OAO LUKOIL

CONSOLIDATED FINANCIAL STATEMENTS

(prepared in accordance with US GAAP)

As of December 31, 2010 and 2009
and for each of the years in the three-year period
ended December 31, 2010

ZAO KPMG
10 Presnenskaya Naberezhnaya
Moscow, Russia 123317

Telephone +7 (495) 937 4477
Fax +7 (495) 937 4400/99
Internet www.kpmg.ru

Independent Auditors' Report

The Board of Directors
OAO LUKOIL:

We have audited the accompanying consolidated balance sheets of OAO LUKOIL and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO LUKOIL and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

ZAO KPMG

ZAO KPMG
Moscow, Russian Federation
March 4, 2011

ZAO KPMG, a company incorporated under the Laws of the Russian Federation, a subsidiary of KPMG Europe LLP, and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

OAO LUKOIL
Consolidated Balance Sheets
As of December 31, 2010 and 2009
(Millions of US dollars, unless otherwise noted)

	Note	2010	2009
Assets			
Current assets			
Cash and cash equivalents	3	2,368	2,274
Short-term investments		168	75
Accounts receivable, net	5	8,219	5,935
Inventories	6	6,231	5,432
Prepaid taxes and other expenses		2,934	3,549
Other current assets		697	574
Total current assets		**20,617**	**17,839**
Investments	7	5,637	5,944
Property, plant and equipment	8, 9	54,629	52,228
Deferred income tax assets	13	676	549
Goodwill and other intangible assets	10	1,446	1,653
Other non-current assets		1,012	806
Total assets		**84,017**	**79,019**
Liabilities and Equity			
Current liabilities			
Accounts payable		5,607	4,906
Short-term borrowings and current portion of long-term debt	11	2,125	2,058
Taxes payable		2,099	1,828
Other current liabilities		944	902
Total current liabilities		**10,775**	**9,694**
Long-term debt	12, 16	9,069	9,265
Deferred income tax liabilities	13	2,417	2,080
Asset retirement obligations	8	1,788	1,189
Other long-term liabilities		360	412
Total liabilities		**24,409**	**22,640**
Equity	15		
OAO LUKOIL stockholders' equity			
Common stock		15	15
Treasury stock, at cost		(3,683)	(282)
Equity-linked notes		(980)	-
Additional paid-in capital		4,700	4,699
Retained earnings		59,212	51,634
Accumulated other comprehensive loss		(67)	(75)
Total OAO LUKOIL stockholders' equity		**59,197**	**55,991**
Non-controlling interests		411	388
Total equity		**59,608**	**56,379**
Total liabilities and equity		**84,017**	**79,019**

President of OAO LUKOIL
Alekperov V.Y.

Chief accountant of OAO LUKOIL
Kozyrev I.A.

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

OAO LUKOIL
Consolidated Statements of Income
For the years ended December 31, 2010, 2009 and 2008
(Millions of US dollars, unless otherwise noted)

	Note	2010	2009	2008
Revenues				
Sales (including excise and export tariffs)	22	104,956	81,083	107,680
Costs and other deductions				
Operating expenses		(7,969)	(7,124)	(8,126)
Cost of purchased crude oil, gas and products		(43,579)	(31,977)	(37,851)
Transportation expenses		(5,608)	(4,830)	(5,460)
Selling, general and administrative expenses		(3,558)	(3,306)	(3,860)
Depreciation, depletion and amortization		(4,154)	(3,937)	(2,958)
Taxes other than income taxes	13	(8,978)	(6,474)	(13,464)
Excise and export tariffs		(18,878)	(13,058)	(21,340)
Exploration expenses		(336)	(218)	(487)
Loss on disposals and impairments of assets		(363)	(381)	(425)
Income from operating activities		**11,533**	**9,778**	**13,709**
Interest expense		(712)	(667)	(391)
Interest and dividend income		174	134	163
Equity share in income of affiliates	7	472	351	375
Currency translation loss		(122)	(520)	(918)
Other non-operating income (expense)		125	(13)	(244)
Income before income taxes		**11,470**	**9,063**	**12,694**
Current income taxes		(2,104)	(1,922)	(4,167)
Deferred income taxes		(247)	(72)	700
Total income tax expense	13	**(2,351)**	**(1,994)**	**(3,467)**
Net income		**9,119**	**7,069**	**9,227**
Less: net income attributable to non-controlling interests		(113)	(58)	(83)
Net income attributable to OAO LUKOIL		**9,006**	**7,011**	**9,144**
Earnings per share of common stock attributable to OAO LUKOIL (US dollars):				
Basic	15	10.95	8.28	10.88
Diluted	15	10.94	8.28	10.88

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

OAO LUKOIL
Consolidated Statements of Stockholders' Equity and Comprehensive Income
For the years ended December 31, 2010, 2009 and 2008
(Millions of US dollars, unless otherwise noted)

	2010		2009		2008	
	Stockholders' equity	Comprehen-sive income	Stockholders' equity	Comprehen-sive income	Stockholders' equity	Comprehen-sive income
Common stock						
Balance as of January 1	15		15		15	
Balance as of December 31	**15**		**15**		**15**	
Treasury stock						
Balance as of January 1	(282)		(282)		(1,591)	
Stock purchased	(3,664)		-		(219)	
Stock disposed	263		-		1,528	
Balance as of December 31	**(3,683)**		**(282)**		**(282)**	
Equity-linked notes						
Balance as of January 1	-		-		-	
Equity-linked notes purchased	(980)		-		-	
Balance as of December 31	**(980)**		**-**		**-**	
Additional paid-in capital						
Balance as of January 1	4,699		4,694		4,499	
Premium on non-outstanding shares issued	1		-		20	
Effect of stock compensation plan	98		20		103	
Convertible bonds issue	113		-		-	
Changes in non-controlling interests	(141)		(15)		-	
Treasury stock disposed	(70)		-		-	
Proceeds from sale of treasury stock in excess of carrying amount	-		-		72	
Balance as of December 31	**4,700**		**4,699**		**4,694**	
Retained earnings						
Balance as of January 1	51,634		45,983		38,349	
Net income	9,006	9,006	7,011	7,011	9,144	9,144
Dividends on common stock	(1,428)		(1,360)		(1,510)	
Balance as of December 31	**59,212**		**51,634**		**45,983**	
Accumulated other comprehensive loss, net of tax						
Balance as of January 1	(75)		(70)		(59)	
Pension benefits:						
Prior service cost	12	12	(4)	(4)	(5)	(5)
Actuarial (loss) gain	(4)	(4)	1	1	(6)	(6)
Unrecognized loss on available-for-sale securities	-	-	(2)	(2)	-	-
Balance as of December 31	**(67)**		**(75)**		**(70)**	
Total comprehensive income for the year		9,014		7,006		9,133
Total OAO LUKOIL stockholders' equity as of December 31	**59,197**		**55,991**		**50,340**	
Non-controlling interests						
Balance as of January 1	388		670		577	
Net income attributable to non-controlling interests	113		58		83	
Changes in non-controlling interests	(90)		(340)		10	
Balance as of December 31	**411**		**388**		**670**	
Total equity as of December 31	**59,608**		**56,379**		**51,010**	

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

	Share activity		
	2010	**2009**	**2008**
	(thousands of shares)	**(thousands of shares)**	**(thousands of shares)**
Common stock, issued			
Balance as of January 1	850,563	850,563	850,563
Balance as of December 31	**850,563**	**850,563**	**850,563**
Treasury stock			
Balance as of January 1	(3,836)	(3,836)	(23,321)
Purchase of treasury stock	(68,912)	-	(2,899)
Disposal of treasury stock	3,540	-	22,384
Balance as of December 31	**(69,208)**	**(3,836)**	**(3,836)**

OAO LUKOIL
Consolidated Statements of Cash Flows
For the years ended December 31, 2010, 2009 and 2008
(Millions of US dollars)

	Note	2010	2009	2008
Cash flows from operating activities				
Net income attributable to OAO LUKOIL		**9,006**	**7,011**	**9,144**
Adjustments for non-cash items:				
Depreciation, depletion and amortization		4,154	3,937	2,958
Equity share in income of affiliates, net of dividends received		316	(213)	(238)
Dry hole write-offs		225	117	317
Loss on disposals and impairments of assets		363	381	425
Deferred income taxes		247	72	(700)
Non-cash currency translation gain		(44)	(57)	(668)
Non-cash investing activities		(67)	(20)	(29)
All other items – net		167	138	404
Changes in operating assets and liabilities:				
Trade accounts receivable		(2,285)	(1,171)	2,647
Inventories		(813)	(1,719)	963
Accounts payable		1,508	96	(989)
Taxes payable		274	292	(521)
Other current assets and liabilities		490	19	599
Net cash provided by operating activities		**13,541**	**8,883**	**14,312**
Cash flows from investing activities				
Acquisition of licenses		(15)	(40)	(12)
Capital expenditures		(6,596)	(6,483)	(10,525)
Proceeds from sale of property, plant and equipment		128	91	166
Purchases of investments		(137)	(216)	(398)
Proceeds from sale of investments		126	478	636
Sale of subsidiaries and equity method affiliates, net of cash disposed		130	92	3
Acquisitions of subsidiaries and equity method affiliates (including advances related to acquisitions), net of cash acquired		(932)	(2,473)	(3,429)
Net cash used in investing activities		**(7,296)**	**(8,551)**	**(13,559)**
Cash flows from financing activities				
Net movements of short-term borrowings		(213)	(1,281)	974
Cash received under sales-leaseback transaction		-	-	235
Proceeds from issuance of long-term debt		2,515	5,467	2,884
Principal repayments of long-term debt		(2,267)	(2,697)	(1,547)
Dividends paid on Company's stock		(1,471)	(1,337)	(1,437)
Dividends paid to non-controlling interest stockholders		(85)	(85)	(168)
Financing received from non-controlling interest stockholders		18	20	39
Purchase of Company's stock		(3,664)	-	(219)
Sale of Company's stock		193	-	-
Purchase of equity-linked notes		(980)	-	-
Purchases of non-controlling interests		(192)	(372)	-
Other – net		-	-	2
Net cash (used in) provided by financing activities		**(6,146)**	**(285)**	**763**
Effect of exchange rate changes on cash and cash equivalents		(5)	(12)	(118)
Net increase in cash and cash equivalents		**94**	**35**	**1,398**
Cash and cash equivalents at beginning of year		2,274	2,239	841
Cash and cash equivalents at end of year	3	**2,368**	**2,274**	**2,239**

Supplemental disclosures of cash flow information	2010	2009	2008
Interest paid	718	520	440
Income taxes paid	2,126	1,575	4,902

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

Note 1. Organization and environment

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

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

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

Business and economic environment

The Russian Federation has been experiencing political and economic change, that has affected and will continue to affect the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks, which do not typically exist in other markets. In addition, the recent contraction in the capital and credit markets has further increased the level of economic uncertainty in the environment.

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

Basis of preparation

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

Note 2. Summary of significant accounting policies

Principles of consolidation

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

Note 2. Summary of significant accounting policies (continued)

Use of estimates

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

Revenue

Revenues from the production and sale of crude oil and petroleum products are recognized when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed or determinable. Revenues include excise on petroleum products sales and duties on export sales of crude oil and petroleum products.

