LUKOIL

OAO LUKOIL

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(prepared in accordance with US GAAP)

As of and for the three-month period ended March 31, 2013

(unaudited)

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

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Independent Auditors' Review Report

The Board of Directors

OAO Lukoil:

Report on the Financial Statements

We have reviewed the accompanying consolidated balance sheet of OAO LUKOIL and its subsidiaries as of March 31, 2013, and the related consolidated statements of comprehensive income, stockholders' equity and cash flows for the three-month periods ended March 31, 2013 and 2012.

Management's Responsibility

The Company's management is responsible for the preparation and fair presentation of the interim financial information in accordance with U.S. generally accepted accounting principles; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with U.S. generally accepted accounting principles.

Auditors' Responsibility

Our responsibility is to conduct our reviews in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Entity: Open Joint Stock Company "Oil company "LUKOIL"

Registered by Moscow Registration Chamber on 22 of April 1993, Registration No. 024020.

Entered in the Unified State Register of Legal Entities on 17 July 2002 by Department of the Ministry of Taxes and Duties, Registration No. 1027700035769, Certificate series 77 No 007892347

11, Sretensky Boulevard, Moscow, Russia, 101000

Practitioner: ZAO KPMG, a company incorporated under the Laws of the Russian Federation, a part of the KPMG Europe LLP group, and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Registered by the Moscow Registration Chamber on 25 May 1992, Registration No. 011.585.

Entered in the Unified State Register of Legal Entities on 13 August 2002 by the Moscow Inter-Regional Tax Inspectorate No.39 of the Ministry for Taxes and Duties of the Russian Federation, Registration No. 1027700125628, Certificate series 77 No. 005721432.

Member of the Non-commercial Partnership "Chamber of Auditors of Russia". The Principal Registration Number of the Entry in the State Register of Auditors and Audit Organisations: No.10301000804.

Conclusion

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with U.S. generally accepted accounting principles.

Sloutsky E.A.

Director, power of attorney No. 49/10 dated October 1, 2010

ZAO KPMG

May 22, 2013

Moscow, Russian Federation

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

	Note	As of March 31, 2013 (unaudited)	As of December 31, 2012
Assets			
Current assets			
Cash and cash equivalents	4	2,681	2,914
Short-term investments		301	286
Accounts receivable, net	5	8,641	8,667
Inventories		7,848	8,098
Prepaid taxes and other expenses		3,038	3,541
Other current assets		866	767
Total current assets		**23,375**	**24,273**
Investments	6	4,157	4,124
Property, plant and equipment	7, 8	69,640	66,883
Deferred income tax assets		593	569
Goodwill and other intangible assets	9	1,946	1,964
Other non-current assets		1,463	1,148
Total assets		**101,174**	**98,961**
Liabilities and equity			
Current liabilities			
Accounts payable		6,576	7,263
Short-term borrowings and current portion of long-term debt	10	627	658
Taxes payable		3,075	2,802
Other current liabilities		1,650	1,730
Total current liabilities		**11,928**	**12,453**
Long-term debt	11, 14	5,989	5,963
Deferred income tax liabilities		3,776	3,651
Asset retirement obligations	7	2,212	2,195
Other long-term liabilities		496	511
Total liabilities		**24,401**	**24,773**
Equity	13		
OAO LUKOIL stockholders' equity			
Common stock		15	15
Treasury stock, at cost		(5,189)	(5,189)
Equity-linked notes		(2,500)	(2,500)
Additional paid-in capital		4,733	4,734
Retained earnings		78,797	76,216
Accumulated other comprehensive loss		(65)	(69)
Total OAO LUKOIL stockholders' equity		**75,791**	**73,207**
Non-controlling interests		982	981
Total equity		**76,773**	**74,188**
Total liabilities and equity		**101,174**	**98,961**

First executive vice-president of OAO LUKOIL
Maganov R.U.

Vice-president – Chief accountant of OAO LUKOIL
Khoba L.N.

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

OAO LUKOIL
Consolidated Statements of Comprehensive Income
(Millions of US dollars, unless otherwise noted)

	Note	For the three months ended March 31, 2013 (unaudited)	For the three months ended March 31, 2012 (unaudited)
Revenues			
Sales (including excise and export tariffs)	20	33,770	35,261
Costs and other deductions			
Operating expenses		(2,450)	(2,215)
Cost of purchased crude oil, gas and products		(15,103)	(16,368)
Transportation expenses		(1,650)	(1,605)
Selling, general and administrative expenses		(866)	(829)
Depreciation, depletion and amortization		(1,369)	(1,095)
Taxes other than income taxes		(3,383)	(3,478)
Excise and export tariffs		(5,501)	(5,577)
Exploration expenses		(63)	(43)
Loss on disposals and impairments of assets		(7)	(9)
Income from operating activities		**3,378**	**4,042**
Interest expense		(97)	(161)
Interest and dividend income		61	66
Equity share in income of affiliates	6	158	181
Currency translation loss		(139)	(86)
Other non-operating income (expense)		13	(22)
Income before income taxes		**3,374**	**4,020**
Current income taxes		(646)	(487)
Deferred income taxes		(143)	120
Total income tax expense	3	**(789)**	**(367)**
Net income		**2,585**	**3,653**
Net (income) loss attributable to non-controlling interests		(4)	136
Net income attributable to OAO LUKOIL		**2,581**	**3,789**
Earnings per share of common stock attributable to OAO LUKOIL (US dollars):	13		
Basic		3.42	4.90
Diluted		3.35	4.80
Other comprehensive income, net of tax:			
Defined benefit pension plan:			
Prior service cost arising during the period		4	3
Other comprehensive income		**4**	**3**
Comprehensive income		**2,589**	**3,656**
Comprehensive (income) loss attributable to non-controlling interests		(4)	136
Comprehensive income attributable to OAO LUKOIL		**2,585**	**3,792**

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

OAO LUKOIL
Consolidated Statements of Stockholders' Equity (unaudited)
(Millions of US dollars, unless otherwise noted)

	Common stock	Treasury stock	Equity-linked notes	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total OAO LUKOIL stockholders' equity	Non-controlling interests	Total equity
Three months ended March 31, 2013									
Balances as of December 31, 2012	15	(5,189)	(2,500)	4,734	76,216	(69)	**73,207**	981	**74,188**
Net income	-	-	-	-	2,581	-	**2,581**	4	**2,585**
Other comprehensive income	-	-	-	-	-	4	**4**	-	**4**
Comprehensive income					**2,581**	**4**	**2,585**	**4**	**2,589**
Changes in non-controlling interests	-	-	-	(1)	-	-	**(1)**	(3)	**(4)**
Balances as of March 31, 2013	**15**	**(5,189)**	**(2,500)**	**4,733**	**78,797**	**(65)**	**75,791**	**982**	**76,773**
Three months ended March 31, 2012									
Balances as of December 31, 2011	15	(4,081)	(980)	4,798	67,940	(54)	**67,638**	(172)	**67,466**
Net income (loss)	-	-	-	-	3,789	-	**3,789**	(136)	**3,653**
Other comprehensive income	-	-	-	-	-	3	**3**	-	**3**
Comprehensive income (loss)					**3,789**	**3**	**3,792**	**(136)**	**3,656**
Effect of stock compensation plan	-	-	-	25	-	-	**25**	-	**25**
Stock purchased	-	(128)	-	-	-	-	**(128)**	-	**(128)**
Balances as of March 31, 2012	**15**	**(4,209)**	**(980)**	**4,823**	**71,729**	**(51)**	**71,327**	**(308)**	**71,019**

