OAO AK TRANSNEFT
CONSOLIDATED FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) FOR THE YEAR ENDED 31 DECEMBER 2008

CONTENTS

	Page
Statement of Directors' Responsibilities	3
Independent auditor's report	4
Consolidated Balance Sheet	5
Consolidated Income Statement	6
Consolidated Statement of Cash Flows	7
Consolidated Statement of Changes in Equity	8
Notes to the Consolidated Financial Statements	9

STATEMENT OF DIRECTORS' RESPONSIBILITIES
To the Shareholders of OAO AK Transneft

1. We have prepared the consolidated financial statements for year ended 31 December 2008 which give a true and fair view of the financial position of the OAO AK Transneft (the "Company") and its subsidiaries (the "Group") at the end of the year and of the results of operations and cash flows for the year then ended. Management of the Group is responsible for ensuring that the Group entities keep accounting records which disclose with reasonable accuracy the financial position of each entity and which enable them to ensure that the consolidated financial statements comply with International Financial Reporting Standards and that their statutory accounting reports comply with Russian laws and regulations. Management also has a general responsibility for taking such steps as are reasonably available to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

2. Management considers that, in preparing the consolidated financial statements set out on pages 5 to 39 the Group has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that appropriate International Financial Reporting Standards have been followed.

3. None of the directors held any shares in Group companies during the year ended 31 December 2008.

4. The consolidated financial statements, which are based on the statutory consolidated accounting reports for the year ended 31 December 2008, approved by management in April 2009, have been converted in accordance with International Financial Reporting Standards.

____

N.P. Tokarev
President
26 June 2009

OAO AK Transneft
ul. Bolshaya Polyanka, 57
119180 Moscow
Russian Federation

PRICEWATERHOUSECOOPERS

ZAO PricewaterhouseCoopers Audit
Kosmodamianskaya Nab. 52, Bld. 5
115054 Moscow
Russia
Telephone +7 (495) 967 6000
Facsimile +7 (495) 967 6001
www.pwc.ru

INDEPENDENT AUDITOR'S REPORT

To the shareholders and directors of OAO AK Transneft:

1 We have audited the accompanying consolidated financial statements of OAO AK Transneft and its subsidiaries (the "Group") which comprise the consolidated balance sheet as at 31 December 2008 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

2 Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

3 Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5 We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

6 In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

26 June 2009
Moscow, Russian Federation

	Notes	31 December 2008	31 December 2007
ASSETS			
Non-current assets			
Intangible assets		1,281	930
Property, plant and equipment	6	809,130	633,560
Available-for-sale financial assets	7	962	754
Investment in associates	19	1,062	-
VAT assets	9	10,281	-
Other financial assets		1,505	-
Total non-current assets		**824,221**	**635,244**
Current assets			
Inventories	8	8,904	9,880
Receivables and prepayments	9	19,082	21,035
VAT assets	9	46,710	50,845
Prepaid income tax		3,647	1,188
Available-for-sale financial assets	7	-	848
Cash and cash equivalents	10	60,565	23,498
Total current assets		**138,908**	**107,294**
Total assets		**963,129**	**742,538**
EQUITY AND LIABILITIES			
Equity			
Share capital	11	308	307
Share premium reserve	11	52,553	-
Merger reserve	11	(13,080)	-
Retained earnings		495,081	426,185
Attributable to the shareholders of OAO AK Transneft		**534,862**	**426,492**
Minority interest	12	25,035	22,447
Total equity		**559,897**	**448,939**
Non-current liabilities			
Borrowings and finance lease obligations	13	191,597	71,322
Deferred income tax liabilities	14	24,582	29,391
Provisions for liabilities and charges	15	75,005	63,315
Total non-current liabilities		**291,184**	**164,028**
Current liabilities			
Trade and other payables	16	46,633	35,987
Current income tax payable		1,275	2,329
Borrowings and finance lease obligations	13	64,140	91,255
Total current liabilities		**112,048**	**129,571**
Total liabilities		**403,232**	**293,599**
Total equity and liabilities		**963,129**	**742,538**

