OAO LUKOIL

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(prepared in accordance with US GAAP)

As of and for the three and six month periods ended June 30, 2011

(unaudited)

These interim consolidated financial statements were prepared by OAO LUKOIL in accordance with US GAAP and have not been audited by our independent auditor. If these financial statements are audited in the future, the audit could reveal differences in our consolidated financial results and we can not assure that any such differences would not be material.

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Independent Accountants' Report

The Board of Directors
OAO LUKOIL:

We have reviewed the accompanying consolidated balance sheet of OAO LUKOIL and subsidiaries as of June 30, 2011, the related consolidated statements of income for the three-month and six-month periods ended June 30, 2011 and 2010 and the related consolidated statements of stockholders' equity and comprehensive income and the related consolidated statements of cash flows for the six-month periods ended June 30, 2011 and 2010. This interim financial information is the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial information for them to be in conformity with accounting principles generally accepted in the United States of America.

ZAO KPMG

ZAO KPMG
Moscow, Russian Federation
August 26, 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
(Millions of US dollars, unless otherwise noted)

	Note	As of June 30, 2011 (unaudited)	As of December 31, 2010
Assets			
Current assets			
Cash and cash equivalents	4	4,077	2,368
Short-term investments		179	168
Accounts receivable, net	5	9,229	8,219
Inventories		7,547	6,231
Prepaid taxes and other expenses		3,540	2,934
Other current assets		914	697
Total current assets		**25,486**	**20,617**
Investments	6	5,779	5,637
Property, plant and equipment	7,8	55,779	54,629
Deferred income tax assets		793	676
Goodwill and other intangible assets	9	1,411	1,446
Other non-current assets		2,801	1,012
Total assets		**92,049**	**84,017**
Liabilities and Equity			
Current liabilities			
Accounts payable		6,084	5,607
Short-term borrowings and current portion of long-term debt	10	1,565	2,125
Taxes payable		2,581	2,099
Other current liabilities		2,740	944
Total current liabilities		**12,970**	**10,775**
Long-term debt	11, 14	9,088	9,069
Deferred income tax liabilities		3,026	2,417
Asset retirement obligations	7	2,009	1,788
Other long-term liabilities		380	360
Total liabilities		**27,473**	**24,409**
Equity	13		
OAO LUKOIL stockholders' equity			
Common stock		15	15
Treasury stock, at cost		(3,737)	(3,683)
Equity-linked notes		(980)	(980)
Additional paid-in capital		4,749	4,700
Retained earnings		64,351	59,212
Accumulated other comprehensive loss		(59)	(67)
Total OAO LUKOIL stockholders' equity		**64,339**	**59,197**
Noncontrolling interests		237	411
Total equity		**64,576**	**59,608**
Total liabilities and equity		**92,049**	**84,017**

Vice-president of OAO LUKOIL
Fedotov G.S.

Chief accountant of OAO LUKOIL
Kozyrev I.A.

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

OAO LUKOIL
Consolidated Statements of Income
(Millions of US dollars, unless otherwise noted)

	Note	For the three months ended June 30, 2011 (unaudited)	For the three months ended June 30, 2010 (unaudited)	For the six months ended June 30, 2011 (unaudited)	For the six months ended June 30, 2010 (unaudited)
Revenues					
Sales (including excise and export tariffs)	19	34,912	25,853	64,538	49,755
Costs and other deductions					
Operating expenses		(2,440)	(2,046)	(4,578)	(4,034)
Cost of purchased crude oil, gas and products		(15,162)	(10,741)	(28,007)	(20,043)
Transportation expenses		(1,653)	(1,429)	(3,073)	(2,780)
Selling, general and administrative expenses		(977)	(853)	(1,802)	(1,655)
Depreciation, depletion and amortization		(1,149)	(1,030)	(2,208)	(2,060)
Taxes other than income taxes		(3,547)	(2,269)	(6,369)	(4,349)
Excise and export tariffs		(5,777)	(4,762)	(10,391)	(9,340)
Exploration expenses		(85)	(29)	(113)	(146)
(Loss) gain on disposals and impairments of assets		(157)	13	(160)	10
Income from operating activities		**3,965**	**2,707**	**7,837**	**5,358**
Interest expense		(177)	(196)	(350)	(373)
Interest and dividend income		46	45	91	98
Equity share in income of affiliates	6	173	129	342	236
Currency translation loss		(93)	(2)	(158)	(42)
Other non-operating income (expense)		113	(46)	335	(75)
Income before income taxes		**4,027**	**2,637**	**8,097**	**5,202**
Current income taxes		(649)	(584)	(980)	(1,140)
Deferred income taxes		(165)	10	(473)	44
Total income tax expense	3	**(814)**	**(574)**	**(1,453)**	**(1,096)**
Net income		**3,213**	**2,063**	**6,644**	**4,106**
Net loss (net income) attributable to noncontrolling interests		38	(114)	124	(104)
Net income attributable to OAO LUKOIL		**3,251**	**1,949**	**6,768**	**4,002**
Earnings per share of common stock attributable to OAO LUKOIL (US dollars):	13				
Basic		4.16	2.30	8.66	4.72
Diluted		4.08	2.30	8.48	4.72

