchase of treasury shares	(6,294)	(11,915)
Sale of treasury shares	7,457	9,915
Profit tax on sale of treasury shares	-	(655)
Net cash provided by financing activities	34,716	56,999
Effect of exchange rate changes on cash and cash equivalents	19,295	1,019
Effect of inflation accounting on cash	(13,110)	(1,029)
Increase in cash and cash equivalents	2,969	732
Cash and cash equivalents, at beginning of year	16,916	16,184
Cash and cash equivalents, at end of year	19,885	16,916

A significant portion of operations, including capital expenditures, is transacted by mutual cancellations or barter. Within operating activities in the consolidated statement of cash flows such transactions are included on the same basis as cash transactions (see Note 3), but are excluded from investing and financing activities.

R.I. Vyakhirev
Chairman of the Management Committee

I.N. Bogatyriova
Chief Accountant

OAO GAZPROM
IAS CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

Notes		Number of shares outstanding (billions)	Share capital	Treasury shares	Retained earnings and other reserves	Total shareholders' equity
	Balance at 31 December 1996	21.3	26,757	(1,181)	761,213	786,789
	Net income for the year				20,006	20,006
4, 14	Net treasury share transactions	(0.2)		(3,872)	1,217	(2,655)
16	Translation differences				(184)	(184)
4, 16	Return of social assets to governmental authorities				(6,447)	(6,447)
16	Dividends				(1,179)	(1,179)
	Balance at 31 December 1997	21.1	26,757	(5,053)	774,626	796,330
16	Increase in the nominal value of shares		118,131		(118,131)	-
	Net loss for the year				(147,222)	(147,222)
4, 14	Net treasury share transactions	0.3		1,317	(154)	1,163
16	Translation differences				5,382	5,382
4, 16	Return of social assets to governmental authorities				(2,769)	(2,769)
	Balance at 31 December 1998	21.4	144,888	(3,736)	511,732	652,884

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

1 NATURE OF OPERATIONS

RAO Gazprom was established as a Russian joint stock company by Presidential Decree dated 5 November 1992, No. 1333. The Annual General Meeting of the shareholders, held on 26 June 1998, approved a recommendation from the Board of Directors on revising the name of the organisation in order to comply with the federal law on joint stock companies. Consequently, the new name has become the open joint stock company Gazprom or OAO Gazprom.

OAO Gazprom and its subsidiaries (the "Group") operate one of the largest gas pipeline systems in the world and are responsible for substantially all gas production and high pressure gas transportation in the Russian Federation. The Group is also a major exporter of gas to European countries.

The Group is directly involved in the following activities:

- exploration and drilling for hydrocarbons;
- production of gas and oil;
- transportation of gas and condensates;
- underground storage of gas; and
- domestic and export sale of gas, oil and condensates.

2 RUSSIAN FINANCIAL CRISIS

During 1998, the economy of the Russian Federation entered a period of severe economic instability including, but not limited to, a steep decline in prices of domestic debt and equity securities and a steep devaluation of the Russian Rouble. A return to economic stability is dependent to a large extent on the effectiveness of measures taken by the Government of the Russian Federation and other factors beyond the Group's control. The operations of the Group have been significantly affected by these factors and may continue to be so for the foreseeable future.

3 BASIS OF PRESENTATION

The Group maintains its statutory accounting records and prepares its statutory financial reports in accordance with the Regulation on Accounting and Reporting of the Russian Federation ("RAR"). 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.

According to the Presidential Decree dated 4 August 1997, No. 822, a redenomination of the Russian Rouble ("RR") was announced, resulting in the exchange of the existing national currency with a new one using the ratio of 1,000 Roubles as at 31 December 1997 equal to 1 Rouble as at 1 January 1998. The 1998 consolidated financial statements are expressed in terms of redenominated Roubles and the 1997 consolidated financial statements have been restated for comparative purposes.

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.

The adjustments and reclassifications made to the statutory accounts for the purpose of IAS reporting include the restatement for changes in the general purchasing power of the Rouble in accordance with IAS 29, "Financial Reporting in Hyperinflationary Economies". IAS 29 requires that consolidated financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the 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 ("Goscomstat"), and

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

3 BASIS OF PRESENTATION (continued)

from indices obtained from other published sources for years prior to 1992.

The indices used to restate the consolidated financial statements, based on 1988 prices (1988=100) for the five years ended 31 December 1998, and the respective conversion factors used, are:

Year	Index	Conversion Factor
1994	211,612	5.8
1995	487,575	2.5
1996	594,110	2.1
1997	659,403	1.8
1998	1,216,401	1.0

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

- all amounts are stated in terms of the measuring unit current at 31 December 1998;
- monetary assets and liabilities are not restated because they are already expressed in terms of the monetary unit current at 31 December 1998;
- non-monetary assets and liabilities (items which are not expressed in terms of the monetary unit current at 31 December 1998) and shareholders' equity, including the share capital, are restated by applying the relevant conversion factors;
- all items in the consolidated statements of income and of cash flows are restated by applying appropriate conversion factors to restate the amounts in terms of the measuring unit current at 31 December 1998 with the exception of depreciation, amortisation, loss on disposal of property, plant and equipment and the provision for doubtful accounts;
- 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; and
- comparative amounts as stated for 1997 are restated using the conversion factor 1.8447 in order to state them in terms of the monetary unit current at 31 December 1998.

The consolidated statement of income includes a net monetary gain of RR 62,921 and RR 3,230 for the years ended 31 December 1998 and 1997, respectively, because on average the Group had net monetary liabilities in both years.

Mutual cancellation and barter transactions

A significant portion of accounts receivable arising from sales are settled either through a chain of non-cash transactions involving several enterprises (mutual cancellations) or, to a lesser extent, through direct settlement by goods or services from the final customer (barter). Such transactions are included in the operating activities section of the consolidated statement of cash flows on the same basis as cash transactions since such transactions are considered to be a surrogate for cash in the Russian economy. The Group accepts such consideration as settlement when the value of the consideration is equal to the related account receivable balance. Approximately 46% and 58% of accounts receivable settled during the years ended 31 December 1998 and 1997, respectively, were settled in this manner.

Reclassifications

Minor reclassifications have been made to certain prior year balances to conform to the current year presentation.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Consolidation

Significant subsidiary companies in which the Group, directly or indirectly, has an interest of more than 50% of the voting rights and/or is able to exercise control over the operations, have been fully consolidated. Separate disclosure is made of minority interests. Certain subsidiaries, which it would ordinarily be appropriate to consolidate, have been included in investments on a restated historical cost basis due to their aggregate immateriality to the Group.

Associated undertakings

Investments in associated undertakings are accounted for using the equity method. These are undertakings over which the Group exercises significant influence, but which it does not control.

Deferred profit taxes

Deferred profit tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12, "Income Taxes", Revised 1996 ("IAS 12").

IAS 12 requires the use of a balance sheet liability method for financial reporting and accounting for deferred profit taxes. Deferred profit taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the consolidated balance sheet date.

