JSC Gazprom Neft

Consolidated Financial Statements

As of December 31, 2007 and 2006 and for the years ended December 31, 2007 and 2006

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Contents

PRICEWATERHOUSECOOPERS

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Report of Independent Auditors

To the Board of Directors and Shareholders of
JSC Gazprom Neft

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the financial position of JSC Gazprom Neft and its subsidiaries (the "Company") at December 31, 2007 and December 31, 2006, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

ZAO PricewaterhouseCoopers Audit

May 14, 2008

Currency – US$ thousands

	Notes	2007	2006
Assets			
Current assets:			
Cash and cash equivalents	3	$ 721,323	$ 1,334,733
Short-term investments	4	-	100,000
Short-term loans receivable	4	11,555	125,798
Accounts receivable, net	5	2,262,879	2,388,024
Inventories	6	1,083,479	781,710
Other current assets	7	661,899	684,531
Current deferred income tax assets	19	19,288	28,343
Total current assets		4,760,423	5,443,139
Long-term investments	8	4,684,772	2,760,443
Long-term loans receivable	4	50,986	128,134
Oil and gas properties, net	9	5,801,776	4,569,144
Property, plant and equipment, net	10	831,819	852,205
Construction-in-progress	11	229,668	161,202
Other non-current assets		109,655	55,109
Non-current deferred income tax assets	19	136,933	132,742
Total assets		$ 16,606,032	$ 14,102,118
Liabilities and shareholders' equity			
Current liabilities:			
Short-term loans	12	$ 241,136	$ 56,157
Accounts payable and accrued liabilities	13	1,171,030	648,524
Income and other taxes payable	14	733,727	497,392
Dividends payable		380,771	893,044
Current portion of long-term debt	16	1,097,891	638,363
Total current liabilities		3,624,555	2,733,480
Asset retirement obligations	15	324,328	287,731
Long-term debt	16	2,083,299	977,402
Deferred income tax liabilities	19	140,971	173,206
Total liabilities		6,173,153	4,171,819
Commitments and contingencies	20		
Shareholders' equity:			
Common stock (authorized, issued and outstanding: 4,741,299,639 shares, 0.0016 Ruble par value)	17	1,619	1,619
Additional paid-in capital		-	858,987
Reserves	2	572,726	1,867,449
Retained earnings		9,858,534	7,202,244
Total shareholders' equity		10,432,879	9,930,299
Total liabilities and shareholders' equity		$ 16,606,032	$ 14,102,118

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

	Notes	2007	2006
Revenues			
Refined products and oil and gas sales		$ 20,580,902	$ 19,670,192
Other		519,515	223,952
Total	22	21,100,417	19,894,144
Costs and other deductions			
Crude oil, petroleum and other products purchased		3,928,165	3,704,843
Operating expenses		2,395,445	1,742,360
Selling, general and administrative expenses		1,902,259	1,917,668
Depreciation, depletion and amortization		928,858	802,541
Export duties		3,370,840	4,669,278
Taxes other than income taxes		3,331,535	2,658,275
Cost of other sales		344,378	33,323
Total		16,201,480	15,528,288
Operating income		4,898,937	4,365,856
Other income (expense)			
Income from equity affiliates	8	407,642	506,943
Interest income		93,851	39,161
Interest expense		(149,172)	(126,346)
Other income (expense), net		44,717	(6,058)
Foreign exchange gain, net		161,887	74,494
Total		558,925	488,194
Income before provision for income taxes		5,457,862	4,854,050
Provision for income taxes		1,342,405	1,112,827
Deferred income tax (benefit) expense		(27,371)	80,381
Total	19	1,315,034	1,193,208
Net income		$ 4,142,828	$ 3,660,842
Basic and Diluted Earnings per Common Share (US$ per share)		0.8738	0.7721
Weighted-average number of common shares outstanding Basic and Diluted (millions)		4,741	4,741

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

For the years ended December 31, 2007 and 2006 Currency – US$ thousands

	Common Stock	Additional Paid-in Capital	Reserves	Retained Earnings	Total Shareholders' Equity
Balance as of December 31, 2005	$ 1,619	$ 858,987	$ 1,867,449	$ 4,927,833	$ 7,655,888
Net income for the year	-	-	-	3,660,842	3,660,842
Common stock dividends	-	-	-	(1,386,431)	(1,386,431)
Balance as of December 31, 2006	$ 1,619	$ 858,987	$ 1,867,449	$ 7,202,244	$ 9,930,299
Net income for the year	-	-	-	4,142,828	4,142,828
Recognition of the financial effect of a transaction under common control (see Note 8)		(858,987)	(1,294,723)		(2,153,710)
Common stock dividends	-	-	-	(1,486,538)	(1,486,538)
Balance as of December 31, 2007	$ 1,619	-	$ 572,726	$ 9,858,534	$ 10,432,879

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

For the years ended December 31, 2007 and 2006 Currency – US$ thousands

	2007	2006
Operating activities		
Net income	$ 4,142,828	$ 3,660,842
Reconciliation of net income to net cash provided by operating activities:		
Income from equity affiliates, net of dividends received	(331,158)	(219,890)
Deferred income tax (benefit) expense	(27,371)	80,381
Depreciation, depletion and amortization	928,858	802,541
Asset retirement obligation accretion expense and spending on existing obligations	22,743	20,931
Allowance for doubtful accounts	(7,547)	(23,159)
Gain on disposal of property, plant and equipment	(15,489)	(24,182)
Changes in assets and liabilities, excluding cash and debt:		
Accounts receivable	132,692	(496,740)
Inventories	(301,769)	(345,126)
Other current assets	22,632	(235,013)
Other non-current assets	(54,546)	(27,161)
Accounts payable and accrued liabilities	522,506	120,669
Income and other taxes payable	236,335	(13,568)
Net cash provided by operating activities	5,270,714	3,300,525
Investing activities		
Purchase of investments in associated entities	(3,746,881)	(124,038)
Loan and investment proceeds received	333,701	47,550
Loans issued and purchase of short-term investments	(42,310)	(289,644)
Proceeds from disposals of property, plant and equipment	30,617	27,355
Capital expenditures	(2,210,844)	(1,525,109)
Net cash used in investing activities	(5,635,717)	(1,863,886)
Financing activities		
Short and long-term loans proceeds received	4,905,684	772,073
Short and long-term loans repaid	(3,155,280)	(610,710)
Dividends paid	(1,998,811)	(568,516)
Net cash used in financing activities	(248,407)	(407,153)
Increase (decrease) in cash and cash equivalents	(613,410)	1,029,486
Cash and cash equivalents as of the beginning of the year	1,334,733	305,247
Cash and cash equivalents as of the end of the year	$ 721,323	$ 1,334,733
Supplemental disclosures of cash flows information		
Cash paid for interest (net of amount capitalized)	$ 157,874	$ 131,342
Cash paid for income taxes	$ 1,087,026	$ 1,104,003

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

1. General

Description of Business

JSC Gazprom Neft (formerly OAO Siberian Oil Company) and its subsidiaries (the "Company") is a vertically integrated oil company operating in the Russian Federation. The Company's principle activities include the exploration, production and development of oil and gas fields, the production of refined petroleum products and distribution and marketing operations through its retail outlets. Export trade is conducted through a wholly owned subsidiary Gazprom Neft Trading GmbH, which operates as a trader for the Company's export sales.