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

Foreign currency translation

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

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

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

In all cases, foreign currency transaction gains and losses are included in the consolidated statement of income.

As of December 31, 2010, 2009 and 2008, exchange rates of 30.48, 30.24 and 29.38 Russian rubles to the US dollar, respectively, have been used for translation purposes.

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

Cash and cash equivalents

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

Note 2. Summary of significant accounting policies (continued)

Cash with restrictions on immediate use

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

Accounts receivable

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

Inventories

The cost of finished goods and purchased products is determined using the FIFO cost method. The cost of all other inventory categories is determined using an "average cost" method.

Investments

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

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

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

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

Property, plant and equipment

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

Note 2. Summary of significant accounting policies (continued)

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

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

Production and related overhead costs are expensed as incurred.

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

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

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

Significant unproved properties are assessed for impairment individually on a regular basis and any estimated impairment is charged to expense.

Asset retirement obligations

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

Goodwill and other intangible assets

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

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

Note 2. Summary of significant accounting policies (continued)

Impairment of long-lived assets

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

Income taxes

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

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

An income tax position is recognized only if the uncertain position is more likely than not of being sustained upon examination, based on its technical merits. A recognized income tax position is measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties relating to income tax in income tax expense in the consolidated statements of income.

Interest-bearing borrowings

Interest-bearing borrowings (except those issued with interest rate lower than market value) are initially recorded at the value of net proceeds received. Any difference between the net proceeds and the redemption value is amortized at a constant rate over the term of the borrowing. Amortization is included in the consolidated statement of income and the carrying amounts are adjusted as amortization accumulates.

For borrowings (including convertible notes) issued with interest rate lower than market interest rate, the Group determines book value using market interest rate. The resulting difference is allocated to additional paid-in capital and is amortized at a constant rate over the term of the borrowings. Amortization is included in the consolidated statement of income each year and the carrying amounts are adjusted as amortization accumulates.

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

Note 2. Summary of significant accounting policies (continued)

Pension benefits

The expected costs in respect of pension obligations of Group companies are determined by an independent actuary. Obligations in respect of each employee are accrued over the reporting periods during which the employee renders service in the Group.

The Group recognizes the funded status of the postretirement defined benefit plan in the balance sheet with corresponding adjustments to accumulated other comprehensive income. The adjustment to accumulated other comprehensive income represents the net unrecognized actuarial gains and unrecognized prior service costs. These amounts are subsequently recognized as net periodic benefit cost. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods are recognized as a component of other comprehensive income. These amounts are subsequently recognized as a component of net periodic benefit cost on the same basis as the amounts recognized in accumulated other comprehensive income.

Treasury stock

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

Earnings per share

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

Contingencies

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

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

Environmental expenditures

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

Note 2. Summary of significant accounting policies (continued)

Use of derivative instruments

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

Share-based payments

The Group accounts for liability classified share-based payment awards to employees at fair value on the date of grant and as of each reporting date. Expenses are recognized over the vesting period. Equity classified share-based payment awards to employees are valued at fair value on the date of grant and expensed over the vesting period.

Comparative amounts

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

Recent accounting pronouncements

In December 2010, the FASB issued Accounting Standards Update ("ASU") No. 2010-29, *"Disclosure of Supplementary Pro Forma Information for Business Combinations."* This ASU requires that the pro forma information be presented as if the business combination occurred at the beginning of the prior annual reporting period for purposes of calculating both the current reporting period and the prior reporting period pro forma financial information. The ASU also requires that this disclosure be accompanied by a narrative description of the amount and nature of material nonrecurring pro forma adjustments. The ASU No. 2010-29 is effective for the Group for the reporting periods ending after December 15, 2010. The Group adopted ASU No. 2010-29 for the 2010 annual financial statements. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows presentation.

In December 2010, the FASB issued ASU No. 2010-28, *"When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts."* This ASU modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. As a result, ASU No. 2010-28 is eliminating an entity's ability to assert that a reporting unit is not required to perform Step 2 because the carrying amount of the reporting unit is zero or negative despite the existence of qualitative factors that indicate the goodwill is more likely than not impaired. Therefore, goodwill impairments may be reported sooner than under current practice. The ASU No. 2010-28 is effective for the Group for the reporting periods ending after December 15, 2010. The Group adopted ASU No. 2010-28 for the 2010 annual financial statements. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In July 2010, the FASB issued ASU No. 2010-20, *"Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses,"* which amends Accounting Standards Codification ("ASC") No. 310, *"Receivables."* This ASU provides financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables and requires entities provide disclosures that facilitate financial statement users' evaluation of the following: 1) the nature of credit risk inherent in the entity's portfolio of financing receivables; 2) how that risk is analyzed and assessed in arriving at the allowance for credit losses; 3) the changes and reasons for those changes in the allowance for credit losses. The ASU No. 2010-20 is effective for the Group for the reporting periods ending after December 15, 2010. The Group adopted ASU No. 2010-20 for the 2010 annual financial statements. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

Note 2. Summary of significant accounting policies (continued)

In January 2010, the FASB issued ASU No. 2010-06, *"Improving Disclosures about Fair Value Measurements,"* which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information about purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. This ASU also clarifies existing fair-value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques. ASU No. 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the detailed Level 3 roll forward disclosures (which are effective for the annual reporting periods starting after December 15, 2010 and for interim periods within those annual reporting periods). The Group adopted the requirements of ASU No. 2010-06 (except for the detailed Level 3 roll forward disclosures) starting from the first quarter of 2010. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

Note 3. Cash and cash equivalents

	As of December 31, 2010	As of December 31, 2009
Cash held in Russian rubles	367	557
Cash held in other currencies	1,506	1,384
Cash of a banking subsidiary in other currencies	171	131
Cash held in related party banks in Russian rubles	320	174
Cash held in related party banks in other currencies	4	28
Total cash and cash equivalents	**2,368**	**2,274**

Note 4. Non-cash transactions

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

	Year ended December 31, 2010	Year ended December 31, 2009	Year ended December 31, 2008
Non-cash investing activity	67	20	29
Non-cash acquisitions	-	100	1,969
Total non-cash transactions	**67**	**120**	**1,998**

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

	Year ended December 31, 2010	Year ended December 31, 2009	Year ended December 31, 2008
Net cash used in investing activity	7,296	8,923	13,559
Non-cash acquisitions	-	100	1,969
Non-cash investing activity	67	20	29
Total investing activity	**7,363**	**9,043**	**15,557**

Note 5. Accounts receivable, net

	As of December 31, 2010	As of December 31, 2009
Trade accounts receivable (net of provisions of $182 million and $191 million as of December 31, 2010 and 2009, respectively)	6,748	4,389
Current VAT and excise recoverable	1,149	1,205
Other current accounts receivable (net of provisions of $50 million and $41 million as of December 31, 2010 and 2009, respectively)	322	341
Total accounts receivable, net	**8,219**	**5,935**

Note 6. Inventories

	As of December 31, 2010	As of December 31, 2009
Crude oil and petroleum products	5,093	4,391
Materials for extraction and drilling	356	387
Materials and supplies for refining	37	37
Other goods, materials and supplies	745	617
Total inventories	**6,231**	**5,432**

Note 7. Investments

	As of December 31, 2010	As of December 31, 2009
Investments in equity method affiliates and joint ventures	4,529	4,754
Long-term loans given by non-banking subsidiaries	1,092	1,176
Other long-term investments	16	14
Total long-term investments	**5,637**	**5,944**

Investments in equity method affiliates and corporate joint ventures

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

	Year ended December 31, 2010		Year ended December 31, 2009		Year ended December 31, 2008	
	Total	Group's share	Total	Group's share	Total	Group's share
Revenues	24,348	3,672	5,139	2,275	4,590	2,144
Income before income taxes	9,187	675	1,305	478	1,602	807
Less income taxes	(2,682)	(203)	(407)	(127)	(869)	(432)
Net income	**6,505**	**472**	**898**	**351**	**733**	**375**

Note 7. Investments (continued)

	As of December 31, 2010		As of December 31, 2009	
	Total	Group's Share	Total	Group's share
Current assets	7,462	1,359	6,796	1,524
Property, plant and equipment	18,053	5,099	18,877	5,284
Other non-current assets	989	350	607	240
Total assets	26,504	6,808	26,280	7,048
Short-term debt	701	57	442	274
Other current liabilities	2,844	551	3,982	817
Long-term debt	7,809	1,079	7,769	732
Other non-current liabilities	1,805	592	1,633	471
Net assets	**13,345**	**4,529**	**12,454**	**4,754**

In December 2009, a Group company acquired the remaining 46% interest in its equity affiliate LUKARCO B.V. for $1.6 billion, thereby increasing the ownership stake to 100%. LUKARCO B.V. is a holding company, which owns a 5% share in Tengizchevroil, a joint venture which develops the Tengiz and Korolevskoe fields in Kazakhstan, and a 12.5% share in the Caspian Pipeline Consortium ("CPC"), which carries Kazakhstani and Russian oil to Novorossiysk marine terminal. Therefore the Group increased the ownership in Tengizchevroil from 2.7% to 5% and the ownership in CPC from 6.75% to 12.5%. The first installment in the amount of $300 million was paid in December 2009; the second installment in the amount of $800 million was paid in December 2010; the remaining amount should be paid no later than December 2011. The Group is using the equity method of accounting for investments in Tengizchevroil and CPC.

In June 2009, a Group company entered into an agreement with Total S.A. to acquire a 45% interest in the TRN refinery in the Netherlands. The transaction was finalized in September 2009 in the amount of approximately $688 million (after completion adjustment). The Group supplies crude oil and market refined products in line with its equity stake in the refinery. The refinery has the flexibility to process Urals blend crude oil as well as significant volumes of straight-run fuel oil and vacuum gasoil, which allowed the Group to integrate the plant into its crude oil supply and refined products marketing operations. This plant with a Nelson complexity index of 9.8 has an annual topping capacity of 7.9 million tonnes and an annual capacity of a hydro-cracking unit of approximately 3.4 million tonnes. This acquisition was made in accordance with the Group's plans to develop its refining capacity in Europe.

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

	At cost		Net	
	As of December 31, 2010	**As of December 31, 2009**	**As of December 31, 2010**	**As of December 31, 2009**
Exploration and Production:				
Western Siberia	26,137	23,465	15,260	13,878
European Russia	25,660	24,908	17,713	17,761
International	7,114	6,371	5,624	5,170
Total	58,911	54,744	38,597	36,809
Refining, Marketing, Distribution and Chemicals:				
Western Siberia	5	6	3	5
European Russia	11,057	10,009	7,205	6,717
International	6,883	6,849	4,511	4,783
Total	17,945	16,864	11,719	11,505

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

	At cost		Net	
	As of December 31, 2010	**As of December 31, 2009**	**As of December 31, 2010**	**As of December 31, 2009**
Other:				
Western Siberia	185	186	89	94
European Russia	4,404	4,170	3,881	3,697
International	440	189	343	123
Total	5,029	4,545	4,313	3,914
Total property, plant and equipment	**81,885**	**76,153**	**54,629**	**52,228**

The Company performs a regular annual impairment test of its assets. The test is based on geological models and development programs, which are revised on a regular basis at least annually. The fair value of tested assets is determined using the present value of the expected cash flows.

