TATNEFT

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

PRICEWATERHOUSECOOPERS

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders of OAO Tatneft:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and comprehensive income, of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of OAO Tatneft and its subsidiaries (the "Company") at December 31, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

ZAO PricewaterhouseCoopers Audit

Moscow, Russian Federation
June 26, 2007

	Notes	At December 31, 2006	At December 31, 2005
Assets			
Cash and cash equivalents		8,354	18,184
Accounts receivable, net	6	27,307	20,207
Due from related parties	20	13,827	14,417
Short-term investments	7	15,825	5,116
Current portion of loans receivable	10	5,151	4,497
Inventories	8	11,403	9,948
Prepaid expenses and other current assets	9	22,639	18,808
Total current assets		**104,506**	**91,177**
Long-term loans receivable, net	10	4,997	4,534
Due from related parties	20	6,235	2,561
Long-term investments	7	23,468	8,327
Property, plant and equipment, net	12	178,539	174,212
Other long-term assets	11	1,679	1,333
Total assets		**319,424**	**282,144**
Liabilities and shareholders' equity			
Short-term debt and current portion of long-term debt	13	3,784	5,857
Trade accounts payable		6,543	4,793
Due to related parties	20	704	1,458
Other accounts payable and accrued liabilities	14	13,290	7,097
Capital lease obligations	12	865	630
Taxes payable	16	7,561	9,310
Total current liabilities		**32,747**	**29,145**
Long-term debt, net of current portion	13	290	1,765
Due to related parties	20	15	448
Other long-term liabilities		1,743	403
Asset retirement obligations, net of current portion	12	28,923	26,230
Deferred tax liability	16	20,564	21,619
Capital lease obligations, net of current portion	12	265	124
Total liabilities		**84,547**	**79,734**
Minority interest		**3,174**	**3,689**
Shareholders' equity			
Preferred shares (authorized and issued at December 31, 2006 and 2005 – 147,508,500 shares; nominal value at December 31, 2006 and 2005 - RR1.00)	17	148	148
Common shares (authorized and issued at December 31, 2006 and 2005 - 2,178,690,700 shares; nominal value at December 31, 2006 and 2005 - RR1.00)	17	2,179	2,179
Additional paid-in capital		95,337	89,742
Accumulated other comprehensive income	17	(318)	336
Retained earnings		137,143	111,214
Less: Common shares held in treasury, at cost (111,298,885 shares and 178,440,892 shares at December 31, 2006 and 2005, respectively)		(2,786)	(4,898)
Total shareholders' equity		**231,703**	**198,721**
Total liabilities and shareholders' equity		**319,424**	**282,144**

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

TATNEFT
Consolidated Statements of Operations and Comprehensive Income
(in millions of Russian Roubles)

	Notes	Year ended December 31, 2006	Year ended December 31, 2005
Sales and other operating revenues	16,19	**318,284**	**300,358**
Costs and other deductions			
Operating		57,099	44,846
Purchased oil and refined products		33,882	49,704
Exploration		1,555	1,375
Transportation		6,650	8,493
Selling, general and administrative		20,510	19,323
Depreciation, depletion and amortization	19	10,673	11,013
Loss on disposals of property, plant and equipment and investments and impairments		3,438	6,894
Taxes other than income taxes	16	144,976	116,381
Maintenance of social infrastructure and transfer of social assets	12	328	516
Total costs and other deductions		**279,111**	**258,545**
Other income (expenses)			
Earnings from equity investments	7	621	1,279
Foreign exchange (loss) / gain		(1,829)	67
Interest income		2,036	1,057
Interest expense		(247)	(1,151)
Other income / (expense), net		2,870	(488)
Total other income		**3,451**	**764**
Income before income taxes, minority interest and cumulative effect of change in accounting principle		**42,624**	**42,577**
Income taxes			
Current income tax expense		(13,088)	(15,097)
Deferred income tax benefit		982	1,416
Total income tax expense	16	**(12,106)**	**(13,681)**
Income before minority interest and cumulative effect of change in accounting principle		**30,518**	**28,896**
Minority interest		(745)	(654)
Net income		**29,773**	**28,242**
Foreign currency translation adjustments		(654)	175
Less: change in unrealized loss on available-for-sale securities, net of tax		-	(19)
Comprehensive income		**29,119**	**28,398**
Basic net income per share (RR)	17		
Common		13.65	13.19
Preferred		13.58	12.94
Diluted net income per share (RR)	17		
Common		13.60	13.13
Preferred		13.53	12.88
Weighted average common shares outstanding (millions of shares)	17		
Basic		2,034	1,997
Diluted		2,042	2,006
Weighted average preferred shares outstanding (millions of shares)	17		
Basic		148	148
Diluted		148	148

	Notes	Year ended December 31, 2006	Year ended December 31, 2005
Operating activities			
Net income		29,773	28,242
Adjustments:			
Minority interest		745	654
Depreciation, depletion and amortization	19	10,673	11,013
Deferred income tax benefit		(982)	(1,416)
Loss on disposals of property, plant and equipment and investments and impairments		3,438	6,894
Effects of foreign exchange		(129)	294
Equity earnings net of dividends received		84	(769)
Accretion of asset retirement obligation		2,626	2,380
Change in fair value of trading securities		(1,407)	-
Contributions made to pension plans		(365)	-
Other		31	(22)
Changes in operational working capital, excluding cash:			
Accounts receivable		(6,583)	(9,259)
Inventories		(1,870)	483
Prepaid expenses and other current assets		(4,139)	(5,156)
Trading securities		(9,042)	(921)
Related parties		2,922	3,378
Trade accounts payable		2,560	(2,786)
Other accounts payable and accrued liabilities		6,758	8,514
Taxes payable		(1,497)	1,921
Notes payable		(546)	(8,655)
Other non-current assets		(107)	(257)
Net cash provided by operating activities		**32,943**	**34,532**
Investing activities			
Additions to property, plant and equipment		(16,984)	(14,428)
Proceeds from disposals of property, plant and equipment		655	7,669
Proceeds from disposal of investments		11	(8,726)
Purchase of investments		(9,957)	(985)
Certificates of deposit		(7,230)	(6,780)
Loans receivable		3,073	6,369
Notes receivable		(4,161)	(5,153)
Net change in loans given to bank customers		-	283
Net cash used in investing activities		**(34,593)**	**(21,751)**

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

	Notes	Year ended December 31, 2006	Year ended December 31, 2005
Financing activities			
Proceeds from issuance of debt		30,029	66,251
Repayment of debt		(34,292)	(77,753)
Repayment of capital lease obligations		(1,389)	(978)
Dividends paid to shareholders		(2,319)	(421)
Dividends paid to minority shareholders		(186)	(261)
Purchase of treasury shares		(36)	(238)
Proceeds from sale of treasury shares		13	379
Proceeds from issuance of shares by subsidiaries		-	50
Net cash used in financing activities		**(8,180)**	**(12,971)**
Net change in cash and cash equivalents		**(9,830)**	**(190)**
Cash and cash equivalents at beginning of period		18,184	18,374
Cash and cash equivalents at end of period		**8,354**	**18,184**

Consolidated Statements of Shareholders' Equity

(in millions of Russian Roubles)

	2006		2005	
	Shares	**Amount**	**Shares**	**Amount**
Preferred shares:				
Balance at January 1 and December 31 (shares in thousands)	147,509	148	147,509	148
Common shares:				
Balance at January 1 and December 31 (shares in thousands)	2,178,691	2,179	2,178,691	2,179
Treasury shares, at cost:				
Balance at January 1	178,441	(4,898)	185,560	(5,129)
Purchases	288	(36)	5,378	(238)
Sales	(67,430)	2,148	(12,497)	469
Balance at December 31 (shares in thousands)	111,299	(2,786)	178,441	(4,898)
Additional paid-in capital				
Balance at January 1		89,742		89,625
Treasury share transactions		5,595		117
Balance at December 31		95,337		89,742
Accumulated other comprehensive income				
Balance at January 1		336		180
Foreign currency translation adjustments		(654)		175
Transfer of realized gains included in net income, net of tax		-		(19)
Balance at December 31		(318)		336
Retained earnings				
Balance at January 1		111,214		83,473
Adoption of SFAS 158 (Note 3)		(1,518)		-
Net income		29,773		28,242
Dividends		(2,326)		(501)
Balance at December 31		137,143		111,214
Total shareholders' equity at December 31		**231,703**		**198,721**

Note 1: Organization

OAO Tatneft (the "Company") and its subsidiaries (jointly referred to as "the Group") are engaged in crude oil exploration, development and production principally in the Republic of Tatarstan ("Tatarstan"), a republic within the Russian Federation. The Group also engages in refining and marketing of crude oil and refined products as well as production and marketing of petrochemicals activities, as further described in Note 19.

In 2005 the Company disposed of a controlling interest in OAO Bank Zenit ("Bank Zenit") and all of its interest in AB Devon-Credit ("Bank Devon-Credit"). The Group accounted for its investments in Banking Group Zenit-Devon-Credit under the equity method as of December 31, 2006 and 2005. The results of operations, financial position and cash flows of these entities were included in the Group's consolidated financial statements in prior periods, such periods may not be comparable with the current year presentation.

The Company was incorporated as an open joint stock company effective January 1, 1994 (the "privatization date") pursuant to the approval of the State Property Management Committee of the Republic of Tatarstan (the "Government"). All assets and liabilities previously managed by the production association Tatneft, Bugulminsky Mechanical Plant, Menzelinsky Exploratory Drilling Department and Bavlinsky Drilling Department were transferred to the Company at their book value at the privatization date in accordance with Decree No. 1403 on Privatization and Restructuring of Enterprises and Corporations into Joint-Stock Companies. Such transfers were considered transfers between entities under common control at the privatization date, and were recorded at book value.

At December 31, 2006 and 2005, the Government, through its wholly owned company, OAO Svyazinvestneftekhim, held 36% of the common shares of the Company. As further described in Note 17, the Government owns a "Golden Share" which carries the right to, *inter alia*, veto certain decisions taken at meetings of the shareholders and the Board of Directors. The Government of Tatarstan is able to exercise significant influence through its ownership interest in the Company, its legislative, taxation and regulatory powers, its representation on the Board of Directors and informal influence. The Government has used its influence in the past to facilitate actions that may not maximize shareholder value, such as maintaining employment levels, increasing expenditure on social assets, selling oil to certain customers, transferring exploration or production licenses to small Tatarstan oil companies (including companies not affiliated with the Group), acquiring specified companies or taking actions to raise funds for the benefit of Tatarstan (see Note 20).

The Government of Tatarstan controls or exercises significant influence over a number of the Group's suppliers, such as OAO Tatenergo, a major supplier of electricity to the Group, and a number of the Group's ultimate customers including OAO TAIF. Consequently, the Group may be subject to pressures to enter into transactions that the Group might not otherwise contemplate with suppliers and contractors controlled or significantly influenced by the Government. Related party transactions are further disclosed in Note 20.

On June 30, 2006, the Company's Board of directors approved a plan to remove the Company's securities from listing on the New York Stock Exchange (the "NYSE") and terminate the registration of such securities with the U.S. Securities and Exchange Commission (the "SEC"). On August 18, 2006, the Company notified the NYSE of its intention to delist its securities and on September 5, 2006, the Company filed Form 25 with the SEC to remove its securities from listing on the NYSE. The Company's application on Form 25 became effective and the trading of its securities on the NYSE ceased on September 14, 2006. As a result the Company's Depositary Receipts are no longer listed on the NYSE. On December 15, 2006, the Company filed an application on Form 15 to terminate the registration of its securities with the SEC, which became effective on March 16, 2007. Consequently, the Company is no longer subject to the reporting requirements of the Securities Exchange Act of 1934, including the filing of annual report on Form 20-F. At the same time the Company maintains a Global Depositary Receipts program and its GDRs are listed on the London Stock Exchange.

Note 2: Basis of Presentation

The entities of the Group maintain their accounting records and prepare their statutory financial statements principally in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR"). The accompanying financial statements have been prepared from these accounting records and adjusted as necessary to comply with accounting principles generally accepted in the United States of America ("US GAAP"). The principal differences between RAR and US GAAP relate to: (1) valuation and depreciation of property, plant and equipment; (2) foreign currency translation; (3) deferred income taxes; (4) valuation allowances for unrecoverable assets; (5) capital leases; (6) stock option transactions; (7) accounting for investments in oil and gas properties; (8) recognition and disclosure of guarantees, contingencies and commitments; (9) accounting for asset retirement obligation; (10) business combinations and goodwill; and (11) consolidation and accounting for subsidiaries, equity investees and variable interest entities ("VIEs").