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

OAO LUKOIL
Consolidated Statements of Stockholders' Equity and Comprehensive Income (unaudited)
(Millions of US dollars, unless otherwise noted)

	Common stock	Treasury stock	Equity-linked notes	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total OAO LUKOIL stockholders' equity	Noncontrolling interests	Total equity
Six months ended June 30, 2011									
Balance as of December 31, 2010	15	(3,683)	(980)	4,700	59,212	(67)	**59,197**	411	**59,608**
Net income	-	-	-	-	6,768	-	**6,768**	(124)	**6,644**
Prior service cost	-	-	-	-	-	7	**7**	-	**7**
Unrecognized gain on available for sale securities	-	-	-	-	-	1	**1**	-	**1**
Comprehensive income							**6,776**	**(124)**	**6,652**
Dividends on common stock	-	-	-	-	(1,629)	-	**(1,629)**	-	**(1,629)**
Effect of stock compensation plan	-	-	-	49	-	-	**49**	-	**49**
Stock purchased	-	(54)	-	-	-	-	**(54)**	-	**(54)**
Changes in non-controlling interests	-	-	-	-	-	-	**-**	(50)	**(50)**
Balance as of June 30, 2011	**15**	**(3,737)**	**(980)**	**4,749**	**64,351**	**(59)**	**64,339**	**237**	**64,576**
Six months ended June 30, 2010									
Balance as of December 31, 2009	15	(282)	-	4,699	51,634	(75)	**55,991**	388	**56,379**
Net income	-	-	-	-	4,002	-	**4,002**	104	**4,106**
Prior service cost	-	-	-	-	-	6	**6**	-	**6**
Unrecognized gain on available for sale securities	-	-	-	-	-	1	**1**	-	**1**
Comprehensive income							**4,009**	**104**	**4,113**
Dividends on common stock	-	-	-	-	(1,428)	-	**(1,428)**	-	**(1,428)**
Effect of stock compensation plan	-	-	-	49	-	-	**49**	-	**49**
New shares issued	-	-	-	1	-	-	**1**	-	**1**
Stock purchased	-	(188)	-	-	-	-	**(188)**	-	**(188)**
Stock disposed	-	262	-	(69)	-	-	**193**	-	**193**
Changes in non-controlling interests	-	-	-	3	-	-	**3**	(15)	**(12)**
Balance as of June 30, 2010	**15**	**(208)**	-	**4,683**	**54,208**	**(68)**	**58,630**	**477**	**59,107**

	Share activity (thousands of shares)	
	Common stock	**Treasury stock**
Six months ended June 30, 2011		
Balance as of December 31, 2010	850,563	(69,208)
Purchase of treasury stock	-	(865)
Balance as of June 30, 2011	**850,563**	**(70,073)**
Six months ended June 30, 2010		
Balance as of December 31, 2009	850,563	(3,836)
Purchase of treasury stock	**-**	(3,622)
Disposal of treasury stock	**-**	3,540
Balance as of June 30, 2010	**850,563**	**(3,918)**

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

OAO LUKOIL
Consolidated Statements of Cash Flows
(Millions of US dollars)

	Note	For the six months ended June 30, 2011 (unaudited)	For the six months ended June 30, 2010 (unaudited)
Cash flows from operating activities			
Net income attributable to OAO LUKOIL		**6,768**	**4,002**
Adjustments for non-cash items:			
Depreciation, depletion and amortization		2,208	2,060
Equity share in income of affiliates, net of dividends received		202	(30)
Dry hole write-offs		50	94
Loss (gain) on disposals and impairments of assets		160	(10)
Deferred income taxes		473	(44)
Non-cash currency translation loss (gain)		457	(188)
Non-cash investing activities		(5)	(6)
All other items – net		65	280
Changes in operating assets and liabilities:			
Trade accounts receivable		(1,035)	(800)
Inventories		(1,343)	(764)
Accounts payable		511	779
Taxes payable		488	(16)
Other current assets and liabilities		(709)	902
Net cash provided by operating activities		**8,290**	**6,259**
Cash flows from investing activities			
Acquisition of licenses		(6)	(12)
Capital expenditures		(3,570)	(3,120)
Proceeds from sale of property, plant and equipment		35	31
Purchases of investments		(43)	(170)
Proceeds from sale of investments		45	66
Sale of subsidiaries, net of cash disposed		9	111
Acquisitions of subsidiaries and equity method affiliates (including advances related to acquisitions), net of cash acquired		(2,130)	(53)
Net cash used in investing activities		**(5,660)**	**(3,147)**
Cash flows from financing activities			
Net movements of short-term borrowings		(202)	(771)
Proceeds from issuance of long-term debt		1	13
Principal repayments of long-term debt		(687)	(604)
Dividends paid on Company common stock		(1)	(1)
Dividends paid to non-controlling interest stockholders		(50)	(34)
Financing received from related and third party non-controlling interest stockholders		2	13
Purchase of Company's stock		(54)	(188)
Sale of Company's stock		-	193
Purchase of non-controlling interest		(1)	(186)
Net cash used in financing activities		**(992)**	**(1,565)**
Effect of exchange rate changes on cash and cash equivalents		71	(73)
Net increase in cash and cash equivalents		**1,709**	**1,474**
Cash and cash equivalents at beginning of year		2,368	2,274
Cash and cash equivalents at end of period	4	**4,077**	**3,748**

