ROSNEFT

OIL COMPANY

OPEN JOINT STOCK COMPANY

OJSC Oil Company Rosneft

Consolidated Financial Statements

as of December 31, 2008 and 2007 and
for the years ended December 31, 2008, 2007 and 2006
With Report of Independent Auditors

OJSC Oil Company Rosneft

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Contents

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Report of Independent Auditors

Shareholders and the Board of Directors
of OJSC Oil Company Rosneft

We have audited the accompanying consolidated balance sheets of OJSC Oil Company Rosneft, an open joint stock company ("the Company"), as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. 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.

As discussed in Note 3 to the consolidated financial statements, the Company has not presented pro-forma results of operations for the years 2006 and 2007 as though its significant acquisitions had been completed as of January 1, 2006. These disclosures are required by SFAS No. 141 *"Business Combinations"*.

In our opinion, except for the effects of the matters described in the preceding paragraph, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

Ernst & Young LLC

March 2, 2009

OJSC Oil Company Rosneft

Consolidated Balance Sheets

(in millions of US dollars, except share amounts)

	Notes	As of December 31, 2008	2007
ASSETS			
Current assets:			
Cash and cash equivalents	5	**1,369**	998
Restricted cash	5	**4**	34
Short-term investments	6	**1,710**	338
Accounts receivable, net of allowance	7	**6,299**	9,785
Inventories	8	**1,427**	1,926
Deferred tax assets	20	**152**	156
Prepayments and other current assets	9	**1,846**	1,731
Total current assets		**12,807**	14,968
Non-current assets:			
Long-term investments	10	**2,695**	2,646
Long-term bank loans granted, net of allowance of US$ 15 and US$ 20, respectively		**326**	260
Property, plant and equipment, net	11, 12	**55,204**	51,703
Goodwill	13	**4,507**	3,789
Intangible assets, net	13	**679**	285
Deferred tax assets	20	**118**	57
Other non-current assets	14	**1,177**	1,097
Total non-current assets		**64,706**	59,837
Total assets		**77,513**	74,805
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Accounts payable and accrued liabilities	15	**3,096**	4,022
Short-term loans and current portion of long-term debt	16	**14,084**	15,550
Income and other tax liabilities	18	**1,094**	2,346
Deferred tax liabilities	20	**115**	118
Other current liabilities	10, 26	**308**	88
Total current liabilities		**18,697**	22,124
Asset retirement obligations	21	**1,896**	2,130
Long-term debt	16	**10,081**	11,723
Deferred tax liabilities	20	**5,371**	7,626
Other non-current liabilities	22	**1,870**	2,485
Total non-current liabilities		**19,218**	23,964
Minority interest		**695**	277
Shareholders' equity:			
Common stock par value 0.01 RUB (shares outstanding: 9,598 million as of December 31, 2008 and 2007)	17	**20**	20
Treasury shares:			
- unpledged (at acquisition cost: 505.07 million and 1,000 million shares as of December 31, 2008 and 2007, respectively)		**(3,799)**	(7,521)
- pledged (at acquisition cost: 494.93 million and 0 shares as of December 31, 2008 and 2007, respectively)	16	**(3,722)**	–
Additional paid-in capital	17	**13,108**	13,075
Other comprehensive loss	2	**(40)**	–
Retained earnings		**33,336**	22,866
Total shareholders' equity		**38,903**	28,440
Total liabilities and shareholders' equity		**77,513**	74,805

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

OJSC Oil Company Rosneft

Consolidated Statements of Income and Comprehensive Income

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

	Notes	For the years ended December 31, 2008	2007	2006
Revenues				
Oil and gas sales	25	**36,102**	29,902	23,499
Petroleum products sales and processing fees	25	**31,470**	18,531	9,250
Support services and other revenues		**1,419**	783	350
Total		**68,991**	49,216	33,099
Costs and expenses				
Production and operating expenses		**4,572**	3,870	2,197
Cost of purchased oil, gas, petroleum products and refining costs		**2,942**	1,610	1,320
General and administrative expenses		**1,632**	1,341	757
Pipeline tariffs and transportation costs		**5,673**	4,226	3,226
Exploration expenses		**248**	162	193
Depreciation, depletion and amortization		**3,983**	3,286	1,638
Accretion expense		**120**	78	34
Taxes other than income tax	20	**14,810**	10,890	6,990
Export customs duty	19	**22,006**	13,032	11,140
Total		**55,986**	38,495	27,495
Operating income		**13,005**	10,721	5,604
Other income/(expenses)				
Interest income		**375**	214	135
Interest expense		**(1,112)**	(1,470)	(724)
Loss on disposal of property, plant and equipment		**(58)**	(119)	(95)
Impairment loss	10	**(108)**	–	–
Gain on disposal of investments		**22**	36	3
Equity share in affiliates' (loss)/profits	10	**(7)**	23	17
Dividends and (loss)/income from joint ventures		**(11)**	18	15
Gain from Yukos Oil Company bankruptcy proceedings		–	8,970	–
Other expenses, net		**(135)**	(195)	(320)
Foreign exchange gain / (loss)		**1,148**	(409)	(470)
Total other income/(expenses)		**114**	7,068	(1,439)
Income before income tax and minority interest		**13,119**	17,789	4,165
Income tax	20	**(1,904)**	(4,906)	(540)
Income before minority interest		**11,215**	12,883	3,625
Minority interest in subsidiaries' earnings, net of tax		**(95)**	(21)	(92)
Net income		**11,120**	12,862	3,533
Other comprehensive loss		**(40)**	–	–
Comprehensive income		**11,080**	12,862	3,533
Net earnings per share (in US$) – basic and diluted		**1.16**	1.30	0.37
Weighted average number of shares outstanding (millions)		**9,598**	9,891	9,527

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

OJSC Oil Company Rosneft

Consolidated Statements of Changes in Shareholders' Equity

for the years ended December 31, 2008, 2007 and 2006

(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**	**Shareholders' equity**
Balance at December 31, 2005	**9,092**	**20**	**19**	**–**	**–**	**7,394**	**7,433**
Net and comprehensive income for the year	–	–	–	–	–	**3,533**	**3,533**
Ordinary shares issued during Initial Public Offering	285	–	2,115	–	–	–	2,115
Ordinary shares issued during Share Swap	1,221	–	9,218	–	–	–	9,218
Dividends declared on common stock	–	–	–	–	–	(424)	(424)
Balance at December 31, 2006	**10,598**	**20**	**11,352**	**–**	**–**	**10,503**	**21,875**
Net and comprehensive income for the year	–	–	–	–	–	12,862	12,862
Purchase of shares	(1,000)	–	–	(7,521)	–	–	(7,521)
Recognition of the financial effect of a transaction with a related party under common control (Note 17)	–	–	1,745	–	–	–	1,745
Dividends declared on common stock and other distributions to shareholders	–	–	(22)	–	–	(499)	(521)
Balance at December 31, 2007	**9,598**	**20**	**13,075**	**(7,521)**	**–**	**22,866**	**28,440**
Net and comprehensive income for the year	–	–	–	–	–	11,120	11,120
Recognition of the financial effect of a transaction with a related party under common control (Note 17)	–	–	33	–	–	–	33
Unrealized loss on available-for-sale securities	–	–	–	–	(40)	–	(40)
Dividends declared on common stock	–	–	–	–	–	(650)	(650)
Balance at December 31, 2008	**9,598**	**20**	**13,108**	**(7,521)**	**(40)**	**33,336**	**38,903**

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

OJSC Oil Company Rosneft

Consolidated Statements of Cash Flows

(in millions of US dollars)

	Notes	For the years ended December 31, 2008	2007	2006
Operating activities				
Net income		**11,120**	12,862	3,533
Adjustments to reconcile net income to net cash provided by operating activities:				
Effect of foreign exchange		**(1,263)**	365	392
Depreciation, depletion and amortization		**3,983**	3,286	1,638
Dry hole costs		**27**	93	20
Loss on disposal of property, plant and equipment		**58**	119	95
Asset impairment loss	10	**108**	–	–
Deferred income tax expense/(benefit)	20	**(1,490)**	1,058	(1,845)
Accretion expense	21	**120**	78	34
Equity share in affiliates' loss/(profits)	10	**7**	(23)	(17)
Gain on disposal of investments		**(22)**	(36)	(3)
Acquisition of trading securities		**(119)**	(367)	(181)
Proceeds from sale of trading securities		**137**	501	9
Increase / (decrease) in allowance for doubtful accounts and bank loans granted		**57**	21	(10)
Gain from disposal of promissory notes		**(42)**	–	–
Minority interests in subsidiaries' earnings		**95**	21	92
Gain from Yukos Oil Company bankruptcy proceedings		**–**	(8,970)	–
Cash received from Yukos Oil Company bankruptcy receiver		**–**	11,007	–
Changes in operating assets and liabilities net of acquisitions:				
Decrease / (increase) in accounts receivable		**2,180**	(4,745)	(1,192)
Decrease / (increase) in inventories		**502**	(161)	(91)
Decrease / (increase) in restricted cash		**30**	(16)	5
Increase in prepayments and other current assets		**(114)**	(444)	(231)
Decrease / (increase) in other non-current assets		**228**	(197)	(124)
Increase in long-term bank loans granted		**(61)**	(164)	(41)
Increase in interest payable		**184**	123	36
(Decrease) / increase in accounts payable and accrued liabilities		**(928)**	1,505	678
Increase / (decrease) in income and other tax liabilities		**35**	1,228	(338)
(Decrease) / increase in other current and non-current liabilities		**(439)**	(34)	131
Net cash provided by operating activities		**14,393**	17,110	2,590

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

OJSC Oil Company Rosneft

Consolidated Statements of Cash Flows (continued)

(in millions of US dollars)