Foreign currencies

The balance sheets of foreign subsidiaries and associated undertakings and the monetary assets and liabilities which are held by the Group and denominated in foreign currencies at the year end are translated into Roubles at the exchange rates prevailing at the year end. Exchange differences arising on the retranslation of the net assets of foreign subsidiaries and associated undertakings are recognised as translation differences and included in shareholders' equity. Statements of income of foreign entities are translated at average exchange rates for the year.

Foreign currency transactions 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 consolidated income statement.

Property, plant and equipment

Property, plant and equipment are carried at historical cost restated to the equivalent purchasing power of the Rouble at 31 December 1998 on the basis of indices included in Note 3.

Oil and gas exploration and production activities are accounted for employing a successful effort method. Under this method, costs of successful development and exploratory wells are capitalised. Costs of unsuccessful exploratory wells are expensed upon determination that the well does not justify commercial development. Other exploration costs are expensed as incurred.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Major renewals and improvements are capitalised and the assets replaced are retired. Maintenance, repairs and minor renewals are expensed as incurred. Minor renewals include all expenditures that do not result in a technical enhancement of the asset beyond its original capability. Gains and losses arising from the retirement of property, plant and equipment are included in the consolidated statement of income as incurred.

Interest cost on borrowings to finance the construction of property, plant and equipment are capitalised as part of the cost of the asset during the period of time that is required to complete and prepare the asset for its intended use.

The return to a governmental authority of social assets (such as rest houses, housing, schools and medical facilities) vested to the Group at privatisation are recorded only upon both the transfer of title and relinquishment of operating responsibility of the social assets. These disposals are deemed to be a shareholder transaction because they are returns of assets for the benefit of governmental authorities, as contemplated in the original privatisation arrangements. Consequently, such disposals are accounted for as a charge to other reserves.

Depreciation, depletion and amortization (“D, D&A”) for wells and production equipment has been calculated on restated capitalised costs on a straight line basis rather than, as is the more generally accepted international industry practice, on the unit-of-production basis. As a result, gas production and reserves do not impact the computation of the Group’s D, D&A. For all other assets, depreciation is also computed on a straight line basis over the estimated useful lives of the assets as follows:

	Years
Pipelines	33
Wells and production equipment	12-40
Machinery and equipment	10-18
Buildings and roads	8-50
Social assets	5-50

Assets under construction are not depreciated.

Investments

Long-term investments, excluding marketable securities, are reflected at cost restated to the equivalent purchasing power of the Rouble at 31 December 1998. Provision for impairment is only made where, in the opinion of the Group’s management, there is a diminution in value, which is other than temporary. 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.

Marketable securities

Marketable securities are valued at the lower of restated cost or market value.

Accounts receivable

Accounts receivable are carried at anticipated realisable value. An impairment estimate is made for doubtful receivables based on a review of all outstanding amounts at the year end. This estimate reflects, inter alia, the payment record of specific debtors and management’s perception of the economic risks and factors specific to customers operating in certain regions and markets. Bad debts are written off during the year in which they are identified.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories

Inventories are valued at the lower of net realisable value or weighted average cost, restated to the equivalent purchasing power of the Rouble at 31 December 1998.

Environmental liabilities

Liabilities for environmental remediation are recorded when it is probable that an obligation exists and the amounts can be reasonably estimated.

Pension and other post-retirement benefits

Mandatory contributions to the governmental pension scheme are expensed when incurred. Discretionary pension and other post-retirement benefits are expensed when paid due to the immateriality of such payments.

Revenue recognition

Revenues are recognised for financial reporting purposes when products are delivered to customers and are stated net of VAT, excise taxes and other similar compulsory payments.

Research and development

Research costs are expensed in the year in which they are incurred. Development costs are expensed as incurred, except for major projects when it is probable that the costs will be recovered through commercial activities. Capitalised development costs are amortised over estimated useful lives.

Off-balance sheet derivative financial instruments

Off-balance sheet derivative financial instruments include forward and spot transactions and option contracts in foreign exchange markets. The Group’s normal policy is to measure these instruments using contractual rates, with resultant gains or losses being reported within gains less losses arising from dealing in foreign currency within the consolidated statement of income. The current economic circumstances have necessitated the Group to adopt specific accounting methods. The following describes the accounting methods followed by the Group:

Index Forwards

- The Group has either paid the amount due under index contracts, and realised a loss/gain, or negotiated a settlement for a lesser amount and has recognised a loss/gain based on the agreed terms, or has not settled with the counterparty. Where no settlements or agreements have been reached the loss on the index contracts has been recognised by applying the rate of exchange ruling at the date of the contract maturity, for domestic counterparties, and the year end exchange rate, for foreign counterparties. This difference in the application of exchange rates is due to the fact that settlements with domestic counterparties in the normal course of business have been performed in Roubles, and with foreign counterparties in foreign currency. Management has not recorded a gain where no settlement or agreements have been reached due to the uncertainty of collectibility.

  Gains and losses recognised on the index contracts have been offset within each counterparty since Management believes that there is a legally enforceable right to offset these amounts, and it intends to settle all the contracts with the same counterparty on a net basis.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Deliverable Forwards

- The Group has either paid the amount due under deliverable contracts and recognised a loss/gain, or negotiated a settlement for a lesser amount and has recognised a loss/gain based on the agreed terms, or has not settled with the counterparty. Where no settlements or agreements have been reached the loss on the deliverable contracts has been recognised based on the year-end exchange rate, plus interest and penalties where applicable. Management has not recorded a gain where no settlement or agreements have been reached due to the uncertainty of collectibility.

Gains and losses on the deliverable contracts have not been offset within counterparties.

Options

- Where conditions of an option agreement include the actual delivery of currency, the Group has treated a loss/gain in the same way as for the deliverable forwards contracts, otherwise the Group has used the index forwards approach.

Cash equivalents

Cash and cash equivalents comprise cash in hand and deposits held at call with banks.

Treasury shares

Treasury shares are recorded at cost, using the specific identification method. The gains (losses) arising from treasury share transactions are recognised as a movement in equity, net of associated costs including taxation.

Year 2000 compliance costs

External and internal costs incurred to modify internal use software for the Year 2000 problem are expensed as incurred.

