Bashneft Group

Consolidated financial statements
for the year ended 31 December 2010

BASHNEFT GROUP

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STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

The following statement, which should be read in conjunction with the independent auditors' report set out on page 2, is made with a view to distinguish the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of Joint Stock Oil Company Bashneft (the "Company"), its subsidiaries and its special purpose entities (the "Group").

Management is responsible for the preparation of consolidated financial statements that presents fairly in all material respects the consolidated financial position of the Group as at 31 December 2010, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with the International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards in the Russian Federation;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements for the year ended 31 December 2010 were approved by:

A.L. Korsik
President

A.Y. Lisovenko
Chief Accountant

Ufa, Russian Federation
22 April 2011

ZAO "Deloitte & Touche CIS"
5 Lesnaya Street
Moscow, 125047
Russia

Tel: +7 (495) 787 06 00
Fax: +7 (495) 787 06 01
www.deloitte.ru

REPORT OF THE INDEPENDENT AUDITORS

To the shareholders of Joint Stock Oil Company Bashneft:

We have audited the accompanying consolidated financial statements of Joint Stock Oil Company Bashneft, its subsidiaries and its special purpose entities (the "Group") which comprise the consolidated statement of financial position at 31 December 2010, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte & Touche

Moscow, Russia
22 April 2011

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2010
Millions of US Dollars

	Notes	Year ended 31 December 2010	Year ended 31 December 2009
Revenue	7	13,341	6,775
Cost of purchased crude oil, gas and petroleum products		(2,882)	(933)
Export tariffs and excise		(2,753)	(793)
Production and operating expenses		(2,665)	(2,132)
Taxes other than income tax	9	(1,421)	(913)
Depletion and depreciation		(711)	(631)
Transportation expenses		(538)	(190)
Selling, general and administrative expenses		(470)	(487)
Exploration expenses		(9)	(15)
Gain on reclassification of available-for-sale investments to investments in associates	13	477	-
Other operating expenses, net		(99)	(63)
Operating profit		**2,270**	**618**
Finance income	10	67	41
Finance costs	10	(357)	(21)
Foreign exchange (loss)/gain, net		(2)	5
Share of profit of associates	13	36	-
Profit before income tax		**2,014**	**643**
Income tax	11	(468)	(170)
PROFIT FOR THE YEAR		**1,546**	**473**
OTHER COMPREHENSIVE LOSS			
Effect of translation to presentation currency		(93)	(254)
Other comprehensive loss for the year, net of income tax		**(93)**	**(254)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**1,453**	**219**
Profit for the year attributable to:			
Owners of the Company		1,429	420
Non-controlling interests		117	53
		1,546	**473**
Total comprehensive income for the year attributable to:			
Owners of the Company		1,356	276
Non-controlling interests		97	(57)
		1,453	**219**
EARNINGS PER SHARE			
Weighted average number of ordinary shares in issue during the year	19	162,295,807	170,169,754
Basic and diluted earnings per share (US Dollars per share)		7.26	2.05

The accompanying notes on pages 7-46 form an integral part of these consolidated financial statements.

BASHNEFT GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010
Millions of US Dollars

	Notes	31 December 2010	31 December 2009	1 January 2009
ASSETS				
Non-current assets				
Property, plant and equipment	12	9,552	9,867	10,066
Advances paid for acquisition of property, plant and equipment		120	160	261
Advance payment for acquisition of license for Trebs and Titov deposit		597	-	-
Intangible assets		33	6	3
Financial assets	14	217	65	154
Investments in associates	13	667	-	-
Long-term inventories	15	50	57	77
Other non-current assets	16	3	3	2
		11,239	**10,158**	**10,563**
Current assets				
Inventories	15	625	385	393
Financial assets	14	676	230	70
Trade and other receivables	17	523	227	176
Advances to suppliers and prepaid expenses		157	96	160
Income tax prepaid		11	16	44
Other taxes receivable	23	685	410	203
Cash and cash equivalents	18	1,067	1,166	826
Other current assets		8	1	3
		3,752	**2,531**	**1,875**
TOTAL ASSETS		**14,991**	**12,689**	**12,438**
EQUITY AND LIABILITIES				
Capital and reserves				
Share capital	19	77	77	77
Treasury shares	5	(252)	-	-
Additional paid-in capital		1,160	1,170	2,429
Foreign currency translation reserve		(155)	(104)	-
Retained earnings		4,445	4,162	3,838
Equity attributable to owners of the Company		**5,275**	**5,305**	**6,344**
Non-controlling interests		2,717	3,135	3,356
		7,992	**8,440**	**9,700**
Non-current liabilities				
Borrowings	20	3,118	1,676	51
Decommissioning provision	12	217	231	79
Deferred tax liabilities	11	1,099	1,051	1,119
Other non-current liabilities	21	49	31	31
		4,483	**2,989**	**1,280**
Current liabilities				
Borrowings	20	795	63	66
Trade and other payables	22	659	398	410
Dividends payable		73	3	487
Advances received		553	343	168
Provisions	24	97	24	32
Income tax payable		21	27	8
Other taxes payable	23	318	402	287
		2,516	**1,260**	**1,458**
TOTAL LIABILITIES		**6,999**	**4,249**	**2,738**
TOTAL EQUITY AND LIABILITIES		**14,991**	**12,689**	**12,438**

The accompanying notes on pages 7-46 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2010
Millions of US Dollars

	Year ended 31 December 2010	Year ended 31 December 2009
OPERATING ACTIVITIES		
Profit before income tax	**2,014**	**643**
Adjustments for:		
Depletion and depreciation	711	631
Loss on disposal of property, plant and equipment	66	52
Finance income	(67)	(41)
Finance costs	357	21
Share of profit of associates	(36)	-
Gain on reclassification of available-for-sale investment to investment in associates	(477)	-
Impairment of investment in associate	17	-
Foreign exchange loss/(gain), net	2	(5)
Change in other provisions and allowances	50	33
Other	10	(4)
Operating cash flows before working capital changes	**2,647**	**1,330**
Movements in working capital:		
Inventories	(236)	14
Trade and other receivables	(335)	(70)
Advances to suppliers and prepaid expenses	(62)	52
Other taxes receivable	(263)	(211)
Trade and other payables	232	36
Advances received	213	173
Other taxes payable	(80)	143
Cash generated from operations	**2,116**	**1,467**
Interest paid	(312)	(14)
Income tax paid	(404)	(204)
NET CASH GENERATED FROM OPERATING ACTIVITIES	**1,400**	**1,249**
INVESTING ACTIVITIES		
Payments to controlling shareholder relating to the formation of the Group	-	(1,360)
Payments for acquisition of property, plant and equipment	(492)	(589)
Advance payment for acquisition of license for Trebs and Titov deposit	(597)	-
Proceeds from disposal of property, plant and equipment	10	11
Payment for acquisition of associate	(123)	-
Payments for acquisition of intangible assets	(32)	(3)
Payments for acquisition of financial assets	(2,326)	(210)
Proceeds from disposal of financial assets	1,510	135
Interest received	55	39
NET CASH USED IN INVESTING ACTIVITIES	**(1,995)**	**(1,977)**
FINANCING ACTIVITIES		
Payment for acquisition of Sistema-invest, net of cash acquired	(201)	-
Payments for acquisition of non-controlling interests	(142)	-
Proceeds from borrowings	3,044	2,345
Repayments of borrowings	(899)	(727)
Dividends paid by the Company	(1,290)	(316)
Dividends paid by subsidiaries	(24)	(229)
NET CASH GENERATED FROM FINANCING ACTIVITIES	**488**	**1,073**
Net (decrease)/increase in cash and cash equivalents	**(107)**	**345**
Cash and cash equivalents at beginning of the year	**1,166**	**826**
Effect of translating reporting currency to presentation currency and exchange rate changes on the balance of cash and cash equivalents held in foreign currencies	8	(5)
Cash and cash equivalents at end of the year	**1,067**	**1,166**

The accompanying notes on pages 7-46 form an integral part of these consolidated financial statements.

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2010
Millions of US Dollars

	Notes	Share capital	Treasury shares	Additional paid-in capital	Foreign currency translation reserve	Retained earnings	Equity attributable to owners of the Company	Non-controlling interests	Total
Balance at 1 January 2009		**77**	**-**	**2,429**	**-**	**3,838**	**6,344**	**3,356**	**9,700**
Profit for the year		-	-	-	-	420	**420**	53	**473**
Other comprehensive loss for the year		-	-	-	(144)	-	**(144)**	(110)	**(254)**
Total comprehensive income for the year		**-**	**-**	**-**	**(144)**	**420**	**276**	**(57)**	**219**
Distribution to controlling shareholder relating to the formation of the Group	1	-	-	(1,400)	40	-	**(1,360)**	-	**(1,360)**
Increase of ownership in subsidiaries due to change in controlling shareholder		-	-	141	-	-	**141**	(141)	**-**
Dividends to equity holders		-	-	-	-	(96)	**(96)**	(23)	**(119)**
Balance at 31 December 2009		**77**	**-**	**1,170**	**(104)**	**4,162**	**5,305**	**3,135**	**8,440**
Profit for the year		-	-	-	-	1,429	**1,429**	117	**1,546**
Other comprehensive loss for the year		-	-	-	(73)	-	**(73)**	(20)	**(93)**
Total comprehensive income for the year		**-**	**-**	**-**	**(73)**	**1,429**	**1,356**	**97**	**1,453**
Acquisition of Sistema-invest	5	-	(252)	-	-	163	**(89)**	(307)	**(396)**
Dividends to equity holders		-	-	-	22	(1,360)	**(1,338)**	(23)	**(1,361)**
Acquisition of additional interests in subsidiaries	5	-	-	-	-	49	**49**	(178)	**(129)**
Other equity transactions		-	-	(10)	-	2	**(8)**	(7)	**(15)**
Balance at 31 December 2010		**77**	**(252)**	**1,160**	**(155)**	**4,445**	**5,275**	**2,717**	**7,992**

The accompanying notes on pages 7-46 form an integral part of these consolidated financial statements.

1. GENERAL INFORMATION

Organisation and operations

Joint Stock Oil Company Bashneft (the "Company" or "Bashneft"), its subsidiaries and special purpose entities (together referred to as the "Group" or the "Bashneft Group") are primarily involved in oil production, refining, marketing and distribution of petroleum products and electricity and heat generation in the Bashkortostan region of the Russian Federation. Bashneft is the parent company of a vertically integrated group of oil and gas and energy companies.

