# OAO LUKOIL

## INTERIM CONSOLIDATED FINANCIAL STATEMENTS

## (prepared in accordance with US GAAP)

## As of and for the three and six month periods ended June 30, 2009

## (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.

<u>**Independent Accountants' Review Report**</u>

The Board of Directors of OAO LUKOIL:

We have reviewed the accompanying consolidated balance sheet of OAO LUKOIL and its subsidiaries as of June 30, 2009, the related consolidated statements of income for the three-month and six-month periods ended June 30, 2009 and 2008 and the related consolidated statements of stockholders' equity and comprehensive income and cash flows for the six-month periods ended June 30, 2009 and 2008 in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of OAO LUKOIL.

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

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

ZAO KPMG

ZAO KPMG
Moscow, Russian Federation
August 27, 2009

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

| | Note | As of June 30, 2009 (unaudited) | As of December 31, 2008 |
|---|---|---|---|
| **Assets** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | 4 | 1,550 | 2,239 |
| Short-term investments | | 324 | 505 |
| Accounts and notes receivable, net | 5 | 6,953 | 5,069 |
| Inventories | | 4,655 | 3,735 |
| Prepaid taxes and other expenses | | 2,902 | 3,566 |
| Other current assets | | 788 | 519 |
| **Total current assets** | | **17,172** | **15,633** |
| Investments | 6 | 3,424 | 3,269 |
| Property, plant and equipment | 7 | 51,617 | 50,088 |
| Deferred income tax assets | | 455 | 521 |
| Goodwill and other intangible assets | 8 | 1,204 | 1,159 |
| Other non-current assets | | 1,316 | 791 |
| **Total assets** | | **75,188** | **71,461** |
| **Liabilities and Equity** | | | |
| **Current liabilities** | | | |
| Accounts payable | | 4,118 | 5,029 |
| Short-term borrowings and current portion of long-term debt | 9 | 3,499 | 3,232 |
| Taxes payable | | 1,901 | 1,564 |
| Other current liabilities | | 1,963 | 750 |
| **Total current liabilities** | | **11,481** | **10,575** |
| Long-term debt | 10, 13 | 7,342 | 6,577 |
| Deferred income tax liabilities | | 2,267 | 2,116 |
| Asset retirement obligations | 7 | 851 | 718 |
| Other long-term liabilities | | 452 | 465 |
| **Total liabilities** | | **22,393** | **20,451** |
| **Equity** | 12 | | |
| **OAO LUKOIL stockholders’ equity** | | | |
| Common stock | | 15 | 15 |
| Treasury stock, at cost | | (282) | (282) |
| Additional paid-in capital | | 4,746 | 4,694 |
| Retained earnings | | 47,852 | 45,983 |
| Accumulated other comprehensive loss | | (66) | (70) |
| **Total OAO LUKOIL stockholders’ equity** | | **52,265** | **50,340** |
| Noncontrolling interests | | 530 | 670 |
| **Total equity** | | **52,795** | **51,010** |
| **Total liabilities and equity** | | **75,188** | **71,461** |

Vice-president of OAO LUKOIL
Fedotov G.S.

Deputy Chief accountant of OAO LUKOIL
Kozyrev I.A.

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

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

| | Note | For the three months ended June 30, 2009 (unaudited) | For the three months ended June 30, 2008 (unaudited) | For the six months ended June 30, 2009 (unaudited) | For the six months ended June 30, 2008 (unaudited) |
|---|---|---|---|---|---|
| **Revenues** | | | | | |
| Sales (including excise and export tariffs) | 20 | 20,116 | 31,935 | 34,861 | 56,890 |
| | | | | | |
| **Costs and other deductions** | | | | | |
| Operating expenses | | (1,876) | (1,770) | (3,108) | (3,678) |
| Cost of purchased crude oil, gas and products | | (7,910) | (12,511) | (13,272) | (21,119) |
| Transportation expenses | | (1,187) | (1,359) | (2,356) | (2,554) |
| Selling, general and administrative expenses | | (791) | (994) | (1,520) | (1,790) |
| Depreciation, depletion and amortization | | (1,009) | (703) | (2,003) | (1,327) |
| Taxes other than income taxes | | (1,395) | (3,623) | (2,593) | (6,752) |
| Excise and export tariffs | | (2,888) | (5,191) | (5,407) | (9,776) |
| Exploration expenses | | (32) | (51) | (69) | (85) |
| (Loss) gain on disposals and impairments of assets | | (15) | (186) | 12 | (191) |
| **Income from operating activities** | | **3,013** | **5,547** | **4,545** | **9,618** |
| Interest expense | | (171) | (92) | (334) | (164) |
| Interest and dividend income | | 27 | 49 | 65 | 74 |
| Equity share in income of affiliates | 6 | 71 | 153 | 182 | 282 |
| Currency translation (loss) gain | | (109) | (36) | (124) | 33 |
| Other non-operating income (expense) | | 62 | (70) | 61 | (118) |
| **Income before income taxes** | | **2,893** | **5,551** | **4,395** | **9,725** |
| Current income taxes | | (537) | (1,376) | (837) | (2,440) |
| Deferred income taxes | | (106) | 18 | (196) | 111 |
| **Total income tax expense** | 3 | **(643)** | **(1,358)** | **(1,033)** | **(2,329)** |
| **Net income** | | **2,250** | **4,193** | **3,362** | **7,396** |
| Less: net loss (net income) attributable to noncontrolling interests | | 74 | (63) | (133) | (103) |
| **Net income attributable to OAO LUKOIL** | | **2,324** | **4,130** | **3,229** | **7,293** |
| | | | | | |
| Basic and diluted earnings per share of common stock (US dollars) attributable to OAO LUKOIL: | 12 | 2.74 | 4.92 | 3.81 | 8.70 |

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

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

| | Common stock | Treasury stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive loss | Total for OAO LUKOIL | Noncontrol-ling interests | Total equity |
|---|---|---|---|---|---|---|---|---|
| **Six months ended June 30, 2009** | | | | | | | | |
| Balance as of December 31, 2008 | 15 | (282) | 4,694 | 45,983 | (70) | **50,340** | 670 | **51,010** |
| Net income | - | - | - | 3,229 | - | **3,229** | 133 | **3,362** |
| Prior service cost | - | - | - | - | 6 | **6** | - | **6** |
| Unrecognized loss on available for sale | - | - | - | - | (2) | **(2)** | - | **(2)** |
| Comprehensive income | | | | | | **3,233** | **133** | **3,366** |
| Dividends on common stock | - | - | - | (1,360) | - | **(1,360)** | - | **(1,360)** |
| Effect of stock compensation plan | - | - | 52 | - | - | **52** | - | **52** |
| Changes in the non-controlling interests | - | - | - | - | - | - | (273) | **(273)** |
| **Balance as of June 30, 2009** | **15** | **(282)** | **4,746** | **47,852** | **(66)** | **52,265** | **530** | **52,795** |

| | Common stock | Treasury stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive loss | Total for OAO LUKOIL | Noncontrol-ling interests | Total equity |
|---|---|---|---|---|---|---|---|---|
| **Six months ended June 30, 2008** | | | | | | | | |
| Balance as of December 31, 2007 | 15 | (1,591) | 4,499 | 38,349 | (59) | **41,213** | 577 | **41,790** |
| Net income | - | - | - | 7,293 | - | **7,293** | 103 | **7,396** |
| Prior service cost | - | - | - | - | 6 | **6** | - | **6** |
| Comprehensive income | | | | | | **7,299** | **103** | **7,402** |
| Dividends on common stock | - | - | - | (1,510) | - | **(1,510)** | - | **(1,510)** |
| Effect of stock compensation plan | - | - | 51 | - | - | **51** | - | **51** |
| Issue of non-outstanding common stock held by subsidiaries | - | - | 20 | - | - | **20** | - | **20** |
| Stock purchased | - | (39) | - | - | - | **(39)** | - | **(39)** |
| Stock disposed | - | 1,528 | 72 | - | - | **1,600** | - | **1,600** |
| Changes in the non-controlling interests | - | - | - | - | - | - | 464 | **464** |
| **Balance as of June 30, 2008** | **15** | **(102)** | **4,642** | **44,132** | **(53)** | **48,634** | **1,144** | **49,778** |

| | Share activity (thousands of shares) | |
|---|---|---|
| | **Common stock** | **Treasury stock** |
| **Six months ended June 30, 2009** | | |
| Balance as of December 31, 2008 | 850,563 | (3,836) |
| **Balance as of June 30, 2009** | **850,563** | **(3,836)** |
| | | |
| **Six months ended June 30, 2008** | | |
| Balance as of December 31, 2007 | 850,563 | (23,321) |
| Stock purchased | - | (550) |
| Stock disposed | - | 22,384 |
| **Balance as of June 30, 2008** | **850,563** | **(1,487)** |

