ROSNEFT

OIL COMPANY

OPEN JOINT STOCK COMPANY

Rosneft Oil Company

Consolidated Financial Statements

as of December 31, 2010 and 2009 and
for the years ended December 31, 2010, 2009 and 2008
With Report of Independent Auditors

Rosneft Oil Company

Consolidated Financial Statements

as of December 31, 2010 and 2009

and for the years ended December 31, 2010, 2009 and 2008

Contents

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Report of Independent Auditors

Shareholders and the Board of Directors
of Rosneft Oil Company

We have audited the accompanying consolidated balance sheets of Rosneft Oil Company, an open joint stock company ("the Company"), as of December 31, 2010 and 2009, and the related consolidated statements of income and comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2010 and 2009, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

Ernst & Young LLC

February 4, 2011

Rosneft Oil Company

Consolidated Balance Sheets

(in millions of US dollars, except share amounts)

	Notes	As of December 31, 2010	2009
ASSETS			
Current assets:			
Cash and cash equivalents	3	**4,154**	1,997
Restricted cash	3	**30**	20
Short-term investments	4	**6,814**	2,508
Accounts receivable, net	5	**7,512**	6,458
Inventories	6	**2,111**	1,886
Deferred tax assets	18	**174**	174
Prepayments and other current assets	7	**2,156**	2,126
Assets held for sale	8	**92**	–
Total current assets		**23,043**	15,169
Non-current assets:			
Long-term investments	8	**2,936**	3,744
Long-term bank loans granted, net of allowance of US$ 16 and US$ 17, respectively		**304**	326
Property, plant and equipment, net	9	**61,190**	57,704
Goodwill	11	**4,507**	4,507
Intangible assets, net	11	**767**	811
Deferred tax assets	18	**125**	125
Other non-current assets	12	**957**	846
Total non-current assets		**70,786**	68,063
Total assets		**93,829**	83,232
LIABILITIES AND EQUITY			
Current liabilities:			
Accounts payable and accrued liabilities	13	**3,861**	3,697
Short-term loans and current portion of long-term debt	14	**5,498**	7,838
Income and other tax liabilities	15	**1,971**	1,627
Deferred tax liabilities	18	**86**	77
Other current liabilities		**240**	204
Liabilities related to assets held for sale	8	**37**	–
Total current liabilities		**11,693**	13,443
Asset retirement obligations	19	**2,328**	1,772
Long-term debt	14	**18,057**	15,669
Deferred tax liabilities	18	**4,908**	5,197
Other non-current liabilities	20	**1,339**	1,614
Total non-current liabilities		**26,632**	24,252
Equity:			
Common stock, par value 0.01 RUB (shares outstanding: 9,599.24 million and 9,597.43 million as of December 31, 2010 and 2009, respectively)	16	**20**	20
Treasury shares: (at acquisition cost: 998.94 million and 1,000.75 million shares as of December 31, 2010 and 2009, respectively)		**(7,511)**	(7,525)
Additional paid-in capital		**13,110**	13,108
Other comprehensive loss	2	**(20)**	(22)
Retained earnings		**48,936**	39,250
Total shareholders' equity		**54,535**	44,831
Noncontrolling interests		**969**	706
Total equity		**55,504**	45,537
Total liabilities and equity		**93,829**	83,232

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

Rosneft Oil Company

Consolidated Statements of Income and Comprehensive Income

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

	Notes	For the years ended December 31, 2010	2009	2008
Revenues				
Oil and gas sales	23	**34,767**	24,820	36,102
Petroleum products and petrochemicals sales	23	**26,660**	20,736	31,470
Support services and other revenues		**1,620**	1,270	1,419
Total		**63,047**	46,826	68,991
Costs and expenses				
Production and operating expenses		**4,792**	4,024	4,572
Cost of purchased oil, gas and petroleum products		**2,386**	1,890	2,942
General and administrative expenses		**1,584**	1,416	1,632
Pipeline tariffs and transportation costs		**6,980**	5,414	5,673
Exploration expense		**439**	325	248
Depreciation, depletion and amortization		**5,597**	4,350	3,983
Accretion expense		**107**	87	120
Taxes other than income tax	18	**10,920**	8,061	14,810
Export customs duty	17	**16,743**	12,131	22,006
Total		**49,548**	37,698	55,986
Operating income		**13,499**	9,128	13,005
Other (expenses)/income				
Interest income		**547**	516	375
Interest expense		**(580)**	(605)	(1,112)
Loss on disposal of non-current assets		**(156)**	(350)	(58)
Impairment loss	8	**(31)**	–	(108)
Gain on disposal of investments		**23**	5	22
Equity share in affiliates' profits/(loss)	8	**60**	112	(7)
Dividends and income/(loss) from joint ventures		**11**	(8)	(11)
Other loss, net		**(89)**	(350)	(135)
Foreign exchange gain		**32**	71	1,148
Total other (expenses)/income		**(183)**	(609)	114
Income before income tax		**13,316**	8,519	13,119
Income tax	18	**(2,644)**	(2,000)	(1,904)
Net income		**10,672**	6,519	11,215
Net income attributable to noncontrolling interests		**(272)**	(5)	(95)
Net income attributable to Rosneft		**10,400**	6,514	11,120
Other comprehensive income/(loss)	2	**2**	18	(40)
Comprehensive income		**10,402**	6,532	11,080
Net income attributable to Rosneft per share (in US$) – basic and diluted		**1.08**	0.68	1.16
Weighted average number of shares outstanding (millions)		**9,598**	9,598	9,598

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

Rosneft Oil Company

Consolidated Statements of Changes in Shareholders' Equity

for the years ended December 31, 2010, 2009 and 2008

(in millions of US dollars, except share amounts)

	Number of shares (millions)	Common stock	Additional paid-in capital	Treasury shares	Accumulated other comprehen-sive loss	Retained earnings	Total shareholders' equity	Noncon-trolling interests	Total equity
Balance at December 31, 2007	**9,598.18**	**20**	**13,075**	**(7,521)**	**–**	**22,866**	**28,440**	**277**	**28,717**
Net income for the year	–	–	–	–	–	11,120	11,120	95	11,215
Recognition of the financial effect of a transaction with a related party under common control (Note 16)	–	–	33	–	–	–	33	–	33
Unrealized loss on available-for-sale securities	–	–	–	–	(40)	–	(40)	–	(40)
Dividends declared on common stock	–	–	–	–	–	(650)	(650)	–	(650)
Dividends declared to minority shareholders in subsidiaries	–	–	–	–	–	–	–	(23)	(23)
Change in ownership interests in subsidiaries	–	–	–	–	–	–	–	346	346
Balance at December 31, 2008	**9,598.18**	**20**	**13,108**	**(7,521)**	**(40)**	**33,336**	**38,903**	**695**	**39,598**
Net income for the year	–	–	–	–	–	6,514	6,514	5	6,519
Purchase of shares (Note 16)	(0.75)	–	–	(4)	–	–	(4)	–	(4)
Unrealized gain on available-for-sale securities	–	–	–	–	18	–	18	–	18
Dividends declared on common stock	–	–	–	–	–	(600)	(600)	–	(600)
Dividends declared to minority shareholders in subsidiaries	–	–	–	–	–	–	–	(7)	(7)
Change in ownership interests in subsidiaries	–	–	–	–	–	–	–	13	13
Balance at December 31, 2009	**9,597.43**	**20**	**13,108**	**(7,525)**	**(22)**	**39,250**	**44,831**	**706**	**45,537**
Net income for the year	–	–	–	–	–	10,400	10,400	272	10,672
Sale of shares (Note 16)	1.81	–	(1)	14	–	–	13	–	13
Unrealized gain on available-for-sale securities	–	–	–	–	2	–	2	–	2
Dividends declared on common stock	–	–	–	–	–	(714)	(714)	–	(714)
Dividends declared to minority shareholders in subsidiaries	–	–	–	–	–	–	–	(6)	(6)
Change in ownership interests in subsidiaries	–	–	3	–	–	–	3	(3)	–
Balance at December 31, 2010	**9,599.24**	**20**	**13,110**	**(7,511)**	**(20)**	**48,936**	**54,535**	**969**	**55,504**

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

Rosneft Oil Company

Consolidated Statements of Cash Flows

(in millions of US dollars)

	Notes	For the years ended December 31, 2010	2009	2008
Operating activities				
Net income		**10,672**	6,519	11,215
Adjustments to reconcile net income to net cash provided by operating activities:				
Effect of foreign exchange		**(21)**	(454)	(1,263)
Depreciation, depletion and amortization		**5,597**	4,350	3,983
Dry hole costs		**114**	170	27
Loss on disposal of non-current assets		**156**	350	58
Asset impairment loss	8	**31**	–	108
Deferred income benefit	18	**(253)**	(106)	(1,490)
Accretion expense	19	**107**	87	120
Equity share in affiliates' (profits)/loss	8	**(60)**	(112)	7
Gain on disposal of investments		**(23)**	(5)	(22)
Increase/(decrease) in allowance for doubtful accounts and bank loans granted		**47**	(41)	57
Gain on extinguishment of promissory notes	14	**(178)**	(207)	(42)
Changes in operating assets and liabilities net of acquisitions:				
(Increase)/decrease in accounts receivable		**(964)**	(287)	2,180
(Increase)/decrease in inventories		**(232)**	(459)	502
(Increase)/decrease in restricted cash		**(10)**	(16)	30
Increase in prepayments and other current assets		**(97)**	(280)	(114)
Decrease in other non-current assets		**14**	117	228
Decrease/(increase) in long-term bank loans granted		**23**	(2)	(61)
Increase in interest payable		**63**	128	184
Increase/(decrease) in accounts payable and accrued liabilities		**307**	555	(928)
Increase in income and other tax liabilities		**351**	820	35
Decrease in other current and non-current liabilities		**(239)**	(365)	(439)
Acquisition of trading securities		**(1,134)**	(997)	(119)
Proceeds from sale of trading securities		**901**	554	137
Net cash provided by operating activities		**15,172**	10,319	14,393

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

Rosneft Oil Company

Consolidated Statements of Cash Flows (continued)

(in millions of US dollars)

	Notes	For the years ended December 31, 2010	2009	2008
Investment activities				
Capital expenditures	9	**(8,931)**	(7,252)	(8,732)
Acquisition of licences		**(140)**	(96)	(47)
Acquisition of rights to use trademarks "Sochi 2014"	11	**(18)**	(104)	–
Proceeds from disposals of property, plant and equipment		**55**	33	93
Acquisition of short-term investments, including				
Held-to-maturity securities		**(4,190)**	(2,911)	(1,921)
Available-for-sale securities		**(943)**	(225)	(4)
Proceeds from redemption/sale of short-term investments, including				
Held-to-maturity securities		**1,636**	2,534	1,342
Available-for-sale securities		**665**	66	3
Acquisition of long-term investments, including				
Held-to-maturity securities		**(24)**	(533)	(12)
Available-for-sale securities		**(10)**	(1,035)	(22)
Proceeds from redemption/sale of long-term investments, including				
Held-to-maturity securities		**12**	–	28
Available-for-sale securities		**1**	3	22
Loans to equity investees				
Proceeds from redemption		**3**	1	21
Given loans		**(169)**	(95)	(285)
Acquisition of entities, additional shares in subsidiaries and equity investees, net of cash acquired		**(5)**	(67)	(12)
Proceeds from sale of shares in OJSC Daltransgaz		**–**	–	91
Margin call deposit placed		**–**	(293)	(3,100)
Margin call deposit returned		**–**	1,208	1,713
Placements under reverse REPO agreements		**(403)**	(22)	–
Receipts under reverse REPO agreements		**22**	–	–
Net cash used in investing activities		**(12,439)**	(8,788)	(10,822)
Financing activities				
Proceeds from short-term debt		**274**	1,029	7,090
Repayment of short-term debt		**(779)**	(7,180)	(13,393)
Proceeds from long-term debt		**5,910**	11,844	6,885
Repayment of long-term debt		**(5,235)**	(5,939)	(3,118)
Cash paid for acquisition of treasury shares	16	**–**	(5)	–
Proceeds from sale of treasury shares		**13**	–	–
Dividends paid to shareholders		**(730)**	(622)	(516)
Dividends paid to minority shareholders in subsidiaries		**(11)**	(4)	(22)
Net cash used in financing activities		**(558)**	(877)	(3,074)
Increase in cash and cash equivalents		**2,175**	654	497
Cash and cash equivalents at beginning of period		**1,997**	1,369	998
Effect of foreign exchange on cash and cash equivalents		**(18)**	(26)	(126)
Cash and cash equivalents at end of period		**4,154**	1,997	1,369
Supplementary disclosures of cash flow information				
Cash paid for interest		**618**	690	857
Cash paid for interest (net of amount capitalized)		**271**	336	578
Cash paid for income tax		**2,891**	1,561	2,617
Supplementary disclosure of non-cash activities				
Income tax offsets	5	**–**	289	1,315

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

1. General

Nature of Operations

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 and in certain international markets.

Rosneft State Enterprise was incorporated as an open joint stock company on December 7, 1995. All assets and liabilities previously managed by Rosneft State Enterprise were transferred to the Company at their book value effective on that date together with the Government of the Russian Federation ("State") ownership in other privatized oil and gas companies. The transfer of assets and liabilities was made in accordance with Russian Government Resolution No. 971 dated September 29, 1995, *On the Transformation of Rosneft State Enterprise into an Open Joint Stock Company "Oil Company Rosneft"*. Such transfers represented a reorganization of assets under the common control of the State and, accordingly, were accounted for at their book value. In 2005, the State contributed the shares of Rosneft to the share capital of Open Joint Stock Company ("OJSC") Rosneftegaz. As of December 31, 2005, 100% of the shares of Rosneft less one share were owned by OJSC Rosneftegaz and one share was owned by the Russian Federation Federal Agency for the Management of Federal Property. The decrease in interest is attributable to sales of shares during Rosneft's Initial Public Offering ("IPO") in Russia, sales of Global Depository Receipts ("GDR") for the shares on London Stock Exchange and the share swap realized during the merger of Rosneft and certain subsidiaries during 2006. As of December 31, 2010 and 2009, OJSC Rosneftegaz maintains a 75.16% interest in Rosneft.