The Company was incorporated as an open joint stock company on 13 January 1995, following the privatisation of Bashkir Petrochemical Enterprise ("Bashneftekombinat"). The Company's registered office is located at Ufa, Bashkortostan Republic, 450045, Russian Federation.

The Group's oil production, refining, marketing and distribution base includes 167 oilfields, 4 refineries and 319 petrol stations. The Group's electricity and heat generation base includes 30 electricity generation stations with 4,248 megawatts ("MW") and 13,264 gigacalories/hour ("Gcal/h") of electricity and heat generation capacity, respectively.

The following principal subsidiaries incorporated in the Russian Federation were included in the scope of consolidation at 31 December 2010 and 2009, and at 1 January 2009:

		Group's effective interest		
Company	**Principal activities**	**31 December 2010**	**31 December 2009**	**1 January 2009**
OJSC Ufimsky refinery plant	Crude oil processing	63%	56%	54%
OJSC Novoil	Crude oil processing	69%	62%	60%
OJSC Ufaneftekhim	Crude oil processing	60%	47%	42%
OJSC Ufaorgsintez	Production of petrochemicals	63%	51%	50%
OJSC Bashkirenergo	Electricity and heat generation	35%	31%	30%
OJSC Bashkirnefteproduct	Petroleum products trading	62%	56%	48%
LLC Bashneft-dobycha	Production of crude oil and gas	100%	100%	n/a
LLC Bashneft-Bureniye	Construction services	100%	100%	100%

At 31 December 2010, the Group included 93 special purpose entities ("SPEs") (31 December 2009: 105 SPEs; 1 January 2009: 115 SPEs) which were established to provide supporting services to the Company and its subsidiaries engaged in the production and refining of crude oil and the generation of electricity and heat.

Group formation

From 1 January 2009 to April 2009, the Company, OJSC Ufimsky refinery plant ("Ufimsky refinery plant), OJSC Novoil ("Novoil"), OJSC Ufaneftekhim ("Ufaneftekhim"), OJSC Ufaorgsintez ("Ufaorgsintez") and OJSC Bashkirnefteproduct ("Bashkirnefteproduct") (together referred to as the "Group") were under common control of LLC Aguidel-Invest, LLC Yuruzan-Invest, LLC Inzer-Invest and LLC Ural-Invest (hereinafter refer to as "the previous shareholder"). The previous shareholder also owned OJSC Bashkirenergo ("Bashkirenergo") through its controlling interest in these companies.

In April 2009, OJSC JSFC Sistema ("JSFC Sistema") acquired controlling interests in the Company, Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct from the previous shareholder. Because of these acquisitions, JSFC Sistema also obtained control over Bashkirenergo. From 1 April 2009, these companies were under common control of JSFC Sistema.

On 31 December 2009, as part of the reorganisation of JSFC Sistema's oil and gas assets, the Company acquired controlling interests in Ufimsky refinery plant, Novoil, Ufaneftekhim and Ufaorgsintez from JSFC Sistema and on 22 January 2010 the Company acquired a controlling interest in Bashkirnefteproduct and thereby became the holding company of the Group, including Bashkirenergo.

As all the companies of the Group were a single economic entity and were under common control during the year ended 31 December 2009, the change in the Group structure has been accounted for retrospectively and these consolidated financial statements have been prepared as if the reorganisation had occurred on 1 January 2009.

The net assets of Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez, Bashkirnefteproduct and Bashkirenergo as of 1 January 2009 attributable to the previous shareholder in the amount of USD 2,429 million have been accounted for as additional paid-in capital in these consolidated financial statements. Payments made by the Company to JSFC Sistema relating to the acquisition of Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct in the amount of USD 1,360 million were accounted for as distributions to shareholders.

Equity attributable to owners of the Group as of 1 January 2009 and during the period from 1 January 2009 to 1 April 2009 represents the previous shareholder's controlling interests in the Company, Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct during this period. Equity attributable to owners of the Group during the period from 1 April 2009 to 31 December 2009 represents the previous shareholder's controlling interests in the Company, Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct that was acquired by JSCF Sistema on 1 April 2009 and JSCF Sistema's existing shareholding in the Group as of 1 April 2009.

Business environment

Emerging markets such as Russia are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. As has happened in the past, actual or perceived financial problems or an increase in the perceived risks associated with investing in emerging economies could adversely affect the investment climate in Russia and the Russian economy in general.

The global financial turmoil that has negatively affected Russian financial and capital markets in 2008 and 2009 has receded and Russian economy returned to growth in 2010. However significant economic uncertainties remain. Adverse changes arising from systemic risks in global financial systems, including any tightening of the credit environment or Russia, could slow or disrupt the economy, adversely affect the Group's access to capital and cost of capital for the Group and, more generally, its business, results of operations, financial condition and prospects.

2. BASIS OF PREPARATION

Conversion to International Financial Reporting Standards

The consolidated financial statements have been prepared in accordance with the requirements of IFRS 1 First-time Adoption of International Financial Reporting Standards, as a part of the Group's conversion to International Financial Reporting Standards ("IFRS").

The Group applied IFRS 1 in the preparation of the consolidated statement of financial position at 1 January 2009, the Group's transition date to IFRS. Management has elected to apply the exemption under IFRS 1, which allows accounting for property, plant and equipment of the Group at their fair values which represent their deemed cost. Fair values have been determined by an independent valuation at 1 January 2009.

The Group applied all IFRS Standards and Interpretations effective for the annual periods ending 31 December 2010.

Specific disclosures required by IFRS 1 in respect of the Group's transition from Russian accounting standards ("RAS") to IFRS are presented in Note 29.

Standards and Interpretations in issue but not yet adopted

At the date of authorisation of these consolidated financial statements, the following Standards and Interpretations were in issue but not yet effective:

Standards and Interpretations	Effective for annual periods beginning on or after
IFRS 3 Business Combinations (amendments)	1 July 2010
IFRS 7 Financial Instruments: Disclosures (amendments)	1 January 2011
IFRS 9 Financial Instruments: Classification and Measurement	1 January 2013
IAS 1 Presentation of Financial Statements (amendments)	1 January 2011
IAS 12 Income Taxes (amendments)	1 January 2012
IAS 24 Related Party Disclosures (revised)	1 January 2011
IAS 27 Consolidated and Separate Financial Statements (amendments)	1 July 2010
IAS 32 Financial Instruments: Presentation (amendments)	1 February 2010
IAS 34 Interim Financial Reporting (amendments)	1 January 2011
IFRIC 13 Customer Loyalty Programmes (amendments)	1 January 2011
IFRIC 14 IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (amendments)	1 January 2011
IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments	1 July 2010

The impact of adoption of these Standards and Interpretations in the preparation of the consolidated financial statements in future periods is currently being assessed by management. Management anticipates that, except for IFRS 9 Financial Instruments: Classification and Measurement ("IFRS 9"), the adoption of these Standards and Interpretations will have no material impact on the consolidated financial statements of the Group in the period of initial adoption.

IFRS 9 introduces new requirements for the classification and measurement of financial assets. All recognised financial assets that are currently within the scope of IAS 39 Financial Instruments: Recognition and Measurement, will be measured at either amortised cost or fair value.

Functional and presentation currency

The national currency of the Russian Federation is the Russian Rouble ("RUB"), which is the Group's functional currency as it reflects the economic substance of the Group's operations.

Management of the Group has selected US Dollar ("USD") as presentation currency for the convenience of the shareholders and users of the consolidated financial statements. All financial information presented in USD has been rounded to the nearest million.

The translation from functional currency into presentation currency is performed as follows:

- Assets and liabilities are expressed in USD using exchange rates prevailing at the end of the reporting period;
- Income and expenses items are translated at the average exchange rates for the period, unless exchange rate fluctuated significantly during that period, in which case the exchange rate at the dates of the transactions is used;
- Exchange differences, if any, are presented in the foreign currency translation reserve recognised as a separate component in other comprehensive income;
- All equity items are translated at their historical exchange rates; and
- In the consolidated statement of cash flows, cash balances at beginning and end of each period presented are translated at exchange rates at the respective dates. All cash flows are translated at the average exchange rate for the period, unless exchange rates fluctuated significantly during that period, in which case the exchange rate at the dates of the transactions is used. Resulting exchange differences, if any, are presented as *Effect of translating reporting currency to presentation currency and exchange rate changes on the balance of cash and cash equivalents held in foreign currencies*.

3. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards.

Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis except for fair value of the Company's property, plant and equipment measured at fair value at 1 January 2009, the date of transition to IFRS.

Basis of consolidation

The consolidated financial statements incorporate financial statements of the Company and entities (including special purpose entities) controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

All intra-group transactions, balances, income and expenses and any unrealised profits or losses are eliminated in full on consolidation.

Income and expenses of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate. Total comprehensive income of subsidiaries is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by the Group.

Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are generally recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value at the acquisition date.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at fair value or, when applicable, on the basis specified in another IFRS.

When a business combination is achieved in stages, the Group's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when the Group obtains control) and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (which cannot exceed one year from the acquisition date), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognised at that date.

Changes in the Group’s ownership interests in existing subsidiaries

Changes in the Group’s interest in subsidiaries that do not result in a loss of control are accounted for as equity transactions. The carrying amount of the Group’s interest and the non-controlling interests are adjusted to reflect the changes in their relative interest in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to owners of the Company.

When the Group loses control over a subsidiary, the profit or loss on disposal is calculated as the difference between:

- The aggregate of the fair value of the consideration received and the fair value of any retained interest; and
- The previous carrying amount of the assets and liabilities of the subsidiary and any non-controlling interests.

Amounts previously recognised in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred to retained earnings) in the same manner as would be required if the relevant assets or liabilities were disposed of. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 Financial Instruments: Recognition and Measurement or, when applicable, the cost on initial recognition of investments in an associate.

Special purpose entities

Special purpose entities are those undertakings that are created to satisfy specific business needs of the Group and the Group has the right to the majority of the benefits of the SPEs, or is exposed to risks associated with the activities of the SPEs. SPEs are consolidated in the same manner as subsidiaries.

Common control transactions

The assets and liabilities of subsidiaries acquired from entities under common control are recorded at the carrying values recognised by the transferor. Any difference between the carrying value of the net assets of subsidiaries acquired, and the consideration paid by the Group is accounted for as an adjustment to shareholders’ equity. The net assets of the subsidiaries and their results are recognised prospectively from the date on which control of the subsidiaries was obtained by the transferor.