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 six months ended June 30, 2009 (unaudited) | For the six months ended June 30, 2008 (unaudited) |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| **Net income** | | **3,229** | **7,293** |
| Adjustments for non-cash items: | | | |
| Depreciation, depletion and amortization | | 2,003 | 1,327 |
| Equity share in income of affiliates, net of dividends received | | (123) | (217) |
| Dry hole write-offs | | 23 | 25 |
| (Gain) loss on disposals and impairments of assets | | (12) | 191 |
| Deferred income taxes | | 196 | (111) |
| Non-cash currency translation (gain) loss | | (207) | 200 |
| Non-cash investing activities | | (13) | (9) |
| All other items – net | | 161 | 391 |
| Changes in operating assets and liabilities: | | | |
| Accounts and notes receivable | | (2,009) | (1,810) |
| Inventories | | (924) | (2,467) |
| Accounts payable | | 245 | 1,107 |
| Taxes payable | | 337 | 1,988 |
| Other current assets and liabilities | | 234 | (917) |
| **Net cash provided by operating activities** | | **3,140** | **6,991** |
| **Cash flows from investing activities** | | | |
| Acquisition of licenses | | - | (12) |
| Capital expenditures | | (2,995) | (5,034) |
| Proceeds from sale of property, plant and equipment | | 64 | 120 |
| Purchases of investments | | (111) | (289) |
| Proceeds from sale of investments | | 224 | 55 |
| Sale of subsidiaries, net of cash disposed | | 5 | 2 |
| Acquisitions of subsidiaries and non-controlling interests (including advances related to acquisitions), net of cash acquired | | (2,096) | (1,193) |
| **Net cash used in investing activities** | | **(4,909)** | **(6,351)** |
| **Cash flows from financing activities** | | | |
| Net movements of short-term borrowings | | (70) | (88) |
| Cash received under sale-leaseback transaction | | - | 235 |
| Proceeds from issuance of long-term debt | | 1,482 | 2,398 |
| Principal repayments of long-term debt | | (274) | (2,276) |
| Dividends paid on Company common stock | | (1) | (2) |
| Dividends paid to non-controlling interest stockholders | | (34) | (90) |
| Financing received from related and third party non-controlling interest stockholders | | 11 | 22 |
| Purchase of Company's stock | | - | (39) |
| **Net cash provided by financing activities** | | **1,114** | **160** |
| Effect of exchange rate changes on cash and cash equivalents | | (34) | 23 |
| **Net (decrease) increase in cash and cash equivalents** | | **(689)** | **823** |
| Cash and cash equivalents at beginning of year | | 2,239 | 841 |
| **Cash and cash equivalents at end of period** | 4 | **1,550** | **1,664** |

| | | |
|---|---|---|
| Supplemental disclosures of cash flow information | | |
| Interest paid | 305 | 204 |
| Income taxes paid | 473 | 2,239 |

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 Russian Federation has been experiencing political and economic change, that has affected and will continue to affect the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks, which do not typically exist in other markets. In addition, the recent contraction in the capital and credit markets has further increased the level of economic uncertainty in the 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, 2008. 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, 2008 annual consolidated financial statements.

The results for the six-month period ended June 30, 2009 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 minority 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 minority 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.

### *Revenue*

Revenues from the production and sale of crude oil and petroleum products 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 market 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 operations in the Russian Federation and for the majority of operations 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 the consolidated statement of income.

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

In all cases, foreign currency transaction gains and losses are included in the consolidated statement of income.

As of June 30, 2009 and December 31, 2008, exchange rates of 31.29 and 29.38 Russian rubles to the US dollar, respectively, have been used for translation purposes.

The Russian ruble and other currencies of republics of the former Soviet Union are not readily convertible outside of their countries. Accordingly, the translation of amounts recorded in these currencies into US dollars should not be construed as a representation that such currency amounts have been, could be or will in the future be converted into US dollars at the exchange rate shown or at any other exchange rate.

### *Cash and cash equivalents*

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

## Note 2. Summary of significant accounting policies (continued)

### *Cash with restrictions on immediate use*

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

### *Accounts and notes receivable*

Accounts and notes 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 obtained. Non-current receivables are discounted to the present value of expected cash flows in future periods using the original discount rate.

### *Inventories*

Starting from January 1, 2009, the Group elected to change the inventory accounting method for finished goods and purchased products from the weighted average to the FIFO cost method. Management believes the FIFO cost method for these inventory categories is preferable because it reflects the results of the most recent business activity and allows a more rapid reflection of results of operations, and represents a better matching of cost of sales with related sales. The Group determined that it is impracticable to calculate the cumulative effect of applying this change retrospectively because of the lack of information available.

The cost of all other inventory categories is determined using an “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 the consolidated statement of income. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are reported as a separate component of 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 the consolidated statement of income 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 the consolidated statement of income 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 the consolidated statement of income.

### *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, 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.

**Note 2. Summary of significant accounting policies (continued)**

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 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.

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 net of the amounts assigned to assets acquired and liabilities assumed. 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 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.

## Note 2. Summary of significant accounting policies (continued)

### *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.

### *Income taxes*

Deferred income tax assets and liabilities are recognized in respect of 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 the consolidated statement of income 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.

On January 1, 2007, the Group adopted FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes, an interpretation of Statement of Financial Accounting Standards No. 109*" ("FIN 48"). FIN 48 clarifies the accounting for uncertain tax positions, which requires an entity to recognize the effect of an income tax position only if that 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 in the consolidated statements of income.

### *Interest-bearing borrowings*

Interest-bearing borrowings 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 the consolidated statement of income each year and the carrying amounts are adjusted as amortization accumulates.

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

## Note 2. Summary of significant accounting policies (continued)

***Pension benefits***

The expected costs in respect of pension obligations of Group companies are determined by an independent actuary. Obligations in respect of each employee are accrued over the reporting periods during which the employee renders service in the Group.

***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 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 the consolidated statement of income. If the assessment indicates that a potentially material loss 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, 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 outside of its physical crude oil and petroleum products businesses 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 the consolidated statement of income on a net basis. Unrealized gains and losses are carried as assets or liabilities on the consolidated balance sheet.

**Note 2. Summary of significant accounting policies (continued)**

***Share-based payments***

The Group accounts for liability classified share-based payment awards to employees at fair value on the date of grant 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 date of grant and expensed over the vesting period.

***Comparative amounts***

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

***Recent accounting pronouncements***

In June 2009, the FASB issued SFAS No. 167, *"Amendments to FASB Interpretation No. 46(R),"* which amends FASB Interpretation No. 46(R), *"Consolidation of Variable Interest Entities"* to address the effects of the elimination of the qualifying special purpose entity concept in SFAS No. 166, *"Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140,"* and other concerns about the application of key provisions of FASB Interpretation No. 46(R). More specifically, SFAS No. 167 requires a qualitative rather than a quantitative approach to determine the primary beneficiary of a variable interest entity, it amends certain guidance pertaining to the determination of the primary beneficiary when related parties are involved, and it amends certain guidance for determining whether an entity is a variable interest entity. Additionally, this Statement requires continuous assessment of whether an enterprise is the primary beneficiary of a variable interest entity. This statement is effective January 1, 2010. The Group is currently assessing the effect of adoption of SFAS No. 167.

In June 2009, the FASB issued SFAS No. 168, *"The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles."* The FASB Accounting Standards Codification ("Codification") will become the exclusive authoritative reference for US GAAP recognized by the FASB to be applied by nongovernmental entities, except for SEC rules and interpretive releases, which are also authoritative US GAAP for SEC registrants. The change established by SFAS No. 168 divides nongovernmental US GAAP into authoritative Codification and guidance that is not authoritative. The contents of the Codification will carry the same level of authority, eliminating the four-level US GAAP hierarchy previously set forth in SFAS No. 162, which has been superseded by SFAS No. 168. The Codification will supersede all existing non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in the Codification become nonauthoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Group is currently assessing the effect of adoption of SFAS No. 168.

