



# **OAO LUKOIL**

## **INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**(prepared in accordance with US GAAP)**

**As of and for the three and six month periods ended June 30, 2006**

**(unaudited)**

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

## Independent Accountants' Review Report

The Board of Directors of OAO LUKOIL:

We have reviewed the accompanying consolidated balance sheet of OAO LUKOIL and its subsidiaries as of June 30, 2006, the related consolidated statements of income for the three-month and six-month periods ended June 30, 2006 and 2005 and the related consolidated statements of stockholders' equity and cash flows for the six-month periods ended June 30, 2006 and 2005 in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of OAO LUKOIL.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.


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


*KPMG Limited*

KPMG Limited  
Moscow, Russian Federation  
October 12, 2006

**OAo LUKOIL**  
**Consolidated Balance Sheets**  
(Millions of US dollars, unless otherwise noted)

	Note	As of June 30, 2006 (unaudited)	As of December 31, 2005
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	4	2,273	1,650
Short-term investments		92	111
Accounts and notes receivable, net	6	5,781	5,533
Inventories		3,534	2,619
Prepaid taxes and other expenses		2,044	2,107
Other current assets		521	287
Assets held for sale	10	-	190
<b>Total current assets</b>		<b>14,245</b>	<b>12,497</b>
Investments	7	1,323	1,110
Property, plant and equipment	8	28,392	25,464
Deferred income tax assets		231	181
Goodwill and other intangible assets	9	693	680
Other non-current assets		459	413
<b>Total assets</b>		<b>45,343</b>	<b>40,345</b>
<b>Liabilities and Stockholders' equity</b>			
<b>Current liabilities</b>			
Accounts payable		2,422	2,167
Short-term borrowings and current portion of long-term debt	11	1,654	853
Taxes payable		1,850	2,087
Other current liabilities		1,966	729
<b>Total current liabilities</b>		<b>7,892</b>	<b>5,836</b>
Long-term debt	12, 15	4,179	4,137
Deferred income tax liabilities		2,114	1,830
Asset retirement obligations	8	478	387
Other long-term liabilities		355	332
Minority interest in subsidiary companies		537	1,019
<b>Total liabilities</b>		<b>15,555</b>	<b>13,541</b>
<b>Stockholders' equity</b>	14		
Common stock		15	15
Treasury stock, at cost		(728)	(527)
Additional paid-in capital		3,914	3,730
Retained earnings		26,587	23,586
<b>Total stockholders' equity</b>		<b>29,788</b>	<b>26,804</b>
<b>Total liabilities and stockholders' equity</b>		<b>45,343</b>	<b>40,345</b>

  
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President of OAO LUKOIL  
Alekperov V.Y.

  
\_\_\_\_\_  
Chief accountant of OAO LUKOIL  
Khoba L.N.

**OA O LUKOIL**  
**Consolidated Statements of Income**  
(Millions of US dollars, unless otherwise noted)

	Note	For the three months ended June 30, 2006 (unaudited)	For the three months ended June 30, 2005 (unaudited)	For the six months ended June 30, 2006 (unaudited)	For the six months ended June 30, 2005 (unaudited)
<b>Revenues</b>					
Sales (including excise and export tariffs)	22	18,267	13,492	33,210	24,049
Equity share in income of affiliates	7	112	142	210	201
<b>Total revenues</b>		<b>18,379</b>	<b>13,634</b>	<b>33,420</b>	<b>24,250</b>
<b>Costs and other deductions</b>					
Operating expenses		(1,304)	(717)	(2,204)	(1,499)
Cost of purchased crude oil, petroleum and chemical products		(6,406)	(4,942)	(11,706)	(8,322)
Transportation expenses		(919)	(857)	(1,767)	(1,694)
Selling, general and administrative expenses		(737)	(622)	(1,498)	(1,134)
Depreciation, depletion and amortization		(449)	(317)	(857)	(601)
Taxes other than income taxes		(2,062)	(1,597)	(3,833)	(2,894)
Excise and export tariffs		(3,269)	(2,361)	(5,954)	(4,136)
Exploration expenses		(28)	(147)	(63)	(183)
(Loss) gain on disposals and impairments of assets		(30)	70	(22)	53
<b>Income from operating activities</b>		<b>3,175</b>	<b>2,144</b>	<b>5,516</b>	<b>3,840</b>
Interest expense		(79)	(62)	(141)	(117)
Interest and dividend income		25	19	52	37
Currency translation gain (loss)		56	(73)	148	(85)
Other non-operating expense		(14)	(19)	(39)	(6)
Minority interest		(8)	(30)	(18)	(52)
<b>Income before income taxes</b>		<b>3,155</b>	<b>1,979</b>	<b>5,518</b>	<b>3,617</b>
Current income taxes		(815)	(598)	(1,584)	(1,088)
Deferred income taxes		(19)	29	76	61
<b>Total income tax expense</b>	3	<b>(834)</b>	<b>(569)</b>	<b>(1,508)</b>	<b>(1,027)</b>
<b>Net income</b>		<b>2,321</b>	<b>1,410</b>	<b>4,010</b>	<b>2,590</b>
Per share of common stock (US dollars):					
Basic	14	2.80	1.73	4.85	3.18
Diluted	14	2.80	1.71	4.83	3.14

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

**OA O LUKOIL**  
**Consolidated Statements of Stockholders' Equity**  
(Millions of US dollars, unless otherwise noted)

	Common stock	Treasury stock	Additional paid-in capital	Retained earnings	Total Stockholders' equity
<b>Six months ended June 30, 2006</b>					
Balance as of December 31, 2005	15	(527)	3,730	23,586	<b>26,804</b>
Net income	-	-	-	4,010	<b>4,010</b>
Dividends on common stock	-	-	-	(1,009)	<b>(1,009)</b>
Stock purchased	-	(382)	-	-	<b>(382)</b>
Stock disposed	-	181	184	-	<b>365</b>
<b>Balance as of June 30, 2006</b>	<b>15</b>	<b>(728)</b>	<b>3,914</b>	<b>26,587</b>	<b>29,788</b>
<b>Six months ended June 30, 2005</b>					
Balance as of December 31, 2004	15	(706)	3,564	17,938	<b>20,811</b>
Net income	-	-	-	2,590	<b>2,590</b>
Dividends on common stock	-	-	-	(795)	<b>(795)</b>
Stock disposed	-	40	5	-	<b>45</b>
<b>Balance as of June 30, 2005</b>	<b>15</b>	<b>(666)</b>	<b>3,569</b>	<b>19,733</b>	<b>22,651</b>