Under Russian legislation, natural resources, including oil, gas, precious metals and minerals and other commercial minerals situated within the territory of the Russian Federation are the property of the State until they are extracted. Law of the Russian Federation No. 2395-1, *On Subsurface Resources*, regulates relations arising in connection with the geological study, and the use and protection of subsurface resources within the territory of the Russian Federation. Pursuant to the Law, subsurface resources may be developed only on the basis of a licence. The licence is issued by the regional governmental body and contains information on the site to be developed, the period of activity, as well as financial and other conditions. The Company holds licences issued by regional authorities for geological studies, exploration and development of oil and gas blocks and fields in areas where its subsidiaries are located.

Due to the limited capacity of OJSC Transneft's pipeline system, the State Pipeline Commission sets export quotas for each oil company based on the legislation on equal access to the oil pipeline system. In addition, the Company exports certain quantities of crude oil bypassing the Transneft system thus enabling it to increase its export capacities. In 2010, 2009 and 2008, the Company's export sales were approximately 57%, 57% and 56% of produced crude oil, respectively. The remaining production was processed at the Company's refineries for further sales on domestic and international markets.

1. General (continued)

Nature of Operations (continued)

Principal subsidiary companies included in the consolidated financial statements and respective ownership interests of the Company as of December 31, 2010 are as follows:

Name	Nature of Business	Preferred and Common Shares	Voting Shares
		%	%
Exploration and production			
RN-Yuganskneftegaz LLC	Oil and gas production operator services	100.00	100.00
RN-Purneftegaz LLC	Oil and gas production operator services	100.00	100.00
RN-Sakhalinmorneftegaz LLC	Oil and gas production operator services	100.00	100.00
RN-Krasnodarneftegaz LLC	Oil and gas production operator services	100.00	100.00
RN-Stavropolneftegaz LLC	Oil and gas production operator services	100.00	100.00
RN-Severnaya Neft LLC (Northern Oil)	Oil and gas production operator services	100.00	100.00
CJSC RN-Astra	Oil and gas development and production	100.00	100.00
CJSC Sakhalinmorneftegaz Shelf	Oil and gas development and production	100.00	100.00
OJSC Dagneftegaz	Oil and gas development and production	81.22	94.96
OJSC Rosneft-Dagneft	Oil and gas development and production	68.70	91.60
CJSC Vankorneft	Oil and gas development and production	93.96	93.96
OJSC Grozneftegaz	Oil and gas production operator services	51.00	51.00
RN-Exploration LLC	Field survey and exploration	100.00	100.00
RN-Kaiganneftegaz LLC	Field survey and exploration	100.00	100.00
Vostok Smidt Invest LLC	Investment activities	100.00	100.00
Zapad Smidt Invest LLC	Investment activities	100.00	100.00
OJSC East-Siberian Oil and Gas Company	Oil and gas development and production	70.78	70.78
Val Shatskogo LLC	Oil and gas development	100.00	100.00
OJSC Samaraneftegaz	Oil and gas development and production	100.00	100.00
Refining, marketing and distribution			
RN-Tuapse Refinery LLC	Petroleum refining	100.00	100.00
RN-Komsomolsky Refinery LLC	Petroleum refining	100.00	100.00
OJSC Rosneft-MZ Nefteproduct	Petroleum refining	65.42	87.23
OJSC Angarsk Petrochemical Company	Petroleum refining	100.00	100.00
OJSC Achinsk Refinery VNK	Petroleum refining	100.00	100.00
OJSC Angarsk Polymer Plant	Petroleum refining	100.00	100.00
OJSC Kuybyshev Refinery	Petroleum refining	100.00	100.00
OJSC Novokuybyshev Refinery	Petroleum refining	100.00	100.00
OJSC Syzran Refinery	Petroleum refining	100.00	100.00
CJSC Neftegorsk Gas-Processing Plant	Gas processing	100.00	100.00
CJSC Otradny Gas-Processing Plant	Gas processing	100.00	100.00
OJSC Rosneft-ARTAG	Marketing and distribution	38.00	50.67
OJSC Rosneft-Altainefteproduct	Marketing and distribution	64.18	78.59
RN-Arkhangelsknefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Kabardino-Balkarskaya Toplivnaya Company	Marketing and distribution	99.81	99.89
OJSC Rosneft-Kubannefteproduct	Marketing and distribution	89.50	96.61
OJSC Rosneft-Karachaevo-Cherkessknefteproduct	Marketing and distribution	85.99	87.46
OJSC Rosneft-Kurgannefteproduct	Marketing and distribution	83.32	90.33
OJSC Rosneft-Murmansknefteproduct	Marketing and distribution	45.38	60.51
RN-Nakhodkanefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Smolensknefteproduct	Marketing and distribution	66.67	86.97
RN-Tuapsenefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Yamalnefteproduct	Marketing and distribution	49.52	66.03
RN-Vostoknefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Stavropolye	Marketing and distribution	100.00	100.00

1. General (continued)

Nature of Operations (continued)

Name	Nature of Business	Preferred and Common Shares	Voting Shares
		%	%
RN-Trade LLC	Marketing and distribution	100.00	100.00
CJSC Exponeft	Marketing and distribution	45.38	60.51
CJSC Irkutsknefteprodukt	Marketing and distribution	100.00	100.00
OJSC Samaranefteprodukt	Marketing and distribution	100.00	100.00
Samara Terminal LLC	Marketing and distribution	100.00	100.00
OJSC Buryatnefteprodukt	Marketing and distribution	97.48	98.88
CJSC Khakasnefteprodukt VNK	Marketing and distribution	100.00	100.00
OJSC Tomsknefteprodukt VNK	Marketing and distribution	100.00	100.00
OJSC Belgorodnefteprodukt	Marketing and distribution	100.00	100.00
CJSC Bryansknefteprodukt	Marketing and distribution	100.00	100.00
OJSC Voronezhnefteprodukt	Marketing and distribution	100.00	100.00
CJSC Lipetsknefteprodukt	Marketing and distribution	100.00	100.00
CJSC Orelnefteprodukt	Marketing and distribution	100.00	100.00
CJSC Penzanefteprodukt	Marketing and distribution	100.00	100.00
CJSC Tambovnefteprodukt	Marketing and distribution	100.00	100.00
CJSC Ulyanovsknefteprodukt	Marketing and distribution	100.00	100.00
Ulyanovsk Terminal LLC	Marketing and distribution	100.00	100.00
OJSC RN-Moskva	Marketing and distribution	100.00	100.00
CJSC NBA Service	Marketing and distribution	100.00	100.00
OJSC Germes Moskva	Marketing and distribution	85.61	85.61
CJSC Contract Oil	Marketing and distribution	100.00	100.00
CJSC Mytischi Fuel Company	Marketing and distribution	100.00	100.00
OJSC Stavropolnefteproduct	Marketing and distribution	100.00	100.00
U-Kuban LLC	Marketing and distribution	100.00	100.00
RN-Ingushnefteproduct LLC	Marketing and distribution	100.00	100.00
Other			
Rosneft International Ltd.	Holding company	100.00	100.00
CJSC Rosnefteflot	Transportation services	51.00	51.00
OJSC All-Russian Bank for Reconstruction and Development of Russian Regions (VBRR)	Banking	84.67	84.67
CJSC RN-Shelf-Dalniy Vostok	Management company	100.00	100.00
CJSC RN-Sety	Electric-power transmission services	100.00	100.00
RN-Burenie LLC	Drilling services	100.00	100.00
NK Rosneft NTC LLC	Research and development activities	100.00	100.00

All of the above subsidiaries, except for Rosneft International Ltd., are incorporated in the Russian Federation. Rosneft International Ltd. is registered in Ireland.

2. Significant Accounting Policies

Form and Content of the Consolidated Financial Statements

The Company maintains its books and records in accordance with accounting and taxation principles and practices mandated by Russian legislation. The accompanying 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").

In June 2009, the Financial Accounting Standards Board ("FASB") issued the Accounting Standards Update ("ASU") 2009-01 ("ASU 2009-01"). ASU 2009-01 also issued as FASB Statement of Financial Accounting Standards ("SFAS") 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles,* is effective for financial statements issued after September 15, 2009. ASU 2009-01 requires that the FASB's Accounting Standards Codification ("ASC") become the single source of authoritative US GAAP principles recognized by the FASB. The Company adopted ASU 2009-01 effective July 1, 2009 and changed references to US GAAP in its consolidated financial statements issued for the year 2010. The adoption of ASU 2009-01 did not impact the Company's consolidated financial position or results of operations.

Subsequent events have been evaluated through February 4, 2011, the date these consolidated financial statements were issued.

The accompanying 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; (12) accounting for derivative instruments.

Certain items in the consolidated statement of income and comprehensive income, and the consolidated statement of cash flows for the year 2008 were reclassified to conform to the current year presentation of noncontrolling interests according to the provisions of FASB ASC 810, *Consolidation*, which the Company adopted from January 1, 2009.

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, 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, and classification of certain debt amounts. 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.

2. Significant Accounting Policies (continued)

Foreign Currency Translation

The management of the Company has determined that the US dollar ("US$") is the functional and reporting currency for the purpose of financial reporting under US GAAP. Monetary assets and liabilities have been translated into US$ using the official exchange rate of the Central Bank of the Russian Federation ("CBR") as of the balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have, where practicable, been translated into US$ at exchange rates that are close to the actual rate of exchange prevailing on transaction dates.

Gains and losses resulting from the re-measurement into US$ are included in "Foreign exchange gain" in the consolidated statements of income and comprehensive income.

As of December 31, 2010 and 2009, the CBR official rates of exchange were 30.48 rubles ("RUB") and 30.24 RUB per US$, respectively. Average rates of exchange in 12 months of 2010 and 2009 were 30.37 RUB and 31.72 RUB per US$, respectively. As of February 4, 2011, the official rate of exchange was 29.35 RUB per US$.

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

Principles of Consolidation

The consolidated financial statements include the accounts of majority-owned, controlled subsidiaries and variable interest entities where the Company is a primary beneficiary. All significant intercompany transactions and balances have been eliminated. The equity method is used to account for investments in affiliates in which the Company has the ability to exert significant influence over the affiliates' operating and financial policies. 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. The Company's share in net profit or loss of equity investees also includes any other-than-temporary declines in fair value recognized during the period. Investments in other companies are accounted for at cost and adjusted for impairment, if any.

Business Combinations

The Company accounts for its business combinations according to FASB ASC 805, *Business Combinations,* and FASB ASC 810, *Consolidation*. The Company applies the acquisition method of accounting and recognizes the assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. 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, licence and other asset lives and market multiples, among other items.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the consideration transferred plus the fair value of any noncontrolling interest in the acquiree at the acquisition date over the fair values of the identifiable net asset acquired. The excess of the fair values of the identifiable net asset acquired over the consideration transferred plus the fair value of any noncontrolling interest in the acquiree should be recognized as a gain in consolidated statements of income and comprehensive income on the acquisition date.

2. Significant Accounting Policies (continued)

Goodwill and Other Intangible Assets (continued)

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.

In accordance with requirements of FASB ASC 350, *Intangibles – Goodwill and Other*, goodwill and intangible assets with indefinite useful lives are not amortized. Instead, they are tested at least annually for impairment. The impairment loss is recognized when the carrying value of goodwill exceeds its fair value. The impairment test is comprised of two stages. The first step compares the fair value of the reporting unit with its carrying value, including goodwill. If the fair value of the reporting unit exceeds its carrying value, the goodwill of the reporting unit is considered not impaired. Otherwise, the second step of the goodwill impairment test shall be performed to measure the amount of impairment loss resulting from the excess of the reporting unit's carrying value over its fair value. The loss recognized cannot exceed the carrying amount of goodwill. Subsequent reversal of a previously recognized goodwill impairment loss is prohibited.

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.

Noncontrolling Interests

Noncontrolling interests in the net assets and net results of consolidated subsidiaries are shown under "Noncontrolling interests" and "Net income attributable to noncontrolling interests" in the accompanying consolidated balance sheets and statements of income and comprehensive income, respectively. Losses attributable to the Company and the noncontrolling interest in a subsidiary may exceed their interests in the subsidiary's equity. The excess, and any further losses attributable to the Company and the noncontrolling interest, are to be attributed to those interests. That is, the noncontrolling interest continues to be attributed its share of losses even if that attribution results in a deficit noncontrolling interest balance. The actual ruble-denominated balances attributable to noncontrolling interests may differ from these amounts presented in these consolidated financial statements.

Assets Held For Sale

The Company accounts its assets as held for sale in accordance to the provisions of FASB ASC 205-20, *Discontinued operations.* A long-lived asset (disposal group) to be sold is classified as held for sale in the period in which all of the held-for-sale criteria are met, and measured at the lower of its carrying amount or fair value less cost to sell. A long-lived asset is not depreciated (amortized) while it is classified as held for sale.

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

2. Significant Accounting Policies (continued)

Loans and Accounts Receivable

Loans and accounts receivable are stated at their principal amounts outstanding net of loan losses and 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 written off at the average cost or the cost of each unit and are stated at the lower of weighted average cost of acquisition (production) 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.

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 and comprehensive 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 and comprehensive 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.

Repurchase and Resale Agreements

Securities sold under agreements to repurchase ("REPO") and securities purchased under agreements to resell ("reverse REPO") generally do not constitute a sale for accounting purposes of the underlying securities, and so are treated as collateralized financing transactions. Interest paid or received on all REPO and reverse REPO transactions is recorded in "Interest expense" or "Interest income" at the contractually specified rate using the effective interest method.

2. Significant Accounting Policies (continued)

Oil and Gas Exploration and Development

In accordance with FASB ASC 932, *Extractive Activities—Oil and Gas,* oil and gas exploration and development costs 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 commercial 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 expense".