Approved on 26 June 2009 by:

N.P. Tokarev	President
S.N. Suvorova	General director of OOO Transneft Finance, a specialized organization, which performs the accounting function for OAO AK Transneft

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Sales	17	274,977	221,942
Operating expenses	18	(157,484)	(134,848)
Net other operating income	18	9,238	8,203
Operating profit		**126,731**	**95,297**
Financial items:			
Exchange gains		7,194	3,947
Exchange loss		(31,332)	(2,127)
Interest income		2,128	281
Interest expense		(10,150)	(2,273)
Total financial items		**(32,160)**	**(172)**
Share of loss from investments in associates		(69)	-
Profit before income tax		**94,502**	**95,125**
Current income tax expense		(29,151)	(27,164)
Deferred income tax benefit / (expense)		7,174	(3,287)
Income tax expense	14	**(21,977)**	**(30,451)**
Profit for the period		**72,525**	**64,674**
Attributable to:			
Shareholders of OAO AK Transneft		70,506	60,139
Minority interest	12	2,019	4,535

Approved on 26 June 2009 by:

N.P. Tokarev	President
S.N. Suvorova	General director of OOO Transneft Finance, a specialized organization, which performs the accounting function for OAO AK Transneft

The accompanying notes set out on pages 9 to 39 are an integral part of these financial statements

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Cash flows from operating activities			
Cash receipts from customers		320,372	264,787
Cash paid to suppliers and employees, and taxes other than profit tax		(186,523)	(179,506)
Interest paid		(13,722)	(6,008)
Income tax paid		(33,127)	(27,699)
Tax refunds		32,956	10,246
Other cash used in operating activities		(299)	(7,306)
Net cash from operating activities		**119,657**	**54,514**
Cash flows used in investing activities			
Purchase of property, plant and equipment		(130,021)	(146,144)
Proceeds from sales of property, plant and equipment		407	524
Cash on balance sheet of acquired businesses	3	2,826	-
Interest and dividends received		2,157	285
Other cash (used in)/proceeded from investing activities		(555)	269
Net cash used in investing activities		**(125,186)**	**(145,066)**
Cash flows used in financing activities			
Proceeds from long and short-term borrowings		164,494	231,550
Repayment of long and short-term borrowings		(118,096)	(139,921)
Payment of finance lease obligations		(4,094)	(6,048)
Dividends paid		(1,102)	(778)
Net cash from financing activities		**41,202**	**84,803**
Effects of exchange rate changes on cash and cash equivalents		**1,394**	**(46)**
Net increase/ (decrease) in cash and cash equivalents		**37,067**	**(5,795)**
Cash and cash equivalents at the beginning of the period	10	23,498	29,293
Cash and cash equivalents at the end of the period	10	**60,565**	**23,498**

Approved on June 2009 by:

N.P. Tokarev — President

S.N. Suvorova — General director of OOO Transneft Finance, a specialized organization, which performs the accounting function for OAO AK Transneft

The accompanying notes set out on pages 9 to 39 are an integral part of these financial statements

	Attributable to the shareholders of OAO AK Transneft						
	Share capital	**Share premium**	**Merger reserve**	**Retained earnings**	**Total**	**Minority interest**	**Total equity**
Balance at 31 December 2006	**307**	**-**	**-**	**366,917**	**367,224**	**17,912**	**385,136**
Losses arising from change in fair value of available-for-sale financial assets	-	-	-	(86)	(86)	-	(86)
Disposal of available-for-sale financial assets	-	-	-	38	38	-	38
Net loss recognized directly in equity	-	-	-	(48)	(48)	-	(48)
Profit for the period	-	-	-	60,139	60,139	4,535	64,674
Total recognized income for the period	-	-	-	60,091	60,091	4,535	64,626
Dividends paid							
- preference shares	-	-	-	(351)	(351)	-	(351)
- ordinary shares	-	-	-	(472)	(472)	-	(472)
Balance at 31 December 2007	**307**	**-**	**-**	**426,185**	**426,492**	**22,447**	**448,939**
Loss from change in fair value of available-for-sale financial assets	-	-	-	(31)	(31)	-	(31)
Disposal of available-for-sale financial assets	-	-	-	(427)	(427)	-	(427)
Net loss recognised directly in equity	-	-	-	(458)	(458)	-	(458)
Profit for the period	-	-	-	70,506	70,506	2,019	75,525
Total recognised income for the period	-	-	-	70,048	70,048	2,019	72,067
Dividends paid							
- preference shares				(402)	(402)	-	(402)
- ordinary shares				(750)	(750)	-	(750)
Business combination (Note 11)	1	52,553	(13,080)	-	39,474	569	40,043
Balance at 31 December 2008	**308**	**52,553**	**(13,080)**	**495,081**	**534,862**	**25,035**	**559,897**