Supplemental disclosures of cash flow information		
Interest paid	333	378
Income taxes paid	1,115	955

The accompanying notes are an integral part of these interim 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 interim consolidated 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

The accompanying interim consolidated financial statements and notes thereto have not been audited by independent accountants, except for the balance sheet as of December 31, 2010. In the opinion of the Company's management, the interim consolidated financial statements include all adjustments and disclosures necessary to present fairly the Group's financial position, results of operations and cash flows for the interim periods reported herein. These adjustments were of a normal recurring nature.

These interim consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("US GAAP") as applicable to interim consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the Group's December 31, 2010 annual consolidated financial statements.

The results for the six-month period ended June 30, 2011 are not necessarily indicative of the results expected for the full year.

Note 2. Summary of significant accounting policies

Principles of consolidation

These interim 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 June 30, 2011 and December 31, 2010, exchange rates of 28.08 and 30.48 Russian rubles to the US dollar, respectively, have been used for translation purposes.

Cash and cash equivalents

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

Cash with restrictions on immediate use

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

Note 2. Summary of significant accounting policies (continued)

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.

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.

Note 2. Summary of significant accounting policies (continued)

Production and related overhead costs are expensed as incurred.

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

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

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

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.

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.

Note 2. Summary of significant accounting policies (continued)

Income taxes

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

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 statement of income.

Interest-bearing borrowings

Interest-bearing borrowings (except those issued with an interest rate lower than the market rate) 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 an interest rate lower than the 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 reporting period and the carrying amounts are adjusted as amortization accumulates.

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

Pension benefits

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

Treasury stock

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

Note 2. Summary of significant accounting policies (continued)

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.

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.

Note 2. Summary of significant accounting policies (continued)

Changes in accounting policy

In January 2010, the FASB issued Accounting Standards Update ("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 to present separately 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. The Group fully adopted the requirements of ASU No. 2010-06 starting from the first quarter of 2011. 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.

Recent accounting pronouncements

In June 2011, the FASB issued ASU No. 2011-05, *"Presentation of comprehensive income,"* which amends Topic 220 of the Codification. This ASU increases the prominence of other comprehensive income in financial statements. Under this ASU, an entity will have the option to present the components of net income and comprehensive income in either one or two financial statements. The ASU eliminates the option in US GAAP to present other comprehensive income in the statement of changes in equity. ASU No. 2011-05 is effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. The Group is evaluating the effect of the adoption of ASU No. 2011-05 and does not expect any material impact on its results of operations, financial position or cash flows.

In May 2011, the FASB issued ASU No. 2011-04, *"Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs,"* which amends Topic 820 of the Codification. This ASU provides guidance for fair value measurements and disclosure requirements and clarifies the Board's intent about the application of existing fair value measurement requirements. The new standard does not extend the use of fair value but, rather, provides guidance about how fair value should be applied where it already is required or permitted under US GAAP. ASU No. 2011-04 is effective for public entities during interim and annual periods beginning after December 15, 2011 and should be applied prospectively. The Group is evaluating the effect of the adoption of ASU No. 2011-04 and does not expect any material impact on its results of operations, financial position or cash flows.

In April 2011, the FASB issued ASU No. 2011-02, *"A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring,"* which amends Topic 310 of the Codification. This ASU provides additional guidance in considering whether restructuring constitutes a troubled debt restructuring and helps creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties. ASU No. 2011-02 is effective starting from the first interim or annual period beginning on or after June 15, 2011. The Group is evaluating the effect of the adoption of ASU No. 2011-02 and does not expect any material impact on its results of operations, financial position or cash flows.

Note 3. Income taxes

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. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

The Group's effective income tax rate for the periods presented differs from the statutory income tax rate primarily due to domestic and foreign rate differences and the incurrence of costs that are either not tax deductible or only deductible to a certain limit.

