



**ROSNEFT**

O I L C O M P A N Y

OPEN JOINT STOCK COMPANY

## **OJSC Rosneft Oil Company**

### **Interim Consolidated Financial Statements**

*As of and for the three and nine months ended September 30, 2006 and 2005*

# OJSC Rosneft Oil Company

## Interim Consolidated Financial Statements

As of and for the three and nine months ended September 30, 2006 and 2005

### Contents

|   |   |
|---|---|
| Independent Accountants' Review Report.....                     | 1 |
| Interim Consolidated Financial Statements                       |   |
| Consolidated Balance Sheets .....                               | 3 |
| Consolidated Statements of Income .....                         | 4 |
| Consolidated Statement of Changes in Shareholders' Equity ..... | 5 |
| Consolidated Statements of Cash Flows .....                     | 6 |
| Notes to Interim Consolidated Financial Statements .....        | 8 |

## Independent Accountants' Review Report

Shareholders and the Board of Directors  
of OJSC Rosneft Oil Company

We have reviewed the accompanying consolidated balance sheet of OJSC Rosneft Oil Company, an open joint stock company, and subsidiaries ("the Company") as of September 30, 2006 and the related consolidated statements of income for the three and nine months ended September 30, 2006 and 2005, the related consolidated statements of cash flows for the nine months ended September 30, 2006 and 2005, and the related consolidated statement of changes in shareholders' equity for the nine months ended September 30, 2006, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these interim consolidated financial statements is the representation of the management of the Company.

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

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

As discussed in Note 13 to the interim consolidated financial statements, as of December 31, 2004, the Company was not in compliance with certain provisions of debt agreements, which constituted events of default, and as a result the related debt became callable by the respective creditors as of that date. Subsequently the Company has obtained waiver letters from the respective creditors which have provided for a grace period to cure these defaults and this grace period was ultimately extended until December 31, 2006. We do not believe that it is probable that all events of default will be cured before December 31, 2006. The Company continues to classify the related debt in the amount of US\$ 2,025 million as non-current, which is not in compliance with Statement of Financial Accounting Standard (SFAS) No. 78 "*Classification of Obligations That Are Callable by the Creditor*", which requires classification of such debt as current.

As discussed in Note 2 to the consolidated financial statements as of and for the year ended December 31, 2005, the value of property, plant and equipment pertaining to minority interests, resulting from the acquisition of OJSC Yuganskneftegaz, has been recorded at appraised values, rather than at historical cost, as required by accounting principles generally accepted in the United States of America.

The consolidated financial statements as of and for the year ended December 31, 2005, were audited by us and we expressed a qualified opinion on them with respect to the value of property, plant and equipment pertaining to minority interests and classification of debt in our report dated May 15, 2006, but we have not performed any auditing procedures since that date.

*Ernst & Young LLC*

December 25, 2006

# OJSC Rosneft Oil Company

## Consolidated Balance Sheets

(in millions of US dollars, except share amounts)

|  | Notes | September 30, 2006<br>(unaudited) | December 31,<br>2005 |
|--|-------|-----------------------------------|----------------------|
| <b>ASSETS</b>  |       |                                   |                      |
| <b>Current assets:</b>   |       |                                   |                      |
| Cash and cash equivalents  | 4     | \$ 991                            | \$ 1,173             |
| Restricted cash  |       | 28                                | 23                   |
| Short-term investments   | 5     | 415                               | 165                  |
| Accounts receivable, net   | 6     | 3,835                             | 2,858                |
| Inventories  | 7     | 1,018                             | 814                  |
| Deferred tax assets  | 16    | 36                                | 48                   |
| Prepayments and other current assets   |       | 832                               | 897                  |
| <b>Total current assets</b>  |       | <b>7,155</b>                      | <b>5,978</b>         |
| <b>Non-current assets:</b>   |       |                                   |                      |
| Long-term investments  | 8     | 591                               | 436                  |
| Long-term bank loans granted, net  |       | 103                               | 63                   |
| Acquired debt receivable, net  | 9     | 456                               | –                    |
| Oil and gas properties, net  | 10    | 23,855                            | 20,939               |
| Property, plant and equipment, net   | 11    | 2,084                             | 2,030                |
| Construction-in-progress   |       | 622                               | 509                  |
| Goodwill   | 3     | 78                                | 35                   |
| Deferred tax assets  | 16    | 8                                 | 8                    |
| Other non-current assets   |       | 162                               | 18                   |
| <b>Total non-current assets</b>  |       | <b>27,959</b>                     | <b>24,038</b>        |
| <b>Total assets</b>  |       | <b>\$ 35,114</b>                  | <b>\$ 30,016</b>     |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |       |                                   |                      |
| <b>Current liabilities:</b>  |       |                                   |                      |
| Accounts payable and accrued liabilities   | 12    | \$ 1,571                          | \$ 1,358             |
| Short-term loans and current portion of long-term debt   | 13    | 4,128                             | 4,005                |
| Income and other tax liabilities   |       | 2,835                             | 2,810                |
| Deferred tax liabilities   | 16    | 8                                 | 40                   |
| Other current liabilities  |       | 17                                | 32                   |
| <b>Total current liabilities</b>   |       | <b>8,559</b>                      | <b>8,245</b>         |
| Asset retirement obligations   | 17    | 641                               | 566                  |
| Long-term debt   | 13    | 7,998                             | 8,198                |
| Deferred tax liabilities   | 16    | 3,897                             | 3,696                |
| Other non-current liabilities  |       | 91                                | 18                   |
| <b>Total liabilities</b>   |       | <b>21,186</b>                     | <b>20,723</b>        |
| <b>Minority interest</b>   |       | <b>1,865</b>                      | <b>1,860</b>         |
| <b>Shareholders' equity:</b>   | 14    |                                   |                      |
| Common stock par value 0.01 RUB (shares issued and outstanding:<br>9 377 238 359 and 9 092 174 000 as of September 30, 2006 and<br>December 31, 2005 respectively) |       | 20                                | 20                   |
| Additional paid-in capital   |       | 2,143                             | 19                   |
| Retained earnings  |       | 9,900                             | 7,394                |
| <b>Total shareholders' equity</b>  |       | <b>12,063</b>                     | <b>7,433</b>         |
| <b>Total liabilities and shareholders' equity</b>  |       | <b>\$ 35,114</b>                  | <b>\$ 30,016</b>     |

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

*See Accountants' Review Report*

OJSC Rosneft Oil Company  
Consolidated Statements of Income

*(in millions of US dollars, except earnings per share data)*

|   | Notes | Three months<br>ended<br>September 30,<br>2006,<br>(unaudited) | Three months<br>ended<br>September 30,<br>2005,<br>(unaudited) | Nine<br>months ended<br>September 30,<br>2006<br>(unaudited) | Nine<br>months ended<br>September 30, 2005,<br>as restated<br>(unaudited) |
|---|-------|--|--|--|---|
| <b>Revenues</b>   |       |  |  |  |   |
| Oil and gas sales   | 18    | \$ 6,580   | \$ 4,748   | \$ 18,137  | \$ 11,468   |
| Petroleum products<br>and processing fees                             | 18    | 2,443  | 2,226  | 7,069  | 5,206   |
| Support services and other revenues                                   |       | 142  | 106  | 315  | 270   |
| <b>Total</b>  |       | <b>9,165</b>   | <b>7,080</b>   | <b>25,521</b>  | <b>16,944</b>   |
| <b>Costs and expenses</b>   |       |  |  |  |   |
| Production and operating expenses                                     |       | 541  | 325  | 1,481  | 1,093   |
| Cost of purchased oil<br>and petroleum products<br>and refining costs |       | 459  | 138  | 1,561  | 443   |
| General and administrative expenses                                   |       | 209  | 214  | 557  | 400   |
| Pipeline tariffs<br>and transportation costs                          |       | 902  | 746  | 2,359  | 1,642   |
| Exploration expenses  |       | 46   | 53   | 144  | 117   |
| Depreciation, depletion<br>and amortization                           |       | 444  | 355  | 1,236  | 1,053   |
| Accretion expense   |       | 9  | 9  | 25   | 26  |
| Taxes other than income tax   |       | 1,844  | 1,506  | 5,284  | 3,706   |
| Export customs duty   | 15    | 2,947  | 1,773  | 7,740  | 3,916   |
| <b>Total</b>  |       | <b>7,401</b>   | <b>5,119</b>   | <b>20,387</b>  | <b>12,396</b>   |
| <b>Operating income</b>   |       | <b>1,764</b>   | <b>1,961</b>   | <b>5,134</b>   | <b>4,548</b>  |
| <b>Other income /(expenses)</b>                                       |       |  |  |  |   |
| Interest income   |       | 42   | 20   | 102  | 57  |
| Interest expense  |       | (190)  | (185)  | (563)  | (576)   |
| Loss on disposal of property,<br>plant and equipment                  |       | (8)  | (21)   | (25)   | (23)  |
| Loss on disposal of investments                                       |       | (1)  | –  | (6)  | (9)   |
| Gain on disposal of share in CJSC<br>Sevmorneftegaz                   | 8     | –  | –  | –  | 1,303   |
| Equity share in affiliates' profits                                   |       | 13   | 11   | 32   | 31  |
| Dividends and income<br>from joint ventures                           |       | 1  | –  | 2  | 3   |
| Other expenses, net   |       | (63)   | (58)   | (69)   | (118)   |
| Foreign exchange (loss) / gain  |       | (39)   | (14)   | (316)  | 145   |
| <b>Total other income / (expenses)</b>                                |       | <b>(245)</b>   | <b>(247)</b>   | <b>(843)</b>   | <b>813</b>  |
| <b>Income before income tax</b>                                       |       | <b>1,519</b>   | <b>1,714</b>   | <b>4,291</b>   | <b>5,361</b>  |
| Income tax expense  | 16    | (445)  | (446)  | (1,264)  | (1,393)   |
| <b>Income before minority interest</b>                                |       | <b>1,074</b>   | <b>1,268</b>   | <b>3,027</b>   | <b>3,968</b>  |
| Minority interest in subsidiaries'<br>earnings, net of tax            |       | (23)   | (60)   | (97)   | (374)   |
| <b>Net income</b>   |       | <b>\$ 1,051</b>  | <b>\$ 1,208</b>  | <b>\$ 2,930</b>  | <b>\$ 3,594</b>   |
| Earnings per share (in US\$) –<br>basic and diluted                   |       | \$ 0.11  | \$ 0.13  | \$ 0.32  | \$ 0.40   |
| Weighted average number<br>of shares outstanding                      |       | 9,311,255,276  | 9,092,174,000  | 9,165,469,574  | 9,092,174,000   |

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

*See Accountants' Review Report*

OJSC Rosneft Oil Company  
Consolidated Statement of Changes in Shareholders' Equity  
For the nine months ended September 30, 2006  
*(in millions of US dollars)*

|  | <b>Common<br/>stock</b> | <b>Additional<br/>paid-in<br/>capital</b> | <b>Retained<br/>earnings</b> | <b>Shareholders'<br/>equity</b> |
|--|-------------------------|---|------------------------------|---------------------------------|
| <b>Balance at December 31,<br/>2005</b>              | \$ 20                   | \$ 19                                     | \$ 7,394                     | \$ 7,433                        |
| Net income for the period<br>(unaudited)             | –                       | –   | <b>2,930</b>                 | <b>2,930</b>                    |
| Ordinary share issue<br>(unaudited) (Note 14)        | –                       | <b>2,124</b>                              | –                            | <b>2,124</b>                    |
| Dividends declared on<br>common stock (unaudited)    | –                       | –   | <b>(424)</b>                 | <b>(424)</b>                    |
| <b>Balance at September 30,<br/>2006 (unaudited)</b> | <b>\$ 20</b>            | <b>\$ 2,143</b>                           | <b>\$ 9,900</b>              | <b>\$ 12,063</b>                |