Approved on 26 June 2009 by:

N.P. Tokarev — President

S.N. Suvorova — General director of OOO Transneft Finance, a specialized organization, which performs the accounting function for OAO AK Transneft

1 NATURE OF OPERATIONS

OAO AK Transneft (the "Company") was established as an open joint stock company and incorporated on 14 August 1993 by the Russian Government Resolution No. 810 under Presidential Decree No. 1403 dated 17 November 1992. The Company's registered office is at 119180 Moscow, ul. Bolshaya Polyanka 57, Russian Federation.

The Company and its subsidiaries (the "Group") described in Note 19 operates the largest crude oil pipeline system in the world totalling 48,529 km. During the year ended 31 December 2008, the Group transported 457 million tonnes of crude oil to domestic and export markets (year ended 31 December 2007 – 464 million tonnes), which represents a substantial majority of the crude oil produced in the territory of the Russian Federation during that period.

In January 2008, OAO AK Transnefteproduct ("Transnefteproduct") became a wholly owned subsidiary of the Company. Transnefteproduct and its subsidiaries ("Group Transnefteproduct") now operates a large oil products pipeline system in the Russian Federation and in the Republics of Belarus and Ukraine totalling approximately 18,739 km. at December 2008. Its associate operates an interconnected system in the Latvian Republic.

The Group's major activity relates to oil transportation services on the territory of the Russian Federation, hence one industry and geographic segment is considered by management.

2 ECONOMIC ENVIRONMENT IN THE RUSSIAN FEDERATION

The ongoing global economic crisis has resulted in, among other things, a lower level of capital market funding lower liquidity levels across the Russian banking sector and higher interbank lending rates. The crisis has also led to bank failures and bank rescues in the United States of America, Western Europe and in Russia.

Related to this crisis, there has been a significant deuteration in the performance of the Russia economy since mid 2008. In addition, since September 2008, there has been increased volatility in currency markets and the Russian Rouble (RR) has depreciated significantly against some major currencies. The official US dollar ("USD") exchange rate of the Central Bank of the Russian Federation ("CBRF") increased from RR 25.3718 at 1 October 2008 to RR 29.3804 at 31 December 2008. The spot Free On Board price per barrel of Urals oil decreased from USD 91.15 at 29 September 2008 to USD 41.83 at 31 December 2008.

Management is unable to predict all developments in the economic environment which could have an impact on the Group's operations and consequently what effect, if any, they could have on the financial position of the Group.The Group believes that the impact of the current crisis on the Group's operations is limited due to the fact that prices for its services are regulated by the Government. Furthermore, the Group's monopoly position on the Russian oil and oil product pipeline transportation market ensures sustainable demand for the Group's services. Group management believes that cash flows from ongoing operations are sufficient to finance the Group's current operations and to service its debt obligations. The short-term debt does not exceed the outstanding balance of the confirmed long-term credit lines. Further the Group does not have any variable interest rate debt obligations and interest payments related to fixed foreign currency obligations are not material compared to its cash flow.

The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations and frequent changes, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Russian Federation. The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

3 BASIS OF PRESENTATION

These consolidated financial statements are prepared in accordance with, and comply with, International Financial Reporting Standards ("IFRS").

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated (see Note 4). The consolidated financial statements of the Group are prepared under the historical cost convention except as described in Notes 4 and 5.