	Share activity (millions of shares)	
	Common stock	Treasury stock
<b>Six months ended June 30, 2006</b>		
Balance as of December 31, 2005	850	(22)
Stock purchased	-	(4)
Stock disposed	-	6
<b>Balance as of June 30, 2006</b>	<b>850</b>	<b>(20)</b>
<b>Six months ended June 30, 2005</b>		
Balance as of December 31, 2004	850	(34)
Stock disposed	-	2
<b>Balance as of June 30, 2005</b>	<b>850</b>	<b>(32)</b>

**OA O LUKOIL**  
**Consolidated Statements of Cash Flows**  
(Millions of US dollars)

Note	For the six months ended June 30, 2006 (unaudited)	For the six months ended June 30, 2005 (unaudited)
<b>Cash flows from operating activities</b>		
<b>Net income</b>	<b>4,010</b>	<b>2,590</b>
Adjustments for non-cash items:		
Depreciation, depletion and amortization	857	601
Equity share in income of affiliates	(138)	(176)
Dry hole costs	13	117
Loss (gain) on disposals and impairments of assets	22	(53)
Deferred income taxes	(76)	(61)
Non-cash currency translation loss (gain)	11	(37)
Non-cash investing activities	(34)	(67)
All other items – net	27	12
Changes in operating assets and liabilities:		
Accounts and notes receivable	(267)	(758)
Short-term loans receivable of a banking subsidiary	32	(17)
Net movements of customers deposits placed in a banking subsidiary	(17)	47
Inventories	(897)	(662)
Accounts payable	258	283
Taxes payable	(244)	889
Other current assets and liabilities	223	(288)
<b>Net cash provided by operating activities</b>	<b>3,780</b>	<b>2,420</b>
<b>Cash flows from investing activities</b>		
Capital expenditures	(2,528)	(1,894)
Proceeds from sale of property, plant and equipment	263	12
Purchases of investments	(154)	(139)
Proceeds from sale of investments	122	79
Sale of interests in subsidiaries and affiliated companies	41	532
Acquisitions of subsidiaries and minority shareholding interest, net of cash acquired	(901)	(408)
<b>Net cash used in investing activities</b>	<b>(3,157)</b>	<b>(1,818)</b>
<b>Cash flows from financing activities</b>		
Net movements of short-term borrowings	1,001	(286)
Proceeds from issuance of long-term debt	196	119
Principal payments of long-term debt	(806)	(171)
Dividends paid	(50)	(26)
Purchases of treasury stock	(382)	-
Proceeds from sale of treasury stock	-	46
Other – net	1	5
<b>Net cash used in financing activities</b>	<b>(40)</b>	<b>(313)</b>
Effect of exchange rate changes on cash and cash equivalents	40	(18)
<b>Net increase in cash and cash equivalents</b>	<b>623</b>	<b>271</b>
Cash and cash equivalents at beginning of the period	1,650	1,257
<b>Cash and cash equivalents at end of the period</b>	<b>4</b>	<b>1,528</b>
Supplemental disclosures of cash flow information		
Interest paid	158	143
Income tax paid	1,301	987

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

## **Note 1. Organization and environment**

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

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

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

### ***Business and economic environment***

The Russian Federation has been experiencing political and economic change, which has affected and will continue to affect the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks, which do not typically exist in other markets.

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

### ***Basis of preparation***

The accompanying interim consolidated financial statements and notes thereto have not been audited by independent accountants, except for the balance sheet as of December 31, 2005. In the opinion of the Company’s management, the interim consolidated financial statements include all adjustments and disclosures necessary to present fairly the Group’s financial position, results of operations and cash flows for the interim periods reported herein. These adjustments were of a normal recurring nature.

These interim consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) as applicable to interim financial statements. These financial statements should be read in conjunction with the Group’s December 31, 2005 annual consolidated financial statements.

The results for the three-month and six-month periods ended June 30, 2006 are not necessarily indicative of the results expected for the full year.

## **Note 2. Summary of significant accounting policies**

### ***Principles of consolidation***

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

## **Note 2 Summary of significant accounting policies (continued)**

### *Use of estimates*

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

### *Revenue recognition*

Revenues from the production and sale of crude oil and petroleum products are recognized when title passes to customers.

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

### *Foreign currency translation*

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

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

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

Foreign currency transaction gains and losses are included in the consolidated statement of income.

As of June 30, 2006 and December 31, 2005, exchange rates of 27.08 and 28.78 Russian rubles to the US dollar, respectively, have been used for translation purposes.

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

### *Cash and cash equivalents*

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



## **Note 2. Summary of significant accounting policies (continued)**

### ***Cash with restrictions on immediate use***

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

### ***Accounts and notes receivable***

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

### ***Inventories***

Inventories, consisting primarily of stocks of crude oil, petroleum products and materials and supplies, are stated at the lower of cost or market value. Cost is determined using an "average cost" method.

### ***Investments***

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

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

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

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

### ***Property, plant and equipment***

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

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

**Note 2. Summary of significant accounting policies (continued)**

Production and related overhead costs are expensed as incurred.

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

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

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

***Goodwill and other intangible assets***

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

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

***Impairment of long-lived assets***

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

***Deferred income taxes***

The estimated effective income tax rate expected to be applicable for the full fiscal year is used in providing for income taxes on a current year-to-date basis. The estimated effective tax rate reflects statutory tax rates for each jurisdiction, the deductibility of expenses and taxability of income, anticipated tax credits and other available tax planning alternatives. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of income in the reporting period that includes the enactment date and is not accounted for as an adjustment of the annual effective tax rate.

## Note 2. Summary of significant accounting policies (continued)

### *Interest-bearing borrowings*

Interest-bearing borrowings are initially recorded at the value of net proceeds received. Any difference between the net proceeds and the redemption value is amortized at a constant rate over the term of the borrowing. Amortization is included in the consolidated statement of income each year and the carrying amounts are adjusted as amortization accumulates.

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

### *Pension benefits*

The expected costs in respect of pension obligations of Group companies are estimated by the management based on pension obligations as of the most recent annual period, which are determined by an independent actuary. Obligations in respect of each employee are accrued over the reporting periods during which the employee renders service in the Group.

### *Treasury stock*

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

### *Earnings per share*

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

### *Contingencies*

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

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

### *Environmental expenditures*

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

## Note 2. Summary of significant accounting policies (continued)

### *Use of derivative instruments*

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

### *Comparative amounts*

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

### *Recent accounting pronouncements*

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" (FIN 48). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The Group is required to adopt the provisions of FIN 48 in the first quarter 2007 and is currently assessing the effect of adoption.

In June 2006, the FASB ratified the consensus reached by the EITF on Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)." The consensus requires disclosure of either the gross or net presentation, and any such taxes reported on a gross basis should be disclosed in the interim and annual financial statements. The Group is required to adopt the provisions of EITF Issue No. 06-3 in the first quarter 2007 and does not expect any material impact on its financial statements upon adoption.