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

*See Accountants' Review Report*

OJSC Rosneft Oil Company  
Consolidated Statements of Cash Flows  
*(in millions of US dollars)*

|  | Nine months ended<br>September 30, 2006<br>(unaudited) | Nine months ended<br>September 30, 2005,<br>as restated<br>(unaudited) |
|--|--|--|
| <b>Operating activities</b>  |  |  |
| <b>Net income</b>  | \$ 2,930   | \$ 3,594   |
| Reconciliation of net income to net cash provided by operating activities:             |  |  |
| Effect of foreign exchange   | 245  | (49)   |
| Gain on disposal of share in CJSC Sevmorneftegaz                                       | –  | (1,303)  |
| Depreciation, depletion and amortization   | 1,236  | 1,053  |
| Dry well expenses  | 20   | 14   |
| Loss on disposal of property, plant and equipment                                      | 25   | 23   |
| Deferred income tax  | (89)   | (62)   |
| Accretion expense  | 25   | 26   |
| Equity share in affiliates' profits  | (32)   | (31)   |
| Increase in allowance for doubtful accounts and bank loans granted                     | 3  | 5  |
| Minority interests in subsidiaries' earnings   | 97   | 374  |
| Changes in operating assets and liabilities net of acquisitions:                       |  |  |
| Increase in accounts receivable  | (982)  | (1,262)  |
| Increase in inventories  | (204)  | (208)  |
| (Increase) / decrease in restricted cash   | (5)  | 3  |
| (Increase) / decrease in prepayments and other current assets                          | 65   | (367)  |
| Increase in other non-current assets   | (137)  | (79)   |
| Increase in long-term bank loans granted   | (35)   | (43)   |
| Increase in interest payable   | 107  | 20   |
| Increase / (decrease) in accounts payable and accrued liabilities                      | 208  | (850)  |
| Increase in income and other tax liabilities   | 25   | 1,119  |
| Increase in other current and non-current liabilities                                  | 58   | 8  |
| <b>Net cash provided by operating activities</b>                                       | <b>3,560</b>   | <b>1,985</b>   |
| <b>Cash flows from investing activities</b>  |  |  |
| Capital expenditures   | (2,131)  | (1,292)  |
| Acquisition of licenses  | (875)  | (135)  |
| Repayment of Sakhalin-1 carried costs (Note 10)  | (1,339)  | –  |
| Proceeds from disposals of property, plant and equipment                               | 21   | 22   |
| Acquisition of short-term investments  | (704)  | (714)  |
| Proceeds from sale of short-term investments   | 450  | 708  |
| Acquisition of entities and additional shares in subsidiaries,<br>net of cash acquired | (181)  | (133)  |
| Proceeds from sale of long-term investments  | 26   | 83   |
| Acquisition of debt receivable   | (463)  | –  |
| Acquisition of long-term investments   | (59)   | (73)   |
| <b>Net cash used in investing activities</b>   | <b>\$ (5,255)</b>                                      | <b>\$ (1,534)</b>  |

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

*See Accountants' Review Report*

OJSC Rosneft Oil Company  
Consolidated Statements of Cash Flows (continued)  
*(in millions of US dollars)*

|   | Nine months ended<br>September 30, 2006<br>(unaudited) | Nine months ended<br>September 30, 2005,<br>as restated<br>(unaudited) |
|---|--|--|
| <b>Cash flows from financing activities</b>                   |  |  |
| Proceeds from short-term debt                                 | \$ 212   | \$ 30  |
| Repayment of short-term debt                                  | (603)  | (1,738)  |
| Proceeds from long-term debt                                  | 2,266  | 2,305  |
| Repayment of long-term debt                                   | (2,068)  | (1,556)  |
| Proceeds from share issue, net of commission (Note 14)        | 2,124  | –  |
| Dividends paid  | (424)  |  |
| Dividends paid to minority shareholders in subsidiaries       | (17)   | (10)   |
| <b>Net cash, provided by / (used in) financing activities</b> | <b>1,490</b>   | <b>(969)</b>   |
| Decrease in cash and cash equivalents                         | (205)  | (518)  |
| Cash and cash equivalents at beginning of period              | 1,173  | 1,033  |
| Effect of foreign exchange on cash and cash equivalents       | 23   | (14)   |
| <b>Cash and cash equivalents at end of period</b>             | <b>\$ 991</b>  | <b>\$ 501</b>  |
| <b>Supplementary disclosures of cash flow information</b>     |  |  |
| Cash paid for interest (net of amount capitalized)            | \$ 429   | \$ 440   |
| Cash paid for income taxes                                    | 1,575  | 1,358  |
| <b>Supplementary disclosure of non-cash activities</b>        |  |  |
| Income tax offsets  | \$ –   | \$ 33  |

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

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements

As of and for the three and nine months ended September 30, 2006 and 2005

*(all amounts in tables are in million of US dollars, except as noted otherwise)*

### **1. Nature of Operations**

Open Joint Stock Company ("OJSC") Rosneft Oil Company ("Rosneft") and its subsidiaries, (collectively the "Company" or the "Group"), are principally engaged in exploration, development, production and sale of crude oil and gas and refining, transportation and sale of petroleum products in the Russian Federation ("RF") and in certain international markets.

### **2. Significant Accounting Policies**

#### **Form and Content of the Interim Consolidated Financial Statements**

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

The interim consolidated financial statements included herein are unaudited and have been prepared in accordance with US GAAP for interim financial reporting of public companies (primarily Accounting Principle Board Opinion 28 (APB 28) "*Interim Financial Reporting*"). These interim consolidated financial statements should be read in conjunction with the Company's 2005 audited consolidated financial statements and the notes related thereto. In the opinion of management, the financial statements reflect all adjustments of a normal and recurring nature necessary to present fairly the Company's financial position, results of operations and cash flows for the interim periods.

The results of operations for nine months ended September 30, 2006 may not be indicative of the results of operations for the full year. These interim consolidated financial statements contain information updated through December 22, 2006.

The accompanying interim consolidated financial statements differ from the financial statements issued for statutory purposes in Russia in that they reflect certain adjustments, not recorded in the Company's statutory books, which are appropriate to present the financial position, results of operations and cash flows in accordance with US GAAP. The principal adjustments relate to: (1) recognition of certain expenses; (2) valuation and depreciation of property, plant and equipment; (3) foreign currency translation; (4) deferred income taxes; (5) valuation allowances for unrecoverable assets; (6) accounting for the time value of money; (7) accounting for investments in oil and gas property and conveyances; (8) consolidation principles; (9) recognition and disclosure of guarantees, contingencies, commitments and certain assets and liabilities; (10) accounting for asset retirement obligations; (11) business combinations and goodwill/negative goodwill.

Certain amounts contained in the consolidated statements of income and cash flows for nine months ended September 30, 2005 were reclassified to conform to the current period presentation and restated to reflect certain prior period adjustments which, in the opinion of the Company's management, are insignificant both individually and in aggregate.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Significant Accounting Policies (continued)

#### Management Estimates

The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheet as well as the amounts of revenues and expenses recognized during the reporting periods. Certain significant estimates and assumptions for the Company include: estimation of economically recoverable oil and gas reserves; rights to and recoverability and useful lives of long-term assets and investments; impairment of goodwill; allowances for doubtful accounts receivable; asset retirement obligations; legal and tax contingencies; environmental remediation obligations; recognition and disclosure of guarantees and other commitments; fair value measurements; ability to renew operating leases and to enter into new lease agreements; classification of certain debt amounts. Some of the most significant estimates are made in connection with the acquisition of OJSC Yuganskneftegaz. Management believes it has a reasonable and appropriate basis for its judgment pertaining to its estimates and assumptions. However, actual results could differ from those estimates.

#### Foreign Currency Translation

The management of the Company has determined the US Dollar as the functional and reporting currency for the purpose of financial reporting under US GAAP. Monetary assets and liabilities have been translated into US dollars using the official exchange rate as of the balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows are translated into US dollars at average exchange rates for the period or exchange rates prevailing on transaction dates where practicable.

Gains and losses resulting from the re-measurement into US dollars are included in the "Foreign exchange (loss)/gain" in the consolidated statement of income.

As of September 30, 2006, December 31, 2005, and as of September 30, 2005, the Central Bank of Russian Federation official rates of exchange ("CB RF exchange rate") were 26.78 rubles, 28.78 rubles and 28.50 rubles per US dollar respectively. As of December 22, 2006 the official rate of exchange was 26.29 rubles per US dollar.

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

#### Principles of Consolidation

The consolidated statements include business transactions of the subsidiaries in which the Company directly or indirectly owns more than 50% of common voting stock, or on which it otherwise exercises control. All intercompany transactions and balances have been eliminated. Investments in other significant entities in which the Company normally owns between 20% and 50% are generally accounted for under the equity method since the Company does not have absolute control, but rather significant influence. The investments in entities where the Company holds the majority of shares, but the minority shareholders have significant influence, are also accounted for using the equity method. Investments in other companies are accounted for at cost and adjusted for estimated impairment.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Significant Accounting Policies (continued)

#### Minority Interest

Minority interests in the net assets and net results of consolidated subsidiaries are shown under "Minority interest" in the accompanying consolidated balance sheets and statements of income. For majority-owned subsidiaries that incur losses, the Company recognizes 100% of the losses, after first reducing the related minority interests' balances to zero, unless minority shareholders committed to fund the losses. Further, when a majority-owned subsidiary becomes profitable, the Company recognizes 100% of profits until such time as the excess losses previously recorded have been recovered. Thereafter, the Company recognizes profits in accordance with the underlying ownership percentage. The actual ruble-denominated balances attributable to minority interests may differ from these amounts presented in these consolidated financial statements.

#### Cash and Cash Equivalents

Cash represents cash on hand and in the Company's bank accounts and interest bearing deposits which can be effectively withdrawn at any time without prior notice or penalties reducing the principal amount of the deposit.

#### Accounts Receivable

Trade accounts receivable are stated at their principal amounts outstanding net of allowances for doubtful debts. Specific 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.

#### Earnings per Share

Basic earnings per share is calculated by dividing net earnings attributable to common shares by the weighted average number of common shares outstanding during the corresponding period. In the absence of any securities-to-shares conversion transactions, the amount of basic earnings per share stated in these financial statements is equal to the amount of diluted earnings per share.

#### Inventories

Inventories, consisting primarily of crude oil, petroleum products and materials and supplies, are stated at the lower of weighted average cost of acquisition or market value. Market value shall not exceed net realizable value (i.e. the price at which inventories can be sold after allowing for the cost of completion and sale), and shall not be lower than net realizable values less the amount of margin.

#### Financial Investments

All debt and equity securities held by the Company are classified into one of the following three categories: trading securities; available-for-sale securities; held-to-maturity securities.

Trading securities are purchased and held principally for the purpose of sale in the nearest future. Held-to-maturity securities represent financial instruments that the Company has both the intent and the ability to hold to maturity. All other securities, which do not fall into these two categories are classified as available-for-sale securities.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Significant Accounting Policies (continued)

#### Financial Investments (continued)

Trading securities and available-for-sale securities are carried at fair (market) value. Held-to-maturity securities are stated at amortized cost. Unrealized gains or losses on trading securities are included in the consolidated statements of income. Unrealized gains and losses on available-for-sale securities less related tax effects are recorded as a separate component of comprehensive income until the date of disposal.

Realized gains and losses from the sale of available-for-sale securities are reported separately for each type of security. Dividends and interest income are recognized in the consolidated statements of income on an accrual basis.

Investments in shares or interests of companies where the Company has less than 20% equity interest and no significant influence, which are not publicly traded and whose market value is not readily available are carried at cost.

If the decline in fair value of an investment below its carrying value is other than temporary, the carrying value of the investment is reduced and a loss in the amount of any such decline is recorded. Cost method investments are evaluated for impairment when events or changes in circumstances occur which may have a significant effect on the fair value of these investments.

#### Sale and Repurchase Agreements and Securities Lending

Sale and repurchase agreements are treated as secured financing transactions. Securities sold under sale and repurchase agreements are included in trading securities. The corresponding liability is presented within short-term debt. The difference between the sale and repurchase price is treated as interest and is accrued over the life of repurchased agreements using the effective interest method.

#### Oil and Gas Properties

In accordance with Statement of Financial Accounting Standard ("SFAS 19"), *Financial Accounting and Reporting by Oil and Gas Producing Companies* (SFAS 19), oil and gas properties and the related expenses are recognized under the successful efforts method. This method prescribes that exploration costs, including geological and geophysical costs and the costs of dry holes, are charged to expense when incurred.

Exploratory well costs (including costs associated with stratigraphic test wells) are temporarily capitalized pending determination of whether potentially economic oil and gas reserves have been discovered by the drilling effort. The length of time necessary for this determination depends on the specific technical or economic difficulties in assessing the recoverability of the reserves. If a determination is made that the well did not encounter oil and gas in economically viable quantities, the well costs are expensed and are reported in "exploration expenses".

Exploratory drilling costs are temporarily capitalized pending determination of whether the well has found proved reserves if both of the following conditions are met:

- The well has found a sufficient quantity of reserves to justify, if appropriate, its completion as a producing well, assuming that the required capital expenditure is made; and
- Satisfactory progress toward ultimate development of the reserves is being achieved, with the Company making sufficient progress assessing the reserves and the economic and operating viability of the project.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Significant Accounting Policies (continued)

#### Oil and Gas Properties (continued)

The Company evaluates the progress made on the basis of regular project reviews which take into account the following factors:

- First, if additional exploratory drilling or other exploratory activities (such as seismic work or other significant studies) are either underway or firmly planned, the Company deems there to be satisfactory progress. For these purposes, exploratory activities are considered firmly planned only if they are included in the Company's three-year exploration plan/budget. At September 30, 2006, exploratory drilling costs capitalized on this basis were not material.
- In cases where exploratory activity has been completed, the evaluation of satisfactory progress takes into account indicators such as the fact that costs for development studies are incurred in the current period, or that governmental or other third-party authorizations are pending or that the availability of capacity on an existing transport or processing facility awaits confirmation. At September 30, 2006, exploratory drilling costs capitalized on this basis were not material.