The Group's functional and presentation currency is the national currency of the Russian Federation the Russian Rouble ("RR"). The official US dollar ("USD") to Russian Rouble ("RR") exchange rates as determined by the Central Bank of the Russian Federation was 29.3804 and 24.5462 as of 31 December 2008 and 31 December 2007, respectively. The official euro ("EUR") to Russian Rouble ("RR") exchange rates as determined by the Central Bank of the Russian Federation was 41.4411 and 35.9332 as of 31 December 2008 and 31 December 2007, respectively.

Business combination under common control

On 24 October 2007 the Extraordinary General Meeting of Shareholders approved an increase in the Company's charter capital by 882,220 roubles through the issuance of an additional 882,220 ordinary shares with a par value of 1 rouble each under a closed subscription.

In January 2008 these shares were issued to the Russian Federal Agency for Federal Property Management, the Group's controlling shareholder in return for the acquisition of 100% interest in Transnefteproduct.

Under IFRS, the Group accounted for this business combination amongst entities under common control using the predecessor values method. Accordingly, assets and liabilities of the transferred entities were accounted for at the carrying value in the books of Transnefteproduct Group, as recorded in that Group's IFRS consolidated financial statements. Information in respect of the comparative period was not restated.

The difference between the historic IFRS book value of the Company's 100% share in Transnefteproduct's net assets and the share premium and the nominal value of the share capital issued as consideration for the interest was recognised within equity as a merger reserve (see Note 11).

The Transnefteproduct Group contributed revenue of RR 16,997 and profit of RR 4 to the Group for the period from the date of acquisition to 31 December 2008. If the acquisition had occurred on 1 January 2008, contributed revenue for year ended 31 December 2008 would have been RR 18,452 and profit for year ended 31 December 2008 would have been RR 602.

Details of the assets and liabilities acquired are as follows:

	IFRS carrying amount immediately before business combination
Cash and cash equivalents	2,826
Property, plant and equipment	54,996
Investments	816
VAT assets	6,253
Other assets	1,221
Borrowings	(21,201)
Trade and other payables	(1,269)
Deferred tax liabilities	(2,336)
Other Liabilities	(1,263)
Net assets of subsidiary acquired	40,043
Less: minority interest	(569)
Net assets recognized on business combination	**39,474**

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following significant accounting policies have been consistently applied by the Group in the preparation of the consolidated financial statements for the year ended 31 December 2008, except for changes resulting from amendments to International Financial Reporting Standards discussed below.

Subsidiaries

Subsidiaries are those companies in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has the power to govern the financial and operating policies of the subsidiary. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All inter-company transactions, balances, and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Minority interest at the balance sheet date represents the minority shareholders' portion of the identifiable assets and liabilities of the subsidiary at the acquisition date, and the minorities' portion of movements in equity since the date of the acquisition. Minority interest is that part of the net results and of the net assets of a subsidiary, including the fair value adjustments, which is attributable to interests which are not owned, directly or indirectly, by the Company. Minority interest is presented within equity in the consolidated financial statements.

Investments in associates

Associates are undertakings over which the Group has significant influence and that are neither a subsidiary nor an interest in joint venture. Significant influence occurred when the Group has the power to participate in the financial and operational policy decisions of the entity but has no control or joint control over those policies. Investments in associates are accounted under equity method.

Property, plant and equipment

Property, plant and equipment are carried at initial historical cost, including, where appropriate, the net present value of the estimated dismantlement or removal cost of the asset at the end of its estimated useful life, less accumulated depreciation. Assets under construction are carried at historical cost and depreciated from the time the asset is available for use. Depreciation is calculated on the straight-line basis to write down the cost of each asset to its estimated residual value over its estimated useful life as follows:

	Years
Buildings and facilities	8-50
Pipelines and tanks	20-50
Other plant and equipment	5-25

Management approves specific plans for prospective dismantlement or decommissioning of sections of pipeline and related facilities on an annual basis and, at that time, the estimated useful life of the related asset is revised and the annual depreciation charge is amended if applicable.