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.

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

- 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 December 31, 2010 and 2009, 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 December 31, 2010 and 2009, exploratory drilling costs capitalized on this basis were not material.

Should the project be deemed commercially 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 exploration and production assets 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 income statement.

2. Significant Accounting Policies (continued)

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, and where impairment arises, these costs are expensed.

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.

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

Asset Group	Average Useful Life
Buildings and constructions	30 - 45 years
Plant and machinery	5 - 25 years
Vehicles and other equipment	6 -10 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 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 and comprehensive 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.

Undivided interests in unincorporated oil and gas joint ventures are consolidated on a proportionate basis.

2. Significant Accounting Policies (continued)

Interests in Joint Operations (continued)

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 FASB ASC 932, 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.

Impairment of Long-Lived Assets

Long-lived assets, including blocks with proved oil and gas reserves, are assessed for potential impairment in accordance with paragraphs 360-10-35-17 through 360-10-35-36 of FASB ASC 360, *Property, Plant and Equipment*.

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.

Individual assets are grouped for impairment purposes at the lowest level of identifiable cash flows that are largely independent of the cash flows from other groups of assets – generally on a field-by-field basis for exploration and production assets, for refining assets – at the entire refining unit, for service stations – at the site level. 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.

Impairment of Investments

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. Fair value determination is based on quoted market prices, if available, or on the present value of expected cash flows using discount rates commensurate with the risks of the investment.

2. Significant Accounting Policies (continued)

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 that 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$ 347 million, US$ 354 million and US$ 279 million of interest expenses on loans and borrowings in 2010, 2009 and 2008, respectively.

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

Asset Retirement Obligations

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

<u>Exploration and Production</u> – 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, licences 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 licence requirements, as well as actual dismantling and other related costs. Asset retirement obligations are calculated in accordance with the provisions of FASB ASC 410-20, *Asset Retirement Obligations.*

<u>Refining, Marketing and Distribution</u> – 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.

2. Significant Accounting Policies (continued)

Asset Retirement Obligations (continued)

FASB ASC 410-20 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 FASB ASC 410-20.

Because of the reasons described above the fair value of an asset retirement obligation cannot be reasonably estimated.

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

FASB ASC 825, *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.

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 and long-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 FASB ASC 740, *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 accounts for uncertain tax positions and reflects liabilities for unrecognized income tax benefits together with corresponding interest and penalties in the consolidated statement of income and comprehensive income as income tax expense.

Derivative Instruments

All derivative instruments are recorded on the consolidated balance sheets at fair value in either other current assets, other non-current assets, other current liabilities or other non-current liabilities. Recognition and classification of a gain or loss that results from recognition of a derivative instrument at fair value depends on the purpose for issuing or holding the derivative instrument. Gains and losses from derivatives that are not accounted for as hedges under FASB ASC 815, *Derivatives and Hedging*, are recognized immediately in the consolidated statement of income and comprehensive income.

2. Significant Accounting Policies (continued)

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 (except freight), duties and taxes on those sales. Revenues include excise taxes and customs duties (see Note 17).

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

Transportation Expenses

Transportation expenses recognized in the consolidated statements of income and comprehensive income represent all expenses incurred in the transportation of crude oil and petroleum products via the Transneft pipeline network, as well as by railway and other transport means. Transportation expenses also include all other shipping and handling costs.

Refinery Maintenance Costs

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

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 unless the aggregate amount of the obligation and the amount and timing of the cash payments are fixed or reliably determinable.

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 statements of income and comprehensive income, 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 FASB ASC 220, *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.

During 2010, 2009 and 2008, the Company recorded other accumulated comprehensive income (net of tax) in the amount of US$ 2 million, income (net of tax) in the amount of US$ 18 million, and loss (net of tax) in the amount of US$ 40 million, respectively, which represent an unrealized financial result from the revaluation of available-for-sale investments.

2. Significant Accounting Policies (continued)

Accounting for Buy/Sell Contracts

Paragraphs 845-10-15-5 through 845-10-15-9 of FASB ASC 845, *Nonmonetary Transactions,* require that two or more legally separate exchange transactions with the same counterparty, including buy/sell transactions, should be combined and considered as a single arrangement, when the transactions are entered into "in contemplation" of one another.

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.

Taxes Collected from Customers and Remitted to Governmental Authorities

Excise taxes are reported gross within sales and other operating revenues and taxes other than income taxes in the consolidated statements of income and comprehensive income, while value-added tax is recorded net in taxes other than income tax liabilities in the consolidated balance sheets.

Changes in Accounting Policies

In August 2009, the FASB issued ASU 2009-05, *Fair Value Measurements and Disclosures (Topic 820): Measuring Liabilities at Fair Value* ("ASU 2009-05") that amends Subtopic 820-10, *Fair value measurements and disclosures, Overall* of Topic 820*,* of the FASB Codification. ASU 2009-05 provides clarification that in circumstances in which a quoted price in active market is not available, a reporting entity is required to use one or more of the following valuation techniques: valuation based on quoted price of identical liability when traded as an asset; quoted prices of similar liabilities or similar liabilities when traded as an assets, or any other technique consistent with the principles of Topic 820, such as present value technique. ASU 2009-05 also clarifies that a reporting entity is not required to include a separate input to existence of restriction that prevents the transfer of the liability. ASU 2009-05 is effective for the first reporting period (including interim periods) beginning after issuance. Early application is permitted if financial statements for prior period have not been issued. The Company adopted ASU 2009-05 from January 1, 2010. Adoption of ASU 2009-05 did not have a material impact on the Company's consolidated financial position and results of operations.

2. Significant Accounting Policies (continued)

Changes in Accounting Policies (continued)

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* ("ASU 2010-06") that amends Topic 820, *Fair Value Measurements and Disclosures*, of the FASB Codification. ASU 2010-06 requires separate disclosure of significant transfers between Level 1 and Level 2 fair value measurement inputs and a description of the reasons for the transfers. Entity is also required to present separately information about purchases, issuance, and settlements in the reconciliation for fair value measurements using Level 3 inputs. ASU 2010-06 amends existing disclosure requirements in regards of level of disaggregation and inputs and valuation techniques. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about activity in Level 3 fair value measurements that are effective for interim and annual periods beginning after December 15, 2010. The Company adopted ASU 2010-06 from January 1, 2010, except for the disclosures about activity in Level 3 fair value measurements that will be adopted from January 1, 2011. Adoption of ASU 2010-06 did not have a material impact on the Company's consolidated financial position and results of operations.

In March 2010, the FASB issued ASU 2010-11, *Derivatives and Hedging (Topic 815): Scope Exception Related to Embedded Credit Derivatives* ("ASU 2010-11") that amends Topic 815, *Derivatives and Hedging*, of the FASB Codification. ASU 2010-11 clarifies that scope exception for embedded credit derivative features relates to the transfer of credit risk in the form of subordination of one financial instrument to another. ASU 2010-11 is effective at the beginning of the first fiscal quarter beginning after June 15, 2010. Early adoption is permitted at the beginning of each first fiscal quarter beginning after issuance of ASU 2010-11. The Company adopted ASU 2010-11 from July 1, 2010. Adoption of ASU 2010-11 did not have a material impact on the Company's consolidated financial position and results of operations.

Recent Accounting Standards

In July 2010, the FASB issued ASU 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* ("ASU 2010-20") that amends Topic 310, *Receivables,* of the FASB Codification. ASU 2010-20 amends existing disclosures and requires the entity to provide additional disclosures to facilitate financial statement users' evaluation of the following: 1) the nature of credit risk inherent in the entity's portfolio of financing receivables; 2) how that risk is analyzed and assessed in arriving at the allowance for credit losses; 3) the changes and reasons for those changes in the allowance for credit losses. ASU 2010-20 also introduces a new terminology, in particular, the term *financial receivables*. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. Issued in January 2011 ASU 2011-01 deferred effective date for other disclosure requirement. The Company has adopted ASU 2010-20 effective requirements from December 31, 2010. Adoption of ASU 2010-20 didn't have a material impact on the Company's consolidated financial position and results of operations.

In December 2010, The FASB issued ASU 2010-28, *Intangibles—Goodwill and Other* (Topic 350): *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* (ASU 2010-28) that amends Topic 350, *Intangibles—Goodwill and Other,* of the FASB codification. For the reporting units with zero or negative carrying value, an entity is required to perform the goodwill impairment test if it is more likely than not that a goodwill impairment exists. An entity should consider any adverse qualitative factors indicating that an impairment may exist. ASU 2010-28 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. The Company will adopt ASU 2010-28 from January 1, 2011. The Company does not expect ASU 2010-28 to have a material impact on the Company's consolidated financial position and results of operations.

2. Significant Accounting Policies (continued)

Recent Accounting Standards (continued)

In December 2010, The FASB issued ASU 2010-29, *Business Combinations* (Topic 805): *Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29) that amends Topic 805, *Business Combinations,* of the FASB codification. ASU 2010-29 specifies that an entity should disclose revenue and earnings of the combined entity in comparative period as though the business combination had occurred as of the beginning of the comparable prior annual reporting period. ASU 2010-29 also expands the supplemental pro forma disclosures. ASU 2010-29 is effective prospectively for business combinations occurred on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The Company will adopt ASU 2010-29 for business combinations occurred on or after January 1, 2011. The Company does not expect ASU 2010-29 to have a material impact on the Company's consolidated financial position and results of operations.

3. Cash and Cash Equivalents

Cash and cash equivalents as of December 31 comprise the following:

	2010	2009
Cash on hand and at bank accounts in RUB	**671**	624
Cash on hand and at bank accounts in foreign currencies	**843**	748
Deposits	**2,625**	612
Other	**15**	13
Total cash and cash equivalents	**4,154**	1,997

Restricted cash as of December 31 comprises the following:

	2010	2009
Obligatory reserve with the CBR	**21**	15
Other restricted cash	**9**	5
Total restricted cash	**30**	20

The obligatory reserve with the CBR represents the amount deposited by the Company's subsidiary bank, VBRR, with the CBR for securing the current operating activity of the bank. Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBR, which amount depends on the level of funds raised by the credit institution and this amount has certain restrictions for use.

Cash accounts denominated in foreign currencies are primarily in US$.

Deposits are interest bearing and denominated primarily in RUB.

As part of its cash management and credit risk function, the Company regularly evaluates the creditworthiness of financial and banking institutions where it deposits cash. Banking relationships are primarily with Russian subsidiaries of international banking institutions and certain large Russian banks.

4. Short-Term Investments

Short-term investments as of December 31 comprise the following:

	2010	2009
Short-term loans granted	**1**	1
Loans to related parties	**70**	12
Reverse repurchase agreements	**403**	22
Structured deposits (Note 24)	**3,791**	507
Promissory notes held-to-maturity	**–**	81
Trading securities		
Promissory notes	**–**	38
State and corporate bonds	**727**	449
Other	**2**	4
Available-for-sale securities	**487**	210
Bank deposits	**1,333**	1,184
Total short-term investments	**6,814**	2,508

Reverse repurchase agreements are collateralized by trading securities at fair value as of December 31, 2010 in the amount of US$ 403 million (US$ 22 million as of December 31, 2009).

As of December 31, 2010, structured deposits are denominated in US$ and have interest rates ranging from 6.22% to 7.2%. As of December 31, 2009, structured deposit are denominated in US$ and have interest rates of 7.75%.

As of December 31, 2010, trading securities include state and municipal bonds with nominal interest rates ranging from 5.14% to 18.1% and maturities ranging from April 2011 to February 2036, corporate bonds issued by large Russian corporations with maturities ranging from February 2011 to June 2020 and interest rates ranging from 5.8% to 19.0% and bonds issued by CBR with weighted average effective interest rate of 3.52% and with maturities ranging from February 2011 to March 2011. As of December 31, 2009, trading securities include state and municipal bonds with nominal interest rates ranging from 6.9% to 18.0% and maturities ranging from March 2010 to February 2036, corporate bonds issued by large Russian corporations with maturities ranging from June 2010 to December 2016 and interest rates ranging from 7.9% to 19.0%, and nominally interest-free promissory notes with effective interest rates from 9.5% to 15.9%, and with maturities ranging from February 2010 to January 2011.

As of December 31, 2010, available-for-sale securities include state and municipal bonds, corporate bonds and corporate promissory notes. State bonds represent federal loan bonds issued by the Ministry of Finance of the Russian Federation with maturities ranging from January 2011 to May 2015 and nominal interest rates ranging from 4.59% to 6.85%. Municipal bonds represent bonds with nominal interest rates ranging from 8.75% to 18.0% and maturities ranging from March 2012 to December 2014. The corporate bonds represent bonds issued by large Russian corporations with maturities ranging from March 2011 to July 2020 with interest rates ranging from 6.75% to 18.0%. The corporate bonds in the amount of US$ 31 million were pledged under repurchase agreements (see Note 14). Corporate promissory notes represent promissory notes with nominal interest rates ranging from 4.25% to 4.5% with maturities ranging from December 2012 to December 2013 and nominally interest-free promissory notes with weighted average effective interest rate of 3.0% with maturity in June 2015. Amortized cost bases of available-for-sale securities approximate their fair values. As of December 31, 2009, available-for-sale securities include state and corporate bonds. State bonds represent federal loan bonds issued by the Ministry of Finance of the Russian Federation with maturities ranging from July 2010 to August 2025 and nominal interest rates ranging from 6.1% to 10.0% and bonds issued by CBR with weighted average effective interest rate of 7.25% and with maturities ranging from March to June 2010. The corporate bonds represent bonds issued by large Russian corporations, maturing in July 2016 with an interest rate of 7.68%.

4. Short-Term Investments (continued)

As of December 31, 2010, bank deposits are primarily denominated in US$ and have interest rates ranging from 4.7% to 8.0%. As of December 31, 2009, the bank deposits denominated in RUB have interest rates ranging from 10.5% to 10.6% and the bank deposits denominated in USD have interest rates ranging from 6.5% to 7.0%.