	Share activity (thousands of shares)	
	Common stock	**Treasury stock**
Three months ended March 31, 2013		
Balance as of December 31, 2012	850,563	(95,697)
Balance as of March 31, 2013	**850,563**	**(95,697)**
Three months ended March 31, 2012		
Balance as of December 31, 2011	850,563	(76,101)
Stock purchased	-	(2,096)
Balance as of March 31, 2012	**850,563**	**(78,197)**

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

OAO LUKOIL
Consolidated Statements of Cash Flows
(Millions of US dollars)

	Note	For the three months ended March 31, 2013 (unaudited)	For the three months ended March 31, 2012 (unaudited)
Cash flows from operating activities			
Net income attributable to OAO LUKOIL		**2,581**	**3,789**
Adjustments for non-cash items:			
Depreciation, depletion and amortization		1,369	1,095
Equity share in income of affiliates, net of dividends received		(31)	(57)
Dry hole write-offs		1	10
Loss on disposals and impairments of assets		7	9
Deferred income taxes		143	(120)
Non-cash currency translation (gain) loss		(44)	377
Non-cash investing activities		(6)	(2)
All other items – net		(2)	(90)
Changes in operating assets and liabilities:			
Trade accounts receivable		16	(1,425)
Inventories		(41)	(540)
Accounts payable		(689)	(435)
Taxes payable		273	732
Other current assets and liabilities		323	537
Net cash provided by operating activities		**3,900**	**3,880**
Cash flows from investing activities			
Acquisition of licenses		(838)	(1)
Capital expenditures		(3,285)	(2,421)
Proceeds from sale of property, plant and equipment		20	12
Purchases of investments		(62)	(67)
Proceeds from sale of investments		27	22
Sale of subsidiaries, net of cash disposed		80	4
Acquisitions of subsidiaries and equity method affiliates, net of cash acquired		(7)	(66)
Net cash used in investing activities		**(4,065)**	**(2,517)**
Cash flows from financing activities			
Net movements of short-term borrowings		26	109
Proceeds from issuance of long-term debt		42	-
Principal repayments of long-term debt		(75)	(96)
Dividends paid to non-controlling interest stockholders		(28)	(21)
Purchase of Company’s stock		-	(128)
All other items – net		(6)	(1)
Net cash used in financing activities		**(41)**	**(137)**
Effect of exchange rate changes on cash and cash equivalents		(27)	163
Net (decrease) increase in cash and cash equivalents		**(233)**	**1,389**
Cash and cash equivalents at beginning of period		2,914	2,753
Cash and cash equivalents at end of period	4	**2,681**	**4,142**

Supplemental disclosures of cash flow information			
Interest paid		11	78
Income taxes paid		245	453

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

Note 1. Organization and environment

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

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

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

Business and economic environment

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

Basis of preparation

The accompanying interim consolidated financial statements and notes thereto have not been audited by independent accountants, except for the balance sheet as of December 31, 2012. In the opinion of the Company's management, the interim consolidated financial statements include all adjustments and disclosures necessary to present fairly the Group's financial position, results of operations and cash flows for the interim periods reported herein. These adjustments were of a normal recurring nature.

These interim consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("US GAAP") as applicable to interim consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the Group's December 31, 2012 annual consolidated financial statements.

The results for the three-month period ended March 31, 2013 are not necessarily indicative of the results expected for the full year.

Note 2. Summary of significant accounting policies

Principles of consolidation

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

Note 2. Summary of significant accounting policies (continued)

Use of estimates

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

Revenues

Revenues are recognized when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed or determinable. Revenues include excise on petroleum products' sales and duties on export sales of crude oil and petroleum products.

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

Foreign currency translation

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

For the majority of operations in the Russian Federation and outside the Russian Federation, the US dollar is the functional currency. Where the US dollar is the functional currency, monetary assets and liabilities have been translated into US dollars at the rate prevailing at each balance sheet date. Non-monetary assets and liabilities have been translated into US dollars at historical rates. Revenues, expenses and cash flows have been translated into US dollars at rates which approximate actual rates at the date of the transaction. Translation differences resulting from the use of these rates are included in profit or loss.

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

In all cases, foreign currency transaction gains and losses are included in profit or loss.

As of March 31, 2013 and December 31, 2012, exchange rates of 31.08 and 30.37 Russian rubles to the US dollar, respectively, have been used for translation purposes.

Cash and cash equivalents

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

Cash with restrictions on immediate use

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

Note 2. Summary of significant accounting policies (continued)

Accounts receivable

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

Inventories

The cost of finished goods and purchased products is determined using the first-in, first-out cost method (FIFO). The cost of all other inventory categories is determined using the "average cost" method.

Investments

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

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

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

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

Property, plant and equipment

Oil and gas properties are accounted for using the successful efforts method of accounting whereby property acquisitions, successful exploratory wells, all development costs (including development dry holes and the Group's share of operators' expenses during the development stage of production sharing and risk service contracts), and support equipment and facilities are capitalized. Unsuccessful exploratory wells are expensed when a well is determined to be non-productive. Other exploratory expenditures, including geological and geophysical costs are expensed as incurred.

The Group continues to capitalize costs of exploratory wells and exploratory-type stratigraphic wells for more than one year after the completion of drilling if the well has found a sufficient quantity of reserves to justify its completion as a producing well and the Company is making sufficient progress towards assessing the reserves and the economic and operating viability of the project. If these conditions are not met or if information that raises substantial doubt about the economic or operational viability of the project is obtained, the well would be assumed impaired, and its costs, net of any salvage value, would be charged to expense.

Note 2. Summary of significant accounting policies (continued)

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

Production and related overhead costs are expensed as incurred.

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

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

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

Significant unproved properties are assessed for impairment individually on a regular basis and any estimated impairment is charged to expense.

Asset retirement obligations

The Group records the fair value of liabilities related to its legal obligations to abandon, dismantle or otherwise retire tangible long-lived assets in the period in which the liability is incurred. A corresponding increase in the carrying amount of the related long-lived asset is also recorded. Subsequently, the liability is accreted for the passage of time and the related asset is depreciated using the unit-of-production method.