Note 2: Basis of Presentation (continued)

Use of estimates in the preparation of financial statements. The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosures of contingent assets and liabilities. While management uses its best estimates and judgments, actual results could differ from those estimates and assumptions used. Among the estimates made by the management are: in-process inventories, assets valuation allowances, depreciable lives, oil and gas reserves, dismantling costs and income taxes.

Foreign currency transactions and translation. The functional currency of the Group, except for subsidiaries located outside of the Russian Federation is the Russian Rouble because the majority of its revenues, costs, property and equipment purchased, debt and trade liabilities are either priced, incurred, payable or otherwise measured in Russian Roubles. Accordingly, transactions and balances not already measured in Russian Roubles (primarily US Dollars) have been re-measured into Russian Roubles in accordance with the relevant provisions of US Statement of Financial Accounting Standards (“SFAS”) No. 52, *“Foreign Currency Translation”*.

Under SFAS No. 52, revenues, costs, capital and non-monetary assets and liabilities are translated at historical exchange rates prevailing on the transaction dates. Monetary assets and liabilities are translated at exchange rates prevailing on the balance sheet date. Exchange gains and losses arising from re-measurement of monetary assets and liabilities that are not denominated in Russian Roubles are credited or charged to operations.

For operations of subsidiaries located outside of the Russian Federation, that primarily use US Dollars as the functional currency, adjustments resulting from translating foreign functional currency assets and liabilities into Russian Roubles are recorded in a separate component of shareholders’ equity entitled accumulated other comprehensive income. Gains or losses resulting from transactions in other than the functional currency are reflected in net income.

Exchange rates, restrictions and controls. At present, the Russian Rouble is not a fully convertible currency outside of the Russian Federation and, further, the Company throughout 2005 was required to sell up to 10% (from December 27, 2004) of its hard currency earnings for Russian Roubles. In May 2006, the Central Bank abolished the requirement to convert hard currency proceeds. Within the Russian Federation, official exchange rates are determined daily by the Central Bank of Russia (“CBR”). Market rates may differ from the official rates but the differences are, generally, within narrow parameters monitored by the CBR. Accordingly, the translation of foreign currency denominated assets and liabilities into Russian Roubles does not indicate that the Group could realize or settle, in Russian Roubles, the reported values of these assets and liabilities. The official rate of exchange of the Russian Rouble (“RR”) to the US Dollar (“US $”) at December 31, 2006 and 2005 was RR 26.33 and RR 28.78 to US $1.00, respectively.

Barter transactions. Transactions settled by barter are included in the accompanying consolidated balance sheets and statements of operations on the same basis as cash transactions.

Barter transactions relate to sales of crude oil and refined products and are generally transacted through a chain of non-cash transactions involving several companies. In such cases, both sales and purchases are recorded as a result of the barter transaction. Barter sales are recognized at fair value as disclosed in Note 3 “Non-monetary transactions”.

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

Principles of consolidation and long-term investments. The accompanying consolidated financial statements include the operations of all majority-owned, controlled subsidiaries and VIEs, where the Group is the primary beneficiary. In 2006 the Company determined that, despite only 40% direct ownership interest, ZAO Nizhnekasmk Oil Refinery (“NNPZ”) was a variable interest entity and that the Group was its primary beneficiary. Accordingly, the financial position, results of operation and cash flows of NNPZ have been included in the consolidated financial statements as of and for the year ended December 31, 2006. Joint ventures and affiliates in which the Group has significant influence but not control are accounted for using the equity method. Intercompany transactions and accounts are eliminated on consolidation. Other long-term investments are carried at cost and adjusted for estimated impairment. The Group reviews equity method investments for impairment on an annual basis, and records an impairment when circumstances indicate that an other-than-temporary decline in value has occurred. The amount of the impairment is based on quoted market prices, where available, or other valuation techniques, including discounted cash flows. Equity investments and investments in other companies are included in “Long-term investments” in the consolidated balance sheet.

Note 3: Summary of Significant Accounting Policies

Cash equivalents. Cash equivalents are highly liquid short-term investments that are readily convertible into known amounts of cash and have original maturities within three months from their date of purchase. They are carried at cost plus accrued interest, which approximate fair value.

Inventories. Inventories of crude oil, refined oil products, materials and supplies, and finished goods are valued at the lower of cost or net realizable value. For inventories valued at cost, the Group uses the weighted-average-cost method. Costs include both direct and indirect expenditures incurred in bringing an item or product to its existing condition and location, but not unusual/non-recurring costs or research and development costs.

Investments. Debt and equity securities are classified into one of three categories: trading, available-for-sale, or held-to-maturity and consist of certificates of deposit and debt and equity securities classified as available-for-sale or trading.

Securities classified as trading are bought and held principally for the purpose of selling them in the near term. Trading securities are carried at fair value on the consolidated balance sheet. In determining fair value, trading securities are valued at the last trade price if quoted on an exchange or, if traded over-the-counter, at the last bid price. Unrealized and realized gains and losses on trading securities are included in other income of the consolidated statements of operations and comprehensive income.

Securities are classified as available-for-sale when, in management's judgment, they may be sold in response to or in anticipation of changes in market conditions. Available-for-sale securities are carried at estimated fair values on the consolidated balance sheet. Unrealized gains and losses on available-for-sale securities are reported net as increases or decreases to accumulated other comprehensive income. The specific identification method is used to determine realized gains and losses on available-for-sale securities.

If the decline in fair value of an investment below the accounting basis is other-than-temporary, the carrying value of the securities is reduced and a loss in the amount of any such decline is recorded. No such reductions have been required during the past two years.

Long-term investments not designated as available-for-sale or trading securities are recorded at cost because they are not traded on any market and it is not practicable to determine their fair value.

Accounts receivable. Trade accounts receivable are stated at their transaction amounts net of allowances for doubtful accounts. Allowances are recorded against trade receivables whose recovery or collection has been identified as doubtful. Estimates of allowances require the exercise of judgment and the use of assumptions.

Loans receivable. Loans originated by the Group by providing money directly to the borrower are carried at amortized cost less allowance for loan impairment. Loans are recognized when cash is advanced to borrowers.

Oil and gas exploration and development cost. Oil and gas exploration and production activities are accounted for using the successful efforts method whereby costs of acquiring unproved and proved oil and gas property as well as costs of drilling and equipping productive wells, including development dry holes, and related production facilities are capitalized. Exploration expenses, including geological and geophysical expenses and the costs of carrying and retaining undeveloped properties, are expensed as incurred. The costs of exploratory wells that find oil and gas reserves are capitalized pending determination of whether proved reserves have been found. If proved reserves are not found exploratory well costs are expensed. In an area requiring a major capital expenditure before production can begin, an exploratory well remains capitalized if sufficient reserves are discovered to justify its completion as a production well, and additional exploration drilling is underway or firmly planned. The Group does not capitalize the costs of other exploratory wells for more than one year unless proved reserves are found.

Note 3: Summary of Significant Accounting Policies (continued)

Impairment of long-lived assets. Long-lived assets, including proved oil and gas properties at a field level, are assessed for possible impairment in accordance with SFAS No. 144, "*Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144").* Property, plant and equipment used in operations are assessed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recovered. If the carrying amounts are not expected to be recovered by undiscounted pretax future cash flows, the assets are impaired and an impairment loss is recorded in the periods in which the determination of impairment is made. The amount of impairment is determined based on the estimated fair value of the assets determined by discounting anticipated future net cash flows or based on quoted market prices in active markets, if available. In the case of oil and gas fields, the net present value of future cash flows is based on management's best estimate of future prices, which is determined with reference to recent historical prices and published forward prices, applied to projected production volumes of individual fields and discounted at a rate commensurate with the risks involved. The projected production volumes represent reserves, including risk-adjusted probable reserves, expected to be produced based on a stipulated amount of capital expenditures. The production volumes, prices and timing of production are consistent with internal projections and other externally reported information. The price and cost outlook assumptions used in impairment reviews differ from the assumptions used in the Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserve Quantities. In that disclosure, SFAS No. 69, *"Disclosures about Oil and Gas Producing Activities"* requires the use of prices and costs at the balance sheet date, with no projection of future changes in those assumptions.

Individual assets are grouped for impairment purposes at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets - generally on a field-by-field basis for exploration and production assets, at an entire complex level for refining assets or at a site level for service stations. Long-lived assets committed by management for disposal within one year, and meet the other criteria for held for sale pursuant to SFAS 144, are accounted for at the lower of amortized cost or fair value, less cost to sell. Costs of unproved oil and gas properties are evaluated periodically and any impairment assessed is charged to expense.

Depreciation, depletion and amortization. The Group calculates depletion expense for acquisition costs of proved properties using the units-of-production method over proved oil and gas reserves. Depreciation and depletion expense for oil and gas production equipment and wells is calculated using the units-of-production method for each field over proved developed oil and gas reserves. Depreciation of all other plant and equipment is determined on the straight-line method based on estimated useful lives which are as follows:

	Years
Buildings and constructions	25 - 33
Machinery and equipment	5 - 15

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

Capitalized interest. Interest from external borrowings is capitalized on major projects. Capitalized interest is added to the cost of the underlying asset and is amortized over the useful lives of the assets in the same manner as the underlying assets.

Asset retirement obligations. The Group recognizes a liability for the fair value of legally required asset retirement obligations associated with long-lived assets in the period in which the retirement obligations are incurred. The Group capitalizes the associated asset retirement costs as part of the carrying amount of the long-lived assets. Over time the liability is increased for the change in its present value, and the capitalized cost in properties, plant and equipment is depreciated on a units-of-production basis over the useful life of the related assets.

Property dispositions. When complete units of depreciable property are retired or sold, the asset cost and related accumulated depreciation are eliminated, with any gain or loss reflected in the consolidated statements of operations and comprehensive income. When less than complete units of depreciable property are disposed of or retired, the difference between asset cost and sales proceeds, if any, is charged or credited to accumulated depreciation.

Note 3: Summary of Significant Accounting Policies (continued)

Capital leases. Capital leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the interest charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liabilities. Interest charges are charged directly to the consolidated statements of operations and comprehensive income.

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term unless the leased assets are capitalized by virtue of the terms of the lease agreement granting the Group with ownership rights over the leased assets by the end of the lease term or containing a bargain purchase option. In this case, capitalized assets are depreciated over the estimated useful life of the asset regardless of the lease term. Depreciation of assets held under capital leases is included in depreciation, depletion and amortization charge.

Leases where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statements of operations and comprehensive income on a straight-line basis over the lease term.

Environmental expenditures. Environmental expenditures are expensed or capitalized, depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations, and do not have a future economic benefit, are expensed. Liabilities for these expenditures are recorded on an undiscounted basis when environmental assessments or cleanups are probable and the costs can be reasonably estimated.

Pension and post-employment benefits. The Group has various pension plans covering substantially all eligible employees and members of management. The amount of contributions, frequency of benefit payments and other conditions of these plans are regulated by the "Statement of Organization of Non-governmental Pension Benefits for OAO Tatneft Employees" and the contracts concluded between the Company or its subsidiaries, management, and the non-profit organization "National non-governmental pension fund". In accordance with these contracts the Group is committed to make certain contributions on behalf of all employees and guarantees a minimum benefit upon retirement. Contributions or benefits are generally based upon grade and years until official retirement age (age 60 for men and 55 for women), and in the case of management are based upon years of service. In accordance with the provisions of collective agreements concluded on an annual basis between the Company or its subsidiaries and their employees, the Group is obligated to pay certain post-employment benefits, the amounts of which are generally based on salary grade and years of service at the time of retirement. There are no contribution requirements for these benefits, which are paid by the Group directly to employees. The Group's mandatory contributions to the governmental pension scheme are expensed when incurred. Refer also to recent accounting pronouncements below.

Revenue recognition. Revenues from the production and sale of crude oil, petroleum and petrochemical products and all other products are recognized when deliveries of products to final customers are made, title passes to the customer, collection is reasonably assured and sales price to final customers is fixed or determinable. Revenues include excise on petroleum products sales and duties on export sale of crude oil and petroleum products.

Other operating revenues in the consolidated statements of operations and comprehensive income include sales of refined products, petrochemicals and other products and services.

Shipping and handling costs. Shipping and handling costs are included in Transportation expenses caption in the consolidated statements of operations and comprehensive income.

Non-monetary transactions. In accordance with Statement of Financial Accounting Standards No. 153 *"Exchanges of Non-monetary Assets"* such transactions are recorded based on the fair values of the assets (or services) involved which is the same basis as that used in monetary transactions. Thus, the cost of a non-monetary asset acquired in exchange for another non-monetary asset is the fair value of the asset surrendered to obtain it, and a gain or loss is recognized on the exchange if the carrying amount of the asset surrendered differs from its fair value. The fair value of the asset received is used to measure the cost if it is more clearly evident than the fair value of the asset surrendered.