Should the project be deemed economically viable, it is then transferred to the development stage, otherwise the costs are expensed.

Costs, including "internal" costs relating to drilling and equipping of development wells, including development dry holes, as well as costs required for drilling and equipping of injection wells in the process of oil and gas reserves development, are capitalized. These costs are included in oil and gas properties in the consolidated balance sheet.

#### Property, Plant and Equipment

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

Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are included in the statement of income.

#### Depreciation, Depletion and Amortization

Depletion expense of acquisition costs of proved oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalized costs related to oil and gas production is calculated using the unit-of production method based on proved developed reserves. Management of the Company considers each extraction division as the appropriate level for these calculations.

Acquisition costs of unproved properties are not amortized. These costs are reclassified as proved properties when the relevant reserve reclassification is made. Acquisition costs of unproved properties are reviewed for impairment. In case of impairment these costs are expensed when incurred.

Depreciation and amortization charges with respect to property, plant and equipment other than oil and gas properties is computed using the straight-line method and based on their useful lives.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Significant Accounting Policies (continued)

#### Depreciation, Depletion and Amortization (continued)

Depreciation rates are applied to similar types of buildings, machinery and equipment having similar economic characteristics, as shown below:

| <b>Asset Group</b>           | <b>Average Useful Life</b> |
|------------------------------|----------------------------|
| Buildings and constructions  | 30-35 years                |
| Plant and machinery          | 15 years                   |
| Vehicles and other equipment | 6 years                    |
| Service vessels              | 20 years                   |
| Offshore drilling assets     | 20 years                   |

#### Interests in Joint Operations

A joint operation is a contractual arrangement whereby two or more parties (participants) undertake an economic activity that is subject to joint control. Joint control is only exercised when strategic, financial and operating decisions relating to the joint activity are made unanimously by all the parties. A joint venture is as a registered company, partnership or any other legal form for the purposes of handling joint operations.

Financial results, assets and liabilities arising from interests in incorporated joint ventures are recognized in these consolidated financial statements using the equity method of accounting. Under the equity method, investments in joint ventures are recognized at the cost of financial investments increased by any change to the share of net assets from the date of inception of a joint venture, less distributed earnings and impairment of financial investments. The consolidated statements of income include the Company's share in gains and losses arising from joint ventures.

The Company discontinues the use of the equity method of accounting from the date on which it ceases to have joint control over, or have significant influence in, a jointly-controlled entity, or when its interest in a jointly-controlled entity is reclassified to assets held for sale.

Certain activities of the Company (mainly oil exploration and production) are conducted through interests in joint projects, where the parties exercise joint control over the assets without a legal entity being established. Income, expenses, assets and liabilities arising from participation in joint projects are included in the consolidated financial statements on a pro rata basis corresponding to the participation share.

A part of an interest in a jointly-controlled oil and gas exploration and production entity may be assigned to other participants or third parties. In which case, in accordance with SFAS 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, such assignment is performed and accounted for under an arrangement called a "carried interest" whereby the assignee agrees to carry all costs of drilling, developing, and operating the property. The assignee is also entitled to all of the revenue from hydrocarbon production from the property, excluding any third party interest, until all of the assignee's costs, including the contractual rate of return, have been recovered, at such time the assignor will resume its participation in operating expenses and income.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Significant Accounting Policies (continued)

#### Impairment of Long-Lived Assets

Long-lived assets, including blocks with proved oil and gas reserves, are assessed for potential impairment in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

Oil and gas properties are assessed whenever events or circumstances indicate potential impairment. If the carrying value of oil and gas properties is not recoverable through undiscounted cash flows, an impairment is recognized. The impairment is determined on the basis of the estimated fair value of oil and gas properties which, in turn, is measured by discounting future net cash flows or with reference to current market prices of oil and gas properties, if available. Discounted future cash flows from oil and gas fields are based on the most reliable management estimates of future prices that rely on recent actual prices and published prices for forward transactions; such prices are applied to forecast production volumes at particular fields with further discounting for the expected risk level. Forecast production volumes shall be understood as reserves, including probable reserves that are proposed to be extracted using a known amount of capital expenditures. Production volumes and prices correspond to the internal plans and forecasts, as well as other data in the published financial statements. Assumptions regarding future prices and costs used to assess oil and gas properties for impairment differ from those used in the standard procedure for discounting net cash flows from proved oil and gas reserves.

Grouping of assets for the purpose of depreciation is performed on the basis of the lowest level of identifiable cash flows that are largely independent of the cash flows from other groups of assets – as a rule, for oil and gas properties such level is represented by the field, for refining assets – by the whole refining unit, for service stations – by the facilities. Long-lived assets intended by management for use during a period not exceeding one year are recorded at the lower of depreciated value or fair value, less selling expenses.

Acquisition costs of unproved oil and gas properties are assessed for impairment on a regular basis and any estimated impairment is charged to expenses.

Recoverability of oil and gas properties attributable to the refining, marketing and distribution segment is generally assessed on the basis of expected future cash flows from key operating units, usually entire legal entities. Since assets of this segment (particularly refining units) represent an integrated set of operations, this condition is taken into account in measuring the value of particular units or the extent of their utilization to generate other cash flows.

#### Business Combinations

The Company accounts for its business acquisitions under the purchase method of accounting. The total cost of acquisitions is allocated to the underlying assets, including intangible assets, and liabilities based on their respective estimated fair values. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, license and other asset lives and market multiples, among other items.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Significant Accounting Policies (continued)

#### Goodwill and Other Intangible Assets

Goodwill represents the excess of the acquisition cost over the fair value of net assets acquired. The excess of the fair value of the acquired share of net assets over their acquisition cost represents negative goodwill and is allocated among the non-current assets acquired, excluding investments and deferred tax assets, which may result in their value being reduced to zero.

For investees accounted for under the equity method, the excess of the cost to acquire a share in those entities over the fair value of the acquired share of net assets as of the acquisition date is treated as embedded goodwill and is considered in computing the Company's equity share in income/loss of equity investees.

In accordance with requirements of SFAS 142, *Goodwill and Other Intangible Assets*, goodwill and intangible assets with indefinite useful lives are not amortized. Instead, they are tested at least annually for impairment.

Intangible assets that have a finite useful life are amortized using the straight-line method over the shorter of their useful life or the term established by legislation.

#### Capitalized Interest

Interest expense related to the use of borrowed funds used for capital construction projects and acquisition of properties, plant and equipment is capitalized provided such interest expense could have been avoided if the Company had not made capital investments. Interest is capitalized only during the period when construction activities are actually in progress and until the resulting properties are put into operation. The Company capitalized US\$ 103 million and US\$ 73 million of interest expenses on loans and borrowings in the first nine months of 2006 and 2005.

#### Leasing Agreements

Capital leases, which transfer to the Company 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 operation and comprehensive income.

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term unless leased assets are capitalized because the terms of the lease agreement grant the Company ownership rights over the leased assets by the end of the lease term or containing a bargain purchase option. In the latter cases capitalized assets are depreciated over the estimated useful life of the asset regardless of the lease term.

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 operation and comprehensive income on a straight-line basis over the lease term.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Significant Accounting Policies (continued)

#### Asset Retirement Obligations

The Company has conditional asset retirement obligations associated with its core business activities. The nature of the assets and potential obligations are as follows:

Exploration and Production – The Company's exploration, development and production activities involve the use of the following assets: wells, related equipment and operating sites, oil gathering and treatment facilities, tank farms and in-field pipelines. Generally, licenses and other regulatory acts require that such assets be decommissioned upon the completion of production. According to these requirements, the Company is obliged to decommission wells, dismantle equipment, restore the sites and perform other related activities. The Company's estimates of these obligations are based on current regulatory or license requirements, as well as actual dismantling and other related costs. Asset retirement obligations are calculated in accordance with the provisions of SFAS 143, *Accounting for Asset Retirement Obligations*.

Refining, Marketing and Distribution – This business segment covers refining operations, marine and other distribution terminals, and retail sales. The Company's refining operations consist of major petrochemical operations and industrial complexes. These industrial complexes have been in operation for several decades. The Company's management believes that given the nature of the operations, the useful lives of these industrial complexes are indeterminable, while certain of their operating components and equipment have definite useful lives. Legal or contractual asset retirement obligations related to petrochemical, oil refining, marketing and distribution activities are not recognized due to the limited history of such activities in these segments, the lack of clear legal requirements as to the recognition of obligations, as well as the fact that useful lives of such assets are not determinable.

The Company's marine and other distribution terminals, including its retail network, operate under the regulatory requirements of local authorities and lease arrangements. These requirements generally provide for elimination of the consequences of the use of those assets, including dismantling of equipment, restoration of land, etc. The Company's estimate of conditional asset retirement obligations takes into account the above requirements.

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 which 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 SFAS 143 estimates.

Due to continuous changes in the Russian regulatory and legal environment, there could be future changes to the requirements and contingencies associated with the retirement of long-lived assets.

#### Fair Value of Financial Instruments

SFAS 107, *Disclosures about Fair Value of Financial Instruments*, defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Fair Value of Financial Instruments (continued)

Financial assets and financial liabilities recognized in the accompanying consolidated balance sheets include cash and cash equivalents, short-term and long-term investments, accounts receivable and payable, short-term debt and other current and non-current assets and liabilities.

The Company, using available market information, management's estimates and appropriate valuation methodologies, has determined the approximate fair values of financial instruments.

#### Income Taxes

Russian legislation does not contain the concept of a 'consolidated tax payer' and, accordingly, the Company is not subject to Russian taxation on a consolidated basis but rather on an individual company basis. Income taxes are provided on taxable profit as determined under the Russian Federation Tax Code. Deferred income tax assets and liabilities are recognized in the accompanying consolidated financial statements in the amount determined by the Company using the liability method in accordance with SFAS 109, *Accounting for Income Taxes*. This method takes into account future tax consequences, based on the effective tax rate, associated with differences between the carrying values of assets and liabilities and their taxable base, which gives immediate income statement effect to changes in income tax laws, including changes in the tax rates. A valuation allowance for a deferred tax asset is recorded when management believes that it is more likely than not that this tax asset will not be realized.

The Company follows the provisions of APB 28, *Interim Financial Reporting*, to arrive at the effective tax rate. The effective tax rate is the best estimate of the expected annual tax rate to be applied to the taxable income for the current reporting period. The rate is based on the currently enacted tax rate (24%) and includes estimates of the annual tax effect of permanent differences and the realization of certain deferred tax assets.

#### Recognition of Revenues

Revenues are recognized when title passes from the seller to the customer, the contract price is fixed or determinable and collectability of the receivable is reasonably assured. Specifically, domestic sales of crude oil and gas, as well as petroleum products and materials are recognized when title passes. For export sales, title generally passes at the border of the Russian Federation and the Company covers transportation expenses, duties and taxes on those sales. Revenues include excise taxes and custom duties (see Note 15).

Sales of support services are recognized as services performed provided that the service price can be determined and no significant uncertainties regarding the receipt of revenues exist.

Revenues are shown net of value added tax.

#### Transportation Expenses

Transportation expenses recognized in the consolidated statement of income represent all expenses incurred in the transportation of crude oil and petroleum products via the Trasneft pipeline network, as well as by railway and other transport means.

#### Refinery Maintenance Costs

The Company recognizes the costs of overhauls and preventive maintenance performed with respect to oil refining assets as expenses when incurred.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Environmental Liabilities

Environmental expenditures are expensed or capitalized, depending upon 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 clean-ups are probable and the costs can be reasonably estimated.

#### Guarantees

The fair value of a guarantee is determined and recorded as a liability at the time when the guarantee is issued. The initial guarantee amount is subsequently remeasured to reflect the changes in the underlying liability. The expense is included in the related line items of the consolidated income statement, based on the nature of the guarantee. When the likelihood of performing on a guarantee becomes probable, a liability is accrued, provided it is reasonably determinable on the basis of the facts and circumstances at that time.

#### Comprehensive Income

The Company applies SFAS 130, *Reporting Comprehensive Income*, which establishes standards for the calculation and reporting of the Company's comprehensive income (net income plus all other changes in net assets from non-owner sources) and its components in consolidated financial statements.

As of September 30, 2006 and 2005, there were no other comprehensive income items and, therefore, comprehensive income for the first nine months of 2006 and 2005 equals net income.

#### Accounting for Contingencies

Certain conditions may exist as of the date of these consolidated financial statements which may further result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company's management makes an assessment of such contingent liabilities which is based on assumptions and is a matter of opinion. In assessing loss contingencies relating to legal or tax proceedings that involve the Company or unasserted claims that may result in such proceedings, the Company, after consultation with legal or tax advisors, evaluates the perceived merits of any legal or tax proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

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

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

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Recent Accounting Standards

In June 2006, FASB issued Interpretation ("FIN") 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FAS 109. FIN 48, which is the most significant change to accounting for income taxes since the adoption of the liability approach, creates a single model to address uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The statement also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 clearly scopes out income taxes from FAS 5, *Accounting for Contingencies*.

FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The cumulative effect adjustment would not apply to those items that would not have been recognized in earnings, such as the effect of adopting FIN 48 on tax positions related to business combinations.

The Company is currently evaluating the impact FIN 48 will have on the Company's financial statements.

In September 2006, the FASB issued SFAS 158 "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*". The standard will require employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. The standard will make it easier for investors, employees, retirees and others to understand and assess an employer's financial position and its ability to fulfill the obligations under its benefit plans. SFAS 158 applies to plan sponsors that are public and private companies and nongovernmental not-for-profit organizations. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006, for entities with publicly traded equity securities, and at the end of the fiscal year ending after June 15, 2007, for all other entities. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Since the Company has no defined benefit pension plans, this standard will have no impact to the Company's financial position and results of operations.

In November 2006 the FASB's Emerging Issues Task Force ("EITF") made a decision on Issue 06-6 "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments"

- Issue 1 of Issue 06-6 affirmed that the change in fair value of an embedded conversion option upon the modification or exchange of a convertible debt instrument should not be included in the analysis of cash flows performed under Issue 96-19. However, if the guidance in Issue 96-19 does not result in a conclusion that a substantial modification or exchange has occurred, the issuer also must calculate the change in the fair value of the embedded conversion option immediately before and after the modification. If the change in fair value of an embedded conversion option is at least 10 percent of the carrying value of the debt instrument immediately prior to the modification, then a substantial modification or exchange of the debt instrument has occurred and the issuer should apply extinguishment accounting.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 2. Summary of Significant Accounting Policies (continued)

#### Recent Accounting Standards (continued)

- Issue 2 of Issue 06-6 affirmed that when a debt instrument is modified (or exchanged) in a transaction that is not accounted for as an extinguishment, an increase in the fair value of an embedded conversion option resulting from the modification should reduce the carrying amount of the debt instrument (i.e., increasing a debt discount or reducing a debt premium) with a corresponding increase in additional paid-in capital. However, a decrease in the fair value of an embedded conversion option resulting from a modification (or exchange) should not be recognized.

The Company expects that EITF 06-6 will not have a material impact to the Company's financial statements.

### 3. Significant Acquisitions

#### OJSC Rosneft-Krasnodarneftegaz

In the first half of 2005, the Company acquired 33,337,187 common shares (38.66% of the total number of common shares) and 17,633,509 preferred shares (61.63% of the total number of preferred shares) in OJSC Rosneft-Krasnodarneftegaz, thus increasing its share in the share capital of OJSC Rosneft-Krasnodarneftegaz to 95.46%. The purchase price of the above shares amounted to US\$ 110 million and was paid in cash.

The fair value of net assets acquired amounted to US\$ 239 million based on a report of an independent appraiser. Because the fair value of the net assets acquired exceeded the purchase price, negative goodwill existed which has been allocated proportionately between non-current assets, primarily to oil and gas properties and mineral rights. The final purchase price allocation did not have a material effect on the carrying values of assets acquired and liabilities assumed.

#### OJSC Nakhodka Oil Seatrade Port

In June 2006, the Company acquired 97.51% equity shareholding in OJSC Nakhodka Oil Seatrade Port. The purchase price amounted to US\$ 19.5 million and was paid in cash. The purchase price was allocated to the fair value of assets acquired and liabilities assumed, the resulting goodwill amounted to US\$ 9.5 million, which the Company attributes to synergy effect from the future integration with the operations of the Company's subsidiary LLC Rosneft-Nakhodkanefteprodukt.

The results of operations of OJSC Nakhodka Oil Seatrade Port are not material to warrant pro-forma presentation.

#### OJSC Rosneft – Tuapsenefteprodukt

In January 2006, the Company, through one of its subsidiaries, purchased an additional 39.26% of the voting stock (30.24% of the share capital) of OJSC Rosneft – Tuapsenefteprodukt, a consolidated subsidiary. The purchase price amounted to US\$ 100 million and was paid in cash. After the purchase, the Company's share in OJSC Rosneft – Tuapsenefteprodukt increased from 50.67% to 89.93% of voting shares (from 38.00% to 68.24% of the share capital).

The excess of purchase price over the fair value of the net assets acquired was US\$ 34 million and is accounted for as goodwill. The Company explains the existence of the goodwill by expected additional positive effect arising from risk optimization which became possible after obtaining more than 75% of voting power.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 3. Significant Acquisitions (continued)

#### OJSC Daltransgaz

In February 2006, the Company purchased 25% of the additional issue of shares by OJSC Daltransgaz, an equity investee, for RUB 722 million (US\$ 26 million at the CB RF exchange rate as of date of settlement).

In August 2006 the Company purchased 25% of additional issue of shares by OJSC Daltransgaz for RUB 525 million (US\$ 19 million at the CB RF exchange rate as of the date of settlement). The Company continues to maintain its interest in OJSC Daltransgaz of 25% plus one share.

#### OJSC Vserossiysky Bank Razvitiya Regionov

In July 2006 the Company won an auction and purchased 25.49% ordinary shares of OJSC Vserossiysky Bank Razvitiya Regionov (VBRR) for RUB 333 million (US\$ 12 million at the CB RF rate as of the date of settlement), thus increasing its interest in VBRR to 76.47%. The settlement was made in cash. The purchase price was fully allocated to the fair value of assets acquired and liabilities assumed.

#### OJSC Selkupneftegaz

In July 2005, the Company acquired 34 common shares (34% of the total number of common shares) in OJSC Selkupneftegaz, thus increasing its share in the share capital of OJSC Selkupneftegaz to 100%. The purchase price of the above shares amounted to US\$ 20 million and was paid in cash.

The fair value of net assets acquired amounted to US\$ 215 million based on a report of an independent appraiser. Because the fair value of the net assets acquired exceeded the purchase price, the negative goodwill has been allocated proportionately between non-current assets, primarily to mineral rights. The final purchase price allocation did not have a material effect on the carrying values of assets acquired and liabilities assumed.

### 4. Cash and Cash Equivalents

Cash and cash equivalents comprise the following:

|  | <b>September 30, 2006</b> | <b>December 31,</b> |
|--|---------------------------|---------------------|
|  | <b>(unaudited)</b>        | <b>2005</b>         |
| Cash in hand and cash in bank – RUB                | \$ 216                    | \$ 414              |
| Cash in hand and cash in bank – foreign currencies | 183                       | 394                 |
| Deposits and other                                 | 592                       | 365                 |
| <b>Total cash and cash equivalents</b>             | <b>\$ 991</b>             | <b>\$ 1,173</b>     |

Cash accounts denominated in foreign currencies represent primarily cash in US\$.

Deposits and other represent primarily bank deposits denominated in RUB.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 5. Short-Term Investments

Short-term investments comprise the following:

|                                     | September 30, 2006<br>(unaudited) | December 31,<br>2005 |
|-------------------------------------|-----------------------------------|----------------------|
| Short-term loans granted            | \$ 23                             | \$ 27                |
| Loans to related parties            | 34                                | 32                   |
| Trading securities:                 |                                   |                      |
| Promissory notes                    | 3                                 | 7                    |
| Corporate and state bonds           | 129                               | 74                   |
| Other                               | 21                                | 10                   |
| Short-term promissory notes         | 183                               | 7                    |
| Bank deposits                       | 19                                | 3                    |
| Investments for resale              | –                                 | 2                    |
| Other                               | 3                                 | 3                    |
| <b>Total short-term investments</b> | <b>\$ 415</b>                     | <b>\$ 165</b>        |

State bonds primarily represent federal loan bonds issued by the Ministry of Finance of the Russian Federation with maturity ranging from March 2008 to February 2036, coupon yields in 9 months 2006 ranging from 6.1% to 13.5% p.a. and yields to maturity ranging from 6.0% to 8.0% p.a. depending on the issue.

Corporate bonds represent bonds issued by large Russian corporations with maturity ranging from December 2007 to July 2014 and interest rates ranging from 5.5% to 13.8% p.a.

Short-term promissory notes mature in March 2007 and bear an interest rate of 6.5% p.a.

Bank deposits represent RUB-denominated deposits with the term of more than 3 months bearing interest rate of 9.5% p.a.

Unrealized gains and losses on available-for-sale securities are not significant.

### 6. Accounts Receivable, Net

Accounts receivable comprise the following:

|                                       | September 30, 2006<br>(unaudited) | December 31,<br>2005 |
|---------------------------------------|-----------------------------------|----------------------|
| Trade receivables                     | \$ 1,095                          | \$ 935               |
| Value added tax receivable            | 2,012                             | 1,536                |
| Other taxes                           | 91                                | 88                   |
| Banking loans to customers            | 554                               | 305                  |
| Short-term assignment agreements      | –                                 | –                    |
| Other                                 | 157                               | 63                   |
| Less: allowance for doubtful accounts | (74)                              | (69)                 |
| <b>Total accounts receivable, net</b> | <b>\$ 3,835</b>                   | <b>\$ 2,858</b>      |

The Company's trade accounts receivable are denominated primarily in US dollars. Credit risk is managed through the use of letters of credit, and requesting advance payments from customers for the majority of sales.

Value added tax receivable (VAT) primarily includes input VAT associated with export sales, which is reimbursed from the budget in accordance with Russian tax legislation.

*See Accountants' Review Report*

OJSC Rosneft Oil Company

Notes to Interim Consolidated Financial Statements (continued)

**7. Inventories**

Inventories as of September 30, 2006 comprise the following:

|                          | <b>September 30, 2006</b><br><b>(unaudited)</b> | <b>December 31,</b><br><b>2005</b> |
|--------------------------|---|------------------------------------|
| Materials and supplies   | \$ 472  | \$ 332                             |
| Crude oil and gas        | 314   | 300                                |
| Petroleum products       | 232   | 182                                |
| <b>Total inventories</b> | <b>\$ 1,018</b>                                 | <b>\$ 814</b>                      |

Materials and supplies mostly include spare parts, construction materials and pipes. Petroleum products also include those designated for sale as well as for own use.

**8. Long-Term Investments**

Long-term investments comprise the following:

|   | <b>September 30, 2006</b><br><b>(unaudited)</b> | <b>December 31,</b><br><b>2005</b> |
|---|---|------------------------------------|
| <b>Equity method investments</b>          |   |                                    |
| Polar Lights Company LLC                  | \$ 127  | \$ 94                              |
| CJSC Kaspiy-1                             | 30  | 29                                 |
| JV Rosneft-Shell Caspian Ventures Limited | 24  | 21                                 |
| OJSC Daltransgaz                          | 56  | 11                                 |
| OJSC Verkhnechonskneftegaz                | 227   | 231                                |
| Other                                     | 10  | 4                                  |
| <b>Total</b>                              | <b>474</b>                                      | <b>390</b>                         |
| <i>Available for sale securities</i>      |   |                                    |
| Russian government bonds                  | 1   | 2                                  |
| Long-term promissory notes                | 16  | 7                                  |
| <i>Held-to-maturity</i>                   |   |                                    |
| Long-term loans granted                   | 12  | 2                                  |
| Long-term loans to equity investees       | 73  | 21                                 |
| Investments in joint operations           | 2   | 4                                  |
| Cost method investments                   | 13  | 10                                 |
| <b>Total long-term investments</b>        | <b>\$ 591</b>                                   | <b>\$ 436</b>                      |

Equity share in income/(loss) of material investments recorded using the equity method:

|   | <b>Participation interest</b><br><b>(percentage) as of September 30, 2006</b> | <b>Share in income/(loss) of equity investees</b>                 |   |
|---|---|---|---|
|   |   | <b>Nine months ended September 30, 2006</b><br><b>(unaudited)</b> | <b>Nine months ended September 30, 2005</b><br><b>(unaudited)</b> |
| Polar Lights Company LLC                  | 50.00   | \$ 33   | \$ 34   |
| OJSC Daltransgaz                          | 25.00   | -   | -   |
| JV Rosneft-Shell Caspian Ventures Limited | 51.00   | 3   | 16  |
| Rosneft-Stroytransgaz Ltd                 | 50.00   | (1)   | (15)  |
| CJSC Kaspiy-1                             | 45.00   | 1   | -   |
| OJSC Verkhnechonskneftegaz                | 25.94   | (4)   | -   |
| Other                                     | -   | -   | (4)   |
| <b>Total equity share</b>                 |   | <b>\$ 32</b>  | <b>\$ 31</b>  |

See Accountants' Review Report

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 8. Long-Term Investments (continued)

#### **CJSC Sevmorneftegaz**

In January 2002, the Company, through OJSC Rosneft-Purneftegaz, and OJSC Gazprom, through CJSC Rosshelf jointly established CJSC Sevmorneftegaz with equal shares in equity. The cost of investment in CJSC Sevmorneftegaz was US\$ 17 thousand. CJSC Sevmorneftegaz is primarily engaged in exploration and production activities on the Prirazlomnoye and Shtokmanovskoye oil and gas condensate fields.