5 SEGMENT INFORMATION

Management does not separately identify segments within the Group as it operates as a vertically integrated business with substantially all external sales generated by the gas distribution business. However, following the practice suggested by IAS 14, "Segment Reporting", Revised 1997 ("IAS 14") for vertically integrated businesses, information can be analysed based on the following business segments:

- Production - extraction of gas and other hydrocarbons;
- Refining - processing of gas and other hydrocarbons, and sale of other hydrocarbon products;
- Transport - transportation of gas;
- Distribution – gas sales in Russia and abroad; and
- Other – other activities, including banking.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

5 SEGMENT INFORMATION (continued)

	Production	Refining	Transport	Distribution	Other	Total
31 December 1998						
Segment assets	249,639	20,080	563,208	182,496	81,490	1,096,913
Unallocated assets						46,147
Inter-segment eliminations						(63,096)
Consolidated total assets						1,079,964
Segment liabilities	10,659	5,332	18,172	69,689	29,151	133,003
Unallocated liabilities						353,704
Inter-segment eliminations						(63,096)
Consolidated total liabilities						423,611
Capital expenditures for the period	18,451	1,142	25,515	-	4,443	49,551
Depreciation, depletion and amortisation	11,747	959	25,576	-	1,104	39,386
Charges for impairment and provisions	4,934	591	4,999	15,942	5,028	31,494
31 December 1997						
Segment assets	259,253	20,319	595,198	161,668	76,804	1,113,242
Unallocated assets						61,090
Inter-segment eliminations						(58,813)
Consolidated total assets						1,115,519
Segment liabilities	19,013	6,671	28,824	73,390	21,753	149,651
Unallocated liabilities						221,464
Inter-segment eliminations						(58,813)
Consolidated total liabilities						312,302
Capital expenditures for the period	31,146	2,696	34,935	-	3,682	72,459
Depreciation, depletion and amortisation	11,993	642	25,895	-	1,177	39,707
Charges for impairment and provisions	289	12	156	10,964	69	11,490

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

5 SEGMENT INFORMATION (continued)

	Production	Refining	Transport	Distribution	Other	Total
Year ended 31 December 1998						
Segment revenues						
Inter-segment sales	35,391	5,190	95,601	3,488	-	139,670
External sales	2,222	9,943	15,388	212,655	12,594	252,802
Total segment revenues	37,613	15,133	110,989	216,143	12,594	392,472
Segment expenses						
Inter-segment expenses	(350)	(3,410)	(4,188)	(131,722)	-	(139,670)
External expenses	(45,085)	(13,282)	(77,969)	(65,316)	(44,739)	(246,391)
Total segment expenses	(45,435)	(16,692)	(82,157)	(197,038)	(44,739)	(386,061)
Segment result	(7,822)	(1,559)	28,832	19,105	(32,145)	6,411
Unallocated operating expenses						(48,172)
Operating loss						(41,761)
Share of net losses of associated undertakings						(158)
Total monetary effects						(72,680)
Loss before profit tax						(114,599)
Profit tax expense						(36,185)
Loss after profit tax						(150,784)
Minority interest						3,562
Net loss						(147,222)
Year ended 31 December 1997						
Segment revenues						
Inter-segment sales	36,890	5,120	89,504	1,216	-	132,730
External sales	299	12,786	3,053	223,527	12,789	252,454
Total segment revenues	37,189	17,906	92,557	224,743	12,789	385,184
Segment expenses						
Inter-segment expenses	(441)	(4,268)	(1,915)	(126,106)	-	(132,730)
External expenses	(39,028)	(20,144)	(72,663)	(72,724)	(18,380)	(222,939)
Total segment expenses	(39,469)	(24,412)	(74,578)	(198,830)	(18,380)	(355,669)
Segment result	(2,280)	(6,506)	17,979	25,913	(5,591)	29,515
Unallocated operating expenses						(19,137)
Operating income						10,378
Share of net losses of associated undertakings						(78)
Total monetary effects						9,085
Income before profit tax						19,385
Profit tax benefit						1,474
Income after profit tax						20,859
Minority interest						(853)
Net income						20,006

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

5 SEGMENT INFORMATION (continued)

The inter-segment revenues mainly consist of:

- Production – sale of gas to the Distribution segment and sale of hydrocarbons to the Refining segment;
- Transport – rendering transportation services to the Distribution segment; and
- Distribution – sale of gas to the Transport segment for internal needs.

Internal transfer prices are established by the Group management with the objective of providing for the specific funding requirements of the individual segments in the medium and long-term.

The operations of the Group's banking subsidiaries were adversely impacted by the Russian financial crisis (see Note 2). External expenses within Other for the year ended 31 December 1998 include losses on derivatives (see Note 24) and loan losses totalling RR 18,241 and RR 4,100, respectively. Banking activities, after minority interest, contributed a net loss of RR 19,918 and net income of RR 1,872 for the years ended 31 December 1998 and 1997, respectively.

Provisions made against guarantees (see Note 22) have been included within unallocated expenses. Also included within unallocated expenses are corporate expenses, including investments impairment provisions.

Segment assets consist primarily of property, plant and equipment and current assets. Unallocated assets include investments and deferred profit tax assets. Segment liabilities comprise operating liabilities excluding items such as taxes payable, borrowings, and deferred profit tax liabilities.

Capital expenditures comprise additions to property, plant and equipment. Charges for impairment and provisions relate only to those charges made against allocated assets. A significant portion of operations is transacted by mutual cancellations or barter. As disclosed in note 3, such transactions are reported on the same basis as cash transactions. Consequently, expenses paid by mutual cancellations or barter are not disclosed as non-cash expenses in this note.

Substantially all of the Group's assets are located in the Russian Federation. Gas sales to different geographical regions are disclosed in Note 17.

6 ACCOUNTS RECEIVABLE AND PREPAYMENTS

	31 December	
	1998	**1997**
Trade receivables (net of a provision for doubtful accounts of RR 55,526 and RR 63,745 at 31 December 1998 and 1997, respectively)	126,207	140,791
Prepayments and advances paid	23,825	33,216
Other receivables (net of a provision for doubtful accounts of RR 10,957 and RR 3,689 at 31 December 1998 and 1997, respectively)	33,848	27,847
	183,880	201,854

Substantially all trade receivables are currently receivable in accordance with their contractual terms and, accordingly, are classified as current assets. Management has considered the likelihood of collection of receivables beyond 1999 when determining the amount of the provision for doubtful accounts.

Other receivables include RR 22,003 and RR 10,349 of loans receivables relating to the operations of Gazprombank and National Reserve Bank (see Note 21) at 31 December 1998 and 1997, respectively. These balances mainly represent loans issued to other banks and customers.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

7 INVENTORIES

	31 December 1998	31 December 1997
Materials and supplies	25,801	29,489
Gas (in pipelines and storage)	14,102	10,303
Goods for resale	3,743	6,671
Other	1,177	1,697
	44,823	48,160

Inventories are presented net of a provision for obsolescence of RR 6,522 and RR 3,689 at 31 December 1998 and 1997, respectively.