In May 2009, the FASB issued SFAS No. 165, *"Subsequent events."* SFAS No. 165 addresses accounting and disclosure requirements related to subsequent events and requires management to evaluate subsequent events through the date the financial statements are either issued or available to be issued. Companies are required to disclosure the date through which subsequent events have been evaluated. SFAS No. 165 is effective for interim or annual financial periods ending after June 15, 2009 and should be applied prospectively. The Group adopted the provisions of SFAS No. 165 starting from the second quarter of 2009.

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, *"Disclosures about Transfers of Financial Assets and Interest in Variable Interest Entities."* This FSP amends FASB Statement No. 140, *"Accounting for transfers and Servicing of Financial Assets and Extinguishments of Liabilities,"* and requires additional disclosures about transfers of financial assets. It also amends FASB Interpretation No. 46 (R), *"Consolidation of Variable Interest Entities,"* and requires public entities, including sponsors that have a variable interest in a variable interest entity, to provide additional disclosures about their involvement with variable interest entities. The Group adopted the provisions of FSP FAS 140-4 and FIN 46(R)-8 starting from the fourth quarter of 2008. The adoption of the provisions of FSP FAS 140-4 and FIN 46(R)-8 did not have any material impact on the Group's results of operations, financial position or cash flows.

## Note 2. Summary of significant accounting policies (continued)

In March 2008, the FASB issued SFAS No. 161, *"Disclosures about Derivative Instruments and Hedging Activities."* This Statement improves financial reporting about derivative instruments and hedging activities by enhanced disclosures of their effects on an entity's financial position, financial performance and cash flows. The Group adopted the provisions of SFAS No. 161 starting from the first quarter of 2009. The adoption of SFAS No. 161 did not have any impact on the Group's results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS No. 141 (Revised), *"Business combinations."* This Statement applies to all transactions in which an entity obtains control of one or more businesses. In April 2009, this Statement was amended by FASB Staff Position FAS 141 (R)-1. This Statement requires an entity to recognize the fair value of assets acquired and liabilities assumed in a business combination; to recognize and measure the goodwill acquired in the business combination or gain from a bargain purchase and modifies the disclosure requirements. The Group adopted the provisions of SFAS No. 141 (Revised) for business combinations for which the acquisition date is after December 31, 2008. The adoption of SFAS No. 141 (Revised) did not have any impact on the Group's results of operations, financial position or cash flows.

In December 2007, the FASB issued SFAS No. 160, *"Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51."* This Statement applies to all entities that prepare consolidated financial statements (except not-for-profit organizations) and affects those which have an outstanding noncontrolling interest (or minority interest) in their subsidiaries or which have to deconsolidate a subsidiary. This Statement changes the classification of a non-controlling interest; establishing a single method of accounting for changes in the parent company's ownership interest that does not result in deconsolidation and requires a parent company to recognize a gain or loss when a subsidiary is deconsolidated. The Group prospectively adopted the provisions of SFAS No. 160 in the first quarter of 2009, except for the presentation and disclosure requirements which were applied retrospectively. Therefore the adoption of SFAS No. 160 did not have any impact on the Group's results of operations, financial position or cash flows.

In February 2007, the FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities."* This Statement expands the possibility of using fair value measurements and permits enterprises to choose to measure certain financial assets and financial liabilities at fair value. Enterprises shall report unrealized gains and losses on items for which the fair value option has been elected in earnings in each subsequent period. The Group adopted the provisions of SFAS No. 159 in the first quarter of 2008 and elected not to use the fair value option for its financial assets and financial liabilities not already carried at fair value in accordance with other standards. Therefore the adoption of SFAS No. 159 did not have any impact on the Group's results of operations, financial position or cash flows.

In September 2006, the FASB issued SFAS No. 157, *"Fair Value Measurements,"* which establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair value measurements. Effective January 1, 2009, the Group fully adopted SFAS No. 157. Because there usually is a lack of quoted market prices for long-lived assets, the Group determines fair value using the present value of estimated future net cash flows from using these assets or by using historical data of market transactions with similar assets where possible. Fair value used in the initial recognition of asset retirement obligations is determined using the present value of expected future dismantlement costs, which are estimated based on the costs for dismantlement services for similar assets providing by third parties. The adoption of the provisions of SFAS No. 157 did not have a material impact on the Group's results of operations, financial position or cash flows.

## Note 3. Income taxes

Before January 1, 2009, operations in the Russian Federation were subject to a Federal income tax rate of 6.5% and a regional income tax rate that varied from 13.5% to 17.5% at the discretion of the individual regional administration. Starting on January 1, 2009, the Federal income tax rate is 2.0% and regional income tax rate varies from 13.5% to 18.0%. The Group's foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

**(Millions of US dollars, unless otherwise noted)**

## Note 3. Income taxes (continued)

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 and the incurrence of costs that are either not tax deductible or only deductible to a certain limit.

## Note 4. Cash and cash equivalents

| | As of June 30, 2009 | As of December 31, 2008 |
|---|---|---|
| Cash held in Russian rubles | 514 | 444 |
| Cash held in other currencies | 725 | 1,425 |
| Cash of a banking subsidiary in other currencies | 139 | 132 |
| Cash held in related party banks in Russian rubles | 155 | 182 |
| Cash held in related party banks in other currencies | 17 | 56 |
| **Total cash and cash equivalents** | **1,550** | **2,239** |

## Note 5. Accounts and notes receivable, net

| | As of June 30, 2009 | As of December 31, 2008 |
|---|---|---|
| Trade accounts and notes receivable (net of provisions of $141 million and $133 million as of June 30, 2009 and December 31, 2008, respectively) | 5,402 | 3,466 |
| Current VAT and excise recoverable | 1,081 | 855 |
| Other current accounts receivable (net of provisions of $37 million and $38 million as of June 30, 2009 and December 31, 2008, respectively) | 470 | 748 |
| **Total accounts and notes receivable, net** | **6,953** | **5,069** |

## Note 6. Investments

| | As of June 30, 2009 | As of December 31, 2008 |
|---|---|---|
| Investments in equity method affiliates and joint ventures | 3,123 | 2,988 |
| Long-term loans given by non-banking subsidiaries | 290 | 251 |
| Other long-term investments | 11 | 30 |
| **Total long-term investments** | **3,424** | **3,269** |

### *Investments in "equity method" affiliates and 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.

| | For the three months ended June 30, 2009 | | For the three months ended June 30, 2008 | |
|---|---|---|---|---|
| | Total | Group's share | Total | Group's share |
| Revenues | 1,094 | 529 | 1,269 | 614 |
| Income before income taxes | 232 | 118 | 611 | 276 |
| Less income taxes | (92) | (47) | (246) | (123) |
| **Net income** | **140** | **71** | **365** | **153** |

**(Millions of US dollars, unless otherwise noted)**

## Note 6. Investments (continued)

| | For the six months ended June 30, 2009 | | For the six months ended June 30, 2008 | |
|---|---|---|---|---|
| | Total | Group's share | Total | Group's share |
| Revenues | 1,951 | 937 | 2,268 | 1,087 |
| Income before income taxes | 458 | 246 | 1,051 | 489 |
| Less income taxes | (127) | (64) | (415) | (207) |
| **Net income** | **331** | **182** | **636** | **282** |

| | As of June 30, 2009 | | As of December 31, 2008 | |
|---|---|---|---|---|
| | Total | Group's share | Total | Group's share |
| Current assets | 1,831 | 882 | 2,023 | 982 |
| Property, plant and equipment | 5,608 | 2,793 | 5,872 | 2,841 |
| Other non-current assets | 543 | 270 | 544 | 269 |
| Total assets | 7,982 | 3,945 | 8,439 | 4,092 |
| Short-term debt | 282 | 138 | 158 | 47 |
| Other current liabilities | 780 | 372 | 1,188 | 557 |
| Long-term debt | 430 | 205 | 890 | 392 |
| Other non-current liabilities | 220 | 107 | 220 | 108 |
| **Net assets** | **6,270** | **3,123** | **5,983** | **2,988** |

In June 2009, a Group company entered into an agreement with Total to acquire a 45% interest in the TRN refinery in the Netherlands for approximately $725 million subject to certain adjustments. The finalisation of the transaction is expected by the end of 2009. This acquisition is made in accordance with the Company's plans to develop its refining capacity in Europe.