Note 3: Summary of Significant Accounting Policies (continued)

Stock-based compensation. At December 31, 2006 and 2005, the Company had one stock-based compensation plan, which is described more fully in Note 18, Stock-Based Compensation. On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123-R"). SFAS No. 123-R requires all share-based payments to employees, including employee stock options, be measured at fair value and expensed over the requisite service period (generally the vesting period) for awards expected to vest. The Company elected to use the modified prospective method for adoption, which required compensation expense to be recognized for all unvested stock options beginning in the first quarter of adoption. Since the options are granted with an option repurchase feature and because the Company expects to repurchase the stock options after vesting, the Company accounts for its options under the liability method prescribed in SFAS 123-R. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the Company's valuation techniques previously utilized for stock options in footnote disclosures under SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS 123") and compensation expense recognized under Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Such value is recognized as expense over the requisite service period, net of estimated forfeitures, if any, with a corresponding liability to other accounts payable and accrued liabilities. (For further discussion on the impact of the adoption of SFAS No. 123-R, refer to this note under New Accounting Pronouncements – SFAS No. 123-R.). Prior to adoption, the Group accounted for its stock option plan by measuring compensation cost using the variable method presented under APB 25 and FASB Interpretation FIN 44: "Accounting for Certain Transactions involving Stock Compensation and interpretation of APB Opinion No. 25." The table reconciles the Company's reported information under APB 25 in 2005 to the SFAS 123 pro-form disclosures.

	Year ended December 31, 2005
Income before cumulative effect of change in accounting principle	28,242
Add: Stock-based employee compensation expense (APB 25) included in reported net income	894
Deduct: Total stock-based employee compensation expense (SFAS 123) determined under fair value based method for all awards	(913)
Common share dividends	(501)
Preferred share dividends	-
Pro forma net income available to common and preferred shareholders, net of dividends	27,722
Earnings per common share:	
Basic – as reported	13.19
Basic – pro forma	13.18
Diluted – as reported	13.13
Diluted – pro forma	13.12
Earnings per preferred share:	
Basic – as reported	12.94
Basic – pro forma	12.93
Diluted – as reported	12.88
Diluted – pro forma	12.87

Income taxes. Deferred income tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, except for deferred taxes on income considered to be permanently reinvested in foreign subsidiaries. Deferred tax assets and liabilities are measured using enacted tax rates in the periods in which these temporary differences are expected to reverse. Valuation allowances are provided for deferred income tax assets when management believes that it is more likely than not that such assets will not be realized.

Note 3: Summary of Significant Accounting Policies (continued)

Minority interest. Minority interest represents the minority shareholders' proportionate share of the equity of the Group's subsidiaries. This has been calculated based upon the minority interest ownership percentage of these subsidiaries.

Net income per share. Basic income per share is calculated using the two class method of computing income per share. Under this method, net income is reduced by the amount of dividends declared in the current period for each class of shares, and the remaining income is allocated to common and preferred shares to the extent that each class may share in income if all income for the period had been distributed. Diluted income per share reflects the potential dilution arising from options granted to senior managers and the Directors of the Group.

Treasury shares. Common shares of the Company owned by the Group at the balance sheet date are designated as treasury shares and are recorded at cost using the weighted-average method. Gains on resale of treasury shares are credited to additional paid-in capital whereas losses are charged to additional paid-in capital to the extent that previous net gains from resale are included therein or otherwise to retained earnings.

Guarantees. The Group recognizes a liability for the fair value of the obligation it assumes under the guarantee in accordance with the provisions of Financial Accounting Standard Board ("FASB") issued Interpretation No. 45, *"Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others"*.

Variable interest entities. In January 2003, FASB issued FIN 46 and in December 2003, FASB issued a revised interpretation of FIN 46 ("FIN 46-R"), which superseded FIN 46 and clarified and expanded current accounting guidance for Variable Interest Entities ("VIEs".) FIN 46-R clarifies when a company should consolidate in its financial statements the assets, liabilities and activities of a VIE. FIN 46-R provides general guidance as to the definition of a variable interest entity and requires it to be consolidated if a party with an ownership, contractual or other financial interest absorbs the majority of the VIE's expected losses, or is entitled to receive a majority of the residual returns, or both. A variable interest holder that consolidates the VIE is the primary beneficiary and is required to consolidate the VIE's assets, liabilities and non-controlling interests at fair value at the date the interest holder first becomes the primary beneficiary of the VIE. The Group adopted FIN 46 and FIN 46-R effective January 1, 2004.

Oil and oil products traders. The Group routinely enters into a number of transactions in the normal course of business with various crude oil and oil products traders. The Company or its subsidiaries do not hold an equity interest in any of the entities in question.

The Company has been unable to obtain the necessary financial information to determine whether these entities are variable interest entities or whether the Company is the primary beneficiary, principally due to legal and other barriers, privacy laws and information disclosure rules and practices.

Net sales activities with these entities in the years ended December 31, 2006 and 2005 were approximately RR 48,644 million and RR 46,631 million, of which RR 48,590 million and RR 44,994 million resulting from sales of crude oil and RR 54 million and RR 1,637 million from sales of oil products, respectively. Net purchasing activities accounted for approximately RR 9,064 million and RR 10,662 million all related to purchases of oil products in the years ended December 31, 2006 and 2005, respectively.

The Group's maximum exposure to loss because of its involvement with these entities is estimated to be approximately RR 3,159 million and RR 3,870 million, which primarily represents the Group's accounts receivable from these entities as of December 31, 2006 and 2005, respectively.

Recent accounting pronouncements:

Stock-based compensation. In December 2004, FASB issued SFAS No. 123R (revised 2004), *"Share Based Payment"* ("SFAS 123R"), which is a revision of SFAS 123 and supersedes APB 25. SFAS 123R prescribes the accounting for a wide range of share-based compensation arrangements, including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans; pro forma disclosure is no longer permitted. The cost of the equity instruments is to be measured based on fair value of the instruments on the date they are granted (with certain exceptions) and is required to be recognized over the period during which the employees are required to provide services in exchange for the equity instruments. The Group adopted SFAS 123R effective January 1, 2006 using the modified prospective method.

Since 2003, the Group accounted for its stock options under the variable accounting method under APB 25 and expensed all share-based payments which approximated the provisions of SFAS 123R, and all prior year outstanding stock option awards have vested. Therefore, the adoption of SFAS 123R did not materially change the Group's existing accounting practices or the amount of share-based compensation recognized in the consolidated financial statements.

Note 3: Summary of Significant Accounting Policies (continued)

Inventory costs. In November 2004, the FASB issued SFAS No. 151, "*Inventory Costs an amendment of ARB No. 43, Chapter 4"* ("SFAS 151"), which became effective for the Group on January 1, 2006. SFAS 151 requires that items, such as idle facility expense, excessive spoilage, double freight, and re-handling costs, be recognized as a current-period charge. The adoption of SFAS 151 on January 1, 2006 did not have a material impact on the Group's consolidated financial statements.

Nonmonetary exchanges of similar assets. In December 2004, the FASB issued SFAS No. 153, "*Exchanges of Nonmonetary Assets"* ("SFAS 153"), which became effective for the Group on January 1, 2006. SFAS 153 addresses the measurement of exchanges of nonmonetary assets. The guidance in APB 29 is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in APB 29, however, included certain exceptions to that principle. SFAS 153 amends APB 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The adoption of the provisions of SFAS 153 did not have a material impact on the Group's consolidated financial statements.

Accounting changes and error corrections. In May 2005, the FASB issued SFAS No. 154, *"Accounting changes and error corrections"* ("SFAS 154"), which became effective for the Group on January 1, 2006. SFAS 154 replaces APB Opinion No. 20, *"Accounting Changes"* ("APB 20"), and SFAS No. 3, *"Reporting Changes in Interim Financial Statements"*, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS 154 requires retrospective application to prior period's financial statements of all changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change, if a pronouncement which requires the change in accounting principle does not include specific transition provisions. SFAS 154 carries forward without change to the guidance contained in APB 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. The adoption of SFAS 154 on January 1, 2006 did not have a material impact on the Group's consolidated financial statements.

Conditional asset retirement obligations. In March 2005, the FASB issued Interpretation No. 47, *"Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143"* ("FIN 47"), which was adopted by the Group as of December 31, 2005. This interpretation clarifies that an entity is required to recognize a liability for a legal obligation to perform asset retirement activities when the retirement is conditional on a future event if the liability's fair value can be reasonably estimated. The adoption of FIN 47 did not have a material effect on the Group's consolidated financial statements.

Suspended well costs. In April 2005, the FASB issued FASB Staff Position FAS No. 19-1, *"Accounting for suspended well costs" ("FSP FAS 19-1")*, which the Group adopted on July 1, 2005. FSP FAS 19-1 amends SFAS 19 and applies to companies that follow the successful efforts method of accounting. FSP FAS 19-1 concludes that exploratory well costs should continue to be capitalized when the well has found a sufficient quantity of reserves to justify its completion as a producing well and an entity is making sufficient progress assessing the reserves and the economic and operating viability of the project. The adoption of the provisions of FSP FAS 19-1 did not have a material impact on the Group's consolidated financial statements.

Buy / sell transactions. In November 2004, the EITF began deliberating the accounting for buy/sell and related transactions as Issue No. 04-13, *"Accounting for Purchases and Sales of Inventory with the Same Counterparty,"* and reached a consensus at its September 2005 meeting. The EITF concluded that purchases and sales of inventory, including raw materials, work-in-progress or finished goods, with the same counterparty that are entered into "in contemplation" of one another should be combined and reported net for purposes of applying APB Opinion No. 29. Additionally, the EITF concluded that exchanges of finished goods for raw materials or work-in-progress within the same line of business is not an exchange subject to APB Opinion No. 29 and should be recorded at fair value. The new guidance is effective prospectively, and became effective for the Group beginning April 1, 2006, for new arrangements entered into, and for modifications or renewals of existing arrangements. The adoption of this Issue on April 1, 2006 did not have a material impact on the Group's consolidated financial statements.

Note 3: Summary of Significant Accounting Policies (continued)

Impairment of investments. In November 2005, FASB issued FSP FAS 115-1/FAS 124-1, *"The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("FSP 115-1/124-1")*, which became effective for the Group on January 1, 2006. FSP 115-1/124-1 provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other-than-temporary, and on measuring such impairment loss. FSP 115-1/124-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The adoption of this FSP on January 1, 2006 did not have a material impact on the Group's consolidated financial statements.

Presentation of taxes collected from customers. In June 2006, the FASB ratified the earlier EITF consensus on Issue 06-3, *"How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation),"* which will become effective for the Group on January 1, 2007. The new accounting standard requires that a company discloses its policy for recording taxes assessed by a governmental authority on a revenue-producing transaction between a seller and a customer. In addition, for any such taxes that are reported on a gross basis, a company is required to disclose the amounts of those taxes. The Group's current and expected policy in relation to Issue 06-3 is to present the relevant taxes on a gross basis.

Income tax uncertainties. FASB Interpretation No. 48, *"Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109"* ("FIN 48"). In July 2006, the FASB issued FIN 48, which will become effective for the Group on January 1, 2007. This standard clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements. A company can only recognize the tax position in the financial statements if the position is more-likely-than-not to be upheld on audit based only on the technical merits of the tax position. This accounting standard also provides guidance on thresholds, measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition that is intended to provide better financial-statement comparability among different companies. The adoption of FIN 48 is not expected to have a material impact on the Company's consolidated financial statements.

Fair value measurements. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," ("SFAS 157") which provides enhanced guidance for using fair value to measure assets and liabilities, which will become effective for the Group on January 1, 2008. SFAS 157 establishes a common definition of fair value, provides a framework for measuring fair value under US GAAP and expands disclosure requirements about fair value measurements. The impact, if any, to the Group from the adoption in 2008 will depend on the Company's assets and liabilities at that time that are required to be measured at fair value.

Fair value option. In February 2007, FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities"* ("SFAS 159"). This Statement expands the possibility of using fair value measurements and permits enterprises to choose to measure certain financial assets and financial liabilities at fair value. Enterprises shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent period. The Statement is effective in the first quarter 2008. The Group is currently assessing the effect of adoption of SFAS 159.

Pension and Postretirement Plans. In September 2006, the FASB issued SFAS No. 158, *"Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)"* ("SFAS 158"). This Statement requires an employer that sponsors one or more single-employer defined benefit plans to: (a) Recognize the funded status of a benefit plan in its statement of financial position; (b) Recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost; (c) Measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions); (d) Disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. The Company adopted the provisions of this Statement effective December 31, 2006, except for the requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end, which is not effective until December 31, 2008. The adoption of the provisions of SFAS 158 did not have a material impact on the Group's consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires the quantification of misstatements based on their impact to both the balance sheet and the income statement to determine materiality. The guidance provides for a one-time cumulative-effect adjustment to correct for misstatements for errors that were deemed immaterial under a company's prior approach but are material under the SAB 108 approach. SAB 108 is effective for the first annual period ending after November 15, 2006 with early application encouraged.