Goodwill and other intangible assets

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

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

Impairment of long-lived assets

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

Note 2. Summary of significant accounting policies (continued)

Income taxes

Deferred income tax assets and liabilities are recognized in respect of the future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purposes of the consolidated financial statements and their respective tax bases and in respect of operating loss and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse and the assets be recovered and liabilities settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in profit or loss in the reporting period which includes the enactment date. The estimated effective income tax rate expected to be applicable for the full fiscal year is used in providing for income taxes on a current year-to-date basis.

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income in the reporting periods in which the originating expenditure becomes deductible. In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that the deferred income tax assets will be realized. In making this assessment, management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies.

An income tax position is recognized only if the uncertain position is more likely than not of being sustained upon examination, based on its technical merits. A recognized income tax position is measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties relating to income tax in income tax expense.

Interest-bearing borrowings

Interest-bearing borrowings from third parties (except convertible notes) are initially recorded at the value of net proceeds received. Any difference between the net proceeds and the redemption value is amortized at a constant rate over the term of the borrowing. Amortization is included in profit or loss and the carrying amounts are adjusted as amortization accumulates.

For borrowings from related parties (except convertible notes) issued with an interest rate lower than the market interest rate, the Group determines book value using a market interest rate at the moment the borrowing is made. The resulting difference is allocated to additional paid-in capital and is amortized at a constant rate over the term of the borrowings. Amortization is included in profit or loss each period and the carrying amounts are adjusted as amortization accumulates.

For convertible notes issued with a cash conversion option, the Group allocates the proceeds from issuance between a liability component and an equity component. The Group records the equity component at an amount equal to the difference between the proceeds received and the fair value of the liability component, measured as the fair value of a similar liability that does not have an associated equity component. The Group recognizes the interest cost in subsequent periods at its borrowing rate for non-convertible debt.

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

Pension benefits

The expected costs in respect of pension obligations of Group companies are determined by management based on the amount of pension obligations for the previous financial year calculated by an independent actuary. Obligations in respect of each employee are accrued over the periods during which the employee renders service in the Group.

Note 2. Summary of significant accounting policies (continued)

Treasury stock

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

Earnings per share

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

Contingencies

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

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

Environmental expenditures

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

Use of derivative instruments

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

Share-based payments

The Group accounts for liability classified share-based payment awards to employees at fair value on the grant date and as of each reporting date. Expenses are recognized over the vesting period. Equity classified share-based payment awards to employees are valued at fair value on the grant date and expensed over the vesting period.

Comparative amounts

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

Note 2. Summary of significant accounting policies (continued)

Changes in accounting policy

In December 2011, the FASB issued ASU No. 2011-11, *"Disclosures about Offsetting Assets and Liabilities."* This ASU requires entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The Group adopted the requirements of ASU No. 2011-11 starting from the first quarter of 2013. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

In February 2013, the FASB issued ASU No. 2013-02, *"Comprehensive Income (Topic 220)*," that requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. An entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under US GAAP to be reclassified to net income in its entirety in the same reporting period. ASU No. 2013-02 is effective for reporting periods beginning after December 15, 2012. The Group adopted the requirements of ASU No. 2013-02 starting from the first quarter of 2013. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

Recent accounting pronouncements

In March 2013, the FASB issued ASU No. 2013-05, *"Foreign Currency Matters (Topic 830)*," that requires entities to apply the guidance in Subtopic 830-30 to release any related cumulative translation adjustment into net income when a reporting entity ceases to have financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. Additionally, the amendments in this ASU clarify that the sale of an investment in a foreign entity includes both (1) events that result in the loss of a controlling financial interest in a foreign entity and (2) events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date (sometimes also referred to as a step acquisition). Accordingly, the cumulative translation adjustment should be released into net income upon occurrence of those events. ASU No. 2013-05 is effective for annual reporting periods beginning after December 15, 2013, and interim periods within those annual periods, and should be applied prospectively.

Note 3. Income taxes

Operations in the Russian Federation are subject to a Federal income tax rate of 2.0% and a regional income tax rate that varies from 13.5% to 18.0% at the discretion of the individual regional administration. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

The Group's effective income tax rate for the periods presented differs from the statutory income tax rate primarily due to domestic and foreign rate differences, the incurrence of costs that are either not tax deductible or only deductible to a certain limit and taxable or deductible income or loss on foreign currency translation differences of Russian Group companies.

The Company and its Russian subsidiaries file income tax returns in Russia. Tax losses may be fully or partially used to offset taxable profits in the same company in any of the ten years following the year of loss. Until January 1, 2012, there were no provisions in the tax legislation of the Russian Federation to permit the Group to reduce taxable profits of a Group company by offsetting tax losses of another Group company against such profits.

(Millions of US dollars, unless otherwise noted)

Note 3. Income taxes (continued)

Starting from January 1, 2012, if certain conditions are met, taxpayers are able to pay income tax as a consolidated taxpayers' group ("CTG"). This allows taxpayers to offset taxable losses generated by certain participants of a CTG against taxable profits of other participants of the CTG. Certain Group companies met the legislative requirements and paid income tax as a CTG starting from the first quarter of 2012.

Losses generated by a taxpayer before joining a CTG are not available for offset against taxable profits of other participants of the CTG. However, if a taxpayer leaves a CTG, such losses again become available for offset against future profits generated by the same taxpayer. The expiration period of the losses is extended to take account of any time spent within a CTG when the losses were unavailable for use.

Note 4. Cash and cash equivalents

	As of March 31, 2013	As of December 31, 2012
Cash held in Russian rubles	1,023	571
Cash held in US dollars	1,071	1,816
Cash held in other currencies	432	403
Cash held in related party banks in Russian rubles	149	117
Cash held in related party banks in other currencies	6	7
Total cash and cash equivalents	**2,681**	**2,914**

Note 5. Accounts receivable, net

	As of March 31, 2013	As of December 31, 2012
Trade accounts receivable (net of provisions of $236 million and $247 million as of March 31, 2013 and December 31, 2012, respectively)	6,363	6,431
Current VAT and excise recoverable	1,937	1,862
Other current accounts receivable (net of provisions of $51 million and $57 million as of March 31, 2013 and December 31, 2012, respectively)	341	374
Total accounts receivable, net	**8,641**	**8,667**

Note 6. Investments

	As of March 31, 2013	As of December 31, 2012
Investments in equity method affiliates and joint ventures	2,825	2,794
Long-term loans to equity method affiliates and joint ventures	1,320	1,312
Other long-term investments	12	18
Total long-term investments	**4,157**	**4,124**

Investments in equity method affiliates and corporate joint ventures

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

(Millions of US dollars, unless otherwise noted)

Note 6. Investments (continued)

	For the three months ended March 31, 2013		For the three months ended March 31, 2012	
	Total	Group's share	Total	Group's share
Revenues	7,970	788	8,259	1,233
Income before income taxes	4,127	259	3,446	255
Less income taxes	(1,610)	(101)	(1,064)	(74)
Net income	**2,517**	**158**	**2,382**	**181**