OAO Siberian Oil Company (''Sibneft") was created by Presidential Decree Number 872 dated August 24, 1995. On September 29, 1995 Sibneft's charter was approved when the Government of the Russian Federation issued Resolution Number 972. The Omsk Registration Chamber officially registered Sibneft on October 6, 1995. In October 2005 JSC Gazprom completed its acquisition of a 75.68% stake in Sibneft, becoming a subsidiary of JSC Gazprom. On May 30, 2006 Sibneft was renamed into "JSC Gazprom Neft".

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

In 2007 and 2006 the Company processed approximately 60.9% and 56.8% of produced crude oil, respectively, at the Company's refinery and other Russian refineries. The remaining production was sent to export. The Company sells its crude oil under general rules of export quotation applicable for all Russian oil producers. Under these general rules, the export quotas for the Transneft pipeline system are defined and approved by the Energy Commission of the Russian Government based on the legislation on equal access to the oil pipeline system.

Currency Exchange and Control

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

2. Summary of Significant Accounting Policies

Basis of Presentation

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

Principles of Consolidation and Long-term Investments

The accompanying consolidated financial statements include the accounts of majority-owned subsidiaries where no minority shareholder or group of minority shareholders exercise substantive participating rights. Investments in entities that the Company does not control, but has the ability to exercise significant influence over their operating and financial policies, are accounted for under the equity method. Accordingly, the Company's share of net earnings and losses from these companies is included in the consolidated statement of income as income from equity affiliates. All other investments in equity securities are recorded at cost. As further discussed in Note 8, the Company has interests in various Russian and CIS legal entities, which are accounted for using the cost method. Intercompany profits, transactions and balances have been eliminated in consolidation.

The Company is subject to the provisions of Financial Interpretation ("FIN") No. 46(R) "Consolidation of Variable Interest Entities" and FASB Staff Position FIN 46(R)-5, "Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities" ("FSP FIN 46(R)-5"). The Company evaluates its investments and business relationships and consolidates those identified variable interest entities for which the Company is determined to be the primary beneficiary.

The Company reviews its equity investments for impairment whenever events or changes in circumstances indicate that an other than temporary decline in value has occurred. The amount of the impairment is based on quoted market prices, where available, or other valuation techniques, including discounted cash flows.

Reserves and Retained Earnings

Shareholders' equity reserves represent the Company's net asset position, excluding common stock at the time of the Company's formation in 1995. Retained earnings represent all cumulative net profit subsequent to formation.

Management 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 in the balance sheet as well as the revenues and expenses during the reporting periods. Certain significant estimates and assumptions for the Company include: recoverability and useful lives of long-term assets and investments; allowances for doubtful accounts receivable; asset retirement obligations; legal and tax contingencies; depreciation, depletion and amortization; environmental remediation obligations; oil reserves; recognition and disclosure of guarantees and other commitments. While management uses its best estimates and judgments, actual results could differ from those estimates and assumptions used.

Foreign Currency Translation

The management of the Company has determined the US Dollar is the functional and reporting currency of the Company as the majority of its revenues, costs, property and equipment purchased, debt and trade liabilities are either priced, incurred, payable or otherwise measured in US Dollars. Monetary assets and liabilities have been translated into US Dollars at the exchange rate at the balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows are translated into US Dollars at average rates for the period or exchange rates prevailing on the transactions dates where practicable. Gains and losses resulting from the re-measurement into US Dollars are included in the consolidated statement of income.

The official rates of exchange of the Ruble to the US Dollar as of December 31, 2007 and 2006 were 24.55 Rubles and 26.33 Rubles per US $1.00, respectively.

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

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with original maturities of three months or less from the date of purchase.

Accounts Receivable

Accounts receivable are presented at net realizable value. Allowances for doubtful debts are provided for estimated uncollectible amounts. Estimation is made based on aging of the receivable, past history of settlements with the debtor and existing economic conditions. Estimates of allowances require the exercise of judgment and the use of assumptions. The past due status of receivables is determined based on contractual obligations. Changes in allowances for doubtful debts are recorded in the consolidated statements of income within selling, general and administrative expenses.

Loans Receivable

Loans receivable are presented at net realizable value. Allowances are provided for estimated losses. Estimation is made based on past history of settlements with the borrower and existing economic conditions. The past due status of a receivable is determined based on contractual obligations. Interest income is accrued when earned and recorded in the consolidated statements of income as a part of interest income.

Inventories

Inventories, consisting primarily of crude oil, refined oil products and materials and supplies are stated at the lower of weighted average cost or market value. The Company uses the weighted-average-cost method. Costs include both direct and indirect expenditures and charges incurred in bringing an item or product to its existing condition and location.

Oil and Gas Properties

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.

Exploratory well costs (including costs associated with stratigraphic test wells) are temporarily capitalized pending determination of whether such oil and gas reserves have been found proved reserves, which justify commercial development. If such reserves are not found, the drilling costs are charged to exploratory expenses. Intangible drilling costs applicable to productive wells and to development dry holes, as well as tangible equipment costs and costs of injection wells related to development of oil and gas reserves are capitalized.

Property, Plant and Equipment

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

Upon sale or retirement of property, plan and equipment, the cost and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are recorded in the consolidated statements of income.

Depreciation, Depletion and Amortization

Depreciation, depletion and amortization of oil and gas properties are provided on the unit-of-production method based on the ratio of current year production to total estimated future production from proved developed reserves.

The provision for depreciation and amortization with respect to operations other than oil and gas producing activities is computed using the straight-line method based on estimated economic lives. Depreciation rates are applied to similar types of buildings and equipment having similar economic characteristics, as shown below:

Asset Group	Average Life
Buildings and constructions	8-35 years
Machinery and equipment	8-30 years
Vehicles and other equipment	3-10 years

Impairment of Long-lived Assets

Long-lived assets, including proved oil and gas properties at a field level, are assessed for possible impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Property, plant and equipment used in operations are assessed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recovered. If the carrying amounts are not expected to be recovered by undiscounted pretax future cash flows, the assets are impaired and an impairment loss is recorded in the amount by which the asset's carrying value exceeds its fair value, which is calculated based on discounted future cash flows.

In the case of oil and gas fields, the net present value of future cash flows is based on management's best estimate of future prices, which is determined with reference to recent historical prices and published forward prices, applied to projected production volumes of individual fields and discounted at a rate commensurate with the risks involved. The projected production volumes represent reserves, including risk-adjusted probable reserves, expected to be produced based on a stipulated amount of capital expenditures. The production volumes, prices and timing of production are consistent with internal projections and other externally reported information. The price and cost outlook assumptions used in impairment reviews differ from the assumptions used in the Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserve Quantities. In that disclosure, SFAS No. 69, *"Disclosures about Oil and Gas Producing Activities"* requires the use of prices and costs at the balance sheet date, with no projection of future changes in those assumptions.

Individual assets are grouped for impairment purposes at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets - generally on a field-by-field basis for exploration and production assets, at an entire complex level for refining assets or at an operating unit level for other assets. Long-lived assets committed by management for disposal within one year are accounted for at the lower of amortized cost or fair value, less cost to sell. Acquisition costs of unproved oil and gas properties are evaluated periodically and any impairment assessed is charged to expense. No impairment has been recognized for the years ended December 31, 2007 and 2006.

Maintenance and Repair

Maintenance and repairs, which are not significant improvements, are expensed when incurred.