In December 2004, the FASB issued SFAS No. 123(R) "Share-Based Payment," which revises SFAS No. 123 and supersedes Accounting Principles Board (APB) Opinion No. 25 regarding stock-based employee compensation plans. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. The adoption of the provisions of SFAS No. 123(R) during the first quarter 2006 did not have a material impact on the Group's results of operations, financial position or cash flows.

## Note 3. Income taxes

Operations in the Russian Federation are subject to a Federal income tax rate of 6.5% and a regional tax rate that varies from 13.5% to 17.5% at the discretion of the individual regional administration. The majority of the Group's operations in Russia were subject to a combined statutory income tax rate of 24%. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

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

**OA O LUKOIL**  
**Notes to Interim Consolidated Financial Statements (unaudited)**  
(Millions of US dollars, unless otherwise noted)

**Note 4. Cash and cash equivalents**

	<b>As of June 30, 2006</b>	<b>As of December 31, 2005</b>
Cash held in Russian rubles	302	346
Cash held in other currencies	1,377	905
Cash of a banking subsidiary in other currencies	47	102
Cash held in related party banks in Russian rubles	457	173
Cash held in related party banks in other currencies	90	124
<b>Total cash and cash equivalents</b>	<b>2,273</b>	<b>1,650</b>

**Note 5. Non-cash transactions**

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

	<b>For the six months ended June 30, 2006</b>	<b>For the six months ended June 30, 2005</b>
Non-cash investing activity	34	67
Non-cash acquisition of minority interest in a subsidiary	314	-
Settlement of bond liability with the Company's common stock	36	-
<b>Total non-cash transactions</b>	<b>384</b>	<b>67</b>

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

	<b>For the six months ended June 30, 2006</b>	<b>For the six months ended June 30, 2005</b>
Net cash used in investing activity	3,157	1,818
Non-cash acquisition of minority interest in a subsidiary	314	-
Non-cash investing activity	34	67
<b>Total investing activity</b>	<b>3,505</b>	<b>1,885</b>

**Note 6. Accounts and notes receivable, net**

	<b>As of June 30, 2006</b>	<b>As of December 31, 2005</b>
Trade accounts and notes receivable (net of provisions of \$94 million and \$80 million as of June 30, 2006 and December 31, 2005, respectively)	4,247	3,410
Current VAT and excise recoverable	1,334	1,772
Short-term loans receivable of a banking subsidiary	16	48
Other current accounts receivable (net of provisions of \$42 million and \$46 million as of June 30, 2006 and December 31, 2005, respectively)	184	303
<b>Total accounts and notes receivable, net</b>	<b>5,781</b>	<b>5,533</b>

**OA O LUKOIL**  
**Notes to Interim Consolidated Financial Statements (unaudited)**  
(Millions of US dollars, unless otherwise noted)

**Note 7. Investments**

	As of June 30, 2006	As of December 31, 2005
Investments in equity method affiliates and joint ventures	1,103	934
Long-term loans given by non-banking subsidiaries	196	165
Other long-term investments	24	11
<b>Total long-term investments</b>	<b>1,323</b>	<b>1,110</b>

*Investments in “equity method” affiliates and joint ventures*

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

	For the three months ended June 30, 2006		For the three months ended June 30, 2005	
	Total	Group's share	Total	Group's share
Revenues	464	293	799	365
Income before income taxes	409	176	396	196
Less income taxes	(124)	(64)	(109)	(54)
<b>Net income</b>	<b>285</b>	<b>112</b>	<b>287</b>	<b>142</b>

	For the six months ended June 30, 2006		For the six months ended June 30, 2005	
	Total	Group's share	Total	Group's share
Revenues	1,087	582	1,366	623
Income before income taxes	743	333	540	271
Less income taxes	(245)	(123)	(141)	(70)
<b>Net income</b>	<b>498</b>	<b>210</b>	<b>399</b>	<b>201</b>

	As of June 30, 2006		As of December 31, 2005	
	Total	Group's share	Total	Group's share
Current assets	1,263	632	2,650	859
Property, plant and equipment	2,050	1,144	2,171	1,129
Other non-current assets	75	35	71	32
Total assets	3,388	1,811	4,892	2,020
Short-term debt	84	38	1,599	347
Other current liabilities	288	151	590	249
Long-term debt	958	504	904	487
Other non-current liabilities	25	15	6	3
<b>Net assets</b>	<b>2,033</b>	<b>1,103</b>	<b>1,793</b>	<b>934</b>

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

	At cost		Net	
	As of June 30, 2006	As of December 31, 2005	As of June 30, 2006	As of December 31, 2005
Exploration and Production:				
Western Siberia	15,827	14,237	7,959	6,669
European Russia	14,612	13,245	9,362	8,122
International	4,706	4,527	4,213	4,150
<b>Total</b>	<b>35,145</b>	<b>32,009</b>	<b>21,534</b>	<b>18,941</b>
Refining, Marketing, Distribution and Chemicals:				
Western Siberia	30	27	24	22
European Russia	6,572	6,374	4,081	3,921
International	3,706	3,537	2,337	2,254
<b>Total</b>	<b>10,308</b>	<b>9,938</b>	<b>6,442</b>	<b>6,197</b>
Other:				
Western Siberia	159	159	86	78
European Russia	243	215	216	190
International	140	73	114	58
<b>Total</b>	<b>542</b>	<b>447</b>	<b>416</b>	<b>326</b>
<b>Total property, plant and equipment</b>	<b>45,995</b>	<b>42,394</b>	<b>28,392</b>	<b>25,464</b>

As of June 30, 2006 and December 31, 2005, the asset retirement obligations amounted to \$488 million and \$397 million, respectively, of which \$10 million was included in "Other current liabilities" in the consolidated balance sheets as of each balance sheet date. During the six-month periods ended June 30, 2006 and 2005, asset retirement obligations changed as follows:

	For the six months ended June 30, 2006	For the six months ended June 30, 2005
Asset retirement obligations as of January 1	397	317
Accretion expense	21	16
New obligations and changes in estimates of existing obligations	46	26
Spending on existing obligations	(4)	(2)
Property dispositions	(2)	(4)
Foreign currency translation and other adjustments	30	(12)
<b>Asset retirement obligations as of June 30</b>	<b>488</b>	<b>341</b>

**Note 9. Goodwill and other intangible assets**

The carrying value of goodwill and other intangible assets as of June 30, 2006 and December 31, 2005 was as follows:

	As of June 30, 2006	As of December 31, 2005
Amortized intangible assets		
Software	201	205
Licenses and other assets	80	58
Goodwill	412	417
<b>Total goodwill and other intangible assets</b>	<b>693</b>	<b>680</b>

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

**Note 10. Disposition of assets**

In December 2005, the Company made a decision to sell ten tankers. A Group company finalized the sale of eight tankers in May 2006 for a price that approximated the carrying value of \$190 million. As of December 31, 2005, the Group classified these tankers as assets held for sale in the consolidated balance sheet. The sale of the remaining two tankers is expected to be finalized in July 2007. The Group will use these tankers until that date and they continue to be accounted for as property, plant and equipment.