	As of March 31, 2013		As of December 31, 2012	
	Total	Group's share	Total	Group's share
Current assets	7,120	1,049	6,399	983
Property, plant and equipment	19,117	4,033	18,738	4,015
Other non-current assets	561	172	523	167
Total assets	26,798	5,254	25,660	5,165
Short-term debt	1,199	269	1,182	277
Other current liabilities	4,114	639	3,409	496
Long-term debt	7,782	1,271	7,717	1,256
Other non-current liabilities	1,297	250	1,406	342
Net assets	**12,406**	**2,825**	**11,946**	**2,794**

In April 2011, the Company and OAO ANK Bashneft signed an agreement to establish a joint venture and to develop two oil fields named after R.Trebs and A.Titov, located in the Nenets Autonomous District of Russia. According to the agreement, the mineral rights for the development of the fields were re-issued by OAO ANK Bashneft in favor of its 100% subsidiary OOO Bashneft-Polus. In December 2011, the Company acquired 25.1% of OOO Bashneft-Polus for $153 million, and OOO Bashneft-Polus acquired 29 exploration wells located on these fields from a Group company for $60 million. The parties agreed to transport oil extracted from the fields via the Group's transportation infrastructure and to consider the exploitation of certain other nearby infrastructure owned by the Group. In May 2012, state authorities cancelled the order to transfer the mineral rights for the development of the fields named after R.Trebs and A.Titov to the joint venture and the license was returned to OAO ANK Bashneft. Management does not believe that this matter will have a material adverse effect on the Group's financial condition. The Company and OAO ANK Bashneft are continuing cooperation within the project and are carrying out actions for re-issuance of the mineral rights by the state authorities in favor of OOO Bashneft-Polus.

Note 7. Property, plant and equipment and asset retirement obligations

	At cost		Net	
	As of March 31, 2013	As of December 31, 2012	As of March 31, 2013	As of December 31, 2012
Exploration and Production:				
Russia	64,111	61,541	41,381	39,391
International	10,358	9,700	8,027	7,487
Total	74,469	71,241	49,408	46,878
Refining, Marketing, Distribution and Chemicals:				
Russia	13,638	13,182	8,006	7,841
International	10,439	10,297	7,384	7,375
Total	24,077	23,479	15,390	15,216
Power generation and other:				
Russia	5,806	5,621	4,602	4,501
International	389	429	240	288
Total	6,195	6,050	4,842	4,789
Total property, plant and equipment	**104,741**	**100,770**	**69,640**	**66,883**

(Millions of US dollars, unless otherwise noted)

Note 7. Property, plant and equipment and asset retirement obligations (continued)

As of March 31, 2013 and December 31, 2012, the asset retirement obligations amounted to $2,217 million and $2,200 million of which $5 million was included in "Other current liabilities" in the consolidated balance sheets as of each balance sheet date.

During the three-month periods ended March 31, 2013 and 2012, asset retirement obligations changed as follows:

	For the three months ended March 31, 2013	For the three months ended March 31, 2012
Asset retirement obligations as of January 1	2,200	2,126
Accretion expense	45	41
New obligations	9	28
Changes in estimates of existing obligations	13	3
Spending on existing obligations	(1)	(1)
Property dispositions	(1)	(6)
Foreign currency translation and other adjustments	(48)	133
Asset retirement obligations as of March 31	**2,217**	**2,324**

The asset retirement obligations incurred during the three-month periods ended March 31, 2013 and 2012 were Level 3 (unobservable inputs) fair value measurements.

Note 8. Suspended wells

During the three-month period ended March 31, 2013, total suspended exploratory well costs capitalized changed insignificantly ($527 million and $524 million as of March 31, 2013 and December 31, 2012, respectively). Suspended exploratory well costs capitalized for a period greater than one year amounted to $503 million as of March 31, 2013 and December 31, 2012. No capitalized exploratory well costs were charged to expenses during the three-month period ended March 31, 2013.

Note 9. Goodwill and other intangible assets

The carrying value of goodwill and other intangible assets as of March 31, 2013 and December 31, 2012 was as follows:

	As of March 31, 2013	As of December 31, 2012
Amortized intangible assets		
Software	408	419
Licenses and other assets	269	276
Goodwill	1,269	1,269
Total goodwill and other intangible assets	**1,946**	**1,964**

All goodwill relates to the refining, marketing and distribution segment. During the three-month period ended March 31, 2013, there were no changes in goodwill.

Note 10. Short-term borrowings and current portion of long-term debt

	As of March 31, 2013	As of December 31, 2012
Short-term borrowings from third parties	148	113
Short-term borrowings from related parties	5	13
Current portion of long-term debt	474	532
Total short-term borrowings and current portion of long-term debt	**627**	**658**

(Millions of US dollars, unless otherwise noted)

Note 10. Short-term borrowings and current portion of long-term debt (continued)

Short-term borrowings from third parties are unsecured and include amounts repayable in US dollars of $54 million and $54 million, amounts repayable in euros of $10 million and $11 million and amounts repayable in other currencies of $84 million and $48 million as of March 31, 2013 and December 31, 2012, respectively. The weighted-average interest rate on short-term borrowings from third parties was 5.63% and 5.75% per annum as of March 31, 2013 and December 31, 2012, respectively.

Note 11. Long-term debt

	As of March 31, 2013	As of December 31, 2012
Long-term loans and borrowings from third parties	1,261	1,287
6.375% non-convertible US dollar bonds, maturing 2014	898	898
2.625% convertible US dollar bonds, maturing 2015	1,442	1,436
6.356% non-convertible US dollar bonds, maturing 2017	500	500
7.250% non-convertible US dollar bonds, maturing 2019	597	596
6.125% non-convertible US dollar bonds, maturing 2020	998	998
6.656% non-convertible US dollar bonds, maturing 2022	500	500
7.40% Russian ruble bonds, maturing 2013	193	198
Capital lease obligations	74	82
Total long-term debt	6,463	6,495
Current portion of long-term debt	(474)	(532)
Total non-current portion of long-term debt	**5,989**	**5,963**

Long-term loans and borrowings

Long-term loans and borrowings from third parties include amounts repayable in US dollars of $1,025 million and $1,037 million, amounts repayable in euros of $216 million and $230 million and amounts repayable in other currencies of $20 million and $20 million as of March 31, 2013 and December 31, 2012, respectively. This debt has maturity dates from 2013 through 2023. The weighted-average interest rate on long-term loans and borrowings from third parties was 2.36% and 2.28% per annum as of March 31, 2013 and December 31, 2012, respectively. A number of long-term loan agreements contain certain financial covenants which are being met by the Group. Approximately 37% of total long-term loans and borrowings are secured by export sales and property, plant and equipment.