Note 3: Summary of Significant Accounting Policies (continued)

The transition provisions of SAB 108 permit the Company to adjust for the cumulative effect on retained earnings of immaterial errors related to the prior years. Such adjustments do not require previously filed reports with the SEC to be amended. The Company adopted SAB 108 as of December 31, 2006. In accordance with SAB 108, the Company has adjusted beginning retained earnings for the year ended December 31, 2006 in the accompanying consolidated financial statements for the adjustment described below.

Upon the adoption SFAS 158, the Company determined it had certain unrecorded pension and other post employment benefit obligations. As a result, the Company recorded an adjustment for the unrecorded pension and other post employment benefit obligation of RR 1,889 million, an adjustment for the unrecorded prepaid pension asset of RR 371 million, and an adjustment to decrease beginning retained earnings for the year-ended December 31, 2006 by RR 1,518 million.

Note 4: Acquisitions and Divestitures

International Petro-Chemical Growth Fund

In December 2005, Tatneft Oil AG, a subsidiary of the Company, acquired participation shares with a total value of US $394 million in an open-ended investment company International Petro-Chemical Growth Fund Limited ("IPCG Fund"), incorporated in Jersey, Channel Islands, by contributing 116 million ordinary shares of Tatneft and US $1 million in cash into the fund. IPCG Fund invests in debt and equity securities of companies operating in the Russian Federation in general, and the Republic of Tatarstan in particular with priority given to those entities operating in the oil and chemicals industry and, to a lesser extent, the banking sector. IPCG Fund is managed by MARS Capital Management Limited, a company regulated by Jersey Financial Services Limited. The Fund is an indirect shareholder of NNPZ and is expected to participate in the financing of the new refinery and petrochemical facility. At December 31, 2005, the Company owned approximately 93.81% of the total participation shares in IPCG Fund, and its equity investee Bank Zenit owned the remaining 6.19%. As a result, as of December 31, 2005 the 116 million ordinary shares contributed to IPCG Fund were accounted for as treasury shares of the Group.

In June 2006, additional investors contributed ownership interests in Bank Zenit to IPCG Fund in exchange for participation shares in the fund. As a result of these transactions, the Group's ownership interest in IPCG Fund decreased to 44.88%. Therefore in June 2006, the Company deconsolidated IPCG Fund and began accounting for its investments into IPCG Fund under the equity method.

In December 2006, the Group contributed an additional 18.5 million of Tatneft ordinary shares to IPCG Fund in exchange for US $86.8 million in participation shares.

In December 2006, the Group contributed all its shares (50% of all issued shares) of Tatoilgas AG, a Russian joint stock company with a net book value of RR 2,805 million, which were fair valued at US $30 million, into IPCG Fund in exchange for US $30 million in participation shares of the fund. As a result of this transaction, the Company recorded an impairment loss of RR 2,014 million.

Subsequent to these transactions, the Company's ownership interest in IPCG Fund was increased to 47.39%, which did not affect the accounting treatment of the Group's investments into the fund.

At December 31, 2006, IPCG Fund owned 142.2 million Tatneft ordinary shares, of which 47.39% are accounted for as treasury shares of the Group. As a result of the Group's change in interest during 2006, the Company released 74.8 million shares contributed to IPCG Fund previously classified as treasury shares of the Group recognizing an increase to additional paid in capital of RR 5,595 million. At December 31, 2006, IPCG Fund owned an indirect ownership interest in Bank Zenit of 49.99%.

Banking

In April 2005, the Group sold its 26.75% stake in Bank Zenit to three Cyprus based companies unrelated to the Group. The sales price of RR 1,214 million was determined based on the results of an independent valuation. The Group recorded a loss of RR 667 million as a result of this disposal. This transaction reduced the Group's ownership interest in Bank Zenit to 25.95%.

Note 4: Acquisitions and Divestitures (continued)

In May 2006, the Group increased its shareholding in Bank Zenit from 25.95% to 39.73% as a result of acquiring 2,935.3 million newly issued shares of the bank at their par value for RR 2,935.3 million. In March 2007, the Group disposed of 1,138 million of Bank Zenit shares for RR 1,787 million, decreasing the Company's ownership in Bank Zenit to 28.35%. The Group expects to record a gain of approximately RR 350 million as a result of this transaction.

Also, in June 2007 Bank Zenit carried out a private placement of 1,545 million newly issued ordinary shares to a private investor unrelated to the Group, resulting in the dilution of the Group's ownership in Bank Zenit to 24.56%.

In December 2005, the Group sold its 92% interest in Bank Devon-Credit for RR 858 million, to Bank Zenit incurring a loss of RR 438 million.

In June 2006 the Company increased its shareholding in Bank AK Bars from 29.46% up to 32.19% as a result of acquiring newly issued shares at their par value for RR 3,825 million. In May 2007, the Company subsequently disposed of its entire interest in Bank AK Bars for RR 6.8 billion to a third party. The Group expects to record a loss of approximately RR 900 million as a result of this transaction.

OAO Nizhnekasmk NPZ

In 2003 OAO Tataro-American Investments and Finance ("TAIF"), then a related party to the Group, brought a case before the Arbitration Court of Tatarstan Republic claiming a return of crude distilling unit (the "CDU") leased to OAO Nizhnekamsk NPZ, a subsidiary of the Group operating a refinery in Nizhnekamsk, Tatarstan (the "Refinery"), because of breach by OAO Nizhnekamsk NPZ of several provisions of the lease agreement dated December 29, 2001. The CDU was installed at the Refinery in 2002 and represents vital assets of the Refinery's operations. On October 6, 2003 the Arbitration Court ruled in favor of TAIF and this decision was reinforced by the Arbitration Court of Tatarstan Republic on January 13, 2004. Following a court order the CDU was returned to TAIF. As a result, in September 2005, the Group signed agreements to sell its share of the production assets and inventory of the Refinery to TAIF, including the refining units, for approximately RR 7.2 billion, net of VAT, incurring a loss of approximately RR 3.0 billion. The sales agreements provided TAIF the ability to repay the Company over a period not to exceed 18 months, incurring interest monthly on any unpaid portion based on the Russian Central Bank Refinancing Rate. During 2005, TAIF paid approximately RR 7.5 billion, net of VAT, including RR 265 million in interest and performance penalties, which has been reflected as interest income in the consolidated statements of operations and comprehensive income. As part of this transaction, TAIF also agreed to provide the Company's subsidiary OAO TKNK with a RR 344 million interest free loan maturing on December 31, 2007. In October 2005, the Group entered into a three year supply contract with TAIF in order to supply up to 650,000 tons per month of crude oil to TAIF at market price to be refined at the Refinery. In February 2006, the Company signed an additional sales agreement with TAIF, providing for the sale of additional refining assets for RR 198 million, net of VAT. The Company did not record any gain or loss as a result of this transaction.

Other

In April 2006 the Group acquired from a third party 100% of the outstanding shares of OAO "LDS-1000", the owner of the ice hockey arena in the city of Kazan, for RR 2.9 billion.

In August 2005, the Group acquired from a third party two land plots in the city of Kazan, Tatarstan, the total size of which is approximately 2 million square meters, for US $47 million. The acquisition was made on market terms for investment purposes. In June 2006, the Group disposed of one plot for US$ $3.1 million, recognizing a gain of RR 8 million. In May 2007, the Company disposed of the second plot for US$ 56.0 million, recognizing a gain of RR 268 million.

Note 5: Cash and Cash Equivalents, and Cash Flow Information

The consolidated statements of cash flows provide information about changes in cash and cash equivalents. At December 31, 2006 and 2005, cash and cash equivalents of the Group, include US Dollar denominated amounts of RR 294 million (US $11 million) and RR 4,299 million (US $149 million), respectively.

Note 6: Accounts Receivable

Accounts receivable are as follows:

	At December 31, 2006			At December 31, 2005		
	Total accounts receivable	Accounts receivable from related parties	Accounts receivable from third parties	Total accounts receivable	Accounts receivable from related parties	Accounts receivable from third parties
Trade - domestic	6,627	330	6,297	6,956	682	6,274
Trade - export (US $719 million and US $586 million at December 31, 2006 and 2005, respectively)	18,924	-	18,924	16,880	4,346	12,534
Other receivables	2,251	165	2,086	1,606	207	1,399
Total accounts receivable, net	**27,802**	**495**	**27,307**	**25,442**	**5,235**	**20,207**

Accounts receivables are presented net of an allowance for doubtful accounts of RR 317 million and RR 792 million at December 31, 2006 and 2005, respectively.

Note 7: Short and Long-Term Investments

Short-term investments are classified as follows:

	At December 31, 2006	At December 31, 2005
Certificates of deposit	12,760	6,780
Trading securities	13,987	2,366
Total short-term investments	**26,747**	**9,146**
Less: due from related parties	(10,922)	(4,030)
Short-term investments, net	**15,825**	**5,116**

Trading securities are held in the Group with the objective of earning profits on short-term price differences.

Short-term investments classified as trading securities are as follows:

	At December 31, 2006	At December 31, 2005
Russian government debt securities	1,066	340
Corporate debt securities	3,624	815
Equity securities	9,297	1,211
Total trading securities	**13,987**	**2,366**
Less: corporate debt securities due from related parties	(1,172)	-
Trading securities, net	**12,815**	**2,366**

For the year ended December 31, 2006 the Group recognized RR 1,407 million in mark-to-market gains on trading securities, which are including in other income (expense) in the consolidated statements of operations and comprehensive income.

Note 7: Short and Long-Term Investments (continued)

Long-term investments are as follows:

	Ownership percentage at	Net book value at		Group's share of income for the year ended December 31,	
	December 31, 2006	December 31, 2006	December 31, 2005	2006	2005
Investments in equity affiliates and joint ventures:					
ZAO Tatex	50	2,028	2,001	222	363
IPCG Fund (Note 4)	47	7,070	-	(986)	-
Bank AK Bars (Note 4)	32	7,521	3,128	494	467
Bank Zenit (Note 4)	40	5,057	1,740	837	348
Other	20-50	530	298	54	101
Total investments in equity affiliates and joint ventures / income		**22,206**	**7,167**	**621**	**1,279**
Long-term investments, at cost:					
ZAO Ukrtatnafta	9	504	504		
ZAO OLK Center-Kapital	13	193	193		
Other	0-20	315	463		
Total long-term investments, at cost		**1,012**	**1,160**		
Long-term certificates of deposit		1,250	-		
Less: due from related parties		(1,000)	-		
Total long-term investments		**23,468**	**8,327**		

Long-term investments not designated as available-for-sale or trading securities are recorded at cost because they are not traded on any market and it is not practicable to determine their fair value.

During the years ended December 31,2006 and 2005 the Group received dividends from equity investees of RR 705 million and RR 510 million, respectively.

The condensed financial information of the Group's equity basis investments is as follows:

	2006	2005
Sales / interest income	26,240	19,601
Net income	6,017	4,700
Current assets	205,562	118,302
Long-term assets	37,303	13,163
Current liabilities	151,975	105,528
Long-term liabilities	19,252	6,951

On October 23, 2006, the Group entered into a five-year management agreement with the Tatarstan government for the fiduciary management of 426,293,985 ordinary shares, or 28.78%, of ZAO Ukrtatnafta held by the Tatarstan government. Under this agreement, the Group is entitled to manage these shares subject to the written approval of the Tatarstan government. The Group's investment of 8.6% in Ukrtatnafta is accounted for under cost method in these consolidated financial statements as Management believes the Group does not have the ability to exercise significant influence over ZAO Ukrtatnafta.

Note 8: Inventories

Inventories are as follows:

	At December 31, 2006	At December 31, 2005
Materials and supplies	5,186	4,729
Crude oil	3,577	2,869
Refined oil products	1,308	1,402
Petrochemical supplies and finished goods	1,332	948
Total inventories	**11,403**	**9,948**

Note 9: Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets are as follows:

	At December 31, 2006	At December 31, 2005
VAT recoverable	7,396	5,462
Advances	5,888	526
Prepaid export duties	2,628	6,238
Prepaid income tax	2,188	2,244
Prepaid transportation expenses	414	392
Deferred tax asset (Note 16)	288	749
Other	3,837	3,197
Prepaid expenses and other current assets	**22,639**	**18,808**

Note 10: Loans Receivable

	At December 31, 2006	At December 31, 2005
Notes receivable	5,475	8,417
Loans to employees	1,110	1,656
Other foreign currency denominated loans receivable	790	-
Other Russian Rouble denominated loans receivable	10,418	6,671
Total loans and notes receivable	**17,793**	**16,744**
Less: current portion of loans receivable and short-term loans	(5,151)	(4,497)
Less: due from related parties (Note 20)	(7,645)	(7,713)
Total long-term loans and notes receivable	**4,997**	**4,534**

Loans and notes receivable reported as of December 31, 2006 in the amounts of RR 2,260 million, RR 1,867 million and RR 4,996 million mature in 2008, 2009 and after 2010, respectively.