As a result of the test, during the year ended December 31, 2010, the Company recognized an impairment loss of $164 million for its exploration and production assets in the Western Siberia, Timan-Pechora and Central European regions of Russia. During the year ended December 31, 2009, the Company recognized an impairment loss of $238 million for its exploration and production assets in the Timan-Pechora and Central European regions of Russia. During the year ended December 31, 2009, the Group also recognized an impairment loss of $63 million related to the project in Iran due to incapability of undertaking further works because of the threat of economic sanctions of the US Government.

As of December 31, 2010 and 2009, the asset retirement obligations amounted to $1,798 million and $1,199 million, respectively, of which $10 million was included in “Other current liabilities” in the consolidated balance sheets as of each balance sheet date. During 2010 and 2009, asset retirement obligations changed as follows:

	2010	**2009**
Asset retirement obligations as of January 1	1,199	728
Accretion expense	124	63
New obligations	190	146
Changes in estimates of existing obligations	314	311
Spending on existing obligations	(6)	(7)
Property dispositions	(4)	(13)
Foreign currency translation and other adjustments	(19)	(29)
Asset retirement obligations as of December 31	**1,798**	**1,199**

The asset retirement obligations incurred during 2010 and 2009 were Level 3 (unobservable inputs) fair value measurements.

Note 9. Suspended wells

Net changes in capitalized exploratory suspended wells during 2010, 2009 and 2008 were as follows:

	2010	**2009**	**2008**
Balance as of January 1	406	337	216
Additions pending the determination of proved reserves	156	124	130
Charged to expenses	(94)	(36)	(9)
Reclassification to proved properties	(63)	(19)	-
Balance as of December 31	**405**	**406**	**337**

Note 9. Suspended wells (continued)

Aging of capitalized suspended exploratory well costs were as follows:

	As of December 31, 2010	As of December 31, 2009	As of December 31, 2008
Exploratory well costs capitalized			
for a period of one year or less	213	124	125
for two years	7	122	88
for three years	89	86	61
for four years	82	58	49
for five years or more	14	16	14
for a period of greater than one year	192	282	212
Total exploratory well costs capitalized	**405**	**406**	**337**
Number of projects that have exploratory well costs capitalized for a period greater than one year	11	15	20

Aging of the exploratory wells that have been capitalized for more than one year since completion of drilling as of December 31, 2010:

Project name (field name)	Location	As of December 31, 2010	Years wells drilled
Block A	Saudi Arabia	154	2007-2008
Vinnikovskoe	European Russia	7	2008
Centralno-Astrakhanskoe	European Russia	6	2008-2009
Gabishevskoe	European Russia	5	2008-2009
Shiriaevskoe	European Russia	4	2004-2005
6 projects of less than $4 million each	European Russia	16	2005-2009
Total of 11 projects		**192**	

The Company is currently evaluating the development plans for these projects.

Note 10. Goodwill and other intangible assets

The carrying value of goodwill and other intangible assets as of December 31, 2010 and 2009 was as follows:

	As of December 31, 2010	As of December 31, 2009
Amortized intangible assets		
Software	391	419
Licenses and other assets	409	465
Goodwill	646	769
Total goodwill and other intangible assets	**1,446**	**1,653**

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

In December 2010, the Group recognized an impairment loss of $114 million relating to goodwill on the acquisition of the Akpet group due to a change in market conditions partly caused by legislative changes. The fair value was determined based on a present value technique (Level 3 fair value measurements). The Akpet group operates petrol filling stations on the basis of dealer agreements and owns eight refined product terminals, five LNG storage tanks, three jet fuel terminals and a lubricant production plant in Turkey. There were other minor changes in goodwill relating to the disposition of assets.

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

	As of December 31, 2010	As of December 31, 2009
Short-term borrowings from third parties	728	442
Short-term borrowings from related parties	66	77
13.5% Russian ruble bonds	-	496
Current portion of long-term debt	1,331	1,043
Total short-term borrowings and current portion of long-term debt	**2,125**	**2,058**

Short-term borrowings from third parties are unsecured and include amounts repayable in US dollars of $609 million and $282 million, amounts repayable in Euros of $29 million and $76 million, amounts repayable in Russian rubles of nil and $18 million and amounts repayable in other currencies of $90 million and $66 million as of December 31, 2010 and 2009, respectively. The weighted-average interest rate on short-term borrowings from third parties was 1.87% and 2.02% per annum as of December 31, 2010 and 2009, respectively.

Russian ruble bonds

In June 2009, the Company issued 15 million short-term stock exchange bonds with a face value of 1,000 Russian rubles each. The bonds were placed at their face value with a maturity of 364 days. The coupon yield was 13.5% per annum and was paid at the maturity date. In June 2010, the Company redeemed all issued bonds in accordance with the conditions of the bond issue.

Note 12. Long-term debt

	As of December 31, 2010	As of December 31, 2009
Long-term loans and borrowings from third parties (including loans from banks in the amount of $2,071 million and $3,967 million as of December 31, 2010 and 2009, respectively)	3,764	4,043
Long-term loans and borrowings from related parties	-	1,939
6.375% non-convertible US dollar bonds, maturing 2014	896	895
2.625% convertible US dollar bonds, maturing 2015	1,388	-
6.356% non-convertible US dollar bonds, maturing 2017	500	500
7.250% non-convertible US dollar bonds, maturing 2019	595	595
6.125% non-convertible US dollar bonds, maturing 2020	998	-
6.656% non-convertible US dollar bonds, maturing 2022	500	500
7.10% Russian ruble bonds, maturing 2011	262	265
13.35% Russian ruble bonds, maturing 2012	820	827
9.20% Russian ruble bonds, maturing 2012	328	331
7.40% Russian ruble bonds, maturing 2013	197	198
Capital lease obligations	152	215
Total long-term debt	10,400	10,308
Current portion of long-term debt	(1,331)	(1,043)
Total non-current portion of long-term debt	**9,069**	**9,265**

Long-term loans and borrowings

Long-term loans and borrowings from third parties include amounts repayable in US dollars of $1,707 million and $3,493 million, amounts repayable in Euros of $369 million and $487 million, amounts repayable in Russian rubles of $1,667 million (including loans from ConocoPhillips) and $42 million, and amounts repayable in other currencies of $21 million and $21 million as of December 31, 2010 and 2009, respectively. This debt has maturity dates from 2011 through 2038. The weighted-average interest rate on long-term loans and borrowings from third parties was 4.50% and 2.77% per annum as of December 31, 2010 and 2009, respectively. The weighted-average interest rate on long-term loans and borrowings from third parties, excluding ConocoPhillips, which ceased to be a related party of the Group by the end of the third quarter of 2010, was 1.92% per annum as of December 31, 2010.

Note 12. Long-term debt (continued)

A number of long-term loan agreements contain certain financial covenants which are being met by the Group. Approximately 8% of total long-term loans and borrowings from third parties are secured by export sales and property, plant and equipment.

A Group company has an unsecured syndicated loan agreement with an outstanding amount of $720 million as of December 31, 2010, with maturity dates up to 2013. The loan was arranged by ABN AMRO Bank, Banco Bilbao Vizcaya Argentaria, BNP Paribas, The Bank of Tokyo-Mitsubishi UFJ, ING Bank, Mizuho Corporate Bank and WestLB. Borrowings under this agreement bear interest from three month LIBOR plus 0.85% to three month LIBOR plus 0.95% per annum.

Two Group companies have unsecured loan agreements with an outstanding amount of $212 million as of December 31, 2010, maturing in 2011. The loans were arranged by ABN AMRO Bank, The Bank of Tokyo-Mitsubishi UFJ, Barclays Capital, BNP Paribas, Citibank, Dresdner Kleinwort, ING Bank and WestLB. Borrowings under these agreements bear interest at three month LIBOR plus 3.25% per annum.

The Company has an unsecured syndicated loan agreement with the European Bank for Reconstruction and Development with an outstanding amount of $221 million as of December 31, 2010, maturing up to 2017. Borrowings under this agreement bear interest from six month LIBOR plus 0.45% to six month LIBOR plus 0.65% per annum.

A Group company has a secured loan agreement, arranged by Credit Suisse, supported by an Overseas Private Investment Corporation guarantee, with an outstanding amount of $158 million as of December 31, 2010. Borrowings under this agreement bear interest at six month LIBOR plus 4.8% per annum and have maturity dates up to 2015.

A Group company has an unsecured loan agreement with Citibank with an outstanding amount of $121 million as of December 31, 2010, maturing up to 2019. Borrowings under this agreement bear interest at euribor plus 0.125% per annum.

A Group company has an unsecured loan agreement with Citibank with an outstanding amount of $100 million as of December 31, 2010, maturing in 2011. Borrowings under this agreement bear interest at one month LIBOR plus 0.90% per annum.

As of December 31, 2010, the Group has a number of other loan agreements with fixed rates with a number of banks and other organizations totaling $133 million, maturing from 2011 to 2017. The weighted average interest rate under these loans was 3.98% per annum.

As of December 31, 2010, the Group has a number of other floating rate loan agreements with a number of banks and other organizations totaling $442 million, maturing from 2011 to 2018. The weighted average interest rate under these loans was 1.18% per annum.

Group companies have a number of loan agreements nominated in Russian rubles with ConocoPhillips, the Group's former related party, with an outstanding amount of $1,657 million as of December 31, 2010. This amount includes $1,424 million loaned by ConocoPhillips to our joint venture OOO Narianmarneftegaz ("NMNG") (refer to Note 18. Consolidation of Variable Interest Entity). Borrowings under these agreements bear interest at fixed rates ranging from 6.8% to 8.0% per annum and have maturity dates up to 2038. Financing under these agreements is used to develop oil production and distribution infrastructure in the Timan-Pechora region of the Russian Federation.

US dollar convertible bonds

In December 2010, a Group company issued unsecured convertible bonds totaling $1.5 billion with a coupon yield of 2.625% and maturity in June 2015. The bonds were placed at face value. The bonds are convertible into LUKOIL ADRs (each representing one ordinary share of the Company) and have a conversion price of $73.7087 per ADR. Bondholders have the right to convert the bonds into LUKOIL ADRs during the period starting from 40 days after the issue date and ending 6 dealing days before the maturity date. The issuer has the right to redeem the bonds after December 31, 2013.

Note 12. Long-term debt (continued)

US dollar non-convertible bonds

In November 2010, a Group company issued two tranches of non-convertible bonds totaling $1.0 billion with a coupon yield of 6.125% and maturity in 2020. The first tranche totaling $800 million was placed at a price of 99.081% of the bond's face value with a resulting yield to maturity of 6.250%. The second tranche totaling $200 million was placed at a price of 102.44% of the bond's face value with a resulting yield to maturity of 5.80%. These tranches have a half year coupon period.

In November 2009, a Group company issued two tranches of non-convertible bonds totaling $1.5 billion. The first tranche totaling $900 million with a coupon yield of 6.375% per annum was placed with a maturity of 5 years at a price of 99.474% of the bond's face value with a resulting yield to maturity of 6.500%. The second tranche totaling $600 million with a coupon yield of 7.250% per annum was placed with a maturity of 10 years at a price of 99.127% of the bond's face value with a resulting yield to maturity of 7.375%. These tranches have a half year coupon period.