Note 4. Cash and cash equivalents

	As of June 30, 2011	As of December 31, 2010
Cash held in Russian rubles	1,354	367
Cash held in other currencies	2,588	1,506
Cash of a banking subsidiary in other currencies	81	171
Cash held in related party banks in Russian rubles	46	320
Cash held in related party banks in other currencies	8	4
Total cash and cash equivalents	**4,077**	**2,368**

Note 5. Accounts receivable, net

	As of June 30, 2011	As of December 31, 2010
Trade accounts receivable (net of provisions of $171 million and $182 million as of June 30, 2011 and December 31, 2010, respectively)	7,270	6,748
Current VAT and excise recoverable	1,476	1,149
Other current accounts receivable (net of provisions of $59 million and $50 million as of June 30, 2011 and December 31, 2010, respectively)	483	322
Total accounts receivable, net	**9,229**	**8,219**

Note 6. Investments

	As of June 30, 2011	As of December 31, 2010
Investments in equity method affiliates and joint ventures	4,711	4,529
Long-term loans given by non-banking subsidiaries	1,059	1,092
Other long-term investments	9	16
Total long-term investments	**5,779**	**5,637**

Investments in "equity method" affiliates and joint ventures

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

	For the three months ended June 30, 2011		For the three months ended June 30, 2010	
	Total	Group's share	Total	Group's share
Revenues	8,518	1,284	8,050	1,008
Income before income taxes	3,578	275	2,125	170
Less income taxes	(1,130)	(102)	(453)	(41)
Net income	**2,448**	**173**	**1,672**	**129**

	For the six months ended June 30, 2011		For the six months ended June 30, 2010	
	Total	Group's share	Total	Group's share
Revenues	16,420	2,371	11,658	1,743
Income before income taxes	6,906	509	4,399	341
Less income taxes	(2,106)	(167)	(1,300)	(105)
Net income	**4,800**	**342**	**3,099**	**236**

Note 6. Investments (continued)

	As of June 30, 2011		As of December 31, 2010	
	Total	Group's share	Total	Group's share
Current assets	6,879	1,360	7,462	1,359
Property, plant and equipment	17,969	5,406	18,053	5,099
Other non-current assets	1,672	552	989	350
Total assets	26,520	7,318	26,504	6,808
Short-term debt	1,018	215	701	57
Other current liabilities	3,820	766	2,844	551
Long-term debt	7,379	975	7,809	1,079
Other non-current liabilities	1,613	651	1,805	592
Net assets	**12,690**	**4,711**	**13,345**	**4,529**

In January 2011, a Group company received a notice that the Board of Directors of ERG S.p.A. ("ERG") decided to partially exercise its option to sell to the Group an 11% interest in the joint venture which operates the ISAB refining complex located in Priolo (Italy). The notice was received in accordance with the initial agreement on the establishment of the joint venture signed in 2008. The transaction was finalized on April 1, 2011, in the amount of approximately €241 million ($342 million). As a result the Group's interest in the joint venture was increased from 49% to 60%. Based on the agreement ERG and the Company still have equal participation rights. Therefore the Group continues to use the equity method of accounting for this joint venture. ERG has a put option to sell its remaining share in the joint venture to the Group in full.

In April 2011, the Company and OAO ANK Bashneft signed an agreement to establish a joint venture and to develop two oil fields named after R.Trebs and A.Titov, located in the Nenets Autonomous District of Russia. According to the agreement, the Company will acquire 25.1% of the joint venture for approximately $169 million. The mineral rights for the development of the fields will be re-issued by OAO ANK Bashneft in favor of the joint venture. The acquisition is subject to certain approvals by the authorities in Russia. The parties agreed to transport oil extracted from the fields via the Group's transportation infrastructure and to consider the exploitation of certain other nearby infrastructure owned by the Group.

Note 7. Property, plant and equipment and asset retirement obligations

	At cost		Net	
	As of June 30, 2011	As of December 31, 2010	As of June 30, 2011	As of December 31, 2010
Exploration and Production:				
Russia	53,814	51,797	34,037	32,973
International	7,460	7,114	5,846	5,624
Total	61,274	58,911	39,883	38,597
Refining, Marketing, Distribution and Chemicals:				
Russia	11,416	11,062	7,193	7,208
International	6,578	6,883	4,196	4,511
Total	17,994	17,945	11,389	11,719
Power generation and other:				
Russia	4,638	4,589	3,900	3,970
International	823	440	607	343
Total	5,461	5,029	4,507	4,313
Total property, plant and equipment	**84,729**	**81,885**	**55,779**	**54,629**

Note 7. Property, plant and equipment and asset retirement obligations (continued)

As of June 30, 2011 and December 31, 2010, the asset retirement obligation amounted to $2,015 million and $1,798 million, respectively, of which $6 and $10 million was included in "Other current liabilities" in the consolidated balance sheets as of June 30, 2011 and December 31, 2010, respectively. During the six-month periods ended June 30, 2011 and 2010, asset retirement obligations changed as follows:

	For the six months ended June 30, 2011	For the six months ended June 30, 2010
Asset retirement obligations as of January 1	1,798	1,199
Accretion expense	77	60
New obligations	32	85
Changes in estimates of existing obligations	(9)	90
Spending on existing obligations	(1)	(2)
Property dispositions	(2)	(2)
Foreign currency translation and other adjustments	120	(47)
Asset retirement obligations as of June 30	**2,015**	**1,383**

The asset retirement obligations incurred during the six-month periods ended June 30, 2011 and 2010 were Level 3 (unobservable inputs) fair value measurements.