The cost of assets acquired from entities under common control is measured as the carrying value of the asset given up by the transferor at the date of the transaction. Any difference between the carrying value of the assets acquired, and the consideration paid by the Group is accounted for as an adjustment to shareholders’ equity.

Foreign currencies

In preparing financial information of the individual entities, transactions in currencies other than the Russian Rouble are recorded at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date.

Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Property, plant and equipment

Recognition and measurement

The Group has utilised the exemption available to first-time adopters under IFRS 1 with regard to determining the carrying value of property, plant and equipment at the transition date. Property, plant and equipment of the Company and its subsidiaries acquired or constructed before 1 January 2009 are recorded at amounts determined by an independent valuation at 1 January 2009. The basis of valuation was fair value. In some instances, when items of property plant and equipment are of a specialised nature, they were valued at depreciated replacement cost. For each item of property plant and equipment the replacement cost was estimated as the current cost to replace the assets with a functionally equivalent asset. The estimated replacement cost was adjusted for accrued depreciation, including physical depreciation and functional and economic obsolescence. The result of this valuation comprised deemed cost at 1 January 2009.

Items of property, plant and equipment acquired after 1 January 2009 are measured at historic acquisition or construction cost.

Oil and gas exploration and evaluation expenditures are accounted for using the “successful efforts” method of accounting. Costs are accumulated on a field-by-field basis. Geological and geophysical costs are expensed as incurred. Costs directly associated with an exploration well, and exploration and property leasehold acquisition cost are capitalised until the determination of reserves is evaluated. If it is determined that commercial discovery has not been achieved, these costs are recognised in profit or loss. Capitalisation is made within property, plant and equipment. Once commercial reserves are found, exploration and evaluation assets are tested for impairment and transferred to development assets. No depreciation or amortisation is recognised during the exploration and evaluation phase. Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of commercially proven development wells, is capitalised within property, plant and equipment and intangible assets according to nature. When development is completed on a specific field, it is transferred to production or intangible assets. No depreciation or amortisation is charged during the exploration and evaluation phase. Extraction assets are aggregated exploration and evaluation tangible assets, and development expenditures associated with the production of proved reserves.

Property, plant and equipment include the initial estimate of the cost of conservation and liquidation of wells, pipelines, other oil and gas facilities and site restoration.

Construction cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment. Borrowing costs that are directly attributable to the acquisition or construction of assets, that necessarily takes a substantial period of time to get ready for its intended use, are capitalised as part of the cost of that asset.

The cost of replacing a part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognised in profit or loss.

Depletion and depreciation

Property, plant and equipment related to oil production activities are depreciated using the unit-of-production method. Unit-of-production rates are based on proved developed reserves, which are oil, gas and other mineral reserves estimated to be recovered from existing facilities using current operating methods except for assets whose useful lives are shorter than the lifetime of the field, in which case the straight-line method is applied. Where individually insignificant, unproved oil and gas properties may be grouped and amortised based on factors such as the average concession term and past experience of recognising proved reserves. Acquisition costs of proved properties are depleted using the unit-of-production method based upon total proved reserves. For this purpose, the oil and gas reserves of the Group have been determined based on estimates of hydro-carbon reserves in accordance with internationally recognised definitions by internationally recognised petroleum engineers to the extent that the reserves will be extracted by the end of the expected useful life of the field reserves.

Assets which are not directly associated with oil production activities are depreciated on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives of major classes of property, plant and equipment for the current year are as follows:

Buildings and constructions	2-100 years
Machinery and equipment	2-39 years
Transport	1-57 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date, with the effect of any changes in estimates being accounted for on a prospective basis.

Intangible assets

Intangible assets are measured at cost less accumulated amortisation and impairment losses. Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets.

The estimated useful life for the software for the current year is two years. Amortisation methods and useful lives are reviewed annually, with the effect of any changes in estimate being accounted for on a prospective basis.

Investments in associates

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, an investment in an associate is initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of the profit or loss and other comprehensive income of the associate. When the Group's share of losses of an associate exceeds the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. Additional losses are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of an associate recognised at the date of acquisition is recognised as goodwill, which is included within the carrying amount of the investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

The requirements of IAS 39 are applied to determine whether it is necessary to recognise any impairment loss with respect to the Group's investment in an associate. When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with IAS 36 Impairment of Assets as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, any impairment loss recognised forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognised in accordance with IAS 36 to the extent that the recoverable amount of the investment subsequently increases.

When a group entity transacts with its associate, profits and losses resulting from the transactions with the associate are recognised in the Group' consolidated financial statements only to the extent of interests in the associate that are not related to the Group.

Impairment of tangible and intangible assets

At the end of each reporting period, the Group reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

The recoverable amount is the higher of fair value less cost to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Financial instruments

Financial assets and financial liabilities are recognised when a Group entity becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Financial assets

Financial assets are recognised and derecognised on a trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value plus transaction costs.

Financial assets of the Group are classified into the following specified categories: available-for-sale (“AFS”) financial assets, held-to-maturity investments and loans and receivables.

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period, to the carrying amount on initial recognition.

AFS financial assets

Listed and unlisted shares held by the Group that are traded in an active market are classified as AFS and are stated at fair value, except for investments in shares for which there are no available market quotations and whose fair value cannot be reliably measured, which are accounted at cost.

Fair value of AFS financial assets with standard terms and conditions and traded in active markets is determined with reference to quoted market prices.

Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve. Where the investment is derecognised, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss, except for derecognition due to transactions under common control, where the respective cumulative gain or loss is reclassified within the consolidated statement of changes in equity.

Held-to-maturity investments

Promissory notes and debentures with fixed or determinable payments and fixed maturity dates which the Group has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are recorded at amortised cost less impairment, if any. Interest income is recognised using the effective interest method.

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest method less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

Equity securities classified as AFS, a significant and prolonged decline in the fair value of the securities below its costs is considered to be objective evidence of impairment.

For other financial assets objective evidence of impairment could include:

- Significant financial difficulty of the counterparty; or
- Default or delinquency in interest or principle payments; or
- It is becoming probable that the counterparty will enter bankruptcy or financial re-organisation.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of an allowance account. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss in the period.

With the exception of AFS equity securities, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

In respect of AFS equity securities, impairment losses previously recognised in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognised in other comprehensive income.

Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial assets and substantially all the risk and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risk and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

Inventories

Inventories are stated at the lower of cost and net realisable value. The cost of inventories is based on the weighted average principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity.

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and costs necessary to make the sale.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, current accounts and cash deposits with banks and highly liquid investments with maturities of three months or less, that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

Financial liabilities

Financial liabilities of the Group are classified into the following specified categories: financial guarantee contract liabilities and other financial liabilities.

Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of:

- The amount of the obligation under the contract, as determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- The amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with the revenue recognition policies set out below.

Other financial liabilities

Other financial liabilities, including trade and other payables, loans and borrowings, are initially measured at fair value, net of transaction costs. Financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

Provisions and contingencies

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Contingencies

Contingent liabilities are not recognised in the consolidated financial statements unless they arise as a result of a business combination. Contingencies attributable to specific events are disclosed unless the probability of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognised in the consolidated financial statements but are disclosed when an inflow of economic benefits is probable.

Decommissioning provision

Decommissioning provision relates primarily to the conservation and liquidation of wells, pipelines, other oil and gas facilities and site restoration. Management estimates the obligation related to these costs based on internally generated engineering estimates, current statutory requirements and industry practices. Future decommissioning costs, discounted to net present value, are capitalised and a corresponding obligation is recognised as soon as a constructive obligation to incur such costs arises and the amount can be reliably estimated. The unwinding of the discount is recognised as finance cost. Oil and gas properties related to decommissioning are depreciated using the unit-of-production method based on proved developed reserves.

The adequacy of the decommissioning provision is periodically reviewed in the light of current laws and regulations, and adjustments are made as necessary. Changes in the estimated expenditure are reflected as an adjustment to the provision and the corresponding asset.

Employee benefit obligations

Remuneration to employees in respect of services rendered during the reporting period, including accrual for unused vacation and bonuses and related social taxes, is recognised as an expense in the period when it is earned.

Defined contribution plan

Subsidiaries registered in the Russian Federation are legally obliged to make defined contributions to the State Pension Fund. This defined contribution plan is financed on a pay-as-you-earn basis.

Defined benefit plans

For defined benefit retirement plans, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at the end of each reporting period and with immediate recognition of all actuarial gains and losses in the income statement. Past service cost is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the statement of financial position represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost.

Share-based payment arrangements

For cash-settled share-based payments, a liability is recognised for the goods or services acquired, measured initially at the fair value of the liability. At the end of each reporting period until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with any changes in fair value recognised in profit or loss for the year.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts and after eliminating sales within the Group.

The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Group's activities as described below. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Cash received in advance from customers is not included in current year revenue, and is recognised within advances received.

Sales of crude oil and petroleum products

Revenue from the sales of crude oil and petroleum products (“goods”) is recognised when all the following conditions are satisfied:

- The Group has transferred to the buyer the significant risks and rewards of ownership of the goods;
- The Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the entity; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Sales of electricity and heat

Revenues from sales of electricity and heat are recognised when electricity and heat are supplied to customers. Revenue from services on transmission of electricity and heat energy is recognised in the period when occurred.

Rendering of services

Revenue from a contract to provide services is recognised by reference to the stage of completion of the contract.

Revenue from time and material contracts is recognised at the contractual rates as labour hours are delivered and direct expenses are incurred.

Construction contracts

Contract revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognised in profit or loss in proportion to the stage of completion of the contract. Contract expenses are recognised as incurred unless they create an asset related to future contract activity.

The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

Interest income

Interest income is recognised using the effective interest method. When a loan and receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loan and receivables are recognised using the original effective interest rate.

Dividend income

Dividend income is recognised when the right to receive payment is established.

Rental income

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time when the assets are substantially ready for their intended use or sale. Investment income earned on temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the finance costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

Leasing – the Group as lessee

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are initially recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments.

The corresponding liability to the lessor is included in the consolidated statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognised immediately in profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see above). Contingent rentals are recognised as expenses in the periods in which they are incurred.

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

Income tax

Income tax expense comprises current and deferred tax.

Current tax

Current tax is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised.

Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is expected to be settled or assets realised, based on tax rates that have been enacted or substantially enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Earnings per share

The Group presents basic and diluted earnings per share (“EPS”) data for its ordinary shares. Profit for the year attributable to owners of the Company is allocated between the Company’s ordinary and preference shares based on the two-class method. Under the two-class method, profit for the year attributable to each class of share is allocated according to their participation rights in the undistributed earnings of the Company. Basic EPS is calculated by dividing profit or loss attributable to ordinary shares of the Company by the weighted average number of ordinary shares outstanding during the period adjusted for shares purchased by the Group and held as treasury shares. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding.

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Group’s accounting policies, described in note 3, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities and recognised amounts of income and expenses that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

The most significant areas requiring the use of management estimates and assumptions relate to:

- Control over SPEs;
- Useful economic lives of property, plant and equipment;
- Impairment of property, plant and equipment;
- Decommissioning provision;
- Allowances for doubtful receivables;
- Allowances for obsolete and slow-moving inventories;
- Legal contingencies; and
- Taxation.

Control over special purpose entities

Management judgement is involved in the assessment of control and the consolidation of certain SPEs in the Group's financial statements. The Group does not have any direct or indirect shareholdings in these SPEs and management periodically reviews the status of each of these entities.

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPE's risks and rewards, the Group concludes that it controls the SPE. SPEs controlled by the Group were established under terms that impose strict limitations on the decision-making powers of the SPEs' management and that result in the Group receiving the majority of the benefits related to the SPEs' operations and net assets, being exposed to the majority of risks incident to the SPEs' activities, and retaining the majority of the residual or ownership risks related to the SPEs or their assets.

Useful economic lives of property, plant and equipment

The estimation of the useful life of an item of property, plant and equipment is a matter of management judgement based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage based on production and reserve estimates, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any of these conditions or estimates may result in adjustments to future depreciation rates.

Based on the terms included in the licences and past experience, management believes oil production licences will be extended past their current expiration dates at insignificant additional costs. Because of the anticipated licence extensions, the assets are depreciated over their useful lives beyond the end of the current licence term.

Other property, plant and equipment are depreciated on a straight-line basis over their useful economic lives. Management periodically, at the end of each reporting period, reviews the appropriateness of the assets useful economic lives and residual values. The review is based on the current condition of the assets, the estimated period during which they will continue to bring economic benefit to the Group and the estimated residual value.

Impairment of property, plant and equipment

At the end of each reporting period, the Group reviews the carrying amounts of its property, plant and equipment to determine whether there is any indication that those assets are impaired. In making the assessment for impairment, assets that do not generate independent cash flows are allocated to an appropriate cash-generating unit. Management necessarily applies its judgement in allocating assets that do not generate independent cash flows to appropriate cash-generating units, and also in estimating the timing and value of underlying cash flows within the value in use calculation. In determining the value in use calculation, future cash flows are estimated at each cash-generating unit based on a cash flows projection utilising the latest budgeted information available.

Decommissioning provision

The Group's oil and gas activities are subject to various laws and regulations governing the protection of the environment. The Group estimates environmental obligations based on management's understanding of the current legal requirements in the various jurisdictions, terms of the licence agreements and internally generated engineering estimates. Provision is made, based on net present values, for decommissioning costs as soon as the obligation arises. Actual costs incurred in future periods could differ materially from the amounts provided. Additionally, future changes to environmental laws and regulations, life of oil and gas reserves estimates and discount rates could affect the carrying amount of this provision.

Allowances for doubtful receivables

The Group creates an allowance for doubtful receivables to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of the allowance for doubtful receivables, management bases its estimates on the current overall economic conditions, the ageing of accounts receivable balances, historical write-off experience, customer creditworthiness and changes in payment terms. Changes in the economy, industry or specific customer conditions may require adjustments to the estimated allowance for doubtful receivables.

Allowances for obsolete and slow-moving inventories

The Group creates an allowance for obsolete and slow-moving inventories. Estimates of net realisable value of inventories are based on the most reliable evidence available at the time the estimates are made. These estimates take into consideration fluctuations of prices or costs directly relating to events occurring subsequent to the reporting date to the extent that such events confirm conditions existing at the end of the reporting period. Changes in the supply and demand for the products, any subsequent changes to prices or costs may require adjustments to the estimated allowance for obsolete and slow-moving inventories.

Legal contingencies

Legal proceedings covering a wide range of matters are pending or threatened against the Group. Periodically, the status of each significant loss contingency is reviewed to assess the potential financial exposure of the Group. The Group records provisions for pending litigation when it determines that an unfavourable outcome is probable and the amount of loss can be reasonably estimated. Due to the inherent uncertain nature of litigation, the ultimate outcome or actual cost of settlement may materially vary from estimates. Provisions are based on the best information available at the time. As additional information becomes available, the potential liability related to pending claims and litigation is reassessed and, if required, estimates are revised. Such revisions in estimates could have a material impact on the future of the Group's results.

Taxation

Significant judgement is required in determining the provision for taxation in the Russian Federation. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated additional tax assessments as a result of tax audits based on estimates of whether it is probable that additional taxes will be due.

Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax provisions in the period in which such determinations are made.

Deferred tax assets are reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilised. The estimation of that probability includes judgements based on the expected performance of the Group. Various factors are considered to assess the probability of the future utilisation of deferred tax assets, including past operating results, operational plans, expiration of tax losses carried forward, and tax planning strategies. If actual results differ from these estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected.

Millions of US Dollars

5. BUSINESS COMBINATIONS AND INCREASE OF OWNERSHIP IN SUBSIDIARIES

OJSC "Sistema-invest"

On 9 April 2010, the Group acquired 25% interest in OJSC "Sistema-invest" ("Sistema-invest") from a third party for a cash consideration of USD 202 million.

As a result of this transaction, the shareholding structure of Sistema-invest was as follows:

	Interest
JSFC "Sistema"	65%
Bashneft	25%
Third party	10%
Total	**100%**

Sistema-invest is a special purpose entity controlled by JSFC "Sistema" that owns equity interests in the Company, Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct. The other assets and liabilities of Sistema-invest at the date of the transaction comprised mainly a loan from VTB. The transaction, in substance, represents an acquisition of the Company's own shares and additional interests in subsidiaries. The Group accounts for assets, liabilities, equity, revenues and expenses of Sistema-invest to the extent of its interest in Sistema-invest. The Company's proportionate interest in its own shares was accounted for as treasury shares and the proportionate increase in the Company's interest in subsidiaries was accounted for as an increase in ownership in subsidiaries acquired by the Group.

At the date of acquisition, Group's proportionate interest in the fair value of Sistema-invest's net assets amounted to USD 621 million. The excess of the Group's proportionate interest in the net assets acquired over the consideration paid was recognised in the Group's consolidated statement of changes in equity as an increase in treasury shares and retained earnings in the amounts of USD 267 million and USD 152 million, respectively. The transaction resulted in a decrease in non-controlling interests in the amount of USD 277 million.

On 3 December 2010, Sistema-invest acquired 10% of its own shares from a third party for a cash consideration of USD 120 million. As a result of this transaction, the Group's proportionate interest in Sistema-invest increased from 25% to 27.78%. The excess of the Group's proportionate interest in the fair value of Sistema-invest's net assets over the Group's proportionate interest in the consideration paid by Sistema-invest for its own shares was recognised in the Group's consolidated statement of changes in equity as an increase in treasury shares and retained earnings in the amounts of USD 19 million and USD 11 million, respectively. The transaction resulted in a decrease in non-controlling interests in the amount of USD 30 million.

As a result of this transaction, the shareholding structure of Sistema-invest was as follows:

	Interest
JSFC "Sistema"	72.22%
Bashneft	27.78%
Total	**100.00%**

At 31 December 2010, the carrying value of treasury shares held by the Company was as follows:

	Treasury shares acquired on 9 April 2010	Treasury shares acquired on 3 December 2010	Total
Fair value	486	52	**538**
Excess of the Group's proportionate interest in the net assets acquired over the consideration paid attributable to treasury shares	(267)	(19)	**(286)**
Total	**219**	**33**	**252**

Millions of US Dollars

The increase in the Group's interest in the Company and its subsidiaries as a result of the acquisition of 25% interest in Sistema-invest and Sistema-invest's acquisition of 10% of its own shares was as follows:

	Effective ownership acquired on 9 April 2010	**Effective ownership acquired on 3 December 2010**	**Total**
Bashneft (treasury shares)	5.19%	0.58%	5.77%
Ufimsky refinery plant	5.62%	0.62%	6.24%
Novoil	6.40%	0.71%	7.11%
Ufaneftekhim	4.55%	0.51%	5.06%
Ufaorgsintez	5.38%	0.60%	5.98%
Bashkirnefteproduct	4.30%	0.48%	4.78%
Bashkirenergo[1]	1.99%	0.22%	2.21%

Increase of ownership in subsidiaries

In June 2010, the Group acquired additional interests in subsidiaries as follows: 7.7% in Ufaneftekhim, 0.2% in Novoil, 0.7% in Ufimsky refinery plant, 5.0% in Ufaorgsintez and 0.8% in Bashkirnefteproduct for a total cash consideration of USD 129 million. As a result of these acquisitions, the Group's effective interest in Bashkirenergo increased by 1.5%. The excess of the Group's share in net assets acquired over the consideration paid of USD 49 million was recognised directly in the consolidated statement of changes in equity as an increase in retained earnings. As a result of these acquisitions, the Group recognised a decrease in net assets attributable to non-controlling interests of USD 178 million.

6. SEGMENT INFORMATION

For management purposes the Group is organised into three segments: Extraction, Refining and Marketing. Reports reviewed by the Board of Directors of the Group that are used to allocate resources to segments and to assess their performance are prepared on the same basis.

The operations of each of the Group's reportable segments are as follows:

- Extraction: The Extraction segment comprises subsidiaries and business units of the Company engaged in exploration and production of crude oil;
- Refining: The Refining segment comprises subsidiaries and business units of the Company engaged in processing crude oil and oil products; and
- Marketing: The Marketing segment comprises subsidiaries and business units of the Company engaged in wholesale and retail of oil and oil products.

Subsidiaries and business units of the Company engaged in electricity and heat generation are not included within the reportable operating segments, as they are not included in the reports provided to the Board of Directors. The results of these operations are included in the "Other segment" column below.

There are varying levels of integration between the Extraction, Refining and Marketing reportable segments. This integration includes transfers of crude oil from the Extraction segment to the Refining segment for processing into petroleum products.

Information regarding the results of each reportable segment is reviewed by the Board of Directors. Segment Profit before tax is used to measure segment performance, as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries.