	Notes	For the years ended December 31, 2008	2007	2006
Investment activities				
Capital expenditures	11	**(8,732)**	(6,240)	(3,462)
Assets acquisitions		**–**	(540)	–
Acquisition of licences		**(47)**	(90)	(916)
Repayment of Sakhalin-1 carried costs		**–**	–	(1,339)
Proceeds from disposals of property, plant and equipment		**93**	58	27
Acquisition of short-term investments, including				
Held-to-maturity securities		**(1,921)**	(219)	(277)
Available-for-sale securities		**(4)**	(25)	–
Proceeds from sale of short-term investments, including				
Held-to-maturity securities		**1,342**	122	139
Available-for-sale securities		**3**	177	–
Acquisition of long-term investments, including				
Held-to-maturity securities		**(297)**	(251)	(50)
Available-for-sale securities		**(22)**	(46)	(11)
Proceeds from sale of long-term investments, including				
Held-to-maturity securities		**49**	28	6
Available-for-sale securities		**22**	57	27
Acquisition of entities and additional shares in subsidiaries, net of cash acquired	3, 4	**(12)**	(17,061)	(194)
Proceeds from sale of shares in OJSC Tomskneft VNK		**–**	3,452	–
Proceeds from sale of shares in OJSC Daltransgaz	17	**91**	–	–
Settlement/(acquisition) of debt receivable		**–**	483	(463)
Margin call deposit placed	16	**(3,100)**	–	–
Margin call deposit returned	16	**1,713**	–	–
Net cash used in investing activities		**(10,822)**	(20,095)	(6,513)
Financing activities				
Proceeds from short-term debt		**7,090**	14,391	2,768
Repayment of short-term debt		**(13,393)**	(3,731)	(796)
Proceeds from long-term debt		**6,885**	3,435	2,887
Repayment of long-term debt		**(3,118)**	(2,598)	(3,250)
Proceeds from share issue, net of commission		**–**	–	2,115
Dividends paid to shareholders		**(516)**	(521)	(424)
Cash paid for acquisition of treasury shares		**–**	(7,521)	–
Dividends paid to minority shareholders in subsidiaries		**(22)**	(15)	(75)
Net cash provided by/(used in) financing activities		**(3,074)**	3,440	3,225
Increase / (decrease) in cash and cash equivalents		**497**	455	(698)
Cash and cash equivalents at beginning of period		**998**	505	1,173
Effect of foreign exchange on cash and cash equivalents		**(126)**	38	30
Cash and cash equivalents at end of period		**1,369**	998	505
Supplementary disclosures of cash flow information				
Cash paid for interest (net of amount capitalized)		**578**	1,152	610
Cash paid for income taxes		**2,617**	4,267	2,157
Supplementary disclosure of non-cash activities				
Net assets of subsidiaries contributed by minority shareholders in exchange for shares issued by Rosneft		**–**	–	9,218
Income tax offsets	7	**1,315**	–	1

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

1. General

Nature of Operations

Open Joint Stock Company ("OJSC") Oil Company Rosneft ("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 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, 2007 and 2008, 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, 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, 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 2008, 2007 and 2006, the Company's export sales were approximately 56%, 61% and 70% of produced crude oil, respectively. The remaining production was processed at the Company's refineries and other Russian 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, 2008 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
Rosneft 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
CJSC Komsomolskneft	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
OJSC Grozneftegaz	Oil and gas production operator services	51.00	51.00
CJSC Vostokshelf	Field survey and exploration	100.00	100.00
RN-Kazakhstan LLC	Field survey and exploration	100.00	100.00
RN-Kaiganneftegaz LLC	Field survey and exploration	100.00	100.00
CJSC Vankorneft	Field survey and exploration	93.96	93.96
Taymyrneft LLC	Investment activities	60.00	60.00
Vostok Smidt Invest LLC	Investment activities	100.00	100.00
Zapad Smidt Invest LLC	Investment activities	100.00	100.00
Vostok-Energy LLC	Field survey and exploration	51.00	51.00
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 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	88.66	92.91
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
OJSC Nakhodka Oil Seatrade Port	Transshipment	100.00	100.00
CJSC Exponeft	Marketing and distribution	45.38	60.51
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
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
CJSC FPK KEDR M	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
Other			
Rosneft International Limited	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	76.47	76.47
CJSC RN-Shelf-Dalniy Vostok	Management company	100.00	100.00
RN-Burenie LLC	Drilling services	100.00	100.00
NK Rosneft NTC LLC	Research & 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.

Currency Exchange and Control

Foreign currencies, in particular the US dollar and the Euro, play a significant role in the underlying economics of many business transactions in Russia. For the oil and gas sector in particular, substantial export arrangements as well as investing and financing activities are conducted in foreign currencies, primarily the US dollar.

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").

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/negative goodwill; (12) accounting for derivative instruments.

Certain items in the consolidated balance sheet as of December 31, 2007 and the consolidated statement of cash flows for 2007 were reclassified to conform to the current year presentation.

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. Some of the most significant estimates were made in connection with the acquisition of Yukos Oil Company assets (see Note 3). Management believes it has a reasonable and appropriate basis for its judgment pertaining to its estimates and assumptions. However, actual results could differ from those estimates.

Foreign Currency Translation

The management of the Company has determined that the US Dollar is the functional and reporting currency for the purpose of financial reporting under US GAAP. Monetary assets and liabilities have been translated into US dollars using the official exchange rate as of the balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have, where practicable, been translated into US dollars 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 dollars are included in "Foreign exchange gain/(loss)" in the consolidated statements of income and comprehensive income.

2. Significant Accounting Policies (continued)

Foreign Currency Translation (continued)

As of December 31, 2008 and 2007, the Central Bank of the Russian Federation ("CBR") official rates of exchange were 29.38 rubles and 24.55 rubles per US dollar, respectively. As of March 2, 2009, the official rate of exchange was 35.72 rubles (‘RUB’) per US dollar.

The translation of local currency denominated assets and liabilities into US dollars for the purposes of these financial statements does not indicate that the Company could realize or settle, in US dollars, the reported values of these assets and liabilities. Likewise, it does not indicate that the Company could return or distribute the reported US dollar (“USD”) 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.

Minority Interest

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

Cash and Cash Equivalents

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

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.

2. Significant Accounting Policies (continued)

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 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.

Sale and Repurchase Transactions Involving Securities

Transactions involving sale and repurchase of securities ("REPO") are accounted for as secured financing whereby the Company retains these securities in the balance sheet and records a liability to a counterparty within "Short-term loans and current portion of long-term debt" or "Long-term debt", depending on its maturity. The difference between sale and repurchase prices is treated as an interest expense recognized in the consolidated statement of income and comprehensive income over the term of the sale and repurchase transaction using the effective interest method.

2. Significant Accounting Policies (continued)

Sale and Repurchase Transactions Involving Securities (continued)

Under the terms of the repurchase agreements, the value of assets underlying the debt is marked-to-market by the counterparty at its discretion, as frequently as on a daily basis. If the value of the underlying asset declines, the counterparty has the ability to require the Company to post additional margin—cash or other liquid collateral—to compensate for the decline in value of the asset. Conversely, if the value of the underlying asset increases, a portion of the margin previously posted may be returned to the Company.

Oil and Gas Exploration and Development

In accordance with Statement of Financial Accounting Standard ("SFAS") 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies,* 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 expenses".

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

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

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, 2008 and 2007, 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, 2008 and 2007, 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 development assets in the consolidated balance sheet.

2. Significant Accounting Policies (continued)

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.

Depreciation, Depletion and Amortization

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

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

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 - 35 years
Plant and machinery	15 years
Vehicles and other equipment	6 years
Service vessels	20 years
Offshore drilling assets	20 years

Interests in Joint Operations

A joint operation is a contractual arrangement whereby two or more parties (participants) undertake an economic activity that is subject to joint control. Joint control is only exercised when strategic, financial and operating decisions relating to the joint activity are made unanimously by all the parties. A joint venture is 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.

2. Significant Accounting Policies (continued)

Interests in Joint Operations (continued)

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.

A part of an interest in a jointly-controlled oil and gas exploration and production entity may be assigned to other participants or third parties. In which case, in accordance with SFAS 19, 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 SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

Oil and gas properties are assessed whenever events or circumstances indicate potential impairment. If the carrying value of oil and gas properties is not recoverable through undiscounted cash flows, an impairment is recognized. The impairment is determined on the basis of the estimated fair value of oil and gas properties which, in turn, is measured by discounting future net cash flows or with reference to current market prices of oil and gas properties, if available. Discounted future cash flows from oil and gas fields are based on the most reliable management estimates of future prices that rely on recent actual prices and published prices for forward transactions; such prices are applied to forecast production volumes at particular fields with further discounting for the expected risk level.

Forecast production volumes shall be understood as reserves, including probable reserves that are proposed to be extracted using a known amount of capital expenditures. Production volumes and prices correspond to the internal plans and forecasts, as well as other data in the published financial statements. Assumptions regarding future prices and costs used to assess oil and gas properties for impairment differ from those used in the standard procedure for discounting net cash flows from proved oil and gas reserves.

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.

2. Significant Accounting Policies (continued)

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.

Business Combinations

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

Goodwill and Other Intangible Assets

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

For investees accounted for under the equity method, the excess of the cost to acquire a share in those entities over the fair value of the acquired share of net assets as of the acquisition date is treated as embedded goodwill.

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

Assets Held for Sale

The Company accounts its assets as held for sale in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. 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.

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$ 279 million, US$ 178 million and US$ 109 million of interest expenses on loans and borrowings in 2008, 2007 and 2006, 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 containing a bargain purchase option. In the latter cases capitalized assets are depreciated over the estimated useful life of the asset regardless of the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statements of 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:

Exploration and Production – the Company's exploration, development and production activities involve the use of the following assets: wells, related equipment and operating sites, oil gathering and treatment facilities, tank farms and in-field pipelines. Generally, 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 SFAS 143, Accounting for Asset Retirement Obligations.

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

2. Significant Accounting Policies (continued)

Asset Retirement Obligations (continued)

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

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

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

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

Fair Value of Financial Instruments

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

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 SFAS 109, *Accounting for Income Taxes*. This method takes into account future tax consequences, based on the effective tax rate, associated with differences between the carrying values of assets and liabilities and their taxable base, which gives immediate income statement effect to changes in income tax laws, including changes in the tax rates. A valuation allowance for a deferred tax asset is recorded when management believes that it is more likely than not that this tax asset will not be realized.

Starting from January 1, 2007 the Company accounts for uncertain tax positions in accordance with FIN 48 *Accounting for Uncertainty in Income Taxes*. Under the provisions of FIN 48, liabilities for unrecognized income tax benefits together with corresponding interest and penalties are recorded in the consolidated statement of income and comprehensive income as income tax expense. The adoption of FIN 48 had an insignificant impact on the consolidated financial statements.

2. Significant Accounting Policies (continued)

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 SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, are recognized immediately in the consolidated statement of income and comprehensive income.

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 custom duties (see Note 19).

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 when environmental assessments or clean-ups are probable and the costs can be reasonably estimated.

Guarantees

The fair value of a guarantee is determined and recorded as a liability at the time when the guarantee is issued. The initial guarantee amount is subsequently remeasured to reflect the changes in the underlying liability. The expense is included in the related line items of the consolidated 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.