Renewals and improvements are capitalized and the assets replaced are retired. Maintenance, repairs, and minor renewals are expensed as incurred. Gains and losses arising from the retirements or other disposals of property, plant and equipment are included in the consolidated income statement.

Crude oil and oil products used for technical operation of the pipeline network (“linefill”) owned by the Group is treated as a separate component of the pipeline class of asset and is not depreciated as its residual value exceeds its carrying amount. Any additions to linefill over the period are recognized at cost, and any disposals are written off at weighed average carrying value of linefill.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Oil surpluses arising from operations are recognized at market value and are debited to inventory and credited to oil surplus, a component of net other operating income, in the consolidated income statement.

Disposals of oil surpluses are accounted for as revenues and included in sales in the consolidated income statement.

The prepayments which relate to PPE are included in the category Assets under construction including prepayments.

Leased assets
Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and equipment acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at the inception of the lease, less accumulated depreciation and impairment losses. Each lease payment is allocated between the liability and finance charges so as to achieve a constant effective interest rate on the finance balance outstanding. The property, plant and equipment under finance leases is depreciated over the shorter of the useful life of the asset and the lease term.

Inventories
Inventories are valued at the lower of weighted average cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Impairment of assets
At each balance sheet date, management assesses whether there is any indication that the recoverable value of the Group’s assets has declined below the carrying value. When such a decline is identified, the carrying amount is reduced to the estimated recoverable amount. The recoverable amount is the higher of an asset’s fair value less costs to sell and value in use. The amount of the reduction is recorded in the consolidated income statement in the period in which the reduction is identified. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset’s recoverable amount. Non-financial assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered an impairment are reviewed for any indication of possible reversal of the impairment at each reporting date.

Financial assets and liabilities
Financial assets and liabilities carried on the consolidated balance sheet include cash and cash equivalents, available-for-sale financial assets, receivables, borrowings, and trade and other payables and other financial assets. These items are initially recognised at fair value adjusted for transaction costs on the date when the Group becomes a party to the contractual provisions of the instrument. Financial assets are de-recognised only when the rights to the separable benefits under the relevant contract are settled, lost, surrendered, or have expired. Financial liabilities are partially or fully de-recognised only when the obligation specified in the relevant contract is discharged, cancelled, or has expired.

Available-for-sale financial assets are re-measured to fair value at each subsequent balance sheet date, other financial assets and financial liabilities are carried at amortised cost.

The fair values of financial assets and liabilities with a maturity date less than three months from the balance sheet date, including trade and other receivables and payables, are assumed to approximate their carrying amounts unless there is an indication of impairment at the balance sheet date. The fair value of all other financial assets and liabilities is based on the amount receivable or payable at the expected settlement date, discounted to net present value using a rate considered appropriate for the asset or liability.

Available-for-sale financial assets

Fair value of available-for-sale securities is determined using the quoted prices on active market. Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Gains and losses arising from changes in the fair value of the investments classified as available-for-sale are recognised in equity. When the investments classified as available-for-sale are sold or impaired, the fair value adjustments accumulated in equity are included in the consolidated income statement as gains and losses from the investments.

At each balance sheet date the Group assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of financial assets classified as available-for-sale, a significant or prolonged decline in the fair value of the financial assets below its cost is considered in determining whether the financial assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the consolidated income statement.

Accounts receivable

Accounts receivable are carried at original invoice amount inclusive of value added taxes less provision made for impairment. A provision for impairment is established when there is a objective evidence that Group will not be able to collect all amounts due to according to the original terms of the contract. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for the similar borrowers at the date of origination of the receivables. The following principal criteria are used to determine whether there is objective evidence that an impairment loss might have occurred:

- any portion of the receivable is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the counterparty experiences a significant financial difficulty as evidenced by its financial information that the Group obtains;
- the counterparty considers bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the counterparty as a result of changes in the national or local economic conditions that impact the counterparty;
- the value of collateral, if any, significantly decreases as a result of deteriorating market conditions.

Prepayments

Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss.