[1] The Company controls Bashkirenergo through its controlling interests in Ufimsky refinery plant, Novoil and Ufaneftekhim.

Millions of US Dollars

The significant accounting policies of the reportable segments are the same as the Group's accounting policies described in Note 3.

Inter-segment pricing is determined on an arm's length basis.

Information about reportable segments for the year ended 31 December 2010 is as follows:

	Extraction	Refining	Marketing	Other segment	Elimi-nations	Total
External revenues	10,900	29	734	1,678	-	**13,341**
Inter-segment revenues	679	1,461	123	412	(2,675)	**-**
Finance income	42	21	4	-	-	**67**
Finance costs	(350)	(6)	-	(1)	-	**(357)**
Depletion and depreciation	(180)	(398)	(18)	(115)	-	**(711)**
Share of profit of associates	34	-	2	-	-	**36**
Other non-cash income/(expenses), net	431	(57)	(56)	(4)	-	**314**
Capital expenditure	326	144	5	133	-	**608**
Income tax (expense)/benefit	(379)	(49)	2	(42)	-	**(468)**
Profit/(loss) before tax	1,732	172	(24)	134	-	**2,014**

Information about reportable segments for the year ended 31 December 2009 is as follows:

	Extraction	Refining	Marketing	Other segment	Elimi-nations	Total
External revenues	4,113	820	585	1,257	-	**6,775**
Inter-segment revenues	334	463	52	345	(1,194)	**-**
Finance income	10	23	7	1	-	**41**
Finance costs	(17)	(3)	-	(1)	-	**(21)**
Depletion and depreciation	(159)	(349)	(17)	(106)	-	**(631)**
Other non-cash (expenses)/ income, net	(33)	1	-	(10)	-	**(42)**
Capital expenditure	379	215	36	154	-	**784**
Income tax expense	(108)	(22)	(11)	(29)	-	**(170)**
Profit/(loss) before tax	531	(28)	43	97	-	**643**

For the purpose of monitoring segment performance and allocating resources between segments all assets are allocated to reportable segments. The following tables present assets and liabilities of the Group reportable segments at 31 December 2010:

	Extraction	Refining	Marketing	Other segment	Elimi-nations	Total
Investments in associates	560	-	107	-	-	**667**
Segment assets	6,986	5,015	429	1,894	-	**14,324**
Inter-segment assets and eliminations	70	118	24	3	(215)	**-**
Total segment assets	**7,616**	**5,133**	**560**	**1,897**	**(215)**	**14,991**
Segment liabilities	(5,782)	(869)	(115)	(233)	-	**(6,999)**
Inter-segment liabilities and eliminations	(116)	(72)	(7)	(20)	215	**-**
Total segment liabilities	**(5,898)**	**(941)**	**(122)**	**(253)**	**215**	**(6,999)**

Millions of US Dollars

The following tables present assets and liabilities of the Group reportable segments at 31 December 2009:

	Extraction	Refining	Marketing	Other segment	Elimi-nations	Total
Segment assets	5,212	5,088	453	1,936	-	**12,689**
Inter-segment assets and eliminations	85	22	21	1	(129)	**-**
Total segment assets	**5,297**	**5,110**	**474**	**1,937**	**(129)**	**12,689**
Segment liabilities	(2,904)	(975)	(73)	(297)	-	**(4,249)**
Inter-segment liabilities and eliminations	(10)	(36)	(58)	(25)	129	**-**
Total segment liabilities	**(2,914)**	**(1,011)**	**(131)**	**(322)**	**129**	**(4,249)**

The following tables present assets and liabilities of the Group reportable segments at 1 January 2009:

	Extraction	Refining	Marketing	Other segment	Elimi-nations	Total
Segment assets	4,330	5,629	446	2,033	-	**12,438**
Inter-segment assets and eliminations	27	34	8	2	(71)	**-**
Total segment assets	**4,357**	**5,663**	**454**	**2,035**	**(71)**	**12,438**
Segment liabilities	(839)	(1,411)	(104)	(384)	-	**(2,738)**
Inter-segment liabilities and eliminations	-	(30)	(22)	(19)	71	**-**
Total segment liabilities	**(839)**	**(1,441)**	**(126)**	**(403)**	**71**	**(2,738)**

Substantially all of the Group's operations are conducted in the Russian Federation. The geographical regions within the Russian Federation have substantially similar economic and regulatory conditions. Therefore, the Group has not presented any separate geographical disclosure about its non-current assets by geographical area.

The Group's revenue from external customers by geographical location is as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
Russian Federation	7,306	4,849
European Union	5,309	1,646
CIS	726	280
Total	**13,341**	**6,775**

The following counterparties relating to the Extraction segment comprise each more than 10% of the total revenue of the Group:

	Year ended 31 December 2010		Year ended 31 December 2009	
	Revenue	% of the total Revenue	Revenue	% of the total Revenue
Litasco SA	1,634	12%	160	2%
STAR Oil (FZE)	1,522	11%	815	12%

Millions of US Dollars

7. REVENUE

	Year ended 31 December 2010	Year ended 31 December 2009
Petroleum products	9,342	2,828
Crude oil	1,995	1,687
Other revenue	2,004	2,260
Total	**13,341**	**6,775**

Other revenue includes electricity and heat sales in the amount of USD 1,678 million (year ended 31 December 2009: USD 1,257 million).

8. EMPLOYEE BENEFIT EXPENSES

	Year ended 31 December 2010	Year ended 31 December 2009
Wages and salaries	1,073	954
Social tax	214	148
Defined benefit plans (refer to Note 21)	11	7
Other employee benefits	13	-
Total	**1,311**	**1,109**

Employee benefit expenses are included in profit and loss within production and operating expenses and selling, general and administrative expenses.

9. TAXES OTHER THAN INCOME TAX

	Year ended 31 December 2010	Year ended 31 December 2009
Mineral extraction tax	1,108	687
Social taxes	214	148
Property tax	71	65
Other taxes	28	13
Total	**1,421**	**913**

10. FINANCE INCOME AND FINANCE COSTS

	Year ended 31 December 2010	Year ended 31 December 2009
Finance income		
Interest income on loans and promissory notes	36	2
Interest income on cash and deposits	31	39
Total	**67**	**41**
Finance costs		
Interest expense on borrowings	326	8
Unwinding of discount	29	11
Interest expense on defined benefit obligations	2	2
Total	**357**	**21**

Millions of US Dollars

11. INCOME TAX

Income tax expense

	Year ended 31 December 2010	Year ended 31 December 2009
Current year income tax expense	393	200
Adjustments relating to current income tax of prior years	19	5
Current income tax expense	**412**	**205**
Deferred tax expense/(benefit)	**56**	**(35)**
Income tax expense	**468**	**170**

Reconciliation of statutory income tax to income tax expense is as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
Profit before tax	**2,014**	**643**
Income tax at statutory rate	403	129
Non-deductible and non-taxable items	46	31
Adjustments relating to current income tax of prior years	19	5
Current year losses for which no deferred tax asset was recognised	-	5
Income tax expense	**468**	**170**

Deferred income tax

Movements in deferred income tax are as follows:

	1 January 2010	Recognised in profit or loss	Effect of translation to presentation currency	31 December 2010
Property, plant and equipment	1,127	(60)	(8)	1,059
Investments	(3)	95	-	92
Inventories	(7)	16	-	9
Trade and other receivables	-	25	-	25
Decommissioning provision	(46)	(2)	-	(48)
Provisions	(1)	(14)	-	(15)
Trade and other payables	(9)	(4)	-	(13)
Other	(10)	-	-	(10)
Total	**1,051**	**56**	**(8)**	**1,099**

	1 January 2009	Recognised in profit or loss	Effect of translation to presentation currency	31 December 2009
Property, plant and equipment	1,190	(29)	(34)	1,127
Investments	(4)	1	-	(3)
Inventories	(5)	(2)	-	(7)
Trade and other receivables	(16)	15	1	-
Decommissioning provision	(18)	(27)	(1)	(46)
Provisions	1	(2)	-	(1)
Trade and other payables	(5)	(4)	-	(9)
Other	(24)	13	1	(10)
Total	**1,119**	**(35)**	**(33)**	**1,051**

Millions of US Dollars

12. PROPERTY, PLANT AND EQUIPMENT

	Oil and gas properties	Refining	Marketing	Other	Total
Cost / deemed cost					
Balance at 1 January 2009	**3,354**	**4,765**	**368**	**1,579**	**10,066**
Additions	386	215	36	154	**791**
Disposals	(13)	(36)	(4)	(13)	**(66)**
Effect of translation to presentation currency	(84)	(125)	(9)	(38)	**(256)**
Balance at 31 December 2009	**3,643**	**4,819**	**391**	**1,682**	**10,535**
Additions	297	139	5	132	**573**
Disposals	(24)	(50)	(2)	(13)	**(89)**
Impairment	(12)	(3)	(2)	-	**(17)**
Effect of translation to presentation currency	(28)	(37)	(3)	(13)	**(81)**
Balance at 31 December 2010	**3,876**	**4,868**	**389**	**1,788**	**10,921**
Accumulated depletion and depreciation					
Balance at 1 January 2009	**-**	**-**	**-**	**-**	**-**
Charge for the year	(165)	(349)	(20)	(106)	**(640)**
Disposals	-	3	-	-	**3**
Effect of translation to presentation currency	(8)	(17)	(1)	(5)	**(31)**
Balance at 31 December 2009	**(173)**	**(363)**	**(21)**	**(111)**	**(668)**
Charge for the year	(188)	(397)	(22)	(115)	(722)
Disposals	3	9	-	1	13
Effect of translation to presentation currency	2	4	1	1	8
Balance at 31 December 2010	**(356)**	**(747)**	**(42)**	**(224)**	**(1,369)**
Net book value					
At 1 January 2009	**3,354**	**4,765**	**368**	**1,579**	**10,066**
At 31 December 2009	**3,470**	**4,456**	**370**	**1,571**	**9,867**
At 31 December 2010	**3,520**	**4,121**	**347**	**1,564**	**9,552**

Property, plant and equipment of subsidiaries and business units of the Company engaged in electricity and heat generation is included in “other” above.

At 31 December 2010, properties with a carrying amount of USD 214 million (31 December 2009: USD 407 million; 1 January 2009: USD 182 million) are pledged as security for the Group’s bank loans.