5. Accounts Receivable, net

Accounts receivable as of December 31 comprise the following:

	2010	2009
Trade receivables	**4,077**	2,958
Value-added tax and excise receivable (Note 22)	**2,126**	2,269
Other taxes	**283**	211
Banking loans to customers	**789**	753
Acquired receivables	**3**	30
Other	**372**	328
Less: allowance for doubtful accounts	**(138)**	(91)
Total accounts receivable, net	**7,512**	6,458

The Company's trade accounts receivable are denominated primarily in US$. Credit risk is managed through the use of letters of credit. Credit risk in domestic sales of petroleum products is managed through the use of bank guarantees for receivables repayment.

6. Inventories

Inventories as of December 31 comprise the following:

	2010	2009
Materials and supplies	**451**	492
Crude oil and gas	**595**	502
Petroleum products and petrochemicals	**1,065**	892
Total inventories	**2,111**	1,886

Materials and supplies mostly include spare parts. Petroleum products and petrochemicals include those designated for sale as well as for own use.

7. Prepayments and Other Current Assets

Prepayments and other current assets as of December 31 comprise the following:

	2010	2009
Prepayments to suppliers	**665**	705
Prepaid customs duties	**1,315**	1,334
Insurance prepayments	**6**	12
Derivatives (Note 24)	**77**	3
Other	**93**	72
Total prepayments and other current assets	**2,156**	2,126

Prepaid customs duties primarily represent export duties related to the export of crude oil and petroleum products (see Note 17).

8. Long-Term Investments

Long-term investments as of December 31 comprise the following:

	2010	2009
Equity method investments		
OJSC Tomskneft VNK	**1,334**	1,488
Polar Lights Company LLC	**70**	84
JV Rosneft-Shell Caspian Ventures Ltd.	**19**	16
OJSC Verkhnechonskneftegaz	**277**	234
CJSC Vlakra	**110**	110
Investments in power and utilities companies	**190**	272
Other	**174**	66
Total equity method investments	**2,174**	2,270
Available-for-sale securities		
OJSC TGK-11	**–**	20
Long-term promissory notes	**–**	4
Other securities in Company's banks	**17**	14
Bank deposits – US$ denominated	**–**	833
Held-to-maturity securities		
Russian government bonds	**49**	36
Long-term loans to equity investees	**679**	550
Cost method investments	**17**	17
Total long-term investments	**2,936**	3,744

US$ denominated deposits placed in June 2009 in a state controlled bank for two years were reclassified to short-term investments in accordance with their maturities during the second quarter (see Note 4).

Long-term loans to equity investees generally have contractual maturities from 3 to 8 years and primarily include loans to OJSC Verkhnechonskneftegaz. The amount also includes a loan in the amount of US$ 116 million provided by the Company in April 2010 to National Oil Consortium ("NOC"). The Company's share in NOC is 20%. NOC is involved in geological exploration of the block Junin-6 in Venezuela.

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

	Participation interest (percentage) as of December 31, 2010	Share in income/(loss) of equity investees		
		2010	2009	2008
Polar Lights Company LLC	**50.00**	**16**	26	36
OJSC Verkhnechonskneftegaz	**25.94**	**43**	5	(17)
JV Rosneft-Shell Caspian Ventures Ltd.	**51.00**	**3**	2	3
OJSC Kubanenergo	**26.26**	**(45)**	–	–
OJSC Tomskneft VNK	**50.00**	**38**	147	56
West Kamchatka Holding B.W.	**60.00**	**–**	–	(51)
Other	**various**	**5**	(68)	(34)
Total equity share in profits/(loss)		**60**	112	(7)

8. Long-Term Investments (continued)

OJSC Tomskneft VNK

OJSC Tomskneft VNK is a joint venture engaged in crude oil exploration and production in Western Siberia. The Shareholder Agreement provides that key decisions regarding the business operations of OJSC Tomskneft VNK shall be subject to unanimous approval by both participants and none of the participants has a preferential voting right. The investment in OJSC Tomskneft VNK includes goodwill of US$ 368 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 to the 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.

During 2008 the Company reviewed whether decline in value of its investment in PLC was other than temporary according to FASB ASC 323, *Investments-Equity Method and Joint Ventures*. To measure the fair value of the investment the Company used a discounted cash flow model. The fair value of the Company's share in PLC was less than its carrying value. The Company concluded that an other than temporary decline in value of the investment existed and recognized impairment loss in the amount of US$ 58.3 million. No further impairment was identified in 2009 and 2010.

JV Rosneft-Shell Caspian Ventures Ltd.

JV Rosneft-Shell Caspian Ventures Ltd. ("JV") is a joint venture in which the Company holds 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 December 6, 1996, the Company and 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 commenced operation.

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.

In the third quarter of 2008, commercial production began at the Verkhnechonskoye oil field. OJSC Verkhnechonskneftegaz is financed through long-term loans provided by the Company and other participants pro rata to their corresponding shareholdings.

CJSC Vlakra

CJSC Vlakra has the right to use a land plot and office premises located in Moscow.

8. Long-Term Investments (continued)

Investments in Power and Utilities Companies

Investments in power and utilities companies primarily comprise investments in shares of electric power generation, transmission, distribution and maintenance companies located in the Tomsk region and in the south of Russia.

The Company acquired interests in OJSC Tomskenergo and OJSC Kubanenergo through the auctions for the sale of the assets of Yukos Oil Company that were held in May and July 2007. In 2007, OJSC Tomskenergo was merged into OJSC TGK-11. Following the conversion of OJSC Tomskenergo's shares as a result of the above merger, the Company's interest in the share capital of OJSC TGK-11 amounted to 5.28%. In July 2008, an arbitrazh court ruled in favor of the Company to nullify reorganization and the conversion of OJSC Tomskenergo's shares. In July 2009, the arbitrazh court approved amicable agreement of transferring OJSC TGK-11's additional shares to the Company as compensation of losses from shares conversion. In September 2009, the Company received additional shares of OJSC TGK-11, increasing its share in OJSC TGK-11's total equity to 6.77%. As of December 31, 2010 and 2009 this investment was accounted for as an available-for-sale security.

In October 2009, the Company exercised its right of first refusal and acquired additional shares issued by OJSC Kubanenergo for RUB 1,972 million (US$ 68 million at the CBR official exchange rate as of date of acquisition). The acquisition did not change the Company's interest.

Assets Held For Sale

In December 2010, the Company signed an agreement of intent to exchange its interest in a number of equity investees and one subsidiary for noncontrolling interest in a major power and utilities holding company. Transaction is scheduled for completion in the first half of 2011.

The major classes of assets and liabilities included as part of a disposal group are the following:

	As of December 31, 2010
Current assets	55
Equity investments	30
Other non-current assets	7
Total assets	**92**
Current liabilities	37
Total liabilities	**37**

The Company measured a disposal group at the lower of its carrying amount or fair value less cost to sell and recognized US$ 31 million impairment loss in the consolidated statement of income and comprehensive income.

The disposal group relates to All other category in Segment Information (Note 23).

9. Property, Plant and Equipment, net

	Cost		Accumulated depreciation		Net carrying amount	
	December 31, 2010	**December 31, 2009**	**December 31, 2010**	**December 31, 2009**	**December 31, 2010**	**December 31, 2009**
Exploration and production	**66,991**	60,474	**(18,784)**	(14,429)	**48,207**	46,045
Refining, marketing and distribution	**15,344**	13,646	**(4,562)**	(3,915)	**10,782**	9,731
Other activities	**3,026**	2,549	**(825)**	(621)	**2,201**	1,928
Total property, plant and equipment	**85,361**	76,669	**(24,171)**	(18,965)	**61,190**	57,704

Exploration and production assets include costs to acquire unproved properties in the amount of US$ 4,104 million as of December 31, 2010, and US$ 4,131 million as of December 31, 2009. The Company plans to explore and develop the respective properties. The Company's management believes these costs are recoverable.

The Company used reserve data (see supplementary oil and gas disclosure) to calculate depreciation, depletion and amortization relating to oil and gas properties for 2010 and 2009 and for the assessment of impairment of oil and gas assets.

As described in the "Depreciation, Depletion and Amortization" section of Note 2, the Company calculates depletion using the unit-of-production method over proved or proved developed oil and gas reserves depending on the nature of the costs involved. The proved or proved developed reserves used in the unit of production method assume the extension of the Company’s production licences beyond their current expiration dates until the end of the economic lives of the fields as discussed below in further detail.

The Company’s oil and gas fields are located principally in the territory of the Russian Federation. The Company obtains licences from the governmental authorities to explore and produce oil and gas from these fields. The Company’s existing production licences generally expire during the period 2011 to 2051. Expiration dates of licences for the most significant fields are between 2013 and 2051, and the licence for the largest field, Priobskoye, expires in 2044. The economic lives of the major licenced fields extend significantly beyond these dates. Under Russian law, the Company is entitled to renew the licences to the end of the economic lives of the fields, provided certain conditions are met. In fact, the Subsurface Resources Administrator (Rosnedra) extends licences for a period of up to 25 years regardless of the expected life of a field. Article 10 of the Law *"On Subsurface Resources"* provides that a licence to use a field "shall be" extended at its scheduled termination at the initiative of the subsoil user if necessary to finish production of the field, provided that there are no violations of the conditions of the licence.

The legislative history of Article 10 indicates that the term "shall" replaced the term "may" in August 2004, clarifying that the subsoil user has an absolute right to extend the licence term so long as it has not violated the conditions of the licence. In 2007 - 2010, the Company extended 80 of its main production licences for a period of up to 25 years based on the expected life of each field. The Company’s current production plans are based on the assumption, which management considers to be reasonably certain, that the Company will be able to extend all other existing licences. These plans have been designed on the basis that the Company will be producing crude oil through the economic lives of the fields and not with a view to exploiting the Company’s reserves to maximum effect only through the licence expiration dates.

9. Property, Plant and Equipment, net (continued)

Accordingly, management has included in proved reserves in the supplementary information on oil and gas exploration and production activities of the consolidated financial statements as of and for the year ended December 31, 2010 all reserves that otherwise meet the standards for being characterized as "proved" and that the Company estimates it can produce through the economic lives of Company's licensed fields.

Proved reserves should generally be limited to those that can be produced through the licence expiration date unless there is a long and clear track record which supports the conclusion that extension of the licence will be granted as a matter of course. The Company believes that extension of the licences will occur as a matter of course as fully described above.

Sakhalin-1

The Company's primary investment in production sharing agreements ("PSA") is through the Sakhalin-1 project ("PSA 1"), which is operated by ExxonMobil, one of the PSA participants. The Company has a 20% interest in this unincorporated joint venture.

Cash Flow Details

Capital expenditures in the consolidated statements of cash flows comprise the following:

	2010	2009	2008
Acquisition and construction of property, plant and equipment	**8,918**	7,252	8,154
Construction materials	**13**	–	578
Total capital expenditures	**8,931**	7,252	8,732

10. Leased Property, Plant and Equipment, net

The following is the analysis of property, plant and equipment under capital leases as of December 31, included within "Property, plant and equipment, net" (Note 9):

	2010	2009
Oil and gas properties	**27**	32
Less: accumulated depletion	**(6)**	(7)
Oil and gas properties, net	**21**	25
Other property, plant and equipment		
Buildings and constructions	**–**	1
Plant and machinery	**17**	19
Vehicles	**181**	184
Total	**198**	204
Less: accumulated depreciation	**(85)**	(59)
Property, plant and equipment, net	**113**	145
Total net book value of leased property	**134**	170

10. Leased Property, Plant and Equipment, net (continued)

Below is the analysis of the repayment of capital lease obligations as of December 31:

	2010
2011	**34**
2012	**24**
2013	**18**
2014	**14**
2015 and after	**109**
Imputed interest	**(80)**
Present value of capital lease payments	**119**

The charge to income resulting from amortization of leased property, plant and equipment is included with "Depreciation, depletion and amortization" in consolidated statements of income and comprehensive income for 2010, 2009 and 2008 in the amount of US$ 39 million, US$ 26 million and US$ 46 million, respectively.

Operating Lease

The total amount of operating lease expenses was as follows:

	2010	2009	2008
Total lease expenses	**233**	240	210
Total sublease revenues	**1**	2	5

11. Goodwill and Intangible Assets

As of December 31, 2010 and 2009, goodwill represents the excess of the purchase price of additional shares and interests in various entities in the refining, marketing and distribution segment and the exploration and production segment in the amounts of US$ 3,793 million and US$ 714 million, respectively, over the fair value of the corresponding acquired share in net assets.

In accordance with FASB ASC 350, *Intangibles-Goodwill and Other*, the Company performed its annual impairment test of goodwill as of October 1, 2010. Consistent with prior years, the review for impairment was carried out during the beginning of the fourth quarter of 2010 using data that was appropriate at that time. As a result of this annual test, no impairment of goodwill was identified.

Goodwill acquired through business combinations has been allocated to the reporting units being its operating segments – the exploration and production segment and refining, marketing and distribution segment. In assessing whether goodwill has been impaired, the carrying amount of the reporting unit (including goodwill) was compared with the estimated fair value of the reporting unit.

The Company estimated fair value of the reporting units using a discounted cash flow model. The future cash flows were adjusted for risks specific to the asset and discounted using a discount rate, which represented the Company's post-tax weighted average cost of capital.

11. Goodwill and Intangible Assets (continued)

The Company's business plan, approved by the Company's Board of Directors, is the primary source of information for the determination of the reporting units' fair values. They contain implicit forecasts for oil and natural gas production, refinery throughputs, sales volumes for various types of refined products, revenues, operating and capital expenditures. As an initial step in the preparation of these plans, various assumptions, such as oil prices, natural gas prices, refining margins, refined product margins and cost inflation rates, are set in the business plan. These assumptions take account of existing prices, US$ and RUB inflation rates, other macroeconomic factors and historical trends and variability.

In determining the fair value for each of the reporting units, cash flows for a period of 12 years have been discounted and aggregated with the reporting unit's terminal value.

For the purposes of impairment testing, the Company's Urals oil price assumptions were based on the forecasted quoted market prices.