2. Significant Accounting Policies (continued)

Comprehensive Income

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

As of December 31, 2008 the Company recorded other accumulated comprehensive loss in the amount of US$ 40 million (net of tax) which represents an unrealized loss resulting from the revaluation of available-for-sale investments. As of December 31, 2007 and 2006, there are no material comprehensive income items and, therefore, comprehensive income for 2007 and 2006 equals net income.

Accounting for Buy/Sell Contracts

The Company applies the Financial Accounting Standards Board's ("FASB") Emerging Issues Task Force ("EITF") Issue No. 04-13*, Accounting for Purchases and Sales of Inventory with the Same Counterparty,* which requires that two or more legally separate exchange transactions with the same counterparty, including buy/sell transactions, be combined and considered as a single arrangement for the purposes of applying the provisions of APB 29, *Accounting for Non-monetary Transactions*, 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, while value-added tax is recorded net in taxes other than income tax liabilities in the consolidated balance sheets.

2. Significant Accounting Policies (continued)

Recent Accounting Standards

In April 2008, the FASB issued Staff Position ("FSP") FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* ("FSP FAS 142-3") with the objective of improving the consistency between the useful life of a recognized intangible asset under SFAS 142, *Goodwill and Other Intangible Assets,* and the period of expected cash flows used to measure the fair value of the asset under SFAS 141 (revised 2007), *Business Combinations,* and other US GAAP standards. FSP FAS 142-3 establishes additional factors to be considered by an entity in developing assumptions about renewal or extension used to determine the useful life of an intangible asset recognized under SFAS 142. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company will adopt FSP FAS 142-3 effective January 1, 2009. The Company does not expect FSP FAS 142-3 to have a material impact on the Company's consolidated financial position and results of operations.

In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*. FSP is intended to improve disclosures about credit derivatives by requiring more information about the potential adverse effects of changes in credit risk on the financial position, financial performance, and cash flows of the sellers of credit derivatives. The FSP also amends FASB Interpretation ("FIN") 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others*, to require an additional disclosure about the current status of the payment/performance risk of a guarantee. The provisions of the FSP that amend FAS 133 and FIN 45 are effective for reporting periods (annual or interim) ending after November 15, 2008. Application of FSP FAS 133-1 and FIN 45-4 will not have a material impact on the Company's consolidated financial position and results of operation.

In October 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* ("FSP FAS 157-3") that applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurements in accordance with FAS 157, *Fair Value Measurements*. FSP FAS 157-3 clarifies the application of FAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS 157-3 shall be effective upon issuance, including prior periods for which financial statements have not been issued. Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate (FAS 154, *Accounting Changes and Error Corrections*). The disclosure provisions of FAS 154 for a change in accounting estimate are not required for revisions resulting from a change in valuation technique or its application. For additional information, see Note 26 — Fair Value of Financial Instruments and Risk Management. The Company does not expect FSP FAS 157-3 to have a material impact on the Company's consolidated financial statements.

2. Significant Accounting Policies (continued)

Recent Accounting Standards (continued)

In November 2008, the FASB ratified EITF 08-6, *Equity Method Investment Accounting Considerations* ("EITF 08-6"). EITF 08-6 clarifies the accounting for certain transactions and impairment considerations involving equity method investments in the context of issuance of FAS141(R), *Business Combinations,* and Statement 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51.* EITF 08-6 applies to all investments accounted for under the equity method. Among other things EITF 08-6 clarifies initial measurement of equity investments; impairment testing of equity investments; accounting by equity investor for a share issuance by an investee. EITF 08-6 is effective in fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. Earlier application is not permitted. The Company will adopt EITF 08-6 effective January 1, 2009. The Company does not expect EITF 08-6 to have a material impact on the Company's consolidated financial position and results of operations.

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities* ("FSP FAS 140-4 and FIN 46(R)-8"). FSP FAS 140-4 and FIN 46(R)-8 applies to public entities that are subject to the disclosure requirements of FAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("FAS 140") and public enterprises that are subject to the disclosure requirements of Interpretation 46(R), *Consolidation of Variable Interest Entities* ("FIN 46 (R)") as amended by this FSP. FSP FAS 140-4 and FIN 46(R)-8 amends FAS 140 to require additional disclosures about transfers of financial assets. FSP FAS 140-4 and FIN 46(R)-8 also amends Interpretation 46(R) to require additional disclosure about variable interest in a variable interest entity. FSP FAS 140-4 and FIN 46(R)-8 is effective for the first reporting period (interim or annual) ending after December 15, 2008. Application of FSP FAS 140-4 and FIN 46(R)-8 will not have a material impact on the Company's consolidated financial position and results of operations.

In December 2008, the FASB issued FSP FAS 132(R)-1, *Employers' Disclosures about Postretirement Benefit Plan Assets* ("FSP FAS 132(R)-1"). FSP FAS 132(R)-1 applies to an employer that is subject to the disclosure requirements of FAS 132(R), *Employers' Disclosures about Pensions and Other Postretirement Benefits.* FSP FAS 132(R)-1 specifies additional disclosures about plan assets in an employer's defined benefit pension or other postretirement plan. FSP FAS 132(R)-1 is effective for fiscal years ending after December 15, 2009. Earlier application of the provisions of this FSP is permitted. The Company will adopt FSP FAS 132(R)-1 for the year ending December 31, 2009. The Company does not expect FSP FAS 132(R)-1 to have a material impact on the Company's consolidated financial position and results of operations.

3. Significant Acquisitions in 2007

From April through August 2007, Neft-Aktiv LLC, the Company's wholly owned subsidiary, won a number of auctions for the sale of certain assets of Yukos Oil Company following the bankruptcy proceedings of Yukos Oil Company. The acquired assets included movable and immovable properties, as well as equity interests in enterprises engaged in exploration and production, refining and marketing, service and maintenance companies.

The total acquisition price for the above properties and interests amounted to RUB 469.88 billion (US$ 18.22 billion at the CBR official exchange rate as of the dates of acquisitions).

The total acquisition price was allocated to the fair value of assets acquired and liabilities assumed in the amount of US$ 13.16 billion, including US$ 12.51 billion of business combinations presented in the table below.

3. Significant Acquisitions in 2007 (continued)

Based on the purchase price allocation, total goodwill in the amount of US$ 5.06 billion is attributed primarily to the refining, marketing and distribution segment (US$ 3.61 billion), as well as to the exploration and production segment (US$ 1.45 billion). Both segments are expected to benefit from the synergies of the acquisitions. Included in the exploration and production segment is goodwill in the amount of US$ 743 million related to OJSC Tomskneft VNK and certain other assets, 50% interests of which were sold in December 2007.

The Company consolidated the operating results of the acquired entities starting from the dates on which respective ownership was transferred. The transfer dates are different for every asset and depend on the date of signing the transfer act (for joint-stock companies) or the notice date (for limited liability companies).

The following table summarizes the Company's final purchase price allocation to the fair value of assets acquired and liabilities assumed:

	Preliminary purchase price allocation	Final purchase price allocation
ASSETS		
Current assets:		
Cash and cash equivalents	1,185	**1,185**
Short-term investments	698	**647**
Accounts receivable	3,122	**3,296**
Inventories	860	**860**
Prepayments and other current assets	546	**548**
Total current assets	6,411	**6,536**
Long-term investments	209	**137**
Property, plant and equipment	15,220	**14,267**
Intangible assets	274	**683**
Deferred tax assets	195	**248**
Other non-current assets	241	**241**
Total non-current assets	16,139	**15,576**
Total assets	22,550	**22,112**
LIABILITIES		
Accounts payable	1,226	**1,228**
Short-term loans and borrowings and current portion of long-term debt	2,498	**2,522**
Income and other tax liabilities	509	**528**
Deferred tax liabilities	237	**237**
Other current liabilities	387	**380**
Total current liabilities	4,857	**4,895**
Asset retirement obligations	908	**908**
Long-term debt	951	**963**
Deferred tax liabilities	2,397	**2,641**
Other non-current liabilities	193	**193**
Total non-current liabilities	4,449	**4,705**
Total liabilities	9,306	**9,600**
Total net assets acquired	13,244	**12,512**
Minority interest	(8)	**(8)**
Purchase price	17,607	**17,563**
Goodwill	4,371	**5,059**

3. Significant Acquisitions in 2007 (continued)

Property, plant and equipment includes mineral rights in the amount of US$ 219 million.

Other current liabilities and other non-current liabilities include accrued liabilities for pre-acquisition contingencies in the amount of US$ 198 million and US$ 55 million, respectively. These contingent liabilities arose from lawsuits against the newly acquired companies. Tax related pre-acquisition contingencies in the amount of US$ 158 million are included within income and other tax liabilities.

The preliminary purchase price allocation, which already includes adjustments, made in 2007, was further adjusted due to the revisions made in the first half of 2008 of fair values of the assets acquired and liabilities assumed, which primarily include refinement of the fair values of property, plant and equipment and intangible assets of marketing and distribution companies. The Company has not made any adjustments of purchase price allocation to the fair value of assets acquired and liabilities assumed after June 30, 2008.

Pro forma financial information assuming that the acquisition of assets occurred as of the beginning of 2006, which is required by SFAS 141, *Business Combinations,* has not been presented herein as the Company does not have access to reliable US GAAP financial information regarding the acquired assets for the periods prior to the acquisition.

4. Other Acquisitions

Acquisition of Oil Product Retail Networks

In the third quarter of 2007, the Company acquired, via its subsidiaries, 100% of shares and interests in OJSC JV ANTARES, Oxoil Limited (Cyprus) and Rokada Market LLC for US$ 55 million, US$ 42 million and RUB 1,482 million (US$ 57.8 million at the CBR official exchange rate at the transaction date), respectively. The acquired assets included gas station networks and petroleum storage depots located in the Moscow region and the Stavropol region of the Russian Federation.

The following table summarizes the Company's final allocation of the purchase price of OJSC JV ANTARES, Oxoil Limited and Rokada Market LLC to the estimated fair value of assets acquired and liabilities assumed:

	Final purchase price allocation
Current assets	27
Non-current assets	166
Total assets	**193**
Current liabilities	25
Non-current liabilities	39
Total liabilities	**64**
Total net assets acquired	**129**
Minority interest	**(4)**
Purchase price	**155**
Goodwill	**30**

Operating results of OJSC JV ANTARES, Oxoil Limited and Rokada Market LLC are not material and therefore pro forma financial information has not been disclosed in these financial statements.