8 PROPERTY, PLANT AND EQUIPMENT

	Pipelines	Wells and production equipment	Machinery and equipment	Buildings and roads	Total operating assets	Social assets	Assets under construction	Total
At 31.12.96								
Restated cost	475,714	157,067	182,985	187,350	1,003,116	77,014	165,124	1,245,254
Accumulated D,D&A	(181,533)	(70,997)	(113,148)	(95,079)	(460,757)	(16,088)	-	(476,845)
Net book value at 31.12.96	294,181	86,070	69,837	92,271	542,359	60,926	165,124	768,409
D,D&A	(14,071)	(5,573)	(9,556)	(8,679)	(37,879)	(1,828)	-	(39,707)
Additions	11,421	14,620	874	41,885	68,800	8,161	(4,502)	72,459
Disposals	(2,338)	(3,165)	(2,254)	(2,171)	(9,928)	(13,622)	(6,432)	(29,982)
Increase in impairment provision	-	-	-	-	-	-	(408)	(408)
Net book value at 31.12.97	289,193	91,952	58,901	123,306	563,352	53,637	153,782	770,771
At 31.12.97								
Restated cost	483,713	171,096	171,945	229,729	1,056,483	64,728	153,782	1,274,993
Accumulated D,D&A	(194,520)	(79,144)	(113,044)	(106,423)	(493,131)	(11,091)	-	(504,222)
Net book value at 31.12.97	289,193	91,952	58,901	123,306	563,352	53,637	153,782	770,771
D,D&A	(14,143)	(5,016)	(9,706)	(8,590)	(37,455)	(1,931)	-	(39,386)
Additions	1,197	10,800	14,826	16,272	43,095	6,261	195	49,551
Disposals	(598)	(1,072)	(2,116)	(3,479)	(7,265)	(6,339)	(2,623)	(16,227)
Increase in impairment provision	-	-	-	-	-	-	(10,588)	(10,588)
Net book value at 31.12.98	275,649	96,664	61,905	127,509	561,727	51,628	140,766	754,121
At 31.12.98								
Restated cost	482,661	180,188	180,608	239,695	1,083,152	62,668	140,766	1,286,586
Accumulated D,D&A	(207,012)	(83,524)	(118,703)	(112,186)	(521,425)	(11,040)	-	(532,465)
Net book value at 31.12.98	275,649	96,664	61,905	127,509	561,727	51,628	140,766	754,121

Assets under construction are presented net of a provision for impairment of RR 14,646 and RR 4,058 at 31 December 1998 and 1997, respectively.

Included in additions above is capitalised interest of RR 3,001 and RR 2,993 for the years ended 31 December 1998 and 1997, respectively.

Included in the property, plant and equipment above are fully depreciated assets of RR 122,765 and RR 108,118 at 31 December 1998 and 1997, respectively, which are still in service.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

8 PROPERTY, PLANT AND EQUIPMENT (continued)

D,D&A disclosed above includes RR 567 and RR 716 for the years ended 31 December 1998 and 1997, respectively, which is considered a cost of self constructed assets and thus capitalised rather than expensed in the consolidated statement of income. Similarly, certain D,D&A is capitalised as a component of gas inventories and expensed in the consolidated statement of income when the gas is sold.

The Group's gas fields are operated under licenses granted by federal and local authorities. These licenses to develop and extract hydrocarbons expire between 2013 and 2016, however, they may be extended. Management intends to extend the licenses on properties expected to produce subsequent to their expiration dates.

9 INVESTMENTS

	31 December	
	1998	**1997**
Nonconsolidated subsidiaries	13,259	8,631
Associated undertakings	7,754	6,932
Other investments	25,134	32,154
	46,147	47,717

Investments are presented net of a provision for impairment of RR 34,143 and RR 11,474 at 31 December 1998 and 1997, respectively.

Nonconsolidated subsidiaries

Nonconsolidated subsidiaries include a number of entities that were not consolidated due to their aggregate immateriality to the Group.

During 1998, the Group continued a restructuring program intended to enhance the overall efficiency of its operations. As a part of this program, a number of non-core activities, such as agriculture, were segregated from the ongoing operations and transferred to newly formed subsidiaries. The aggregate carrying value of financial investments in new subsidiaries created in this way, being the net asset value of these new subsidiaries as of the date of their separating from the Group companies, was RR 15,833 and RR 9,777 at 31 December 1998 and 31 December 1997, respectively. As it is management's intention to divest these activities where possible and the value expected from their disposal is minimal, a provision for impairment was subsequently provided against the carrying value of investments in those companies.

Principal associated undertakings

			% of share capital held at 31 December	
	Country		**1998**	**1997**
Europol Gas	Poland	Gas distribution and transportation	49	49
Gasum Oy	Finland	Gas distribution and transportation	25	25
Prometheus Gas	Greece	Construction	50	50
Wintershall Gas GmbH	Germany	Gas distribution and transportation	35	35

Other investments

Included in Other investments is an interest-bearing loan of RR 9,025 and RR 4,532 at 31 December 1998 and 1997, respectively, receivable from Wintershall Gas GmbH.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

9 INVESTMENTS (continued)

Other investments also include Ukrainian bonds held by National Reserve Bank with a carrying value of RR 5,340 and RR 5,908 as at 31 December 1998 and 1997, respectively. These bonds were issued by the Ukrainian government in settlement for gas sales made to the Ukraine in 1994. The bonds are denominated in United States ("US") dollars, carry an interest rate of 8.5% per annum and are redeemable between June 1999 and March 2006. The Group has the intention and ability to hold these bonds to maturity. The Group has pledged Ukrainian bonds of RR 2,661 and RR 596 against certain short-term borrowings at 31 December 1998 and 1997, respectively.

10 ACCOUNTS PAYABLE AND ACCRUED CHARGES

	31 December	
	1998	1997
Trade payables	38,791	55,974
Accruals and deferred income	2,698	2,033
Advances received	1,719	1,682
Other payables	26,700	31,149
	69,908	90,838

Other payables includes RR 20,295 and RR 9,478 of banking liabilities relating to the operations of Gazprombank and National Reserve Bank (see Note 21) at 31 December 1998 and 1997, respectively. These balances mainly represent amounts due to banks' customers.

11 TAXES PAYABLE

	31 December	
	1998	1997
Excise tax (including deferred amounts of RR 21,783 and RR 24,972 at 31 December 1998 and 1997, respectively)	36,701	40,797
VAT (including deferred amounts of RR 10,587 and RR 13,112 at 31 December 1998 and 1997, respectively)	20,254	21,633
Tax penalties and interest	19,120	21,670
Road use and housing fund taxes (including deferred amounts of RR 4,910 and RR 5,903 at 31 December 1998 and 1997, respectively)	11,186	11,810
Mineral use and mineral restoration taxes (including deferred amounts of RR 1,424 and RR 1,393 at 31 December 1998 and 1997, respectively)	3,827	3,178
Profit tax	1,959	4,189
Pension fund and other social taxes	1,457	3,579
Other taxes	4,596	9,168
	99,100	116,024

The deferred amounts included in the taxes above are payable upon settlement of the related trade receivable balances. Substantially all accrued taxes above, excluding the deferred amounts, incur interest at a rate of 1/300 of the refinancing rate of the Central Bank of Russia (as of 5 August 1999 the refinancing rate was 55% p.a.), but not higher than 0.1% per day. The amount of interest incurred after 1 January 1999 cannot exceed the amount of unpaid tax. Interest does not accrue on tax penalties and interest.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

11 TAXES PAYABLE (continued)

On 9 June 1998, the Government of the Russian Federation issued Resolution No. 576 which reduced by 80% the amount of statutory interest on certain taxes payable as of 1 April 1998. The cumulative effect of this resolution was recognised in the consolidated financial statements in 1997 and, as a result, a net interest income on taxes payable of RR 4,600 was recognised for that year. Excluding the effects of the adjustment of prior year interest expense on taxes payable, the interest expense on taxes payable for 1997 was RR 11,780.