Capitalized Interest

Interest is capitalized on expenditures made in connection with capital projects that, theoretically, could have been avoided if expenditures for the assets had not been made. Interest is only capitalized for the period when construction activities are actually in progress and until the resulting properties are put into operation. During 2007 and 2006, interest capitalized related to capital projects amounted to US$ 7.8 million and US$ 11.2 million, respectively.

Minority Interest in Subsidiary Companies

Minority interest in the consolidated balance sheets reflects minority owners' percent share of shareholders' capital in subsidiaries. The minority interest is calculated based on the shareholders' equity of each subsidiary as determined under US GAAP.

Minority owners' interest in the Company's subsidiaries is as follows:

	December 31, 2007		December 31, 2006	
	Voting	Total	Voting	Total
Gazpromneft-Noyabrskneftegazgeofizika	19%	19%	19%	19%
Meretoyakhaneftegaz	33%	33%	33%	33%
Sibneft-Ugra	1%	1%	1%	1%
Tyumennefteproduct	10%	10%	10%	10%

Income Taxes

Russian legislation does not contain the concept of a "consolidated tax payer" and, accordingly, the Company is not subject to taxation on a consolidated basis. Current income taxes are provided on taxable profit of each subsidiary as determined under the Russian Federation Tax Code at a rate of 24%, as of December 31, 2007 and 2006, after adjustments for certain items which are not deductible for taxation purposes.

Deferred income tax assets and liabilities are recognized in the accompanying consolidated financial statements in the amounts determined by the Company using the liability method in accordance with SFAS 109 "Accounting for Income Taxes". This method takes into account future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purpose 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 be settled. A valuation allowance for deferred tax asset is recorded when management believes that it is more likely than not that this tax asset will not be realized in the future.

Starting from January 1, 2007 the Company accounts for uncertain tax positions in accordance with FIN 48 *Accounting for Uncertainty in Income Taxes*. Liabilities for unrecognized income tax benefits under the provisions of FIN 48 together with corresponding interest and penalties are recorded in the consolidated statement of income as income tax expense. The adoption of FIN 48 did not have a material impact on the Company's financial position or results of operation.

Earnings per Share

Basic and diluted earnings per common share have been determined by dividing the available income to common shareholders by the weighted average number of shares outstanding during the year. There are no potentially dilutive securities.

Contingencies

Certain conditions may exist as of the date these financial statements are issued, which may result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company's management and legal counsel assess such contingent liabilities. The assessment of loss contingencies necessarily involves an exercise of judgment and is a matter of opinion. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed. If loss contingencies can not be reasonably estimated, management recognizes the loss when information becomes available.

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

Recognition of Revenues

Revenues from the production and sale of crude oil, petroleum and chemical products and all other products are recognized when deliveries of products to final customers are made, title passes to the customer, collection is reasonably assured and sales price to final customers is fixed or determinable. Specifically, domestic crude oil sales and petroleum product and materials sales are recognized when they are shipped to customers, which is generally when title passes. For export sales, title generally passes at the border of the Russian Federation and the Company is responsible for transportation, duties and taxes on those sales.

Other revenues consist primarily of sales of services such as transportation, construction, utilities and other services are recognized when goods are provided to customers and services are performed providing that the price for the service can be determined and no significant uncertainties regarding realization exist.

Revenues are stated net of VAT and excises on oil products.

Transportation Costs

The Company incurred US$ 1,366.6 million and US$ 1,410.8 million on delivering of crude oil and refined products to its customers for the years ended December 31, 2007 and 2006, respectively. Transportation expenses (including shipping and handling costs) are included within selling, general and administrative expenses in the consolidated statements of income.

Retirement and Other Benefit Obligations

The Company and its subsidiaries do not have any substantial pension arrangements separate from the State pension scheme of the Russian Federation, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such contributions are charged to expense as incurred. In addition, the Company has no post-retirement benefits or significant other compensated benefits requiring accrual.

Asset Retirement Obligations

The Company records the fair value of legal obligations to retire and remove long-lived assets in the period in which the obligation is incurred (typically when the asset is installed at the production location or when drilling is commenced). When the liability is initially recorded, the Company capitalizes this cost by increasing the carrying amount of the related properties, plants and equipment. Over time the liability is increased for the change in its present value, and the capitalized cost in properties, plants and equipment is depreciated over the useful life of the related asset.

FAS 143 calls for measurements of asset retirement obligations to include, as a component of expected costs, an estimate of the price that a third party would demand, and could expect to receive, for bearing the uncertainties and unforeseeable circumstances inherent in the obligations, sometimes referred to as a market-risk premium. To date, the oil and gas industry in Russia has few examples of credit-worthy third parties who are willing to assume this type of risk, for a determinable price, on major oil and gas production facilities and pipelines. Therefore, because determining such a market-risk premium would be an arbitrary process, it has been excluded from the Company's assets retirement obligation estimates.

The Company's field exploration, development, and production activities include assets related to well bores and related equipment, gathering and oil processing systems, oil storage units and pipelines to main transportation trunks. Generally, its licenses and other operating permits require certain actions to be taken by the Company in the abandonment of these operations after the end of production. Such actions include well abandonment activities, equipment dismantlement and other reclamation activities. The Company's estimates of future abandonment costs consider present regulatory or license requirements and are based upon management's experience of the costs and requirement of such activities. Most of these costs are not expected to be incurred until several years, or decades, in the future and will be funded from general Company's resources at the time of removal.

Management believes that present regulatory and permitting activities do not stipulate an obligation associated with abandoning of gathering and oil processing systems, oil storage units and pipelines to main transportation trunks. As a result, the Company believes that it does not have clear or definitive legal or contractual obligations associated with activities to retire or otherwise abandon those assets.

The Company's refining operations consist of major industrial complexes. These industrial complexes have been in operation for several decades. Because of the nature of the operation of these complexes, management believes that these industrial complexes have indeterminable lives, while certain operating components and equipment have definite lives. Management believes that present regulatory and permitting activities do not stipulate an obligation associated with abandoning these industrial complexes. Furthermore, management believes that existing regulatory requirements do not stipulate an obligation associated with its retail networks. As a result, the Company believes that it does not have clear or definitive legal or contractual obligations associated with activities to retire or otherwise abandon those assets.

Inasmuch as the regulatory and legal environment in Russia continues to evolve, there could be future changes to the requirements and costs associated with abandoning long-lived assets.