Cash and cash equivalents

Cash and cash equivalents consist of cash, bank balances, and highly liquid investments which are readily convertible to known amounts of cash, subject to an insignificant risk of changes in value, and which have original maturities of three months or less.

VAT assets

VAT assets primarily relate to VAT incurred on capital construction, operating and export activities. VAT is included in current assets if the amount is expected to be recovered within 12 months after the reporting date.

Borrowings

Borrowings are recognised initially at the fair value of the proceeds received which is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price, net of transaction costs incurred. In subsequent periods, borrowings are carried at amortised cost, using the effective interest rate method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised as interest expense over the period of the borrowings.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income taxes

Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the balance sheet date. The income tax charge comprises current tax and deferred tax and is recognised in the income statement except if it is recognised directly in equity because it relates to transactions that are also recognised, in the same or a different period, directly in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

State pension fund

The Group makes contributions for the benefit of employees to a State pension fund. The contributions are expensed as incurred.

Provisions (including dismantlement)

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made.

Provisions are reassessed at each balance sheet date, and are included in the consolidated financial statements at their expected net present values using the discount rate appropriate to the liability in the economic environment of the Russian Federation.

Changes in the provisions resulting from the passage of time are reflected in the consolidated income statement of each period under financial items. Changes in the provisions resulting from the changes in the discount rate and other changes in provisions, related to a change in the expected pattern or estimated cost of settlement of the obligation, are treated as a change in an accounting estimate in the period of the change by adjusting the corresponding asset or expense.

Pension provision

In addition to contributions to State pension fund, the Group sponsors a defined contribution plan for its employees. The Group's contributions to the defined contribution plan are based upon 12% of accrued annual payroll. The Group's contributions to this plan are expensed when incurred and are included within salaries and pension expense in operating expenses.

The Group also operates a defined benefit plan, that represents lump sum payments to employees on their retirement. Pension costs are recognised using the projected unit credit method. The cost of providing pension contributions is charged to operating expenses in the consolidated income statement so as to spread the regular cost over the service lives of employees. The pension obligation is measured at the present value of the estimated future cash outflows using interest rates of government securities, which have the terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognised in full as they arise in the income statement.

Environmental provision

The Group recognises separately the estimated cost of crude oil spillages, including the cost of the obligation to restore the environment, and the estimated recoveries under applicable insurance policies, when it is virtually certain that reimbursement will be received at the date of the spillage.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised as expenses immediately unless they mitigate or prevent future environmental contamination, in which case they are capitalised.

Revenue recognition

Revenues from transportation services are recognized when the services are provided as evidenced by the delivery of crude oil or oil products to the owner or the owner's customer in accordance with the contract. Revenues from oil and oil products sales are recognized upon shipment of goods to the customer, when the goods cease to be under physical control of the Group and risks of ownership have been transferred to the buyer.

Share capital and dividends

Ordinary shares and non-redeemable preferred shares with the right to receive discretionary annual fixed dividends are both classified as equity.

Dividends are recognised as a liability and deducted from shareholders' equity on the date on which they are approved. Dividends proposed at any time, and those approved between the balance sheet date and the date of issuing the consolidated financial statements, are disclosed.

New accounting developments

The Group has early adopted revised IAS 23 "Borrowing costs" as of 1 January 2007, which is generally effective for annual periods beginning on or after 1 January 2009. The Standard eliminates the option of recognizing the borrowing costs immediately as an expense to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. The adoption of the amendment resulted in no change in the opening balance of retained earnings and other reserves as of 1 January 2007.

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2009 or later periods and which the Group has not early adopted, if not stated otherwise:

IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009). The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Puttable financial instruments and obligations arising on liquidation—IAS 32 and IAS 1 Amendment (effective from 1 January 2009). The amendment requires classification as equity of some financial instruments that meet the definition of a financial liability. The Group does not expect the amendment to affect its consolidated financial statements.

IAS 1, Presentation of Financial Statements (revised September 2007; effective for annual periods beginning on or after 1 January 2009). The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Group expects the revised IAS 1 to affect the presentation of its financial statements but to have no impact on the recognition or measurement of specific transactions and balances.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously “minority interests”) even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent’s ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree’s identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed.