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

Russian ruble bonds

In December 2009, the Company issued 10 million stock exchange bonds with a face value of 1,000 Russian rubles each. The bonds were placed at the face value with a maturity of 1,092 days. The bonds have a 182 days' coupon period and bear interest at 9.20% per annum.

In August 2009, the Company issued 25 million stock exchange bonds with a face value of 1,000 Russian rubles each. The bonds were placed at the face value with a maturity of 1,092 days. The bonds have a 182 days' coupon period and bear interest at 13.35% per annum.

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

Maturities of long-term debt

Annual maturities of total long-term debt during the next five years, including the portion classified as current, are $1,331 million in 2011, $1,556 million in 2012, $645 million in 2013, $1,069 million in 2014, $1,548 million in 2015 and $4,251 million thereafter.

Note 13. Taxes

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

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

Note 13. Taxes (continued)

Starting on January 1, 2009, operations in the Russian Federation are subject to a Federal income tax rate of 2.0% and a regional income tax rate that varies from 13.5% to 18.0% at the discretion of the individual regional administration. Until January 1, 2009, the Federal income tax rate was 6.5% and regional income tax rate varied from 13.5% to 17.5%. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

As of January 1, 2010 and 2009, and during 2010, 2009 and 2008, the Group did not have any unrecognized tax benefits and thus, no interest and penalties related to unrecognized tax benefits were accrued. The Group's policy is to record interest and penalties related to unrecognized tax benefits as components of income tax expense. In addition, the Group does not expect that the amount of unrecognized tax benefits will change significantly within the next 12 months.

The Company and its Russian subsidiaries file standalone income tax returns in Russia. With a few exceptions, income tax returns in Russia are open to examination by the Russian tax authorities for tax years beginning in 2008.

There are not currently, and have not been during the three years ended December 31, 2010, any provisions in the taxation legislation of the Russian Federation to permit the Group to reduce taxable profits in a Group company by offsetting tax losses in another Group company against such profits. Tax losses of a Group company in the Russian Federation may, however, be used fully or partially to offset taxable profits in the same company in any of the ten years following the year of loss.

Domestic and foreign components of income before income taxes were:

	Year ended December 31, 2010	**Year ended December 31, 2009**	**Year ended December 31, 2008**
Domestic	10,569	9,013	12,767
Foreign	901	50	(73)
Income before income taxes	**11,470**	**9,063**	**12,694**

Domestic and foreign components of income taxes were:

	Year ended December 31, 2010	**Year ended December 31, 2009**	**Year ended December 31, 2008**
Current			
Domestic	1,693	1,677	3,614
Foreign	411	245	553
Current income tax expense	2,104	1,922	4,167
Deferred			
Domestic	299	98	(523)
Foreign	(52)	(26)	(177)
Deferred income tax expense (benefit)	247	72	(700)
Total income tax expense	**2,351**	**1,994**	**3,467**

Note 13. Taxes (continued)

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

	Year ended December 31, 2010	Year ended December 31, 2009	Year ended December 31, 2008
Income before income taxes	11,470	9,063	12,694
Notional income tax at the Russian statutory rate (20% for the years 2010 and 2009, and 24% for 2008)	2,294	1,813	3,047
Increase (reduction) in income tax due to:			
Non-deductible items, net	266	252	792
Foreign rate differences	(4)	68	159
Effect of enacted tax rate changes	-	-	(299)
Domestic regional rate differences	(226)	(251)	(261)
Change in valuation allowance	21	112	29
Total income tax expense	**2,351**	**1,994**	**3,467**

Taxes other than income taxes were:

	Year ended December 31, 2010	Year ended December 31, 2009	Year ended December 31, 2008
Mineral extraction tax	7,864	5,452	12,267
Social taxes and contributions	429	399	512
Property tax	518	470	405
Other taxes and contributions	167	153	280
Taxes other than income taxes	**8,978**	**6,474**	**13,464**

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

	As of December 31, 2010	As of December 31, 2009
Other current assets	77	66
Deferred income tax assets – non-current	676	549
Other current liabilities	(85)	(50)
Deferred income tax liabilities – non-current	(2,417)	(2,080)
Net deferred income tax liability	**(1,749)**	**(1,515)**

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

	As of December 31, 2010	As of December 31, 2009
Accounts receivable	42	42
Long-term liabilities	387	295
Inventories	1	5
Property, plant and equipment	263	209
Accounts payable	14	28
Operating loss carry forwards	527	555
Other	161	132
Total gross deferred income tax assets	1,395	1,266
Less valuation allowance	(418)	(397)
Deferred income tax assets	**977**	**869**

Note 13. Taxes (continued)

	As of December 31, 2010	As of December 31, 2009
Property, plant and equipment	(2,513)	(2,189)
Accounts payable	(2)	(6)
Accounts receivable	(30)	(7)
Long-term liabilities	(61)	(58)
Inventories	(57)	(68)
Investments	(15)	(16)
Other	(48)	(40)
Deferred income tax liabilities	**(2,726)**	**(2,384)**
Net deferred income tax liability	**(1,749)**	**(1,515)**

As a result of acquisitions during 2009 the Group recognized a net deferred tax liability of $35 million.

As of December 31, 2010, retained earnings of foreign subsidiaries included $17,777 million for which deferred taxation has not been provided because remittance of the earnings has been indefinitely postponed through reinvestment and, as a result, such amounts are considered to be indefinitely invested. It is not practicable to estimate the amount of additional taxes that might be payable on such undistributed earnings.

In accordance with ASC No. 830, *"Foreign currency matters"* and ASC No. 740, *"Income Taxes"* deferred tax assets and liabilities are not recognized for the changes in exchange rate effects resulting from the translation of transactions and balances from the Russian ruble to the US dollar using historical exchange rates. Also, in accordance with ASC No. 740, no deferred tax assets or liabilities are recognized for the effects of the related statutory indexation of property, plant and equipment.

Based upon the levels of historical taxable income and projections for future taxable income over the periods in which the deferred income tax assets are deductible, management believes it is more likely than not that Group companies will realize the benefits of the deductible temporary differences and loss carry forwards, net of existing valuation allowances as of December 31, 2010 and 2009.

As of December 31, 2010, the Group had operating loss carry forwards of $2,073 million of which $3 million expire during 2011, $203 million expire during 2012, $444 million expire during 2013, $14 million expire during 2014, $1 million expire during 2015, $389 million expire during 2016, $40 million expire during 2017, $6 million expire during 2018, $15 million expire during 2019, $15 million expire during 2020, $374 million expire during 2021, $5 million expire during 2025, $67 million expire during 2026, $77 million expire during 2027, $107 million expire during 2028, $60 million expire during 2029, $64 million expire during 2030, and $187 million have an indefinite carry forward.

Note 14. Pension benefits

The Company sponsors a postretirement benefits program. The primary component of the post employment and post retirement benefits program is a defined benefit pension plan that covers the majority of the Group's employees. This plan is administered by a non-state pension fund, LUKOIL-GARANT, and provides pension benefits primarily based on years of service and final remuneration levels. The Company also provides several long-term employee benefits such as a death-in-service benefit and lump-sum payments upon retirement of a defined benefit nature and other defined benefits to certain old age and disabled pensioners who have not vested any pensions under the pension plan.

Note 14. Pension benefits (continued)

The Company's pension plan primarily consists of a defined benefit plan enabling employees to contribute a portion of their salary to the plan and at retirement to receive a lump sum amount from the Company equal to all past contributions made by the employee (up to 2% of annual salary up to October 1, 2010 and up to 4% of annual salary in further periods). Employees also have the right to receive upon retirement the benefits accumulated under the previous pension plan that was replaced in December 2003. These benefits have been fixed and included in the benefit obligation as of December 31, 2010 and 2009. The amount was determined primarily based on a formula including past pensionable service and relative salaries as of December 31, 2003.

The Company uses December 31 as the measurement date for its post employment and post retirement benefits program. An independent actuary has assessed the benefit obligations as of December 31, 2010 and 2009.

The following table provides information about the benefit obligations and plan assets as of December 31, 2010 and 2009. The benefit obligations below represent the projected benefit obligation of the pension plan.

	2010	**2009**
Benefit obligations		
Benefit obligations as of January 1	291	288
Effect of exchange rate changes	(2)	(7)
Service cost	16	17
Interest cost	23	23
Plan amendments	6	6
Actuarial loss (gain)	2	(3)
Acquisitions	3	8
Benefits paid	(40)	(30)
Curtailment gain	(3)	(11)
Benefit obligations as of December 31	**296**	**291**
Plan assets		
Fair value of plan assets as of January 1	108	88
Effect of exchange rate changes	(1)	(1)
Return on plan assets	6	12
Employer contributions	39	45
Divestiture	-	(6)
Benefits paid	(40)	(30)
Fair value of plan assets as of December 31	**112**	**108**
Funded status	(184)	(183)
Amounts recognized in the consolidated balance sheet as of December 31, 2010 and 2009		
Accrued benefit liabilities included in "Other long-term liabilities"	(144)	(143)
Accrued benefit liabilities included in "Other current liabilities"	(40)	(40)

Weighted average assumptions used to determine benefit obligations as of December 31, 2010 and 2009:

	2010	**2009**
Discount rate	7.80%	8.70%
Rate of compensation increase	7.70%	8.10%

Note 14. Pension benefits (continued)

Weighted average assumptions used to determine net periodic benefit costs for the year ended December 31, 2010 and 2009:

	2010	**2009**
Discount rate	8.70%	9.00%
Rate of compensation increase	8.10%	8.61%
Expected rate of return on plan assets	10.07%	10.89%

Included in accumulated other comprehensive loss as of December 31, 2010 and 2009, are the following before-tax amounts that have not yet been recognized in net periodic benefit cost:

	2010	**2009**
Unamortized prior service cost	84	96
Unrecognized actuarial gain	(6)	(10)
Total costs	**78**	**86**

Amounts recognized in other comprehensive loss during the year ended December 31, 2010 and 2009:

	2010	**2009**
Additional loss (gain) arising during the period	4	(5)
Additional prior service cost from plan amendment	6	6
Re-classified prior service cost amortization	(18)	(2)
Net amount recognized for the period	**(8)**	**(1)**

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

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

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

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

Type of assets	**As of December 31, 2010**	**As of December 31, 2009**
Promissory notes of Russian issuers	-	3%
Russian corporate bonds	37%	25%
Russian municipal bonds	2%	4%
Bank deposits	41%	42%
Equity securities of Russian issuers	5%	8%
Shares of OAO LUKOIL	1%	2%
Shares in investment funds	13%	14%
Other assets	1%	2%
	100%	100%

Note 14. Pension benefits (continued)

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

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

Components of net periodic benefit cost were as follows:

	Year ended December 31, 2010	Year ended December 31, 2009	Year ended December 31, 2008
Service cost	16	17	22
Interest cost	23	23	19
Less expected return on plan assets	(11)	(10)	(11)
Amortization of prior service cost	18	2	11
Curtailment gain	(3)	(11)	-
Total net periodic benefit cost	**43**	**21**	**41**

Total employer contributions for 2011 are expected to be $32 million. An amount of $14 million before-tax is included in other comprehensive income and expected to be recognized in the net periodic benefit cost in 2011.