In June 2008, a Group company signed an agreement with ERG S.p.A. to establish a joint venture to operate the ISAB refinery complex in Priolo, Italy. In December 2008, the Group completed the acquisition of a 49% stake in the joint venture for €1.45 billion (approximately $1.83 billion) and paid €600 million (approximately $762 million) as a first installment. The remaining amount was paid in February 2009. The seller has a put option, the effect of which would be to increase the Group's stake in the company operating the ISAB refinery complex up to 100%. As of June 30, 2009, the fair value of this option for the Group is zero. The agreement states that each partner will be responsible for procuring crude oil and marketing refined products in line with its equity stake in the joint venture. The ISAB refinery complex has the flexibility to process Urals blend crude oil, and the Group integrated its share of the ISAB refinery complex capacity into its crude oil supply and refined products marketing operations. The ISAB refinery complex has an annual refining capacity of 16 million tonnes. The ISAB refinery complex also includes three jetties and storage tanks totaling 3,700 thousand cubic meters.

**(Millions of US dollars, unless otherwise noted)**

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

| | At cost | | Net | |
|---|---|---|---|---|
| | As of June 30, 2009 | As of December 31, 2008 | As of June 30, 2009 | As of December 31, 2008 |
| Exploration and Production: | | | | |
| Western Siberia | 22,625 | 21,663 | 13,394 | 12,784 |
| European Russia | 22,700 | 21,842 | 16,198 | 15,881 |
| International | 6,149 | 5,910 | 5,095 | 5,009 |
| Total | 51,474 | 49,415 | 34,687 | 33,674 |
| Refining, Marketing, Distribution and Chemicals: | | | | |
| Western Siberia | 85 | 122 | 60 | 107 |
| European Russia | 11,616 | 11,021 | 8,404 | 8,051 |
| International | 6,773 | 6,462 | 4,796 | 4,633 |
| Total | 18,474 | 17,605 | 13,260 | 12,791 |
| Other: | | | | |
| Western Siberia | 177 | 178 | 86 | 89 |
| European Russia | 3,798 | 3,618 | 3,454 | 3,385 |
| International | 188 | 200 | 130 | 149 |
| Total | 4,163 | 3,996 | 3,670 | 3,623 |
| **Total property, plant and equipment** | **74,111** | **71,016** | **51,617** | **50,088** |

In June 2008, the Company performed impairment testing of certain exploration and production assets located in oil fields in the Timan-Pechora region of Russia, due to a revision of geological models. The revision resulted in a reduction of planned development activities on these oil fields. The fair value of these assets was determined using the present value of the expected cash flows. As a result, the Company recognized an impairment loss of $156 million during the six-month period ended June 30, 2008.

As of June 30, 2009 and December 31, 2008, the asset retirement obligation amounted to $861 million and $728 million, respectively, of which $10 million was included in “Other current liabilities” in the consolidated balance sheets as of each balance sheet date. During the six-month periods ended June 30, 2009 and 2008, asset retirement obligations changed as follows:

| | For the six months ended June 30, 2009 | For the six months ended June 30, 2008 |
|---|---|---|
| Asset retirement obligations as of January 1 | 728 | 821 |
| Accretion expense | 33 | 45 |
| New obligations | 37 | 63 |
| Changes in estimates of existing obligations | 121 | 30 |
| Spending on existing obligations | (2) | (4) |
| Property dispositions | (6) | - |
| Foreign currency translation and other adjustments | (50) | 41 |
| **Asset retirement obligations as of June 30** | **861** | **996** |

**(Millions of US dollars, unless otherwise noted)**

## Note 8. Goodwill and other intangible assets

The carrying value of goodwill and other intangible assets as of June 30, 2009 and December 31, 2008 was as follows:

| | **As of June 30, 2009** | **As of December 31, 2008** |
|---|---|---|
| Amortized intangible assets | | |
| Software | 441 | 500 |
| Licenses and other assets | 430 | 335 |
| Goodwill | 333 | 324 |
| **Total goodwill and other intangible assets** | **1,204** | **1,159** |

All goodwill amounts relate to the refining, marketing and distribution segment.

## Note 9. Short-term borrowings and current portion of long-term debt

| | **As of June 30, 2009** | **As of December 31, 2008** |
|---|---|---|
| Short-term borrowings from third parties | 1,647 | 2,301 |
| Short-term borrowings from related parties | 69 | - |
| 13.5% Russian ruble bonds | 479 | - |
| Current portion of long-term debt | 1,304 | 931 |
| **Total short-term borrowings and current portion of long-term debt** | **3,499** | **3,232** |

Short-term borrowings are unsecured and include amounts repayable in US dollars of $1,014 million and $1,529 million and amounts repayable in Russian rubles of $602 million and $70 million as of June 30, 2009 and December 31, 2008, respectively. The weighted-average interest rate on short-term borrowings from third parties was 9.05% and 5.15% per annum as of June 30, 2009 and December 31, 2008, respectively.

### *Russian ruble bonds*

In June 2009, the Company issued 15 million short-term stock exchange bonds with a face value of 1,000 Russian rubles each. Bonds were placed at the face value with a maturity of 364 days. The coupon yield is 13.5% per annum and is paid at the maturity date.

## Note 10. Long-term debt

| | **As of June 30, 2009** | **As of December 31, 2008** |
|---|---|---|
| Long-term loans and borrowings from third parties | 4,743 | 3,384 |
| Long-term loans and borrowings from related parties | 2,022 | 2,165 |
| 6.356% US dollar bonds, maturing 2017 | 500 | 500 |
| 6.656% US dollar bonds, maturing 2022 | 500 | 500 |
| 7.25% Russian ruble bonds, maturing 2009 | 192 | 204 |
| 7.10% Russian ruble bonds, maturing 2011 | 256 | 272 |
| 8.00% Russian ruble bonds, maturing 2012 | - | 8 |
| 7.40% Russian ruble bonds, maturing 2013 | 192 | 204 |
| Capital lease obligations | 241 | 271 |
| Total long-term debt | 8,646 | 7,508 |
| Current portion of long-term debt | (1,304) | (931) |
| **Total non-current portion of long-term debt** | **7,342** | **6,577** |

**(Millions of US dollars, unless otherwise noted)**

## Note 10. Long-term debt (continued)

### *Long-term loans and borrowings*

Long-term loans and borrowings include amounts repayable in US dollars of $2,751 million and $2,844 million, amounts repayable in Russian rubles of $2,090 million and $2,277 million and amounts repayable in euro of $1,903 million and $375 million as of June 30, 2009 and December 31, 2008, respectively. Long-term loans and borrowings have maturity dates from 2009 through 2038. Approximately 5% of this debt is secured by export sales and property, plant and equipment. The weighted-average interest rate on long-term loans and borrowings from third parties was 5.30% and 4.09% per annum as of June 30, 2009 and December 31, 2008, respectively. A number of long-term loan agreements contain certain financial covenants due levels of which are being maintained by the Group.

### *US dollar bonds*

In June 2007, a Group company issued non-convertible bonds totaling $1 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 nominal value and have a half year coupon period.

### *Russian ruble bonds*

In January 2007, OAO UGK TGK-8 ("TGK-8"), a newly acquired subsidiary (refer to Note 14. Business combinations) issued 3.5 million non-convertible bonds with a face value of 1,000 Russian rubles each. These bonds were placed at the face value with a maturity of 5 years, with a coupon yield of 8.0% per annum and they have a half year coupon period. By the end of May 2009, TGK-8 redeemed all issued bonds in accordance with the conditions of the bonds issue.

In December 2006, the Company issued 14 million non-convertible bonds with a face value of 1,000 Russian rubles each. Eight million bonds were placed with a maturity of 5 years and a coupon yield of 7.10% per annum and six million bonds were placed with a maturity of 7 years and a coupon yield of 7.40% per annum. All bonds were placed at the face value and have a half year coupon period.

In November 2004, the Company issued 6 million non-convertible bonds with a face value of 1,000 Russian rubles each, maturing on November 23, 2009. The bonds have a half year coupon period and bear interest at 7.25% per annum.