Note 11: Long-term assets

	At December 31, 2006	At December 31, 2005
Prepaid pension assets (Note 15)	502	-
Non-current deferred tax assets (Note 16)	447	-
Long-term accounts receivable	280	992
Other long-term assets	450	341
Total loans and notes receivable and advances	**1,679**	**1,333**

Note 12: Property, Plant and Equipment

Property, plant and equipment are as follows:

	Cost	Accumulated depreciation, depletion and amortization	Net book value
Oil and gas properties	258,908	121,215	137,693
Buildings and constructions	31,811	10,898	20,913
Machinery and equipment	50,138	40,381	9,757
Assets under construction	10,176	-	10,176
December 31, 2006	**351,033**	**172,494**	**178,539**
Oil and gas properties	261,983	123,184	138,799
Buildings and constructions	29,084	10,190	18,894
Machinery and equipment	48,945	37,990	10,955
Assets under construction	5,564	-	5,564
December 31, 2005	**345,576**	**171,364**	**174,212**

As stated in Note 3, the Group calculates depreciation, depletion and amortization using the units-of-production method over proved or proved developed oil and gas reserves depending on the nature of the costs involved. The proved or proved developed reserves used in the units-of-production method assume the extension of the Group's production license beyond their current expiration dates until the end of the economic lives of the fields as discussed below in further detail.

The Group's oil and gas fields are located principally on the territory of Tatarstan. The Group obtains licenses from the governmental authorities to explore and produce oil and gas from these fields. Most of the Group's existing production licenses expire from 2013 to 2019, and the license for the Group's largest field, Romashkinskoye, expires in 2038. The economic lives of the Group's licensed fields extend beyond these dates. Under Russian law, the Group is entitled to renew the licenses to the end of the economic lives of the fields, provided certain conditions are met. Article 10 of the Subsoil Law provides that a license to use a field "shall be" extended at its scheduled termination at the initiative of the subsoil user if necessary to finish production in the field, provided that there are no violations of the conditions of the license. The legislative history of Article 10 indicates that the term "shall" replaced the term "may" in August 2004, clarifying that the subsoil user has the right to extend the license term so long as it has not violated the conditions of the license. In 2006 the Group received a written confirmation from the Federal Regional Agency for Subsoil Use under the Ministry of Natural Resources of the Russian Federation confirming that, as of the date, it has not identified any violations of the terms of the Group's licenses that could prevent their extension and that, based on approved development plans and in accordance with the Subsoil Law, the Group's licenses will be extended at the Group's request. In addition, in August 2006, the term of the Group's license to produce oil and gas from the Group's largest field, Romashkinsokoye, was extended through 2038. The Group's right to extend licenses is, however, dependent on the Group continuing to comply with the terms of the licenses, and management has the ability and intent to do so. Management plans to request the extension of the licenses that have not yet been extended. The Group's current production plans are based on the assumption, which management considers to be reasonably certain, that the Group will be able to extend all existing licenses. These plans have been designed on the basis that the Group will be producing crude oil through the economic lives of the fields and not with a view to exploiting the Group's reserves to maximum effect only through the license expiration dates.

Note 12: Property, Plant and Equipment (continued)

Management is reasonably certain that the Group will be allowed to produce oil from the Group's reserves after the expiration of existing production licenses and until the end of the economic lives of the fields. "Reasonable certainty" is the applicable standard for defining proved reserves under the SEC's Regulation S-X, Rule 4-10. Accordingly, management has included in proved reserves in the supplementary information on oil and gas exploration and production activities of the consolidated financial statements as of and for the year ended December 31, 2006 all reserves that otherwise meet the standards for being characterized as "proved" and that the Group estimates the Group can produce through the economic lives of Group's licensed fields.

Proved reserves generally should be limited to those that can be produced through the license expiration date unless there is a long and clear track record which supports the conclusion that the extension of the license will be granted as a matter of course. The Group believes that the extension of the licenses is a matter of course as fully described above. To assist the financial statement reader in understanding the proved oil reserves that will be produced during the existing license period and those that will be produced during the period of the expected license extension, the proved oil reserves have been presented separately for each of these two periods in the accompanying supplementary unaudited oil and gas information (see SFAS No. 69, "*Disclosures about Oil and Gas Producing Activities*").

Asset Retirement Obligations. Effective January 1, 2003, the Group adopted SFAS 143 which applies to legal obligations associated with the retirement of tangible long-lived assets. SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Subsequently, the liability is accreted for the passage of time and the related asset is depreciated over its estimated useful life. The adoption of SFAS 143 affected the accounting and reporting of the assets, liabilities and expenses related to these obligations.

The Group has numerous asset removal obligations that it is required to perform under law or contract once an asset is permanently taken out of service. The Group's field exploration, development, and production activities include assets related to: well bores and related equipment and operating sites, gathering and oil processing systems, oil storage facilities and pipelines to main transportation trunks. Generally, the Group's licenses and other operating permits require certain actions to be taken by the Group in the abandonment of these operations. Such actions include well abandonment activities, equipment dismantlement and other reclamation activities. The Group's estimates of future abandonment costs consider present regulatory or license requirements and are based upon management's experience of the costs and requirement for such activities. Most of these costs are not expected to be incurred until several years, or decades, in the future and will be funded from general Group resources at the time of removal. The Group is not subject to any legal or contractual obligations, to retire or otherwise abandon petrochemical, refining and marketing and distribution assets. Inasmuch as the regulatory and legal environment in Russia continues to evolve, there could be future changes to the requirements and costs associated with abandoning long-lived assets.

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

The following tables summarize the Group's asset retirement obligations and asset retirement costs activities for the years ended December 31:

Asset Retirement Obligations

	2006	2005
Balance, beginning of year	**26,262**	**23,803**
Accretion of discount	2,626	2,380
New obligations	147	156
Spending on existing obligations	(45)	(77)
Balance, end of year	**28,990**	**26,262**
Less: current portion of asset retirement obligations (Note 14)	(67)	(32)
Long-term balance, end of year	**28,923**	**26,230**

Note 12: Property, Plant and Equipment (continued)

Asset Retirement Costs

	2006	2005
Gross balance, beginning of year	**15,158**	**15,002**
New obligations	147	156
Gross balance, end of year	**15,305**	**15,158**
Less accumulated depreciation, depletion and amortization	(2,516)	(2,119)
Net balance, end of year	**12,789**	**13,039**

The Group's asset retirement costs are included within oil and gas properties.

Capital leases. The Group leases machinery and equipment. In 2006 and 2005 the Group capitalized leased assets in the amount of RR 1,689 million and RR 677 million and made lease payments of RR 1,313 million and RR 978 million, respectively.

The following is an analysis of the leased property under capital leases:

	At December 31, 2006	At December 31, 2005
Machinery and equipment	5,830	4,141
Less: accumulated amortization	(2,644)	(1,647)
	3,186	**2,494**

The following is a schedule by year of future lease payments under capital leases together with the present value of the future minimum lease payments as of December 31, 2006:

Year ended December 31:	
2007	865
2008	188
2009	125
2010	106
2011	35
Total future lease payments	**1,319**
Less interest	(189)
Present value of future minimum lease payments	**1,130**
Less current portion	(865)
Long-term portion of capital lease obligations	**265**

Social assets. During the years ended December 31, 2006 and 2005 the Group transferred social assets with a net book value of RR 40 million and RR 352 million, respectively, to local authorities. At December 31, 2006 and December 31, 2005, the Group held social assets with a net book value of RR 3,339 million and RR 3,906 million all of which were constructed after the privatization date. The social assets comprise mainly dormitories, hotels, gyms and other facilities. The Group may transfer some of these social assets to local authorities in the future, but does not expect these to be significant. The Group incurred social infrastructure expenses of RR 288 million and RR 164 million for the years ended December 31, 2006 and 2005, respectively, for maintenance that mainly relates to housing, schools and cultural buildings (see also Note 1).

Note 13: Debt

	At December 31, 2006	At December 31, 2005
Short-term debt		
Foreign currency denominated debt		
Current portion of long-term debt	1,391	2,761
Other foreign currency denominated debt	1,103	299
Rouble denominated debt		
Current portion of long-term debt	-	1,675
Other rouble denominated debt	1,697	2,070
Less: due to related parties (Note 20)	(407)	(948)
Total short-term debt	**3,784**	**5,857**
Long-term debt		
Foreign currency denominated debt		
BNP Paribas	1,097	2,638
Credit Suisse First Boston	290	1,586
Other foreign currency denominated debt	4	53
Rouble denominated debt	305	1,924
Total long-term debt	**1,696**	**6,201**
Less: due to related parties (Note 20)	(15)	-
Less: current portion	(1,391)	(4,436)
Total long-term debt, net of current portion	**290**	**1,765**

Foreign currency debts are primarily denominated in US Dollars.

Short-term foreign currency denominated debt. As of December 31, 2006 other short-term foreign currency denominated debt includes a loan from Credit Suisse Zurich.

In December 2003 the Group entered into a RR 1,034 million (US $35 million) one month revolving overdraft facility with Credit Suisse Zurich. The monthly revolving loan bears interest at 1 month LIBOR plus varying margin of about 1.8% per annum and is collateralized by crude oil sales. The amount of loan outstanding as of December 31, 2006 and 2005 was RR 1,103 million (US $41.8 million) and RR 299 million (US $10.3 million), respectively.

Short-term Russian Rouble denominated debt. Russian Rouble denominated short-term debt is primarily comprised of loans with Russian banks. Short-term Rouble denominated loans of RR 1,697 million and RR 2,070 million bear contractual interest rates of 7% to 20% and 6% to 14% per annum for the periods ended December 31, 2006 and December 31, 2005, respectively. The loans are collateralized by the assets of the Group.

Weighted-average interest rates for short-term debt, excluding short-term portion of long-term debt as of December 31, 2006 and 2005 were 3.29% and 8.36%, respectively.

Long-term foreign currency denominated debt. In October 2002, the Group entered into a loan agreement with BNP Paribas for US $300 million. The amount outstanding under this loan as of December 31, 2006 was RR 1,097 million of which RR 1,097 million is classified as current. The loan bears interest at LIBOR plus 3.75%, per annum. The loan is collateralized by crude oil export contracts of 120 thousand tons per month, and matures in October 2007. The loan agreement requires compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth, and maximum debt and interest coverage ratios.

In March 2002 the Group entered into a US $200 million loan agreement with Credit Suisse First Boston. The amount of loan outstanding as of December 31, 2006 was RR 290 million of which RR 290 million is classified as current. The loan bears interest at LIBOR plus 3.78% per annum, is collateralized by crude oil export contracts of 80 thousand tons per month. The loan was repaid according to it's scheduled maturity in March 2007. The loan agreement requires compliance with certain financial covenants including, but not limited to, limitations on total indebtedness and total debt service.

Note 13: Debt (continued)

For the year ended December 31, 2006 the Group was in compliance with all covenants required by its loan agreements. For the year ended December 31, 2005 the Group was in compliance with all covenants required by the loan agreements except for the covenant relating to the US $300 million debt facility with BNP Paribas and US $200 million debt facility with Credit Suisse First Boston which required the provision of its audited consolidated US GAAP financial statements for the year ended December 31, 2005 and interim consolidated financial information which was required to be sent to the banks by July 31, 2005. The Company attained a waiver for this covenant in 2005.

Long-term Russian Rouble denominated debt. Long-term Russian Rouble denominated debt includes other loans bearing interest rates from 0.01% to 20%. Other loans represent non-banking loans. The amount of loans outstanding as of December 31, 2006 amounted to RR 305 million. The loans mature between June 2008 to November 2015.

The fair value of the Group's long-term debt approximates to its book value. Fair value assessment share subject to considerable uncertainty.

Aggregate maturities of long-term debt outstanding at December 31, 2006 are as follows:

2007	1,391
2008	157
2009	93
2010	25
2011	-
Thereafter	30
Total long-term debt	**1,696**

Interest paid during the years ended December 31, 2006 and 2005 was RR 517 million and RR 1,038 million, respectively.

The Group has no subordinated debt and no debt that may be converted in an equity instrument of the Group.