In December 2004, it was resolved to sell the Company's share in the project to the other participant (which was OJSC Gazprom) (the "Buyer") and full payment was received under the share purchase agreement. At December 31, 2004 and 2003 this investment was classified under equity method investments. Title to shares in CJSC Sevmorneftegaz was transferred to the Buyer in the first half of 2005. Under the share purchase provisions, the Buyer had the right to notify the Company in writing, not later than the end of June 2005, of its intention to sell the acquired share back to the Company and the Company was obliged to take back and pay for such share. The Buyer did not exercise its right to repurchase at the time stipulated in the contract, therefore in June 2005 the Company recorded a gain on the sale of the interest in CJSC Sevmorneftegaz in the amount of US\$ 1,303 million.

#### **Polar Lights Company LLC ("PLC")**

PLC is a limited liability company owned 50% by Conoco Phillips Timan-Pechora Inc., and 50% by the Company. PLC is primarily engaged in the development of the Ardalin and satellite fields in the Timan-Pechora Basin located 125 kilometers south of the Barents Sea above the Arctic Circle. Development of the Ardalin field commenced in late 1992 and the first oil was produced in 1994.

#### **JV Rosneft-Shell Caspian Ventures Limited**

JV Rosneft-Shell Caspian Ventures Limited ("JV") is a joint venture in which the Company holds a 51% interest. The Articles of Incorporation of this joint venture stipulate, however, that key decisions regarding its business shall be subject to unanimous approval by both participants and none of the participants has a preferential voting right.

On February 6, 1997, the Company, through the JV, signed an agreement with eight oil and gas companies and government agencies of the Russian Federation and the Republic of Kazakhstan for the establishment of Caspian Pipeline Consortium ("CPC"). The purpose of the consortium is to design, finance, construct and operate a pipeline from the oil fields located in Western Kazakhstan through Russia to the port of Novorossiysk. The interest of the JV in the CPC is 7.5%. In October 2001, the CPC pipeline was put in operation.

#### **CJSC Kaspiy-1**

In 1997, a subsidiary of the Company made a contribution to the share capital of CJSC Kaspiy-1, which was founded to construct an oil refinery in Makhachkala (Dagestan Republic). The refinery has been commissioned in 2006.

#### **OJSC Daltransgaz**

OJSC Daltransgaz is an operator for the program to supply gas to the Sakhalin Region and the Khabarovsk and Primorye Territories.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 8. Long-Term Investments (continued)

#### OJSC Verkhnechonskneftegaz

OJSC Verkhnechonskneftegaz holds the licence for the development of the Verkhnechonskoye oil and gas condensate deposit, which is the largest oil deposit in the Irkutsk region.

#### Rosneft-Stroytransgaz Ltd

Rosneft-Stroytransgaz Ltd is a joint venture with STG Oil and Gas Limited which was founded for the purpose of exploration and subsequent production of oil and gas in Gara Tisselit (block 245 SOUTH) in Algeria.

### 9. Acquired Debt Receivable, Net

The Company and a group of banks led by Societe Generale S.A. entered into an agreement granting the Company the right to claim the outstanding balance due from Yukos Oil Company under a syndicated loan of US\$ 1,000 million. Under this agreement, the right to claim the debt and other rights and benefits per original loan agreement between the bank syndicate and Yukos Oil Company were transferred from the banks to the Company in March 2006 upon the payment of the outstanding loan principal, accumulated interest (up to the date of repayment), legal and other fees in the amount totaling US\$ 483 million.

In particular the Company took over from the bank syndicate the claimant position in the court hearings, in Amsterdam Arbitration court, with respect to the collection the outstanding debt balance.

The carrying value of the receivable is stated net of allowance for losses in the amount of US\$ 27 million. No interest is being accrued on this balance.

### 10. Oil and Gas Properties, Net

Oil and gas properties comprise the following:

|  | <b>September 30, 2006</b> | <b>December 31,</b> |
|--|---------------------------|---------------------|
|  | <b>(unaudited)</b>        | <b>2005</b>         |
| Wells and related facilities             | \$ 15,723                 | \$ 12,606           |
| Mineral rights                           | 11,547                    | 10,723              |
| Pipelines                                | 1,303                     | 1,057               |
| Equipment under capital lease            | 25                        | 214                 |
| Total cost                               | <b>28,598</b>             | 24,600              |
| Less: accumulated depletion              | <b>(4,743)</b>            | (3,661)             |
| <b>Total oil and gas properties, net</b> | <b>\$ 23,855</b>          | <b>\$ 20,939</b>    |

Mineral rights include costs to acquire unproved properties in the amount of US\$ 2,202 million as of September 30, 2006 and US\$ 1,382 million as of December 31, 2005. The Company plans to explore and develop the respective fields. The Company's management believes these costs are recoverable.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 10. Oil and Gas Properties, Net (continued)

OJSC Yuganskneftegaz in its operating activities enters into short-term lease contracts for a significant number of wells and related equipment and facilities. These agreements are entered into with the owners of the wells, equipment and facilities, which are certain subsidiaries of Yukos Oil Company. All of the lease agreements are cancellable in nature and most expire within one year. The inability of the Company to extend these lease agreements and/or otherwise obtain rights to use the wells and related facilities in the oil production may have material adverse consequences for the Company's ability to extract and recover a portion of the carrying value of the \$8,365 million in oil and gas properties and the \$9,081 million in mineral rights acquired in the business combination. During 2005, all the expired lease contracts were extended for a period of up to one year. The Company's management plans to attempt to further extend the above leases. Following a claim brought by OJSC Yuganskneftegaz in March 2006, the Moscow Arbitration Court ruled that the 100% ownership interest in one of the subsidiaries, which is the most significant lessor, should be transferred from Yukos Oil Company to OJSC Yuganskneftegaz. This ruling was upheld in the appeal hearings on June 1, 2006, which made it legally binding and enforceable. This ruling was also upheld in cassational instance on July 26, 2006. However, given the current Yukos Oil Company bankruptcy proceedings, such transfer will only be effected with the approval of the bankruptcy receiver. The Company believes that it will likely be able to continue to extract minerals from the related sites.

#### Sakhalin-1

The Company's primary investment in a PSA is through the Sakhalin-1 project (PSA 1), which is operated by ExxonMobil, one of the PSA participants. In February 2001, the Company signed an agreement with Oil and Natural Gas Corporation ("ONGC") in relation to its interest in the PSA 1 which reduced the Company's interest to 20%. The Company recorded the investment in its retained share under the "carried interest" method. Commercial hydrocarbon production under PSA 1 commenced in October 2005. Accordingly, the Company's share in hydrocarbon reserves was reclassified as proved developed reserves.

On July 31, 2006 the Company repaid US\$ 1,34 billion (including accumulated interest) to ONGC with respect to the costs of the Company carried by ONGC in previous years. Following this settlement the Company recovered the right to receive the income equivalent to its interest in the project and commenced accounting for this investment using proportionate consolidation method. Primarily all costs were recorded as oil and gas properties.

### 11. Property, Plant and Equipment, Net

Property, plant and equipment as of September 30, 2006 comprise the following:

|   | September 30, 2006<br>(unaudited) | December 31,<br>2005 |
|---|-----------------------------------|----------------------|
| Service vessels                           | \$ 6                              | \$ 8                 |
| Buildings and constructions               | 2,028                             | 1,941                |
| Plant and machinery                       | 1,082                             | 1,096                |
| Vehicles and other equipment              | 390                               | 356                  |
| Assets under capital lease                | 6                                 | 12                   |
| Total                                     | 3,512                             | 3,413                |
| Less: accumulated depreciation            | (1,428)                           | (1,383)              |
| <b>Property, plant and equipment, net</b> | <b>\$ 2,084</b>                   | <b>\$ 2,030</b>      |

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 12. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities comprise the following:

|   | September 30, 2006<br>(unaudited) | December 31,<br>2005 |
|---|-----------------------------------|----------------------|
| Trade accounts payable                                | \$ 764                            | \$ 649               |
| Salary and other benefits payable                     | 92                                | 157                  |
| Advances received                                     | 229                               | 192                  |
| Dividends payable                                     | 11                                | 60                   |
| Banking customer accounts                             | 348                               | 252                  |
| Yukos Oil Company debt acquisition liability          | –                                 | 27                   |
| Promissory notes payable                              | 1                                 | 2                    |
| Other   | 126                               | 19                   |
| <b>Total accounts payable and accrued liabilities</b> | <b>\$ 1,571</b>                   | <b>\$ 1,358</b>      |

The Company's accounts payable are denominated primarily in RUB. Dividends payable mainly represent dividends payable to Rosneft shareholders which were declared in June 2006.

### 13. Short-Term Loans and Long-Term Debt

Short-term loans and borrowings comprise the following:

|   | September 30, 2006<br>(unaudited) | December 31,<br>2005 |
|---|-----------------------------------|----------------------|
| <b>Loans and borrowings - US\$ denominated</b>                          |                                   |                      |
| Bank loans  | \$ 248                            | \$ 794               |
| Customer deposits   | 27                                | 42                   |
| Other   | –                                 | 3                    |
| <b>Loans and borrowings – RUB denominated</b>                           |                                   |                      |
| Bank loans  | 60                                | 9                    |
| Promissory notes payable  | 757                               | 657                  |
| Customer deposits   | 186                               | 96                   |
| Other   | 489                               | 453                  |
|   | 1,767                             | 2,054                |
| Current portion of long-term debt                                       | 2,361                             | 1,951                |
| <b>Total short-term loans and current portion<br/>of long-term debt</b> | <b>\$ 4,128</b>                   | <b>\$ 4,005</b>      |

The rate of interest on the Company's short-term loans denominated in US\$ was from LIBOR plus 2% p.a. to LIBOR plus 3.02% p.a. The RUB denominated loans generally bear an annual interest rate ranging from 2.25% to 7% p.a.

Promissory notes are primarily payable on demand and bear an interest rate ranging from 0% to 18% p.a. Interest free promissory notes are recorded at amortized cost.

Customer deposits represent fixed-term deposits placed by customers with the Company's subsidiary bank, denominated in RUB and foreign currencies. Customer deposits denominated in RUB bear an interest rate ranging from 4% to 12.1% p.a. Customer deposits denominated in foreign currencies bear an interest rate ranging from 3% to 6.5% p.a.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 13. Short-Term Loans and Long-Term Debt (continued)

Other RUB-denominated borrowings primarily include four loans provided to OJSC Yuganskneftegaz by YUKOS Capital S.a.r.l., which bear interest of 9% p.a. and mature in 2007. As of September 30, 2006 and December 31, 2005 these loans are classified as current since the creditor demanded early repayment of these loans due to non-compliance with the terms of the loan agreements.

Long-term debt comprises the following:

|   | September 30, 2006<br>(unaudited) | December 31,<br>2005 |
|---|-----------------------------------|----------------------|
| Bank loans, denominated in hard currency  | \$ 5,174                          | \$ 4,220             |
| Bank loans raised for funding the acquisition of<br>OJSC Yuganskneftegaz – US\$ denominated | 5,019                             | 5,743                |
| Borrowings – US \$ denominated  | 32                                | 49                   |
| Customer deposits – denominated in hard currency  | 15                                | 8                    |
| Borrowings – RUB denominated  | 11                                | 9                    |
| Customer deposits – RUB denominated   | 77                                | 60                   |
| Bonds of the subsidiary bank – RUB denominated  | 3                                 | 20                   |
| Other long-term liabilities – RUB denominated   | 28                                | 40                   |
|   | 10,359                            | 10,149               |
| Current portion of long-term debt   | (2,361)                           | (1,951)              |
| <b>Total long-term debt</b>   | <b>\$ 7,998</b>                   | <b>\$ 8,198</b>      |

The rates of interest on the Company's long-term bank loans denominated in US\$ were from 4.35% to 12.92% p.a. Weighted average interest rates on these loans were LIBOR plus 0.74% p.a. and LIBOR plus 2.19% p.a., as of September 30, 2006 and as of December 31, 2005, respectively. These loans are primarily secured by contracts for the export of crude oil.

In January 2006, a subsidiary of the Company registered in Cyprus signed a loan agreement with a major international bank for an amount of EUR 188 million or US\$ 238.5 million using the CB RF exchange rate as of September 30, 2006. The loan bears an interest rate of EURIBOR plus 0.35% p.a. The first drawdown was made during the first nine months of 2006 in the amount of EUR 109.08 million or US\$ 138.4 million using the CB RF exchange rate as of September 30, 2006. Funds borrowed are to be invested in the construction of ice-reinforced tankers for crude oil transportation purposes in north-western regions of the Russian Federation. The loan is scheduled to be repaid within the twelve years following the completion of tanker construction.

In February 2006, the Company signed a loan agreement with a syndicate of Western banks for US\$ 2,000 million with a term of 5 years. The loan bears interest at LIBOR plus 0.65% p.a. The loan funds were used to repay loans with less favorable terms.