US dollar convertible bonds

In December 2010, a Group company issued unsecured convertible bonds totaling $1.5 billion with a coupon yield of 2.625% and maturity in June 2015. The bonds were placed at face value. The bonds are convertible into LUKOIL ADRs (each representing one ordinary share of the Company) and currently have a conversion price of $71.08 per ADR. Bondholders have the right to convert the bonds into LUKOIL ADRs during the period starting from 40 days after the issue date and ending 6 dealing days before the maturity date. The issuer has the right to redeem the bonds after December 31, 2013.

US dollar non-convertible bonds

In November 2010, a Group company issued two tranches of non-convertible bonds totaling $1.0 billion with a coupon yield of 6.125% and maturity in 2020. The first tranche totaling $800 million was placed at a price of 99.081% of the bond’s face value with a resulting yield to maturity of 6.250%. The second tranche totaling $200 million was placed at a price of 102.44% of the bond’s face value with a resulting yield to maturity of 5.80%. All bonds have a half year coupon period.

Note 11. Long-term debt (continued)

In November 2009, a Group company issued two tranches of non-convertible bonds totaling $1.5 billion. The first tranche totaling $900 million with a coupon yield of 6.375% per annum was placed with a maturity of 5 years at a price of 99.474% of the bond's face value with a resulting yield to maturity of 6.500%. The second tranche totaling $600 million with a coupon yield of 7.250% per annum was placed with a maturity of 10 years at a price of 99.127% of the bond's face value with a resulting yield to maturity of 7.375%. All bonds have a half year coupon period.

In June 2007, a Group company issued non-convertible bonds totaling $1.0 billion. $500 million were placed with a maturity of 10 years and a coupon yield of 6.356% per annum. Another $500 million were placed with a maturity of 15 years and a coupon yield of 6.656% per annum. All bonds were placed at face value and have a half year coupon period.

Russian ruble bonds

In December 2006, the Company issued 6 million non-convertible bonds with a face value of 1,000 Russian rubles each. The bonds were placed at face value with a maturity of 7 years and a coupon yield of 7.40% per annum. The bonds have a half year coupon period.

Note 12. Pension benefits

The Group sponsors a postretirement defined benefit pension program that covers the majority of the Group's employees. One type of pension plan is based on years of service, final remuneration levels as of the end of 2003 and employee gratitude, received during the period of work. The other type of pension plan is based on the salary. These plans are solely financed by Group companies. Simultaneously employees have the right to receive pension benefits with a share-based payment by the Group (up to 4% of the annual salary of the employee). Plan assets and pensions payoffs are managed by a non-state pension fund, LUKOIL-GARANT.

The Group also provides several long-term social benefits, including lump-sum death-in-service benefit, in case of disability and upon retirement payments. Also certain payments are received by retired employees upon reaching a certain old age and invalidity.

Components of net periodic benefit cost were as follows:

	For the three months ended March 31, 2013	**For the three months ended March 31, 2012**
Service cost	4	4
Interest cost	5	5
Less expected return on plan assets	(2)	(2)
Amortization of prior service cost	4	3
Total net periodic benefit cost	**11**	**10**

Note 13. Stockholders' equity

Common stock

	As of March 31, 2013 (thousands of shares)	**As of December 31, 2012 (thousands of shares)**
Authorized and issued common stock, par value of 0.025 Russian rubles each	850,563	850,563
Treasury stock	(95,697)	(95,697)
Outstanding common stock	**754,866**	**754,866**

Note 13. Stockholders' equity (continued)

Earnings per share

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

	For the three months ended March 31, 2013	For the three months ended March 31, 2012
Net income attributable to OAO LUKOIL	2,581	3,789
Add back interest and accretion on 2.625% convertible US dollar bonds, maturing 2015 (net of tax at effective rate)	16	16
Total diluted net income attributable to OAO LUKOIL	2,597	3,805
Weighted average number of outstanding common shares (thousands of shares)	754,866	773,074
Add back treasury shares held in respect of convertible debt (thousands of shares)	21,103	20,438
Weighted average number of outstanding common shares, assuming dilution (thousands of shares)	775,969	793,512
Earnings per share of common stock attributable to OAO LUKOIL (US dollars):		
Basic	3.42	4.90
Diluted	3.35	4.80

Note 14. Financial and derivative instruments

Fair value

The fair values of cash and cash equivalents (Level 1), current and long-term accounts receivable (Level 3) are approximately equal to their value as disclosed in the consolidated financial statements. The fair value of long-term receivables was determined by discounting with estimated market interest rates for similar financing arrangements.

The fair value of long-term debt (Level 3) differs from the carrying amount in the consolidated financial statements. The estimated fair value of long-term debt as of March 31, 2013 and December 31, 2012 was $7,025 million and $7,035 million, respectively, determined as a result of discounting using estimated market interest rates for similar financing arrangements. These amounts include all future cash outflows associated with the long-term debt repayments, including the current portion and interest. Market interest rates mean the rates of raising long-term debt by companies with a similar credit rating for similar tenors, repayment schedules and similar other main terms. During the three months ended March 31, 2013, the Group did not have significant transactions or events that would result in nonfinancial assets and liabilities measured at fair value on a nonrecurring basis.

Derivative instruments

The Group uses financial and commodity-based derivative contracts to manage exposures to fluctuations in foreign currency exchange rates, commodity prices, or to exploit market opportunities. Since the Group is not currently using hedge accounting, defined by Topic 815, *"Derivative and hedging,"* of the Codification, all gains and losses, realized or unrealized, from derivative contracts have been recognized in profit or loss.

Topic 815 of the Codification requires purchase and sales contracts for commodities that are readily convertible to cash (e.g., crude oil, natural gas and gasoline) to be recorded on the balance sheet as derivatives unless the contracts are for quantities the Group expects to use or sell over a reasonable period in the normal course of business (i.e., contracts eligible for the normal purchases and normal sales exception). The Group does apply the normal purchases and normal sales exception to certain long-term contracts to sell oil products. This normal purchases and normal sales exception is applied to eligible crude oil and refined product commodity purchase and sales contracts. However, the Group may elect not to apply this exception (e.g., when another derivative instrument will be used to mitigate the risk of a purchase or sale contract but hedge accounting will not be applied; in which case both the purchase or sales contract and the derivative contract mitigating the resulting risk will be recorded on the balance sheet at fair value).