In May 2006, the Group completed the sale of its remaining 21% ownership interest in OAO Bank Petrocommerce for \$33 million. The sale was made to a related party, whose management and directors include members of the Group's management and Board of Directors. The carrying value of this investment as of the date of transaction was equal to the selling price.

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

	As of June 30, 2006	As of December 31, 2005
Short-term borrowings from third parties	1,301	315
Short-term borrowings from related parties	-	1
Current portion of long-term debt	353	537
<b>Total short-term borrowings and current portion of long-term debt</b>	<b>1,654</b>	<b>853</b>

Short-term borrowings are primarily repayable in US dollars and are unsecured. The weighted-average interest rate on short-term borrowings from third parties was 5.4% and 5.6% per annum as of June 30, 2006 and December 31, 2005, respectively.

**Note 12. Long-term debt**

	As of June 30, 2006	As of December 31, 2005
Long-term loans and borrowings from third parties	3,462	4,233
Long-term loans and borrowings from related parties	694	65
3.5% Convertible US dollar bonds, maturing 2007	62	94
7.25% Russian ruble bonds, maturing 2009	222	208
Capital lease obligation	92	74
Total long-term debt	4,532	4,674
Current portion of long-term debt	(353)	(537)
<b>Total non-current portion of long-term debt</b>	<b>4,179</b>	<b>4,137</b>

***Long-term loans and borrowings***

Long-term loans and borrowings are primarily repayable in US dollars, maturing from 2006 through 2035. About one third of this debt is secured by export sales and property, plant and equipment. The weighted-average interest rate on long-term loans and borrowings from third parties was 6.4% and 5.8% per annum as of June 30, 2006 and December 31, 2005, respectively.



**Note 12. Long-term debt (continued)**

*Convertible US dollar bonds*

On November 29, 2002, a Group company issued 350,000 3.5% convertible bonds with a face value of \$1,000 each, maturing on November 29, 2007, and exchangeable for 12.246 (previously 12.112) global depository receipts (“GDRs”) of the Company per bond. The bonds are convertible into GDRs on or after January 9, 2003 up to the maturity dates. The GDRs are exchangeable into four shares of common stock of the Company. Bonds not converted by the maturity date must be redeemed for cash. The redemption price at maturity will be 120.53% of the face value in respect of these bonds. A Group company may redeem the bonds for cash prior to maturity, subject to certain restrictions and early redemption charges. The carrying amount of the bonds is being accreted to their redemption value with the accreted amount being charged to the consolidated statement of income.

As of June 30, 2006, bondholders had converted 295,346 bonds into 14.3 million shares of common stock of the Company. Subsequent to period end, as of October 12, 2006, bondholders had converted an additional 50 bonds into 2.5 thousand shares of common stock of the Company.

A Group company held sufficient treasury stock to permit the full conversion of the bonds to GDRs.

*Russian ruble bonds*

In November 2004, the Company issued 6 million Russian ruble bonds with a nominal value of 1,000 Russian rubles each, maturing on November 23, 2009. For a period of 7 days commencing on November 13, 2007 the bondholders have the right to demand the Company repurchase the bonds. The bonds have a half year coupon period and bear interest at 7.25% per annum.

**Note 13. Pension benefits**

The Company sponsors a post employment and post retirement benefits program that covers the majority of the Group’s employees. The plan primarily consists of a defined benefit plan enabling employees to contribute a portion of their salary to the plan and at retirement to receive a lump sum amount from the Company equal to all past contributions made by the employee up to 7% of their annual salary. This plan is administered by a non-state pension fund, LUKOIL-GARANT, and provides pension benefits primarily based on years of service and final remuneration levels. The Company also provides several long-term employee benefits such as death-in-service benefit and lump-sum payments upon retirement of a defined benefit nature and other defined benefits to certain old age and disabled pensioners who have not vested any pensions under the pension plan.

Components of net periodic benefit cost were as follows:

	For the three months ended June 30, 2006	For the three months ended June 30, 2005	For the six months ended June 30, 2006	For the six months ended June 30, 2005
Service cost	3	1	6	2
Interest cost	4	6	9	11
Less expected return on plan assets	(2)	(1)	(4)	(2)
Amortization of prior service cost	1	3	3	6
Actuarial gain	-	(1)	(1)	(2)
<b>Total net periodic benefit cost</b>	<b>6</b>	<b>8</b>	<b>13</b>	<b>15</b>

**Note 14. Stockholders' equity**

*Earnings per share*

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

	For the three months ended June 30, 2006	For the three months ended June 30, 2005	For the six months ended June 30, 2006	For the six months ended June 30, 2005
Net income	2,321	1,410	4,010	2,590
Add back convertible debt interest (net of tax at effective rate)				
3.5% Convertible US dollar bonds, maturing 2007	1	7	2	13
<b>Total diluted net income</b>	<b>2,322</b>	<b>1,417</b>	<b>4,012</b>	<b>2,603</b>
Weighted average number of outstanding common shares (thousands of shares)	827,495	813,492	827,511	813,265
Add back treasury shares held in respect of convertible debt (thousands of shares)	2,665	16,957	2,794	16,957
<b>Weighted average number of outstanding common shares, after dilution (thousands of shares)</b>	<b>830,160</b>	<b>830,449</b>	<b>830,305</b>	<b>830,222</b>

*Dividends*

At the annual stockholders' meeting on June 28, 2006, dividends were declared for 2005 in the amount of 33 Russian rubles per common share, which at the date of the meeting was equivalent to \$1.22. Dividends payable of \$920 million and \$7 million are included in "Other current liabilities" in consolidated balance sheet as of June 30, 2006 and December 31, 2005, respectively.

At the annual stockholders' meeting on June 28, 2005, dividends were declared for 2004 in the amount of 28.00 Russian rubles per common share, which at the date of the decision was equivalent to \$0.98.