Recent Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, "Fair Value Measurements," which establishes a formal framework for measuring fair values of assets and liabilities in financial statements that are already required by US GAAP to be measured at fair value. SFAS No. 157 clarifies guidance in FASB Concepts Statement (CON) No. 7 which discusses present value techniques in measuring fair value. Additional disclosures are also required for transactions measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. In November 2007, the FASB granted a one year deferral (to fiscal years beginning after November 15, 2008) for non-financial assets and liabilities to comply with SFAS No. 157. The Company does not believe that SFAS No. 157 will have a material impact on its financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115," which permits companies to choose, at specified dates, to measure certain eligible financial instruments at fair value. The objective of this Statement is to reduce volatility in preparer reporting that may be caused as a result of measuring related financial assets and liabilities differently and to expand the use of fair value measurements. The provisions of the Statement apply only to entities that elect to use the fair value option and to all entities with available-for-sale and trading securities. Additional disclosures are also required for instruments for which the fair value option is elected. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. No retrospective application is allowed, except for companies that choose to adopt early. At the effective date, companies may elect the fair value option for eligible items that exist at that date, and the effect of the first re-measurement to fair value must be reported as a cumulative-effect adjustment to the opening balance of retained earnings. Since the Company has not elected to adopt the fair value option for eligible items, it does not believe that SFAS No. 159 will have an impact on its financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations." SFAS No. 141(R) was issued in an effort to continue the movement toward the greater use of fair values in financial reporting and increased transparency through expanded disclosures. It changes how business acquisitions are accounted for and will impact financial statements at the acquisition date and in subsequent periods. Certain of these changes will introduce more volatility into earnings. The acquirer must now record all assets and liabilities of the acquired business at fair value, and related transaction and restructuring costs will be expensed rather than the previous method of being capitalized as part of the acquisition. SFAS No. 141(R) also impacts the annual goodwill impairment test associated with acquisitions, including those that close before the effective date of SFAS No. 141(R). The definitions of a "business" and a "business combination" have been expanded, resulting in more transactions qualifying as business combinations. SFAS No. 141(R) is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 31, 2008 and earlier adoption is prohibited. The Company cannot predict the impact that the adoption of SFAS No. 141(R) will have on its financial position, results of operations or cash flows with respect to any acquisitions completed after December 31, 2007.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements, an amendment of Accounting Research Bulletin (ARB) No. 51." SFAS No. 160 clarifies that a noncontrolling interest (previously commonly referred to as a minority interest) in a subsidiary is an ownership interest in the consolidated entity and should be reported as equity in the consolidated financial statements. The presentation of the consolidated income statement has been changed by SFAS No. 160, and consolidated net income attributable to both the parent and the noncontrolling interest is now required to be reported separately. Previously, net income attributable to the noncontrolling interest was typically reported as an expense or other deduction in arriving at consolidated net income and was often combined with other financial statement amounts. In addition, the ownership interests in subsidiaries held by parties other than the parent must be clearly identified, labeled, and presented in the equity in the consolidated financial statements separately from the parent's equity. Subsequent changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary should be accounted for consistently, and when a subsidiary is deconsolidated, any retained noncontrolling equity interest in the former subsidiary must be initially measured at fair value. Expanded disclosures, including a reconciliation of equity balances of the parent and noncontrolling interest are also required. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 and earlier adoption is prohibited. Prospective application is required. At this time, the Company does not have any material noncontrolling interests in consolidated subsidiaries. Therefore, it does not believe that the adoption of SFAS No. 160 will have a material impact on its financial position, results of operations or cash flows.

Reclassifications

Certain reclassifications have been made to previously reported amounts to conform with the current year's presentation; such reclassifications have no effect on net income or shareholders' equity.

3. Cash and Cash Equivalents

Cash and cash equivalents as of December 31, comprise the following (in US$ thousands):

	2007	2006
Cash in bank – Rubles	$ 176,988	$ 346,266
Cash in bank – foreign currency	237,480	274,581
Bank deposits and other cash equivalents	305,583	712,336
Cash on hand	1,272	1,550
Total cash and cash equivalents	$ 721,323	$ 1,334,733

The majority of cash in bank – foreign currency is primarily represented by US Dollars. As of December 31, 2007 cash in bank includes US$ 54.3 million in Gazprombank, a related party.

As of December 31, 2007 the majority of bank deposits are primarily represented by Rubles. As of December 31, 2006 the majority of bank deposits were primarily represented by US Dollars. Bank deposits represent deposits with original maturities of less than 90 days at the date of acquisition.

4. Loans Receivable and Short-term Investments

Short-term loans receivable of US$ 11.6 million and US$ 125.8 million are mostly due from related parties as of December 31, 2007 and 2006, respectively. These Ruble denominated loans mature between one month and one year and bear no interest. The fair value of these loans approximates their carrying value in the consolidated financial statements due to their short-term nature.

Long-term loans receivables of US$ 51.0 million and US$ 128.1 million are mostly due from related parties as of December 31, 2007 and 2006, respectively. These loans bear no interest and mature between 2009 and 2012. The fair value of these loans is approximately US$ 37.1 million and US$ 107.8 million as of December 31, 2007 and 2006 assuming a discount rate of 10.0% and 10.5% as of December 31, 2007 and 2006, respectively (CBR interbank refinancing rate).

As of December 31, 2006 short-term investments consisted entirely of bank deposits with maturities at the date of purchase in excess of 90 days.

5. Accounts Receivable

The composition of accounts receivable is as follows as of December 31, (in US$ thousands):

	2007	2006
Trade receivables	$ 1,220,249	$ 896,170
Value added tax receivable	898,194	1,065,911
Related party receivables	25,108	13,029
Other receivables	135,988	437,121
Less allowance for doubtful accounts	(16,660)	(24,207)
Total accounts receivable	$ 2,262,879	$ 2,388,024

Trade receivables represent amounts due from regular customers in the ordinary course of business, denominated primarily in US Dollars, and are short-term in nature.

Other receivables are comprised of taxes receivable and other receivables.

6. Inventories

The following are the major components of inventories as of December 31, (in US$ thousands):

	2007	2006
Crude oil	$ 121,115	$ 101,571
Petroleum products	356,482	269,108
Materials and supplies	576,907	389,837
Other	28,975	21,194
Total inventories	$ 1,083,479	$ 781,710

7. Other Current Assets

The following are the major components of other current assets as of December 31, (in US$ thousands):

	2007	2006
Prepaid customs duties	$ 407,193	$ 348,610
Advances paid	232,783	315,300
Prepaid expenses	21,923	20,621
Total other current assets	$ 661,899	$ 684,531

8. Long-Term Investments

None of the companies listed below are publicly traded in Russia and due to the nature of the financial markets it is not possible to obtain a current market price for these investments. The significant equity and other long-term investments are summarized below as of December 31, 2007 and 2006 (in US$ thousands):

	Ownership percentage as of December 31, 2007	Net book value as of December 31,		Company's share of income for the year ended December 31,	
		2007	2006	2007	2006
Investments in equity affiliates:					
JSC Slavneft	49.9	$ 2,501,498	$ 2,186,742	$ 391,239	$ 502,546
JSC Tomskneft VNK	50.0	1,418,934	-	5,393	-
JSC Moscow Oil Refinery	38.8	315,606	304,596	11,010	4,397
Total investments in equity affiliates / income		4,236,038	2,491,338	407,642	506,943
Long-term investments, at cost:					
JSC Mosnefteprodukt	27.4	56,018	56,018		
Other various marketing entities		162,364	160,808		
Other entities		230,352	52,279		
Total long-term investments, at cost		448,734	269,105		
Total long-term investments		$ 4,684,772	$ 2,760,443	$ 407,642	$ 506,943

The Company's investment in JSC Slavneft and various minority stakes in Slavneft' subsidiaries ("Slavneft") are held through a series of off-shore entities and an investment trust. During 2005, the Company and TNK-BP agreed to jointly manage the refineries of the Slavneft group with each party purchasing its share of production, refer also to Note 21 Related Party Transactions. During 2007, Slavneft paid dividends to the Company of US$ 76.5 million (US$ 287.1 million in 2006).