Intangible assets comprise the following:

	Cost		Accumulated amortization		Net carrying amount	
	December 31, 2010	**December 31, 2009**	**December 31, 2010**	**December 31, 2009**	**December 31, 2010**	**December 31, 2009**
Land leasehold rights	**718**	718	**(125)**	(89)	**593**	629
Rights to use trade-marks "Sochi 2014"	**172**	172	**(47)**	(16)	**125**	156
Other	**61**	34	**(12)**	(8)	**49**	26
Total intangible assets	**951**	924	**(184)**	(113)	**767**	811

Land leasehold rights were purchased with the assets of the companies acquired during 2007 and are amortized on a straight line basis over an estimated average useful life of 20 years.

Rights to use trademarks "Sochi 2014" were acquired in the third quarter of 2009. The cost of these rights is amortized on a straight line basis over an estimated useful life of 5.5 years, which is the period the Company expects to benefit from these assets.

The charge to income resulting from amortization of intangible assets is included with "Depreciation, depletion and amortization" in consolidated statements of income and comprehensive income for 2010, 2009 and 2008 in the amount of US$ 81 million, US$ 61 million and US$ 59 million, respectively.

The following represents the estimated aggregate amortization expense for each of the five succeeding fiscal years for intangible assets subject to amortization:

2011	**81**
2012	**81**
2013	**81**
2014	**74**
2015	**36**
Total amortization expense for the five succeeding years	**353**

12. Other Non-Current Assets

Other non-current assets as of December 31 comprise the following:

	2010	2009
Advance payment in favour of Factorias Vulcano S.A.	**–**	90
Advances paid for capital construction	**752**	553
Debt issue costs	**60**	75
Prepaid insurance	**17**	11
Long-term receivables (Note 22)	**13**	22
Other	**115**	95
Total other non-current assets	**957**	846

13. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities as of December 31 comprise the following:

	2010	2009
Trade accounts payable	**1,457**	1,570
Salary and other benefits payable	**442**	436
Advances received	**601**	455
Dividends payable	**10**	3
Banking customer accounts	**1,067**	822
Accrued expenses	**163**	260
Other	**121**	151
Total accounts payable and accrued liabilities	**3,861**	3,697

The Company's accounts payable are denominated primarily in RUB.

14. Short-Term Loans and Long-Term Debt

Short-term loans and borrowings as of December 31 comprise the following:

	2010	2009
Customer deposits – foreign currencies	**86**	154
Customer deposits – RUB denominated	**271**	277
Promissory notes payable	**84**	81
Promissory notes payable – Yukos related	**1,312**	1,424
Borrowings – RUB denominated – Yukos related	**269**	672
Repurchase agreements	**27**	–
Other borrowings	**286**	368
	2,335	2,976
Current portion of long-term debt	**3,163**	4,862
Total short-term loans and borrowings and current portion of long-term debt	**5,498**	7,838

Customer deposits represent fixed-term deposits placed by customers with the Company's subsidiary banks, denominated in RUB and foreign currencies. Customer deposits denominated in RUB bear an interest rate ranging from 0.5% to 15.75% and those denominated in foreign currencies bear an interest ranging from 0.3% to 11.6%.

As of December 31, 2010, weighted average interest rate on promissory notes was 5.06%. The promissory notes are recorded at amortized cost.

14. Short-Term Loans and Long-Term Debt (continued)

Promissory notes payable – Yukos related represent financing originally received from the entities that were related to Yukos Oil Company on the debt issue date. The promissory notes are primarily payable on demand and bear interest ranging from 0% to 18%. The promissory notes are recorded at amortized cost.

RUB denominated borrowings – Yukos related primarily include borrowings provided by Yukos Capital S.a.r.l., which bear interest of 9% and matured at the end of 2007. The Company partially repaid these liabilities following the court order (see Note 22).

In 2010, the Company received cash under the repurchase agreements and recorded these transactions as secured financing. As of December 31, 2010 the amounts owed under these repurchase agreements were RUB 825 million (US$ 27 million at the CBR official exchange rate as of December 31, 2010) and were secured by the corporate bonds owned by the Company with the fair value of US$ 31 million (see Note 4).

During 2010, the Company wrote off unclaimed promissory notes where statute of limitations expired and recognized gain in the amount of US$ 178 million in the consolidated statement of income and comprehensive income within other expenses, net.

Long-term debt as of December 31 comprises the following:

	2010	**2009**
Bank loans – foreign currencies	**20,716**	18,767
Bank loans raised for funding the acquisition of OJSC Yuganskneftegaz – US$ denominated	**110**	1,415
Customer deposits – foreign currencies	**44**	55
Customer deposits – RUB denominated	**277**	208
Promissory notes payable	**69**	60
Promissory notes payable – Yukos related	**–**	1
Other borrowings	**4**	25
	21,220	20,531
Current portion of long-term debt	**(3,163)**	(4,862)
Total long-term debt	**18,057**	15,669

The interest rates on the Company's long-term bank loans denominated in foreign currencies range from LIBOR plus 0.58% to LIBOR plus 3.25%. These bank loans are primarily secured by contracts for the export of crude oil.

As of December 31, 2010, 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% repayable in equal monthly installments. It is scheduled to be fully repaid in 2011. This loan is secured by the Company's receivables under a long-term export contract for the supply of crude oil (see Note 22).

Customer deposits represent fixed-term deposits placed by customers with the Company's subsidiary banks, denominated in RUB and foreign currencies. The RUB-denominated deposits bear interest ranging from 1.0% to 16.25%. Deposits denominated in foreign currencies bear interest of 0.75% to 14.5%.

As of December 31, 2010, weighted average interest rate on promissory notes payable was 12.53%. The promissory notes are recorded at amortized cost.

14. Short-Term Loans and Long-Term Debt (continued)

Generally, long-term loans are secured by oil export contracts. Usually, under the terms of such contracts, the lender is provided with an express right of claim for contractual revenue which must be remitted directly to transit currency (US$ denominated) accounts with those banks, should the Company fail to make timely debt repayments.

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 net assets acquired and debt incurred as part of the Company's acquisition of OJSC Yuganskneftegaz in December 2004, the Company was not in compliance with various financial and other covenants of existing loan agreements as of December 31, 2004. Subsequently the Company obtained creditors' waivers with respect to events of default related to the claims of the Yukos Capital S.a.r.l. litigation (see Note 22) and restructured all tax liabilities of a former OJSC Yuganskneftegaz (see Note 20). As a result, the Company is in compliance with all restrictive financial and other covenants contained within its loan agreements as of December 31, 2010 and 2009. The creditors' waivers were granted up to the expiry dates of the respective long-term debt.

The scheduled aggregate maturity of long-term debt outstanding as of December 31, 2010 is as follows:

	2010
2011	3,163
2012	2,143
2013	659
2014	623
2015 and after	14,632
Total long-term debt, including current portion	**21,220**

15. Income and Other Tax Liabilities

Income and other tax liabilities as of December 31 comprise the following:

	2010	2009
Mineral extraction tax	**1,103**	901
Value-added tax	**347**	302
Excise tax	**135**	159
Personal income tax	**16**	19
Property tax	**66**	57
Income tax	**205**	137
Other	**99**	52
Total income and other tax liabilities	**1,971**	1,627

Tax liabilities above include the respective current portion of non-current restructured tax liabilities (see Note 20).

16. Shareholders' Equity

On June 18, 2010, the annual general shareholders' meeting approved dividends on the Company's common shares for 2009 in the amount of RUB 24.4 billion or RUB 2.3 per share, which corresponds to US$ 782 million or US$ 0.07 per share at the CBR official exchange rate at the approval date. US$ 714 million of the above relate to outstanding shares, including tax on dividends on treasury shares of US$ 7 million.

In 2009, the Company purchased 747,112 of its own shares for RUB 117.3 million or RUB 157 per share, which corresponds to US$ 3.8 million or US$ 5.05 per share at the CBR official exchange rates on the transaction dates.

In December 2010, the Company sold 1,807,513 of its own shares for RUB 392.2 million or RUB 217 per share, which corresponds to US$ 12.7 million or US$ 7.03 per share at the CBR official exchange rates on the transaction dates.

Result of Transactions with Related Parties under Common Control

In December 2008, the Company completed the sale of its 25% interest in OJSC Daltransgaz. The proceeds from the sale amounted to RUB 2.6 billion (US$ 90.8 million at the CBR exchange rate as of the transaction date). Gain on the sale amounted to US$ 33.3 million, net of income tax effect (US$ 8.6 million). Since the transaction was executed with a related party under common control, the Company recorded this gain, net of income tax effect, as a component of additional paid-in capital.

Amounts Available for Distribution to Shareholders

Amounts available for distribution to shareholders are based on Rosneft Oil Company's statutory accounts prepared in accordance with Russian accounting standards, which differ significantly from US GAAP (see Note 2). Russian legislation identifies the basis of distribution as the current period net profit calculated in accordance with statutory accounting standards. According to Russian legislation, dividends cannot exceed the accounting income for the reporting year.

17. Export Customs Duty

Export customs duty for the years ended December 31, comprises the following:

	2010	**2009**	**2008**
Oil and gas sales			
Export customs duty	**13,031**	9,441	17,200
Petroleum products and petrochemicals sales			
Export customs duty	**3,712**	2,690	4,806
Total export customs duty	**16,743**	12,131	22,006

Effective July 1, 2010, export customs duty rate was raised from 0 to US$ 69.9 (per ton) for crude oil exported from the Company's fields in Eastern Siberia. This change was taken into consideration in assessing of the Company's proved reserves disclosed in the Supplementary Oil and Gas Disclosure (unaudited) in the Company's consolidated financial statements as of and for the year ended December 31, 2010.

18. Income and Other Taxes

Income tax expenses for the years ended December 31 comprise the following:

	2010	2009	2008
Current income tax expense	**2,897**	2,106	3,394
Deferred income tax benefit	**(253)**	(106)	(1,490)
Total income tax expense	**2,644**	2,000	1,904

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 as of December 31:

	2010	2009
Deferred income tax asset arising from tax effect of:		
Asset retirement obligations	**209**	178
Property, plant and equipment	**54**	57
Prepayments and other current assets	**18**	5
Accounts receivable	**31**	17
Accounts payable and accruals	**82**	66
Inventories	**9**	14
Long-term investments	**34**	22
Interest swap contract	**39**	31
Other	**96**	131
Total deferred tax asset	**572**	521
Valuation allowance for deferred income tax asset	**(273)**	(222)
Deferred income tax asset, net	**299**	299
Deferred income tax liability arising from tax effect of:		
Mineral rights	**(2,409)**	(2,359)
Property, plant and equipment and other	**(2,585)**	(2,915)
Deferred income tax liability	**(4,994)**	(5,274)
Net deferred income tax liability	**(4,695)**	(4,975)

Classification of deferred taxes:

	2010	2009
Current deferred tax assets	**174**	174
Non-current deferred tax assets	**125**	125
Current deferred tax liabilities	**(86)**	(77)
Non-current deferred tax liabilities	**(4,908)**	(5,197)

18. Income and Other Taxes (continued)

Although the Company does not pay tax on a consolidated basis, a reconciliation of expected income tax expense to the actual tax expense for the years ended December 31 is as follows:

	2010	2009	2008
Income before income taxes and minority interest	**13,316**	8,519	13,119
Statutory income tax rate	**20.00%**	20.00%	24.00%
Theoretical income tax expense	**2,663**	1,704	3,149
Add/(deduct) tax effect of:			
Change in valuation allowance	**50**	(15)	102
Effect of income tax preferences	**(331)**	(175)	(167)
Adjustments of income tax for prior periods	**–**	4	7
Unrecognized income tax benefits	**20**	2	(4)
Effect from the change of income tax rate	**–**	–	(956)
Permanent accounting differences arising from:			
Non-deductible items, net	**362**	493	373
Foreign exchange effects, net	**(20)**	(90)	(814)
Accrued tax interest	**3**	–	56
Other	**(103)**	77	158
Income taxes	**2,644**	2,000	1,904

The effect of income tax preferences, in the above table, represents the impact of lower income tax rates for Rosneft and certain of its subsidiaries under applicable regional laws. These laws provide that the income tax exemptions, ranging from 4% to 4.5%, are granted to 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.

Effect from the change of income tax rate in the above table represents the impact of statutory income tax rate decrease from 24% to 20%. Tax law amendments were enacted by Federal Law No.305-FZ on December 30, 2008, and are effective January 1, 2009.

As of December 31, 2010 and 2009 the Company analyzed its tax positions for uncertainties affecting recognition and measurement thereof. Following the analysis, the Company believes that it is more likely than not that the majority of all deductible tax positions stated in the income tax return would be sustained upon the examination by the tax authorities. This is supported by the results of the examinations of the income tax returns which have been conducted to date.

In addition to income tax, the Company incurred other taxes as follows:

	2010	2009	2008
Mineral extraction tax	**9,051**	6,502	12,817
Excise tax	**1,105**	893	1,120
Property tax	**284**	236	261
Other	**480**	430	612
Total taxes other than income tax	**10,920**	8,061	14,810

19. Asset Retirement Obligations

The movement of asset retirement obligations is as follows:

	2010	2009
Asset retirement obligations as of the beginning of the reporting period	**1,772**	1,896
Recognition of additional obligations for new wells	**88**	15
Accretion expense	**107**	87
Increase/(decrease) as a result of changes in estimates	**383**	(223)
Spending on existing obligations	**(22)**	(3)
Asset retirement obligations as of the end of the reporting period	**2,328**	1,772

Asset retirement obligations represent an estimate of costs of wells liquidation, recultivation of sand pits, slurry ponds, disturbed lands and dismantling pipelines and power transmission lines.

Russian legislation does not stipulate any funds reservation for purposes of settling asset retirement obligations.