5. Cash and Cash Equivalents

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

	2008	2007
Cash on hand and in bank accounts in RUB	**412**	474
Cash on hand and in bank accounts in foreign currencies	**830**	111
Deposits	**21**	378
Other	**106**	35
Total cash and cash equivalents	**1,369**	998

Restricted cash as of December 31 comprises the following:

	2008	2007
Obligatory reserve with the CBR	**2**	25
Other restricted cash	**2**	9
Total restricted cash	**4**	34

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 represent primarily cash in US dollars.

Deposits represent primarily bank deposits denominated in RUB that may be readily convertible into cash and may be withdrawn by the Company at any time without prior notice or penalties.

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.

6. Short-Term Investments

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

	2008	2007
Short-term loans granted	**1**	4
Loans to related parties	**8**	25
Cash margin under repurchase agreement (Note 16)	**893**	–
Promissory notes held-to-maturity	**600**	123
Trading securities		
Promissory notes	**1**	1
State and corporate bonds	**76**	149
Other	**4**	4
Available-for-sale securities	**22**	27
Bank deposits	**105**	5
Total short-term investments	**1,710**	338

6. Short-Term Investments (continued)

Promissory notes held-to-maturity include an interest-free promissory note issued by a major state-owned Russian bank maturing on or after July 31, 2009. The nominal value of this promissory note is RUB 16.5 billion (US$ 560.5 million at the CBR official exchange rate as of December 31, 2008). At December 31, 2008, the amortized cost of the promissory note was RUB 15.3 billion (US$ 529.8 million at the CBR official exchange rate as of December 31, 2008).

Other RUB-denominated short-term promissory notes which are held to maturity bear an interest of 8.0%.

The fair value of held to maturity securities approximates their carrying value recognized in the financial statements.

State bonds primarily represent federal loan bonds issued by the Ministry of Finance of the Russian Federation with maturities ranging from March 2009 to February 2036 and nominal interest rates ranging from 6.1% p.a. to 11.0% p.a.

Corporate bonds represent bonds issued by large Russian corporations and bonds issued by the CBR with maturities ranging from March 2009 to July 2016 and interest rates ranging from 7.7% to 16.5%.

7. Accounts Receivable, Net

Accounts receivable as of December 31 comprise the following:

	2008	**2007**
Trade receivables	**1,785**	3,812
Value-added tax receivable	**1,907**	4,029
Other taxes	**1,349**	499
Banking loans to customers	**1,007**	996
Acquired receivables	**74**	140
Other	**311**	381
Less: allowance for doubtful accounts	**(134)**	(72)
Total accounts receivable, net	**6,299**	9,785

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

In 2008, the value-added tax (VAT) and excise receivables were settled through cash payments and a legal offset against current tax liabilities (see Note 18). The total amount of VAT and excise recovered was RUB 63.3 billion (US$ 2.55 billion at the average annual exchange rate), including US$ 1.3 billion of income tax offsets.

8. Inventories

Inventories as of December 31 comprise the following:

	2008	**2007**
Materials and supplies	**478**	503
Crude oil and gas	**252**	516
Petroleum products	**697**	907
Total inventories	**1,427**	1,926

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

9. Prepayments and Other Current Assets

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

	2008	**2007**
Prepayments to suppliers	**651**	637
Prepayments to customs brokers	**683**	166
Insurance prepayments	**6**	21
Customs	**415**	814
Other	**91**	93
Total prepayments and other current assets	**1,846**	1,731

Customs primarily represent export duty prepayments related to the export of crude oil and petroleum products (see Note 19).

10. Long-Term Investments

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

	2008	**2007**
Equity method investments		
OJSC Tomskneft VNK	**1,475**	1,419
Polar Lights Company LLC	**94**	153
JV Rosneft-Shell Caspian Ventures Limited	**19**	27
OJSC Daltransgaz	**–**	49
OJSC Verkhnechonskneftegaz	**218**	222
CJSC Vlakra	**109**	108
OJSC Kubanenergo	**94**	102
Other	**164**	210
Total equity method investments	**2,173**	2,290
Available-for-sale securities		
OJSC TGK-11	**7**	43
Long-term promissory notes	**4**	7
Held-to-maturity securities		
Russian government bonds	**29**	1
Long-term loans granted	**1**	3
Long-term loans to equity investees	**467**	279
Cost method investments	**14**	19
Other	**–**	4
Total long-term investments	**2,695**	2,646

10. Long-Term Investments (continued)

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

	Participation interest (percentage) as of December 31, 2008	Share in income/(loss) of equity investees		
		2008	**2007**	**2006**
Polar Lights Company LLC	**50.00**	**36**	36	47
CJSC Kaspiy-1	**41.22**	–	–	(29)
OJSC Verkhnechonskneftegaz	**25.94**	**(17)**	(11)	(6)
JV Rosneft-Shell Caspian Ventures Limited	**51.00**	**3**	6	7
OJSC Tomskneft VNK	**50.00**	**56**	5	–
Taihu Ltd	**51.00**	–	–	–
OJSC Daltransgaz	**25.00**	–	(8)	–
West Kamchatka Holding B.W.	**60,00**	**(51)**	–	–
Other	**various**	**(34)**	(5)	(2)
Total equity share		**(7)**	23	17

Polar Lights Company LLC ("PLC")

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

During 2008 the Company reviewed whether decline in value of its investment in PLC was other than temporary according to APB Opinion 18, *The Equity Method of Accounting for Investments in Common Stock*. 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 exists and recognized impairment loss in the amount of US$ 58.3 million (see Note 26).

West Kamchatka Holding B.W. ("WKH")

WKH is an enterprise jointly established by the Company (60%) and K.K. Korea Kamchatka Co. Ltd. ("KKK") (40%). WKH, through its wholly-owned subsidiary Kamchatneftegaz LLC, is engaged in offshore exploration project in Kamchatka region. Project financing during the geologic exploration period is carried out by the KKK. According to the Shareholder and Operational agreement, key operational decisions are subject to unanimous approval of the Board of Directors. In accordance with the agreement the Company's investment in WKH is accounted for using equity method.

Due to the expiration of the licence in 2008, the relevant share of the Company's liabilities for winding up the project was recorded in the consolidated balance sheet as of December 31, 2008 as other current liabilities in the amount of US$ 51 million.

JV Rosneft-Shell Caspian Ventures Limited

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

10. Long-Term Investments (continued)

JV Rosneft-Shell Caspian Ventures Limited (continued)

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

OJSC Daltransgaz

OJSC Daltransgaz is an operator for the program to supply gas to the Sakhalin Region and the Khabarovsk and Primorye Territories. In December 2008, the Company finalized the sale of a 25% equity interest in OJSC Daltransgaz (see Note 17).

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, the Company commenced commercial production 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.

Taihu Ltd / OJSC Udmurtneft

In November 2006, the Company acquired a 51% equity share in Taihu Ltd, a joint venture incorporated for holding interest in and strategic management of OJSC Udmurtneft. The Company paid 5,100 Cyprus Pounds (approximately US$ 11 thousand) for this investment which has been included within equity method investments. The other party to the joint venture is China Petrochemical Corporation ("Sinopec") with a respective share of 49%.

The Shareholder Agreement in respect of this joint venture stipulates 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.

In December 2006, Taihu Ltd, through its wholly owned subsidiary, acquired a 96.86% equity interest in OJSC Udmurtneft for US$ 3.5 billion. The credit facility for financing the purchase of 96.86% shares of OJSC Udmurtneft was provided to Taihu Ltd by Bank of China and principally secured by OJSC Udmurtneft's shares, without recourse to the Company.

OJSC Udmurtneft is located in the Volga-Ural region of the Russian Federation and holds the licences for the development of 24 productive oil and gas condensate deposits. OJSC Udmurtneft is a group of 17 companies.

OJSC Tomskneft VNK

In December 2007, the Company finalized the sale of 50% equity interests in OJSC Tomskneft VNK, Strezhevskoy Refinery LLC and several other companies which had been previously acquired through the auction for the sale of the assets of Yukos Oil Company (see Note 3). 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.

10. Long-Term Investments (continued)

OJSC TGK-11, OJSC Kubanenergo

The Company acquired interests in OJSC Tomskenergo, OJSC Kubanenergo through the auctions for the sale of the assets of Yukos Oil Company that were held in May and July 2007(see Note 3). 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%. As of December 31, 2007 and 2008 this investment was accounted for as an available for sale security. In December 2008, an arbitration court ruled in favor of the Company to nullify reorganization and the conversion of Tomskenergo's shares. This decision came into effect, however the defendant appealed to the court and hearings are scheduled on March 11, 2009.

CJSC Vlakra

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

Other Investments

Other investments 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, that are recognized in the accounting records of the entities acquired in 2007 through the bankruptcy auctions of Yukos Oil Company's assets (see Note 3).

11. Property, Plant and Equipment, Net

	Cost		Accumulated depreciation		Net carrying amount	
	December 31, 2008	December 31, 2007	December 31, 2008	December 31, 2007	December 31, 2008	December 31, 2007
Exploration and production	**54,876**	48,416	**(11,163)**	(8,437)	**43,713**	39,979
Refining, marketing and distribution	**12,777**	12,906	**(3,300)**	(2,372)	**9,477**	10,534
Other activities	**2,510**	1,512	**(496)**	(322)	**2,014**	1,190
Total property, plant and equipment	**70,163**	62,834	**(14,959)**	(11,131)	**55,204**	51,703

Exploration and production assets include costs to acquire unproved properties in the amount of US$ 4,149 million as of December 31, 2008, and US$ 4,165 million as of December 31, 2007. 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 2008 and 2007 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.

11. Property, Plant and Equipment, Net (continued)

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 2009 to 2044. Expiration dates of licences for the most significant fields are between 2013 and 2044, 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, the Company filed 42 applications for the extension of the licence terms and extended 22 of its main production licences for the period equivalent to the expected life of the fields. In 2008, the Company filed 31 applications for the extension of the licence terms and extended 9 of its main production licences for a period of up to 25 years based on the expected life of a 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.

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, 2008 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.

Sakhalin-5

The participants of the project are subsidiaries of the Company and BP p.l.c. In March 2004, the licence for geological study of the Kaigansko-Vasyukansky block held by the Company was transferred to CJSC Elvari Neftegaz, which is a wholly owned subsidiary of Elvary Neftegaz Holdings B.V., an entity jointly established by the participants of the project.