## Note 11. Pension benefits

The Company sponsors a post employment and post retirement benefits program that covers the majority of the Group's employees. The plan primarily consists of a defined benefit plan enabling employees to contribute a portion of their salary to the plan and at retirement to receive a lump sum amount from the Company equal to all past contributions made by the employee up to 2% of their annual salary. This plan is administered by a non-state pension fund, LUKOIL-GARANT, and provides pension benefits primarily based on years of service and final remuneration levels. The Company also provides several long-term employee benefits such as death-in-service benefit and lump-sum payments upon retirement of a defined benefit nature and other defined benefits to certain old age and disabled pensioners who have not vested any pensions under the pension plan.

Components of net periodic benefit cost were as follows:

| | **For the three months ended June 30, 2009** | **For the three months ended June 30, 2008** | **For the six months ended June 30, 2009** | **For the six months ended June 30, 2008** |
|---|---|---|---|---|
| Service cost | 4 | 6 | 8 | 12 |
| Interest cost | 6 | 4 | 11 | 9 |
| Less expected return on plan assets | (3) | (2) | (5) | (5) |
| Amortization of prior service cost | 3 | 3 | 6 | 6 |
| **Total net periodic benefit cost** | **10** | **11** | **20** | **22** |

## Note 12. Stockholders' equity

### *Common stock*

| | As of June 30, 2009 (thousands of shares) | As of December 31, 2008 (thousands of shares) |
|---|---|---|
| Authorized and issued common stock, par value of 0.025 Russian rubles each | 850,563 | 850,563 |
| Common stock held by subsidiaries, not considered as outstanding | (82) | (82) |
| Treasury stock | (3,836) | (3,836) |
| Outstanding common stock | **846,645** | **846,645** |

### *Earnings per share*

The weighted average number of outstanding common shares was 846,646 thousand shares, 839,679 thousand shares, 846,646 thousand shares and 837,868 thousand shares for the three months ended June 30, 2009 and 2008 and for the six months ended June 30, 2009 and 2008, respectively. There is no potential dilution in earnings available to common stockholders and as such diluted earnings per share are not disclosed.

### *Dividends*

At the annual stockholders' meeting on June 25, 2009, dividends were declared for 2008 in the amount of 50.00 Russian rubles per common share, which at the date of the meeting was equivalent to $1.61. Dividends payable of $1,364 million and $12 million are included in "Other current liabilities" in the consolidated balance sheets as of June 30, 2009 and December 31, 2008, respectively.

At the annual stockholders' meeting on June 26, 2008, dividends were declared for 2007 in the amount of 42.00 Russian rubles per common share, which at the date of the meeting was equivalent to $1.78.

## Note 13. Financial and derivative instruments

### *Fair value*

The fair values of cash and cash equivalents, current accounts and notes receivable, and liquid securities are approximately equal to their value as disclosed in the consolidated financial statements.

The fair value of long-term receivables included in other non-current assets approximates the amounts 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 differs from the amount disclosed in the consolidated financial statements. The estimated fair value of long-term debt as of June 30, 2009 and December 31, 2008, was $7,635 million and $5,425 million, respectively, 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 six months ended June 30, 2009, 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 SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activity"* hedge accounting, all gains and losses, realized or unrealized, from derivative contracts have been recognized in the consolidated income statement.

**(Millions of US dollars, unless otherwise noted)**

## Note 13. Financial and derivative instruments (continued)

SFAS No. 133 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 the 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).

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

| | As of June 30, 2009 | | | | As of December 31, 2008 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Assets | | | | | | | | |
| Commodity derivatives | - | 1,544 | - | **1,544** | - | 1,995 | - | **1,995** |
| **Total assets** | **-** | **1,544** | **-** | **1,544** | **-** | **1,995** | **-** | **1,995** |
| Liabilities | | | | | | | | |
| Commodity derivatives | (5) | (1,656) | - | **(1,661)** | - | (1,655) | - | **(1,655)** |
| **Total liabilities** | **(5)** | **(1,656)** | **-** | **(1,661)** | **-** | **(1,655)** | **-** | **(1,655)** |
| **Net (liabilities) assets** | **(5)** | **(112)** | **-** | **(117)** | **-** | **340** | **-** | **340** |

The derivative values above are based on analysis of each contract as the fundamental unit of account as required by SFAS No. 157, *"Fair Value Measurements;"* 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 derivative contracts*

The Group operates in the worldwide crude oil, refined product, natural gas, natural gas liquids and electric power 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 a limited, 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 June 30, 2009 was:

| | As of June 30, 2009 |
|---|---|
| **Assets** | |
| Accounts receivable | 1,544 |
| **Liabilities** | |
| Accounts payable | 1,661 |

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

## Note 13. Financial and derivative instruments (continued)

As required under SFAS No. 161, *"Disclosures about Derivative Instruments and Hedging Activities,"* 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); however, derivative assets and liabilities resulting from eligible commodity contracts have been netted in the consolidated balance sheet in accordance with FIN 39, "*Offsetting of Amounts Related to Certain Contracts,"* and are recorded as accounts receivable in amount of $104 million and accounts payable in amount of $221 million.

The gain and losses from commodity derivatives were included in the consolidated income statements in "Cost of purchased crude oil, gas and products" and for the three and six months ended June 30, 2009 were in the total amount of net loss of $487 million (of which realized losses were $284 million and unrealized losses were $203 million) and of $542 million (of which realized losses were $131 million and unrealized losses were $411 million), respectively.

As of June 30, 2009, 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 at June 30, 2009 was not significant.

The impact from foreign currency derivatives during the three and six months ended June 30, 2009 on the consolidated income statement was not significant. The net position of outstanding foreign currency swap contracts as of June 30, 2009 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 nonperformance. 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 falls below investment grade. Cash is the primary collateral in all contracts; however, many also permit the Group to post letters of credit as collateral.

**(Millions of US dollars, unless otherwise noted)**

## Note 13. Financial and derivative instruments (continued)

There were no derivative instruments with such credit-risk-related contingent features that were in a liability position on June 30, 2009. The Group posted $57 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) on June 30, 2009, and it would be below investment grade, the Group would be required to post additional collateral of $4 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.

## Note 14. Business combinations

In the first quarter of 2009, the Group acquired 100% interests in OOO Smolenskneftesnab, OOO IRT Investment, OOO PM Invest and OOO Retaier House for $238 million. These are holding companies, which between them own 96 petrol stations and plots of land in Moscow, the Moscow region and other regions of central European Russia. This acquisition was made in order to expand the Group's presence on the most advantageous retail market in the Russian Federation. The Group preliminarily allocated $308 million to property, plant and equipment, $61 million to deferred tax liability and $9 million to other liabilities.

In March 2008, a Group company entered into an agreement with a related party, whose management and directors include members of the Group's management and Board of Directors, to acquire a 64.31% interest in TGK-8 for approximately $2,117 million. The purchase consideration partly consists of 23.55 million shares of common stock of the Company (at a market value of approximately $1,620 million). The transaction was finalized in May 2008. The following table summarizes the determined fair value of the assets acquired and liabilities assumed of TGK-8 at the date of acquisition. Value of property, plant and equipment was determined by an independent appraiser.

| | |
|---|---|
| Cash and short-term investments | 724 |
| Other current assets | 266 |
| Property, plant and equipment | 2,092 |
| Other non-current assets | 319 |
| **Total assets acquired** | **3,401** |
| Current liabilities | (196) |
| Non-current deferred tax liabilities | (357) |
| Long-term debt | (149) |
| Minority interest | (582) |
| **Total liabilities assumed** | **(1,284)** |
| **Net assets acquired** | **2,117** |

From May to December 2008, a Group company acquired additional interests in TGK-8 for a total of $1,075 million. These acquisitions increased the Group's ownership to 95.53%. As a result of this additional acquisition the Group recognized property, plant and equipment and a deferred tax liability amounting to $802 million and $192 million, respectively. From January to June 2009, a Group company acquired the remaining 4.47% of share capital of TGK-8 for approximately $127 million. The acquisition increased the Group's ownership to 100%. TGK-8 is a power generating company which owns power plants located in the Astrakhan, Volgograd and Rostov regions, the Krasnodar and Stavropol Districts, and the Republic of Dagestan of the Russian Federation. This acquisition is made in accordance with the Company's plans to develop its electric power business.