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

	2011	2012	2013	2014	2015	5-year period 2011-2015	5-year period 2016-2020
Pension benefits	55	15	10	10	9	99	28
Other long-term employee benefits	40	16	15	14	13	98	56
Total expected benefits to be paid	**95**	**31**	**25**	**24**	**22**	**197**	**84**

Note 15. Stockholders' equity

Common stock

	As of December 31, 2010 (thousands of shares)	As of December 31, 2009 (thousands of shares)
Authorized and issued common stock, par value of 0.025 Russian rubles each	850,563	850,563
Common stock held by subsidiaries, not considered as outstanding	-	(82)
Treasury stock	(69,208)	(3,836)
Outstanding common stock	**781,355**	**846,645**

Dividends and dividend limitations

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

Note 15. Stockholders' equity (continued)

The Company's net profits were 139,853 million Russian rubles, 45,148 million Russian rubles and 66,926 million Russian rubles respectively for 2010, 2009 and 2008, pursuant to the statutory financial statements, which at the US dollar exchange rates as of December 31, 2010, 2009 and 2008, amounted to $4,589 million, $1,493 million and $2,278 million, respectively.

At the annual stockholders' meeting on June 24, 2010, dividends were declared for 2009 in the amount of 52.00 Russian rubles per common share, which at the date of the meeting was equivalent to $1.68. Dividends payable of $13 million are included in "Other current liabilities" in the consolidated balance sheets as of December 31, 2010 and 2009.

At the annual stockholders' meeting on June 25, 2009, dividends were declared for 2008 in the amount of 50.00 Russian rubles per common share, which at the date of the meeting was equivalent to $1.61.

At the annual stockholders' meeting on June 26, 2008, dividends were declared for 2007, in the amount of 42.00 Russian rubles per common share, which at the date of the decision was equivalent to $1.78.

Earnings per share

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

	Year ended December 31, 2010	Year ended December 31, 2009	Year ended December 31, 2008
Net income	9,006	7,011	9,144
Add back interest on 2.625% convertible US dollar bonds, maturing 2015 (net of tax at effective rate)	3	-	-
Total diluted net income	9,009	7,011	9,144
Weighted average number of outstanding common shares (thousands of shares)	822,359	846,646	840,108
Add back treasury shares held in respect of convertible debt (thousands of shares)	892	-	-
Weighted average number of outstanding common shares, after dilution (thousands of shares)	823,251	846,646	840,108

Treasury shares

On July 28, 2010, a Group company signed a stock purchase agreement with a ConocoPhillips' subsidiary to purchase 64.6 million of the Company's ordinary shares at $53.25 per share for the total amount of $3,442 million. This transaction was finalized in August 2010. Additionally, under this agreement the Group had a 60-day option to purchase any or all of the remaining 98.7 million of the Company's ordinary shares held by the ConocoPhillips' subsidiary for the price of $56 per share.

On September 26, 2010, the Group company exercised its option to acquire shares from the ConocoPhillips' subsidiary by sending a notice of exercise in respect of 42,500,000 LUKOIL ADRs (each representing one ordinary share of the Company). The Group company sold these ADRs to UniCredit Bank AG. These transactions were completed on September 29, 2010 when 42,500,000 LUKOIL ADRs were directly transferred to UniCredit Bank AG, and UniCredit Bank AG paid the purchase price of $2.38 billion to the ConocoPhillips' subsidiary.

Simultaneously, UniCredit Bank AG issued a series of equity-linked notes to the Group company that are redeemable for 17,500,000 LUKOIL ADRs on or before September 29, 2011. These equity-linked notes have been classified within OAO LUKOIL stockholders' equity.

Note 15. Stockholders' equity (continued)

UniCredit Bank AG also issued an option to the Group company to purchase from UniCredit Bank AG an additional 25,000,000 LUKOIL ADRs on or before September 29, 2011. The option provides for the purchase of LUKOIL ADRs at market price with a floor of $56 per ADR and is not valid if the market price per ADR is $50 or below. This option currently has a fair value of zero.

A related party of the Group has equity-linked notes that are redeemable for 25,000,000 LUKOIL ADRs on or before September 29, 2011 should the Group company not exercise its option or the option becomes invalid. If the Group company exercises the option the related party will receive from UniCredit Bank AG the cash value of ADRs equivalent to that paid by the Group company.

Note 16. Financial and derivative instruments

Fair value

The fair values of cash and cash equivalents, current accounts receivable, long-term receivables and liquid securities are approximately equal to their value as disclosed in the consolidated financial statements. The fair value of long-term receivables was determined by discounting with estimated market interest rates for similar financing arrangements.

The fair value of long-term debt differs from the amount disclosed in the consolidated financial statements. The estimated fair value of long-term debt as of December 31, 2010 and 2009 was $10,225 million and $9,976 million, respectively, as a result of discounting using estimated market interest rates for similar financing arrangements. These amounts include all future cash outflows associated with the long-term debt repayments, including the current portion and interest. Market interest rates mean the rates of raising long-term debt by companies with a similar credit rating for similar tenors, repayment schedules and similar other main terms. During the year ended December 31, 2010, the Group did not have significant transactions or events that would result in nonfinancial assets and liabilities measured at fair value on a nonrecurring basis.

Derivative instruments

The Group uses financial and commodity-based derivative contracts to manage exposures to fluctuations in foreign currency exchange rates, commodity prices, or to exploit market opportunities. Since the Group is not currently using hedge accounting, defined by ASC No. 815, *"Derivative and hedging,"* all gains and losses, realized or unrealized, from derivative contracts have been recognized in the consolidated income statement.

ASC No. 815 requires purchase and sales contracts for commodities that are readily convertible to cash (e.g., crude oil, natural gas and gasoline) to be recorded on the balance sheet as derivatives unless the contracts are for quantities the Group expects to use or sell over a reasonable period in the normal course of business (i.e., contracts eligible for the normal purchases and normal sales exception). The Group does apply the normal purchases and normal sales exception to certain long-term contracts to sell oil products. This normal purchases and normal sales exception is applied to eligible crude oil and refined product commodity purchase and sales contracts; however, the Group may elect not to apply this exception (e.g., when another derivative instrument will be used to mitigate the risk of the purchase or sale contract but hedge accounting will not be applied, in which case both the purchase or sales contract and the derivative contract mitigating the resulting risk will be recorded on the balance sheet at fair value).

Note 16. Financial and derivative instruments (continued)

The fair value hierarchy for the Group's derivative assets and liabilities accounted for at fair value on a recurring basis was:

	As of December 31, 2010				As of December 31, 2009			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets								
Commodity derivatives	-	226	-	**226**	-	341	-	**341**
Total assets	-	**226**	-	**226**	-	**341**	**-**	**341**
Liabilities								
Commodity derivatives	-	(264)	-	**(264)**	-	(386)	-	**(386)**
Total liabilities	**-**	**(264)**	-	**(264)**	**-**	**(386)**	**-**	**(386)**
Net liabilities	**-**	**(38)**	-	**(38)**	**-**	**(45)**	**-**	**(45)**

The derivative values above are based on an analysis of each contract as the fundamental unit of account as required by ASC No. 820, *"Fair Value Measurements and Disclosures;"* therefore, derivative assets and liabilities with the same counterparty are not reflected net where the legal right of offset exists. Gains or losses from contracts in one level may be offset by gains or losses on contracts in another level or by changes in values of physical contracts or positions that are not reflected in the table above.

Commodity derivative contracts

The Group operates in the worldwide crude oil, refined product, natural gas and natural gas liquids markets and is exposed to fluctuations in the prices for these commodities. These fluctuations can affect the Group's revenues as well as the cost of operating, investing and financing activities. Generally, the Group's policy is to remain exposed to the market prices of commodities. However, the Group uses futures, forwards, swaps and options in various markets to balance physical systems, meet customer needs, manage price exposures on specific transactions, and do a limited, immaterial amount of trading not directly related to the Group's physical business. These activities may move the Group's profile away from market average prices.

The fair value of commodity derivative assets and liabilities as of December 31, 2010 was:

	As of December 31, 2010
Assets	
Accounts receivable	224
Liabilities	
Accounts payable	264

Hedge accounting has not been used for items in the table.

As required under ASC No. 815 the amounts shown in the preceding table are presented gross (i.e., without netting assets and liabilities with the same counterparty where the right of offset and intent to net exist). Derivative assets and liabilities resulting from eligible commodity contracts have been netted in the consolidated balance sheet and are recorded as accounts receivable in the amount of $26 million and accounts payable in the amount of $66 million.

Financial results from commodity derivatives were included in the consolidated income statements in "Cost of purchased crude oil, gas and products" and for the years ended December 31, 2010 and 2009 amounted to a net loss of $232 million (of which realized losses were $235 million and unrealized gain was $3 million) and a net loss of $781 million (of which realized losses were $406 million and unrealized losses were $375 million), respectively.

As of December 31, 2010, the net position of outstanding commodity derivative contracts, primarily to manage price exposure on underlying operations, was not significant.

Note 16. Financial and derivative instruments (continued)

Currency exchange rate derivative contracts

The Group has foreign currency exchange rate risk resulting from its international operations. The Group does not comprehensively hedge the exposure to currency rate changes, although the Group selectively hedges certain foreign currency exchange rate exposures, such as firm commitments for capital projects or local currency tax payments and dividends.

The fair value of foreign currency derivatives assets and liabilities open at December 31, 2010 was not significant.

The impact from foreign currency derivatives during the year ended December 31, 2010 on the consolidated income statement was not significant. The net position of outstanding foreign currency swap contracts as of December 31, 2010 also was not significant.

Credit risk

The Group's financial instruments that are potentially exposed to concentrations of credit risk consist primarily of cash equivalents, over-the-counter derivative contracts and trade receivables. Cash equivalents are placed in high-quality commercial paper, money market funds and time deposits with major international banks and financial institutions.

The credit risk from the Group's over-the-counter derivative contracts, such as forwards and swaps, derives from the counterparty to the transaction, typically a major bank or financial institution. Individual counterparty exposure is managed within predetermined credit limits and includes the use of cash-call margins when appropriate, thereby reducing the risk of significant non-performance. The Group also uses futures contracts, but futures have a negligible credit risk because they are traded on the New York Mercantile Exchange or the ICE Futures.

Certain of the Group's derivative instruments contain provisions that require the Group to post collateral if the derivative exposure exceeds a threshold amount. The Group has contracts with fixed threshold amounts and other contracts with variable threshold amounts that are contingent on the Group's credit rating. The variable threshold amounts typically decline for lower credit ratings, while both the variable and fixed threshold amounts typically revert to zero if the Group falls below investment grade. Cash is the primary collateral in all contracts; however, many contracts also permit the Group to post letters of credit as collateral.

There were no derivative instruments with such credit-risk-related contingent features that were in a liability position on December 31, 2010. The Group posted $3 million in collateral in the normal course of business for the over-the-counter derivatives. If the Group's credit rating were lowered one level from its "BBB-" rating (per Standard and Poors) on December 31, 2010, and it would be below investment grade, the Group would be required to post additional collateral of $5 million to the Group's counterparties for the over-the-counter derivatives, either with cash or letters of credit. The maximum additional collateral based on the lowest downgrade would be $16 million in total.