Millions of US Dollars

Decommissioning provision

Balance at 1 January 2009	**79**
Unwinding of discount	11
New obligations	1
Changes in estimates of existing obligations	135
Effect of translation to presentation currency	5
Balance at 31 December 2009	**231**
Unwinding of discount	29
New obligations	3
Changes in estimates of existing obligations	(29)
Effect of translation to presentation currency	(3)
Balance at 31 December 2010	**231**

Current and non-current portions of decommissioning provision are as follows:

	31 December 2010	31 December 2009	1 January 2009
Current portion	14	-	-
Non-current portion	217	231	79
Total	**231**	**231**	**79**

The Group's decommissioning provision relates primarily to the conservation and liquidation of wells, pipelines and other oil and gas facilities and site restoration. Key assumptions used for evaluation of decommissioning provision were as follows:

	31 December 2010	31 December 2009	1 January 2009
Discount rate	12.38%	10.69%	14.96%
Inflation rate	2.25%-10.81%	2.33%-10.42%	2.64%-6.20%

The Group has estimated the costs to be incurred using the cost of technology and materials that are currently available.

13. INVESTMENTS IN ASSOCIATES

	Year ended 31 December 2010
Balance at beginning of the year	**-**
Reclassified from available-for-sale investments	545
Acquired during the year	123
Share of post-acquisition profits	36
Impairment	(17)
Effect of translation to presentation currency	(20)
Balance at end of the year	**667**

The Group holds 38.5% interest in OJSC "Belkamneft" ("Belkamneft"), a company engaged in the production of crude oil. At 31 December 2009 and 1 January 2009, the Group's 38.5% interest in Belkamneft was classified as an available-for-sale investment as the Group was not able to exercise significant influence over the operating and financing activities of the investee. On 23 April 2010, JSFC Sistema (the Group's parent company) acquired 49.9% interest in OJSC "Russneft" (Belkamneft's parent Company). As a result of this transaction, the Group obtained significant influence over Belkamneft and reclassified the investment in Belkamneft from available-for-sale to investments in associates. The excess of the fair value of the investment over the carrying value in amount of USD 477 million was recognised in profit and loss as gain on reclassification of available-for-sale investments to investments in associates.

Millions of US Dollars

On 31 July 2010, the Group acquired 49.99% interest in OJSC "Aspec" from a related party for a cash consideration of USD 123 million. OJSC "Aspec" is the holding company of the Aspec Group ("Aspec"). Aspec is engaged in wholesale and retail of oil products, real estate development and also owns an automotive retail business. Aspec's petrol stations and storage depots are located throughout the Russian Federation, with its headquarter located in the Republic of Udmurtia. As at 31 December 2010, the Group recognised an impairment loss in the amount of USD 17 million on its investment in Aspec.

The following is a summary of the financial information of associates:

	31 December 2010
Total assets	2,903
Total liabilities	567
Net assets	**2,336**
Group's share of net assets of associates	**923**

	Year ended 31 December 2010
Total revenue	1,514
Total profit for the year	138
Group's share of profit of associates	**36**

14. FINANCIAL ASSETS

	31 December 2010	31 December 2009	1 January 2009
Non-current investments			
Held-to-maturity investments	217	-	-
Available-for-sale investments, at cost	-	65	66
Loans given, at amortised cost	-	-	1
Deposits	-	-	87
Total	**217**	**65**	**154**
Current investments			
Held-to-maturity investments	547	4	2
Loans given, at amortised cost	118	1	20
Deposits	11	225	48
Total	**676**	**230**	**70**

At 31 December 2010, current and non-current held-to-maturity investments represent promissory notes which bear interest at rates varying from 3.5% to 5.0% per annum and mature in 2011 and 2012, respectively.

Available-for-sale investments at cost at 1 January 2009 and 31 December 2009 represent a 38.5% investment in Belkamneft (refer to Note 13). The Group accounted for this investment at cost as the fair value of the investment could not be reliably measured.

Loans given at amortised cost at 31 December 2010 is unsecured and bear interest at rates varying from 5.0% to 8.3% per annum.

At 31 December 2010, current deposits represent bank deposits which bear interest at rates varying from 7.5% to 14.5% (31 December 2009: 5.0% to 15.0%; 1 January 2009: 5.0% to 15.0%) per annum. Non-current deposits at 1 January 2009 represents bank deposits which bore interest at rates varying from 7.0% to 14.8% per annum.

Millions of US Dollars

15. INVENTORIES

	31 December 2010	31 December 2009	1 January 2009
Inventories expected to be recovered after twelve months			
Catalytic agents	44	51	70
Raw materials and other inventories	6	6	7
Total	**50**	**57**	**77**
Inventories expected to be recovered in the next twelve months			
Petroleum products	333	121	51
Crude oil	7	16	7
Raw materials and other inventories	335	295	380
Total	**675**	**432**	**438**
Less: allowance for obsolete and slow-moving items	(50)	(47)	(45)
Total	**625**	**385**	**393**

The cost of inventories (excluding crude oil) recognised as expense during the year ended 31 December 2010 amounted to USD 1,637 million (year ended 31 December 2009: USD 1,304 million). At 31 December 2010, none of the Group's inventories were stated at net realisable value (31 December 2009: USD 17 million; 1 January 2009: USD 8 million).

16. OTHER NON-CURRENT ASSETS

At 31 December 2010, other non-current assets included long-term accounts receivable in the amount of USD 3 million (31 December 2009: USD 3 million; 1 January 2009: USD 2 million), net of allowance for doubtful receivables in the amount of USD 24 million (31 December 2009: USD 26 million; 1 January 2009: USD 3 million).

17. TRADE AND OTHER RECEIVABLES

	31 December 2010	31 December 2009	1 January 2009
Trade receivables	545	255	211
Other receivables	72	44	47
Total	**617**	**299**	**258**
Less: allowance for doubtful receivables	(94)	(72)	(82)
Total	**523**	**227**	**176**

The average credit period for the Group's customers is 30 days. During this period no interest is charged on the outstanding balances. Before accepting any new customer, the Group uses an internal credit system to assess the potential customer's credit quality and defines credit limits separately for each individual customer. At 31 December 2010, the Group's five largest customers represent 67.9% (31 December 2009: 37.9%; 1 January 2009: 25.7%) of the outstanding trade receivables balance. Creditworthiness of the existing customers is also periodically evaluated based on internal and external information regarding the history of settlements with these customers. The Group regularly analyses accounts receivable turnover ratios, maturity dates and takes appropriate measures on collection of debts due.

Millions of US Dollars

Allowances for doubtful receivables are recognised against trade and other receivables older than 30 days based on estimated irrecoverable amounts, determined by reference to past experience and are regularly reassessed based on the facts and circumstances existing at each reporting date.

Ageing of trade and other receivables was as follows:

	31 December 2010		31 December 2009		1 January 2009	
	Gross	Impairment provision	Gross	Impairment provision	Gross	Impairment provision
Not past due	444	-	184	-	102	-
Past due up to 30 days	25	-	3	-	1	-
Past due from 31 to 90 days	26	(6)	15	(3)	49	(6)
Past due from 91 to 180 days	13	(5)	12	(6)	16	(4)
Past due from 181 to 365 days	27	(24)	11	(8)	11	(2)
Past due over 365 days	82	(59)	74	(55)	79	(70)
Total	**617**	**(94)**	**299**	**(72)**	**258**	**(82)**

Movement in the allowance for doubtful receivables in respect of trade and other receivables was as follows:

	31 December 2010	31 December 2009
Balance at the beginning of the year	**72**	**82**
Recognised in profit or loss	27	(6)
Amounts written-off as uncollected	(5)	(2)
Effect of translation to presentation currency	-	(2)
Balance at the end of the year	**94**	**72**

18. CASH AND CASH EQUIVALENTS

	31 December 2010	31 December 2009	1 January 2009
Call deposits	549	668	56
Bank balances	164	497	769
Other cash and cash equivalents	354	1	1
Total	**1,067**	**1,166**	**826**

Call deposits mostly represent overnight bank deposits and are denominated in USD and in RUB. USD-denominated deposits bear interest at rates varying from 0.1% to 0.2% per annum. RUB-denominated deposits bear interest at rates varying from 0.5% to 2.7% (31 December 2009: 5.0% to 15.0%; 1 January 2009: 5.0% to 15.0%) per annum. Maturity dates for these deposits are within 3 months from the date they originated.

As part of its cash and credit risk management function, the Group regularly evaluates the creditworthiness of financial and banking institutions where it deposits cash and cash equivalents. Banking relationships are with large Russian banks with external credit ratings of at least B+.

Millions of US Dollars

19. SHARE CAPITAL

Authorised, issued and outstanding share capital

	31 December 2010	31 December 2009	1 January 2009
170,169,754 ordinary shares with a par value of RUB 1.00	64	64	64
34,622,686 preferred shares with a par value of RUB 1.00	13	13	13
Total	**77**	**77**	**77**

The nominal value of share capital was adjusted for hyperinflation from the actual dates of share issuance to 31 December 2002.

Dividends and retained earnings

The holders of the Company's ordinary shares are entitled to one vote per share at shareholders' meetings and a right to dividends, as declared periodically.

The holders of the Company's preferred shares receive a non-cumulative dividend at the Company's discretion or whenever dividends to ordinary shareholders are declared. They do not have the right to vote at shareholders' meetings if dividends are declared but carrying one vote per share if dividends are not declared.

Ordinary and preferred shares rank equally with regard to the Company's residual assets in the event of liquidation.

At 1 January 2009, the Company had an outstanding balance of USD 240 million of dividends payable, which were declared in prior years and were paid to shareholders during 2009. On 30 June 2009, the Company declared a dividend of USD 0.468 per share amounting to USD 96 million which was fully paid during the period from 30 June 2009 to 31 December 2009.

On 29 June 2010, the Company declared a dividend of USD 3.54 per share amounting to USD 725 million which was fully paid during the period from 29 June 2010 to 31 December 2010. On 17 December 2010, the Company declared a dividend of USD 3.40 per share amounting to USD 696 million, out of which USD 73 million remained unpaid as of 31 December 2010.

The statutory financial statements of the Company are the basis for the profit distribution and other appropriations.

Earnings per share

Earnings per share ("EPS") is calculated by dividing profit for the year attributable to ordinary shares of the Company by the weighted average number of ordinary shares outstanding during the year adjusted for shares purchased by the Group and held as treasury shares. Profit for the year attributable to owners of the Company is allocated between the Company's ordinary and preference shares at a ratio of 1:1 in accordance with their participation rights as described in the Company's charter. Profit attributable to ordinary shareholders of the Company for the year ended 31 December 2010 was USD 1,429 million (year ended 31 December 2009: USD 420 million). The weighted average number of ordinary shares outstanding during the year ended 31 December 2010 was 162,295,807 (31 December 2009: 170,169,754). Reciprocal interests relating to Sistema-invest's ownership in the Group are deducted from the total outstanding shares in computing the weighted average number of outstanding ordinary shares.