The following table summarizes the financial information of Slavneft as of December 31, (in US$ thousands):

	2007	2006
Current assets	$ 1,363,125	$ 982,623
Long-term assets	5,443,367	4,712,162
Total liabilities	1,897,401	1,321,665
Revenues	6,239,364	6,584,451
Net Income including minority interest	784,803	1,008,079

In December 2007 the Company acquired a 50% equity interest in JSC Tomskneft VNK ("Tomskneft") and its subsidiaries from a subsidiary of OJSC Oil Company Rosneft ("Rosneft") for US$ 3,567.3 million. The purchase price was based on the fair value of Tomskneft, which amounted to US$ 3,670.0 million as determined by an independent appraiser. As part of this transaction, the Company and Rosneft agreed to jointly manage the business operations of Tomskneft and to each purchase their respective share of Tomskneft's annual production. As both the Company and Rosneft are ultimately controlled by the Russian Federation, the transaction was deemed to have occurred between entities under common control and therefore was accounted for at Rosneft's historical cost. Accordingly, the difference of US$ 2,153.7 million between the purchase price and historical cost was charged to additional-paid-in-capital and reserves in shareholders' equity.

The following table summarizes the financial information of JSC Moscow Oil Refinery as of December 31, (in US$ thousands):

	2007	2006
Total assets	$ 457,804	$ 453,385
Total liabilities	133,865	157,802
Net Income	28,355	11,323

The 27.4% interest in JSC Mosnefteprodukt is accounted for as a cost basis investment as the Company does not have the ability to exercise significant influence over this entity as it has no participation on JSC Mosnefteprodukt's board of directors.

9. Oil and Gas Properties

Oil and gas properties as of December 31, are as follows (in US$ thousands):

	2007	2006
Oil and gas properties	$ 12,599,083	$ 10,869,740
Less: Depreciation, depletion and amortization	(6,797,307)	(6,300,596)
Total oil and gas properties, net	$ 5,801,776	$ 4,569,144

The Company's oil and gas fields and related hydrocarbons belong to government authorities. The Company obtains licenses from such government authorities and pays royalties to explore and produce from these fields. These licenses expire between 2013 and 2050. During 2007 management was successful in extending several licences and believes the remaining licences may be extended at the initiative of the Company and management intends to extend such licenses for properties expected to produce subsequent to their original license expiry dates.

10. Property, Plant and Equipment

Property, plant and equipment as of December 31, is as follows (in US$ thousands):

	2007	2006
Buildings	$ 3,352,082	$ 3,107,905
Machinery and equipment	1,393,440	1,317,741
Vehicles and other equipment	79,941	67,591
	4,825,463	4,493,237
Less: Accumulated depreciation	(3,993,644)	(3,641,032)
Total property, plant and equipment, net	$ 831,819	$ 852,205

11. Construction-in-Progress

Construction-in-progress includes various construction projects and machinery and equipment delivered but not installed yet. As of December 31, 2007, detail of construction-in-progress is as follows (in US$ thousands):

	Construction Work in Progress	Machinery/ Equipment To be installed	Total
Buildings	$ 61,023	$ -	$ 61,023
Plant and machinery	66,998	-	66,998
Vehicles and other equipment	66,776	34,871	101,647
Total	$ 194,797	$ 34,871	$ 229,668
Comparative balance at December 31, 2006	$ 123,870	$ 37,332	$ 161,202

12. Short-Term Loans

As of December 31, the Company has short-term loans outstanding as follows (in US$ thousands):

	2007	2006
Banks	$ 165,399	$ 40,385
Related parties	59,823	731
Other	15,914	15,041
Total	$ 241,136	$ 56,157

In general, short-term loans are used for the provision of working capital needs. As of December 31, 2007 and 2006 more than 50.0% of the loans were provided in US Dollars.

As of December 31, 2007 the Company has a US$ 40.0 million loan outstanding from Raiffeisenbank repayable in US Dollars. The loan bears a floating interest rate of LIBOR plus 0.5% and matures in August 2008. As of December 31, 2006 the Company had a US$ 40.0 million loan from Raiffeisen Bank repayable in US Dollars which bore interest at LIBOR plus 0.5%.

As of December 31, 2007, the Company has a US$ 50.0 million loan outstanding from ING Bank repayable in US Dollars. The loan bears a floating interest rate of LIBOR plus 0.55% and matures in December 2008.

As of December 31, 2007 the Company also has a US$ 75.0 million loan outstanding from Sumitomo Mitsui Banking Corporation repayable in US Dollars. The loan bears a floating interest rate of LIBOR plus 0.55% and matures in March 2008.

As of December 31, 2007 the Company has a loan from Slavneft of US$ 59.1 million repayable in Rubles which bears interest at a rate of 6%. Slavneft is a related party to the Company.

Weighted average interest rates related to the short-term loans outstanding as of December 31, 2007 for US Dollar and Ruble denominated loans equal 5.2% and 4.9%, respectively. Weighted average interest rates related to the short-term loans outstanding as of December 31, 2006 for US Dollar and Ruble denominated loans equaled 5.8% and 1%, respectively.

13. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities as of December 31, comprise the following (in US$ thousands):

	2007	2006
Trade accounts payable	$ 522,705	$ 265,397
Advances received from customers	271,957	217,432
Related party accounts payable	225,049	69,408
Accrued interest	39,043	45,574
Other payables	112,276	50,713
Total accounts payable	$ 1,171,030	$ 648,524

14. Income and Other Taxes Payable

Income and other taxes payable comprise the following, as of December 31 (in US$ thousands):

	2007	2006
Mineral extraction tax	$ 345,533	$ 216,824
Value added tax	230,056	218,220
Excise tax	67,139	11,940
Income tax	56,566	3,246
Property tax	24,801	37,109
Other	9,632	10,053
Total income and other taxes payable	$ 733,727	$ 497,392

15. Asset Retirement Obligations

The following summarizes the activity of the asset retirement obligations (in US$ thousands)

	2007	2006
Beginning balance as of January 1,	$ 287,731	$ 260,983
Change in estimate	13,854	5,817
Spending on existing obligations	(267)	-
Accretion expense	23,010	20,931
Ending balance as of December 31,	$ 324,328	$ 287,731

16. Long-term Debt

As of December 31, the Company has long-term outstanding loans as follows (in US$ thousands):

	2007	2006
Bonds	$ 500,000	$ 900,000
Bank loans outstanding	2,662,025	681,696
Other borrowings	19,165	34,069
Less current portion of long- term debt	(1,097,891)	(638,363)
Total long-term debt	$ 2,083,299	$ 977,402

Bank loans are comprised of loan facilities in US Dollars and Rubles primarily from major western and Russian banks and their affiliates.

In December 2002, the Company placed US$ 500.0 million in 7-year Eurobonds on the Luxemburg Stock Exchange. The bonds bear interest of 10.75% per year and have semi-annual coupon payments due on January, 15 and July, 15 of each year. Accrued interest for the bonds was US$ 25.7 million and US$ 25.4 million as of December 31, 2007 and 2006, respectively.

In January 2002, the Company placed US$ 250.0 million in 5-year Eurobonds on the Luxemburg Stock Exchange. The bonds bore interest of 11.5% per year. Subsequently, in March 2002, the Company extended the issue up to US$ 400.0 million. All bonds have semi-annual coupon payments due on February, 13 and August, 13 of each year. Accrued interest for the bonds was US$ 18.0 million as of December 31, 2006. On February 12, 2007, the Company fully repaid these Eurobonds for US$ 400.0 million and accrued interest of US$ 23.0 million. As the amount was repaid in February 2007, these bonds were included in the current portion of long-term debt as of December 31, 2006.