As of September 30, 2006 the bank loans raised for funding the acquisition of OJSC Yuganskneftegaz represent a long-term loan obtained through a government-owned bank at a rate of LIBOR plus 0.7% p.a. repayable in equal monthly installments. It is scheduled for repayment in 2011 and is secured by pledging the Company's receivables under a long-term contract for the supply of crude oil (see Note 19).

Weighted average interest rates on US\$ denominated borrowings were 8.67% p.a. and 8.54% p.a. as of September 30, 2006 and December 31, 2005, respectively.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 13. Short-Term Loans and Long-Term Debt (continued)

Customer deposits include fixed-term RUB and foreign currency denominated customer deposits placed with the Company's subsidiary bank which mature primarily in the first half of 2007 and are included in the current portion of long-term debt. The RUB-denominated deposits bear an interest rate ranging from 7.5% to 10.5% p.a. Deposits denominated in foreign currencies bear an interest rate ranging from 6.85% to 9% p.a.

As of September 30, 2006 other long-term liabilities include primarily interest-free promissory notes which mature in 2007. The promissory notes are stated at amortized cost and are included in the current portion of long-term debt.

The Company is obliged to comply with a number of restrictive financial and other covenants contained within its loan agreements. Restrictive covenants include maintaining certain financial ratios. As a result of the Company's acquisition of OJSC Yuganskneftegaz in December 2004, and the resulting debt incurred and assets and liabilities, including contingent liabilities, consolidated, the Company was not in compliance with various financial and other covenants of existing loan agreements as of that date.

As of December 31, 2004 the long-term portion of the debt outstanding under loan agreements which were in default amounted to US\$ 1,661 million. This debt continued to be reflected as long-term in nature in the December 31, 2004 consolidated balance sheet. In July 2005, the creditors waived violations related to restrictive financial ratios and agreed to amend the financial ratio covenants in line with the Company's new structure and new scope of activities. The creditors also waived other events of default arising from the breach of other covenant provisions. To date, the creditors have provided waivers relating to these provisions which have been granted on condition that the Company furnishes to the creditors, by no later than December 31, 2006, acceptable evidence that the Company has:

1. Discharged in full, or restructured, OJSC Yuganskneftegaz's tax liabilities for 2004 (which should not be in excess of a set limit),
2. Discharged in full, or restructured, OJSC Yuganskneftegaz's tax liabilities for the periods 1999 to 2003,
3. Discharged in full, or restructured, the indebtedness to YUKOS Capital S.a.r.l. in the amount of US\$ 483 million,
4. Discharged in full, or restructured, the guarantee claims of Societe General S.A. related to a US\$ 1,600 million loan (see Note 19).

These conditions also apply to certain new borrowings obtained throughout 2005 and also subsequent to that date. Thus, as of September 30, 2006 and December 31, 2005, long-term borrowings, for which creditors waived events of default arising from the breach of certain covenant provisions, amounted to US\$ 2,025 million and US\$ 2,831 million, respectively. This debt continues to be reflected as long-term in nature as of September 30, 2006 and December 31, 2005.

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 13. Short-Term Loans and Long-Term Debt (continued)

In case the conditions referred to above remain unfulfilled, the Company has applied for the extension of the waivers. The Company believes that the probability of such extensions being granted is high.

The aggregate maturity of long-term debt outstanding as of September 30, 2006 is as follows (assuming the debt will not be called by creditors ahead of scheduled maturities):

|                             | <b>(unaudited)</b> |
|-----------------------------|--------------------|
| Up to December 31, 2006     | \$ 679             |
| 2007                        | 2,301              |
| 2008                        | 2,596              |
| 2009                        | 2,437              |
| 2010                        | 2,100              |
| 2011 and after              | 246                |
| <b>Total long-term debt</b> | <b>\$ 10,359</b>   |

### 14. Shareholders' Equity

In June 2006, the annual general shareholders' meeting approved dividends on the Company's common shares for 2005 in the amount of RUB 11.3 billion or US\$ 424 million at the CB RF exchange rate as at the date of decision, which corresponds to US\$ 0.05 per share.

In July 2006 the shareholders of Rosneft made the initial public offering of ordinary shares of Rosneft in Russia, as well as global depository receipts ("GDR") for these shares on London Stock Exchange. 1,126,357,616 of the Company's ordinary shares were sold. Additionally, newly issued 285,064,359 ordinary shares of the Company were placed. As a result of the offering, the Company's proceeds from sales of new shares amounted to US\$ 2,124 million (net of commission). The difference between nominal value of shares and share price was recognized as additional paid-in capital.

### 15. Revenue Related Taxes

Revenues include export customs duty composed of:

|   | Three months<br>ended<br>September 30,<br>2006,<br>(unaudited) | Three months<br>ended<br>September 30,<br>2005,<br>(unaudited) | Nine months<br>ended<br>September 30,<br>2006<br>(unaudited) | Nine months<br>ended<br>September 30,<br>2005, as restated<br>(unaudited) |
|---|--|--|--|---|
| <i>Oil and gas sales</i>                                |  |  |  |   |
| Export customs duty                                     | \$ 2,586   | \$ 1,477   | \$ 6,726   | \$ 3,325  |
| <i>Petroleum products sales<br/>and processing fees</i> |  |  |  |   |
| Export customs duty                                     | 361  | 296  | 1,014  | 591   |
| <b>Total revenue related taxes</b>                      | <b>\$ 2,947</b>  | <b>\$ 1,773</b>  | <b>\$ 7,740</b>  | <b>\$ 3,916</b>   |

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 16. Income Tax

Income taxes comprise the following:

|   | Three months<br>ended<br>September 30,<br>2006,<br>(unaudited) | Three months<br>ended<br>September 30,<br>2005,<br>(unaudited) | Nine months<br>ended<br>September 30,<br>2006<br>(unaudited) | Nine months<br>ended<br>September 30,<br>2005, as restated<br>(unaudited) |
|---|--|--|--|---|
| Current income tax expense              | \$ 399   | \$ 467   | \$ 1,353   | \$ 1,455  |
| Deferred income tax charge<br>(benefit) | 46   | (21)   | (89)   | (62)  |
| <b>Total income tax</b>                 | <b>\$ 445</b>  | <b>\$ 446</b>  | <b>\$ 1,264</b>  | <b>\$ 1,393</b>   |

The Company does not file a consolidated tax return, rather each legal entity files separate tax returns with various authorities, primarily in the Russian Federation.

Temporary differences between these consolidated financial statements and tax records gave rise to the following deferred income tax assets and liabilities comprise the following:

|   | September 30,<br>2006<br>(unaudited) | December 31,<br>2005 |
|---|--------------------------------------|----------------------|
| Deferred income tax asset arising from tax effect of:     |                                      |                      |
| PSA 1 deferred deductible expenses                        | \$ 103                               | \$ 101               |
| Asset retirement obligations                              | 45                                   | 54                   |
| Property, plant and equipment                             | 103                                  | 75                   |
| Accounts receivable                                       | 18                                   | 9                    |
| Accounts payable and accruals                             | 15                                   | 32                   |
| Other   | 74                                   | 56                   |
| Total   | 358                                  | 327                  |
| Valuation allowance for deferred income tax asset         | (314)                                | (271)                |
| Deferred income tax asset                                 | 44                                   | 56                   |
| Deferred income tax liability arising from tax effect of: |                                      |                      |
| Mineral rights  | (2,280)                              | (2,172)              |
| Property, plant and equipment                             | (1,625)                              | (1,564)              |
| Deferred income tax liability                             | (3,905)                              | (3,736)              |
| <b>Net deferred income tax liability</b>                  | <b>\$ (3,861)</b>                    | <b>\$ (3,680)</b>    |

OJSC Yuganskneftegaz paid income tax during 2006 at lower rates subject to a 4% income tax exemption under the regional laws. These laws provide that the income tax exemptions are granted to the oil and gas producing companies, which make capital investments, agreed with regional administrations, within the respective region and participate in various social projects. These exemptions are granted on an annual basis.

Consistent with the prior periods the most significant reconciling items between theoretical income tax expense and recorded tax expense remain (1) change in valuation allowance for deferred tax assets, (2) effect of income tax preference (discussed above), and (3) foreign exchange effects.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 17. Asset Retirement Obligations

For the first nine months ended September 30, the movement of asset retirement obligations is as follows:

|   | <b>2006</b>        |
|---|--------------------|
|   | <b>(unaudited)</b> |
| Asset retirement obligations as of the beginning of the reporting period  | \$ 566             |
| Recognition of additional obligations for new wells                       | 14                 |
| Accretion expense   | 25                 |
| Increase as a result of change in estimates                               | 36                 |
| <b>Asset retirement obligations as of the end of the reporting period</b> | <b>\$ 641</b>      |

### 18. Related Party Transactions

In the course of its usual activity, the Company regularly enters into transactions with other enterprises which are directly or indirectly controlled by the Russian Government. Such enterprises are business units of RAO UES, OJSC Gazprom, OJSC Russian Railways, OJSC Sberbank, Vnesheconombank, OJSC Vneshtorgbank, CJSC Gazprombank, OJSC Transneft and federal agencies including tax authorities. Management considers these business relations as part of regular activities in the Russian Federation and believes that they will remain unchanged in the foreseeable future.

Total amounts of transactions with companies controlled by the Russian Government for each of the reporting periods ending September 30, as well as related party balances as of September 30, 2006 and December 31, 2005 are provided in the table below:

|   | <b>Nine months ended</b>  | <b>Nine months ended</b>  |
|---|---------------------------|---------------------------|
|   | <b>September 30, 2006</b> | <b>September 30, 2005</b> |
|   | <b>(unaudited)</b>        | <b>(unaudited)</b>        |
| <b>Revenues</b>                                     |                           |                           |
| Oil and gas sales                                   | \$ 3                      | \$ 13                     |
| Sales of petroleum products and processing fees     | 131                       | 77                        |
| Support services and other revenues                 | 8                         | 3                         |
|   | \$ 142                    | \$ 93                     |
| <b>Costs and expenses</b>                           |                           |                           |
| Production and operating expense                    | \$ 12                     | \$ 9                      |
| Pipeline tariffs and transportation costs           | 1,488                     | 885                       |
| Other expenses                                      | 13                        | 12                        |
|   | \$ 1,513                  | \$ 906                    |
| <b>Other operations</b>                             |                           |                           |
| Sale of short-term and long-term investments        | \$ 4                      | \$ 35                     |
| Acquisition of short-term and long-term investments | 14                        | 72                        |
| Proceeds from short-term and long term debt         | 4,867                     | 2,357                     |
| Repayment of short-term and long term debt          | 7,064                     | 3,653                     |
| Deposits placed                                     | 8,952                     | 766                       |
| Deposits paid                                       | 8,175                     | 674                       |
| Borrowings issued                                   | 121                       | 1,151                     |
| Repayment of borrowings issued                      | 111                       | 1,149                     |
| Interest expense                                    | 301                       | 353                       |
| Interest income                                     | \$ 23                     | \$ -                      |

*See Accountants' Review Report*

OJSC Rosneft Oil Company

Notes to Interim Consolidated Financial Statements (continued)

18. Related Party Transactions (continued)

|  | September 30,<br>2006<br>(unaudited) | December 31,<br>2005 |
|--|--------------------------------------|----------------------|
| <i>Assets</i>                                      |                                      |                      |
| Cash and cash equivalents                          | \$ 29                                | \$ 376               |
| Accounts receivable and other current assets       | 11                                   | 23                   |
| Prepayments  | 161                                  | 154                  |
| Short-term and long-term investments               | 264                                  | 180                  |
|  | <u>\$ 465</u>                        | <u>\$ 733</u>        |
| <i>Liabilities</i>                                 |                                      |                      |
| Accounts payable                                   | \$ 37                                | \$ 4                 |
| Short-term and long-term debt (including interest) | 5,552                                | 6,890                |
|  | <u>\$ 5,589</u>                      | <u>\$ 6,894</u>      |

Total amounts of transactions with other related parties (other than the companies controlled by the Russian Government), primarily equity investees and joint ventures, for each of the reporting periods ending September 30, as well as related party balances as of September 30, 2006 and December 31, 2005 are provided in the table below:

|   | Nine months ended<br>September 30, 2006<br>(unaudited) | Nine months ended<br>September 30, 2005<br>(unaudited) |
|---|--|--|
| <i>Revenues</i>                                     |  |  |
| Oil and gas sales                                   | \$ 25  | \$ 6   |
| Sales of petroleum products and processing fees     | 65   | 35   |
| Support services and other revenues                 | 28   | 38   |
|   | <u>\$ 118</u>  | <u>\$ 79</u>   |
| <i>Costs and expenses</i>                           |  |  |
| Pipeline tariffs and transportation costs           | 11   | 8  |
| Production and operating expense                    | –  | 11   |
| Other expenses                                      | 36   | 20   |
|   | <u>\$ 47</u>   | <u>\$ 39</u>   |
| <i>Other operations</i>                             |  |  |
| Sales of short-term and long-term investments       | \$ 18  | \$ 172   |
| Acquisition of short-term and long-term investments | 67   | 31   |
| Proceeds from short-term and long term debt         | 20   | 91   |
| Repayment of short-term and long term debt          | 29   | 91   |
| Deposits placed                                     | –  | 23   |
| Deposits paid                                       | –  | 6  |
| Borrowings issued                                   | 86   | 45   |
| Repayment of borrowings issued                      | 27   | 73   |
| Interest expense                                    | 3  | 20   |
| Interest income                                     | 8  | 1  |
| Dividends received                                  | \$ 4   | \$ 4   |

See Accountants' Review Report

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 18. Related Party Transactions (continued)

|  | September 30,<br>2006 (unaudited) | December 31,<br>2005 |
|--|-----------------------------------|----------------------|
| <i>Assets</i>                                      |                                   |                      |
| Accounts receivables and other current assets      | \$ 39                             | \$ 13                |
| Prepayments  | 14                                | –                    |
| Short-term and long-term investments               | 211                               | 128                  |
|  | \$ 264                            | \$ 141               |
| <i>Liabilities</i>                                 |                                   |                      |
| Accounts payable                                   | \$ 58                             | \$ 12                |
| Short-term and long-term debt (including interest) | 17                                | 14                   |
|  | \$ 75                             | \$ 26                |

### 19. Commitments and Contingencies

#### Russian Business Environment

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government. In addition laws and regulations, including interpretations, enforcement and judicial processes, continue to evolve in Russia. Other laws and regulations and certain other restrictions producing a significant effect on the Company's industry, including, but not limited to the following issues: rights to use subsurface resources, environmental matters, site restoration, transportation and export, corporate governance, taxation, etc.