Millions of US Dollars

20. BORROWINGS

	31 December 2010		31 December 2009		1 January 2009	
	Rate, %	Outstanding balance	Rate, %	Outstanding balance	Rate, %	Outstanding balance
Non-current liabilities						
Unsecured non-convertible bonds	*12.5%*	1,633	*12.5%*	1,642	*8.3%*	51
Unsecured borrowings	*11.9%-12.0%*	1,466	-	-	-	-
Secured borrowings	*16.0%*	19	*16.0%*	34	-	-
Total		**3,118**		**1,676**		**51**
Current liabilities						
Short-term unsecured borrowings	*3.6%-7.2%*	773	*9.5%-12.5%*	16	*13.0%-15.5%*	37
Current portion of secured borrowings	*16.0%*	14	*16.0%*	12	-	-
Short-term secured borrowings	*4.5%-20.0%*	8	*13.0%-18.0%*	35	*13.0%-18.0%*	29
Total		**795**		**63**		**66**

Unsecured non-convertible bonds

On 22 December 2009, the Company issued 50,000,000 non-convertible RUB-denominated bonds at a par value of USD 32. The bonds have a coupon rate of 12.5% per annum, payable semi-annually. The Group has the right to modify the coupon rate annually from 21 December 2012 at which point bondholders have the right to redeem the bonds at par value.

Unsecured borrowings

At 31 December 2010, unsecured borrowings are denominated in RUB and USD and were obtained from a variety of lenders. The borrowings mature from 2011 through 2017 (31 December 2009: 2010) and bear interest at fixed rates.

21. OTHER NON-CURRENT LIABILITITES

	31 December 2010	31 December 2009	1 January 2009
Defined benefit obligation	37	29	25
Non-current portion of phantom share plan	9	-	-
Other non-current liabilities	3	2	6
Total	**49**	**31**	**31**

Defined benefit plans

The Group operates a number of unfunded defined benefit plans for its employees. In accordance with these plans, the employees are entitled to certain benefits in accordance with the terms of collective agreements (such as retirement bonus, jubilee bonus, reimbursement of funeral costs).

The valuation of the Group's defined benefit obligation was performed by an independent actuary. The principal assumptions used for the purpose of the actuarial valuations were as follows:

	31 December 2010	31 December 2009	1 January 2009
Discount rate	7.8%	8.5%	8.5%
Expected rate of salary increase	5.0%	5.0%	5.0%
Expected benefit increase	5.0%	5.0%	5.0%
Average life expectancy of employees from the date of retirement	19	19	19

Millions of US Dollars

Amounts recognised in profit or loss in respect of these defined benefit plans are as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
Current service cost	3	2
Interest cost	2	2
Actuarial losses	6	3
Total	**11**	**7**

Movements in the present value of the defined obligation were as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
Defined benefit obligation at the beginning of the year	**29**	**25**
Actuarial losses	6	3
Current service cost	3	2
Interest cost	2	2
Benefits paid	(3)	(2)
Effect of translation to presentation currency	-	(1)
Defined benefit obligation at the end of the year	**37**	**29**

Phantom share plan

In 2010, the Company granted share appreciation rights to key management personnel of the Group. In accordance with the terms of the plan, the eligible employees are entitled to a cash payment based on a number of vested phantom shares, the value of which is to be determined by an independent appraiser at each vesting date. The program has 3 stages and is effective during the period from 2010 to 2012. Liabilities under the phantom share plan were as follows:

	Year ended 31 December 2010
Balance at the beginning of the year	-
Granted during the year	**13**
Balance at the end of the year	**13**

At 31 December 2010, the Group recognised USD 4 million as a current liability and USD 9 million as non-current liability under the phantom share plan.

22. TRADE AND OTHER PAYABLES

	31 December 2010	31 December 2009	1 January 2009
Trade payables	424	269	200
Other payables and accrued expenses	235	129	210
Total	**659**	**398**	**410**

The average credit period on purchase of the majority of inventories and services consumed is 35 days (31 December 2009: 45 days; 1 January 2009: 45 days). No interest is charged on the outstanding balance of trade and other payables during this period.

Millions of US Dollars

23. TAXES

	31 December 2010	31 December 2009	1 January 2009
Other taxes receivable			
VAT recoverable	285	180	117
Custom duties prepaid	252	105	27
Other taxes	148	125	59
Total	**685**	**410**	**203**
Other taxes payable			
VAT	120	161	122
Mineral extraction tax	103	80	24
Excise tax	51	105	86
Other taxes	44	56	55
Total	**318**	**402**	**287**

24. PROVISIONS

Provisions at 31 December 2010 include an amount of USD 83 million in relation to legal claims brought against the Group. The provision charge is recognised in profit or loss within other operating expenses. The balance at 31 December 2010 is expected to be settled in 2011. In management's opinion the outcome of these legal claims will not give rise to any significant loss beyond the amounts provided at 31 December 2010.

25. RELATED PARTIES

At 31 December 2010, 2009 and 1 January 2009, the Group had the following outstanding balances with related parties:

	Amount owed by related parties		
	31 December 2010	31 December 2009	1 January 2009
Sistema-invest	786	1	-
Other Sistema Group companies	118	161	26
Total	**904**	**162**	**26**

	Amount owed to related parties		
	31 December 2010	31 December 2009	1 January 2009
Sistema-invest	-	3	81
Other Sistema Group companies	44	1	3
LLC Aguidel-Invest, LLC Yuruzan-Invest, LLC Inzer-Invest, LLC Ural-Invest	-	-	234
Other related parties	16	-	-
Total	**60**	**4**	**318**

The amounts outstanding were unsecured and are expected to be net settled or settled in cash. The Group does not create an allowance for doubtful receivables in respect of outstanding balances of related parties. No balances owed by related parties were past due but not impaired.

No expense has been recognised in the current year for bad debts in respect of amounts owed by related parties.

Millions of US Dollars

The Group entered into the following transactions with related parties:

	31 December 2010	31 December 2009
Sistema-invest		
Dividends paid	275	65
Loans issued	1,661	-
Proceeds from repayment of loans issued	607	-
Sale of goods and services	-	2
Purchase of goods and services	-	36
Interest income	29	-
Other Sistema Group companies		
Dividends paid	753	54
Loans issued	290	-
Proceeds from repayment of loans issued	290	-
Sale of goods and services	32	1
Purchase of goods and services	26	-
Purchase of property	55	-
Interest income	10	2
LLC Aguidel-Invest, LLC Yuruzan-Invest, LLC Inzer-Invest, LLC Ural-Invest		
Dividends paid	-	121
Associates of the Group		
Sale of goods and services	425	-
Key management personnel		
Acquisition of investments	123	-
Other related parties		
Sale of goods and services	323	-

During the year ended 31 December 2010, the Group transferred USD 19 million (year ended 31 December 2009: USD 14 million) as a donation to Charity Fund Sistema, a related party of the Group.

Compensation of key management personnel

The remuneration of directors and other key management personnel was as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
Wages and salaries	45	20
Share-based payments	4	-
Total	**49**	**20**

At 31 December 2010, outstanding balances in respect of wages and salaries of key management personnel were USD 34 million (31 December 2009: USD 11 million; 1 January 2009: USD 2 million).

Terms and conditions of transactions with related parties

Sales and purchases of goods and services to and from related parties were made on market terms. Interest rates on loans issued and promissory notes acquired reflect market terms.

Millions of US Dollars

26. FINANCIAL RISK MANAGEMENT

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The Board of Directors' policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. The Group may adjust the amount of dividends paid to shareholders and return on capital to shareholders, issue new shares or sell assets to reduce debt, maintain or adjust the capital structure.

The Board of Directors monitors the return on capital, which the Group defines OIBDA divided by total net borrowings. The Group defines OIBDA as operating profit adjusted for depletion, depreciation and amortisation and total net borrowings as total borrowings minus cash and cash equivalents. Since OIBDA is not a standard IFRS measure, the Group's definition of OIBDA may differ from that of other companies.

The Group's gearing ratio was as follows:

	31 December 2010	31 December 2009
OIBDA	2,981	1,249
Total net borrowings	2,846	573
OIBDA to net borrowings ratio	**1.05**	**2.18**

Major categories of financial instruments

	31 December 2010	31 December 2009	1 January 2009
Financial assets			
Trade and other receivables, excluding prepayments	523	227	176
Available-for-sale investments	-	65	66
Loans given	118	1	20
Held-to-maturity investments	764	4	2
Deposits	11	225	135
Cash and cash equivalents	1,067	1,166	826
Total financial assets	**2,483**	**1,688**	**1,225**
Financial liabilities			
Borrowings	3,913	1,739	117
Trade and other payables, including dividends payable	732	401	897
Total financial liabilities	**4,645**	**2,140**	**1,014**

Millions of US Dollars

The main risks arising from the Group's financial instruments are foreign currency, commodity price and liquidity risks.

Foreign currency risk

Currency risk is the risk that the financial results of the Group will be adversely impacted by changes in exchange rates to which the Group is exposed. The Group undertakes certain transactions denominated in foreign currencies and is exposed primarily with respect to the US Dollar.

The Group manages its net exposure to foreign exchange risk by balancing both financial assets and financial liabilities denominated in Russian Rouble and US Dollar. The Group does not use derivatives to manage its foreign currency risk exposure.

The carrying amount of the Group's US-dollar denominated monetary assets and liabilities at 31 December 2010, 2009 and 1 January 2009 were as follows:

	31 December 2010	31 December 2009	1 January 2009
Assets			
Trade and other receivables, excluding prepayments	293	108	17
Cash and cash equivalents	430	311	159
Total assets	**723**	**419**	**176**
Liabilities			
Trade and other payables	3	3	4
Loans and borrowings	201	-	-
Total liabilities	**204**	**3**	**4**

The table below details the Group's sensitivity to the strengthening of the US Dollar against the Russian Rouble by 10%. This analysis assumes that all other variables, in particular interest rates, remain constant. This analysis is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis was applied to monetary items at the end of the period denominated in the respective currencies.

	Year ended 31 December 2010	Year ended 31 December 2009
Increase in profit before tax	52	42

The effect of a corresponding strengthening of the Russian Rouble against the US Dollar is approximately equal and opposite.