20. Other Non-Current Liabilities

Other non-current liabilities as of December 31 comprise the following:

	2010	2009
Restructured tax liabilities	**1,020**	1,312
Long-term lease obligations	**97**	112
Deferred income	**20**	53
Liabilities to municipalities under amicable agreements	**51**	77
Liabilities for rights to use trademarks "Sochi 2014" (Note 11)	**38**	52
Environmental remediation liability	**111**	–
Other	**2**	8
Total other non-current liabilities	**1,339**	1,614

In February and March 2008, the Company received signed resolutions of the Government of the Russian Federation and relevant regional and local authorities regarding the restructuring of the respective tax liabilities. Under the tax restructuring plan, the restructured tax liabilities shall be repaid quarterly within five years starting from March 2008. The Company’s payments excluding interest amounted to RUB 6,425 million and RUB 3,486 million (US$ 210.4 million and US$ 144.3 million at the CBR official exchange rate as of the payment dates) for the years ended December 31, 2010 and 2009, respectively. The Company intends to undertake all possible actions to comply with the tax restructuring plan in full.

As of December 31, 2010, total accrued environmental remediation liabilities were US$145 million (2009 - $16 million), of which US$ 34 million (2009 - $16 million) included in accrued expenses (see Note 13). Environmental remediation liabilities will be settled over five years and are discounted using 11% discount rate.

21. Related Party Transactions

In the normal course of business the Company enters into transactions with other enterprises which are directly or indirectly controlled by the Russian Government. Such enterprises are OJSC Gazprom, OJSC Russian Railways, OJSC Sberbank, Vnesheconombank, OJSC Bank VTB, OJSC Gazprombank, OJSC AK Transneft and federal agencies, including tax authorities.

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

	2010	2009	2008
Revenues and Income			
Oil and gas sales	**248**	164	163
Petroleum products and petrochemicals sales	**644**	293	616
Support services and other revenues	**50**	103	83
Interest income	**228**	95	54
	1,170	655	916
Costs and expenses			
Production and operating expenses	**173**	192	228
Pipeline tariffs and transportation costs	**4,152**	3,054	3,410
Other expenses	**3**	69	88
Interest expense	**8**	109	220
Banking fees	**9**	12	16
	4,345	3,436	3,962
Other operations			
Sale of short-term and long-term investments	–	505	1,180
Purchase of short-term and long-term investments	**21**	31	1,693
Proceeds from short-term and long-term debt	–	2	2,921
Repayment of short-term and long-term debt	**1,412**	3,466	2,670
Deposits placed	**3,466**	1,897	48
Deposits paid	**797**	86	–

	December 31, 2010	December 31, 2009
Assets		
Cash and cash equivalents	**677**	755
Accounts receivable	**171**	40
Prepayments and other current assets	**502**	395
Short-term and long-term investments	**6,287**	2,309
	7,637	3,499
Liabilities		
Accounts payable	**50**	56
Short-term and long-term debt (including interest)	**114**	1,417
	164	1,473

21. Related Party Transactions (continued)

Total amounts of transactions with related parties (except for those controlled by the Government of the Russian Federation), which are primarily equity investees and joint ventures, for each of the reporting periods ending December 31, as well as related party balances as of December 31 are provided in the tables below:

	2010	2009	2008
Revenues and Income			
Oil and gas sales	**43**	27	43
Petroleum products and petrochemicals sales	**130**	115	227
Support services and other revenues	**203**	336	362
Interest income	**36**	27	11
Dividends received	**37**	178	61
	449	683	704
Costs and expenses			
Production and operating expenses	**343**	261	203
Purchase of oil and petroleum products	**1,480**	1,342	774
Other expenses	**111**	218	207
Interest expense	**3**	–	3
	1,937	1,821	1,187
Other operations			
Purchase of short-term and long-term investments	**8**	121	–
Proceeds from short-term and long-term debt	**1**	78	373
Repayment of short-term and long-term debt	**141**	1	219
Borrowings issued	**162**	69	147
Repayment of borrowings issued	**4**	3	74

	December 31, 2010	December 31, 2009
Assets		
Accounts receivable	**247**	225
Prepayments and other current assets	**9**	7
Short-term and long-term investments	**460**	569
	716	801
Liabilities		
Accounts payable	**132**	215
Short-term and long-term debt (including interest)	**258**	364
	390	579

22. Commitments and Contingencies

Russian Business Environment

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, included to the following: rights to use subsurface resources, environmental matters, site restoration, transportation and export, corporate governance, taxation, etc.

22. Commitments and Contingencies (continued)

Russian Business Environment (continued)

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Russia. While the Russian Government has introduced a range of stabilization measures aimed at providing liquidity and supporting debt refinancing for Russian banks and companies, there continues to be uncertainty regarding the access to capital and cost of capital for the Company and its counterparties, which could affect the Company's consolidated financial position, consolidated results of operations and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Company's business in the current circumstances, further market deterioration could negatively affect the Company's consolidated results and consolidated financial position in a manner not currently determinable.

Taxation

Legislation and regulations regarding taxation in Russia continue to evolve. 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, the amounts of penalties and interest can be significant in relation to the amounts of unreported taxes.

In Russia tax returns 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 return 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 and transactions with significant (by more than 20%) price fluctuations.

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, it could have an adverse effect on the Group's financial condition and results of operations. The Company's management believes that such transfer pricing related income tax positions taken by the Company are sustainable and will not have any significant negative impact on the Company's financial statements. The Company provides finance for operations of its subsidiaries by various means which may lead to certain tax risks. The Company's management believes that the related tax positions are sustainable and will not have any significant negative impact on the Company's consolidated financial position or results of operations.

During 2009 and 2010, the tax authorities held tax examinations in the Company and its subsidiaries for 2007-2009 fiscal years. The Company does not expect results of the examinations to have a material impact on the Company's consolidated financial position or results of operations. Tax years or periods prior to 2007 are not subject to examination.

22. Commitments and Contingencies (continued)

Taxation (continued)

As of December 31, 2010, there is a possible risk that RUB 1.2 billion (US$ 39 million at the CBR official exchange rate as of December 31, 2010) of VAT receivable (see Note 5) will not be recovered.

The Company's management believes that the outcome of the above tax risks will not have any significant impact on the Company's consolidated financial position or results of operations. Overall, management believes that the Company has paid or accrued all taxes that are applicable. For taxes other than income tax, where uncertainty exists, the Company has accrued tax liabilities based on management's best estimate of the probable outflow of resources, which will be required to settle these liabilities. Possible liabilities which were identified by management at the balance sheet dates as those that can be subject to different interpretations of the tax laws and regulations are not accrued in the 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.

The Company has contractual obligations for capital additions as of December 31, 2010 amounted to approximately RUB 100.3 billion (US$ 3.3 billion at the CBR official exchange rate as of December 31, 2010).

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 leaks that pollute land, air pollution and placement of oil waste. 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 specific measures to mitigate the adverse impact of its current operations on the environment.

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.

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 consolidated financial statements and that may have a material adverse effect on the consolidated operating results or financial position of the Company.

Social and Sponsorship Expenses

The Company is required to maintain certain social infrastructure assets (not owned by the Company and not recorded in the consolidated financial statements) for use by its employees, as well as to incur other social and sponsorship costs. Partly in exchange the Company receives regional tax incentives enabling it to further develop its business.

22. Commitments and Contingencies (continued)

Social and Sponsorship Expenses (continued)

The Company incurred US$ 116 million, US$ 198 million, and US$ 139 million in social and sponsorship expenses in 2010, 2009 and 2008, respectively. These expenses are presented within other expenses in the consolidated statements of income and comprehensive income.

Pension Plans

The Company and its subsidiaries make payments to the State Pension Fund of the Russian Federation. These payments are calculated by the employer as percentage from the salary expense and are expensed as accrued.

The Company also maintains a defined contribution corporate pension plan to finance non-state pensions of its employees. Under this plan, in 2010, 2009 and 2008 the Company made and expensed contributions amounting to US$ 90 million, US$ 95 million and US$ 83 million, respectively.

Guarantees and Indemnity

As of December 31, 2010, 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 the 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 agreements. In the event the Company makes payments under guarantees issued, it has a right to claim the amounts paid from the debtor.

In January 2007, RN-Yuganskneftegaz LLC signed a guarantee agreement in respect of all the obligations of RN-Energo LLC, the Company's wholly owned subsidiary, under the contract for electricity supply with OJSC Tyumenskaya Energosbytovaya Companiya for the period through December 31, 2010, in the amount of RUB 1.5 billion (US$ 49 million at the CBR official exchange rate as of December 31, 2010). Guarantee agreement is terminated from January 1, 2011 due to expiration of contract for electricity supply.

In November 2009, Rosneft signed a guarantee agreement in respect of all the obligations of RN-Tuapse Refinery LLC, the Rosneft's wholly owned subsidiary, under the contract for delivery of power generating units with Siemens Industrial Turbomachinery AB for the period through September 30, 2012, in the amount of 960 million Swedish krona (US$ 141 million at the CBR based cross-rate as of December 31, 2010). In November 2009, Rosneft entered into a loan agreement with a western bank to finance the above delivery contract.

In October 2010, the Company concluded a share purchase agreement to acquire 50% stake in Ruhr Oel GmbH and related joint venture agreement seller's rights for US$ 1.6 billion. Final purchase consideration is subject to adjustment as of the closing date of the transaction. Acquisition is expected to be finalized in the first half of 2011. The Company has provided a guarantee in the amount to US$ 200 million to the seller for the compensation of losses in case of unilateral unsubstantiated termination of this transaction. The Company will account for its investment in Ruhr Oel GmbH using the equity method.

22. Commitments and Contingencies (continued)

Litigations, Claims and Assessments

In 2006, Yukos Capital S.a.r.l., a former subsidiary of Yukos Oil Company, initiated arbitral proceedings against OJSC Yuganskneftegaz, which was subsequently merged into the Company, and OJSC Samaraneftegaz, the Company's subsidiary, in various arbitration courts alleging default under six ruble-denominated loans. The International Commercial Arbitration Court (the "ICAC") at the Russian Federation Chamber of Commerce and Industry issued four arbitration awards in favor of Yukos Capital S.a.r.l. concerning four of the loans in the aggregate amount of approximately RUB 12.9 billion (US$ 423 million at the CBR official exchange rate as of December 31, 2010). Separately, in August 2007, arbitration panel formed pursuant to the International Chamber of Commerce ("ICC") rules issued an award against OJSC Samaraneftegaz in the amount of approximately RUB 3.1 billion (US$ 102 million at the CBR official exchange rate as of December 31, 2010) in loan principal and interest plus post award interest of 9% p.a. on the above amount of loan principal and interest concerning the two other loans.

In 2007, the Company successfully challenged the ICAC awards and the ICAC awards were set aside by the Russian courts, including the Supreme Arbitrazh Court of the Russian Federation. Yukos Capital S.a.r.l., nevertheless, sought to enforce the ICAC awards in the Netherlands. The district court in Amsterdam refused to enforce the ICAC awards on the ground that they were properly set aside by a competent court. Yukos Capital S.a.r.l. appealed and on April 28, 2009 the Amsterdam Court of Appeals reversed the district court judgment and allowed Yukos Capital S.a.r.l. to enforce the ICAC awards in the Netherlands. The Company sought review of the decision of the Amsterdam Court of Appeal in to the Supreme Court of the Netherlands.

In early 2010 Yukos Capital S.a.r.l. filed an additional lawsuit against the Company in the High Court of Justice in London, seeking enforcement of the ICAC awards in England and Wales, as well as interest on those awards.

On June 25, 2010, the Supreme Court of the Netherlands declared inadmissible the Company's appeal of the decision of the Amsterdam Court of Appeals enforcing the ICAC awards in the Netherlands. Although the Company does not agree with the decisions of the Dutch courts noted above, on August 11, 2010 it complied with those decisions and arranged for relevant payments to be made with respect to the claim against the Company. In addition to the amounts paid, Yukos Capital S.a.r.l. continues to seek statutory interest in the High Court of Justice in London in the amount of approximately US$ 160 million as of the date of its Particulars of Claim.

The Company intends to defend its position vigorously in the remaining proceedings in England. A hearing on certain preliminary issues is currently scheduled for May 2011.

In 2007, lawsuits with Russian arbitrazh courts in Moscow and Samara were filed to nullify the loan agreements with Yukos Capital S.a.r.l. Court hearings have been suspended.

On July 2, 2010 Yukos Capital S.a.r.l. filed a petition with the U.S. District Court for the Southern District of New York seeking confirmation of the ICC award against OJSC Samaraneftegaz noted above. On or before August 12, 2010, Yukos Capital S.a.r.l. also commenced parallel proceedings in the Arbitrazh Court of the Samara Region seeking enforcement of the same award in the Russian Federation. As directed by the Arbitrazh Court of Samara Region, OJSC Samaraneftegaz filed a formal defense on October 4, 2010. A substantive hearing is currently scheduled for February 15, 2011.

22. Commitments and Contingencies (continued)

Litigations, Claims and Assessments (continued)

On October 15, 2010, OJSC Samaraneftegaz also filed a motion with the U.S. District Court for the Southern District of New York requesting the court to either dismiss Yukos Capital S.a.r.l.'s petition or, in the alternative, to stay the action pending resolution of the parallel Russian enforcement proceedings. At a hearing held on January 7, 2011, the U.S. District Court for the Southern District of New York granted the motion of OJSC Samaraneftegaz and stayed the action pending completion of the Russian enforcement proceedings. Yukos Capital S.a.r.l. has moved for reconsideration or leave to appeal this order of the U.S. District Court for the Southern District of New York and briefing of the motion by both parties is due to be completed in February 2011.

The Company and its subsidiary participate in arbitral proceedings against OJSC Sakhaneftegaz and OJSC Lenaneftegaz for the recovery of certain loans and guarantees of indemnity in the amount of RUB 1,286 million (US$ 42 million at the CBR official exchange rate as of December 31, 2010). The respective accounts receivable in the amount of US$ 13 million (net of allowance in the amount of US$ 29 million) are recorded as long-term receivables in the consolidated balance sheet (see Note 12).