Note 14: Other Accounts Payable and Accrued Liabilities

Other accounts payable and accrued liabilities are as follows:

	At December 31, 2006	**At December 31, 2005**
Salaries and wages payable	4,556	2,909
Advances received from customers	3,098	-
Insurance provision	2,577	2,082
Current portion of asset retirement obligations	67	32
Other accrued liabilities	3,012	2,074
Less: due from related parties (Note 20)	(20)	-
Total other accounts payable and accrued liabilities	**13,290**	**7,097**

Note 15: Pensions and Post Employment Benefits

On December 31, 2006, the Company adopted SFAS 158. This statement requires employers to recognize the funded status of all postretirement defined benefit plans in the statement of financial position. Refer also to Note 3 for additional information regarding the adoption of SFAS 158 and its effect on the Company's consolidated financial statements.

The Company sponsors a post retirement program for all eligible employees, whereby the Company makes an annual contribution on behalf of all employees to the non-profit organization National Non-governmental Pension Fund (the "Fund"). Employees are also eligible to make contributions into the Fund. The amount of contributions, frequency of benefit payments and other conditions of this plan are regulated by the Statement of Organization of Non-governmental Pension Benefits for OAO Tatneft Employees (the "Agreement") and the Fund. The Company also guarantees a minimum benefit upon retirement to all participants in the Fund covered by the Agreement. The minimum guaranteed benefit component of this plan is accounted for as a defined benefit plan, with the resulting projected benefit obligation netted against the fair value of the contributions made to date as of each measurement date.

The Group has several pension programs for management, which are concluded through various agreements between the Company, the Fund and management. Under the agreements, participants are provided a monthly benefit payment, generally based upon grade, for a period of 10 to 25 years subsequent to retirement. The Company makes voluntary periodic contributions to the Fund on behalf of eligible participants.

In accordance with the provisions of collective agreements concluded on an annual basis between the Company or its subsidiaries and their employees, the Group is obligated to pay certain post-employment benefits, including a lump sum payment upon retirement. Benefits are generally based on salary grade and years of service at the time of retirement. There are no contribution requirements for these benefits, which are paid by the Group directly to retirees.

The Company uses December 31 as the measurement date for its post retirement benefits program.

The following table provides information about the benefit obligations, plan assets and actuarial assumptions used as of December 31, 2006. The benefit obligations below represent the projected benefit obligation of the pension plans.

Note 15: Pensions and Post Employment Benefits (continued)

	At December 31, 2006
Benefit obligations	
Benefit obligations as of January 1	3,202
Effect of exchange rate changes	(11)
Service cost	37
Interest cost	83
Benefit paid	(99)
Benefit obligations as of December 31	**3,212**
Plan assets	
Fair value of plan assets as of January 1	1,684
Return on plan assets	148
Contributions	365
Benefit paid	(99)
Fair value of plan assets as of December 31	**2,098**
Net amount recognized	**1,114**

Amounts recognized in the consolidated balance sheet as of December 31, 2006, under SFAS No. 158	
Accrued benefit liabilities included in “other accounts payable and accrued expenses”	(98)
Accrued benefit liabilities included in “other long-term liabilities”	(1,518)
Prepaid benefit obligations included in “other long-term assets”	502
Net amount recognized	**(1,114)**

Assumptions:	
Discount rate	9%
Expected return on plan assets	9%
Rate of increase in salary levels	6%

Components of net periodic benefit pension were as follows:

	Year ended December 31, 2006
Service cost	37
Interest cost	83
Less expected return on plan assets	(148)
Effect of exchange rates	(11)
Total net periodic pension benefit	**(39)**

Note 16: Taxes

Deferred income taxes reflect the impact of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and such amounts recognized for statutory tax purposes. Deferred tax assets (liabilities) are comprised of the following at December 31, 2006 and 2005:

	At December 31, 2006	At December 31, 2005
Accounts receivable	129	-
Obligations under capital leases	271	181
Other accounts payable	298	204
Prepaid expenses and other current assets	238	100
Pension liabilities	176	-
Other	710	938
Deferred tax assets	**1,822**	**1,423**
Property, plant and equipment	(18,960)	(20,527)
Inventories	(886)	-
Long-term investments	(941)	(587)
Undistributed Earnings	(663)	(686)
Other liabilities	(201)	(493)
Deferred tax liabilities	**(21,651)**	**(22,293)**
Net deferred tax liability	**(19,829)**	**(20,870)**

At December 31, 2006 and 2005, deferred taxes were classified in the consolidated balance sheet as follows:

	At December 31, 2006	At December 31, 2005
Current deferred tax asset	288	749
Non-current deferred tax assets	447	-
Non-current deferred tax liability	(20,564)	(21,619)
Net deferred tax liability	**(19,829)**	**(20,870)**

Presented below is a reconciliation between the provision for income taxes and taxes determined by applying the statutory tax rate to income before income taxes:

	Year ended December 31, 2006	Year ended December 31, 2005
Income before income taxes and minority interest	42,624	42,577
Theoretical income tax expense at statutory rate	10,230	10,218
Increase (reduction) due to:		
Non-deductible expenses	1,818	3,089
Non-taxable income	(273)	(59)
Other	331	433
Income tax expenses	**12,106**	**13,681**

No provision has been made for additional income taxes of RR 5,819 million on undistributed earnings of a foreign subsidiary. These earnings have been and will continue to be reinvested. These earnings could become subject to additional tax of approximately RR 873 million if they were remitted as dividends.

Note 16: Taxes (continued)

Income taxes paid during the years ended December 31, 2006 and 2005 was RR 13,735 million and RR 15,490 million, respectively.

The Company is subject to a number of taxes other than income taxes, which are detailed as follows:

	Year ended December 31, 2006	Year ended December 31, 2005
Export duties	85,358	65,667
Unified production tax	56,843	46,600
Property tax	1,322	1,488
Excise taxes	602	408
Penalties and interest	102	1,166
Other	749	1,052
Total taxes other than income taxes	**144,976**	**116,381**

In April 2005, the Company received a claim for back taxes from the federal tax authorities, based on their review of the Company’s tax filings for the years 2001, 2002 and 2003, in the amount of RR 1,380 million. This amount includes both alleged non-payment and under-payment of taxes as well as fines and penalties. The amount of the tax claim was accrued in the financial statements as of December 31, 2003. While the Group could have challenged this claim, the issue of any such claim would have been uncertain, given the results of recent Russian companies’ tax claims. Consequently, in May 2005 the Group paid the entire amounts claimed. The Company's 2004 and 2005 tax filings were recently subject to routine examination by taxing authorities. There were no significant findings as a result of these examinations.

Export duties and excise taxes are included in revenues in the consolidated statements of operations and comprehensive income.

Effective from January 1, 2005 the base tax rate for the unified production tax was increased from RR 347 to RR 419 per ton of crude oil and non-taxable threshold was increased from US $8.00 per barrel to US $9.00 per barrel. From January 1, 2007, the unified production tax rate RR 419 per ton of crude oil is multiplied by the ratio which shows the dynamics of world crude oil prices and by depletion rate of an oil field. The depletion rates are registered in the clause 3 and 4 of the chapter 342 of the Tax Code.

At December 31, 2006 and 2005, taxes payable were as follows:

	At December 31, 2006	At December 31, 2005
Unified production tax	4,430	4,356
Value Added Tax on goods sold	1,508	2,485
Other	1,623	2,469
Total taxes payable	**7,561**	**9,310**

The Russian government has recently revised the Russian tax system. The new tax system is intended to reduce the number of taxes and the overall tax burden on businesses and to simplify the tax laws. However, the revised tax system relies heavily on the judgments of local tax officials and fails to address many of the existing problems. Even in the event of further reforms to tax legislation, they may not result in a reduction of the tax burden on Russian companies and the establishment of a more efficient tax system. Conversely, they may introduce additional tax collection measures. Accordingly, the Group may have to pay significantly higher taxes, which could have a material adverse effect on its business.

Note 16: Taxes (continued)

Russian transfer pricing legislation introduced January 1, 1999 provides taxing authorities with the ability to make transfer pricing adjustments and impose additional tax liabilities related to all controllable transactions, provided that the transaction price differs from the market price by more than 20%.

Controllable transactions include transactions with interdependent parties, as determined under the Russian Tax Code, and all cross-border transactions (irrespective whether such transactions are performed between related or unrelated parties), transactions where the price applied by a taxpayer differs by more than 20% from the price applied in similar transactions by the same taxpayer within a short period of time, and barter transactions. There is no formal guidance as to how these rules should be applied in practice. Furthermore, the arbitration court's practice with respect to these matters is contradictory.

Note 17: Share Capital, Additional Capital and Other Comprehensive Income

Authorized share capital. At December 31, 2006 the authorized share capital consists of 2,178,690,700 voting common shares and 147,508,500 non-voting preferred shares; both classes of shares have a nominal value of RR 1.00 per share.

Golden share. OAO Svyazinvestneftekhim, a company wholly owned by the government of Tatarstan, as of December 31, 2006 holds approximately 33.59% of the Company's capital stock. These shares were contributed to Svyazinvestneftekhim by the Ministry of Land and Property Relations of Tatarstan in 2003. Tatarstan also holds a "Golden Share" – a special governmental right – in the Company. The exercise of its powers under the Golden Share enables the Tatarstan government to appoint one representative to the Board of Directors and Revision Committee of the Company and to veto certain major decisions, including those relating to changes in the share capital, amendments to the Charter, liquidation or reorganization and "major" and "interested party" transactions as defined under Russian law. The Golden Share currently has an indefinite term. The Tatarstan government also controls or exercises significant influence over a number of the Company's suppliers and contractors, such as the electricity producer OAO Tatenergo and the petrochemicals company OAO Nizhnekamskneftekhim (see also Note 1).

Rights attributable to preferred shares. Unless a different amount is approved at the annual shareholders meeting, preferred shares earn dividends equal to their nominal value. The amount of a dividend for a preferred share may not be less than the amount of a dividend for a common share.
Preferred shareholders may vote at meetings only on the following decisions:

- the amendment of the dividends payable per preferred share;
- the issuance of additional shares with rights greater than the current rights of preferred shareholders; and
- the liquidation or reorganization of the Company.

The decisions listed above can be made only if approved by 75% of preferred shareholders.

Holders of preferred shares acquire the same voting rights as holders of common shares in the event that dividends are either not declared, or declared but not paid, on preferred shares. On liquidation, the shareholders are entitled to receive a distribution of net assets. Under Russian Joint Stock Companies Law and the Company's charter in case of liquidation, preferred shareholders have priority over ordinary shareholders to be paid declared but unpaid dividends on preferred shares and the liquidation value of preferred shares, if any.

Amounts available for distribution to shareholders. Amounts available for distribution to shareholders are based on the Company's non-consolidated statutory accounts prepared in accordance with RAR, which differ significantly from US GAAP (see Note 2). The statutory accounts are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current period net profit calculated in accordance with RAR. However, this legislation and other statutory laws and regulations dealing with distribution rights are open to legal interpretation. For the years ended December 31, 2006 and 2005, the Company had a statutory current profit of RR 35,649 million and RR 36,563 million, respectively, as reported in the published statutory accounts of the Company.

Note 17: Share Capital, Additional Capital and Other Comprehensive Income (continued)

At the general meeting of shareholders on June 30, 2006, 2005 annual dividends of RR 1 per common share and RR 1 per preferred share were approved for all shareholders. The Company's board of directors recommended to the annual general meeting of shareholders, to be held on June 29, 2007, the approval of 2006 annual dividends on the Company's ordinary and preferred shares of RR 4.60 per share.

Other comprehensive income. The balance of accumulated other comprehensive income as reported on the consolidated balance sheet is as follows:

	At December 31, 2006	At December 31, 2005
Net foreign currency translation adjustment gain	(318)	336
Accumulated other comprehensive income	**(318)**	**336**

Net income per share. Under the two-class method of computing net income per share, net income is computed for common and preferred shares according to dividends declared and participation rights in undistributed earnings. Under this method, net income is reduced by the amount of dividends declared in the current period for each class of shares, and the remaining income is allocated to common and preferred shares to the extent that each class may share in income if all income for the period had been distributed.

	Year ended December 31, 2006	Year ended December 31, 2005
Net income	29,773	28,242
Common share dividends	(2,179)	(501)
Preferred share dividends	(148)	-
Income available to common and preferred shareholders, net of dividends	**27,446**	**27,741**
Basic:		
Weighted average number of shares outstanding (millions of shares):		
Common	2,034	1,997
Preferred	148	148
Combined weighted average number of common and preferred shares outstanding	2,182	2,145
Basic net income per share (RR)		
Common	13.65	13.19
Preferred	13.58	12.94
Diluted:		
Weighted average number of shares outstanding (millions of shares):		
Common	2,042	2,006
Preferred	148	148
Combined weighted average number of common and preferred shares outstanding assuming dilution	2,190	2,154
Diluted net income per share (RR)		
Common	13.60	13.13
Preferred	13.53	12.88

Minority interest. Minority interest is adjusted by dividends paid by the Group's subsidiaries amounting to RR 186 million and RR 261 million at December 31, 2006 and 2005, respectively.