**Note 15. Financial and derivative instruments**

*Commodity derivative instruments*

The Group uses derivative instruments in its international petroleum products marketing and trading operations. The types of derivative instruments used include futures and swap contracts, used for hedging purposes, and purchase and sale contracts that qualify as derivative instruments. The Group maintains a system of controls over these activities that includes policies covering the authorization, reporting and monitoring of derivative activity. The Group recognized an expense from the use of derivative instruments of \$98 million, \$45 million, \$173 million and \$177 million during the three months ended June 30, 2006 and 2005 and during the six months ended June 30, 2006 and 2005, respectively. The expense is included in "Cost of purchased crude oil, petroleum and chemical products" in the consolidated statements of income. The fair value of derivative contracts outstanding and recorded on the consolidated balance sheets was a net liability of \$37 million and \$26 million as of June 30, 2006 and December 31, 2005, respectively.

*Fair value*

The fair values of cash and cash equivalents, current accounts and notes receivable, and liquid securities are approximately equal to their value as disclosed in the consolidated financial statements.

The fair value of long-term receivables included in other non-current assets approximates the amounts disclosed in the consolidated financial statements as a result of discounting using estimated market interest rates for similar financing arrangements. The fair value of long-term debt differs from the amount disclosed in the consolidated financial statements. The estimated fair value of long-term debt as of June 30, 2006 and December 31, 2005 was \$4,729 million and \$5,081 million, respectively, as a result of discounting using estimated market interest rates for similar financing arrangements. These amounts include all future cash outflows associated with the long-term debt repayments, including the current portion, and interest.

**Note 16. Business combinations**

In June 2006, a Group company acquired 100% of the share capital of Khanty-Mansiysk Oil Corporation (“KMOC”) from Marathon Oil Corporation for \$853 million (including \$249 million repayment of KMOC debt), which is subject to finalisation of working capital and other adjustments in accordance with the purchase agreement. KMOC owns approximately 95% of the share capital of OAO Khantymansiyskneftegazgeologia and 100% of the share capital of OAO Paitykh Oil and OAO Nazymgeodobycha (“KMOC subsidiaries”). KMOC subsidiaries operate oil and gas fields in the West Siberian region of the Russian Federation.

KMOC’s results of operations are included in the Group’s consolidated statement of income from June 2006.

The following table summarizes the preliminary estimation of the fair value of the assets acquired and liabilities assumed at the date of acquisition. The Group will finalize the purchase price allocation upon the completion of an independent assessment of the oil and gas reserves acquired.

Current assets	95
Property, plant and equipment	897
Other non-current assets	38
<b>Total assets acquired</b>	<b>1,030</b>
Current liabilities	(21)
Non-current deferred tax liabilities	(133)
Long-term debt	(249)
Minority interest	(14)
Other long-term liabilities	(9)
<b>Total liabilities assumed</b>	<b>(426)</b>
<b>Net assets acquired</b>	<b>604</b>

During the period from November to December 2005, a Group company acquired 51% of the share capital of OAO Primorieneftgaz for \$261 million. OAO Primorieneftgaz is a Russian oil and gas exploration company operating in European Russia. Subsequently, in May 2006, a Group company acquired the remaining 49% of the share capital of OAO Primorieneftgaz for 4.165 million shares of common stock of the Company (at a market value of approximately \$314 million), thereby increasing the Group’s ownership stake in OAO Primorieneftgaz to 100%.

In March 2005, a Group company acquired a 100% interest in Oy Teboil Ab and Suomen Petrooli Oy for \$160 million. Oy Teboil Ab and Suomen Petrooli Oy are marketing and distribution companies mainly engaged in operating a chain of retail petrol stations, wholesale of refined products and production and sale of lubricants in Finland.

In January 2005, a Group company acquired an additional 22% interest in LUKOIL Neftochim Bourgas AD for \$56 million (20.7% interest was acquired from a related party for \$52 million). The acquisition increased the Group’s ownership stake in LUKOIL Neftochim Bourgas AD to 93.2%. In August 2005, a Group company acquired an additional 4% interest in LUKOIL Neftochim Bourgas AD for \$10 million, thereby increasing the Group’s ownership stake in LUKOIL Neftochim Bourgas AD to 97.2%.

Purchases of interests in KMOC, OAO Primorieneftgaz, Oy Teboil Ab, Suomen Petrooli Oy and LUKOIL Neftochim Bourgas AD did not have a material impact on the Group’s consolidated operations for the six months ended June 30, 2006 and 2005. Therefore, no pro-forma income statement information has been provided in these interim consolidated financial statements.

**Note 17. Consolidation of Variable Interest Entity**

On June 30, 2005, the Company completed the formation of a joint venture with ConocoPhillips within the framework of their broad-based strategic alliance. This joint venture was created by selling ConocoPhillips an interest in the Company's wholly owned subsidiary OOO Narianmarneftegaz ("NMNG") for \$529 million. The purpose of the joint venture is to develop oil reserves in the Timan-Pechora region of the Russian Federation. The Group and ConocoPhillips have equal voting rights over the joint venture's activity and effective ownership interests of 70% and 30%, respectively. NMNG's total assets were approximately \$2.3 billion and \$1.9 billion as of June 30, 2006 and December 31, 2005, respectively.

The Group determined that NMNG is a variable interest entity as the Group's voting rights are not proportionate to its ownership rights and all of NMNG's activities are conducted on behalf of the Group and ConocoPhillips, its related party. The Group is considered to be the primary beneficiary and has consolidated NMNG.

As a result of the transaction, the Group recognized a gain of \$87 million, which is included in the consolidated statement of income for the three-month and six-month periods ended June 30, 2005. The Group recorded an additional gain of \$65 million during the third and the fourth quarters of 2005 related to finalization of purchase price adjustments.

During 2005, the Group and ConocoPhillips agreed to provide financing to NMNG by means of long-term loans in the proportion of their effective ownership interests. The loan maturities are 30 years, with the option to be extended for a further 35 years with the agreement of both parties. As of December 31, 2005, these loans bore interest at 0.1% per annum. The loan proceeds were originally accounted for by NMNG primarily as equity contributions as a result of recording the loan obligations at their present value based on market interest rates. The difference between the proceeds and the present value represented contributions to NMNG's equity.

In the second quarter of 2006, the Group and ConocoPhillips reached an agreement to amend the contractual interest rates of the original loans to 8.0% per annum. As a result of the amendment, the financing received from the Group and ConocoPhillips was transferred from equity to long-term debt by NMNG. Also during the six months ended June 30, 2006, the Group and ConocoPhillips agreed to provide additional financing to NMNG under similar terms as the original financing arrangements with an interest rate of 6.8% per annum.

As of June 30, 2006, the outstanding amount due to ConocoPhillips from NMNG was \$572 million and is presented within "Long-term loans and borrowings from related parties", of which \$509 million bears interest at 8% per annum and \$63 million at 6.8% per annum.