12 SHORT-TERM LOANS AND CURRENT PORTION OF LONG-TERM BORROWINGS

	31 December 1998	31 December 1997
Short-term loans	18,899	12,482
Current portion of long-term borrowings	7,145	3,754
	26,044	16,236

13 LONG-TERM BORROWINGS

	Currency	Due	31 December 1998	31 December 1997
Long-term borrowings payable to:				
A French banking consortium	US dollar	2000-2005	61,950	21,989
A German banking consortium	US dollar	2000-2005	51,625	27,486
An Italian banking consortium	US dollar	1998-2007	29,910	15,759
An international banking consortium	Deutsche mark	2000-2005	12,223	6,274
A German banking consortium	Deutsche mark	1999-2009	10,999	5,473
A German consortium	Deutsche mark	2000-2009	9,946	1,920
A German bank	Deutsche mark	1998-2002	9,877	6,198
Japanese companies	US dollar	1998	-	1,070
Other long-term borrowings			5,357	1,170
Total long-term borrowings			191,887	87,339
Less: current portion of long-term borrowings			(7,145)	(3,754)
			184,742	83,585

Due for repayment:

	31 December 1998	31 December 1997
Between one and two years	24,562	3,832
Between two and five years	98,937	43,612
After five years	61,243	36,141
	184,742	83,585

Interest rates on the borrowings are variable except for the Japanese and Italian borrowings, which bear fixed interest rates. The annual interest rates on US dollar denominated borrowings range from 5.7 % to 7.4 % per annum at 31 December 1998 and from 5.7 % to 7.7 % per annum at 31 December 1997. The annual interest rates on Deutsche mark ("DM") denominated borrowings range from 3.7 % to 8.5 % per annum at 31 December 1998 and from 4.1 % to 8.5 % per annum at 31 December 1997. With the exception of the Japanese borrowing, substantially all other borrowings are secured by contractual obligations to sell gas in Western Europe. The amount payable to an international banking consortium is also secured by certain assets of Zarubezhgaz Erdgashandels GmbH, a wholly owned subsidiary.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

13 LONG-TERM BORROWINGS (continued)

The US dollar to RR exchange rates were 20.65 and 5.96 at 31 December 1998 and 1997, respectively. The DM to RR exchange rates were 12.35 and 3.36 at 31 December 1998 and 1997, respectively.

Included within cash and cash equivalents on the consolidated balance sheet are balances totalling RR 10,894 and RR 5,995 at 31 December 1998 and 1997, respectively, which are restricted as to withdrawal under the terms of certain of the borrowings noted above. In addition, cash and cash equivalents includes RR 1,354 and RR 1,358 at 31 December 1998 and 1997, respectively, which are restricted as to withdrawal under Russian banking regulations.

14 PROFIT TAX

	Year ended 31 December	
	1998	**1997**
Profit tax (expense) benefit consists of:		
Current tax expense	(13,692)	(26,067)
Deferred tax (expense) benefit	(22,493)	27,541
	(36,185)	1,474

The Group accrues profit tax at the rate of 35% and 43% on profits from non-banking and banking activities, correspondingly, computed in accordance with the Russian tax legislation. Net (loss) income before profit tax for financial reporting purposes is reconciled to tax expense as follows:

	Year ended 31 December	
	1998	**1997**
IAS loss (income) before profit tax	114,599	(19,385)
Theoretical profit tax benefit (expense) at a statutory rate thereon	40,110	(6,785)
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-temporary impact of monetary gains and losses	(121,943)	(33,275)
Expenses not deductible for tax purposes	(26,875)	(11,138)
Inflation effect on deferred profit tax balance at beginning of year	(6,124)	1,557
Net reversal (increase) in valuation allowance on deferred tax assets	74,819	(160,411)
Temporary difference on statutory revaluation of the tax base	-	202,917
Allowance for capital expenditures	-	4,879
Other	3,828	3,730
Actual profit tax (expense) benefit for the year	(36,185)	1,474

The non-temporary impact of monetary gains and losses reflects the taxation charges and benefits arising from the restatement for the effects of inflation of non-monetary assets and liabilities.

Profit tax expense in the consolidated statement of income is stated net of RR 655 of tax attributable to gains arising on treasury share transactions for the year ended 31 December 1997. No profit tax expense was associated with treasury share transactions for the year ended 31 December 1998 (see Note 4).

As a result of the changes in the Russian tax legislation, a profit tax rate of 30% (38% for banking activities) has been enacted starting from 1 April 1999. As this tax rate was not substantively enacted at 31 December 1998, the effect of the change will be reflected in the consolidated financial statements for the year ended 31 December 1999. The estimated amount of the change of deferred tax liabilities as at 31 December 1998 resulting from reduction in the tax rate is RR 1,303.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

14 PROFIT TAX (continued)

Differences between the tax basis of assets and liabilities and their carrying value for IAS financial reporting purposes give rise to certain temporary differences. The tax effect of the movement on these temporary differences is recorded at the rate of 35% or 43% as applicable.

	31 December 1998	Movement in year	31 December 1997
Tax effects of taxable temporary differences:			
Accounts receivable	(11,603)	8,056	(19,659)
Inventories	(4,415)	(4,415)	-
Investments	(3,622)	(3,622)	-
Property, plant and equipment	(2,133)	(205,050)	202,917
Tax effects of deductible temporary differences:			
Tax losses carryforward	17,570	17,570	-
Provision for doubtful accounts	13,883	(1,107)	14,990
Loss on derivatives	6,601	6,601	-
Less valuation allowance:			
Property, plant and equipment	-	173,863	(173,863)
Provision for doubtful accounts	(12,257)	(1,246)	(11,011)
Tax losses carryforward	(6,542)	(6,542)	-
Loss on derivatives	(6,601)	(6,601)	-
Net deferred profit tax (liability) asset	(9,119)	(22,493)	13,374

Deferred profit tax liabilities arise mainly from the use of a modified cash basis of accounting for taxation purposes whereby sales are recognised when cash or other settlement is received.

An element of exchange losses recognised in the 1998 consolidated financial statements was not fully deductible for tax purposes in 1998, but can be carried forward for relief against any taxable profits in the next 5 years. These exchange losses together with the provisions for doubtful accounts and loss on derivatives give rise to deferred profit tax assets. Valuation allowances have been recorded against the net deferred profit tax assets for which it is not probable that sufficient taxable profit will be available to allow the benefit of that deferred tax asset to be utilised.

The deferred profit tax asset recognised in 1997 arose principally from differences in the taxable (historical cost, as adjusted by revaluations) and financial reporting (historical cost, as adjusted for the effect of IAS 29) bases of property, plant and equipment. This difference was due the fact that in 1997 there was a significant statutory revaluation of the tax base as a result of an independent appraisal. This deferred profit tax asset was reversed in 1998 as the statutory revaluation of the tax base was offset by the effects of hyperinflation.