Note 8. Suspended wells

During the six-month period ended June 30, 2011, total suspended exploratory well costs capitalized changed insignificantly and amounted to $416 million and $405 million as of June 30, 2011 and December 31, 2010, respectively. Suspended exploratory well costs capitalized for the period greater than one year amounted to $260 million and $192 million as of June 30, 2011 and December 31, 2010, respectively. No suspended wells were charged to expenses during the six-month period ended June 30, 2011.

Note 9. Goodwill and other intangible assets

The carrying value of goodwill and other intangible assets as of June 30, 2011 and December 31, 2010 was as follows:

	As of June 30, 2011	As of December 31, 2010
Amortized intangible assets		
Software	385	391
Licenses and other assets	380	409
Goodwill	646	646
Total goodwill and other intangible assets	**1,411**	**1,446**

All goodwill amounts relate to the refining, marketing and distribution segment. During the six-month period ended June 30, 2011, there were no changes in goodwill.

Note 10. Short-term borrowings and current portion of long-term debt

	As of June 30, 2011	As of December 31, 2010
Short-term borrowings from third parties	598	728
Short-term borrowings from related parties	5	66
Current portion of long-term debt	962	1,331
Total short-term borrowings and current portion of long-term debt	**1,565**	**2,125**

Short-term borrowings from third parties are unsecured and include amounts repayable in US dollars of $555 million and $609 million, amounts repayable in Euro of $11 million and $29 million and amounts repayable in other currencies of $32 million and $90 million as of June 30, 2011 and December 31, 2010, respectively. The weighted-average interest rate on short-term borrowings from third parties was 2.02% and 1.87% per annum as of June 30, 2011 and December 31, 2010, respectively.

Note 11. Long-term debt

	As of June 30, 2011	As of December 31, 2010
Long-term loans and borrowings from third parties	3,281	3,764
6.375% non-convertible US dollar bonds, maturing 2014	897	896
2.625% convertible US dollar bonds, maturing 2015	1,399	1,388
6.356% non-convertible US dollar bonds, maturing 2017	500	500
7.250% non-convertible US dollar bonds, maturing 2019	596	595
6.125% non-convertible US dollar bonds, maturing 2020	998	998
6.656% non-convertible US dollar bonds, maturing 2022	500	500
7.10% Russian ruble bonds, maturing 2011	285	262
13.35% Russian ruble bonds, maturing 2012	890	820
9.20% Russian ruble bonds, maturing 2012	356	328
7.40% Russian ruble bonds, maturing 2013	214	197
Capital lease obligations	134	152
Total long-term debt	10,050	10,400
Current portion of long-term debt	(962)	(1,331)
Total non-current portion of long-term debt	**9,088**	**9,069**

Long-term loans and borrowings

Long-term loans and borrowings from third parties include amounts repayable in US dollars of $1,123 million and $1,707 million, amounts repayable in Euro of $370 million and $369 million, amounts repayable in Russian rubles of $1,765 million and $1,667 million (including loans from ConocoPhillips), and amounts repayable in other currencies of $23 million and $21 million as of June 30, 2011 and December 31, 2010, 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 5.09% and 4.50% per annum as of June 30, 2011 and December 31, 2010, respectively. A number of long-term loan agreements contain certain financial covenants which are being met by the Group. Approximately 9% of total long-term debt is secured by export sales and property, plant and equipment.

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 $1,756 million as of June 30, 2011. This amount includes $1,531 million loaned by ConocoPhillips to joint venture OOO Narianmarneftegaz ("NMNG") (refer to Note 15. 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.

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.

Note 11. Long-term debt (continued)

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 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 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 face value and have a half year coupon period.

Note 12. Pension benefits

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

Components of net periodic benefit cost were as follows:

	For the three months ended June 30, 2011	For the three months ended June 30, 2010	For the six months ended June 30, 2011	For the six months ended June 30, 2010
Service cost	4	4	8	8
Interest cost	6	7	12	13
Less expected return on plan assets	(3)	(2)	(6)	(5)
Amortization of prior service cost	3	4	7	7
Total net periodic benefit cost	**10**	**13**	**21**	**23**

Note 13. Stockholders' equity

Common stock

	As of June 30, 2011 (thousands of shares)	As of December 31, 2010 (thousands of shares)
Authorized and issued common stock, par value of 0.025 Russian rubles each	850,563	850,563
Treasury stock	(70,073)	(69,208)
Outstanding common stock	**780,490**	**781,355**

Earnings per share

The calculation of diluted earnings per share for the reporting periods was as follows:

	For the three months ended June 30, 2011	For the three months ended June 30, 2010	For the six months ended June 30, 2011	For the six months ended June 30, 2010
Net income	3,251	1,949	6,768	4,002
Add back interest and accretion on 2.625% convertible US dollar bonds, maturing 2015 (net of tax at effective rate)	16	-	31	-
Total diluted net income	3,267	1,949	6,799	4,002
Weighted average number of outstanding common shares (thousands of shares)	781,228	847,812	781,291	847,232
Add back treasury shares held in respect of convertible debt (thousands of shares)	20,350	-	20,350	-
Weighted average number of outstanding common shares, after dilution (thousands of shares)	801,578	847,812	801,641	847,232
Earnings per share of common stock attributable to OAO LUKOIL (US dollars):				
Basic	4.16	2.30	8.66	4.72
Diluted	4.08	2.30	8.48	4.72

Dividends

At the annual stockholders' meeting on June 23, 2011, dividends were declared for 2010 in the amount of 59.00 Russian rubles per common share, which at the date of the meeting was equivalent to $2.11. Dividends payable of $1,802 million and $13 million are included in "Other current liabilities" in the consolidated balance sheets as of June 30, 2011 and December 31, 2010, 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.