11. Property, Plant and Equipment, Net (continued)

Sakhalin-5 (continued)

The Shareholders and Operating Agreement was signed between the participants and the operator in June 2004. In accordance with the terms of the agreement, during the exploration stage project funding will be fully provided by BP p.l.c., while during the development stage BP p.l.c. will carry a portion of payments due from the Company and will provide credit support to obtain project funding.

The Company recognizes this investment using the equity method of accounting.

Other Projects

The Company is a party to project associated with the exploration and development of the Sakhalin shelf (Vostochno-Shmidtovsky block). Under this arrangement, the other participant (BP p.l.c.) carries the costs associated with the exploration of this offshore block. Exploration and development of this project is still at an early stage. The Company's costs (currently insignificant) associated with this project were capitalized.

In July 2005, the Company entered into a PSA agreement with the Kazakhstan Government for the joint development of the Kurmangazy oil and gas prospect. The participants of the project are a subsidiary of the Company, RN Kazakhstan LLC, and a subsidiary of Kazakhstan State JSC "NK KazMunaiGaz – KazMunaiTeniz" ("KazMunaiTeniz"), with equal shares of 50%. The agreement provided for a signing bonus in the amount of US$ 50 million. The Company's share of US$ 25 million is recognized within mineral rights. In accordance with the terms of the agreement, upon a commercial discovery the Russian Federation has an option to buy a 25% share in the project at a future market price, by reducing the share of RN-Kazakhstan LLC in the project. If the Russian Federation does not exercise its option, this share shall be sold to third parties at a market price or redistributed between the participants in equal parts. If the share is sold, the proceeds from the sale shall be used to cover the expenses already incurred, including those borne by RN Kazakhstan LLC which are attributable to the disposed share. Any excess of the proceeds from the sale of the share over the expenses shall be equally distributed between RN Kazakhstan LLC and KazMunaiTeniz.

Cash Flows Details

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

	2008	2007	2006
Acquisition and construction of property, plant and equipment	**8,154**	5,931	3,293
Construction materials	**578**	309	169
Total capital expenditures	**8,732**	6,240	3,462

12. Leased Property, Plant and Equipment, Net

The following is the analysis of the property, plant and equipment under capital leases as of December 31:

	2008	2007
Oil and gas properties	**32**	42
Less: accumulated depletion	**(4)**	(6)
Oil and gas properties, net	**28**	36
Other property, plant and equipment		
Buildings and constructions	**1**	5
Plant and machinery	**31**	39
Vehicles	**352**	174
Total	**384**	218
Less: accumulated depreciation	**(63)**	(24)
Property, plant and equipment, net	**321**	194
Total net book value of leased property	**349**	230

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

	2008
2009	**51**
2010	**46**
2011	**36**
2012	**7**
2013 and after	**4**
Imputed interest	**(13)**
Present value of capital lease payments	**131**

Operating Lease

The total amount of operating lease expenses was as follows:

	2008	2007	2006
Total lease expenses	**210**	156	116
Total sublease revenues	**5**	4	8

13. Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price of additional shares and interests in various entities, acquired during 2007, in the refining, marketing and distribution (R&M) segment and the exploration and production (E&P) segment in the amounts of US$ 3,632 million and US$ 714 million, respectively, over the fair value of the corresponding share in net assets (see Notes 3 and 4) and US$ 161 million related to the refining, marketing and distribution segment acquisitions before 2007.

In accordance with SFAS 142, the Company performed its annual impairment test of goodwill as of October 1, 2008. Consistent with prior years, the review for impairment was carried out during the beginning of the fourth quarter of 2008 using data that was appropriate at that time. As a result of this annual test, no impairment of goodwill was identified.

Following a significant adverse economic downturn in the fourth quarter of 2008, the Company estimated that the fair value of its reporting units could potentially be reduced below their carrying amounts and performed an additional impairment test of goodwill as of December 31, 2008. This testing was carried out using macroeconomic and other assumptions that were appropriate as of December 31, 2008. As a result of this additional test, no impairment of goodwill was identified.

13. Goodwill and Intangible Assets (continued)

Goodwill acquired through business combinations (see Note 3) has been allocated to the reporting units being its operating segments - E&P and R&M segments. 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.

The five year business plan as well as the long-term business strategy, approved by the Company's Board of Directors, are the primary sources 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 dollar and Russian ruble 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 primarily include rights to leasehold land purchased with the assets of the companies acquired during 2007 (see Notes 3 and 4). Land rights are amortized based on an average useful life of 20 years.

	Cost		Accumulated amortization		Net carrying amount	
	December 31, 2008	**December 31, 2007**	**December 31, 2008**	**December 31, 2007**	**December 31, 2008**	**December 31, 2007**
Land leasehold rights	**718**	274	**(53)**	–	**665**	274
Other	**19**	12	**(5)**	(1)	**14**	11
Total intangible assets	**737**	286	**(58)**	(1)	**679**	285

The charge to income resulting from amortization of intangible assets is included with *Depreciation, depletion and amortization* expense in consolidated statements of income and comprehensive income for the 2008, 2007 and 2006 in the amount of US$ 59 million, US$ 4 million and US$ 3 million, respectively.

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

2009	**39**
2010	**39**
2011	**39**
2012	**36**
2013	**36**
Total amortization expense for the five succeeding years	**189**

14. Other Non-Current Assets

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

	2008	2007
Advance payment in favour of Factorias Vulcano S.A	**178**	233
Advances paid for capital construction	**739**	610
Debt issue costs	**118**	40
Long-term VAT receivable	**4**	85
Prepaid insurance	**14**	15
Long-term receivables (Note 24)	**23**	51
Other	**101**	63
Total other non-current assets	**1,177**	1,097

As of December 31, 2007, an advance payment was made in favour of Factorias Vulcano S.A for the construction of three twin-hull shuttle oil tankers. In November 2008, one of the three tankers was put into operation. It is planned that the remaining two vessels will be put into operation in 2009.

15. Accounts Payable and Accrued Liabilities

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

	2008	2007
Trade accounts payable	**1,432**	2,034
Salary and other benefits payable	**405**	286
Advances received	**268**	568
Dividends payable	**2**	2
Banking customer accounts	**763**	818
Accrued expenses	**71**	158
Other	**155**	156
Total accounts payable and accrued liabilities	**3,096**	4,022

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

Salary and other benefits payable include US$ 35 million to be paid out during 2009 in connection with the staff reduction programme.

16. Short-Term Loans and Long-Term Debt

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

	2008	2007
Bank loans – foreign currencies	**608**	10,352
Bank loans – RUB denominated	**2,639**	51
Customer deposits – foreign currencies	**149**	20
Customer deposits – RUB denominated	**213**	291
Promissory notes payable	**1,598**	50
Promissory notes payable – Yukos related	**687**	904
Borrowings – RUB denominated	**309**	234
Borrowings – RUB denominated – Yukos related	**650**	728
Repurchase obligation	**1,916**	–
	8,769	12,630
Current portion of long-term debt	**5,315**	2,920
Total short-term loans and borrowings and current portion of long-term debt	**14,084**	15,550

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

In March-May 2007, the Company obtained bridge financing from a consortium of international banks in the total amount of US$ 22.0 billion to finance acquisitions (see Note 3). These bridge loans were fully repaid or refinanced in 2008.

As of December 31, 2008, weighted average interest rates on short-term loans in foreign currency and in RUB were 7.66% and 12.96%, respectively.

Customer deposits represent fixed-term deposits placed by customers with the Company's subsidiary bank, denominated in RUB and foreign currencies. Customer deposits denominated in RUB bear an interest rate ranging from 0.01% p.a. to 13.1% p.a. Customer deposits denominated in foreign currencies bear an interest rate ranging from 0.01% p.a. to 15.0% p.a.

As of December 31, 2008, weighted average interest rate on promissory notes was 10.44%. The promissory notes are recorded at amortized cost.

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 rates ranging from 0% to 18% p.a. The promissory notes are recorded at amortized cost.

RUB denominated borrowings are interest-free and were received from equity investees.

RUB denominated borrowings – Yukos related primarily include borrowings provided by Yukos Capital S.a.r.l., which bore interest of 9% p.a. and matured at the end of 2007 (see Note 24).

In June 2008, the Group sold 412.86 million treasury shares of Rosneft to a syndicate of international banks for a cash consideration of US$ 2.35 billion payable under a repurchase agreement. The Company has a right and obligation to repurchase the shares within one year. The repurchase obligation carries an interest of 5.76% p.a. In accordance with the repurchase agreement, this transaction was accounted for in the consolidated balance sheet as secured financing. In the third and fourth quarters of 2008, as a result of margin calls Rosneft transferred an additional 82.07 million treasury shares as collateral and paid US$ 1.39 billion in cash, of which US$ 0.5 billion was credited towards the repurchase obligation. As of December 31, 2008, the repurchase obligation (without accrued interest) amounted to US$ 1.9 billion.

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

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

	2008	2007
Bank loans – foreign currencies	**11,645**	9,611
Bank loans raised for funding the acquisition of OJSC Yuganskneftegaz – US$ denominated	**2,641**	3,737
Borrowings – US$ denominated	**9**	12
Borrowings – RUB denominated	**18**	20
Borrowings – RUB denominated – Yukos related	**–**	12
Customer deposits – foreign currencies	**15**	10
Customer deposits – RUB denominated	**91**	146
Bonds issued by subsidiary bank – RUB denominated	**–**	24
Promissory notes payable	**48**	50
Promissory notes payable – Yukos related	**929**	1,021
	15,396	14,643
Current portion of long-term debt	**(5,315)**	(2,920)
Total long-term debt	**10,081**	11,723

In February 2008, Rosneft raised a floating interest syndicated loan in the amount of US$ 3.0 billion and made an additional drawdown of US$ 425 million in April 2008. The loan is repayable by equal quarterly instalments within 5 years. The loan is secured by oil export contracts.

In July 2008, Rosneft raised another floating interest syndicated loan in the amount of US$ 2.85 billion and made an additional drawdown of US$ 350 million in September 2008. The loan is repayable by equal quarterly instalments within 5 years. The loan is secured by oil export contracts.

The interest rates on the Company's long-term bank loans denominated in foreign currencies range from LIBOR plus 0.5% to LIBOR plus 1.25%. These loans also include inter-bank loans raised by Rosneft subsidiary bank. These bank loans are primarily secured by contracts for the export of crude oil.

As of December 31, 2008, the bank loans raised for funding the acquisition of OJSC Yuganskneftegaz represent a long-term loan obtained through a government-owned bank at a rate of LIBOR plus 0.7% p.a. repayable in equal monthly installments. It is scheduled 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 24).