Note 17. Business combinations

In the first quarter of 2009, the Group acquired 100% interests in OOO Smolenskneftesnab, OOO IRT Investment, OOO PM Invest and OOO Retaier House for $238 million. These are holding companies, which between them own 96 petrol stations and plots of land in Moscow, the Moscow region and other regions of central European Russia. This acquisition was made in order to expand the Group's presence on the most advantageous retail market in the Russian Federation. The Group allocated $165 million to goodwill, $113 million to property, plant and equipment, $15 million to other assets, $8 million to deferred tax liability and $47 million to other liabilities. The value of property, plant and equipment was determined by an independent appraiser.

Note 17. Business combinations (continued)

This business combination did not have a material impact on the Group's consolidated operations for the year ended December 31, 2009. Therefore, no pro-forma income statement information has been provided.

Note 18. Consolidation of Variable Interest Entity

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

The Group originally determined that NMNG is a variable interest entity as the Group's voting rights are not proportionate to its ownership rights and all of NMNG's activities are conducted on behalf of the Group and ConocoPhillips, its former related party. Based on the requirements of ASC No. 810, *"Consolidation"* the Group performs a regular qualitative analysis as to whether it is the primary beneficiary of this VIE. As a result the Group is still considered to be the primary beneficiary of NMNG and consolidated it.

NMNG's total assets were approximately $5.5 billion and $5.9 billion as of December 31, 2010 and 2009, respectively.

Note 19. Commitments and contingencies

Capital expenditure, exploration and investment programs

Under the terms of existing exploration and production license agreements in Russia the Group has to fulfill certain obligations: oil and gas exploration, wells drilling, fields development, etc., and the Group also has commitments to reach a defined level of extraction on the fields. Management believes that the Group's approved annual capital expenditure budgets fully cover all the requirements of the described license obligations.

Group companies have commitments for capital expenditure contributions in the amount of $720 million related to various production sharing agreements over the next 27 years.

The Company has signed a three-year agreement for the years 2010-2012 for drilling services with OOO Eurasia Drilling Company. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for 2011 to be approximately $1,139 million.

The Company has signed a strategic agreement for the ongoing provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for 2011 to be approximately $349 million.

The Group has a commitment to execute the capital construction program of its power generation segment and under the terms of this program power plants with a total capacity of 890 MW should be constructed. Currently the Group is approving certain amendments to the capital construction program, including its extension by the end of 2013. As of December 31, 2010, the Group estimates the amount of this commitment to be approximately $660 million.

Note 19. Commitments and contingencies (continued)

Operating lease obligations

Group companies have commitments of $846 million primarily for the lease of vessels and petroleum distribution outlets. Operating lease expenses were $155 million and $185 million during the years ended December 31, 2010 and 2009, respectively. Commitments for minimum rentals under these leases as of December 31, 2010 are as follows:

	As of December 31, 2010
2011	220
2012	168
2013	130
2014	110
2015	100
beyond	118

Insurance

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

Environmental liabilities

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

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

Social assets

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

Note 19. Commitments and contingencies (continued)

Taxation environment

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

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

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

Litigation and claims

On November 27, 2001, Archangel Diamond Corporation (“ADC”), a Canadian diamond development company, filed a lawsuit in the District Court of Denver, Colorado against OAO Archangelskgeoldobycha (“AGD”), a Group company, and the Company (together the “Defendants”). ADC alleged that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. ADC claimed total damages of approximately $4.8 billion, including compensatory damages of $1.2 billion and punitive damages of $3.6 billion. On October 15, 2002, the District Court dismissed the lawsuit for lack of personal jurisdiction. This ruling was upheld by the Colorado Court of Appeals on March 25, 2004. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts’ ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was dismissed from the lawsuit. The Supreme Court found, however, that the trial court made a procedural error by failing to hold an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company, which is whether the Company had systematic and continuous contacts in the State of Colorado at the time the lawsuit was filed. In a modified opinion dated December 19, 2005, the Colorado Supreme Court remanded the case to the Colorado Court of Appeals (instead of the District Court) to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). On June 29, 2006, the Colorado Court of Appeals declined to dismiss the case based on forum non conveniens. The Company filed a petition for certiorari on August 28, 2006, asking the Colorado Supreme Court to review this decision. On March 5, 2007, the Colorado Supreme Court remanded the case to the District Court. On June 11, 2007, the District Court ruled it would conduct an evidentiary hearing on the issue of whether the Company is subject to general personal jurisdiction in the State of Colorado. Discovery regarding jurisdiction was commenced.

Note 19. Commitments and contingencies (continued)

On June 26, 2009, three creditors of ADC filed an Involuntary Bankruptcy Petition putting ADC into bankruptcy. ADC ultimately confirmed entry of an Order For Relief and the matter was converted to a Chapter 11 Case by order dated September 29, 2009. On November 25, 2009, after adding a claim, ADC removed the case from the Colorado District Court to the US Bankruptcy Court. On December 22, 2009, the Company filed a motion seeking to have the case remanded to the Colorado District Court. On December 31, 2009, before there was a ruling on the motion seeking remand ADC filed a motion seeking withdrawal of the reference to the Bankruptcy Court and requesting the case be heard by the US District Court. On February 3, 2010, the US Bankruptcy Court ordered the Motion For Withdrawal Of The Reference be transferred to the US District Court for further action. All pending motions as well as discovery were stayed pending further order of the Court. On July 7, 2010, the District Court denied ADC's Motion for Withdrawal of reference and returned the case to the Bankruptcy Court for the determination of the Company's Motion for Remand and Abstention seeking return of the case to the Colorado state court. On October 28, 2010, the Bankruptcy Court granted the Company's Motion for Remand and Abstention and remanded the case to the Denver District Court (Colorado state court) where it is now pending. ADC is expected to commence discovery regarding general jurisdiction shortly after the Court holds a status conference on March 18, 2011. Management intends to contest jurisdiction and denies all material allegations against the Company. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

As of the date the financial statements were available to be issued 76 claims in relation to a violation of the anti-monopoly regulation were initiated against several Group companies in Russia and abroad. The Group companies were accused of violations primarily involving abuse of their dominant market position and execution of coordinated actions in oil products retail markets.

In 2008 and 2009, the Federal Anti-monopoly Service of the Russian Federation ("FAS of Russia") considered two cases which resulted in decisions being issued against a number of major Russian oil companies, including the Company and the Group's refinery plants, alleging abuse of their dominant position in the oil products wholesale market of the Russian Federation.

As for the first case, the Group refinery plants appealed the decisions of FAS of Russia in the Moscow Arbitration Court. These appeals were combined in one proceeding. In addition the Group's refinery plants appealed against the administrative fines accrued by FAS of Russia to the courts in their locations. Due to abandonment of the claim by the Group's refinery plants the combined proceeding was terminated on December 13, 2010. Due to the same reason appeals against the administrative fines of the Group's refinery plants have also been terminated. The Group's refinery plants filed an application to FAS of Russia asking for payment deferrals for the fines accrued. As of the date the financial statements were available to be issued, deferral has been approved for some of the Group's refineries. The remaining applications are under consideration.

As for the second case, the Group's refinery plants filed claims against the decisions of FAS of Russia and administrative fines accrued. Due to the signing of the agreement between FAS of Russia and OOO LUKOIL-Volgogradneftepererabotka, OOO LUKOIL-Nizhegorodnefteorgsintez and OOO LUKOIL-Permnefteorgsintez fines were significantly reduced and lawsuits were terminated. A similar agreement is agreed to be signed with OOO LUKOIL-UNP. Currently, proceedings on this case are stayed. OOO LUKOIL-Nizhegorodnefteorgsintez has already paid the fines. FAS of Russia approved payment deferrals for OOO LUKOIL-Volgogradneftepererabotka and OOO LUKOIL-Permnefteorgsintez. OOO LUKOIL-UNP is going to file an application for payment deferrals to FAS of Russia.

The total amount of administrative penalties claimed from the Group which are estimated to be possible and probable is currently $106 million, of which a provision of $96 million was accrued in the Group's consolidated financial statements as of December 31, 2010 as probable to be paid. These expenses were included in "Other non-operating expense" of the consolidated statements of income.

Note 19. Commitments and contingencies (continued)

On February 9, 2011, FAS of Russia filed a new lawsuit against the three largest Russian oil companies, including the Company, accusing them of abuse of their dominant position in the oil products market. However, the Company is not aware of the claim details until the case starts being considered. The order of legal proceedings has not been received by the Company as of the date the financial statements were available to be issued.

In March 2010, an ethanol purchase agreement signed by Getty Petroleum Marketing Inc., a Group Company, and Bionol Clearfield LLC came into force. The initial term of the agreement was five years. On June 1, 2010, Getty Petroleum Marketing Inc. filed an Arbitration claim to make amendments to the ethanol purchase agreement and to compensate for losses. On June 18, 2010, Bionol Clearfield LLC filed a counter-claim to the Arbitration tribunal of the American Arbitration Association with examination of the case in Boston to execute the agreement or to pay compensation. The amount of the claim of Bionol Clearfield LLC is $250 million. The counterparties came to an agreement about the schedule of court hearings and documents submission. Hearings began on February 16, 2011. At this time it is not possible to predict whether any of the issues in the Arbitration are remote or probable, or the likely outcome of the Arbitration. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

The Group is involved in cost recovery disputes with the Republic of Kazakhstan. The Group's share of the claim is approximately $244 million. Management is of the view that substantially all of the amounts subject to dispute are in fact recoverable under the Final Production Sharing Agreement. Management believes that the ultimate resolution of the claim will not have a material adverse impact on the Group's operating results or financial condition.

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

Note 20. Related party transactions

In the rapidly developing business environment in the Russian Federation, companies and individuals have frequently used nominees and other forms of intermediary companies in transactions. The senior management of the Company believes that the Group has appropriate procedures in place to identify and properly disclose transactions with related parties in this environment and has disclosed all of the relationships identified which it deemed to be significant. Related party sales and purchases of oil and oil products were primarily to and from affiliated companies and the Company's shareholder ConocoPhillips. Related party processing services were provided by affiliated refineries. As a result of the purchase of the Company's shares by a Group company from ConocoPhillips in September 2010 (refer to Note 15. Stockholders' equity), ConocoPhillips ceased to be a related party of the Group by the end of the third quarter of 2010.

Below are related party transactions not disclosed elsewhere in the financial statements. Refer also to Notes 3, 4, 7, 11, 12, 14, 15, 18 and 21 for other transactions with related parties.

Sales of oil and oil products to related parties were $2,383 million, $1,152 million and $436 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Other sales to related parties were $134 million, $69 million and $86 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Purchases of oil and oil products from related parties were $521 million, $862 million and $1,891 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Note 20. Related party transactions (continued)

Purchases of processing services from related parties were $719 million, $539 million and nil for the years ended December 31, 2010, 2009 and 2008, respectively.

Purchases of insurance services from related parties were nil, nil and $93 million during the years ended December 31, 2010, 2009 and 2008, respectively.

Other purchases from related parties were $39 million, $28 million and $33 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Amounts receivable from related parties, including loans and advances, were $419 million and $591 million as of December 31, 2010 and 2009, respectively. Amounts payable to related parties were $114 million and $97 million as of December 31, 2010 and 2009, respectively.