## Note 14. Business combinations (continued)

In March 2008, a Group company entered into an agreement to acquire 75 petrol stations and storage facilities in Bulgaria for approximately $367 million. The transaction was finalized in the second quarter of 2008. The Group determined the fair value of assets acquired and as a result recognized property, plant and equipment of $367 million.

These business combinations did not have a material impact on the Group's consolidated operations for the six-month periods ended June 30, 2009 and 2008. Therefore, no pro-forma income statement information has been provided.

## Note 15. Consolidation of Variable Interest Entity

The Group and ConocoPhillips have a joint venture OOO Narianmarneftegaz ("NMNG") which develops oil reserves in the Timan-Pechora region of the Russian Federation. The Group and ConocoPhillips have equal voting rights over the joint venture's activity and effective ownership interests of 70% and 30%, respectively.

The Group determined that NMNG is a variable interest entity as the Group's voting rights are not proportionate to its ownership rights and all of NMNG's activities are conducted on behalf of the Group and ConocoPhillips, its related party. The Group is considered to be the primary beneficiary and has consolidated NMNG.

NMNG's total assets were approximately $6.6 billion and $7.1 billion as of June 30, 2009 and December 31, 2008, respectively.

The Group and ConocoPhillips agreed to provide financing to NMNG by means of long-term loans in proportion to their effective ownership interests. These loans mature from 2035 to 2038, with the option to be extended for a further 35 years with the agreement of both parties. As of June 30, 2009, borrowings under these agreements bear fixed interest in the range of 6.8% to 8.2% per annum.

As of June 30, 2009, the amount outstanding to ConocoPhillips from NMNG was $1,730 million, which consists of a number of loans with a weighted-average interest rate of 7.82% per annum. This amount is presented within "Long-term loans and borrowings from related parties."

## Note 16. Financial guarantees

The Group has entered into various guarantee arrangements. These arrangements were entered into in order to optimize affiliated companies' financing terms. The undiscounted maximum amount of potential future payments for the guarantees issued in favour of equity companies (including LUKARCO) was $119 million and $161 million as of June 30, 2009 and December 31, 2008, respectively.

### *Guarantees on debt*

LUKARCO, an investee recorded under the equity method of accounting has a loan facility on which $130 million was drawn as of June 30, 2009. Borrowings under this loan bear interest at LIBOR plus 2.5% per annum, maturing by May 1, 2012. To enhance the credit standing of LUKARCO, the Company guarantees 54% of the interest payment as well as the repayment of 54% of the loan at maturity. The total amount of the Company's guarantees was $70 million and $98 million, which included nil and $2 million related to accrued interest on the outstanding amount, as of June 30, 2009 and December 31, 2008, respectively. Payments are due if the Company is notified that LUKARCO is not able to fulfil its obligations at maturity date. The Company's guarantee is secured by its 54% interest in LUKARCO with the carrying value of $708 million and $586 million as of June 30, 2009 and December 31, 2008, respectively. There are no material amounts being carried as liabilities for the Group's obligations under this guarantee.

## Note 17. Commitments and contingencies

### *Capital expenditure, exploration and investment programs*

The Group owns and operates refineries in Bulgaria (LUKOIL Neftochim Bourgas AD) and Romania (Petrotel-LUKOIL). As a result of Bulgaria and Romania joining the European Union in 2007, LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL are required to upgrade their refining plants to comply with the requirements of European Union legislation in relation to the quality of produced petroleum products and environmental protection. These requirements are stricter than those which previously existed under Bulgarian and Romanian legislation. The Group estimates the amount of future capital commitment required to upgrade LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL to be approximately $436 million and $37 million, respectively.

Under the terms of existing exploration and production license agreements in Russia the Group has to fulfill certain operations: oil and gas exploration, wells drilling, fields development, etc., and the Group also has commitments to reach a defined level of extraction on the fields. Management believes that the Group’s approved annual capital expenditure budgets fully cover all the requirements of the described license obligations.

In connection with the sale of LUKOIL-Burenie in 2004, the Group signed a five year contract for drilling services. Under the terms of the contract, drilling services of $347 million will be provided by LUKOIL-Burenie (now Eurasia Drilling Company) during the second half of 2009.

The Company has signed a four-year agreement for the provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group’s capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for the second half of 2009 to be approximately $305 million.

Group companies have commitments for capital expenditure contributions in the amount of $636 million related to various production sharing agreements over the next 29 years.

The Group has a commitment to purchase equipment for the modernization of its petrochemical refinery Karpatnaftochim Ltd., located in Ukraine, over the next 2 years. As of June 30, 2009, this commitment was approximately $67 million.

The Group has a commitment to execute the capital construction program of TGK-8 (refer to Note 14. Business combinations). Under the terms of this program, power plants with total capacity of 890 MW should be constructed by the end of 2012. As of June 30, 2009, the Group estimates the amount of this commitment to be approximately $1,112 million.

Group companies have investment commitments relating to oil deposits in Iraq of $495 million to be spent within 3 years from when exploitation of these deposits becomes possible. Due to significant changes in the political and economic situation in Iraq the future of this contract is not clear, however, the Group is actively pursuing its legal right to this contract in Iraq in alliance with ConocoPhillips.

**(Millions of US dollars, unless otherwise noted)**

## Note 17. Commitments and contingencies (continued)

### *Operating lease obligations*

Group companies have commitments of $1,137 million primarily for the lease of vessels and petroleum distribution outlets. Operating lease expenses were $33 million, $44 million, $66 million and $77 million for the three months ended June 30, 2009 and 2008 and for the six months ended June 30, 2009 and 2008, respectively. Commitments for minimum rentals under these leases as of June 30, 2009 are as follows:

| | As of June 30, 2009 |
|---|---|
| For the six-months ending December 31, 2009 | 230 |
| 2010 fiscal year | 261 |
| 2011 fiscal year | 162 |
| 2012 fiscal year | 127 |
| 2013 fiscal year | 100 |
| beyond | 257 |

### *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 charged against income. 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 or expensed as incurred.

## Note 17. Commitments and contingencies (continued)

### *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, which 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 taxation risks in the Russian Federation and other emerging markets where Group companies operate substantially more significant than those in other countries where taxation regimes have been subject to development and clarification over long periods.

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, ADC, a Canadian diamond development company, filed a lawsuit in the District Court of Denver, Colorado against OAO Archangelskgeoldobycha ("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 total damages of approximately $4.8 billion, including 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 Supreme Court found, however, that the trial court made a procedural error by not holding an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company, which is whether the Company had systematic and continuous contacts in the State of Colorado at the time the lawsuit was filed. In a modified opinion dated December 19, 2005, the Colorado Supreme Court remanded the case to the Colorado Court of Appeals (instead of the District Court) to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). On June 29, 2006, the Colorado Court of Appeals declined to dismiss the case based on forum non conveniens. The Company filed a petition for certiorari on August 28, 2006, asking the Colorado Supreme Court to review this decision. This petition has been rejected. On March 5, 2007, the Colorado Supreme Court remanded the case to the District Court. On June 11, 2007, the District Court ruled it would conduct an evidentiary hearing on the issue of whether the Company is subject to general personal jurisdiction in the State of Colorado. Two pre-trial conferences were held with the Court in January 2009. The Court has allowed limited discovery to proceed. Discovery is limited to questions regarding jurisdiction. On May 12, 2009, the Court heard plaintiffs' motion to compel responses to interrogatories and production of document requests regarding personal jurisdiction and issued an order requesting the Company to produce all information and documents responsive to all ADC's interrogatories and requests.

## Note 17. Commitments and contingencies (continued)

ADC subsequently filed a motion asking the Court to reconsider its earlier order and order much broader discovery. The Court has not ruled on the motion to reconsider. On June 26, 2009, three creditors of ADC filed an Involuntary Bankruptcy Petition pursuant to 11 US Code §303 against ADC. The Bankruptcy Court simultaneously issued an automatic stay staying all matters involving ADC. The stay is in effect until at least August 31, 2009. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

In 2001, ADC filed a lawsuit with the Arbitral Tribunal of the Arbitration Institute of the Stockholm Chamber of Commerce ("Arbitration Tribunal") against AGD claiming alleged non-performance under an agreement between the parties and its obligation to transfer the diamond exploration license to Almazny Bereg. This lawsuit claimed compensation of damages amounting to $492 million. Since 2001, there were a number of sessions of the Arbitration Tribunal. On June 16, 2009, termination of the process was announced by ADC. The Arbitration Tribunal is preparing a Procedural Order on the termination of the process and arbitration expenses. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

In July 2008, the Federal Anti-monopoly Service of the Russian Federation ("FAS of Russia") filed claims against major Russian oil companies, including the Company, alleging abuse of their dominant position on the wholesale refinery products' market and setting monopolistically high prices for petrol, diesel fuel, jet fuel and fuel oil. The claim in respect of the Company's actions in the fourth quarter of 2007 and the first half of 2008 was appealed in the Moscow Arbitration Court. In June 2009, the Court rejected the Company's appeal. The Court's decision was appealed and the appeal hearing has not yet been scheduled.