(Millions of US dollars, unless otherwise noted)

Note 14. Financial and derivative instruments (continued)

The fair value hierarchy for the Group's derivative assets and liabilities accounted for at fair value on a recurring basis was:

	As of March 31, 2013				As of December 31, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets								
Commodity derivatives	-	703	-	**703**	-	417	-	**417**
Total assets	**-**	**703**	**-**	**703**	**-**	**417**	**-**	**417**
Liabilities								
Commodity derivatives	-	(759)	-	**(759)**	-	(459)	-	**(459)**
Total liabilities	**-**	**(759)**	**-**	**(759)**	**-**	**(459)**	**-**	**(459)**
Net liabilities	**-**	**(56)**	**-**	**(56)**	**-**	**(42)**	**-**	**(42)**

The derivative values above are based on an analysis of each contract as the fundamental unit of account as required by Topic 820, *"Fair Value Measurements and Disclosures,"* of the Codification. Therefore, derivative assets and liabilities with the same counterparty are not reflected net where the legal right of offset exists. Gains or losses from contracts in one level may be offset by gains or losses on contracts in another level or by changes in values of physical contracts or positions that are not reflected in the table above.

Commodity derivatives are valued using quotations provided by brokers and price index developers. These quotes are corroborated with market data and are classified as Level 2. Commodity derivatives are valued using industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and contractual prices for the underlying instruments, as well as other relevant economic measures.

Commodity derivative contracts

The Group operates in the worldwide crude oil, refined product, natural gas and natural gas liquids markets and is exposed to fluctuations in the prices for these commodities. These fluctuations can affect the Group's revenues as well as the cost of operating, investing and financing activities. Generally, the Group's policy is to remain exposed to the market prices of commodities. However, the Group uses futures, forwards, swaps and options in various markets to balance physical systems, meet customer needs, manage price exposures on specific transactions, and do an immaterial amount of trading not directly related to the Group's physical business. These activities may move the Group's profile away from market average prices.

The fair value of commodity derivative assets and liabilities as of March 31, 2013 was:

	As of March 31, 2013	**As of December 31, 2012**
Assets		
Accounts receivable	703	417
Liabilities		
Accounts payable	(759)	(459)

Hedge accounting has not been used for items in the table.

As required under Topic 815 of the Codification the amounts shown in the preceding table are presented gross (i.e., without netting assets and liabilities with the same counterparty where the right of offset and intent to net exist). Derivative assets and liabilities resulting from eligible commodity contracts have been netted in the consolidated balance sheet and are recorded as accounts receivable in the amount of $33 million and accounts payable in the amount of $89 million.

Financial results from commodity derivatives were included in the consolidated statements of comprehensive income in "Cost of purchased crude oil, gas and products". Realized losses were $62 million and unrealized losses were $3 million for the three months ended March 31, 2013, realized losses were $619 million and unrealized gains were $167 million for the three months ended March 31, 2012.

Note 14. Financial and derivative instruments (continued)

As of March 31, 2013, the net position of outstanding commodity derivative contracts, primarily to manage price exposure on underlying operations, was not significant.

Currency exchange rate derivative contracts

The Group has foreign currency exchange rate risk resulting from its international operations. The Group does not comprehensively hedge the exposure to currency rate changes, although the Group selectively hedges certain foreign currency exchange rate exposures, such as firm commitments for capital projects or local currency tax payments and dividends.

The fair value of foreign currency derivatives assets and liabilities open as of March 31, 2013 was not significant.

The impact from foreign currency derivatives during the three months ended March 31, 2013 on the consolidated statement of comprehensive income was not significant. The net position of outstanding foreign currency swap contracts as of March 31, 2013 also was not significant.

Credit risk

The Group's financial instruments that are potentially exposed to concentrations of credit risk consist primarily of cash equivalents, over-the-counter derivative contracts and trade receivables. Cash equivalents are placed in high-quality commercial paper, money market funds and time deposits with major international banks and financial institutions.

The credit risk from the Group's over-the-counter derivative contracts, such as forwards and swaps, derives from the counterparty to the transaction, typically a major bank or financial institution. Individual counterparty exposure is managed within predetermined credit limits and includes the use of cash-call margins when appropriate, thereby reducing the risk of significant non-performance. The Group also uses futures contracts, but futures have a negligible credit risk because they are traded on the New York Mercantile Exchange or the ICE Futures.

Certain of the Group's derivative instruments contain provisions that require the Group to post collateral if the derivative exposure exceeds a threshold amount. The Group has contracts with fixed threshold amounts and other contracts with variable threshold amounts that are contingent on the Group's credit rating. The variable threshold amounts typically decline for lower credit ratings, while both the variable and fixed threshold amounts typically revert to zero if the Group's credit rating falls below investment grade. Cash is the primary collateral in all contracts; however, many contracts also permit the Group to post letters of credit as collateral.

There were no derivative instruments with such credit-risk-related contingent features that were in a liability position as of March 31, 2013. The Group posted $7 million in collateral in the normal course of business for the over-the-counter derivatives. If the Group's credit rating were lowered one level from its "BBB-" rating (per Standard and Poors) as of March 31, 2013, and it would be below investment grade, the Group would be required to post additional collateral of $5 million to the Group's counterparties for the over-the-counter derivatives, either with cash or letters of credit. The maximum additional collateral based on the lowest downgrade would be $14 million in total.

(Millions of US dollars, unless otherwise noted)

Note 15. Business combinations

In September 2012, after approval by European regulatory authorities, the Group acquired a 20% interest in the joint venture which operates the ISAB refining complex (Priolo, Italy) for €494 million (approximately $621 million) after final adjustments. This transaction was exercised in line with the initial agreement on the establishment of the joint venture signed in 2008. This agreement gave the second investor – ERG S.p.A. a step-by-step put option to sell its share in the joint venture to the Group. Accordingly, the Group's stake in the joint venture increased from 60% to 80% and the Group obtained control and consolidated this joint venture. The Group allocated $646 million to goodwill, $2,914 million to property, plant and equipment, $747 million to deferred tax liability, $1,024 million to current assets and $444 million to current liabilities. The value of property, plant and equipment was determined by an independent appraiser.

Note 16. Consolidation of Variable Interest Entity

The Group and ConocoPhillips had a joint venture, OOO Narianmarneftegaz ("NMNG"), which develops oil reserves in the Timan-Pechora region of the Russian Federation. The Group and ConocoPhillips had equal voting rights over the joint venture's activity and effective ownership interests of 70% and 30%, respectively. In August 2012, the Group acquired ConocoPhillips' investment in NMNG and certain assets related to NMNG for $604 million. The acquisition brought the Group's total ownership interest in NMNG to 100%.

Up until the date of acquisition of the 30% interest, the Group consolidated NMNG due to the fact that NMNG was a variable interest entity and the Group was considered to be the primary beneficiary.

Note 17. Commitments and contingencies

Capital expenditure, exploration and investment programs

The Group owns and operates a number of assets under which it has commitments for capital expenditure in relation to its exploration and investment programs. They mainly relate to existing license agreements in the Russian Federation, production sharing agreements and long-term service contracts. The Group also has a commitment to execute an investment program in its power generation companies.

In February 2013, the Group started to construct a vacuum gasoil refinery complex at OOO LUKOIL-Volgogradneftepererabotka. Completion is expected at the end of 2015. As of March 31, 2013, the amount of capital commitment related to this construction is evaluated as $1,1 billion.