Customer deposits represent fixed-term deposits placed by customers with the Company's subsidiary bank, denominated in RUB and foreign currencies. The RUB-denominated deposits bear interest rates ranging from 1.0% p.a. to 14.0% p.a. Deposits denominated in foreign currencies bear interest rates of 4.5%- 9.0% p.a.

Promissory notes payable include promissory notes with the effective interest rates ranging from 10% to 14% p.a. The promissory notes mature primarily in 2009 and are recorded at amortized cost.

16. 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 bear interest rates ranging from 0% to 12% p.a. and mature primarily in 2009. The promissory notes are recorded at amortized cost. In 2008, the Company wrote-off unclaimed promissory notes where statute of limitations expired and recognised income in amount of US$ 74 million in the consolidated statement of income and comprehensive income as other income.

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 Company's acquisition of OJSC Yuganskneftegaz in December 2004, and the resulting debt incurred and assets and liabilities, including contingent liabilities, consolidated, the Company was not in compliance with various financial and other covenants of existing loan agreements as of December 31, 2004.

In July 2005, the creditors waived violations related to restrictive financial ratios and agreed to amend the financial ratio covenants in line with the Company's new structure and new scope of activities. The creditors also waived other events of default arising from the breach of other covenant provisions. Effective January 1, 2007, the creditors granted amendments to the loan agreements which remove these provisions and have included new provisions whereby the Company must:

- redeem, secure, discharge in full or restructure (and comply with any restructuring plans once it is agreed upon) all OJSC Yuganskneftegaz's tax liabilities by January 3, 2008;
- pay any arbitration award relating to Moravel Litigation (see Note 24) or the Yukos Capital S.a.r.l. Litigation if any such arbitration award is granted by a court of the Russian Federation, within the time frame provided for such payment under Russian Law.

These conditions also apply to certain new borrowings obtained throughout 2007 and 2008. Additionally, in November and December 2007, the creditors waived certain possible violations and/or events of default under the loan agreements with respect to the loans payable to Yukos Capital S.a.r.l. by OJSC Tomskneft VNK and OJSC Samaraneftegaz, and to the condition related to OJSC Yuganskneftegaz's tax liabilities described above, effective through January 3, 2009, inclusively (see Note 24). In 2008, the Company fully restructured OJSC Yuganskneftegaz's tax liabilities (see Note 22). In December 2008, the creditors waived certain possible violations and/or events of default under the loan agreements with respect to the loans payable to Yukos Capital S.a.r.l. by OJSC Samaraneftegaz (waiver extended until January 3, 2010).

As of December 31, 2008, the Company is in compliance with all restrictive financial and other covenants contained within its loan agreements.

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

The scheduled aggregate maturity of long-term debt outstanding as of December 31, 2008 is as follows:

	2008
2009	5,315
2010	4,604
2011	2,695
2012	2,005
2013 and after	777
Total long-term debt	**15,396**

17. Shareholders' Equity

On June 5, 2008, the annual general shareholders' meeting approved dividends on the Company's common shares for 2007 in the amount of RUB 16,957 million or RUB 1.60 per share, which corresponds to US$ 712 million or US$ 0.07 per share at the CBR official exchange rate at the date of declaring the dividends. US$ 650 million of the above related to outstanding shares.

Result of Transactions with Related Parties under Common Control

In December 2007, the Company sold 50% of its interests in OJSC Tomskneft VNK, Imushchestvo-Service-Strezhevoy LLC, Strezhevskoy Refinery LLC and OJSC Tomskneftegeofizika and several other companies which had been previously acquired through the auction for the sale of the assets of Yukos Oil Company (see Note 3). The proceeds from the sale amounted to RUB 88.18 billion (US$ 3,570 million at the CBR exchange rate as of the transaction date.) The net result of the sale amounted to US$ 1,745 million, net of income tax effect (US$ 285 million). Since the transaction was executed with a related party under common control, the Company recorded this result, net of income tax effect, as a component of additional paid-in capital. Upon the completion of the sale, the investment in the above entities remaining with the Company is accounted for using the equity method of accounting (see Note 10).

In December 2008, the Company finalized 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 result, 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 OJSC Oil Company Rosneft'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 consolidated net profit calculated in accordance with statutory accounting standards. According to Russian legislation, dividends cannot exceed the accounting income for the reporting year. However, this legislation and other statutory laws and regulations dealing with distribution rights are open to different legal interpretations.

18. Income and Other Tax Liabilities

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

	2008	2007
Mineral extraction tax	**393**	1,084
Value-added tax	**244**	214
Excise tax	**138**	184
Personal income tax	**20**	24
Property tax	**66**	23
Income tax	**113**	651
Other	**120**	166
Total income and other tax liabilities	**1,094**	2,346

Tax liabilities above include the respective current portion of non-current restructured tax liabilities (see Note 22).

19. Export Customs Duty

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

	2008	2007	2006
Oil and gas sales			
Export customs duty	**17,200**	10,754	9,763
Petroleum products sales and processing fees			
Export customs duty	**4,806**	2,278	1,377
Total revenue related taxes	**22,006**	13,032	11,140

Petroleum products sales also include excise taxes which are presented in Note 20.

20. Income and Other Taxes

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

	2008	2007	2006
Current income tax expense	**3,394**	3,848	2,385
Deferred income tax (benefit)/expense	**(1,490)**	1,058	(1,845)
Total income tax expense	**1,904**	4,906	540

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.

20. Income and Other Taxes (continued)

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:

	2008	2007
Deferred income tax asset arising from tax effect of:		
Tax loss carry-forward	–	33
Asset retirement obligations	**155**	77
Property, plant and equipment	**53**	50
Prepayments and other current assets	**6**	15
Accounts receivable	**38**	27
Accounts payable and accruals	**54**	63
Inventories	**11**	16
Long-term investments	**56**	4
Interest swap contract	**38**	3
Other	**96**	60
Total	**507**	348
Valuation allowance for deferred income tax asset	**(237)**	(135)
Deferred income tax asset	**270**	213
Deferred income tax liability arising from tax effect of:		
Mineral rights	**(2,578)**	(3,996)
Other properties, plant and equipment and other	**(2,908)**	(3,748)
Deferred income tax liability	**(5,486)**	(7,744)
Net deferred income tax liability	**(5,216)**	(7,531)

Classification of deferred taxes:

	2008	2007
Current deferred tax assets	**152**	156
Non-current deferred tax assets	**118**	57
Current deferred tax liabilities	**(115)**	(118)
Non-current deferred tax liabilities	**(5,371)**	(7,626)

20. 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:

	2008	2007	2006
Income before income taxes and minority interest	**13,119**	17,789	4,165
Statutory income tax rate	**24.00%**	24.00%	24.00%
Theoretical income tax expense	**3,149**	4,269	1,000
Add /(deduct) tax effect of:			
Change in valuation allowance	**102**	(42)	(94)
Effect of income tax preferences	**(167)**	(135)	(77)
Previously unrecognized deferred tax asset	–	–	(539)
Adjustments of income tax for prior periods	**7**	(36)	(30)
Unrecognized income tax benefits	**(4)**	18	–
Effect from the change of income tax rate	**(956)**	–	–
Permanent accounting differences arising from:			
Non-deductible items, net	**373**	202	86
Foreign exchange effects, net	**(814)**	276	113
Accrued tax interest	**56**	177	–
Other	**158**	177	81
Income taxes	**1,904**	4,906	540

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 3.5% to 4%, are granted to the oil and gas producing companies which make capital investments, agreed with regional administrations, within the respective region and participate in various social projects. These exemptions are granted on an annual basis.

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, 2008 and December 31, 2007 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 most tax positions stated in the income tax return that reduce the income tax base 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.

During 2007 and 2008, the tax authorities held tax examinations in the Company and its subsidiaries for 2004-2007 fiscal years. The Company does not expect results of examinations to have a material impact on the Company's consolidated financial statements. Tax years or periods prior to 2004 are not subject to examination.

20. Income and Other Taxes (continued)

The following table shows a reconciliation of the beginning and ending unrecognized tax benefits for 2008 and 2007:

	2008	2007
Unrecognized tax benefits as of the beginning of the year	**18**	–
Increase for tax positions of prior years	**38**	13
Decrease for tax positions of prior years	**(6)**	–
Decrease for tax positions due to settlements with tax authorities	**(36)**	–
Increase of tax positions of the current year	**–**	5
Unrecognized tax benefits as of the end of the year	**14**	18

The total amount of unrecognized tax benefits that, if recognized, would affect the effective income tax rate is US$ 10 million and US$ 12 million as of December 31, 2008 and December 31, 2007, respectively.

Accrued liabilities for interest and penalties for income tax totalled US$ 301.6 million and US$ 300.1 million as of December 31, 2008 and December 31, 2007, respectively. Interest for income tax in the amount of US$ 62 million and US$ 89 million were accrued in the consolidated statement of income and comprehensive income in 2008 and 2007, respectively.

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

	2008	2007	2006
Mineral extraction tax	**12,817**	9,323	6,342
Excise tax	**1,120**	861	329
Property tax	**261**	186	107
Other	**612**	520	212
Total taxes other than income tax	**14,810**	10,890	6,990

21. Asset Retirement Obligations

The movement of asset retirement obligations is as follows:

	2008	2007
Asset retirement obligations as of the beginning of the reporting period	**2,130**	748
Recognition of additional obligations for new wells	**21**	11
Accretion expense	**120**	78
(Decrease)/increase as a result of changes in estimates	**(371)**	909
Acquired liabilities	**–**	908
Disposed liabilities of OJSC Tomskneft VNK	**–**	(521)
Spending on existing obligations	**(4)**	(3)
Asset retirement obligations as of the end of the reporting period	**1,896**	2,130

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.

22. Other Non-current Liabilities

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

	2008	2007
Restructured tax liabilities	**1,611**	2,146
Long-term lease obligations	**86**	147
Deferred income	**63**	115
Liabilities to municipalities under amicable agreements	**91**	48
Other	**19**	29
Total other non-current liabilities	**1,870**	2,485

In February and March 2008, the Company received signed resolutions of the Government of the Russian Federation and those of the relevant regional and local authorities regarding the restructuring of the respective tax liabilities. Under the tax restructuring plan, the outstanding tax liabilities shall be repaid quarterly within five years starting from March 2008. The Company's payments excluding interest amounted to RUB 4,646 million (US$ 186.3 million at the CBR official exchange rate as of the payment dates) for the year ended December 31, 2008.