Note 14. 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.

Note 14. Financial and derivative instruments (continued)

The fair value of long-term debt differs insignificantly from the amount disclosed in the consolidated financial statements. The estimated fair value of long-term debt as of June 30, 2011 and December 31, 2010 was $10,109 million and $10,225 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 six months ended June 30, 2011, 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).

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

	As of June 30, 2011				As of December 31, 2010			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets								
Commodity derivatives	-	1,004	-	**1,004**	-	226	-	**226**
Total assets	-	**1,004**	-	**1,004**	-	**226**	-	**226**
Liabilities								
Commodity derivatives	-	(910)	-	**(910)**	-	(264)	-	**(264)**
Total liabilities	-	**(910)**	-	**(910)**	-	**(264)**	-	**(264)**
Net assets (liabilities)	-	**94**	-	**94**	-	**(38)**	-	**(38)**

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.

Note 14. Financial and derivative instruments (continued)

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 June 30, 2011 was:

	As of June 30, 2011
Assets	
Accounts receivable	1,004
Liabilities	
Accounts payable	910

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 $142 million and accounts payable in the amount of $48 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 three and six months ended June 30, 2011 were in the total amount of net gain of $185 million (of which realized loss was $281 million and unrealized gain was $466 million) and net loss of $642 million (of which realized loss was $798 million and unrealized gain was $156 million), respectively.

As of June 30, 2011, the net position of outstanding commodity derivative contracts, primarily to manage price exposure on underlying operations, was not significant.

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 June 30, 2011 was not significant.

The impact from foreign currency derivatives during the three and six months ended June 30, 2011 on the consolidated income statement was not significant. The net position of outstanding foreign currency swap contracts as of June 30, 2011 also was not significant.

Note 14. Financial and derivative instruments (continued)

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 June 30, 2011. The Group posted $21 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 June 30, 2011, 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 15. 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 $5.4 and $5.5 billion as of June 30, 2011 and December 31, 2010, respectively.

Note 16. 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 $504 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 the second half of 2011 to be approximately $707 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 the second half of 2011 to be approximately $254 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 applying for certain amendments to the capital construction program, including its extension to the end of 2014. As of June 30, 2011, the Group estimates the amount of this commitment to be approximately $685 million.

Operating lease obligations

Group companies have commitments of $538 million primarily for the lease of vessels and petroleum distribution outlets. Operating lease expenses were $37 million, $37 million, $82 million and $70 million for the three months ended June 30, 2011 and 2010 and for the six months ended June 30, 2011 and 2010, respectively. Commitments for minimum rentals under these leases as of June 30, 2011 are as follows:

	As of June 30, 2011
For the six-months ending December 31, 2011	130
2012 fiscal year	122
2013 fiscal year	78
2014 fiscal year	63
2015 fiscal year	38
beyond	107

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.

Note 16. Commitments and contingencies (continued)

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.

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.

Note 16. Commitments and contingencies (continued)

Litigation and claims

On November 27, 2001, Archangel Diamond Corporation ("ADC"), a Canadian diamond development company, filed a lawsuit in the Denver District Court, Colorado against OAO Arkhangelskgeoldobycha ("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 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 Colorado 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 and remanded the case to the Colorado Court of Appeals to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). The Colorado Court of Appeals declined to dismiss the case based on forum non conveniens and the case was remanded to the District Court. In June 2009, three creditors of ADC filed an Involuntary Bankruptcy Petition putting ADC into bankruptcy. In November 2009, after adding a claim, ADC removed the case from the District Court to the US Bankruptcy 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 where it is now pending. Discovery regarding general jurisdiction has commenced. 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 60 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. The total amount of fines claimed against the Group companies for these violations were $111 million. As of the date the financial statements were available to be issued this amount was paid by the Group in full.

On February 9, 2011, FAS of Russia filed a new case against the three largest Russian oil companies, including the Company, accusing them of abuse of their dominant position in the oil products market. The decision accusing the Company in establishing monopolistically high prices on diesel fuel during the period October 2010 – January 2011 was issued on August 9, 2011. As of the date the financial statements were available to be issued, the Company has not received the official decision of FAS of Russia. The Group determined the total amount of administrative penalties probable to be paid as a result of this case and accrued a provision of $17 million as of June 30, 2011.

The Group is involved in cost recovery disputes with the Republic of Kazakhstan. The Group's share of the claim is approximately $295 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 17. 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, 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 4, 6, 10, 12 and 18 for other transactions with related parties.