During 2006 the Company obtained US$ 630.0 million syndicated loan from Citibank and ABN-AMRO Bank maturing in July 2009, bearing floating interest at rates of LIBOR plus 0.6%. As of December 31, 2007, the amount outstanding under this syndicated loan is US$ 443.3 million (including current portion of US$ 280 million). As of December 31, 2006 the amount outstanding under the loan was US$ 630.0 million (including current portion of US$ 186.7 million).

During 2007 the Company obtained US$ 2.2 billion syndicated loan from Calyon, ABN-AMRO, Commerzbank and Citibank (including current portion of US$ 800 million). The loan matures in September 2010 and bears interest at a rate of LIBOR plus 0.75%.

As of December 31, 2007 the Company has US$ 17.1 million loan from Gazprombank (all current), bearing interest rate of 9.6%. As of December 31, 2006 the Company had a loan from Gazprombank amounting to US$ 51.7 million (all current). The loan bore interest rate of 6.0%. Gazprombank is a related party to the Company.

The loan agreements contain financial covenants that require the Company's ratios of Consolidated EBITDA to Consolidated Interest Payable, Consolidated Indebtedness to Consolidated Tangible Net Worth and Consolidated Indebtedness to Consolidated EBITDA. Management believes the Company is in compliance with these covenants as of December 31, 2007 and 2006, respectively.

Maturities of long-term loans as of December 31, 2007 are as follows (in US$ thousands):

Year due	Amount due
2008	$ 1,097,891
2009	1,475,199
2010	600,000
2011	3,100
2012	-
2013	5,000
	$ 3,181,190

17. Shareholders' equity

The Presidential Decree establishing Sibneft stated that the charter capital of the Company would be equal to 38 percent of the aggregate of the Charter capitals of its four subsidiaries at the date of formation. The 38 percent of the aggregate of the Charter capitals of the four subsidiaries also gave the Company 51 percent of the voting common stock in each of the subsidiaries and represented the Government's ownership in these companies. This consolidation of the Government's ownership into one company established the share capital of Sibneft at 4,516,396,250 shares of 0.0016 Rubles each. On December 16, 1998 the Company issued additionally 224,903,389 shares of 0.0016 Rubles each. For the purposes of these financial statements, the Ruble value of the shares has been translated into US Dollars at the historical exchange rate.

The common stock represents the authorized capital of the Company, as stated in its charter document. The common shareholders are allowed one vote per share. Dividends paid to shareholders are determined by the directors and approved at the annual shareholders' meeting.

18. Fair Value of Financial Instruments

<u>Fair values</u>

The estimated fair values of financial instruments are determined with reference to various market information and other valuation methodologies as considered appropriate, however considerable judgment is required in interpreting market data to develop these estimates. Accordingly, the estimates are not necessarily indicative of the amounts that the Company could realize in a current market situation. Certain of these financial instruments are with major financial institutions and expose the Company to market and credit risk. The creditworthiness of these institutions is routinely reviewed and full performance is anticipated.

The net carrying values of cash and cash equivalents, short-term investments, short-term loans receivable, accounts receivable and payable, taxes payable and accrued liabilities approximate their fair values because of the short maturities of these instruments. As discussed in Note 4, the fair value of the long-term loans receivable from related parties is approximately US$ 37.1 million as of December 31, 2007.

As discussed in Note 8, the Company has investments in certain Russian and CIS companies. There are no quoted market prices for these instruments and a precise estimate of fair value could not be made without incurring excessive costs.

Loan arrangements on short-term and long-term debt have both fixed and variable interest rates that reflect the currently available terms for similar debt. The carrying value of this debt is a reasonable approximation of its fair value.

Credit risk

Company's financial instruments that are potentially exposed to concentrations of credit risk consist primarily of accounts receivable, cash and cash equivalents, as well as prepaid VAT, loans receivable and advances. A significant portion of the Company's accounts receivable is due from domestic and export trading companies. The Company does not generally require collateral to limit the exposure to loss; however, letters of credit and prepayments may be used. Although collection of these receivables could be influenced by economic factors affecting these entities, management believes there is no significant risk of loss to the Company beyond provisions already recorded.

The Company deposits available cash mostly with a variety of Russian banks and Russian affiliates of international banks. Management periodically reviews the creditworthiness of the banks in which it deposits cash.

Prepaid VAT, representing amounts payable or paid to suppliers, is recoverable from the tax authorities via offset against VAT payable to the tax authorities on the Company's revenue or direct cash receipts from the tax authorities. Management periodically reviews the recoverability of the balance of prepaid VAT and believes it is fully recoverable within one year.

19. Income Taxes

The Company's provision for income taxes as reported in the accompanying consolidated statements of income for the years ended December, 31 is as follows (in US$ thousands):

	2007	2006
Current income taxes	$ 1,342,405	$ 1,112,827
Deferred income taxes	(27,371)	80,381
Total provision for income taxes	$ 1,315,034	$ 1,193,208

The current portion of income taxes represents the total income tax expense for the Company and each of its subsidiaries. Although the Company does not pay tax on a consolidated basis, a reconciliation of expected income tax expense to the actual tax expense for the years ended December 31, 2007 and 2006, is as follows (in US$ thousands):

	2007	2006
Income before income taxes	$ 5,457,862	$ 4,854,050
Statutory income tax rate	24.0%	24.0%
"Expected" income tax expense	1,309,887	1,164,972
Add (deduct) tax effect of:		
Benefit of foreign income taxed at lower rates	(8,421)	(176)
Difference between enacted tax rate and taxes to be withheld from dividends	(10,416)	(19,612)
Non-deductible expenses and other permanent accounting differences	23,984	48,024
Income taxes	$ 1,315,034	$ 1,193,208
Effective tax rate	24.1%	24.6%

Temporary differences between the Russian statutory accounts and these financial statements give rise to the following deferred income tax assets and liabilities as of December 31, 2007 and 2006 (in US$ thousands):

	2007	2006
Assets arising from the tax effect of:		
Allowance for doubtful accounts	$ 4,658	$ 5,581
Inventories	9,265	9,269
Prepaid expenses	5,365	13,493
Current deferred income tax assets	$ 19,288	$ 28,343
Asset retirement obligation	$ 77,839	$ 69,047
Tax loss carryforward	17,457	55,498
Fixed assets	41,637	8,197
Non-current deferred income tax assets	$ 136,933	$ 132,742
Equity Investment and other investments	(16,686)	(12,499)
Fixed assets	(124,285)	(160,707)
Deferred income tax liability	$ (140,971)	$ (173,206)
Net deferred income tax asset (liability)	$ 15,250	$ (12,121)

For Russian income tax purposes, certain subsidiaries of the Company have accumulated tax losses totaling US$ 72.7 million as of December 31, 2007 (US$ 231.2 million as of December 31, 2006), resulting in associated deferred income tax assets of US$ 17.5 million and US$ 55.5 million, respectively. Tax losses carried forward as of December 31, 2007, expire between 2012 - 2017.

20. Commitments and Contingencies

Taxes

The tax authorities are currently reviewing the operation of the Company and its subsidiaries for the year 2005. The review is in process; the impact of the result of the tax review is not determinable, however management believes that the ultimate resolution of this matter will not have a material impact on the Company's financial position, results of operations and cash flows.

Russian tax and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant authorities. The Russian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. The Supreme Arbitration Court issued guidance to lower courts on reviewing tax cases providing a systemic roadmap for anti-avoidance claims, and it is possible that this will significantly increase the level and frequency of tax authorities scrutiny. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. The years 2006 and 2007 are currently open for review.