The Company was a plaintiff in arbitral proceedings against OJSC National Bank TRUST (further "TRUST") for the repayment under a deposit agreement. In December 2009, parties concluded an amicable agreement according to which TRUST agreed to repay further to previously repaid amounts, an additional amount of RUB 946 million (US$ 31 million at the CBR official exchange rate as of December 31, 2009) by April 1, 2010. In April 2010, TRUST fully repaid its debt.

During 2008, 2009 and 2010, the Federal Antimonopoly Service ("FAS Russia") and its regional bodies claimed that Rosneft and certain companies of the Group violated certain antimonopoly regulations in relation to petroleum products trading. The Company is appealing all claims in relevant arbitrazh courts. As of the issue date of these consolidated financial statements, court proceedings on the majority of cases had ended. Among other things, on December 1, 2010 the Moscow Arbitrazh court decided to reduce the RUB 5.3 billion fine, imposed on the Company by FAS Russia in 2009, to RUB 2 billion. In December 2010 the fine was paid to the Russian state budget. The total amount of administrative penalties assessed as of the financial statements issue date is RUB 1,603 million (US$ 52.6 million at the CBR official exchange rate as of December 31, 2010). To the extent probable, this contingent liability is accrued in these consolidated financial statements.

The Company and its 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.

Licence 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.

22. Commitments and Contingencies (continued)

Oil Supplies

In January 2005, the Company entered into a long-term contract for the term from February 2005 through December 2010 with China National United Oil Corporation for the sale of crude oil via rail to China in the total amount of 48.4 million tons. The contract is based on usual commercial terms with an agreed formula linked to market prices. The contract obligations for the sale of crude oil are expired in January 2011 (see Note 14).

In February 2009, Rosneft entered into a long-term contract for the term from January 2011 through December 2030 with China National Petroleum Corporation ("CNPC") for the sale of crude oil via pipeline to China in the total amount of 180 million tons. The contract is based on usual commercial terms with an agreed formula linked to market prices. Afterwards, CNPC assigned all its rights, title and interest in this contract to China National United Oil Corporation.

In April 2009, Rosneft entered into a long-term contract for the term from January 2011 through December 2030 with OJSC AK Transneft for the sale of crude oil via pipeline to China in the total amount of 120 million tons. The contract is based on usual commercial terms with an agreed formula linked to market prices.

23. Segment Information

Presented below is information about the Company's operating segments in accordance with FASB ASC 280, *Segment Reporting.* 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 refining, marketing and distribution segment is engaged in processing crude oil and other hydrocarbons into petroleum products, as well as the purchase, sale and transportation of crude oil and petroleum products. Corporate assets are allocated between exploration and production and refining, marketing and distribution in proportion to sales of these segments. Drilling services, construction services, banking and finance services, and other activities are combined in the "All other" category. 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 significant accounting policies applied to each operating segment are consistent with those applied to the consolidated financial statements. Sales transactions for goods and services between the operating segments are carried out using prices agreed upon between Rosneft and its subsidiaries.

Operating segments in 2010:

	Exploration and production	Refining, marketing and distribution	All other	Total elimination	Consolidated
Revenues from external customers	1,149	59,847	2,051	–	63,047
Intersegmental revenues	17,737	4,337	7,845	(29,919)	–
Total revenues	18,886	64,184	9,896	(29,919)	63,047
Production and operating expenses and cost of purchased oil, gas and petroleum products	2,348	3,746	1,084	–	7,178
Depreciation, depletion and amortization	4,503	864	230	–	5,597
Operating income	10,111	28,167	5,140	(29,919)	13,499
Total other expenses, net					(183)
Income before tax					13,316
Total assets	49,961	35,871	7,997	–	93,829

23. Segment Information (continued)

Operating segments in 2009:

	Exploration and production	Refining, marketing and distribution	All other	Total elimination	Consolidated
Revenues from external customers	981	44,358	1,487	–	46,826
Intersegmental revenues	9,723	2,876	5,490	(18,089)	–
Total revenues	10,704	47,234	6,977	(18,089)	46,826
Production and operating expenses and cost of purchased oil, gas and petroleum products	1,935	3,239	740	–	5,914
Depreciation, depletion and amortization	3,405	755	190	–	4,350
Operating income	5,172	17,437	4,608	(18,089)	9,128
Total other expenses, net					(609)
Income before tax					8,519
Total assets	47,531	28,522	7,179	–	83,232

Operating segments in 2008:

	Exploration and production	Refining, marketing and distribution	All other	Total elimination	Consolidated
Revenues from external customers	1,967	65,456	1,568	–	68,991
Intersegmental revenues	10,736	3,549	5,291	(19,576)	–
Total revenues	12,703	69,005	6,859	(19,576)	68,991
Production and operating expenses and cost of purchased oil, gas and petroleum products	2,447	4,288	779	–	7,514
Depreciation, depletion and amortization	3,060	748	175	–	3,983
Operating income	6,385	22,097	4,099	(19,576)	13,005
Total other income, net					114
Income before tax					13,119
Total assets	44,934	24,002	8,577	–	77,513

Below is a breakdown of revenues by domestic and export sales, with a classification of export sales based on the country of incorporation of the foreign customer.

	2010	2009	2008
Oil and gas sales			
Export sales of crude oil – Europe and other directions	**22,895**	18,275	25,648
Export sales of crude oil – Asia	**9,824**	4,744	7,815
Export sales of crude oil – CIS	**1,363**	1,313	2,084
Domestic sales of crude oil	**269**	134	154
Domestic sales of gas	**416**	354	401
Total oil and gas sales	**34,767**	24,820	36,102
Petroleum products and petrochemicals sales			
Export sales of petroleum products – Europe and other directions	**8,401**	6,827	9,607
Export sales of petroleum products – Asia	**5,985**	4,895	6,556
Export sales of petroleum products – CIS	**172**	144	743
Domestic sales of petroleum products	**11,686**	8,630	14,160
Sales of petrochemicals	**416**	240	404
Total petroleum products and petrochemicals sales	**26,660**	20,736	31,470

23. Segment Information (continued)

The Company had one major customer in 2010 and one such customer in 2009 and 2008 which accounted for 10% or more of total revenues in each respective year. These customers accounted for revenues of US$ 9,559 million, US$ 5,332 million, and US$ 12,422 million or 15%, 11% and 18% of total revenues, respectively. These revenues are recognized mainly under the refining, marketing and distribution segment. Management does not believe that the Company is dependent on any particular customer.

24. Fair Value of Financial Instruments and Risk Management

Effective January 1, 2008, the Company adopted FASB ASC 820, which defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs when measuring fair value.

FASB ASC 820 defines three levels of inputs that may be used to measure fair value:

Level 1– Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to assess at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2– Observable inputs other than Level 1 prices such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or model-derived valuations or other inputs that are observable or can be corroborated by observable market data.

Level 3– Unobservable inputs for the asset or liability. These inputs reflect the Company's own assumptions about the assumptions a market participant would use in pricing the asset or liability.

Assets and liabilities of the Company that are measured at fair value on a recurring basis are presented in the table below in accordance with the fair value hierarchy.

	Fair value measurement as of December 31, 2010			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Current assets				
Trading securities	154	575	–	729
Available-for-sale securities	129	358	–	487
Derivatives	–	77	–	77
Net assets held for sale	55	–	–	55
Non-current assets				
Available-for-sale securities	–	17	–	17
Total assets measured at fair value	**338**	**1,027**	**–**	**1,365**
Current liabilities:				
Derivatives	–	(191)	–	(191)
Total liabilities measured at fair value	**–**	**(191)**	**–**	**(191)**

24. Fair Value of Financial Instruments and Risk Management (continued)

	Fair value measurement as of December 31, 2009			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Current assets				
Trading securities	434	57	–	491
Available-for-sale securities	24	186	–	210
Derivatives	–	3	–	3
Non-current assets				
Available-for-sale securities	20	18	–	38
Total assets measured at fair value	**478**	**264**	**–**	**742**
Current liabilities:				
Derivatives	–	(152)	–	(152)
Total liabilities measured at fair value	–	**(152)**	**–**	**(152)**

The market for a number of financial assets is not active. In accordance with requirements of FASB ASC 820-10-35-47 observable inputs of Level 2 were used to determine fair value of such financial assets.

The Company, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, commodity price risk, interest rate risks and credit risks. The Company manages these risks and monitors its exposure on a regular basis.

The fair value of cash and cash equivalents, held-to-maturity securities, accounts receivable, accounts payable, and other current assets approximates their carrying value recognized in these financial statements. The fair value of long-term debt differs from the 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$ 18,555 million and US$ 17,916 million as of December 31, 2010 and 2009, 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$. In addition, substantial financing and investing activities, obligations and commitments are also undertaken in US$. However, significant operating and investing expenditures, other obligations and commitments as well as tax liabilities are denominated in rubles. As a result the Company is exposed to the corresponding currency risk.

The Company enters into contracts to economically hedge certain of its risks associated with ruble appreciation and increased interest expense accrued on loans received by the Company. Hedge accounting pursuant to FASB ASC 815 is not applied to these instruments.

In December 2007, the Company entered into a 5-year interest rate swap contract with a notional amount of US$ 3 billion. Under the terms of the contract, a floating LIBOR rate may be converted into a certain fixed rate. The other party has a call option to terminate the deal. The fair value of the interest swap contract was recorded in the consolidated balance sheets as of December 31, 2010 and 2009 as other current liabilities in the amount of US$ 157.8 million and US$ 151.5 million, respectively. The change in fair value was recorded in the consolidated statement of income and comprehensive income for 2010 as a component of interest expense in the amount of US$ 6.3 million.

24. Fair Value of Financial Instruments and Risk Management (continued)

In December 2008, the Company entered into a 5-year interest rate swap contract with a notional amount of US$ 500 million. Under the terms of the contract, a floating LIBOR rate may be converted into a certain fixed rate. The other party will have a call option to terminate the deal commencing two years after the contract date. The fair value of the interest swap contract was recorded in the consolidated balance sheets as of December 31, 2010 as other current liabilities in the amount of US$ 33.4 million, and as of December 31, 2009 as other current asset in the amount of US$ 2.7 million (see Note 7). The change in fair value was recorded in the consolidated statement of income and comprehensive income for 2010 as a component of interest expense in the amount of US$ 36.1 million.

In October 2009, the Company entered into a fixed interest rate structured deposit agreement with a nominal amount of US$ 500 million (see Note 4) which expired in October 2010. On the deposit repayment date the spot RUB/US$ exchange rate was not higher than agreed conversion rate.

In May 2010, the Company entered into fixed interest rate structured deposit agreements with two banks for nominal amounts of US$ 500 million and US$ 495 million (see Note 4) which similarly expire in May 2011. If on the deposit repayment date the spot RUB/US$ exchange rate is higher than the agreed conversion rate, the other party has a call option to repay amount in RUB which shall be equal to the nominal deposit amount multiplied by the respective conversion rate. Embedded call options were bifurcated from the host contracts and recorded at fair value in the consolidated balance sheet as of December 31, 2010 as other current asset in the amount of US$ 11.1 million (see Note 7). The resulting change in fair values was recorded in the consolidated statement of income and comprehensive income for 2010 as a component of foreign exchange gain in the amount of US$ 11.1 million.

In June 2010, the Company entered into a fixed interest rate structured deposit agreement with a nominal amount of US$ 200 million (see Note 4) which expires in June 2011. If on the deposit repayment date the spot RUB/US$ exchange rate is higher than the agreed conversion rate, the other party has a call option to repay amount in RUB which shall be equal to the nominal deposit amount multiplied by the respective conversion rate. Embedded call option was bifurcated from the host contract and recorded at fair value in the consolidated balance sheet as of December 31, 2010 as other current asset in the amount of US$ 4.4 million (see Note 7). The change in fair value was recorded in the consolidated statement of income and comprehensive income for 2010 as a component of foreign exchange gain in the amount of US$ 4.4 million.

In July 2010, the Company entered into fixed interest rate structured deposit agreements with two banks for nominal amounts of US$ 250 million and US$ 500 million (see Note 4) which expire in July 2011. If on the deposit repayment date the spot RUB/US$ exchange rate is higher than the agreed conversion rate, the other party has a call option to repay amount in RUB which shall be equal to the nominal deposit amount multiplied by the respective conversion rate. Embedded call options were bifurcated from the host contracts and recorded at fair value in the consolidated balance sheet as of December 31, 2010 as other current asset in the amount of US$ 14.6 million (see Note 7). The resulting change in fair values was recorded in the consolidated statement of income and comprehensive income for 2010 as a component of foreign exchange gain in the amount of US$ 14.6 million.

24. Fair Value of Financial Instruments and Risk Management (continued)

In September 2010, the Company entered into fixed interest rate structured deposit agreements with two banks for nominal amounts of US$ 100 million and US$ 150 million (see Note 4) which expire in September 2011. If on the deposit repayment date the spot RUB/US$ exchange rate is higher than the agreed conversion rate, the other party has a call option to repay amount in RUB which shall be equal to the nominal deposit amount multiplied by the respective conversion rate. Embedded call options were bifurcated from the host contracts and recorded at fair value in the consolidated balance sheet as of December 31, 2010 as other current asset in the amount of US$ 6.3 million (see Note 7). The resulting change in fair values was recorded in the consolidated statement of income and comprehensive income for 2010 as a component of foreign exchange gain in the amount of US$ 6.3 million.

In October 2010, the Company entered into fixed interest rate structured deposit agreements with two banks for nominal amounts of US$ 193 million and US$ 250 million (see Note 4) which expire in October 2011. If on the deposit repayment date the spot RUB/US$ exchange rate is higher than the agreed conversion rate, the other party has a call option to repay amount in RUB which shall be equal to the nominal deposit amount multiplied by the respective conversion rate. Embedded call options were bifurcated from the host contracts and recorded at fair value in the consolidated balance sheet as of December 31, 2010 as other current asset in the amount of US$ 10.1 million (see Note 7). The resulting change in fair values was recorded in the consolidated statement of income and comprehensive income for 2010 as a component of foreign exchange gain in the amount of US$ 10.1 million.