Note 21. Compensation plan

Since December 2009, the Company has a compensation plan to certain members of management for the period from 2010 to 2012, which is based on assigned shares and provides compensation consisting of two parts. The first part represents annual bonuses that are based on the number of assigned shares and the amount of dividend per share. The payment of these bonuses is contingent on the Group meeting certain financial KPIs in each financial year. The second part is based upon the Company's common stock appreciation from 2010 to 2012, with rights vesting after the date of the compensation plan's termination. The number of assigned shares is approximately 17.3 million shares.

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

The second part of the share plan is classified as equity settled. The grant date fair value of the plan was estimated at $295 million using the Black-Scholes-Merton option-pricing model, assuming a risk-free interest rate of 8.0% per annum, an expected dividend yield of 3.09% per annum, an expected term of three years and a volatility factor of 34.86%. The expected volatility factor was estimated based on the historical volatility of the Company's shares for the previous five year period up to January 2010.

As of December 31, 2010, there was $197 million of total unrecognized compensation cost related to unvested benefits. This cost is expected to be recognized periodically by the Group up to December 2012.

During the period from 2007 to 2009, the Company had a compensation plan available to certain members of management. Its conditions were similar to the conditions of the new compensation plan introduced in December 2009. The number of assigned shares was approximately 15.5 million shares. Because of an unfavorable market situation the conditions for exercising the second part of this share plan were not met and therefore no payments or share transfers to employees took place by the end of the compensation plan.

Related to these plans the Group recorded $129 million, $105 million and $134 million of compensation expenses during 2010, 2009 and 2008, respectively, of which $98 million, $20 million and $103 million, respectively, are recognized as an increase in additional paid-in capital. As December 31, 2010 and 2009, $33 million and $26 million related to these plans are included in "Other current liabilities" of the consolidated balance sheets, respectively. The total recognized tax benefits related to these accruals were $21 million during the years ended December 31, 2010, 2009 and 2008.

Note 22. Segment information

Presented below is information about the Group's operating and geographical segments for the years ended December 31, 2010, 2009 and 2008, in accordance with ASC No. 280, *"Segment reporting."*

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

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

Operating segments

2010	**Exploration and production**	**Refining, marketing and distribution**	**Chemicals**	**Power generation**	**Other**	**Elimination**	**Consolidated**
Sales							
Third parties	3,091	99,064	1,331	1,416	54	-	104,956
Inter-segment	33,885	912	278	1,277	529	(36,881)	-
Total sales	36,976	99,976	1,609	2,693	583	(36,881)	104,956
Operating expenses	3,891	3,085	385	1,913	335	(1,640)	7,969
Depreciation, depletion and amortization	2,841	967	40	183	123	-	4,154
Interest expense	874	1,153	29	38	409	(1,791)	712
Income tax expense	1,449	880	37	(14)	-	(1)	2,351
Net income	6,226	2,934	102	(167)	(12)	(77)	9,006
Total assets	59,176	62,458	1,524	4,454	16,575	(60,170)	84,017
Capital expenditures	4,933	1,320	76	420	95	-	6,844

2009	**Exploration and production**	**Refining, marketing and distribution**	**Chemicals**	**Power generation**	**Other**	**Elimination**	**Consolidated**
Sales							
Third parties	2,257	76,650	1,022	1,087	67	-	81,083
Inter-segment	22,096	784	162	1,065	725	(24,832)	-
Total sales	24,353	77,434	1,184	2,152	792	(24,832)	81,083
Operating expenses	3,500	2,682	352	1,474	472	(1,356)	7,124
Depreciation, depletion and amortization	2,612	936	41	198	150	-	3,937
Interest expense	886	1,205	14	52	381	(1,871)	667
Income tax expense	1,221	821	12	(7)	6	(59)	1,994
Net income	5,456	2,263	(69)	(162)	(147)	(330)	7,011
Total assets	55,033	56,286	1,371	4,041	14,250	(51,962)	79,019
Capital expenditures	4,687	1,316	113	283	135	-	6,534

Note 22. Segment information (continued)

2008	**Exploration and production**	**Refining, marketing and distribution**	**Chemicals**	**Power generation**	**Other**	**Elimination**	**Consolidated**
Sales							
Third parties	1,753	103,132	2,067	654	74	-	107,680
Inter-segment	25,854	1,582	28	1,260	808	(29,532)	-
Total sales	27,607	104,714	2,095	1,914	882	(29,532)	107,680
Operating expenses	3,490	4,713	798	1,171	523	(2,569)	8,126
Depreciation, depletion and amortization	1,939	816	34	69	100	-	2,958
Interest expense	870	570	4	60	241	(1,354)	391
Income tax expense	955	2,510	14	(83)	17	54	3,467
Net income	4,234	5,130	(117)	(85)	(75)	57	9,144
Total assets	47,130	45,039	940	3,982	9,573	(35,203)	71,461
Capital expenditures	7,890	2,067	121	364	147	-	10,589

Geographical segments

	2010	**2009**	**2008**
Sales of crude oil within Russia	956	735	600
Export of crude oil and sales of crude oil by foreign subsidiaries	26,342	19,914	24,007
Sales of petroleum products within Russia	10,928	8,101	13,872
Export of petroleum products and sales of petroleum products by foreign subsidiaries	60,018	46,888	62,542
Sales of chemicals within Russia	728	514	880
Export of chemicals and sales of chemicals by foreign subsidiaries	642	574	1,232
Other sales within Russia	2,881	2,235	2,335
Other export sales and other sales by foreign subsidiaries	2,461	2,122	2,212
Total sales	**104,956**	**81,083**	**107,680**

2010	**Western Siberia**	**European Russia**	**International**	**Elimination**	**Consolidated**
Sales					
Third parties	385	17,231	87,340	-	104,956
Inter-segment	17,417	27,416	38	(44,871)	-
Total sales	17,802	44,647	87,378	(44,871)	104,956
Operating expenses	2,300	4,686	1,972	(989)	7,969
Depletion, depreciation and amortization	968	2,425	761	-	4,154
Interest expense	33	530	427	(278)	712
Income taxes	631	1,362	359	(1)	2,351
Net income	2,984	5,556	542	(76)	9,006
Total assets	21,785	56,897	30,225	(24,890)	84,017
Capital expenditures	2,004	3,329	1,511	-	6,844

Note 22. Segment information (continued)

2009	**Western Siberia**	**European Russia**	**International**	**Elimination**	**Consolidated**
Sales					
Third parties	130	13,750	67,203	-	81,083
Inter-segment	11,035	26,918	18	(37,971)	-
Total sales	11,165	40,668	67,221	(37,971)	81,083
Operating expenses	1,972	4,387	1,173	(408)	7,124
Depletion, depreciation and amortization	963	2,223	751	-	3,937
Interest expense	62	643	406	(444)	667
Income taxes	624	1,210	219	(59)	1,994
Net income	2,873	4,638	(168)	(332)	7,011
Total assets	20,418	43,890	28,038	(13,327)	79,019
Capital expenditures	1,878	3,186	1,470	-	6,534

2008	**Western Siberia**	**European Russia**	**International**	**Elimination**	**Consolidated**
Sales					
Third parties	138	19,905	87,637	-	107,680
Inter-segment	15,436	38,808	40	(54,284)	-
Total sales	15,574	58,713	87,677	(54,284)	107,680
Operating expenses	1,918	5,155	2,274	(1,221)	8,126
Depletion, depreciation and amortization	832	1,499	627	-	2,958
Interest expense	37	196	260	(102)	391
Income taxes	640	2,397	376	54	3,467
Net income	1,848	7,615	(449)	130	9,144
Total assets	17,136	37,598	23,577	(6,850)	71,461
Capital expenditures	2,915	5,660	2,014	-	10,589

The Group's international sales to third parties include sales in Switzerland of $53,245 million, $37,724 million and $47,066 million for the years ended December 31, 2010, 2009 and 2008, respectively. The Group's international sales to third parties include sales in the USA of $8,595 million, $8,144 million and $12,171 million for the years ended December 31, 2010, 2009 and 2008, respectively. These amounts are attributed to individual countries based on the jurisdiction of subsidiaries making the sale.

Note 23. Subsequent events

In accordance with the requirements of ASC No. 855, *"Subsequent events,"* the Group evaluated subsequent events through the date the financial statements were available to be issued. Therefore subsequent events were evaluated by the Group up to March 4, 2010.

In January 2011, the Company received notice that the Board of Directors of ERG S.p.A. ("ERG") resolved to sell to the Company 11% in the joint venture to operate the ISAB refining complex located in Priolo (Italy). This is a partial exercise of ERG's option to sell its stake. Thus, the Group's ownership will be increased from 49% to 60%. The transaction is expected to be finalized at the end of the first quarter of 2011 and the amount payable will be €205 million ($283 million), excluding inventory. The notice was received in accordance with the initial agreement on creation of the joint venture signed in 2008. Based on the agreement ERG has a put option, the effect of which would be to increase the Group's stake in the company operating the ISAB refinery complex up to 100%.

This section provides unaudited supplemental information on oil and gas exploration and production activities in accordance with ASC No. 932, *"Disclosures About Oil and Gas Producing Activities"* in six separate tables:

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

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

I. Capitalized costs relating to oil and gas producing activities

As of December 31, 2010	International	Russia	Total consolidated companies	Group's share in equity companies
Unproved oil and gas properties	536	302	838	293
Proved oil and gas properties	6,578	50,662	57,240	2,319
Accumulated depreciation, depletion, and amortization	(1,490)	(18,530)	(20,020)	(597)
Net capitalized costs	5,624	32,434	38,058	2,015

As of December 31, 2009	International	Russia	Total consolidated companies	Group's share in equity companies
Unproved oil and gas properties	545	305	850	285
Proved oil and gas properties	5,826	47,237	53,063	1,998
Accumulated depreciation, depletion, and amortization	(1,201)	(16,460)	(17,661)	(454)
Net capitalized costs	5,170	31,082	36,252	1,829

As of December 31, 2008	International	Russia	Total consolidated companies	Group's share in equity companies
Unproved oil and gas properties	519	507	1,026	158
Proved oil and gas properties	5,391	42,248	47,639	855
Accumulated depreciation, depletion, and amortization	(901)	(14,649)	(15,550)	(209)
Net capitalized costs	5,009	28,106	33,115	804

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

Year ended December 31, 2010	International	Russia	Total consolidated companies	Group's share in equity companies
Acquisition of properties - proved	113	-	113	-
Acquisition of properties - unproved	-	15	15	122
Exploration costs	199	220	419	16
Development costs	798	3,686	4,484	115
Total costs incurred	1,110	3,921	5,031	253

Year ended December 31, 2009	International	Russia	Total consolidated companies	Group's share in equity companies
Acquisition of properties - proved	-	17	17	1,154
Acquisition of properties - unproved	-	23	23	97
Exploration costs	221	162	383	11
Development costs	549	3,726	4,275	146
Total costs incurred	770	3,928	4,698	1,408

Year ended December 31, 2008	International	Russia	Total consolidated companies	Group's share in equity companies
Acquisition of properties - proved	806	6	812	-
Acquisition of properties - unproved	49	5	54	6
Exploration costs	357	313	670	9
Development costs	719	6,430	7,149	139
Total costs incurred	1,931	6,754	8,685	154

III. Results of operations for oil and gas producing activities

The Group's results of operations for oil and gas producing activities are presented below. In accordance with ASC No. 932, sales and transfers to Group companies are based on market prices. Income taxes are based on statutory rates. The results of operations exclude corporate overhead and interest costs.