Commodity price risk

Commodity price risk is the risk or uncertainty arising from possible movements in prices for crude oil and related products, and their impact on the Group's future performance and results of the Group's operations. A decline in the prices could result in a decrease in net income and cash flows. An extended period of low prices could precipitate a decrease in development activities and could cause a decrease in the volume of reserves available for transportation and processing through the Group's systems or facilities and ultimately impact the Group's ability to deliver under its contractual obligations.
The Group's overall strategy in production and sales of crude oil and related products is centrally managed. As of 31 December 2010, if the average crude oil price and petroleum products had weakened by 10% with all other variables held constant, profit before tax would have been lower by USD 460 million for the year ended 31 December 2010. As of 31 December 2009, if the average crude oil price and petroleum products had weakened by 10% with all other variables held constant, profit before tax would have been lower by USD 210 million for the year ended 31 December 2009.

Millions of US Dollars

Liquidity risk

Liquidity risk is the risk that the Group will not be able to settle all its liabilities as they fall due. The Group's liquidity position is carefully monitored and managed. The Group has a detailed budgeting and cash forecasting process to help ensure that it has adequate cash available to meet its payment obligations.

The following tables detail the Group's remaining contractual maturity for its financial liabilities and net-settled financial liabilities at 31 December 2010. The tables include both interest and principal cash flows. The contractual maturity is based on the earliest date on which the Group may be required to pay or net-settle its financial liabilities.

	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-5 years	Over 5 years
Unsecured borrowings	2,239	3,430	111	874	704	1,741
Secured borrowings	41	46	9	9	28	-
Unsecured non-convertible bonds	1,633	2,051	103	103	1,845	-
Dividends payable	73	73	73	-	-	-
Trade and other payables	659	659	659	-	-	-
Total	**4,645**	**6,259**	**955**	**986**	**2,577**	**1,741**

The following tables detail the Group's remaining contractual maturity for its financial liabilities and net-settled financial liabilities at 31 December 2009. The tables include both interest and principal cash flows. The contractual maturity is based on the earliest date on which the Group may be required to pay or net-settle its financial liabilities.

	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-5 years	Over 5 years
Unsecured borrowings	16	17	6	11	-	-
Secured borrowings	81	93	10	45	38	-
Unsecured non-convertible bonds	1,642	2,272	103	103	2,066	-
Dividends payable	3	3	3	-	-	-
Trade and other payables	398	398	398	-	-	-
Total	**2,140**	**2,783**	**520**	**159**	**2,104**	**-**

The following tables detail the Group's remaining contractual maturity for its financial liabilities and net-settled financial liabilities at 1 January 2009. The tables include both interest and principal cash flows. The contractual maturity is based on the earliest date on which the Group may be required to pay or net-settle its financial liabilities.

	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-5 years	Over 5 years
Unsecured borrowings	37	41	41	-	-	-
Secured borrowings	29	35	17	2	16	-
Unsecured non-convertible bonds	51	60	2	2	56	-
Dividends payable	487	487	487	-	-	-
Trade and other payables	410	410	410	-	-	-
Total	**1,014**	**1,033**	**957**	**4**	**72**	**-**

Millions of US Dollars

For the management of its day to day liquidity requirements the management had following financing facilities.

	31 December 2010	31 December 2009	1 January 2009
Committed credit facilities	948	228	242
Less: amounts withdrawn	(56)	(101)	(61)
Total unused credit facilities	**892**	**127**	**181**

Interest rate risk

The Group's exposure to interest rate risk is limited as the Group's loans and borrowings have fixed interest rates.

27. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial assets and liabilities is determined as follows:

- The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices; and
- The fair value of other financial assets and financial liabilities are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions.

As at 31 December 2010, 2009 and 1 January 2009, management believes that the carrying values of all significant financial assets and financial liabilities recorded at amortised cost in the consolidated financial statements approximated their fair values, except for the unsecured non-convertible bonds with carrying value of USD 1,633 million and fair value USD 1,518 million.

Management believes that the carrying value of financial assets and liabilities approximated their fair values due to (i) their short-term nature for current financial assets and liabilities, (ii) the fact that interest rates on loans receivable approximate current market rates for similar debt instruments, and (iii) the fact that the interest rates on long-term liabilities approximate the current market rates for similar instruments as the majority of loans and borrowings were obtained in 2009 and 2010.

The Group do not have any financial instruments that are measured subsequent to initial recognition at fair value.

28. COMMITMENTS AND CONTINGENCIES

Capital commitments

At 31 December 2010, contractual capital commitments of the Group amounted to USD 176 million (31 December 2009: USD 136 million; 1 January 2009: USD 358 million). These commitments are expected to be settled during 2011.

Operating leases: Group as a lessee

The Group leases certain production equipment, transport and office premises. The leases typically run for periods varying from 1 to 10 years with no renewal option at the end of the lease term. In addition to the above, the Group's extraction, refining, marketing and distribution and other facilities are located under operating leases, which expire in various years through 2060.

Millions of US Dollars

Future minimum rental expenses under non-cancellable operating leases are as follows:

	31 December 2010	31 December 2009	1 January 2009
Due in one year	37	32	33
Due from one to five years	105	113	127
Thereafter	514	457	485
Total	**656**	**602**	**645**

Taxation contingencies in the Russian Federation

The taxation system in the Russian Federation is at a relatively early stage of development, and is characterised by numerous taxes, frequent changes and inconsistent enforcement at federal, regional and local levels.

The government of the Russian Federation has commenced a revision of the Russian tax system and passed certain laws implementing tax reform. The new laws reduce the number of taxes and overall tax burden on businesses and simplify tax litigation. However, these new tax laws continue to rely heavily on the interpretation of local tax officials and fail to address many existing problems. Many issues associated with practical implication of new legislation are unclear and complicate the Group’s tax planning and related business decisions.

In terms of Russian tax legislation, authorities have a period of up to three years to re-open tax declarations for further inspection. Changes in the tax system that may be applied retrospectively by authorities could affect the Group’s previously submitted and assessed tax declarations.

While management believes that it has adequately provided for tax liabilities based on its interpretation of current and previous legislation, the risk remains that tax authorities in the Russian Federation could take differing positions with regard to interpretive issues. This uncertainty may expose the Group to additional taxation, fines and penalties that could be significant.

With regard to matters where practice concerning payment of taxes is unclear, management estimated possible tax exposure at 31 December 2010, to be approximately of USD 184 million (31 December 2009: USD 121 million; 1 January 2009: USD 14 million).

Legal contingencies

At 31 December 2010, unresolved legal claims against the Group amounted to USD 50 million. Management estimates the unfavourable outcome of the legal claims to be possible.

Insurance

The insurance industry in the Russian Federation is in a developing stage and many forms of insurance protection common in developed markets are not generally available.

The Group does not have full coverage for property damage, for business interruption and third party liabilities in respect of environmental damage arising from accidents on the Group’s property or relating to the Group’s operations. Until the Group obtains adequate insurance coverage, there is a risk that the losses could have a material adverse effect on the Group’s operations and financial position.

Millions of US Dollars

29. RECONCILIATIONS REQUIRED BY IFRS 1 FIRST TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARD (UNAUDITED)

The Company's transition date to IFRS is 1 January 2009, when the opening consolidated IFRS statement of financial position was prepared.

Reconciliation of equity at the date of the transition to IFRS and at the reporting dates is as follows:

	31 December 2010 (unaudited)	31 December 2009 (unaudited)	1 January 2009 (unaudited)
Equity in accordance with RAS (unaudited)	**3,305**	**3,234**	**2,797**
Recognition of non-controlling interests on consolidation of the Group	2,717	3,135	3,356
Effect of acquisition of subsidiaries from entities under common control	1,160	1,170	2,429
Valuation of other non-current assets under IFRS 1	(2)	(87)	(100)
Valuation of property, plant and equipment under IFRS 1	1,732	1,852	1,652
Valuation of investments	(407)	(398)	(233)
Valuation of trade and other receivables	38	(32)	(33)
Valuation of inventory	(110)	(90)	(36)
Derecognition of income tax and other taxes payable	(19)	-	29
Recognition of decommissioning provision	(231)	(231)	(79)
Deferred tax	(343)	(262)	(238)
Other IFRS adjustments	152	149	156
Equity in accordance with IFRS	**7,992**	**8,440**	**9,700**

Reconciliation of profit for the years ended 31 December 2010 and 2009 is as follows:

	Year ended 31 December 2010 (unaudited)	Year ended 31 December 2009 (unaudited)
Profit for the year in accordance with RAS (unaudited)	**1,449**	**493**
Consolidation of subsidiaries of the Company	208	86
Reversal of available-for-sale investments revaluation calculated under RAS	(393)	(50)
Gain on reclassification of available-for-sale investments to investments in associates	477	-
Valuation of inventory	(43)	(11)
Unwinding of discount on decommissioning provision	(28)	(12)
Effect of differences in deferred tax recognition criteria under IFRS	(97)	12
Effects of other IFRS adjustments	(27)	(45)
Profit for the year in accordance with IFRS	**1,546**	**473**
Effect of translation to presentation currency	(93)	(254)
Total comprehensive income for the year	**1,453**	**219**

30. EVENTS SUBSEQUENT TO THE REPORTING PERIOD

Orenburgnefteproduct

On 4 April 2011, the Group acquired 94% interest in OJSC “Orenburgnefteproduct”(“ONP”) from OJSC NK “Russneft”. ONP is engaged in wholesale and retail of oil products in the Orenburg region of the Russian Federation. The purchase consideration included a fixed payment of USD 90 million and an additional payment equal to ONP’s net working capital at the date of the transaction. According to the purchase agreement, the additional payment should be defined within 30 days after the acquisition.

Trebs and Titov

On 8 February 2011, the license for the development of the Trebs and Titov oil fields was granted to the Group. The total consideration paid to acquire the license amounted to USD 629 million.
On 15 April 2011, the Group entered into an agreement with OJSC “Lukoil”, a major Russian oil company, for the joint development of the Trebs and Titov oil fields. Under the terms of the agreement, the Group is required to transfer the license to its subsidiary, 25% stake of which will be acquired by OJSC “Lukoil”.

Key management changes

On 6 April 2011, the Board of Directors of the Company appointed Alexander Korsik as President of the Company. Prior to his appointment, Mr. Korsik has held the position of Senior Vice-President of JSFC Sistema and Head of its Oil and Energy Business Unit.