The temporary differences associated with undistributed earnings of subsidiaries amount to RR 1,948 and RR 13,570 at 31 December 1998 and 31 December 1997, respectively. A deferred profit tax liability on these temporary differences was not recognised because management controls the timing of the reversal of the temporary differences and believes that they will not reverse in the foreseeable future.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

15 PROVISIONS FOR LIABILITIES AND CHARGES

Notes		31 December 1998	31 December 1997
24	Provision for losses on derivatives	15,755	4
22	Provision for guarantees	13,000	-
	Provision for environmental liabilities	2,952	2,952
	Other	2,991	2,663
		34,698	5,619

16 SHAREHOLDERS' EQUITY

Share capital

Share capital authorised and issued totals RR 144,888 and RR 26,757 at 31 December 1998 and 31 December 1997, respectively, and consists of 23.7 billion ordinary shares.

The increase in share capital is the result of the redenomination of the nominal share capital of each ordinary share from RR 0.01 new Roubles to RR 5 new Roubles (old RR 10 and old RR 5,000, respectively). The redenomination was approved by shareholders at the Annual General Meeting on 26 June 1998. In accordance with applicable Russian legislation, this increase resulted in a reclassification within reserves of RR 118,131.

Retained earnings and other reserves

Included in retained earnings and other reserves are the effects of the cumulative restatement to the equivalent purchasing power of the Rouble, and cumulative translation differences of RR 8,044 and RR 2,662 arising on the retranslating of the net assets of foreign subsidiaries and associated undertakings at 31 December 1998 and 1997, respectively.

Other reserves include a statutory fund for social assets, created at the time of privatisation. The Group is negotiating to return certain of these assets to governmental authorities, though this process is expected to be protracted. Social assets with a net book value of RR 2,769 and RR 6,447 have been transferred to governmental authorities during the years ended 31 December 1998 and 1997, respectively. These transactions have been recorded as a charge to other reserves.

The statutory accounting reports of the parent company, OAO Gazprom, are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net profit, as calculated in accordance with RAR. For 1998, the statutory loss for the parent company was RR 42,494. However, the legislation and other statutory laws and regulations dealing with distribution rights are open to legal interpretation and accordingly management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these consolidated financial statements. Taking into account the statutory loss recorded for the year by the parent company, dividends were not accrued for the year ended 31 December 1998. The amount of dividends approved by the shareholders and accrued for the year ended 31 December 1997 was RR 1,179.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

17 SALES

	Year ended 31 December 1998	1997
Gas sales (including excise tax, net of VAT) to customers in:		
Russia	106,212	131,059
Former Soviet Union (excluding Russia)	37,990	51,832
Europe	136,288	114,089
Gross sales of gas	280,490	296,980
Excise tax	(65,611)	(73,155)
Net sales of gas	214,879	223,825
Sales of gas condensate and other oil products (net of sales taxes)	9,942	12,786
Gas transit sales	15,388	3,053
Other revenues	12,593	12,790
	252,802	252,454

18 OPERATING EXPENSES

	Year ended 31 December 1998	1997
External transit costs	39,242	36,859
Depreciation, depletion and amortisation	37,189	38,991
Staff costs	30,162	30,122
Taxes other than on income	28,802	31,003
Provision for doubtful accounts	20,587	20,225
Derivative losses	18,241	4
Provision for impairment of investments	16,613	968
Provisions for guarantees and other charges	14,966	59
Materials	13,985	12,105
Provision for impairment of assets under construction	10,588	408
Electricity	7,686	8,833
Disposal of property, plant and equipment	6,476	16,567
Impairment provision for cost of nonconsolidated subsidiaries	6,056	9,777
Provision for inventory obsolescence	2,833	504
Goods for resale	2,477	2,775
Research and development	2,460	2,352
Gas purchases	1,443	1,625
Tax penalties	989	1,592
Other	33,768	27,307
	294,563	242,076

Operating expense captions above include RR 13,122 and RR 14,844 attributable to maintenance and repairs as well as RR 5,885 and RR 6,196 of social expenditures for the years ended 31 December 1998 and 1997, respectively.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

18 OPERATING EXPENSES (continued)

Taxes other than on income consist of:

	Year ended 31 December 1998	1997
Road use and housing fund tax	13,620	14,887
Mineral use tax (royalty)	5,678	5,936
Property tax	3,927	4,549
Mineral restoration tax	2,976	3,499
Other taxes	2,601	2,132
	28,802	31,003

Taxes other than on income included in operating expenses are computed as follows:

- Mineral use tax imposed at rates ranging from 6 % to 16 % of the sales value of gas and hydrocarbons produced. The actual rates of the tax are dictated in field licenses and are based on various factors;
- Mineral restoration tax is imposed at the rate of 10 % of the sales value of gas and hydrocarbons sold by the production units. Under current legislation, up to 100 % of mineral restoration tax assessments may be offset by a sum equal to the value of certain exploration works performed and paid for by the Group. In 1998 and 1997, the Group recovered 34 % of mineral restoration tax assessments;
- Road use and housing fund tax - vary by region and locality but generally do not exceed 2.5 % and 1.5 %, respectively of sales in the respective region; and
- Property tax imposed at a maximum of 2 % on the average annual net book value of fixed assets, intangible assets and inventory. Legislation provides for the exclusion of trunk pipelines from the taxable base.

All taxes discussed above are calculated based on amounts calculated in accordance with statutory Russian accounting regulations.

19 RECONCILIATION OF RAR (LOSS) PROFIT TO IAS NET (LOSS) INCOME

	Year ended 31 December 1998	1997
RAR (loss) profit per statutory accounts	(42,494)	42,115
Effects of IAS adjustments:		
Provisions other than for doubtful accounts	(45,442)	(11,716)
Expenses charged directly to equity under RAR	(29,522)	(40,233)
Provision for doubtful accounts	(20,587)	(20,225)
Deferred profit tax	(22,493)	27,541
Inventory indexation (effect on operating expenses)	(12,505)	(2,636)
Additional loss recognised on unsettled derivatives	(18,241)	-
Reversal of exchange difference on accounts receivable written off for IAS purposes in previous periods	(10,092)	(270)
Additional taxation	(3,802)	(5,298)
Monetary gain	62,921	3,230
Decrease in prior year's interest on taxes payable	2,893	33,503
Elimination of loss (profit) from sale of treasury shares	154	(1,217)
Other	(8,012)	(4,788)
IAS net (loss) income	(147,222)	20,006

20 (LOSS) EARNINGS PER SHARE

(Loss) earnings per share have been calculated by dividing the net (loss) income for the year by the weighted average number of shares outstanding during the year.

There were 21.4 and 21.2 billion weighted average shares outstanding for the years ended 31 December 1998 and 1997, respectively.

21 PRINCIPAL ENTERPRISES AND SUBSIDIARY UNDERTAKINGS

Principal enterprises

OAO Gazprom consists of a number of separate enterprises which individually are not joint stock companies but are recognised as separate legal entities.

Principal enterprises operating as part of OAO Gazprom are as follows:

Astrakhangazprom	Lentransgaz	Tomsktransgaz
Bashtransgaz	Mostransgaz	Tyumengazsnabkomplekt
CSTS	Nadymgazprom	TyumentNIIgiprogaz
Dagestangazprom	Novourengoiskiy GHK	Tyumentransgaz
Gazexport	Noyabrskgazdobycha	Uraltransgaz
Gazflot	Orenburggazprom	Urengoigazprom
Gazkomplektimpex	Permtransgaz	VNIIgaz
Gazkompromselstroy	Samaratransgaz	Volgogradtransgaz
Gaznadzor	Severgazprom	Volgotransgaz
Gazobezopasnost	Surgutgazprom	Yugtransgaz
Kavkaztransgaz	Tattransgaz	Yamburggazdobycha
Kubangazprom		

All of the above enterprises are wholly-owned and operate in the Russian Federation.