The Company intends to undertake all possible actions to comply with the tax restructuring plan in full.

23. 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, former business units of RAO UES, 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:

	2008	2007	2006
Revenues and Income			
Oil and gas sales	**163**	99	27
Sales of petroleum products and processing fees	**616**	218	148
Support services and other revenues	**83**	13	8
Interest income	**54**	9	25
	916	339	208
Costs and expenses			
Production and operating expenses	**228**	109	17
Pipeline tariffs and transportation costs	**3,410**	2,873	2,032
Other expenses	**88**	73	5
Interest expense	**220**	335	384
Banking fees	**16**	13	13
	3,962	3,403	2,451
Other operations			
Sale of short-term and long-term investments	**1,180**	–	4
Purchase of short-term and long-term investments	**1,693**	–	14
Proceeds from short-term and long-term debt	**2,921**	3,654	2,463
Repayment of short-term and long-term debt	**2,670**	5,675	2,104
Deposits placed	**48**	90	374
Deposits paid	**–**	55	499

23. Related Party Transactions (continued)

	December 31, 2008	December 31, 2007
Assets		
Cash and cash equivalents	**617**	139
Accounts receivable	**158**	87
Prepayments and other current assets	**278**	258
Short-term and long-term investments	**105**	90
	1,158	574
Liabilities		
Accounts payable	**28**	16
Short-term and long-term debt (including interest)	**5,211**	5,322
	5,239	5,338

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:

	2008	2007	2006
Revenues and Income			
Oil and gas sales	**43**	34	31
Sales of petroleum products and processing fees	**227**	158	84
Support services and other revenues	**362**	103	26
Interest income	**11**	44	8
Dividends received	**61**	28	13
	704	367	162
Costs and expenses			
Production and operating expenses	**203**	67	10
Purchase of oil and petroleum products	**774**	621	103
Other expenses	**207**	112	64
Interest expense	**3**	3	4
	1,187	803	181
Other operations:			
Proceeds from short-term and long-term debt	**373**	13	33
Repayment of short-term and long-term debt	**219**	23	51
Borrowings issued	**147**	64	88
Repayment of borrowings issued	**74**	24	22

	December 31, 2008	December 31, 2007
Assets		
Accounts receivable	**132**	204
Prepayments and other current assets	**15**	13
Short-term and long-term investments	**214**	297
	361	514
Liabilities		
Accounts payable	**213**	941
Short-term and long-term debt (including interest)	**297**	235
	510	1,176

24. 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 but not limited to the following: rights to use subsurface resources, environmental matters, site restoration, transportation and export, corporate governance, taxation, etc.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The ongoing 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 financial position, results of operations and business prospects.

In accordance with the legislation, in effect until November 1, 2008, crude export duty was revised by the Russian Government once every two months on the basis of two-month price monitoring for Urals blend on the global markets. A significant gap between the oil price and the export customs duty in the fourth quarter of 2008 had a negative impact on the Company's financial results following the slump in oil prices which had primarily been caused by the global financial crisis resulting in the economic slowdown and a reduced demand for crude oil. Since November 1, 2008, the size of oil export customs duty has been established on the basis of monthly oil price monitoring.

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 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 with significant (by more than 20%) price fluctuations.

24. Commitments and Contingencies (continued)

Taxation (continued)

The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and courts. Due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge the Group's prices and propose an adjustment. If such price adjustments are upheld by the Russian courts and implemented, 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.

The Company is currently challenging a number of decisions made by the tax authorities to accrue additional and decline reimbursement of VAT paid to suppliers in the amount of RUB 8,655 million (US$ 295 million at the CBR official exchange rate as of December 31, 2008) and with respect to excise tax in the amount of RUB 3,609 million (US$ 123 million at the CBR official exchange rate as of December 31, 2008).

The Company's management believes that the outcome of these tax cases 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 embodying economic benefits, 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.

Environmental Matters

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

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

24. Commitments and Contingencies (continued)

Environmental Matters (continued)

Currently it is not possible to reasonably estimate the liabilities of the Company which may be incurred should the legislation be amended.

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

Social Commitments

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.

The Company incurred US$ 52 million, US$ 55 million, and US$ 64 million in social infrastructure and similar expenses in 2008, 2007 and 2006, respectively. These expenses are presented as other expenses in the consolidated statements of income and comprehensive income.

Charity and Sponsorship

During 2008, 2007 and 2006, the Company made donations of US$ 87 million, US$ 117 million, and US$ 41 million, respectively, for charity and sponsorship in various regions of Russia where the Company operates. These expenses are presented as 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 contributes to corporate pension fund to finance non-state pensions of its employees. These payments are made based on the defined contribution plan. In 2008, 2007 and 2006, the Company made contributions to the non-state corporate pension fund amounting to US$ 83 million, US$ 67 million, and US$ 41 million, respectively.

Insurance

The Company insures its assets with OJSC Sogaz, a related party.

As of December 31, 2008 and 2007, the amount of coverage of assets under such insurance amounted to US$ 21,750 million and US$ 11,706 million, respectively.

Guarantees and Indemnity

As of December 31, 2008, 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 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.

24. Commitments and Contingencies (continued)

Guarantees and Indemnity (continued)

In January 2007, the Company signed a guarantee agreement in respect of all the obligations of CJSC Vankorneft per an irrevocable documentary letter of credit for the amount of US$ 62 million and a period of up to 730 days. In the event of default, as specified in the agreement, the bank may request the Company to place a deposit in the amount sufficient to cover all of the Company's existing and potential obligations payable during the period of validity of such letter of credit. As of December 31, 2008, the amount outstanding under the letter of credit was US$ 8.8 million.

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 Kompaniya for the period through January 31, 2010, in the amount of US$ 51 million.

During 2007 and 2008, the Company successfully defended its position in various courts as to the invalidity of guarantees provided by OJSC Yuganskneftegaz, OJSC Samaraneftegaz and OJSC Tomskneft VNK related to the Yukos Oil Company indebtedness of US$ 1,600 million to Moravel Investments Limited. As most of the relevant indebtedness was collected by the principal creditor, the Company has concluded that the probability of any unfavourable outcome in relation to the matter is now remote.

Litigations, Claims and Assessments

Yukos Capital S.a.r.l., a former subsidiary of Yukos Oil Company, initiated arbitral proceedings against the Company and OJSC Samaraneftegaz, the Company's subsidiary, in various courts alleging default under six ruble-denominated loans. The International Court of Commercial Arbitration ("ICCA") at the Russian Federation Chamber of Commerce and Industry and International Court of Arbitration at the International Chamber of Commerce ("ICC") ruled in favour of Yukos Capital S.a.r.l. to award amounts under the loan agreements.

ICCA rulings were cancelled by a Russian court. An Amsterdam Court ruled against enforcement of the said ICCA decisions in the Netherlands (this ruling was appealed by Yukos Capital S.a.r.l, appeals instance decision is awaiting.). Additionally, in 2007 claims were filed to declare the loan agreements null and void. The court hearings for these claims are planned for the first half of 2009. The Company believes that payments in excess of US$ 650 million (see Note 16) are possible, but their amount can not be reasonably estimated.

The Company and its subsidiary are plaintiffs 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$ 44 million at the CBR official exchange rate as of December 31, 2008). The respective accounts receivable in the amount of US$ 23 million (net of allowance in the amount of US$ 21 million) are recorded as long-term receivables in the consolidated balance sheet (see Note 14).

The Company is also a plaintiff in arbitral proceedings against OJSC National Bank TRUST (further 'TRUST') for the repayment under a deposit agreement, which is recorded in the consolidated balance sheet in the amount of RUB 1,802 million (US$ 61 million at the CBR official exchange rate as of December 31, 2008). On June 30, 2008, the court of first instance upheld the full amount of claims filed by Rosneft against TRUST. The decision was upheld by appeal court on December 30, 2008 and then further appealed by TRUST. This amount is recorded in the consolidated balance sheet as acquired receivables (see Note 7). The Company believes that the maximum amount of possible loss is limited by the amounts currently recorded in the consolidated balance sheet.

24. Commitments and Contingencies (continued)

Litigations, Claims and Assessments (continued)

In the second half of 2008 and first quarter 2009, the Federal Antimonopoly Service ("FAS Russia") and its regional bodies ruled that Rosneft and certain companies of the Group violated certain antimonopoly regulations in relation to petroleum products trading. The total amount of administrative penalty asserted as of the financial statements issue date is RUB 1,968 million (US$ 67 million at the CBR official exchange rate as of December 31, 2008). The Company appealed the rulings and believes that payments of some portion of the above penalties are possible, with respect to the above, but the ultimate amount cannot be reasonably estimated.

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.

Oil Supplies

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

25. Segment Information

Presented below is information about the Company's operating segments in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information.* The Company determines its operating segments based on the nature of their operations. The performance of these operating segments is assessed by management on a regular basis. The E&P segment is engaged in field exploration and development and production of crude oil and natural gas. The R&M 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.

25. Segment Information (continued)

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 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**
Operating expenses and cost of purchased oil and petroleum products	**2,447**	**4,288**	**779**	**–**	**7,514**
Depreciation, amortization and depletion of reserves	**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**

Operating segments in 2007:

	Exploration and production	Refining, marketing and distribution	All other	Total elimination	Consolidated
Revenues from external customers	2,145	46,631	440	–	49,216
Intersegmental revenues	9,788	2,197	2,104	(14,089)	–
Total revenues	11,933	48,828	2,544	(14,089)	49,216
Operating expenses and cost of purchased oil and petroleum products	2,634	2,472	374	–	5,480
Depreciation, amortization and depletion of reserves	2,828	374	84	–	3,286
Operating income	4,980	18,052	1,778	(14,089)	10,721
Total other income, net					7,068
Income before tax					17,789
Total assets	41,888	25,445	7,472	–	74,805

25. Segment Information (continued)

Operating segments in 2006:

	Exploration and production	Refining, marketing and distribution	All other	Total elimination	Consolidated
Revenues from external customers	442	32,460	197	–	33,099
Intersegmental revenues	10,465	1,287	903	(12,655)	–
Total revenues	10,907	33,747	1,100	(12,655)	33,099
Operating expenses and cost of purchased oil and petroleum products	1,670	1,635	212	–	3,517
Depreciation, amortization and depletion of reserves	1,420	201	17	–	1,638
Operating income	2,126	15,367	766	(12,655)	5,604
Total other expenses, net					(1,439)
Income before tax					4,165
Total assets	33,934	10,757	2,099	–	46,790

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.