In February 2009, the FAS of Russia initiated further proceedings against the same group of companies in relation to their activities for the second half of 2008 and the first quarter of 2009. The Company was accused of unjustifiably increasing prices in respect of oil products sold by the Group's refineries, withholding oil products from the market, and creating discriminatory conditions in relation to sales of oil products to certain contractors. The hearing in respect of the Company is scheduled for August 28, 2009.

In the second half of 2008 and first half of 2009, the FAS of Russia filed claims against several Group companies in relation to violation of the anti-monopoly regulation. The companies were accused of violations primarily involving the abuse of the dominant market position via setting monopolistically high retail prices and actions on setting and maintaining retail prices on petrol and diesel fuel in coordination with other market participants. These claims are being appealed in the courts.

The amount of possible penalties for the violation of anti-monopoly regulation by the Group in 2008-2009 is estimated at $117 million to $175 million. Management believes that the Group complied with all regulatory and legal requirements and, consequently, believes that the ultimate resolution of the anti-monopoly claims will lead to cancellation of these penalties and will have not a material adverse impact on the Group's operating results or 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 and the Company's shareholder ConocoPhillips. Insurance services were provided by the related parties, whose management and directors include members of the Group's management.

## Note 18. Related party transactions (continued)

Below are related party transactions not disclosed elsewhere in the financial statements. Refer also to Notes 4, 6, 9, 10, 11, 14, 15, 16 and 19 for other transactions with related parties.

Sales of oil and oil products to related parties were $437 million, $47 million, $525 million and $95 million during the three months ended June 30, 2009 and 2008 and during the six months ended June 30, 2009 and 2008, respectively.

Other sales to related parties were $15 million, $24 million, $29 million and $45 million during the three months ended June 30, 2009 and 2008 and during the six months ended June 30, 2009 and 2008, respectively.

Purchases of oil and oil products from related parties were $237 million, $592 million, $399 million and $1,033 million during the three months ended June 30, 2009 and 2008 and during the six months ended June 30, 2009 and 2008, respectively.

Purchases of processing services from related parties were $118 million, nil, $217 million and nil during the three months ended June 30, 2009 and 2008 and during the six months ended June 30, 2009 and 2008, respectively.

Purchases of insurance services from related parties were nil, $38 million, nil and $80 million during the three months ended June 30, 2009 and 2008 and during the six months ended June 30, 2009 and 2008, respectively.

Other purchases from related parties were $6 million, $15 million, $11 million and $23 million during the three months ended June 30, 2009 and 2008 and during the six months ended June 30, 2009 and 2008, respectively.

Amounts receivable from related parties, including loans and advances, were $396 million and $248 million as of June 30, 2009 and December 31, 2008, respectively. Amounts payable to related parties were $77 million and $36 million as of June 30, 2009 and December 31, 2008, respectively.

## Note 19. Compensation plan

In December 2006, the Company introduced a compensation plan to certain members of management for the period from 2007 to 2009, which is based on assigned shares and provides compensation consisting of two parts. The first part represents annual bonuses that are based on the number of assigned shares and amount of dividend per share. The payment of these bonuses is contingent on the Group meeting certain financial KPIs in each financial year. The second is based upon the Company’s common stock appreciation from 2007 to 2009, with rights vesting after the date of the compensation plan’s termination. The number of assigned shares is approximately 15.5 million shares.

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

The second part of the share plan is classified as equity. The grant date fair value of the plan is estimated at $289 million. The fair value was estimated using the Black-Scholes-Merton option-pricing model, assuming a risk-free interest rate of 6.00% per annum, an expected dividend yield 1.59% per annum, expected term of three years and a volatility factor of 30.07%. The expected volatility factor was estimated based on the historical volatility of the Company’s shares for the previous three year period up to January 2007.

**(Millions of US dollars, unless otherwise noted)**

## Note 19. Compensation plan (continued)

Related to this plan the Group recorded $36 million, $37 million, $67 million and $69 million of compensation expenses during the three months ended June 30, 2009 and 2008 and during the six months ended June 30, 2009 and 2008, respectively, of which $25 million, $25 million, $52 million and $51 million, respectively, are recognized as an increase in additional paid-in capital. As of June 30, 2009 and December 31, 2008, $25 million and $22 million related to this plan are included in "Other current liabilities" of the consolidated balance sheets, respectively. The total recognized tax benefit related to these accruals during the three months ended June 30, 2009 and 2008 and during the six months ended June 30, 2009 and 2008, is $7 million, $9 million, $13 million and $17 million, respectively.

As of June 30, 2009, there was $32 million of total unrecognized compensation cost related to unvested benefits. This cost is expected to be recognized periodically by the Group up to December 2009.

## Note 20. Segment information

Presented below is information about the Group's operating and geographical segments for the three and six months ended June 30, 2009 and 2008, in accordance with SFAS No. 131, *"Disclosures about Segments of an Enterprise and Related Information."*

The Group has four operating segments – exploration and production; refining, marketing and distribution; chemicals 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. Activities of the other business operating segment include a power generation business and the development of businesses beyond the Group's traditional operations.

Geographical segments have been determined based on the area of operations and include three segments. They are Western Siberia, European Russia and International.

## Operating segments

**For the three months ended June 30, 2009**

| | Exploration and production | Refining, marketing and distribution | Chemicals | Other | Elimination | Consolidated |
|---|---|---|---|---|---|---|
| Sales | | | | | | |
| Third parties | 582 | 19,098 | 223 | 213 | - | 20,116 |
| Inter-segment | 5,821 | 192 | 28 | 459 | (6,500) | - |
| Total sales | 6,403 | 19,290 | 251 | 672 | (6,500) | 20,116 |
| Operating expenses and total cost of purchases | 954 | 14,285 | 205 | 562 | (6,220) | 9,786 |
| Depreciation, depletion and amortization | 636 | 269 | 13 | 91 | - | 1,009 |
| Interest expense | 216 | 323 | 4 | 98 | (470) | 171 |
| Income tax expense | 537 | 124 | 1 | (2) | (17) | 643 |
| Net income | 1,545 | 907 | (34) | (42) | (52) | 2,324 |
| Total assets | 50,219 | 52,777 | 1,061 | 14,859 | (43,728) | 75,188 |
| Capital expenditures | 1,123 | 304 | 32 | 115 | - | 1,574 |

**(Millions of US dollars, unless otherwise noted)**

## Note 20. Segment information (continued)

**For the three months ended June 30, 2008**

| | Exploration and production | Refining, marketing and distribution | Chemicals | Other | Elimination | Consolidated |
|---|---|---|---|---|---|---|
| Sales | | | | | | |
| Third parties | 394 | 30,730 | 640 | 171 | - | 31,935 |
| Inter-segment | 9,056 | 433 | 6 | 504 | (9,999) | - |
| Total sales | 9,450 | 31,163 | 646 | 675 | (9,999) | 31,935 |
| Operating expenses and total cost of purchases | 1,410 | 21,186 | 578 | 571 | (9,464) | 14,281 |
| Depreciation, depletion and amortization | 442 | 206 | 9 | 46 | - | 703 |
| Interest expense | 211 | 140 | 1 | 69 | (329) | 92 |
| Income tax expense | 739 | 619 | 3 | (3) | - | 1,358 |
| Net income | 2,286 | 2,247 | 16 | 42 | (461) | 4,130 |
| Total assets | 50,717 | 51,078 | 1,053 | 12,907 | (40,659) | 75,096 |
| Capital expenditures | 2,112 | 533 | 18 | - | - | 2,663 |