Noyabrskgasdobycha was formed in 1998 from assets formerly held by Surgutgazprom.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

21 PRINCIPAL ENTERPRISES AND SUBSIDIARY UNDERTAKINGS (continued)

Principal subsidiaries

	Percent of share capital held at 31 December	
	1998	**1997**
Burgaz	100	100
Gazavtomatika	51	51
Gazenergoservice	51	51
Gazfund	100	100
Gazpromavia	100	100
Gazprombank (includes 51% ownership of Atalanos Ertekforgalmi Bank ("AEB")	89	88
Informgaz	100	-
IRTs Gazprom	100	-
Mezhregiongaz	100	100
Nadymstroygazdobytcha	100	-
National Reserve Bank	65	57
Servicegazprom	100	-
Spetsgazavtotrans	51	51
Szhizhenyi Gaz	100	-
Volgogradneftemash	51	51
Zapsibgazprom	51	51
Zarubezhgaz Erdgashandels GmbH ("ZGG")	100	100

All of the subsidiary undertakings are incorporated in the Russian Federation, with the exception of AEB and ZGG which are incorporated in Hungary and Germany, respectively. ZGG acts as the holding company for the Group's interests in a number of gas distribution and transportation companies operating in Central Europe.

In the light of plans to reduce the Group's interest in the ordinary share capital of National Reserve Bank to 35% and a lack of long-term control for the Group over the bank's financial and operating policy decisions, National Reserve Bank was treated as an associated undertaking in the 1997 consolidated financial statements. In 1998, the management of National Reserve Bank was unable to fully implement its planned reorganisation of the bank's shareholding structure. The delay in the reorganisation was caused primarily by the impact of the financial crisis in Russia (see Note 2) on the operations of National Reserve Bank. This crisis also necessitated Group management taking a more active role in the control of the National Reserve Bank than that which existed at the end of 1997. Accordingly, the results from the National Reserve Bank have been fully consolidated in the 1998 consolidated financial statements and the 1997 comparatives have been restated for the purpose of consistency and comparability. In April 1999, the planned reorganisation was approved by the Russian Central Banking authorities and the Group's interest in the ordinary share capital of National Reserve Bank was formally reduced to 35%.

22 COMMITMENTS AND CONTINGENT LIABILITIES

Operating environment

The operations and earnings of the Group continue, from time to time and in varying degrees, to be affected by political, legislative, fiscal and regulatory developments, including those related to environmental protection, in Russia. 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, which generally are not covered by insurance, as well as their effect on future operations and earnings, are not predictable. While no provisions for self-insurance are included in the accompanying consolidated balance sheet, the occurrence of significant losses and impairments associated with facilities could have material effects on the Group's operations.

Year 2000 problem

The Russian government and other organisations that provide significant federal infrastructure services have announced a number of measures to address the Year 2000 problem. Group management are unable to conclude whether such steps will be sufficient to mitigate potential disruption to such infrastructure services. Furthermore, the current financial crisis as discussed in Note 2 above, could affect the ability of the government and other organisations to fund announced Year 2000 compliance programs. Any substantial disruption of infrastructure services would have an adverse effect on the operations of the Group.

Legal proceedings

The Group is a party to certain legal proceedings arising in the ordinary course of business. Additionally, 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 result of operations or financial position of the Group.

Taxation

Russian tax legislation is subject to varying interpretations and constant changes. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group may not coincide with that of management. As a result, tax authorities may detect violations of the tax legislation in transactions made and the Group may be assessed additional taxes, penalties and interest, which can be significant. The three previous calendar years are open to inspection in accordance with Russian tax legislation. This three year limit can be extended in certain circumstances.

Industry changes

The industry is continuing to undergo significant restructuring and reform initiatives and the future direction and effects of reforms are unknown at this time. Potential reforms in tariff setting policies, settlements of outstanding debts by governmental entities, and other government initiatives could each have a significant, but undeterminable effect on enterprises operating in the industry.

22 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

Environmental matters

The Group and its predecessor entities have operated in the gas exploration, extraction and transportation industry in the Russian Federation for many years. The normal activities of the Group have probably resulted in damage to the environment. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. 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 that extend the life of the related property or mitigate or prevent future environmental contamination are capitalised. Potential liabilities which might arise as a result of stricter enforcement of existing 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 there are no significant liabilities for environmental damage, other than amounts that have been accrued in the financial statements.

Social commitments

The Group significantly contributes to the maintenance and upkeep of the local infrastructure and the welfare of its employees in the areas of its production, including contributions toward the construction, development and maintenance of housing, hospitals, transport services, recreation and other social needs in the geographical areas in which it operates.

Financial guarantees

The Group has issued guarantees to third parties in the amount of RR 35,507 and RR 15,194 (guarantees of USD 1,719 million and USD 1,382 million) at 31 December 1998 and 1997, respectively.

As a result of the financial crisis discussed in Note 2, management believes that the Group will be required to settle certain of the obligations resulting from the guarantees. At 31 December 1998, a provision of RR 13,000 has been recorded within “Provisions for liabilities and charges” in respect of the guarantees issued. It is anticipated that the majority of the provision will be used during the years 2000 to 2001.

Capital commitments

In the normal course of business, the Group has entered into contracts for the purchase of property, plant and equipment. As of 31 December 1998, purchase commitments of associated companies (in respect of the share owned by the Group) amounted to RR 6,153; these commitments mainly relate to financing of construction of the YAGAL pipeline in Germany and the Polish section of the Yamal-Europe pipeline. The Board has approved a capital expenditure budget of RR 52,620 for 1999, including RR 23,276 in respect of capital expenditures on construction of the Yamal project (that includes, in particular, construction of Yamal-Europe pipeline).

23 RELATED PARTIES

Government

The Government of the Russian Federation owns approximately 38.37 % of the issued shares of the Group and governmental economic and social policies affect the Group’s financial position, results of operations and cash flows.

As a condition of privatisation in 1992, the Government imposed an obligation on the Group to provide an uninterrupted supply of gas to customers in the Russian Federation at government controlled prices. Despite widespread non-payment by Russian customers, the Group has an obligation to deliver.

23 RELATED PARTIES (continued)

Other

Included within other long-term assets are receivables from Europolgaz, an associated undertaking, in the amount of RR 17,785 and RR 2,386 at 31 December 1998 and 1997, respectively.

Gazprombank, a subsidiary of the Group, has made a number of loans to related parties, including Europolgaz. Such loans totalled RR 11,443 and RR 3,102 at 31 December 1998 and 1997, respectively, and are due at various dates from 1999 to 2016. In determining the interest rates for related party financing, the Group follows a pricing policy which requires positive interest margins to be earned on all lendings to related parties (see Note 21).