**Note 18. Financial guarantees**

The following table provides the undiscounted maximum amount of potential future payments for each major group of guarantees:

	As of June 30, 2006	As of December 31, 2005
Guarantees of equity investees' debt	416	454
Guarantees of third parties' debt	28	19
<b>Total</b>	<b>444</b>	<b>473</b>

**Note 18. Financial guarantees (continued)***Guarantees on debt*

LUKARCO, an investee recorded under the equity method of accounting has a loan facility on which \$687 million was drawn as of June 30, 2006. Borrowings under this loan bear interest at LIBOR plus 2.5% and are partly payable by February 7, 2007 with the remaining outstanding balance repayable by May 1, 2012. To enhance the credit standing of LUKARCO, the Company guarantees 54% of the interest payment as well as the repayment of 54% of the loan at maturity. As of June 30, 2006, the total amount of the Company's guarantee was \$416 million, which includes \$46 million related to accrued interest on the outstanding amount. Payments are due if the Company is notified that LUKARCO is not able to fulfill its obligations at maturity date. The Company's guarantee is secured by its 54% interest in LUKARCO with the carrying value of \$305 million and \$259 million as of June 30, 2006 and December 31, 2005, respectively. There are no material amounts being carried as liabilities for the Group's obligations under this guarantee.

**Note 19. Commitments and contingencies***Capital expenditure, exploration and investment programs*

The Group owns and operates refineries in Bulgaria (LUKOIL Neftochim Bourgas AD) and Romania (Petrotel-LUKOIL). As a result of Bulgaria and Romania joining the European Union in 2007, LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL are required to upgrade their refining plants to comply with the requirements of European Union legislation in relation to the quality of produced petroleum products and environmental protection. These requirements are stricter than existing Bulgarian and Romanian legislation. The Group estimates the amount of future capital commitment required to upgrade LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL to be approximately \$607 million and \$60 million, respectively.

Group companies have commitments under the terms of existing license agreements in the Russian Federation of \$1,421 million over the next 5 years and of \$276 million thereafter. Management believes that a significant portion of these commitments will be fulfilled by the services to be performed by OOO Eurasia Drilling Company and ZAO Globalstroy-Engineering as discussed below.

In connection with the sale of OOO LUKOIL-Burenie in 2004, the Group signed a five year contract for drilling services. Under the terms of the contract, drilling services of \$319 million, \$585 million, \$678 million and \$683 million will be provided by OOO Eurasia Drilling Company (former OOO LUKOIL-Burenie) during the second half of 2006 and the fiscal years 2007, 2008, and 2009, respectively.

In 2005, the Company has signed a four-year agreement for the provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for the second half of 2006 and the fiscal year 2007 to be approximately \$514 million and \$931 million, respectively.

Group companies have commitments for capital expenditure contributions in the amount of \$344 million related to various production sharing agreements over the next 32 years.

Group companies have investment commitments relating to oil deposits in Iraq of \$495 million to be spent within 3 years from when exploitation becomes possible. Due to significant changes in the political and economic situation in Iraq the future of this contract is not clear, however, the Group is actively pursuing its legal right to this contract in Iraq in alliance with ConocoPhillips.

**Note 19. Commitments and contingencies (continued)**

*Operating lease obligations*

The Group has commitments of \$1,286 million primarily for the lease of vessels and petroleum distribution outlets over the next 8 years. Commitments for minimum rentals under these leases as of June 30, 2006 are as follows:

	<b>As of June 30, 2006</b>
For the six-months ending December 31, 2006	151
2007 fiscal year	228
2008 fiscal year	163
2009 fiscal year	133
2010 fiscal year	133
beyond	478

*Insurance*

The insurance industry in the Russian Federation and certain other areas where the Group has operations is in the course of development. Management believes that the Group has adequate property damage coverage for its main production assets. In respect of third party liability for property and environmental damage arising from accidents on Group property or relating to Group operations, the Group has insurance coverage that is generally higher than insurance limits set by the local legal requirements. Management believes that the Group has adequate insurance coverage of the risks, which could have a material effect on the Group's operations and financial position. The Group has limited business interruption insurance coverage. Management does not believe that it is appropriate to have full insurance coverage against business interruption given the Group's geographical diversity and the limited impact it considers likely to occur from a single event.

*Environmental liabilities*

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

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

**Note 19. Commitments and contingencies (continued)***Litigation and claims*

On November 27, 2001, Archangel Diamond Corporation (“ADC”), a Canadian diamond development company, filed a lawsuit in the District Court of Denver, Colorado against OAO “Arkhangelskgeoldobycha” (“AGD”), a Group company, and the Company (together the “Defendants”). ADC alleged that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. ADC claimed total damages of approximately \$4.8 billion, including compensatory damages of \$1.2 billion and punitive damages of \$3.6 billion. On October 15, 2002, the District Court dismissed the lawsuit for lack of personal jurisdiction. This ruling was upheld by the Colorado Court of Appeals on March 25, 2004. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts’ ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was completely dismissed from the lawsuit. The Supreme Court found, however, that the trial court made a procedural error by not holding an evidentiary hearing before making its ruling concerning general jurisdiction, which is whether the Company had systematic and continuous contacts in the State of Colorado at the time the lawsuit was filed. In a modified opinion dated December 19, 2005, the Colorado Supreme Court remanded the case to the Colorado Court of Appeals (instead of the District Court) to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). On June 29, 2006, the Colorado Court of Appeals declined to dismiss the case based on forum non conveniens. The Company filed a petition for certiorari on August 28, 2006 asking the Colorado Supreme Court to review this decision. If the Colorado Supreme Court declines to review the forum non conveniens issue, then the lawsuit will return to the District Court for a hearing on general jurisdiction. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group’s financial condition.

On February 20, 2004, the Stockholm District Court overturned the decision of the Arbitral Tribunal of the Arbitration Institute of the Stockholm Chamber of Commerce made on June 25, 2001 dismissing ADC’s action against AGD based on lack of jurisdiction. ADC’s lawsuit against AGD was initially filed with the Arbitral Tribunal of the Arbitration Institute of the Stockholm Chamber of Commerce claiming alleged non-performance under an agreement between the parties and its obligation to transfer the diamond exploration license to Almazny Bereg. This lawsuit claimed compensation of damages amounting to \$492 million. In March 2004, AGD filed an appeal against the Stockholm District Court decision with the Swedish Court of Appeals. On November 15, 2005, the Swedish Court of Appeals denied AGD’s appeal and affirmed the Stockholm District Court decision. On December 13, 2005, AGD filed an appeal against the Swedish Court of Appeals decision with the Swedish Supreme Court. On April 13, 2006 the Swedish Supreme Court denied the application of AGD for appeal against the Swedish Court of Appeal’s decision dated November 15, 2005. On May 6, 2006 a Notice of Arbitration was received on behalf of ADC. The procedure to appoint the arbitrators is currently in progress. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group’s financial condition.