**For the six months ended June 30, 2009**

| | Exploration and production | Refining, marketing and distribution | Chemicals | Other | Elimination | Consolidated |
|---|---|---|---|---|---|---|
| Sales | | | | | | |
| Third parties | 964 | 32,962 | 400 | 535 | - | 34,861 |
| Inter-segment | 9,330 | 380 | 37 | 887 | (10,634) | - |
| Total sales | 10,294 | 33,342 | 437 | 1,422 | (10,634) | 34,861 |
| Operating expenses and total cost of purchases | 1,693 | 23,259 | 382 | 1,116 | (10,070) | 16,380 |
| Depreciation, depletion and amortization | 1,297 | 508 | 21 | 177 | - | 2,003 |
| Interest expense | 418 | 500 | 6 | 193 | (783) | 334 |
| Income tax expense | 681 | 382 | (1) | 5 | (34) | 1,033 |
| Net income | 3,152 | 624 | (60) | (190) | (297) | 3,229 |
| Total assets | 50,219 | 52,777 | 1,061 | 14,859 | (43,728) | 75,188 |
| Capital expenditures | 2,241 | 607 | 61 | 131 | - | 3,040 |

(Millions of US dollars, unless otherwise noted)

## Note 20. Segment information (continued)

**For the six months ended June 30, 2008**

| | Exploration and production | Refining, marketing and distribution | Chemicals | Other | Elimination | Consolidated |
|---|---|---|---|---|---|---|
| Sales | | | | | | |
| Third parties | 796 | 54,573 | 1,281 | 240 | - | 56,890 |
| Inter-segment | 16,250 | 853 | 13 | 865 | (17,981) | - |
| Total sales | 17,046 | 55,426 | 1,294 | 1,105 | (17,981) | 56,890 |
| Operating expenses and total cost of purchases | 2,515 | 37,438 | 1,130 | 919 | (17,205) | 24,797 |
| Depreciation, depletion and amortization | 843 | 400 | 18 | 66 | - | 1,327 |
| Interest expense | 403 | 287 | 1 | 125 | (652) | 164 |
| Income tax expense | 1,272 | 1,042 | 11 | 4 | - | 2,329 |
| Net income | 3,735 | 3,949 | 23 | 171 | (585) | 7,293 |
| Total assets | 50,717 | 51,078 | 1,053 | 12,907 | (40,659) | 75,096 |
| Capital expenditures | 4,093 | 889 | 45 | 48 | - | 5,075 |

## Geographical segments

| | **For the three months ended June 30, 2009** | **For the three months ended June 30, 2008** | **For the six months ended June 30, 2009** | **For the six months ended June 30, 2008** |
|---|---|---|---|---|
| Sales of crude oil within Russia | 38 | 82 | 43 | 330 |
| Export of crude oil and sales of oil of foreign subsidiaries | 5,293 | 7,200 | 9,056 | 13,067 |
| Sales of refined products within Russia | 1,783 | 3,669 | 3,400 | 6,698 |
| Export of refined products and sales of refined products of foreign subsidiaries | 11,698 | 19,115 | 19,898 | 33,392 |
| Sales of chemicals within Russia | 100 | 256 | 176 | 481 |
| Export of chemicals and sales of chemicals of foreign subsidiaries | 146 | 401 | 274 | 804 |
| Other sales within Russia | 485 | 613 | 1,010 | 1,090 |
| Other export sales and other sales of foreign subsidiaries | 573 | 599 | 1,004 | 1,028 |
| **Total sales** | **20,116** | **31,935** | **34,861** | **56,890** |

**For the three months ended June 30, 2009**

| | Western Siberia | European Russia | International | Elimination | Consolidated |
|---|---|---|---|---|---|
| Sales | | | | | |
| Third parties | 36 | 2,971 | 17,109 | - | 20,116 |
| Inter-segment | 3,069 | 6,694 | 35 | (9,798) | - |
| Total sales | 3,105 | 9,665 | 17,144 | (9,798) | 20,116 |
| Operating expenses and total cost of purchases | 537 | 3,870 | 14,933 | (9,554) | 9,786 |
| Depletion, depreciation and amortization | 244 | 567 | 198 | - | 1,009 |
| Interest expense | 14 | 179 | 100 | (122) | 171 |
| Income tax expense | 218 | 354 | 88 | (17) | 643 |
| Net income | 1,336 | 924 | 72 | (8) | 2,324 |
| Total assets | 19,084 | 42,977 | 25,031 | (11,904) | 75,188 |
| Capital expenditures | 485 | 739 | 350 | - | 1,574 |

**(Millions of US dollars, unless otherwise noted)**

## Note 20. Segment information (continued)

**For the three months ended June 30, 2008**

| | Western Siberia | European Russia | International | Elimination | Consolidated |
|---|---|---|---|---|---|
| Sales | | | | | |
| Third parties | 39 | 5,190 | 26,706 | - | 31,935 |
| Inter-segment | 5,570 | 12,219 | 8 | (17,797) | - |
| Total sales | 5,609 | 17,409 | 26,714 | (17,797) | 31,935 |
| Operating expenses and total cost of purchases | 771 | 6,661 | 24,162 | (17,313) | 14,281 |
| Depletion, depreciation and amortization | 195 | 343 | 165 | - | 703 |
| Interest expense | 9 | 45 | 56 | (18) | 92 |
| Income tax expense | 399 | 899 | 238 | (178) | 1,358 |
| Net income | 1,530 | 2,607 | 213 | (220) | 4,130 |
| Total assets | 19,890 | 42,460 | 27,789 | (15,043) | 75,096 |
| Capital expenditures | 796 | 1,426 | 441 | - | 2,663 |

**For the six months ended June 30, 2009**

| | Western Siberia | European Russia | International | Elimination | Consolidated |
|---|---|---|---|---|---|
| Sales | | | | | |
| Third parties | 65 | 5,570 | 29,226 | - | 34,861 |
| Inter-segment | 5,003 | 11,624 | 42 | (16,669) | - |
| Total sales | 5,068 | 17,194 | 29,268 | (16,669) | 34,861 |
| Operating expenses and total cost of purchases | 938 | 6,356 | 25,240 | (16,154) | 16,380 |
| Depletion, depreciation and amortization | 472 | 1,152 | 379 | - | 2,003 |
| Interest expense | 24 | 268 | 202 | (160) | 334 |
| Income tax expense | 310 | 636 | 121 | (34) | 1,033 |
| Net income | 1,385 | 2,026 | 120 | (302) | 3,229 |
| Total assets | 19,084 | 42,977 | 25,031 | (11,904) | 75,188 |
| Capital expenditures | 931 | 1,416 | 693 | - | 3,040 |

**For the six months ended June 30, 2008**

| | Western Siberia | European Russia | International | Elimination | Consolidated |
|---|---|---|---|---|---|
| Sales | | | | | |
| Third parties | 78 | 9,626 | 47,186 | - | 56,890 |
| Inter-segment | 9,954 | 21,872 | 16 | (31,842) | - |
| Total sales | 10,032 | 31,498 | 47,202 | (31,842) | 56,890 |
| Operating expenses and total cost of purchases | 1,320 | 12,188 | 42,415 | (31,126) | 24,797 |
| Depletion, depreciation and amortization | 374 | 632 | 321 | - | 1,327 |
| Interest expense | 16 | 94 | 104 | (50) | 164 |
| Income tax expense | 710 | 1,452 | 345 | (178) | 2,329 |
| Net income | 2,681 | 4,449 | 506 | (343) | 7,293 |
| Total assets | 19,890 | 42,460 | 27,789 | (15,043) | 75,096 |
| Capital expenditures | 1,476 | 2,787 | 812 | - | 5,075 |

## Note 20. Segment information (continued)

The Group's international sales to third parties include sales in Switzerland of $9,403 million, $14,343 million, $15,883 million and $25,774 million for the three months ended June 30, 2009 and 2008 and for the six months ended June 30, 2009 and 2008, respectively. The Group's international sales to third parties include sales in the USA of $2,191 million, $3,905 million, $3,748 million and $7,107 million for the three months ended June 30, 2009 and 2008 and for the six months ended June 30, 2009 and 2008, 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 SFAS No. 165, "*Subsequent events,*" the Group evaluated subsequent events through the date the financial statements were available to be issued. Therefore subsequent events were evaluated by the Group up to August 27, 2009.