#### Taxation

Legislation and regulations regarding taxation in Russia continue to evolve. The various legislation and regulations are not always clearly written and their interpretation is subject to the opinions of the local, regional and national tax authorities. Instances of inconsistent opinions are not unusual.

The current regime of penalties and interest related to reported and discovered violations of Russia's laws, decrees and related regulations is severe. Interest and penalties are levied when an understatement of a tax liability is discovered. As a result, penalties and interest can result in amounts higher than unreported taxes.

In Russia tax declarations remain open and subject to inspection for a period of up to three years. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review during the three-year period.

Russian transfer pricing rules were introduced in 1999, giving Russian tax authorities the right to make transfer pricing adjustments and impose additional tax liabilities in respect of all "controlled" transactions, provided that the transaction price deviates from the market price by more than 20%. Controlled transactions include transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions with significant (by more than 20%) price fluctuations.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 19. Commitments and Contingencies (continued)

#### Taxation (continued)

The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and courts. Due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge the Group's prices and propose an adjustment. If such price adjustments are upheld by the Russian courts and implemented, the Group's future financial results could be adversely affected. In addition, the Group could face significant losses associated with the assessment of prior tax underpaid and related interest and penalties, which could have an adverse effect on the Group's financial condition and results of operations. The Management believes that such transfer pricing related tax contingencies are remote rather than possible or probable and cannot be reasonably estimated.

During 2004 several tax audits of OJSC Yuganskneftegaz for 1999-2003 years took place and their results have been appealed in court (see the "Litigation" caption below).

During 2005 tax audits of several subsidiaries for the years 2002-2003 took place. The results of these tax audits are currently being appealed with the tax authorities. The Company's management believes that the resolution of these matters will not have any material effect on the consolidated financial statements.

The Company and its certain subsidiaries are currently being audited by tax authorities for the years 2004-2006 (up to September 30, 2006). The Company's management believes that the outcome of these tax audits will not result in any material tax payments.

Overall, management believes that the Company has paid or accrued all taxes that are applicable. Where uncertainty exists, the Company has accrued tax liabilities based on management's best estimate of the probable outflow of resources embodying economic benefits, which will be required to settle these liabilities. Possible liabilities which were identified by management at the balance sheet date as those that can be subject to different interpretations of the tax laws and regulations are not accrued in the interim consolidated financial statements.

#### Capital Commitments

The Company and its subsidiaries are engaged in ongoing capital projects for exploration and development of production facilities and modernization of refineries and the distribution network. The budgets for these projects are generally set on an annual basis. Depending on the current market situation, actual expenditures may vary from the budgeted amounts.

#### Environmental Matters

Due to the nature of its business, Rosneft and its subsidiaries are subject to federal legislation regulating environmental protection. The majority of environmental liabilities arise as a result of accidental oil spills and leaks that pollute land, and air pollution. The Company considers fines paid and other environmental liabilities as immaterial, given the scale of its operations.

In the course of its operations, the Company seeks to comply with international environmental standards and monitors compliance therewith on a regular basis. With a view to improve environmental activities, the Company takes a number of measures to mitigate the adverse impact of its current operations on the environment.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 19. Commitments and Contingencies (continued)

#### Environmental Matters (continued)

Legislation that regulates environmental protection in the Russian Federation is evolving, and the Company evaluates its liabilities in accordance therewith. Currently it is not possible to reasonably estimate the liabilities of the Company which may be incurred should the legislation be amended (if amended at all).

The management believes that, based on the existing legislation, the Company is unlikely to have liabilities that need to be accrued in addition to the amounts already recognized in the interim consolidated financial statements and that may have a material adverse effect on the operating results or financial position of the Company.

#### Pension Plans

For the first nine months of 2006 and 2005 the Company contributed to the non-governmental corporate pension fund under the defined contribution plan US\$ 16 million and US\$ 11.6 million, respectively.

#### Social Commitments

The Company possesses social infrastructure assets for use by employees. In accordance with the Presidential Edict on privatization in Russia, the Company is required to transfer social infrastructure assets to the relevant local city administrations without significant consideration. Accordingly, as the Company does not have ownership of these assets, they are not recorded in the interim consolidated financial statements. However, the Company is required to maintain these assets.

The Company incurred US\$ 81 million and US\$ 48 million in social infrastructure and similar expenses for the first nine months of 2006 and 2005, respectively. These expenses are included in other expenses in the consolidated statement of income.

#### Insurance

The Company insured its assets through the insurance company SK Neftepolis LLC.

As of September 30, 2006 and December 31, 2005 the amount of coverage on assets under such insurance amounted to US\$ 1,686 million and US\$ 1,345 million, respectively.

Russian insurance providers do not offer business interruption insurance. Currently, it is not a common practice in Russia to obtain such insurance.

#### Guarantees and Indemnity

As of September 30, 2006 the Company has provided guarantees for certain debt agreements primarily of its subsidiaries. In accordance with the debt agreements, the Company is obliged to perform on the guarantee and to pay the bank all amounts of outstanding guaranteed liabilities, including interest.

The Company cannot substitute guarantees issued by any novation agreement or mutual offset. The Company's obligations under guarantees issued are valid in case of any change in loan agreements.

After the full payment and settlement of all obligations under the guarantees, the Company has the right to subrogate its respective part of all bank claims against the debtor in accordance with the loan agreement. In the event the Company makes payments under guarantees issued, it has a right to claim the amounts paid from the debtor.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 19. Commitments and Contingencies (continued)

#### Guarantees and Indemnity (continued)

The Company's outstanding guarantees as of September 30, 2006 are as follows:

| Beneficiary Bank                            | Loan debtor          | Maturity date | Contractual principal amount | Amount of outstanding liability (principal amount) as of September 30, 2006 |
|---|----------------------|---------------|------------------------------|---|
| Societe Generale S.A<br>(as Facility Agent) | Yukos<br>Oil Company | May 29, 2009  | \$ 1,600                     | \$ 656  |

In May 2005, Moravel Investments Limited, an affiliate of Yukos Oil Company, filed an arbitral claim against OJSC Yuganskneftegaz in the London Court of International Arbitration for the recovery of US\$ 662 million pertaining to the loan of US\$ 1,600 million from Societe Generale S.A. The Company is contesting the claim vigorously. The case was heard in July 2006 and the Company is currently awaiting the decision, which is expected within six months. The Company believes that the probability of any payments under the above guarantee is remote. On March 17, 2006 the Moscow Arbitration Court ruled that the guarantee agreement signed by OJSC Yuganskneftegaz with respect to Yukos Oil Company loan received from Societe Generale S.A. in the amount of US\$ 1,600 million was invalid. This ruling was upheld on May 15, 2006 by the 9<sup>th</sup> Appeal Arbitration Court in appeal hearings, which made it legally binding and enforceable. This ruling was also upheld in cassational instance on August 31, 2006. The management believes that this ruling supports the Company's position in the London Court of International Arbitration

#### Litigation, Claims and Assessments

In 2002 an option agreement was entered into between Total E&P Vankor (Total) and Anglo-Siberian Oil Company Limited (ASOC) under which Total had a conditional option to buy the latter's 60% stake in Taimyrneft LLC which ASOC held through Anglo-Siberian Oil Company Limited (Cyprus) (ASOC Cyprus) for US\$ 1 million. ASOC and ASOC Cyprus belong to the Rosneft International Group. Total obtained injunctions in various jurisdictions to prevent ASOC Cyprus from trading in the shares of Taimyrneft LLC. During 2004 Total E&P Vankor filed a claim against ASOC Cyprus for US\$ 640 million under the sale and purchase agreement for 52% share in Eniseineft LLC. Total alleged that under the terms of a sale agreement, the shareholding in Eniseineft LLC should have been sold to them. The Company contested this on the grounds that the relevant conditions precedent to the sale had not been met. The arbitration proceedings were completed during late 2005, the Company has not sustained any losses (see also Note 22).

In 2005 Total filed for arbitration under the option agreement requesting the specific performance under the option agreement or alternatively damages of US\$ 424 million. The Company's management believes that the claim is without merit and the option is not exercisable. Beyond professional fees, which are not material to the Company, it is unclear whether any further liabilities will be incurred but the Company's management does not believe these will be material. The decision of the arbitration is expected no earlier than in late December 2006.

The Company is a co-defendant in the litigation in the USA in respect of the acquisition of OJSC Yuganskneftegaz. This litigation was brought by certain holders of American Depository Receipts ("ADRs") of Yukos Oil Company seeking US\$ 3 million in damages due to the fall in market value of the ADRs. The Company believes that this claim is without merit.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 19. Commitments and Contingencies (continued)

#### Litigation, Claims and Assessments (continued)

The Company is also a co-defendant in litigation in the Moscow Arbitration Court with respect to the auction for the common shares of OJSC Yuganskneftegaz. This litigation was brought by Yukos Oil Company. The claimant is seeking to recover all the common shares of OJSC Yuganskneftegaz and also damages in the total amount of RUB 388 billion (approximately US\$ 14.5 billion at the CB RF exchange rate as of September 30, 2006). The court hearings have been postponed till January 25, 2007. The Company believes that this claim is without merit.

The Company's subsidiaries are involved in other litigations which arise from time to time in the course of their business activities. The Company's management believes that the ultimate result of these litigations will not significantly affect the operating results or financial position of the Company.

#### License Agreements

In accordance with certain license agreements or separate agreements concluded from time to time with the local and regional authorities the Company is required to maintain certain levels of expenditures for health, safety and environmental protection, as well as maintain certain level of capital expenditures. Generally these expenditures are within the normal operating and capital budgets and are accounted for when incurred in accordance with existing accounting policies for respective costs and expenses.

#### Oil Supplies

In January 2005, the Company entered into a long-term contract until 2010 with China National United Oil Corporation for export supplies of crude oil in the total amount of 48.4 million tonnes to be delivered in equal annual amounts. The prices are determined based on usual commercial terms for crude oil deliveries.

### 20. Segment Information

Presented below is information about the Company's operating segments in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company determines its operating segments based on the nature of their operations. The performance of these operating segments is assessed by management on a regular basis. The exploration and production segment is engaged in field exploration and development and production of crude oil and natural gas. The refinery, marketing and distribution segment is engaged in processing crude oil and other hydrocarbons into petroleum products, as well as purchasing, sale and transportation of crude oil and petroleum products. The other activities segment consists of banking, finance services, drilling services, construction services and other activities. Substantially all of the Company's operations are conducted in the Russian Federation. Further, the geographical regions within the Russian Federation have substantially similar economic and regulatory conditions. Therefore, the Company has not presented any separate geographical disclosure.

The segments are combinations of subsidiaries. The significant accounting policies applied to each segment are consistent with those applied to the interim consolidated financial statements. Sales transactions for goods and services between the segments are carried out using prices agreed upon between Rosneft and its subsidiaries.