During the three-month period ended March 31, 2013, there were no other significant changes in the capital commitments from those disclosed in the Group's consolidated financial statements for the year ended December 31, 2012.

Operating lease obligations

Group companies have commitments of $465 million primarily for the lease of vessels and petroleum distribution outlets. Operating lease expenses were $81 million and $50 million during the three-month periods ended March 31, 2013 and 2012, respectively. Commitments for minimum rentals under these leases as of March 31, 2013 are as follows:

	As of March 31, 2013
For the nine months ending December 31, 2013	120
2014 fiscal year	101
2015 fiscal year	71
2016 fiscal year	51
2017 fiscal year	37
beyond	85

Note 17. Commitments and contingencies (continued)

Insurance

The insurance industry in the Russian Federation and certain other areas where the Group has operations is in the course of development. Management believes that the Group has adequate property damage coverage for its main production assets. In respect of third party liability for property and environmental damage arising from accidents on Group property or relating to Group operations, the Group has insurance coverage that is generally higher than insurance limits set by the local legal requirements. Management believes that the Group has adequate insurance coverage of the risks, which could have a material effect on the Group's operations and financial position.

Environmental liabilities

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

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

Social assets

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

Taxation environment

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

Note 17. Commitments and contingencies (continued)

The tax authorities in each region may have a different interpretation of similar taxation issues which may result in taxation issues successfully defended by the Group in one region being unsuccessful in another region. There is some direction provided from the central authority based in Moscow on particular taxation issues. The Group has implemented tax planning and management strategies based on existing legislation at the time of implementation. The Group is subject to tax authority audits on an ongoing basis, as is normal in the Russian environment and other republics of the former Soviet Union, and, at times, the authorities have attempted to impose additional significant taxes on the Group. Management believes that it has adequately met and provided for tax liabilities based on its interpretation of existing tax legislation. However, the relevant tax authorities may have differing interpretations and the effects on the financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

Litigation and claims

On November 27, 2001, Archangel Diamond Corporation ("ADC"), a Canadian diamond development company, filed a lawsuit in the Denver District Court, Colorado against OAO Arkhangelskgeoldobycha ("AGD"), a Group company, and the Company (together the "Defendants"). ADC alleged that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. ADC claimed compensatory damages of $1.2 billion and punitive damages of $3.6 billion. On October 15, 2002, the District Court dismissed the lawsuit for lack of personal jurisdiction. This ruling was upheld by the Colorado Court of Appeals on March 25, 2004. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts' ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was dismissed from the lawsuit. The Colorado Supreme Court found, however, that the trial court made a procedural error by failing to hold an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company and remanded the case to the Colorado Court of Appeals to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). The Colorado Court of Appeals declined to dismiss the case based on forum non conveniens and the case was remanded to the District Court. In June 2009, three creditors of ADC filed an Involuntary Bankruptcy Petition putting ADC into bankruptcy. In November 2009, after adding a claim, ADC removed the case from the District Court to the US Bankruptcy Court. On October 28, 2010, the Bankruptcy Court granted the Company's Motion for Remand and Abstention and remanded the case to the Denver District Court. On October 20, 2011, the Denver District Court dismissed all claims against the Company for lack of jurisdiction. ADC filed notice of appeal on April 17, 2012. On August 23, 2012, the Court of Appeals affirmed the Denver District Court's dismissal for lack of jurisdiction. ADC filed a Petition for Rehearing which was denied on September 20, 2012. ADC then filed a petition for Writ of Certiorari in the Colorado Supreme Court on October 18, 2012. The Company filed its Response to the Writ on November 1, 2012. The Colorado Supreme Court has not indicated yet if it will consider this case. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

On January 6, 2012, ADC filed a lawsuit in the US District Court for the District of Colorado (federal court) reasserting almost identical claims asserted in the aforementioned lawsuit and dismissed by the Denver District Court (state court) notwithstanding ADC's appeal of the state court's decision. In Federal Court case, the Company has filed a Motion to Dismiss and discovery has been stayed pending further action. The Company plans to seek dismissal of the case and vigorously defend the matter. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

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

Note 18. Related party transactions

In the rapidly developing business environment in the Russian Federation, companies and individuals have frequently used nominees and other forms of intermediary companies in transactions. The senior management of the Company believes that the Group has appropriate procedures in place to identify and properly disclose transactions with related parties in this environment and has disclosed all of the relationships identified which it deemed to be significant. Related party sales and purchases of oil and oil products were primarily to and from affiliated companies. Related party processing services were provided by affiliated refineries.

Below are related party transactions not disclosed elsewhere in the interim consolidated financial statements. Refer also to Notes 4, 6, 10, 12 and 19 for other transactions with related parties.

Sales of oil and oil products to related parties were $88 million and $296 million for the three months ended March 31, 2013 and 2012, respectively.

Other sales to related parties were $17 million and $15 million for the three months ended March 31, 2013 and 2012, respectively.

Purchases of oil and oil products from related parties were $46 million and $139 million for the three months ended March 31, 2013 and 2012, respectively.

Purchases of processing services from related parties were $57 million and $239 million for the three months ended March 31, 2013 and 2012, respectively.

Other purchases from related parties were $24 million and $14 million for the three months ended March 31, 2013 and 2012, respectively.

Amounts receivable from related parties, including short-term loans and advances, were $393 million and $496 million as of March 31, 2013 and December 31, 2012, respectively. Amounts payable to related parties were $78 million and $85 million as of March 31, 2013 and December 31, 2012, respectively.

Note 19. Compensation plan

During the period from 2010 to 2012, the Company had a compensation plan available to certain members of management, which was based on assigned shares and provided compensation consisting of two parts.

The first part represented annual bonuses that were based on the number of assigned shares and amount of dividend per share. The payment of these bonuses were contingent on the Group meeting certain financial KPIs in each financial year. The second part was based upon the Company's common stock appreciation from 2010 to 2012, with rights vested in December 2012. The number of assigned shares for this compensation plan was approximately 17.3 million shares.

For the first part of the share plan the Group recognized a liability based on expected dividends and number of assigned shares. The second part of the share plan originally was classified as equity settled. In 2012, this compensation plan was amended in relation to all participants, which resulted in reclassification of the plan as a liability settled. Liability for this part of the share plan was settled in January-April 2013.

In late December 2012, the Company introduced a new compensation plan to certain members of management for the period from 2013 to 2017. Its conditions are similar to the conditions of the previous compensation plan after modification. The number of assigned shares is approximately 19 million shares.

For the first part of the new share plan the Group recognized a liability based on expected dividends and number of assigned shares.