Operating Environment

While there have been improvements in the economic situation in the Russian Federation in recent years, the country continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in any countries outside of the Russian Federation, restrictive currency controls, and a level of inflation. The prospects for future economic stability in the Russian Federation are largely dependent upon the effectiveness of economic measures undertaken by the government, together with legal, regulatory, and political developments.

Environmental Matters

The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Company periodically evaluates its potential obligations under environmental regulation. Management is of the opinion that the Company has met the government's requirements concerning environmental matters, and therefore believes that the Company does not have any material current environmental liabilities.

21. Related Party Transactions

JSC Moscow Oil Refinery (Moscow Refinery)

During the period ending December 31, 2007 the Company processed 3.3 million tons of crude oil (3.2 million tons in 2006) at Moscow Refinery based on processing agreements. Total cost of processing for the period ending December 31, 2007 was US$ 94.8 million (US$ 64.4 million for 2006). Such transactions are in the ordinary course of business and on terms available to other suppliers. The Company sold 0.1 million tons of oil products (0.1 million tons of oil products in 2006) amounting to US$ 9.4 million (US$ 4.7 million in 2006). The Company has US$ 14.5 million in payables to Moscow Refinery and US$ 1.9 million in receivables from Moscow Refinery as of December 31, 2007. As of December 31, 2006 the Company had US$ 2.3 million payables to Moscow Refinery.

Slavneft Group (Slavneft)

During the period ending December 31, 2007 the Company conducted numerous transactions with Slavneft. The Company sold directly 0.8 million tons of crude oil (2.0 million tons in 2006) to Slavneft amounting to US$ 298.1 million (US$ 558.9 million in 2006) and 0.8 million tons of oil products (0.2 million tons of oil products in 2006) amounting to US$ 256.8 million (US$ 84.9 million in 2006). The Company and TNK-BP have in principle agreed to split Slavneft's production based on each party's respective interest. During the period ending December 31, 2007 the Company purchased from Slavneft 10.4 million tons of crude oil and 0.9 million tons of oil products amounting to US$ 2,090.3 million and US$ 416.1 million, respectively. During the period ending December 31, 2006 the Company purchased from Slavneft 10.2 million tons of crude and 3.0 million tons of oil products amounting to US$ 1,851.6 million and US$ 1,000.9 million, respectively. During the period ending December 31, 2007 the Company processed 6.4 million tons of crude oil (4.9 million tons in 2006) for a total cost of processing amounting to US$ 195.6 million (US$ 129.6 million in 2006). During the period ending December 31, 2007 the Company purchased 0.4 billion cubic meters of gas (0.4 billion cubic meters in 2006) amounting to US$ 3.4 million (US$ 2.9 million in 2006) from Slavneft. The Company has US$ 172.8 million in payables to Slavneft and US$ 16.7 million in receivables from Slavneft as of December 31, 2007. As of December 31, 2006 the Company had US$ 39.5 million in payables to Slavneft and US$ 8.9 million in receivables from Slavneft.

Gazprom Group (Gazprom)

The Company conducted numerous transactions with Gazprom, its primary shareholder. During the period ending December 31, 2007 the Company purchased from a subsidiary of Gazprom 0.5 billion cubic meters of gas (0.6 billion cubic meters in 2006) amounting to US$ 36.0 million (US$ 16.4 million in 2006) and sold to a subsidiary of Gazprom 1.8 billion cubic meters of gas (2.0 billion cubic meters in 2006) amounting to US$ 17.3 million (US$ 13.9 million in 2006). During the period ending December 31, 2007 Gazprom's subsidiaries performed construction works and sold other goods and services to the Company amounting to US$ 32.1 million (US$ 23.2 million in 2006). During the period ending December 31, 2007 the Company sold oil products and rendered various services to Gazprom amounting to US$ 116.8 million (US$ 67.0 million in 2006). The Company has US$ 37.8 million in payables to Gazprom and US$ 6.5 million in receivable from Gazprom as of December 31, 2007. As of December 31, 2006 the Company had US$ 27.6 million in payables to Gazprom and US$ 4.1 million in receivables from Gazprom.

Refer to Note 3 Cash and Cash Equivalents, Note 4 Short-term Loans Receivable and Long-term Loans Receivable, Note 8 Long-term Investments, Note 12 Short-term Loans and Note 16 Long-term Debt.

22. Segment information

Presented below is information about the Company's operating segments for the years ended December 31, 2007 and 2006. The Company determined its operating segments based on differences in the nature of their operations considering the regular review by the chief operating decision maker to make decisions about resources to be allocated and to assess performance of the Company. During the fourth quarter of 2007, the Company changed how segment performance is evaluated and decisions are made to allocate resources to the segments resulting in a change from three operating segments to two operating segments. Prior year disclosures have been revised to reflect the change in operating segments. The accounting policies used by the segments are the same as the accounting policies described in Summary of Significant Accounting Policies (Note 2).

The exploration and production segment explores, develops and produces crude oil and natural gas and sells its production to the refining, marketing and distribution segment. The refining and marketing segment processes crude oil into refined products and purchases, sells and transports crude oil and refined petroleum products.

Operating Segments 2007 (in US$ thousands):

	Exploration and Production	Refining, Marketing and Distribution	Elimination	Consolidated
Revenues				
Revenues from external customers	$ 86,450	$ 21,013,967		$ 21,100,417
Inter-segment revenues	6,473,710	21,517	(6,495,227)	-
Total	6,560,160	21,035,484	(6,495,227)	21,100,417
Operating income	814,306	4,084,631	-	4,898,937
Capital expenditures	2,044,235	166,609	-	2,210,844
Depreciation, depletion and amortization	838,278	90,580	-	928,858
Income tax expense	280,780	1,034,254	-	1,315,034
Segment assets as of December 31, 2007	11,030,189	15,066,257	(9,490,414)	16,606,032

Operating Segments 2006 (in US$ thousands):

	Exploration and Production	Refining, Marketing and Distribution	Elimination	Consolidated
Revenues				
Revenues from external customers	$ 79,151	$ 19,814,993		$ 19,894,144
Inter-segment revenues	5,414,909	18,358	(5,433,267)	-
Total	5,494,060	19,833,351	(5,433,267)	19,894,144
Operating income	714,366	3,651,490	-	4,365,856
Capital expenditures	1,393,900	131,209	-	1,525,109
Depreciation, depletion and amortization	713,006	89,535	-	802,541
Income tax expense	270,681	922,527	-	1,193,208
Segment assets as of December 31, 2006	7,717,390	9,720,832	(3,336,104)	14,102,118

For the year ended December 31, 2007 the Company had one customer which accounted for approximately 27.1% of the Company's sales. Management does not believe that the Company is reliant on any particular customer.

The geographical segmentation of the Company's revenue is presented below (in US$ thousands):

	2007	2006
Export	$ 13,071,191	$ 14,027,199
Domestic	6,443,474	4,634,629
CIS	1,585,752	1,232,316
Total revenues from external customers	$ 21,100,417	$ 19,894,144

Substantially all of the Company's long-lived assets are located in the Russian Federation.

23. Subsequent Events

On May 13, 2008, the Company's board of directors recommended to the general shareholder's meeting to approve an annual dividend of 25,603 million rubles (US$ 1,074 million as of that date) for the 2007 fiscal year.