Sales of oil and oil products to related parties were $430 million, $364 million, $686 million and $579 million during the three months ended June 30, 2011 and 2010 and during the six months ended June 30, 2011 and 2010, respectively.

Other sales to related parties were $13 million, $15 million, $27 million and $36 million during the three months ended June 30, 2011 and 2010 and during the six months ended June 30, 2011 and 2010, respectively.

Purchases of oil and oil products from related parties were $126 million, $141 million, $205 million and $288 million during the three months ended June 30, 2011 and 2010 and during the six months ended June 30, 2011 and 2010, respectively.

Purchases of processing services from related parties were $267 million, $172 million, $434 million and $348 million during the three months ended June 30, 2011 and 2010 and during the six months ended June 30, 2011 and 2010, respectively.

Other purchases from related parties were $14 million, $10 million, $28 million and $23 million during the three months ended June 30, 2011 and 2010 and during the six months ended June 30, 2011 and 2010, respectively.

Amounts receivable from related parties, including loans and advances, were $447 million and $419 million as of June 30, 2011 and December 31, 2010, respectively. Amounts payable to related parties were $89 million and $114 million as of June 30, 2011 and December 31, 2010, respectively.

Note 18. 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. The fair value was estimated using the Black-Scholes-Merton option-pricing model, assuming a risk-free interest rate of 8.0% per annum, an expected dividend yield 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.

Note 18. Compensation plan (continued)

As of June 30, 2011, there was $148 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.

Related to these plans the Group recorded $39 million, $33 million, $71 million and $65 million of compensation expenses during the three months ended June 30, 2011 and 2010 and during the six months ended June 30, 2011 and 2010, respectively, of which $24 million during the three months ended June 30, 2011 and 2010 and $49 million during the six months ended June 30, 2011 and 2010 are recognized as an increase in additional paid-in capital, respectively. As of June 30, 2011 and December 31, 2010, $36 million and $33 million related to these plans are included in "Other current liabilities" of the consolidated balance sheets, respectively. The total recognized tax benefit related to these accruals during the three months ended June 30, 2011 and 2010 and during the six months ended June 30, 2011 and 2010, is $8 million, $7 million, $14 million and $13 million, respectively.

Note 19. Segment information

Presented below is information about the Group's operating and geographical segments for the three and six months ended June 30, 2011 and 2010, 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. 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 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 are based on the area of operations and include two segments: Russia and International. Geographical segments presentation has been changed starting from the three months period ended March 31, 2011, due to the reassessment of the Company's management system.

Operating segments

For the three months ended June 30, 2011

	Exploration and production	Refining, marketing and distribution	Chemicals	Power generation	Other	Elimination	Consolidated
Sales							
Third parties	885	33,092	543	364	28	-	34,912
Inter-segment	10,299	509	180	390	611	(11,989)	-
Total sales	11,184	33,601	723	754	639	(11,989)	34,912
Operating expenses	1,114	865	88	573	511	(711)	2,440
Depreciation, depletion and amortization	703	300	15	62	33	36	1,149
Interest expense	189	189	4	12	126	(343)	177
Income tax expense	466	258	14	(7)	-	83	814
Net income (net loss)	1,583	1,500	28	(108)	(43)	291	3,251
Total assets	58,683	62,039	1,477	4,294	21,044	(55,488)	92,049
Capital expenditures	1,562	271	14	28	17	-	1,892

Note 19. Segment information (continued)

For the three months ended June 30, 2010

	Exploration and production	Refining, marketing and distribution	Chemicals	Power generation	Other	Elimination	Consolidated
Sales							
Third parties	661	24,564	312	280	36	-	25,853
Inter-segment	7,953	284	55	296	444	(9,032)	-
Total sales	8,614	24,848	367	576	480	(9,032)	25,853
Operating expenses	986	888	44	442	364	(678)	2,046
Depreciation, depletion and amortization	688	254	9	47	32	-	1,030
Interest expense	206	250	5	10	99	(374)	196
Income tax expense	267	317	5	(11)	(2)	(2)	574
Net income (net loss)	1,451	771	30	(44)	(252)	(7)	1,949
Total assets	52,763	54,618	1,179	4,183	13,770	(44,123)	82,390
Capital expenditures	1,273	304	20	111	14	-	1,722

For the six months ended June 30, 2011

	Exploration and production	Refining, marketing and distribution	Chemicals	Power generation	Other	Elimination	Consolidated
Sales							
Third parties	1,785	60,748	1,038	916	51	-	64,538
Inter-segment	20,358	893	306	798	1,125	(23,480)	-
Total sales	22,143	61,641	1,344	1,714	1,176	(23,480)	64,538
Operating expenses	2,112	1,988	189	1,152	911	(1,774)	4,578
Depreciation, depletion and amortization	1,372	609	30	125	67	5	2,208
Interest expense	368	370	8	24	248	(668)	350
Income tax expense	1,049	343	25	(4)	7	33	1,453
Net income (net loss)	3,889	2,650	83	(83)	79	150	6,768
Total assets	58,683	62,039	1,477	4,294	21,044	(55,488)	92,049
Capital expenditures	2,979	498	28	78	31	-	3,614