Note 18: Stock-Based Compensation

On December 31, 2000 the Board of Directors of the Company approved the Company's stock compensation plan (the "Plan") for senior management and directors of the Company. Under the provisions of the Plan the Company is entitled to issue options to its directors and senior management on an annual basis based on approval of the Board of Directors. The Board of Directors determines the number and exercise price of options as well as their expiration and vesting periods. In accordance with the Plan for all options issued, the Company reserves the right to repurchase outstanding options at the price determinable as the maximum weighted average daily market price for the preceding three years for trades on the Moscow Interbank Currency Exchange less the exercise price of the option.

Option issuance must be registered with the Federal Financial Markets Service (formerly the Federal Commission for the Securities Markets of the Russian Federation) within one year after the approval of the Board of Directors. After registration, the number of options, their exercise prices and other conditions are communicated to the eligible person usually within three weeks after registration through the signing of a security sales contract between the Company or its subsidiary and such person. On the signing date, the option holder pays the non-refundable portion of the exercise price and the remaining amount is payable on the exercise date. The vesting period commences from the date of signing (the grant date).

In 2006 and 2005 the Company issued 9,526,000 and 9,840,000 options, respectively, for its senior management and directors with the right to repurchase outstanding options at the price determinable as the maximum weighted average daily market price for the preceding three years for trades on the Moscow Interbank Currency Exchange less the exercise price of option.

All options issued in 2006 and 2005 vest 270 days from the grant date and expire 365 days after the grant date. Each option gives the option holders the right to purchase one share of the Company

In 2006 and 2005, the Company repurchased options issued in 2005 and 2004 through a cash settlement at the price of RR 153.54 and RR 94.03, respectively. The amount of compensation expense in respect of the Plan recognized in the consolidated statements of operations and comprehensive income for the years ended December 31, 2006 and 2005 was RR 1,454 million and RR 894 million, respectively.

The following table summarizes stock option activity for the periods presented:

	2006		2005	
	Shares	**Price**	**Shares**	**Price**
Outstanding, beginning of year	**9,840,000**	**16.23**	**10,028,000**	**11.70**
Granted	9,526,000	23.82	9,840,000	16.23
Repurchased	(9,611,000)	16.23	(10,028,000)	11.70
Forfeited	(229,000)	16.23	-	-
Outstanding, end of year	**9,526,000**	**23.82**	**9,840,000**	**16.23**
Exercisable, end of year	**-**	**-**	**-**	**-**

The remaining lives of options outstanding at December 31, 2006 and 2005 were 0.25 and 0.25 years, respectively.

The fair value of the Group's stock options is the estimated present value at the date of grant using the Black-Scholes option pricing model with the following assumptions.

Note 18: Stock-Based Compensation (continued)

	Year ended December 31, 2006	Year ended December 31, 2005
Average grant date fair value of options	176.31	94.57
Assumption used:		
Risk-free interest rate	5%	4%
Dividend yield	1%	1%
Volatility factor	46%	38%
Expected life (years)	1	1

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, this option pricing model requires the input of highly subjective assumptions, including the expected stock price volatility.

Note 19: Segment Information

The Group's business activities are conducted predominantly through three business segments: exploration and production, refining and marketing and petrochemicals. The segments were determined according to how management recognizes the segments within the Group for making operating decisions and how they are evident from the Group structure.

Exploration and production segment activities consist of exploration, development, extraction and sale of own crude oil. Intersegment sales consist of other goods and services provided to other operating segments.

Refining and marketing comprises purchases and sales of crude oil and refined products from third parties, own refining activities and retailing operations.

Sales of petrochemical products include sales of petrochemical raw materials and refined products, which are used in production of tires.

Other sales include revenues from ancillary services provided by the specialized subdivisions and subsidiaries of the Group, such as sales of oilfield equipment and drilling services provided to other companies in Tatarstan, revenues from the sale of auxiliary petrochemical related services and materials as well as other business activities, which do not constitute reportable business segments.

For the year ended December 31, 2006, the Group had four customers which accounted for RR 174,561 million in crude oil sales, comprising 28%, 21%, 16% and 9% respectively of the total tons of crude oil sold by the Group during the year. For the year ended December 31, 2005, the Group had three customers which accounted for RR 123,753 million in crude oil sales, comprising 26%, 13% and 9%, respectively of the total tons of crude oil sold by the Group during the year. During the year ended December 31, 2005, the Group had one customer which accounted for RR 19,002 million in other refining and marketing revenues, which represents 20% of these revenues. Management does not believe the Group is reliant on any particular customer.

The Group evaluates performance of its reportable operating segments and allocates resources based on income or losses before income taxes and minority interest not including interest income, expense, earnings from equity investments, other income and monetary effects. Segment accounting policies are the same as those disclosed in Note 3. Intersegment sales are at prices that approximate market.

Note 19: Segment Information (continued)

Segment sales and other operating revenues. Reportable operating segment sales and other operating revenues are stated in the following table:

	Year ended December 31, 2006	Year ended December 31, 2005
Exploration and production		
Domestic own crude oil	48,430	28,811
CIS own crude oil	62,947	45,071
Non – CIS own crude oil	121,292	118,294
Intersegment sales	1,280	2,602
Total exploration and production	**233,949**	**194,778**
Refining and marketing		
Crude oil purchased	4,121	2,331
Refined products	32,687	42,174
Domestic sales	36,808	44,505
Crude oil purchased	658	315
Refined products	6,487	4,954
CIS sales[1]	7,145	5,269
Crude oil purchased	421	9,113
Refined products	4,294	19,252
Non – CIS sales[2]	4,715	28,365
Total refining and marketing	**48,668**	**78,139**
Petrochemicals		
Tires - domestic sales	15,610	11,538
Tires - CIS sales	3,168	2,427
Tires - non-CIS sales	1,165	815
Petrochemical products	804	1,368
Total petrochemicals	**20,747**	**16,148**
Total segment sales	**303,364**	**289,065**
Corporate and other sales	16,200	13,895
Elimination of intersegment sales	(1,280)	(2,602)
Total sales and other operating revenues	**318,284**	**300,358**

[1] - CIS is an abbreviation for Commonwealth of Independent States (excluding the Russian Federation).

[2] - Non-CIS sales of crude oil and refined products are mainly made to European markets.

Note 19: Segment Information (continued)

Segment earnings and assets. Segment earnings are as follows:

	Year ended December 31, 2006	Year ended December 31, 2005
Segment earnings (loss)		
Exploration and production	39,972	40,076
Refining and marketing	5,174	14,064
Petrochemicals	889	1,031
Total segment earnings	**46,035**	**55,171**
Corporate and other	(6,862)	(13,358)
Other income	3,451	764
Income before income taxes and minority interest	**42,624**	**42,577**

Segment assets are as follows:

	At December 31, 2006	At December 31, 2005
Assets		
Exploration and production	189,963	172,326
Refining and marketing	16,853	13,297
Petrochemicals	15,962	15,691
Corporate and other	96,646	80,830
Total assets	**319,424**	**282,144**

The Group's assets and operations are primarily located and conducted in Russia.

Segment depreciation, depletion and amortization and additions to property, plant and equipment are as follows:

	Year ended December 31, 2006	Year ended December 31, 2005
Depreciation, depletion and amortization		
Exploration and production	5,709	5,884
Refining and marketing	475	679
Petrochemicals	1,106	1,209
Corporate and other	3,383	3,241
Total segment depreciation, depletion and amortization	**10,673**	**11,013**
Additions to property, plant and equipment		
Exploration and production	12,032	9,000
Refining and marketing	3,101	527
Petrochemicals	621	729
Corporate and other	6,249	5,005
Total additions to property, plant and equipment	**22,003**	**15,261**

Note 20: Related Party Transactions

Transactions are entered into in the normal course of business with significant shareholders, directors and companies with which the Group has significant shareholders and directors in common (see also Note 1). These transactions include sales of crude oil and refined products, purchases of electricity and banking transactions.

OAO Svyazinvestneftekhim, which is wholly-owned by the Tatarstan government, is the Group's largest shareholder, owning, directly and through its subsidiary Investneftekhim, 33.59% of capital stock and 35.87% of the Company's ordinary shares as of May 15, 2006. The Tatarstan government also holds a Golden Share. Currently, four of the Company's directors, including the Chairman of the Board, are senior members of the Tatarstan government. In the ordinary course of business, the Group regularly enters into transactions with other entities that are controlled, either directly or indirectly, by the government of Tatarstan or over which it exercises significant influence. These enterprises include, among others, Tatenergo and Nizhnekamskneftekhim.

In 2005, a significant portion of the Group's export sales of crude oil and refined products were to Efremov Kautschuk GmbH, a subsidiary of OAO Efremovsky Zavod Sinteticheskogo Kauchuka. OAO Efremovsky Zavod Sinteticheskogo Kauchuka was a related party to the Group in 2005 as members of the Group's senior management were on its board of directors. Sales to Efremov Kautschuk GmbH totalled RR 82,324 million for the year ended December 31, 2005. In 2006 the Group no longer considers Efremov Kautschuk GmbH and OAO Efremovsky Zavod Sinteticheskogo Kauchuka as related parties as the Group no longer has significant representation on the board of directors of OAO Efremovsky Zavod Sinteticheskogo Kauchuka.

In January 2004, at the request of the Tatarstan government, the Company purchased interest-free promissory note due in 2024 in the amount of RR 960 million from Tatgospostavki, a unitary company controlled by the government of Tatarstan. Tatgospostavki used the proceeds of this transaction to finance social expenditures planned under Tatarstan's budget. The fair value of this note is RR 173 million and RR 157 million as of December 31, 2006 and 2005, respectively, calculated using an implied rate of return of 10%.

In July 2005, the Group provided a subordinated loan to Bank Zenit in the amount of RR 1.7 billion, maturing in 7 years, bearing interest at 8.5% per annum. As at December 31, 2006 the Group's subordinated loans to Bank Zenit totaled RR 1.7 billion.

During 2006 the Group lent US$15 million to Bank Zenit, an equity investee, for 10 years under a subordinate loan agreement, and acquired from a third party an additional US$15 million subordinated loan to Bank Zenit due on December 5, 2009. Both loans carry fixed interest at the rate of 7% per annum.

The amounts of transactions for each year and the outstanding balances at each year end with related parties are as follows:

	Year ended December 31, 2006	Year ended December 31, 2005
Sales of crude oil	-	63,247
Volumes of crude oil sales (thousand tons)	-	6,403
Sales of refined products	10	23,866
Volumes of refined product sales (thousand tons)	1	2,870
Sales of petrochemical products	-	2,105
Other sales	1,060	1,074
Purchases of crude oil	(103)	(1,304)
Volumes of crude oil purchases (thousand tons)	14	143
Purchases of refined products	-	(51)
Volumes of refined products purchases (thousand tons)	-	14
Purchases of petrochemical products	-	(3,578)
Purchases of electricity	(2,628)	(4,089)
Other purchases	(504)	(3,551)

Note 20: Related Party Transactions (continued)

	At December 31, 2006	At December 31, 2005
Assets		
Accounts receivable (Note 6)	495	5,235
Notes receivable (Note 10)	1,856	3,960
Short-term certificates of deposit (Note 7)	9,750	4,030
Trading securities (Note 7)	1,172	-
Loans receivable (Note 10)	554	1,192
Due from related parties short-term	**13,827**	**14,417**
Long-term certificates of deposit (Note 7)	1,000	-
Long-term loans receivable (Note 10)	5,235	2,561
Due from related parties long-term	**6,235**	**2,561**
Liabilities		
Other accounts payable (Note 14)	(20)	-
Notes payable	-	(43)
Short-term debt (Note 13)	(407)	(948)
Trade accounts payable	(277)	(467)
Due to related parties short-term	**(704)**	**(1,458)**
Notes payable	-	(448)
Long-term debt (Note 13)	(15)	-
Due from related parties long-term	**(15)**	**(448)**

Note 21: Financial Instruments and Risk Management

Fair values. The carrying amounts of short-term financial instruments approximates fair value because of the relatively short period of time between the origination of these instruments and their expected realization.

Information concerning the fair value of long-term investments is disclosed in Note 7.

Information concerning the fair value of loans receivable is disclosed in Note 10.

Information concerning the fair value of short-term and long-term debt is disclosed in Note 13.