24 FINANCIAL INSTRUMENTS

Fair values

The fair value of financial instruments is determined with reference to various market information and other valuation methods as considered appropriate. At 31 December 1998 and 1997, the fair values of financial instruments other than long-term investments, trade receivables and trade payables are held by the Group did not materially differ from their carrying value. Management does not believe it is practicable to estimate the fair value of long-term investments, trade receivables and trade payables. These financial instruments are not traded at Russian financial market and an objective estimate of fair value is not, therefore, available. Information on the fair values of off-balance sheet derivative instruments is included below.

Credit risks

Financial instruments, which potentially subject the Group to concentrations of credit risk primarily consist of accounts receivables. Credit risks related to accounts receivable are systematically monitored and are considered when bad debt provisions are established. A significant portion of the Group’s accounts receivable are from local gas distribution companies and energy companies. Although collection of these receivables could be influenced by governmental and economic factors affecting these industries, management believes there is no significant risk of losses to the Group other than to the extent to which provision for doubtful accounts has already been made.

Cash is placed in financial institutions which are considered at time of deposit to have minimal risk of default.

Off-balance sheet derivative instruments

At 31 December 1998, the Group had outstanding contracts with Russian and foreign banks whereby it had agreed to buy or sell Roubles in exchange for another currency at an exchange rate agreed to at the date of the contract. Management believes that it is possible that contracts between Russian banks may become void or other remedial measures may eventually become available. In the event the outstanding contracts are declared void or settled at an amount different than the amount called for in the contract, the losses and gains would be adjusted and the difference would be recognised in the consolidated statement of income in the period that the settlement occurs.

Foreign exchange off-balance sheet financial instruments are generally traded in an over-the-counter market with professional market counterparties on standardised contractual terms and conditions. The nominal amounts for off-balance sheet financial instruments are not reflected in the consolidated balance sheet.

(In millions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1998)

24 FINANCIAL INSTRUMENTS (continued)

The following table provides an analysis of the principal or agreed amounts of contracts outstanding at the year-end and losses or gains arising. The table includes both the contracts for which the date of maturity is past due and no settlements had been completed as at 31 December 1998, and the contracts with the maturity date subsequent to the 31 December 1998. The amounts included in the table are presented on a net basis after gross positions were grouped and netted off by counterparty.

	Domestic			Foreign		
	Principal or agreed amount	Loss	Gain	Principal or agreed amount	Loss	Gain
Deliverable forwards	1,033	-	164	-	-	-
Index forwards	73,106	(11,670)	10,316	207	(413)	-
Options						
purchased	7,578	-	2,236	-	-	-
written	4,853	(1,661)	-	4,857	(2,011)	-
Total gross position	86,570	(13,331)	12,716	5,064	(2,424)	-

The economic conditions in the Russian Federation have had a significant adverse effect on the ability of many Banks to fulfil their contractual obligations. Accordingly, management has not recorded the receivable and above noted gains based on the evaluation of the credit worthiness of the counterparties.

25 POST BALANCE SHEET EVENT

In accordance with the Decree of the President of the Russian Federation dated 28 April 1997, No. 426, and for the purpose of bringing the legal status of the mentioned subsidiaries into compliance with the Civil Code of the Russian Federation, in 1999 OAO Gazprom plans to carry out a structural reorganisation of the principal enterprises of the Group. OAO Gazprom's management believes that this reorganisation will not have a significant impact on the financial position and the results of the Group activity as of the reporting date.

OAO Gazprom has utilized the services of DeGolyer and MacNaughton to perform an independent evaluation of its reserve base according to internationally accepted standards. DeGolyer and MacNaughton has concluded the update of sixteen selected properties as of December 31, 1998 and has commenced work on certain other properties not previously evaluated in accordance with internationally accepted standards. OAO Gazprom continues to utilise the Russian reserve classification for the fields which have not been evaluated by DeGolyer and MacNaughton.

To date, the results obtained by DeGolyer and MacNaughton have not shown any material differences from those reported by OAO Gazprom. Nonetheless, for purposes of the disclosure below the amount of gas reserves attributable to the fields not yet evaluated in accordance with internationally accepted standards have been adjusted to reflect the coefficient of internal estimates to independent valuation. The oil and condensate reserves which have not yet been evaluated in accordance with internationally accepted standards are disclosed according to the Russian reserve classification.

The table shown below lists proved and probable reserves estimated by DeGolyer and MacNaughton as of December 31, 1998 and December 31, 1997. Also shown are adjusted December 31, 1997 estimates based on December 31, 1996 results reduced by 1997 actual production, which were used in the 19978 disclosures. Proved reserves are those that have been proved to a high degree of certainty by analysis of the producing history of a reservoir and/or by volumetric analysis of adequate geological and engineering data. Probable reserves are those that are susceptible of being proved that are based on reasonable evidence of producible hydrocarbons within the limits of a structure or reservoir above known or inferred fluid contacts, but are defined to a lesser degree of certainty because of a more limited well control and/or the lack of definitive production tests.

Numerous uncertainties are inherent in estimating quantities of proved and probable gas reserves. The accuracy of any reserve estimate is a function of the quality of the available data and engineering and geological interpretation and judgement. The results of drilling, testing, and production after the date of the estimate may require substantial upward or downward revision. In addition, changes in prices could have an effect on the OAO Gazprom reserves because the estimates of reserves are based on prices and costs at the date when such estimates are made.

GAS RESERVES

Proved and Probable (trillions of cubic meters)	**31 December 1998**	**Adjusted 31 December 1997**	**31 December 1997**
Fields subject to independent evaluation			
Yamal	4.946	4.936	4.946
Yamburg	3.897	3.809	4.059
Urengoi	3.708	3.935	3.909
Zapolarne	2.976	-	-
Others*	2.727	1.014	1.014
Total Western Siberia	18.254	13.694	13.928
Ural Volga	0.482	0.506	0.507
	18.736	14.200	14.435
Fields not subject to independent evaluation			
Astranhan	2.157	2.195	NA
Shtokman	2.156	2.156	NA
Medvezye	0.641	0.693	NA
Zapolarne	-	3.074	NA
Other	3.358	5.790	NA
	8.312	13.908	NA
Total OAO Gazprom	**27.048**	**28.108**	**NA**

*1997 results only reflect fields estimated for 31 December 1996.

CONDENSATE, OIL and GAS LIQUIDS RESERVES**

Proved and Probable (millions of tonnes)	**31 December 1998**	**Adjusted 31 December 1997**	**31 December 1997**
Fields subject to independent evaluation	322.2	132.9	326.75
Fields not subject to independent evaluation	1,438.5	1,639.0	NA
Total OAO Gazprom	**1,760.7**	**1,771.9**	**NA**

** 1997 and 1998 results include Gas Liquids which were not estimated for Adjusted 1997.

The above disclosure does not contain any reserves of OAO Gazprom located outside of the Russian Federation or any reserves attributable to properties with unresolved license considerations. All exploration and production license were granted to OAO Gazprom in accordance with the Law of Subsoil Resources and Regulation on the Licensing and Usage of the Subsoil. OAO Gazprom believes that the company is in substantial compliance with all its material licenses.

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