For the six months ended June 30, 2010

	Exploration and production	Refining, marketing and distribution	Chemicals	Power generation	Other	Elimination	Consolidated
Sales							
Third parties	1,394	46,956	607	730	68	-	49,755
Inter-segment	15,926	561	124	609	877	(18,097)	-
Total sales	17,320	47,517	731	1,339	945	(18,097)	49,755
Operating expenses	1,898	1,620	210	909	706	(1,309)	4,034
Depreciation, depletion and amortization	1,366	518	19	93	64	-	2,060
Interest expense	438	498	11	15	218	(807)	373
Income tax expense	597	480	12	(6)	2	11	1,096
Net income (net loss)	2,639	1,916	52	(40)	(416)	(149)	4,002
Total assets	52,763	54,618	1,179	4,183	13,770	(44,123)	82,390
Capital expenditures	2,390	532	43	200	25	-	3,190

Note 19. Segment information (continued)

Geographical segments

	For the three months ended June 30, 2011	For the three months ended June 30, 2010	For the six months ended June 30, 2011	For the six months ended June 30, 2010
Sales of crude oil within Russia	420	295	843	481
Export of crude oil and sales of oil of foreign subsidiaries	7,879	6,109	15,002	12,688
Sales of refined products within Russia	3,839	2,627	6,867	4,973
Export of refined products and sales of refined products of foreign subsidiaries	20,707	15,274	37,700	28,414
Sales of chemicals within Russia	264	181	503	350
Export of chemicals and sales of chemicals of foreign subsidiaries	295	138	572	270
Other sales within Russia	799	630	1,747	1,451
Other export sales and other sales of foreign subsidiaries	709	599	1,304	1,128
Total sales	**34,912**	**25,853**	**64,538**	**49,755**

For the three months ended June 30, 2011

	Russia	International	Elimination	Consolidated
Sales				
Third parties	6,325	28,587	-	34,912
Inter-segment	10,879	16	(10,895)	-
Total sales	17,204	28,603	(10,895)	34,912
Operating expenses	1,670	556	214	2,440
Depletion, depreciation and amortization	928	190	31	1,149
Interest expense	87	120	(30)	177
Income tax expense	508	196	110	814
Net income	2,641	314	296	3,251
Total assets	72,183	34,439	(14,573)	92,049
Capital expenditures	1,551	341	-	1,892

For the three months ended June 30, 2010

	Russia	International	Elimination	Consolidated
Sales				
Third parties	4,262	21,591	-	25,853
Inter-segment	8,474	8	(8,482)	-
Total sales	12,736	21,599	(8,482)	25,853
Operating expenses	1,576	483	(13)	2,046
Depletion, depreciation and amortization	848	182	-	1,030
Interest expense	110	123	(37)	196
Income tax expense	508	69	(3)	574
Net income	1,730	307	(88)	1,949
Total assets	61,095	29,497	(8,202)	82,390
Capital expenditures	1,309	413	-	1,722

Note 19. Segment information (continued)

For the six months ended June 30, 2011

	Russia	International	Elimination	Consolidated
Sales				
Third parties	11,819	52,719	-	64,538
Inter-segment	20,214	27	(20,241)	-
Total sales	32,033	52,746	(20,241)	64,538
Operating expenses	3,596	1,017	(35)	4,578
Depletion, depreciation and amortization	1,821	387	-	2,208
Interest expense	170	235	(55)	350
Income tax expense	1,159	282	12	1,453
Net income	6,064	544	160	6,768
Total assets	72,183	34,439	(14,573)	92,049
Capital expenditures	2,958	656	-	3,614

For the six months ended June 30, 2010

	Russia	International	Elimination	Consolidated
Sales				
Third parties	8,285	41,470	-	49,755
Inter-segment	16,827	13	(16,840)	-
Total sales	25,112	41,483	(16,840)	49,755
Operating expenses	3,069	984	(19)	4,034
Depletion, depreciation and amortization	1,673	387	-	2,060
Interest expense	224	239	(90)	373
Income tax expense	956	131	9	1,096
Net income	3,785	242	(25)	4,002
Total assets	61,095	29,497	(8,202)	82,390
Capital expenditures	2,422	768	-	3,190

The Group’s international sales to third parties include sales in Switzerland of $17,290 million, $13,268 million, $32,029 million and $25,734 million for the three months ended June 30, 2011 and 2010 and for the six months ended June 30, 2011 and 2010, respectively. The Group’s international sales to third parties include sales in the USA of $2,628 million, $2,035 million, $4,680 million and $4,080 million for the three months ended June 30, 2011 and 2010 and for the six months ended June 30, 2011 and 2010, respectively. These amounts are attributed to individual countries based on the jurisdiction of subsidiaries making the sale.

Note 20. 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 August 26, 2011.