Year ended December 31, 2010	International	Russia	Total consolidated companies	Group's share in equity companies
Revenue				
Sales	1,926	19,956	21,882	1,350
Transfers	-	12,278	12,278	13
Total revenues	1,926	32,234	34,160	1,363
Production costs (excluding production taxes)	(218)	(3,023)	(3,241)	(113)
Exploration expense	(240)	(96)	(336)	(2)
Depreciation, depletion, and amortization	(292)	(2,469)	(2,761)	(127)
Accretion expense	(14)	(35)	(49)	-
Taxes other than income taxes	(257)	(17,872)	(18,129)	(321)
Related income taxes	(314)	(1,813)	(2,127)	(275)
Total results of operations for producing activities	591	6,926	7,517	525

Year ended December 31, 2009	International	Russia	Total consolidated companies	Group's share in equity companies
Revenue				
Sales	1,472	13,870	15,342	824
Transfers	-	11,850	11,850	17
Total revenues	1,472	25,720	27,192	841
Production costs (excluding production taxes)	(195)	(2,592)	(2,787)	(98)
Exploration expense	(147)	(71)	(218)	(10)
Depreciation, depletion, and amortization	(323)	(2,235)	(2,558)	(105)
Accretion expense	-	(43)	(43)	-
Taxes other than income taxes	(206)	(12,830)	(13,036)	(186)
Related income taxes	(198)	(1,399)	(1,597)	(203)
Total results of operations for producing activities	403	6,550	6,953	239

Year ended December 31, 2008	International	Russia	Total consolidated companies	Group's share in equity companies
Revenue				
Sales	1,839	24,307	26,146	1,112
Transfers	-	17,941	17,941	11
Total revenues	1,839	42,248	44,087	1,123
Production costs (excluding production taxes)	(202)	(3,006)	(3,208)	(74)
Exploration expense	(356)	(131)	(487)	(7)
Depreciation, depletion, and amortization	(313)	(1,572)	(1,885)	(52)
Accretion expense	-	(25)	(25)	-
Taxes other than income taxes	(61)	(24,668)	(24,729)	(170)
Related income taxes	(294)	(3,272)	(3,566)	(481)
Total results of operations for producing activities	613	9,574	10,187	339

IV. Reserve quantity information

Proved reserves are the estimated quantities of oil and gas reserves which geological and engineering data demonstrate will be recoverable with reasonable certainty in future years from known reservoirs under existing economic and operating conditions. In accordance with ASC No. 932 existing economic and operating conditions are based on the 12-months average price (for the years 2010 and 2009) or year-end price (for the year 2008) and the year-end costs. Proved reserves do not include additional quantities of oil and gas reserves that may result from applying secondary or tertiary recovery techniques not yet tested and determined to be economic.

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

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

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. The Subsoil Law of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. Since the law applies both to newly issued and old licenses and the Group has currently renewed nearly 50% of its licenses, management believes that licenses will be renewed upon their expiration for the remainder of the economic life of each respective field.

In January 2010, the FASB issued ASU No. 2010-03, *"Extractive activities – Oil and Gas (Topic 932): Oil and Gas Reserve Estimation and Disclosures."* The adoption of ASU No. 2010-03 did not have a significant impact on the Group's proved reserves and standardized measure of discounted future net cash flows.

Estimated net proved oil and gas reserves and changes thereto for the years ended December 31, 2010, 2009 and 2008, are shown in the tables set out below.

Millions of barrels	**Consolidated subsidiaries**			**Group's share in equity companies**
	International	Russia	Total	
Crude oil				
January 1, 2008	301	15,191	15,492	223
Revisions of previous estimates	80	(1,205)	(1,125)	1
Purchase of hydrocarbons in place	17	19	36	5
Extensions and discoveries	30	493	523	6
Production	(24)	(660)	(684)	(19)
December 31, 2008	404	13,838	14,242	216
Revisions of previous estimates	(85)	(636)	(721)	15
Purchase of hydrocarbons in place	-	39	39	102
Extensions and discoveries	37	503	540	-
Production	(27)	(673)	(700)	(20)
Sales of reserves	-	(17)	(17)	-
December 31, 2009	329	13,054	13,383	313
Revisions of previous estimates	(4)	(292)	(296)	(4)
Purchase of hydrocarbons in place	62	-	62	-
Extensions and discoveries	10	550	560	10
Production	(26)	(658)	(684)	(25)
December 31, 2010	**371**	**12,654**	**13,025**	**294**
Proved developed reserves				
December 31, 2008	208	8,806	9,014	156
December 31, 2009	186	8,442	8,628	199
December 31, 2010	**207**	**8,401**	**8,608**	**182**

The minority interest share included in the above total proved reserves was 187 million barrels, 242 million barrels and 426 million barrels as of December 31, 2010, 2009 and 2008, respectively. The minority interest share included in the above proved developed reserves was 132 million barrels, 135 million barrels and 203 million barrels as of December 31, 2010, 2009 and 2008, respectively. Substantially all minority interests relate to the reserves in the Russian Federation.

Billions of cubic feet	**Consolidated subsidiaries**			**Group's share in equity companies**
	International	Russia	Total	
Natural gas				
January 1, 2008	4,902	22,845	27,747	174
Revisions of previous estimates	566	(386)	180	4
Purchase of hydrocarbons in place	1,395	4	1,399	-
Extensions and discoveries	118	310	428	7
Production	(175)	(500)	(675)	(11)
December 31, 2008	6,806	22,273	29,079	174
Revisions of previous estimates	(294)	(6,081)	(6,375)	(3)
Purchase of hydrocarbons in place	-	13	13	130
Extensions and discoveries	294	164	458	-
Production	(175)	(436)	(611)	(15)
December 31, 2009	6,631	15,933	22,564	286
Revisions of previous estimates	(35)	1,214	1,179	11
Extensions and discoveries	98	226	324	4
Production	(187)	(540)	(727)	(26)
December 31, 2010	**6,507**	**16,833**	**23,340**	**275**
Proved developed reserves:				
December 31, 2008	1,912	5,893	7,805	114
December 31, 2009	2,002	5,636	7,638	157
December 31, 2010	**2,715**	**6,024**	**8,739**	**143**

The minority interest share included in the above total proved reserves was 31 billion cubic feet, 36 billion cubic feet and 34 billion cubic feet as of December 31, 2010, 2009 and 2008, respectively. The minority interest share included in the above proved developed reserves was 21 billion cubic feet, 23 billion cubic feet and 24 billion cubic feet as of December 31, 2010, 2009 and 2008, respectively. Substantially all minority interests relate to the reserves in the Russian Federation.

V. Standardized measure of discounted future net cash flows

The standardized measure of discounted future net cash flows, related to the above oil and gas reserves, is calculated in accordance with the requirements of ASC No. 932. Estimated future cash inflows from production are computed by applying the 12-months average price (for the years 2010 and 2009) or year-end price (for the year 2008) for oil and gas to year-end quantities of estimated net proved reserves. Adjustment in this calculation for future price changes is limited to those required by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future pre-tax net cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a ten percent discount factor. Discounting requires a year-by-year estimate of when future expenditures will be incurred and when reserves will be produced.

The information provided in the tables set out below does not represent management’s estimate of the Group’s expected future cash flows or of the value of the Group’s proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations. The arbitrary valuation prescribed under ASC No. 932 requires assumptions as to the timing and amount of future development and production costs. The calculations should not be relied upon as an indication of the Group’s future cash flows or of the value of its oil and gas reserves.

	International	Russia	Total consolidated companies	Group’s share in equity companies
As of December 31, 2010				
Future cash inflows	40,871	432,401	473,272	18,629
Future production and development costs	(23,193)	(313,375)	(336,568)	(9,503)
Future income tax expenses	(3,843)	(19,775)	(23,618)	(2,107)
Future net cash flows	13,835	99,251	113,086	7,019
Discount for estimated timing of cash flows (10% p.a.)	(8,641)	(60,808)	(69,449)	(3,656)
Discounted future net cash flows	5,194	38,443	43,637	3,363
Minority share in discounted future net cash flows	-	963	963	-

	International	Russia	Total consolidated companies	Group’s share in equity companies
As of December 31, 2009				
Future cash inflows	31,025	385,266	416,291	14,816
Future production and development costs	(18,778)	(254,811)	(273,589)	(7,692)
Future income tax expenses	(2,337)	(22,285)	(24,622)	(1,489)
Future net cash flows	9,910	108,170	118,080	5,635
Discount for estimated timing of cash flows (10% p.a.)	(6,468)	(66,015)	(72,483)	(3,013)
Discounted future net cash flows	3,442	42,155	45,597	2,622
Minority share in discounted future net cash flows	-	1,370	1,370	-

	International	Russia	Total consolidated companies	Group's share in equity companies
As of December 31, 2008				
Future cash inflows	26,612	312,334	338,946	5,546
Future production and development costs	(18,647)	(185,733)	(204,380)	(3,074)
Future income tax expenses	(318)	(21,250)	(21,568)	(516)
Future net cash flows	7,647	105,351	112,998	1,956
Discount for estimated timing of cash flows (10% p.a.)	(6,132)	(64,296)	(70,428)	(950)
Discounted future net cash flows	1,515	41,055	42,570	1,006
Minority share in discounted future net cash flows	-	1,333	1,333	-

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

Consolidated companies	**2010**	**2009**	**2008**
Discounted present value as at January 1	45,597	42,570	71,871
Net changes due to purchases and sales of minerals in place	(193)	86	(279)
Sales and transfers of oil and gas produced, net of production costs	(12,454)	(11,151)	(15,663)
Net changes in prices and production costs estimates	22,241	36,633	(113,710)
Net changes in mineral extraction taxes	(23,976)	(27,376)	79,317
Extensions and discoveries, less related costs	1,886	1,878	1,423
Development costs incurred during the period	5,565	3,201	3,528
Revisions of previous quantity estimates	(433)	(4,495)	(3,520)
Net change in income taxes	407	(1,104)	11,054
Other changes	(141)	70	123
Accretion of discount	5,138	5,285	8,426
Discounted present value at December 31	**43,637**	**45,597**	**42,570**

Group's share in equity companies	**2010**	**2009**	**2008**
Discounted present value as at January 1	2,622	1,006	4,828
Net changes due to purchases and sales of minerals in place	-	1,182	17
Sales and transfers of oil and gas produced, net of production costs	(927)	(547)	(872)
Net changes in prices and production costs estimates	2,296	2,129	(6,343)
Net changes in mineral extraction taxes	(985)	(1,086)	901
Extensions and discoveries, less related costs	53	3	38
Development costs incurred during the period	120	31	51
Revisions of previous quantity estimates	(56)	137	13
Net change in income taxes	(294)	(442)	1,553
Other changes	234	95	239
Accretion of discount	300	114	581
Discounted present value at December 31	**3,363**	**2,622**	**1,006**