	2008	2007	2006
Oil and gas sales			
Export sales of crude oil – Europe and other directions	**25,648**	20,567	16,323
Export sales of crude oil – Asia	**7,815**	6,255	5,145
Export sales of crude oil – CIS	**2,084**	2,220	1,620
Domestic sales of crude oil	**154**	521	214
Domestic sales of gas	**401**	339	197
Total oil and gas sales	**36,102**	29,902	23,499
Sale of petroleum products			
Export sales of petroleum products – Europe	**9,607**	5,875	3,152
Export sales of petroleum products – Asia	**6,556**	3,476	1,941
Export sales of petroleum products – CIS	**743**	338	202
Domestic sales of petroleum products and processing fees	**14,160**	8,649	3,955
Sales of petrochemical products	**404**	193	–
Total petroleum products sales	**31,470**	18,531	9,250

During the reporting period, the Company had one major customer in 2008, one such customer in 2007 and three such customers in 2006, all being international oil traders which accounted for 10% or more of total revenues. These customers accounted for revenues of US$ 12,422 million, US$ 8,046 million, and US$ 18,001 million or 18%, 16% and 54% 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.

26. Fair Value of Financial Instruments and Risk Management

Effective January 1, 2008, the Company adopted SFAS 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 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. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs when measuring fair value.

SFAS 157 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, 2008			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Current assets				
Trading securities	46	34	–	80
Available-for-sale securities	–	22	–	22
Non-current assets				
Available-for-sale securities	7	4	–	11
Total assets measured at fair value	**53**	**60**	–	**113**
Liabilities:				
Derivative financial instruments	–	(190)	–	(190)
Total liabilities measured at fair value	–	**(190)**	–	**(190)**

The market for a number of financial assets is not active. In accordance with requirements of FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active,* observable inputs of Level 2 were used to disclose fair value of such financial assets.

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

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

	Fair value measurement as of December 31, 2008			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Non-current assets				
Equity method investments	–	–	94	94
Total assets measured at fair value	–	–	**94**	**94**

Equity method investments represent the fair value of the Company's investment in PLC (see Note 10).

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 and accounts payable, other current assets, approximates their carrying value recognized in these financial statements. The Company's management believes that accounts receivable recorded net of allowance for doubtful accounts will be recovered in full during an acceptable time period. The fair value of long-term 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$ 14,153 million and US$ 14,911 million as of December 31, 2008 and 2007, respectively. These amounts include all future cash outflows related to the repayment of long-term loans, including their current portion and interest expenses.

A substantial portion of the Company's sales revenues is received in US dollars. In addition, substantial financing and investing activities, obligations and commitments are also undertaken in US dollars. However, significant operating and investing expenditures, other obligations and commitments as well as tax liabilities are 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 increased interest expense accrued on loans received by the Company. Hedge accounting pursuant to SFAS 133 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 commencing in one year after the contract date. The fair value of the interest swap contract was recorded in the consolidated balance sheets as of December 31, 2008 and December 31, 2007 as other current liabilities in the amount of US$ 189.8 million and US$ 13.5 million, respectively. The change in fair value was recorded in the consolidated statement of income and comprehensive income for 2008 as a component of interest expense in the amount of US$ 176.3 million.

26. 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 in two years after the contract date. The fair value of the interest swap contract was recorded in the consolidated balance sheet as of December 31, 2008 as other non-current liabilities in the amount of US$ 0.8 million. The change in fair value was recorded in the consolidated statement of income and comprehensive income for 2008 as a component of interest expense in the amount of US$ 0.8 million.

The fair value of the interest rate swap contracts are based on estimated amounts that the Company would pay or receive upon termination of the contract as of December 31, 2008.

27. Subsequent Events

In January 2009, Rosneft raised a syndicated floating rate loan in the amount of US$ 1.35 billion which is repayable within 15 months and secured by oil export contracts.

In February 2009, Rosneft secured and agreed principle terms of a long-term floating rate loan from a foreign bank in the amount of up to US$ 15 billion. The loan is repayable within 20 years and secured by oil export contracts.

Supplementary Oil and Gas Disclosure (unaudited)

In accordance with SFAS 69, *Disclosures about Oil and Gas Producing Activities*, 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.

All of the Company's activities are conducted in Russia, which is considered as one geographic area.

Capitalized Costs Relating to Oil and Gas Producing Activities

	As of December 31	
	2008	**2007**
Oil and gas properties related to proved reserves	**50,639**	43,708
Oil and gas properties related to unproved reserves	**4,149**	4,165
Total	**54,788**	47,873
Accumulated depreciation, depletion and amortization, and valuation allowances	**(10,860)**	(7,942)
Net capitalized costs	**43,928**	39,931

The share of the Company in the capitalized costs of equity investees on December 31, 2008 and December 31, 2007 was US$ 2,605 million and US$ 2,331 million, respectively.

Net book value of mineral rights on December 31, 2008 and December 31, 2007 was US$ 17.5 billion and US$ 17.7 billion, respectively.

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

	2008	**2007**	**2006**
Acquisition of proved oil and gas properties	**246**	4,825	8,392
Acquisition of unproved oil and gas properties	**264**	287	2,350
Exploration costs	**248**	162	193
Development costs	**6,405**	4,624	2,795
Total costs incurred	**7,163**	9,898	13,730

The share of the Company in acquisition, exploration and development expenditures of its equity investees was US$ 483 million, US$ 440 million and US$ 46 million in 2008, 2007 and 2006, respectively.

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Results of Operations for Oil & Gas Producing Activities

	2008	2007	2006
Revenues:			
External sales	**18,712**	15,896	11,246
Transfers to other operations	**16,308**	11,006	5,216
Total revenues	**35,020**	26,902	16,462
Production costs (excluding production taxes)	**1,976**	2,638	1,632
Selling, general and administrative expenses	**771**	729	480
Exploration expenses	**248**	162	193
Accretion expense	**120**	78	34
Depreciation, depletion and amortization	**3,060**	2,828	1,420
Taxes other than income tax	**13,261**	9,772	6,636
Income tax	**1,779**	2,173	1,384
Results of operation for producing activities	**13,805**	8,522	4,683

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 2008, 2007 and 2006 was US$ 437 million, US$ 256 million and US$ 59 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, 2008, 2007 and 2006 were appraised by an outside unrelated third-party petroleum engineering consulting firm. Proved reserves are those estimated quantities of crude oil and gas which, by analysis of geological and engineering data, demonstrate with reasonable certainty to be recoverable in the future from existing reservoirs under the existing economic and operating conditions. 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 or may be discovered as a result of secondary and tertiary extraction which have been successfully tested and checked for commercial benefit. Proved developed reserves are the quantities of crude oil and gas expected to be recovered from existing wells using existing equipment and operating methods.

Proved undeveloped oil and gas reserves are 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 drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. 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 tests in the area and in the same reservoir. Due to inherent industry uncertainties and the limited nature of deposit data, estimates of reserves are subject to change as additional information becomes available.

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Reserve Quantity Information (continued)

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 2009 and 2044, and the licences for the most important deposits expire between 2013 and 2044. 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 11).

The Company's estimates of net proved oil and gas reserves and changes thereto for the years ended December 31, 2008, 2007 and 2006 are shown in the table below and expressed in million barrels of oil equivalent (oil production data was recalculated from tonnes to barrels using a ratio of 7.3 barrels per tonne, gas production data was recalculated from cubic meters to barrels of oil equivalent using a ratio of 35.3/6 cubic meters per barrel):

	2008	**2007**	**2006**
	mln. boe.	*mln. boe.*	*mln. boe.*
Beginning of year reserves	**13,538**	12,671	11,813
Revisions of previous estimates	**(244)**	62	1,142
Extension and discovery of new reserves	**837**	558	297
Acquisitions of new properties	**–**	1,039	74
Production	**(771)**	(792)	(655)
End of year reserves	**13,360**	13,538	12,671
Of which:			
Proved reserves under PSA Sakhalin 1	**80**	62	71
Proved developed reserves	**10,032**	10,456	9,891
Minority interest in total proved reserves	**38**	22	15
Minority interest in proved developed reserves	**12**	15	15

The Company's share in the proved reserves of equity investees in 2008, 2007 and 2006 was 1,086 million barrels of oil equivalent, 915 million barrels of oil equivalent and 330 million barrels of oil equivalent, respectively.

The Company's share in the proved developed reserves of equity investees in 2008, 2007 and 2006 was 763 million barrels of oil equivalent, 689 million barrels of oil equivalent and 281 million barrels of oil equivalent, respectively.

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

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 SFAS 69. Estimated future cash inflows from oil and gas production are computed by applying year-end prices 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.

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 SFAS 69 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.

	2008	2007	2006
Future cash inflows	**223,464**	551,015	308,051
Future development costs	**(18,353)**	(20,656)	(16,426)
Future production costs	**(107,242)**	(261,712)	(154,045)
Future income tax expenses	**(15,585)**	(64,589)	(31,991)
Future net cash flows	**82,284**	204,058	105,589
Discount of estimated timing of cash flows	**(46,783)**	(121,681)	(64,019)
Discounted value of future cash flows as of the end of year	**35,501**	82,377	41,570

	2008	2007	2006
Discounted value of future cash flows as of the beginning of year	**82,377**	41,570	51,157
Sales and transfers of oil and gas produced, net of production costs and taxes other than income taxes	**(19,012)**	(12,154)	(7,714)
Changes in price estimates, net	**(71,008)**	45,039	(22,018)
Changes in future development costs	**3,902**	(3,693)	(4,084)
Development costs incurred during the period	**6,411**	4,500	2,795
Revisions of previous reserves estimates	**(275)**	2,207	4,034
Discovery of new reserves, less respective expenses	**2,376**	3,213	1,177
Net change in income taxes	**19,976**	(11,761)	3,580
Accretion of discount	**8,238**	4,157	5,116
Purchase of new oil and gas fields	**–**	7,395	1,464
Other	**2,516**	1,904	6,063
Discounted value of future cash flows as of the end of year	**35,501**	82,377	41,570

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 Company's share in the discounted value of future cash flows related to the oil and gas reserves of equity investees in 2008, 2007 and 2006 was US$ 3,352 million, US$ 9,324 million and US$ 1,086 million, respectively.

The discounted value of future cash flows as of December 31, 2008, 2007 and 2006 includes the interest of other (minority) shareholders in the amount of US$ 142 million, US$ 114 million and US$ 25 million, respectively.