In November 2010, the Company entered into fixed interest rate structured deposit agreements with two banks for nominal amounts of US$ 557 million and US$ 400 million (see Note 4) which expire in November 2011. If on the deposit repayment date the spot RUB/US$ exchange rate is higher than the agreed conversion rate, the other party has a call option to repay amount in RUB which shall be equal to the nominal deposit amount multiplied by the respective conversion rate. Embedded call options were bifurcated from the host contracts and recorded at fair value in the consolidated balance sheet as of December 31, 2010 as other current asset in the amount of US$ 27.3 million (see Note 7). The resulting change in fair values was recorded in the consolidated statement of income and comprehensive income for 2010 as a component of foreign exchange gain in the amount of US$ 27.3 million.

In December 2010, the Company entered into a fixed interest rate structured deposit agreement with a nominal amount of US$ 100 million (see Note 4) which expires in December 2011. If on the deposit repayment date the spot RUB/US$ exchange rate is higher than the agreed conversion rate, the other party has a call option to repay amount in RUB which shall be equal to the nominal deposit amount multiplied by the respective conversion rate. Embedded call option was bifurcated from the host contract and recorded at fair value in the consolidated balance sheet as of December 31, 2010 as other current asset in the amount of US$ 2.9 million (see Note 7). The change in fair value was recorded in the consolidated statement of income and comprehensive income for 2010 as a component of foreign exchange gain in the amount of US$ 2.9 million.

In February and May 2010, the Company entered into forward foreign currency contracts to economically hedge its foreign currency risk of forecasted operating expense. These financial exposures are managed as an integral part of the Company's risk management program, which seeks to reduce the potentially adverse effect that the volatility of the exchange rate markets may have on operating results. During 2010 all forward foreign currency contracts were settled.

Fair values of the interest rate swap contracts and embedded call options are based on estimated amounts that the Company would pay or receive upon termination of the contracts as of December 31, 2010.

25. Subsequent Events

On January 14, 2011 Rosneft and BP announced plans to form a strategic alliance, including a share swap, and to jointly explore hydrocarbon resources of the Russian Arctic. For the share swap, BP plans to issue ordinary shares constituting 5 per cent of its pro forma issued ordinary share capital in exchange for 1,010,158,003 Rosneft's shares. Closing of the share swap and signing of final agreements related to the Arctic exploration joint venture is anticipated in the first half of 2011 and by the end of 2012, respectively, both subject to agreement of related final documentation between the parties.

On January 27, 2011 Rosneft and ExxonMobil entered into an agreement regarding the joint development of oil and gas resources in the Black Sea, which includes an initial focus on oil exploration and production in the Tuapse Trough in the Russian Black Sea basin.

Supplementary Oil and Gas Disclosure (unaudited)

In accordance with FASB ASC 932, *Extractive Activities—Oil and Gas,* subtopic 235, *Notes to Financial Statements*, the Company makes certain supplemental disclosures about its oil and gas exploration and production operations. While this information was developed with reasonable care and disclosed in good faith, it is emphasized that the data represents management's best estimates. Accordingly, this information may not necessarily represent the current financial condition of the Company and its expected future financial results.

In accordance with FASB ASC 932-235-50-1C the Company does not provide complete disaggregated disclosures about its equity investees, because the results are immaterial in comparing with results of consolidated companies.

Capitalized Costs Relating to Oil and Gas Producing Activities

Consolidated entities:	**As of December 31, 2010**	**2009**
Oil and gas properties:		
Proved	**62,960**	56,175
Unproved	**4,104**	4,131
Total capitalized costs	**67,064**	60,306
Accumulated depreciation, depletion and amortization, and valuation allowances	**(18,370)**	(13,977)
Net capitalized costs	**48,694**	46,329

The share of the Company in the capitalized costs of equity investees on December 31, 2010 and 2009 was US$ 2,631 million and US$ 2,547 million, respectively.

Net book value of mineral rights on December 31, 2010 and 2009 was US$ 16.2 billion and US$ 16.8 billion, respectively.

Cost Incurred in Oil and Gas Property Acquisition, Exploration and Development Activities

Consolidated entities:	**2010**	**2009**	**2008**
Acquisition of properties:			
Proved	**–**	–	246
Unproved	**140**	96	264
Exploration costs	**439**	325	248
Development costs	**6,618**	5,422	6,405

The share of the Company in acquisition, exploration and development expenditures of its equity investees was US$ 324 million, US$ 493 million and US$ 483 million in 2010, 2009 and 2008, respectively.

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Results of Operations for Oil & Gas Producing Activities

Consolidated entities:	**2010**	**2009**	**2008**
Revenues:			
Sales	**18,284**	13,463	18,712
Transfers	**12,902**	10,056	16,308
Total	**31,186**	23,519	35,020
Production costs (excluding production taxes)	**2,319**	1,869	1,976
Selling, general and administrative expenses	**740**	630	771
Exploration expenses	**439**	325	248
Accretion expenses	**107**	87	120
Depreciation, depletion, and amortization, and valuation provisions	**4,503**	3,318	3,060
Taxes other than income tax	**10,034**	6,867	13,261
Income tax expenses	**1,845**	1,029	1,779
Results of operation for producing activities	**11,199**	9,394	13,805

Revenues are based on the market prices determined at the point of delivery from production units.

The Company's share in the operating results generated from oil and gas production of equity investees in 2010, 2009 and 2008 was US$ 234 million, US$ 229 million and US$ 437 million, respectively.

Reserve Quantity Information

The recording and reporting of proved reserves is governed by criteria established by regulations of the United States Securities and Exchange Commission. The Company's reserves as of December 31, 2010, 2009 and 2008 were appraised by outside unrelated third-party petroleum engineers.

The Company's proved oil and gas reserves are located entirely in the Russian Federation.

Proved reserves are those quantities of oil and gas which, by analysis of geosciences and engineering data, can be estimated with reasonable certainty to be economically producible from a given date forward from known reservoirs, and under the existing economic conditions, operating methods, and government regulation. In certain cases, recovery of such reserves may require considerable investments in wells and related equipment. Proved reserves also include additional oil and gas reserves that will be extracted after the expiry date of licence agreements if the renewal of such agreements is reasonably certain. Proved developed reserves are the quantities of oil and gas expected to be recovered from existing wells using existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared with the cost of new well.

Proved undeveloped oil and gas reserves are proved reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled unless evidence using reliable technology exits that establishes reasonable certainty of economic producibility at greater distances. Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to drilled within five years, unless the specific circumstances justify a longer time.

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Reserve Quantity Information (continued)

Under no circumstances are estimates of proved undeveloped reserves attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless those techniques have been proved effective by actual project in the same reservoir or an analogous reservoir, or by other evidence using reliable technology establishing reasonable certainty. Due to inherent industry uncertainties and the limited nature of deposit data, estimates of reserves are subject to change as additional information becomes available.

The Company included in proved reserves those reserves which the Company intends to extract after the expiry of the current licences. The licences for the development and production of hydrocarbons currently held by the Company generally expire between 2011 and 2051, and the licences for the most important reserves expire between 2013 and 2051. In accordance with the effective version of the law of the Russian Federation, *On Subsurface Resources* (the "Law"), licences are currently granted for a production period determined on the basis of technological and economic criteria applied to the development of a mineral deposit which guarantee rational use of subsurface resources and necessary environmental protection. In accordance with the Law and upon gradual expiration of old licences issued under the previous version of the Law, the Company extends its hydrocarbon production licences for the whole productive life of the fields. Extension of the licences depends on both current and future compliance with the terms set forth in the licence agreements. As of the date of these financial statements, the Company's operations are generally in compliance with all the terms of the licence agreements and are intended to maintain compliance therewith in the future (see Note 9).

The Company's estimates of net proved oil and gas reserves and changes thereto for the years ended December 31, 2010, 2009 and 2008 are shown in the table below and expressed in million barrels of oil equivalent (oil production data was recalculated from tons to barrels using a field specific ratio in the range from 7.05 to 7.65 barrels per tonne, gas production data was recalculated from cubic meters to barrels of oil equivalent ("boe") using a ratio of 35.3/6 cubic meters per barrel):

Consolidated entities:	**2010**	**2009**	**2008**
Proved developed and undeveloped reserves:	*mln boe*	*mln boe*	*mln boe*
Beginning of year	**13,951**	13,360	13,538
Revisions of previous estimates	**319**	683	(244)
Extensions and discoveries	**541**	703	837
Improved recovery	**–**	–	–
Purchases of minerals in place	**–**	–	–
Production	**(841)**	(795)	(771)
End of year	**13,970**	13,951	13,360
Of which:			
Proved reserves under PSA Sakhalin 1	**80**	66	80
Proved developed reserves			
Beginning of year	**10,204**	10,032	10,456
End of year	**9,769**	10,204	10,032
Proved undeveloped reserves			
Beginning of year	**3,747**	3,328	3,082
End of year	**4,201**	3,747	3,328
Noncontrolling interests in total proved reserves	**122**	103	38
Noncontrolling interests in proved developed reserves	**44**	37	12

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Reserve Quantity Information (continued)

Entity's share of proved developed and undeveloped reserves of investees accounted for by the equity method:	**2010**	**2009**	**2008**
Beginning of year	**1,195**	1,086	915
Revisions of previous estimates	**66**	56	146
Extensions and discoveries	**39**	121	98
Improved recovery	**–**	2	–
Purchases of minerals in place	**–**	–	–
Production	**(72)**	(70)	(73)
End of year	**1,228**	1,195	1,086

The Company's share in the proved developed reserves of equity investees in 2010, 2009 and 2008 was 760 million barrels of oil equivalent, 769 million barrels of oil equivalent and 763 million barrels of oil equivalent, respectively.

The effect of the adoption of ASU 2010-03 on the Total Group's total proved reserves amounted to 76 mboe decrease at the end of 2010 (2009 - 38 mboe decrease) including the Company's share in equity investees.

Standardized Measure of Discounted Future Net Cash Flows and Changes therein Relating to Proved Oil and Gas Reserves

The standardized measure of discounted future net cash flows related to the above oil and gas reserves is calculated in accordance with the requirements of FASB ASC 932-235. Estimated future cash inflows from oil and gas production are computed by applying average of the first-day-of-the-month price for each month within 12-month period before the balance sheet date for oil and gas to year-end quantities of estimated net proved reserves. Adjustment in this calculation for future price changes is limited to those required by contractual arrangements in existence at the end of each reporting period. Future development and production costs are those estimated future expenditures necessary to develop and produce estimated proved reserves as of year-end based on year-end cost indices and assuming continuation of year end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future net pre-tax cash flows, net of the tax bases of related assets.

Discounted future net cash flows are calculated using a 10% discount factor. Discounting requires a year-by-year estimates of future expenditures to be incurred in the periods when the reserves will be extracted.

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Standardized Measure of Discounted Future Net Cash Flows and Changes therein Relating to Proved Oil and Gas Reserves (continued)

The information provided in the tables below does not represent management's estimates of the Company's expected future cash flows or of the value of its proved oil and gas reserves. Estimates of proved reserves change over time as new information becomes available. Moreover, probable and possible reserves which may become proved in the future are excluded from the calculations. The arbitrary valuation prescribed under FASB ASC 932-235 requires assumptions as to the timing and the amount of future development and production costs. The calculations should not be relied upon as an indication of the Company's future cash flows or of the value of its oil and gas reserves.

Consolidated entities:	**2010**	**2009**	**2008**
Future cash inflows	**449,384**	383,839	223,464
Future development costs	**(34,276)**	(29,301)	(18,353)
Future production costs	**(215,802)**	(177,879)	(107,242)
Future income tax expenses	**(31,040)**	(27,550)	(15,585)
Future net cash flows	**168,266**	149,109	82,284
10% annual discount for estimated timing of cash flows	**(93,520)**	(79,563)	(46,783)
Standardized measure of discounted future net cash flows	**74,746**	69,546	35,501
Entity's share of equity method investees:			
Future cash inflows	**43,594**	35,202	22,408
Future development costs	**(4,132)**	(3,851)	(2,450)
Future production costs	**(20,835)**	(13,831)	(11,368)
Future income tax expenses	**(3,648)**	(3,426)	(1,592)
Future net cash flows	**14,979**	14,094	6,998
10% annual discount for estimated timing of cash flows	**(8,542)**	(7,754)	(3,646)
Standardized measure of discounted future net cash flows	**6,437**	6,340	3,352
Total consolidated and equity interests in the standardized measure of discounted future cash flows:	**81,183**	75,886	38,853

The effect of the adoption of ASU 2010-03 on the total Group's standardized measure of discounted future cash flow amounted to approximately US$ 1.6 billion decrease as at the end of the year (2009 – US$ 11 billion decrease) including the Company's share in equity investees.

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Standardized Measure of Discounted Future Net Cash Flows and Changes therein Relating to Proved Oil and Gas Reserves (continued)

Consolidated entities:	2010	2009	2008
Sales and transfers of oil and gas produced during the period	**(18,093)**	(14,153)	(19,012)
Net changes in sales and transfer prices and in production (lifting) costs related to future production	**12,145**	35,895	(71,008)
Changes in estimated future development costs	**(8,895)**	(8,155)	3,902
Previously estimated development costs incurred during the period	**6,618**	5,426	6,411
Net changes due to revisions in quantity estimates	**1,720**	2,510	(275)
Net change due to extensions, discoveries, and improved recovery	**3,479**	8,800	2,376
Net change in income taxes	**(1,667)**	(6,059)	19,976
Accretion of discount	**6,955**	3,550	8,238
Net change due to purchases and sales of minerals in place	**–**	–	–
Other	**2,938**	6,231	2,516
Aggregated change in the standardized measure of discounted future net cash flows for the year	**5,200**	34,045	(46,876)

The discounted value of future cash flows as of December 31, 2010, 2009 and 2008 includes the interest of other noncontrolling shareholders in the amount of US$ 685 million, US$ 892 million and US$ 142 million, respectively.