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

*Social assets*

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

**Note 19. Commitments and contingencies (continued)**

***Taxation environment***

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

The regional organizational structure of the Russian Federation tax authorities and the regional judicial system can mean that taxation issues successfully defended in one region may be unsuccessful in another region. The tax authorities in each region may have a different interpretation of similar taxation issues. There is however some degree of direction provided from the central authority based in Moscow on particular taxation issues.

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

In the second quarter 2005 the Group accrued a provision of \$163 million in relation to the results of tax audits of the Group companies for periods prior to the 2004 financial year. These amounts are included in "Income tax expense" and "Taxes other than income taxes" in the 2005 consolidated statement of income.

**Note 20. Related party transactions**

In the rapidly developing business environment in the Russian Federation, companies and individuals have frequently used nominees and other forms of intermediary companies in transactions. The senior management of the Company considers that the Group has appropriate procedures in place to identify and properly disclose transactions with related parties in this environment and has disclosed all of the relationships identified which it deemed to be significant. Related party sales and purchases of oil and oil products were primarily to and from affiliated companies and the Company's shareholder ConocoPhillips. Insurance services are provided by the related parties, whose management and directors include members of the Group's management. Purchases of construction services were primarily from affiliated companies.

Below are related party transactions not disclosed elsewhere in the financial statements. Refer also to Notes 4, 7, 10, 11, 12, 13, 16, 17, 18 and 21 for other transactions with related parties.

Sales of oil and oil products to related parties were \$178 million, \$230 million, \$350 million and \$292 million during the three months ended June 30, 2006 and 2005 and during the six months ended June 30, 2006 and 2005, respectively.



**Note 20. Related party transactions (continued)**

Other sales to related parties were \$5 million, \$25 million, \$9 million and \$42 million during the three months ended June 30, 2006 and 2005 and during the six months ended June 30, 2006 and 2005, respectively.

Purchases of oil and oil products from related parties were \$539 million, \$573 million, \$983 million and \$995 million during the three months ended June 30, 2006 and 2005 and during the six months ended June 30, 2006 and 2005, respectively.

Purchases of construction services from related parties were \$3 million, \$192 million, \$4 million and \$375 million during the three months ended June 30, 2006 and 2005 and during the six months ended June 30, 2006 and 2005, respectively.

Purchases of insurance services from related parties were \$34 million, \$27 million, \$71 million and \$62 million during the three months ended June 30, 2006 and 2005 and during the six months ended June 30, 2006 and 2005, respectively.

Other purchases from related parties were \$6 million, \$11 million, \$27 million and \$25 million during the three months ended June 30, 2006 and 2005 and during the six months ended June 30, 2006 and 2005, respectively.

Amounts receivable from related parties, including loans and advances, were \$155 million and \$160 million as of June 30, 2006 and December 31, 2005, respectively. Amounts payable to related parties were \$137 million and \$127 million as of June 30, 2006 and December 31, 2005, respectively.

**Note 21. Compensation plan**

During 2003, the Company introduced a compensation plan available to certain members of management, which provides compensation based upon share appreciation of the Company's common stock. The number of shares or rights under the plan is approximately 11 million shares, of which 9 million shares are allocated to individuals. These rights vest in December 2006.

The fair value of this compensation plan was calculated using the Black-Scholes option-pricing model, assuming a risk-free interest rate of 11.5%, an expected dividend yield of 1.46% and a volatility factor of 67.25% for the six months ended June 30, 2006.

As of June 30, 2006 and December 31, 2005, the Group has accrued liabilities of \$537 million and \$283 million, respectively, included in "Other current liabilities", and recorded \$66 million, \$55 million, \$269 million and \$88 million of compensation expense during the three-month periods ended June 30, 2006 and 2005 and during the six-month periods ended June 30, 2006 and 2005, respectively.

As of June 30, 2006, there was \$85 million of total unrecognized compensation cost related to non-vested compensation plan. This cost is expected to be recognized in 2006.

**Note 22. Segment information**

Presented below is information about the Group's operating and geographical segments for the periods ended June 30, 2006 and 2005, in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information."

**OA O LUKOIL****Notes to Interim Consolidated Financial Statements (unaudited)**  
(Millions of US dollars, unless otherwise noted)**Note 22. Segment information (continued)**

The Group has four operating segments - exploration and production; refining, marketing and distribution; chemicals and other business segments. These segments have been determined based on the nature of their operations. Management on a regular basis assesses the performance of these operating segments. The exploration and production segment explores for, develops and produces primarily crude oil. The refining, marketing and distribution segment processes crude oil into refined products and purchases, sells and transports crude oil and refined petroleum products. The chemicals segment refines and sells chemicals products. Activities of the other business operating segment include the development of businesses beyond the Group's traditional operations.

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

**Operating segments****For the three months ended June 30, 2006**

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
<b>Sales</b>						
Third parties	471	17,359	423	14	-	18,267
Inter-segment	5,203	369	6	44	(5,622)	-
<b>Total sales</b>	<b>5,674</b>	<b>17,728</b>	<b>429</b>	<b>58</b>	<b>(5,622)</b>	<b>18,267</b>
<b>Operating expenses and total cost of purchases</b>						
	814	11,996	382	26	(5,508)	7,710
<b>Depreciation, depletion and amortization expense</b>						
	306	135	4	4	-	449
<b>Interest expense</b>						
	146	77	-	45	(189)	79
<b>Income tax expense</b>						
	472	360	2	-	-	834
<b>Net income</b>						
	1,180	1,217	11	56	(143)	2,321
<b>Total assets</b>						
	33,034	30,747	621	6,374	(25,433)	45,343
<b>Capital expenditures</b>						
	1,082	336	49	18	-	1,485

**For the three months ended June 30, 2005**

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
<b>Sales</b>						
Third parties	224	12,805	446	17	-	13,492
Inter-segment	3,480	233	8	25	(3,746)	-
<b>Total sales</b>	<b>3,704</b>	<b>13,038</b>	<b>454</b>	<b>42</b>	<b>(3,746)</b>	<b>13,492</b>
<b>Operating expenses and total cost of purchases</b>						
	695	8,204	343	32	(3,615)	5,659
<b>Depreciation, depletion and amortization expense</b>						
	196	115	4	2	-	317
<b>Interest expense</b>						
	12	81	-	11	(42)	62
<b>Income tax expense</b>						
	223	334	11	1	-	569
<b>Net income</b>						
	756	729	34	22	(131)	1,410
<b>Total assets</b>						
	19,684	19,710	530	3,101	(9,051)	33,974
<b>Capital expenditures</b>						
	732	270	20	23	-	1,045