*See Accountants' Review Report*

OJSC Rosneft Oil Company

Notes to Interim Consolidated Financial Statements (continued)

**20. Segment Information (continued)**

Operating segments during the three months ended September 30, 2006 are as follows:

|  | Exploration<br>and production<br>(unaudited) | Refining,<br>marketing and<br>distribution<br>(unaudited) | Other<br>activities<br>(unaudited) | Total<br>elimination<br>(unaudited) | Consolidated<br>(unaudited) |
|--|--|---|------------------------------------|-------------------------------------|-----------------------------|
| Revenues from external customers                                       | \$ 16  | \$ 8,967  | \$ 182                             | \$ –                                | \$ 9,165                    |
| Intersegmental revenues  | 4,016  | 443   | 1,255                              | (5,714)                             | –                           |
| <b>Total revenues</b>  | <b>\$ 4,032</b>                              | <b>\$ 9,410</b>   | <b>\$ 1,437</b>                    | <b>\$ (5,714)</b>                   | <b>\$ 9,165</b>             |
| Operating expenses and cost<br>of purchased oil and petroleum products | \$ 451                                       | \$ 513  | \$ 36                              | \$ –                                | \$ 1,000                    |
| Depreciation, depletion and amortization                               | 266  | 44  | 134                                | –                                   | 444                         |
| Operating income   | \$ 1,396                                     | \$ 4,857  | \$ 1,225                           | \$ (5,714)                          | \$ 1,764                    |
| Total other income, net  |  |   |                                    |                                     | (245)                       |
| <b>Income before income tax</b>  |  |   |                                    |                                     | <b>\$ 1,519</b>             |

Operating segments during the three months ended September 30, 2005 are as follows:

|  | Exploration<br>and production<br>(unaudited) | Refining,<br>marketing and<br>distribution<br>(unaudited) | Other<br>activities<br>(unaudited) | Total<br>elimination<br>(unaudited) | Consolidated<br>(unaudited) |
|--|--|---|------------------------------------|-------------------------------------|-----------------------------|
| Revenues from external customers                                       | \$ 109                                       | \$ 6,923  | \$ 48                              | \$ –                                | \$ 7,080                    |
| Intersegmental revenues  | 2,515  | 144   | 76                                 | (2,735)                             | –                           |
| <b>Total revenues</b>  | <b>\$ 2,624</b>                              | <b>\$ 7,067</b>   | <b>\$ 124</b>                      | <b>\$ (2,735)</b>                   | <b>\$ 7,080</b>             |
| Operating expenses and cost<br>of purchased oil and petroleum products | \$ 282                                       | \$ 173  | \$ 8                               | \$ –                                | \$ 463                      |
| Depreciation, depletion and amortization                               | 307  | 45  | 3                                  | –                                   | 355                         |
| Operating income   | \$ 444                                       | \$ 4,173  | \$ 79                              | \$ (2,735)                          | \$ 1,961                    |
| Total other income, net  |  |   |                                    |                                     | (247)                       |
| <b>Income before income tax</b>  |  |   |                                    |                                     | <b>\$ 1,714</b>             |

See Accountants' Review Report

OJSC Rosneft Oil Company

Notes to Interim Consolidated Financial Statements (continued)

**20. Segment Information (continued)**

Operating segments during the nine months ended September 30, 2006 are as follows:

|  | Exploration<br>and production<br>(unaudited) | Refining,<br>marketing and<br>distribution<br>(unaudited) | Other<br>activities<br>(unaudited) | Total<br>elimination<br>(unaudited) | Consolidated<br>(unaudited) |
|--|--|---|------------------------------------|-------------------------------------|-----------------------------|
| Revenues from external customers                                       | \$ 249                                       | \$ 24,985   | \$ 287                             | \$ –                                | \$ 25,521                   |
| Intersegmental revenues  | 9,622  | 976   | 1,557                              | (12,155)                            | –                           |
| <b>Total revenues</b>  | <b>\$ 9,871</b>                              | <b>\$ 25,961</b>  | <b>\$ 1,844</b>                    | <b>\$ (12,155)</b>                  | <b>\$ 25,521</b>            |
| Operating expenses and cost<br>of purchased oil and petroleum products | \$ 1,162                                     | \$ 1,777  | \$ 103                             | \$ –                                | \$ 3,042                    |
| Depreciation, depletion and amortization                               | 821  | 275   | 140                                | –                                   | 1,236                       |
| Operating income   | 2,372  | 13,433  | 1,484                              | (12,155)                            | 5,134                       |
| Total other income, net  |  |   |                                    |                                     | (843)                       |
| <b>Income before income tax</b>  |  |   |                                    |                                     | <b>\$ 4,291</b>             |
| <b>Total assets</b>  | <b>\$ 24,247</b>                             | <b>\$ 6,861</b>   | <b>\$ 4,006</b>                    | <b>\$ –</b>                         | <b>\$ 35,114</b>            |

Operating segments during the nine months ended September 30, 2005 are as follows:

|  | Exploration<br>and production<br>(unaudited) | Refining,<br>marketing and<br>distribution<br>(unaudited) | Other<br>activities<br>(unaudited) | Total<br>elimination<br>(unaudited) | Consolidated<br>(unaudited) |
|--|--|---|------------------------------------|-------------------------------------|-----------------------------|
| Revenues from external customers                                       | \$ 278                                       | \$ 16,549   | \$ 117                             | \$ –                                | \$ 16,944                   |
| Intersegmental revenues  | 6,712  | 500   | 221                                | (7,433)                             | –                           |
| <b>Total revenues</b>  | <b>\$ 6,990</b>                              | <b>\$ 17,049</b>  | <b>\$ 338</b>                      | <b>\$ (7,433)</b>                   | <b>\$ 16,944</b>            |
| Operating expenses and cost<br>of purchased oil and petroleum products | \$ 884                                       | \$ 612  | \$ 40                              | \$ –                                | \$ 1,536                    |
| Depreciation, depletion<br>and amortization                            | 934  | 112   | 7                                  | –                                   | 1,053                       |
| Operating income   | 1,338  | 10,435  | 208                                | (7,433)                             | 4,548                       |
| Total other expenses, net  |  |   |                                    |                                     | 813                         |
| <b>Income before income tax</b>  |  |   |                                    |                                     | <b>\$ 5,361</b>             |
| <b>Total assets</b>  | <b>\$ 23,256</b>                             | <b>\$ 4,732</b>   | <b>\$ 938</b>                      | <b>\$ –</b>                         | <b>\$ 28,926</b>            |

See Accountants' Review Report

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 20. Segment Information (continued)

Below is a breakdown of revenues by domestic and export sales, with a classification of export sales based on the direction of shipment.

|   | Three months<br>ended<br>September 30,<br>2006,<br>(unaudited) | Three months<br>ended<br>September 30,<br>2005,<br>(unaudited) | Nine months<br>ended<br>September 30,<br>2006,<br>(unaudited) | Nine months<br>ended<br>September 30,<br>2005,<br>(unaudited) |
|---|--|--|---|---|
| <b>Oil and gas sales</b>                    |  |  |   |   |
| Export sales of crude oil – Europe          | \$ 4,465   | \$ 3,434   | \$ 12,809   | \$ 8,206  |
| Export sales of crude oil – Asia            | 1,458  | 737  | 3,758   | 1,492   |
| Export sales of crude oil – CIS             | 513  | 396  | 1,253   | 1,068   |
| Domestic sales of crude oil                 | 92   | 141  | 171   | 575   |
| Domestic sales of gas                       | 52   | 40   | 146   | 127   |
| <b>Total oil and gas sales</b>              | <b>\$ 6,580</b>  | <b>\$ 4,748</b>  | <b>\$ 18,137</b>  | <b>\$ 11,468</b>  |
| <b>Petroleum products</b>                   |  |  |   |   |
| Export sales of petroleum products – Europe | 812  | 948  | 2,402   | 2,181   |
| Export sales of petroleum products – Asia   | 458  | 371  | 1,539   | 936   |
| Export sales of petroleum products – CIS    | 59   | 21   | 145   | 41  |
| Domestic sales                              | 1,114  | 886  | 2,983   | 2,048   |
| <b>Total petroleum products</b>             | <b>\$ 2,443</b>  | <b>\$ 2,226</b>  | <b>\$ 7,069</b>   | <b>\$ 5,206</b>   |

### 21. Fair Value of Financial Instruments and Risk Management

The Company, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks.

The Company manages these risks and monitors its exposure on a regular basis. The Company does not use hedge or derivative financial instruments.

The fair value of cash and cash equivalents, accounts receivable and accounts payable, promissory notes receivable approximates their carrying value recognized in these financial statements. The Company's management believes that accounts receivable recorded net of allowance for doubtful accounts will be recovered in full during an acceptable time period. The fair value of long-term accounts receivable included in other non-current assets approximates the discounted amounts recognized in these financial statements and is calculated using the estimated market interest rate for similar operations. The fair value of long-term debt differs from amounts recognized in the consolidated financial statements. The estimated fair value of long-term debt discounted using the estimated market interest rate for similar financial liabilities amounted to US\$ 10,063 million and US\$ 10,026 million as of September 30, 2006 and December 31, 2005, respectively. These amounts include all future cash outflows related to the repayment of long-term loans, including their current portion and interest expenses.

A substantial portion of the Company's sales revenues is received in US dollars. In addition, substantial financing and investing activities, obligations and commitments are also undertaken in US dollars. However, significant operating and investing expenditures, other obligations and commitments as well as tax liabilities are undertaken in rubles. As a result of the US dollar drop against the ruble, the Company is exposed to the corresponding currency risk, which is considerably mitigated by the recent increase in oil prices.

*See Accountants' Review Report*

# OJSC Rosneft Oil Company

## Notes to Interim Consolidated Financial Statements (continued)

### 22. Subsequent Events

On October 1, 2006 of the following subsidiaries were merged with OJSC Rosneft via exchange of shares at specified ratios, approved by their respective shareholders ("Share Swap"): OJSC Yuganskneftegaz, OJSC Rosneft-Purneftegaz, OJSC Selkupneftegaz, OJSC Severnaya Neft (Northern Oil), OJSC Rosneft-Krasnodarneftegaz, OJSC Rosneft-Stavropolneftegaz, OJSC Rosneft-Sakhalinmorneftegaz, OJSC Rosneft-Komsomolsky Refinery, OJSC Rosneft-Tuapse Refinery, OJSC Rosneft-Arkhangelsknefteproduct, OJSC Rosneft-Nakhodkanefteproduct, OJSC Rosneft-Tuapsenefteproduct (each, a "Merging Subsidiary" and collectively, the "Merging Subsidiaries").

In the course of Share Swap OJSC NK Rosneft transferred its ordinary shares to the minority shareholders of the Merging Subsidiaries in exchange for ordinary and preferred shares owned by them. The shares of each Merging Subsidiary were exchanged at a certain agreed exchange ratio.

In December 2006 the Federal Tax Service of Russian Federation registered the changes in the Company's Charter related to increase in the Company's Share Capital resulting from issuance of additional shares pursuant to the share swap. The Company's share capital increased by 1,220,939,458 ordinary shares to a total of 10,598,177,817 ordinary shares.

In September 2006 the shareholders of VBRR approved the additional share issue for 223,500 shares with par value of RUB 10,000 each, which will be subsequently bought in full by the Company. The total par value of the shares bought will amount to US\$ 83 million at the CB RF exchange rate as of September 30, 2006. The Company's share in VBRR will be increased to 94.00%.

In October 2006 the Arbitration court passed the judgment on the litigation initiated by Total E&P Vankor against ASOC Cyprus amounting to US\$ 640 million with respect to sales and purchase agreement for 52% shares of Eniseyneft LLC (see also Note 19). The Arbitration court declined all the claims of Total E&P Vankor and obliged it to cover all the legal and arbitration costs suffered by ASOC Cyprus.

In November 2006 the Company exercised the last coupon payment and settled the five-year eurobonds amounting to US\$ 149 million.

In April 2006, Rosneft and China Petrochemical Corporation ("Sinopec") signed the option agreement, stating that Rosneft buys the interest in OJSC Udmurtneft (Udmurtneft) if Sinopec wins the tender for purchasing Udmurtneft from TNK-BP. In June 2006 TNK-BP announced reaching the consensus for selling 96.86% shares of Udmurtneft to Sinopec. To manage the activity of Udmurtneft the joint venture was created with 51% and 49% holdings made by the Company and Sinopec accordingly. The credit facility for financing the purchase of 96.86% shares of Udmurtneft was provided to the joint venture by Bank of China. To repay this financing the cash flows of Udmurtneft will be used directly, without the recourse to the shareholders' assets. In December 2006 the Company finalized the transaction on acquiring the interest in Udmurtneft. The Company will account for this investment using the equity method.

In November 2006, the Company signed a revolving loan agreement with a major Russian state bank for RUB 30 billion with a term up to 3 years. The loan bears interest from 6 to 6.8% p.a. depending on the actual term of financing. In the end of November, 2006, the Company received RUB 30 billion (US\$ 1.12 billion at the CB RF rate as of September 30, 2006) under this loan agreement.

In November 2006, the Company signed the Shareholders and Operating Agreements with BP p.l.c. related to further development of the Sakhalin shelf (Zapadno-Shmidtovsky and Vostochno-Shmidtovsky blocks). In accordance with the terms of the agreements, during the exploration stage project funding will be fully provided by BP p.l.c., it will recover its costs from the Company's share in the extracted hydrocarbons after the beginning of commercial extraction. The Company will record the investment in its share in the projects under the "carried interest" method.

*See Accountants' Review Report*