As required by SFAS No. 69, "Disclosures about Oil and Gas Producing Activities", the Company is making certain supplemental disclosures about its oil and gas exploration and production operations. While this information was developed with reasonable care and disclosed in good faith, it is emphasized that some of the data is necessarily imprecise and represents only approximate amounts because of the subjective judgments involved in developing such information. Accordingly, this information may not necessarily represent the current financial condition of the Company or its expected future results.

The Company's exploration and development activities are exclusively within the Russian Federation; therefore, all of the information provided in this section pertains entirely to this region.

<u>Capitalized Costs Relating to Oil and Gas Producing Activities</u>

The following tables set forth information regarding oil and gas exploration and development costs. The amounts reported as costs incurred include both capitalized costs and costs charged to expense during the period ended December 31, 2007 and 2006, respectively (in US$ thousands):

	2007	2006
Total capitalized costs of oil and gas properties	$ 12,599,083	$ 10,869,740
Less: Accumulated depreciation, depletion and amortization	(6,797,307)	(6,300,596)
Total net capitalized costs of oil and gas properties	$ 5,801,776	$ 4,569,144

The Company's share in the net capitalized costs of equity investees as of December 31, 2007 and 2006 was US$ 3,883 million and US$ 1,723 million, respectively.

	2007	2006
Costs incurred in oil and gas properties acquisitions, exploration and development activities		
Acquisition of properties	$ 50,870	$ -
Development costs	2,044,235	1,393,900
Total costs incurred in oil and gas properties acquisitions, exploration and development activities	$ 2,095,105	$ 1,393,900

The Company's share in acquisitions, exploration and development costs of its equity investees was US$ 682 million and US$ 375 million in 2007 and 2006, respectively.

<u>Results of Operations from Oil and Gas Producing Activities</u>

The Company's results of operations from oil and gas producing activities are shown below. Natural gas production does not represent a material portion of the Company's total oil and gas production.

Sales are derived from realized prices applicable to third party crude oil sales to the Company's various markets (export, domestic and CIS). Transfers to the Company's refining operations represent prices equivalent to those that could be obtained in an arm's-length transaction.

Results of operations for oil and gas producing activities do not include general corporate overhead and monetary effects, or their associated tax effects. Income tax is based on statutory rates for the years ended, respectively, adjusted for tax deductions, tax credits and allowances. For the period ended December 31, 2007 and 2006, respectively (in US$ thousands):

	2007	2006
Revenues from net production		
Sales	$ 6,686,970	$ 7,018,583
Transfers	4,539,780	3,445,836
Total revenues	11,226,750	10,464,419
Production costs	(1,590,416)	(1,080,192)
Accretion expenses	(23,010)	(20,931)
Depreciation, depletion and amortization	(838,278)	(713,006)
Taxes, other than income tax	(5,578,490)	(5,729,286)
Pretax income from producing activities	3,196,556	2,921,004
Income tax expenses	(658,628)	(613,544)
Results of oil and gas producing activities	$ 2,537,928	$ 2,307,460

The Company's share in the results of operations for oil and gas production of equity investees was US$ 743 million and US$ 281 million in 2007 and 2006, respectively.

Proved Oil and Gas Reserve Quantities

Proved reserves are defined as the estimated quantities of oil and gas, which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. In some cases, substantial new investment in additional wells and related support facilities and equipment will be required to recover such proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change over time as additional information becomes available.

Management believes that proved reserves should include quantities, which are expected to be produced after the expiry dates of the Company's production licenses. These licenses expire between 2013 and 2050, with the most significant licenses expiring in 2013 and 2014. Management believes the licences may be extended at the initiative of the Company and management intends to extend such licenses for properties expected to produce subsequent to their license expiry dates. The Company has disclosed information on total proved oil and condensate and gas reserve quantities and standardized measure of discounted future net cash flows.

Proved developed reserves are those reserves, which are expected to be recovered through existing wells with existing equipment and operating methods. Proved undeveloped reserves are those reserves which are expected to be recovered as a result of future investments to drill new wells, to recomplete existing wells and/or install facilities to collect and deliver the production from existing and future wells.

The reserve quantities shown below include 100 percent of the net reserve quantities attributable to the Company's consolidated subsidiaries.

As determined by the Company's independent reservoir engineers, Miller and Lents, the following information presents the balances of proved oil and gas reserve quantities as of December 31, 2007 and 2006, respectively.

Total net proved reserves of crude oil and condensate are presented below (in millions of barrels):

	2007	2006
Proved Reserves at January 1,	3,854	3,398
Production	(242)	(243)
Revision of previous estimates and improved recovery	531	699
Proved reserves at December 31,	4,143	3,854
Minority's share included in the above proved reserves	30	26
Proved developed reserves	2,840	2,735

The Company's share in the proved reserves of equity investees was 1,791 million barrels and 1,288 million barrels in 2007 and 2006, respectively. The Company's share in the proved developed reserves of equity investees was 1,365 million barrels and 1,032 million barrels in 2007 and 2006, respectively.

Standardized measure of discounted future net cash flows and changes therein relating to proved oil and gas reserves

The standardized measure of discounted future net cash flows, related to the above oil and gas reserves, is calculated in accordance with the requirements of SFAS No.69. Estimated future cash inflows from production are computed by applying year-end prices for oil and gas to year-end quantities of estimated proved reserves. Adjustment in this calculation for future price changes is limited to those required by contractual arrangements in existence at the end of each reporting period. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end 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 cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a 10% 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 tables set out below does not represent management's estimate of the Company's expected future cash flows or of the value Company's proved oil and gas reserves. Estimates of proved reserves 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 valuation prescribed under SFAS No.69 requires assumptions as to the timing and the amount of future development and production costs. The calculations should not be relied upon as an indication of the Company's future cash flows or of the value of its oil and gas reserves.

	2007 (in US$ thousands)	2006 (in US$ thousands)
Future cash inflows	$ 206,836,090	$ 119,469,620
Future production costs	(101,111,947)	(59,940,239)
Future development costs	(7,769,696)	(7,212,079)
Future income tax expenses	(24,351,476)	(12,859,593)
Future net cash flows	73,602,971	39,457,709
Future net cash flow 10% annual discount for estimated timing of cash flow	(39,337,750)	(21,286,191)
Standardized measure of discounted future net cash flows	$ 34,265,221	$ 18,171,518

The Company's share in the discounted value of future cash flows related to the oil and gas reserves of equity investees was US$ 16,365 million and US$ 4,917 million in 2007 and 2006, respectively.

<u>Principal sources of changes in standardized measure of discounted future net cash flows</u>

	2007 (in US$ thousands)	2006 (in US$ thousands)
Discounted present value as of beginning of year	$ 18,171,518	$ 18,208,293
Sales and transfers of oil produced, net of production costs and other operating expenses	(4,058,245)	(3,654,541)
Net change in prices received per barrel, net of production costs and other operating expenses	17,885,403	679,293
Changes in future development costs	(2,167,284)	(1,700,574)
Development costs incurred during the period	2,044,235	1,396,558
Revisions of previous quantity estimates	5,595,154	5,629,027
Net change in income taxes	(5,414,375)	(203,738)
Accretion of discount	2,252,193	2,295,865
Other	(43,378)	(4,478,665)
Discounted present value as of end of year	$ 34,265,221	$ 18,171,518

The other change in discounted future net cash flows as of December 31, 2006 in the table above represents a change in the expected timing of cash flows due to corresponding changes in production from year to year.