**OAO LUKOIL**  
**Notes to Interim Consolidated Financial Statements (unaudited)**  
(Millions of US dollars, unless otherwise noted)

**Note 22. Segment information (continued)**

**For the six months ended June 30, 2006**

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
<b>Sales</b>						
Third parties	857	31,462	873	18	-	33,210
Inter-segment	9,534	811	11	87	(10,443)	-
<b>Total sales</b>	<b>10,391</b>	<b>32,273</b>	<b>884</b>	<b>105</b>	<b>(10,443)</b>	<b>33,210</b>
<b>Operating expenses and total cost of purchases</b>						
	1,598	21,673	756	53	(10,170)	13,910
<b>Depreciation, depletion and amortization expense</b>						
	574	266	9	8	-	857
<b>Interest expense</b>						
	227	147	-	82	(315)	141
<b>Income tax expense</b>						
	831	668	8	1	-	1,508
<b>Net income</b>						
	2,004	2,113	33	79	(219)	4,010
<b>Total assets</b>						
	33,034	30,747	621	6,374	(25,433)	45,343
<b>Capital expenditures</b>						
	1,921	619	75	33	-	2,648

**For the six months ended June 30, 2005**

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
<b>Sales</b>						
Third parties	501	22,624	901	23	-	24,049
Inter-segment	6,090	452	14	56	(6,612)	-
<b>Total sales</b>	<b>6,591</b>	<b>23,076</b>	<b>915</b>	<b>79</b>	<b>(6,612)</b>	<b>24,049</b>
<b>Operating expenses and total cost of purchases</b>						
	1,307	14,133	674	58	(6,351)	9,821
<b>Depreciation, depletion and amortization expense</b>						
	372	218	6	5	-	601
<b>Interest expense</b>						
	25	153	-	19	(80)	117
<b>Income tax expense</b>						
	352	651	21	3	-	1,027
<b>Net income</b>						
	1,083	1,610	108	9	(220)	2,590
<b>Total assets</b>						
	19,684	19,710	530	3,101	(9,051)	33,974
<b>Capital expenditures</b>						
	1,386	530	30	37	-	1,983

**OA O LUKOIL**  
**Notes to Interim Consolidated Financial Statements (unaudited)**  
(Millions of US dollars, unless otherwise noted)

**Note 22. Segment information (continued)**

**Geographical segments**

	For the three months ended June 30, 2006	For the three months ended June 30, 2005	For the six months ended June 30, 2006	For the six months ended June 30, 2005
Sales of crude oil within Russia	153	49	202	58
Export of crude oil and sales of oil of foreign subsidiaries	4,840	4,136	8,643	7,601
Sales of refined products within Russia	1,997	1,554	3,877	2,863
Export of refined products and sales of refined products of foreign subsidiaries	10,309	6,870	18,595	11,782
Sales of chemicals within Russia	122	116	261	229
Export of chemicals and sales of chemicals of foreign subsidiaries	296	319	594	650
Other sales within Russia	289	242	530	470
Other export sales and other sales of foreign subsidiaries	261	206	508	396
<b>Total sales</b>	<b>18,267</b>	<b>13,492</b>	<b>33,210</b>	<b>24,049</b>

**For the three months ended June 30, 2006**

	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	87	2,606	15,574	-	18,267
Inter-segment	3,028	7,421	9	(10,458)	-
<b>Total sales</b>	<b>3,115</b>	<b>10,027</b>	<b>15,583</b>	<b>(10,458)</b>	<b>18,267</b>
Operating expenses and total cost of purchases					
	439	3,862	13,760	(10,351)	7,710
Depletion, depreciation and amortization expense	136	192	121	-	449
Interest expense	4	24	61	(10)	79
Income tax expense	225	475	134	-	834
Net income	822	1,373	428	(302)	2,321
Total assets	11,457	24,341	20,180	(10,635)	45,343
Capital expenditures	336	891	258	-	1,485

**For the three months ended June 30, 2005**

	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	57	1,965	11,470	-	13,492
Inter-segment	2,082	5,174	4	(7,260)	-
<b>Total sales</b>	<b>2,139</b>	<b>7,139</b>	<b>11,474</b>	<b>(7,260)</b>	<b>13,492</b>
Operating expenses and total cost of purchases					
	364	2,527	9,898	(7,130)	5,659
Depletion, depreciation and amortization expense	99	151	67	-	317
Interest expense	4	39	30	(11)	62
Income tax expense	125	400	44	-	569
Net income	435	999	175	(199)	1,410
Total assets	8,380	19,088	10,630	(4,124)	33,974
Capital expenditures	283	553	209	-	1,045

**OA O LUKOIL**  
**Notes to Interim Consolidated Financial Statements (unaudited)**  
(Millions of US dollars, unless otherwise noted)

**Note 22. Segment information (continued)**

**For the six months ended June 30, 2006**

	Western Siberia	European Russia	International	Elimination	Consolidated
<b>Sales</b>					
Third parties	152	5,078	27,980	-	33,210
Inter-segment	5,527	13,324	14	(18,865)	-
<b>Total sales</b>	<b>5,679</b>	<b>18,402</b>	<b>27,994</b>	<b>(18,865)</b>	<b>33,210</b>
<b>Operating expenses and total cost of purchases</b>					
	859	6,952	24,724	(18,625)	13,910
<b>Depletion, depreciation and amortization expense</b>					
	249	373	235	-	857
<b>Interest expense</b>					
	8	40	112	(19)	141
<b>Income tax expense</b>					
	396	918	194	-	1,508
<b>Net income</b>					
	1,399	2,503	621	(513)	4,010
<b>Total assets</b>					
	11,457	24,341	20,180	(10,635)	45,343
<b>Capital expenditures</b>					
	654	1,508	486	-	2,648

**For the six months ended June 30, 2005**

	Western Siberia	European Russia	International	Elimination	Consolidated
<b>Sales</b>					
Third parties	134	3,781	20,134	-	24,049
Inter-segment	3,620	9,256	8	(12,884)	-
<b>Total sales</b>	<b>3,754</b>	<b>13,037</b>	<b>20,142</b>	<b>(12,884)</b>	<b>24,049</b>
<b>Operating expenses and total cost of purchases</b>					
	681	4,469	17,316	(12,645)	9,821
<b>Depletion, depreciation and amortization expense</b>					
	189	288	124	-	601
<b>Interest expense</b>					
	9	79	52	(23)	117
<b>Income tax expense</b>					
	163	784	80	-	1,027
<b>Net income</b>					
	610	1,970	355	(345)	2,590
<b>Total assets</b>					
	8,380	19,088	10,630	(4,124)	33,974
<b>Capital expenditures</b>					
	575	1,001	407	-	1,983