(Millions of US dollars, unless otherwise noted)

Note 19. Compensation plan (continued)

The second part of the new share plan was classified as liability settled. The grant date and reporting date fair value of this part of the plan was estimated at $249 million and $236 million, respectively, using the Black-Scholes-Merton option-pricing model, assuming a risk-free interest rate of 6.4% per annum, an expected dividend yield of 4.09% per annum, an expected term of five years and a volatility factor of 16.1%. The expected volatility factor for the annual weighted average share price was estimated based on the historical volatility of the Company's shares for the previous seven year period up to January 2013.

The Group recorded $24 and $33 million of compensation expense during the three months ended March 31, 2013 and 2012, respectively, of which $25 million were recognized as an increase in additional paid-in capital during the three months ended March 31, 2012. As of March 31, 2013 and December 31, 2012, $52 million and $380 million related to these plans were included in "Other current liabilities" of the consolidated balance sheets, respectively.

As of March 31, 2013, there was $224 million of total unrecognized compensation cost related to unvested benefits. This cost is expected to be recognized periodically by the Group up to December 2017.

Note 20. Segment information

Presented below is information about the Group's operating and geographical segments for the three months ended March 31, 2013 and 2012, in accordance with Topic 280, *"Segment reporting,"* of the Codification.

The Group has the following operating segments – exploration and production; refining, marketing and distribution; chemicals; power generation and other business segments. These segments have been determined based on the nature of their operations. Management on a regular basis assesses the performance of these operating segments. The exploration and production segment explores for, develops and produces primarily crude oil. The refining, marketing and distribution segment processes crude oil into refined products and purchases, sells and transports crude oil and refined petroleum products. The chemicals segment refines and sells chemical products. The power generation segment produces steam and electricity, distributes them and provides related services. The activities of the other business operating segment include businesses beyond the Group's traditional operations.

Geographical segments are based on the area of operations and include two segments: Russia and International.

Operating segments

For the three months ended March 31, 2013

	Exploration and production	Refining, marketing and distribution	Chemicals	Power generation	Other	Elimination	Consolidated
Sales							
Third parties	778	32,037	437	489	29	-	33,770
Inter-segment	10,531	429	89	466	735	(12,250)	-
Total sales	11,309	32,466	526	955	764	(12,250)	33,770
Operating expenses	1,419	873	201	538	565	(1,146)	2,450
Depreciation, depletion and amortization	841	396	18	78	32	4	1,369
Interest expense	237	142	13	27	138	(460)	97
Income tax expense	435	307	15	3	7	22	789
Net income (loss)	2,079	530	28	27	(166)	83	2,581
Total assets	69,691	70,050	1,118	4,640	19,914	(64,239)	101,174
Capital expenditures	2,537	630	3	121	113	-	3,404

(Millions of US dollars, unless otherwise noted)

Note 20. Segment information (continued)

For the three months ended March 31, 2012

	Exploration and production	Refining, marketing and distribution	Chemicals	Power generation	Other	Elimination	Consolidated
Sales							
Third parties	1,016	33,471	309	442	23	-	35,261
Inter-segment	11,939	444	98	383	558	(13,422)	-
Total sales	12,955	33,915	407	825	581	(13,422)	35,261
Operating expenses	1,249	818	102	474	436	(864)	2,215
Depreciation, depletion and amortization	697	316	17	62	32	(29)	1,095
Interest expense	211	214	9	15	137	(425)	161
Income tax expense	379	29	10	3	7	(61)	367
Net income (loss)	2,820	1,164	(34)	(62)	11	(110)	3,789
Total assets	64,746	69,051	1,599	4,301	19,357	(63,305)	95,749
Capital expenditures	2,007	346	10	57	42	-	2,462

Geographical segments

	For the three months ended March 31, 2013	For the three months ended March 31, 2012
Sales of crude oil within Russia	538	383
Export of crude oil and sales of crude oil by foreign subsidiaries	5,484	7,305
Sales of petroleum products within Russia	4,117	3,625
Export of petroleum products and sales of petroleum products by foreign subsidiaries	21,379	21,925
Sales of chemicals within Russia	246	52
Export of chemicals and sales of chemicals by foreign subsidiaries	223	276
Other sales within Russia	945	884
Other export sales and other sales of foreign subsidiaries	838	811
Total sales	33,770	35,261

For the three months ended March 31, 2013

	Russia	International	Elimination	Consolidated
Sales				
Third parties	6,273	27,497	-	33,770
Inter-segment	9,943	50	(9,993)	-
Total sales	16,216	27,547	(9,993)	33,770
Operating expenses	1,974	500	(24)	2,450
Depreciation, depletion and amortization	1,089	280	-	1,369
Interest expense	8	121	(32)	97
Income taxes	667	100	22	789
Net income	2,341	156	84	2,581
Total assets	80,710	35,439	(14,975)	101,174
Capital expenditures	2,553	851	-	3,404

(Millions of US dollars, unless otherwise noted)

Note 20. Segment information (continued)

For the three months ended March 31, 2012

	Russia	International	Elimination	Consolidated
Sales				
Third parties	5,949	29,312	-	35,261
Inter-segment	11,010	15	(11,025)	-
Total sales	16,959	29,327	(11,025)	35,261
Operating expenses	1,696	530	(11)	2,215
Depreciation, depletion and amortization	885	210	-	1,095
Interest expense	76	125	(40)	161
Income taxes	314	113	(60)	367
Net income	3,524	375	(110)	3,789
Total assets	77,777	35,859	(17,887)	95,749
Capital expenditures	1,902	560	-	2,462

The Group’s international sales to third parties include sales in Switzerland and the USA of $15,994 million and $3,583 million during the three months ended March 31, 2013 and $17,755 million and $3,032 million during the three months ended March 31, 2012, respectively. These amounts are attributed to individual countries based on the jurisdiction of subsidiaries making the sale.

Note 21. Subsequent events

In accordance with the requirements of Topic 855, *“Subsequent events,”* of the Codification, the Group evaluated subsequent events through the date the interim consolidated financial statements were available to be issued. Therefore subsequent events were evaluated by the Group up to May 22, 2013.

On April 1, 2013, in line with the strategy to grow oil production in Russia the Company signed an agreement to purchase 100% of the shares of ZAO Samara-nafta for $2.05 billion. The transaction was finalized on April 26, 2013 when it was approved by the Federal Anti-monopoly Service. ZAO Samara-nafta is an exploration and production company operating in the Samara and Uljanovsk regions of the Russian Federation.

In April 2013, a Group company acquired 49.99% of the shares of ZAO Kama-oil for $400 million increasing the Group’s ownership up to 99.99%. The Group obtained control and consolidated this company. ZAO Kama-oil is an exploration and production company operating in the Perm region of the Russian Federation.

In April 2013, a Group company issued two tranches of non-convertible bonds totaling $3 billion. The first tranche totaling $1.5 billion was placed with a maturity of 5 years and a coupon yield of 3.416% per annum. The second tranche totaling $1.5 billion was placed with a maturity of 10 years and a coupon yield of 4.563% per annum. All bonds were placed at face value and have a half year coupon period.