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

The Group deposits available cash mostly with financial institutions in the Russian Federation. Deposit insurance for deposits of legal entities is not offered to financial institutions operating in the Russian Federation. To manage this credit risk, the Group allocates its available cash to a variety of Russian banks and Russian affiliates of international banks. Management periodically reviews the credit worthiness of the banks in which it deposits cash.

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

Note 22: Commitments and Contingent Liabilities

Guarantees. At December 31, 2005 the Group guaranteed a third party's debt obligations to Bank Zenit in the amount of RR 526 million. As of December 31, 2005, the Group had not recorded any liability in its consolidated financial statements in connection with these guarantees as the Group did not believe, based on information available, that it was probable any amounts would be paid under these guarantees. These guarantees expire in 2009 and the Group's total exposure including interest on the underlying loans was RR 526 million at December 31, 2005. The obligations were subsequently repaid during 2006. The Group has no outstanding guaranties at December 31, 2006.

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

Taxation. Russian tax legislation is subject to varying interpretations and constant changes. Further, the interpretations of tax legislation by tax authorities as applied to the transactions and activities of the Group may not coincide with that of management. Also interpretations on the application of the tax legislation may vary between regional and Federal tax authorities. As a result, transactions may be challenged by tax authorities and the Group may be assessed for additional taxes, penalties and interest. Consolidated tax returns are not required under existing Russian tax legislation and tax audits are performed on an individual entity basis only. Tax periods remain open to review by the tax authorities for three years.

Environmental contingencies. The Group, through its predecessor entities, has operated in Tatarstan for many years without developed environmental laws, regulations and Group policies. Environmental regulations and their enforcement are currently being considered in the Russian Federation and the Group is monitoring its potential obligations related thereto. The outcome of environmental liabilities under proposed or any future environmental legislation cannot reasonably be estimated at present, but could be material. Under existing legislation, however, management believes that there are no probable liabilities, which would have a material adverse effect on the operating results or financial position of the Group.

Legal contingencies. The Group is subject to various lawsuits and claims arising in the ordinary course of business. The outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present. In the case of all known contingencies the Group accrues a liability when the loss is probable and the amount is reasonably estimable. Based on currently available information, management believes that it is remote that future costs related to known contingent liability exposures would have a material adverse impact on the Group's consolidated financial statements.

Social commitments. The Group contributes significantly to the maintenance of local infrastructure and the welfare of its employees within Tatarstan, which includes contributions towards the construction, development and maintenance of housing, hospitals and transport services, recreation and other social needs. Such funding is periodically determined by the Board of Directors after consultation with governmental authorities and recorded as expenditures when incurred.

Transportation of crude oil. The Group benefits from the blending of its crude oil in the Transneft pipeline system since the Group's crude oil production is generally of a lower quality than that produced by other regions of the Russian Federation which supply through the same pipeline system. There is currently no equalization scheme for differences in crude oil quality within the Transneft pipeline system and the implementation of any such scheme is not determinable at present. However, if this practice were to change, the Group's business could be materially and adversely affected.

In accordance with SFAS No. 69, "*Disclosures about Oil and Gas Producing Activities*", this section provides supplemental information on oil and gas exploration and production activities of the Group.

The Group's oil and gas production is predominantly in Tatarstan within the Russian Federation; therefore, all of the information provided in this section pertains entirely to that region.

Oil Exploration and Production Costs

The following tables set forth information regarding oil exploration and production costs. The amounts reported as costs incurred include both capitalized costs and costs charged to expense during the year.

Costs Incurred in Exploration and Development Activities

	Year ended December 31, 2006	Year ended December 31, 2005
Exploration costs	2,223	1,378
Development costs	7,754	8,517
Total costs incurred in exploration and development activities	**9,977**	**9,895**

Property acquisitions are immaterial to the Group's oil activities.

Capitalized Costs of Proved Oil Properties

	At December 31, 2006	At December 31, 2005
Wells, support equipment and facilities	258,908	261,983
Uncompleted wells, equipment and facilities	2,428	2,314
Total capitalized costs of proved oil properties	**261,336**	**264,297**
Accumulated depreciation, depletion and amortization	(121,215)	(123,184)
Net capitalized costs of proved oil properties	**140,121**	**141,113**

The following information pertains to the drilling activities of the Group:

	Year ended December 31, 2006	Year ended December 31, 2005
Net productive development wells drilled	348	350
Net productive exploratory wells drilled	31	37
Total wells drilled	**379**	**387**

As of December 31, 2006 and 2005 the number of net productive oil wells was 19,185 and 18,867, respectively.

Results of Operations for Oil and Gas Producing Activities

The Group's results of operations from oil producing activities are shown below. Proved natural gas reserves do not represent a significant portion of the Group's total reserves.

In accordance with SFAS 69, results of operations do not include general corporate overhead and monetary effects nor their associated tax effects. Income taxes are based on statutory rates for the year, adjusted for tax deductions, tax credits and allowances.

	Year ended December 31, 2006	Year ended December 31, 2005
Revenues from net production:		
Sales	232,668	192,176
Transfers[1]	2,993	11,835
Total revenues from net production	**235,661**	**204,011**
Less:		
Production and operating costs[2]	34,724	29,373
Exploration expenses	1,555	1,375
Depreciation, depletion and amortization	5,709	5,884
Taxes other than income taxes	141,722	108,716
Related income taxes	12,468	14,079
Results of operations for oil and gas producing activities	**39,483**	**44,584**

[1] Transfers represent crude oil to the refining subsidiaries at the estimated market price of those transactions.
[2] Production and operating costs include transportation expenses and accretion of discount in accordance with SFAS 143.

The average sales price (including transfers) per ton for 2006 and 2005 are RR 9,155 and RR 7,967 respectively. The average production and operating cost per ton for 2006 and 2005 are RR 1,349 and RR 1,147, respectively.

Proved Oil Reserves

As determined by the Group's independent reservoir engineers, Miller and Lents, Ltd., the following information presents the balances of proved oil reserves at December 31, 2006 and 2005. The definitions used are in accordance with applicable US Securities and Exchange Commission ("SEC") regulations.

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

Proved Oil Reserves (continued)

Management believes that proved reserves should include quantities which are expected to be produced after the expiry dates of the Group's production licenses. Most of the Group's existing production licenses expire from 2013 to 2019, and the license for the Group's largest field, Romashkinskoye, expires in 2038. Management believes the licenses may be extended at the initiative of the Group and management expects to extend such licenses for properties expected to produce subsequent to their license expiry date. The Group has disclosed information on proved oil and gas reserve quantities and standardized measure of discounted future net cash flows for periods up to and past license expiry dates separately (see Note 12).

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

"Net" reserves exclude quantities due to others when produced.

A significant portion of the Group's total proved reserves are classified as either developed non-producing or undeveloped. The developed non-producing proved reserves can be produced from existing well bores but require capital costs for workovers, recompletions, or restoration of shut-in wells, additional completion work or future recompletion prior to the start of production. Of the developed non-producing proved reserves, a significant portion represents existing wells which are expected to be put back into production at a future date.

Net proved reserves of crude oil at December 31, 2006:

	Net proved reserves of crude oil recoverable up to license expiry dates		**Net proved reserves of crude oil recoverable past license expiry dates**		**Total net proved reserves of crude oil**	
	(millions of barrels)	*(millions of tons)*	*(millions of barrels)*	*(millions of tons)*	*(millions of barrels)*	*(millions of tons)*
Net proved developed producing reserves	2,301	323	1,275	179	3,576	502
Net proved developed non-producing reserves	693	97	1,436	202	2,129	299
Net proved developed reserves	**2,994**	**420**	**2,711**	**381**	**5,705**	**801**
Net proved undeveloped reserves	52	7	154	22	206	29
Net proved developed and undeveloped reserves	**3,046**	**427**	**2,865**	**403**	**5,911**	**830**

Net proved reserves of crude oil recoverable up to license expiry dates at December 31, 2005 presented in the table above includes the effect of the Group renewal of the Romashkinskoye Field in August, 2006, which was extended through 2038.

Proved Oil Reserves (continued)

Net proved reserves of crude oil at December 31, 2005:

	Net proved reserves of crude oil recoverable up to license expiry dates		**Net proved reserves of crude oil recoverable past license expiry dates**		**Total net proved reserves of crude oil**	
	(millions of barrels)	*(millions of tons)*	*(millions of barrels)*	*(millions of tons)*	*(millions of barrels)*	*(millions of tons)*
Net proved developed producing reserves	2,382	334	1,216	171	3,598	505
Net proved developed non-producing reserves	716	101	1,294	181	2,010	282
Net proved developed reserves	**3,098**	**435**	**2,510**	**352**	**5,608**	**787**
Net proved undeveloped reserves	69	10	195	27	264	37
Net proved developed and undeveloped reserves	**3,167**	**445**	**2,705**	**379**	**5,872**	**824**

Movements in Proved Oil Reserves

	Net proved reserves of crude oil recoverable up to license expiry dates		**Net proved reserves of crude oil recoverable past license expiry dates**		**Total net proved reserves of crude oil**	
	(millions of barrels)	*(millions of tons)*	*(millions of barrels)*	*(millions of tons)*	*(millions of barrels)*	*(millions of tons)*
Balance at December 31, 2004	**1,476**	**206**	**4,325**	**608**	**5,801**	**814**
Revisions	1,873	265	(1,620)	(229)	253	36
Production	(182)	(26)	-	-	(182)	(26)
Balance at December 31, 2005	**3,167**	**445**	**2,705**	**379**	**5,872**	**824**
Revisions	62	8	160	24	222	32
Production	(183)	(26)	-	-	(183)	(26)
Balance at December 31, 2006	**3,046**	**427**	**2,865**	**403**	**5,911**	**830**

Standardized Measure, Including Year-to-Year Changes Therein, of Discounted Future Cash Flows

For the purposes of the following disclosures, estimates were made of quantities of proved reserves and the periods in which they are expected to be produced. Future cash flows were computed by applying year-end prices (as described below) to the Group's estimated annual future production from proved oil reserves. Future development and production costs were computed by applying year-end costs to be incurred in producing and further developing the proved reserves. Future income taxes were computed by applying, generally, year-end statutory tax rates (adjusted for tax deductions, tax credits and allowances) to the estimated future pretax cash flows. The discount was computed by application of a 10% discount factor. The calculations assumed the continuation of existing political, economic, operating and contractual conditions at each of December 31, 2006 and 2005. However, such arbitrary assumptions have not necessarily proven to be the case in the past and may not in the future. Other assumptions of equal validity would give rise to substantially different results. As a result, future cash flows calculated under this methodology are not necessarily indicative of the Group's future cash flows nor the fair value of its oil reserves.

Standardized Measure, Including Year-to-Year Changes Therein, of Discounted Future Cash Flows (continued)

The net price used in the forecast of future net revenue is the weighted average year end price received for sales domestically, for exports to Commonwealth of Independent States ("CIS") countries, and for exports to non-CIS countries, after adjustments, where applicable, for certain costs, duties, and taxes. The weighted average net prices per ton used in the forecasts for 2006 and 2005, are US $187.46 and US $159.71 (US $26.32 and US $22.42 per barrel), respectively. The Company determined the appropriate mix between domestic sales, exports to CIS countries and exports to non-CIS countries using historic percentages which are supported by export quotas granted to the Company by the government. The Company assumes that the current level of export quotas will remain unchanged through the life of reserves.

	As of December 31, 2006	**As of December 31, 2005**
	Future cash flows attributable to total recoverable net proved reserves	Future cash flows attributable to total recoverable net proved reserves
Future cash inflows from production	4,289,534	3,989,580
Future development and production costs	(2,792,398)	(2,344,514)
Future income taxes	(349,835)	(385,099)
Future net cash flows	**1,147,301**	**1,259,967**
10% annual discount	(840,320)	(887,133)
Discounted future net cash flows	**306,981**	**372,834**

Changes in the Standardized Measure of Discounted Future Net Cash Flows From Proved Reserve Quantities

	Year ended December 31, 2006	**Year ended December 31, 2005**
	Future cash flows attributable to total net proved reserves	Future cash flows attributable to total net proved reserves
Beginning of year	**372,834**	**251,319**
Sales and transfers of oil produced, net of production costs and other operating expenses	(59,215)	(65,921)
Net change in prices received per ton, net of production costs and other operating expenses	(98,906)	115,648
Change in estimated future development costs	3,782	(11,679)
Revisions of quantity estimates	5,314	59,115
Development costs incurred during the period	8,314	8,517
Accretion of discount	44,130	34,052
Net change in income taxes	21,409	(35,062)
Other	9,319	16,845
End of year	**306,981**	**372,834**

For the years ended December 31 2006 and 2005 discounted future cash flows for total net proved reserves include RR 64,140 million and RR 70,140 million, respectively, attributable to net proved reserves recoverable past license expiry dates.