Instead, goodwill will be measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.

Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment (issued in January 2008; effective for annual periods beginning on or after 1 January 2009). The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Group does not expect the amendment to affect its consolidated financial statements.

IFRIC 13, Customer Loyalty Programmes (issued in June 2007; effective for annual periods beginning on or after 1 July 2008). IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. IFRIC 13 is not relevant to the Group’s operations because no Group companies operate any loyalty programms.

IFRIC 15, Agreements for the Construction of Real Estate (effective for annual periods beginning on or after 1 January 2009). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. The Group does not expect the amendment to affect its consolidated financial statements.

IFRIC 16, Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 1 October 2008). The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged. The interpretation also clarifies how the gain or loss recycled from the currency translation reserve to profit or loss

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

is calculated on disposal of the hedged foreign operation. Reporting entities will apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 does not have an impact on these consolidated financial statements as the Group does not apply hedge accounting.

IFRIC 17, Distribution of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009). The amendment clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 is not relevant to the Group's operations because it does not distribute non-cash assets to owners.

IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers The Group is currently assessing the impact of the IFRIC 8 on its consolidated financial statements.

In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments issued in May 2008 consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Group does not expect the amendments to have any material effect on its consolidated financial statements.

Improving Disclosures about Financial Instruments - Amendment to IFRS 7, Financial Instruments: Disclosures (issued in March 2009; effective for annual periods beginning on or after 1 January 2009). The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity will be required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee in the earliest period in which the guarantee could be called; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further
have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The Group is currently assessing the impact of the amendment on disclosures in its financial statements.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Embedded Derivatives - Amendments to IFRIC 9 and IAS 39 (effective for annual periods ending on or after 30 June 2009). The amendments clarify that on reclassification of a financial asset out of the ‘at fair value through profit or loss’ category, all embedded derivatives have to be assessed and, if necessary, separately accounted for.

Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity’s own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. The Group does not expect the amendments to have any material effect on its financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group’s consolidated financial statements.

5 CRITICAL ESTIMATES IN APPLYING ACCOUNTING POLICIES

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated and are based on management’s experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results could differ from these estimates and judgments. Management also makes certain judgments, apart from those involving estimations, in the process of applying the accounting policies. Judgments that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Taxation

Russian tax and customs legislation is subject to varying interpretations (see Note 20).

Useful lives of property, plant and equipment

Items of property, plant and equipment are stated at cost less accumulated depreciation. The estimation of the useful life of an item of property, plant and equipment is a matter of management judgment based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any of these conditions or estimates may result in adjustments to future depreciation rates.
Should the useful life of the oil pipeline increases up to 50 years, the profit for the year ended 31 December 2008 would be RR 2,830 higher (the year ended 31 December 2007: RR 3,302).

5 CRITICAL ESTIMATES IN APPLYING ACCOUNTING POLICIES (continued)

Dismantlement provision

Provisions are established for the expected cost of dismantling parts of the existing pipeline network based on the average current cost per kilometre of removal according to an estimated plan of replacement over the long term. The provision calculation is based on the assumption that dismantlement activities are expected to cover the same number of kilometres each year over the useful life of the network. Changes in this assumption or assumptions with regard to expected costs, technical change, and discount rate may result in adjustments to the established provisions (see Note 15), expenses and assets.

Should the average current cost per kilometre of oil pipeline removal increase/ (decrease) by 10%, the profit for the period in 2008 would be RR 698 lower/higher (2007: RR 303)

The Group's estimates for provisions for liabilities and charges are based on currently available facts and the Group's estimates of the ultimate outcome or resolution of the liability in the future. Actual results may differ from the estimates, and the Group's estimates can be revised in the future, either negatively or positively, depending upon the outcome or expectations based on the facts surrounding each exposure.

6 PROPERTY, PLANT AND EQUIPMENT

	Buildings and facilities	Pipelines and tanks	Other plant and equipment	Linefill	Assets under construction including prepayments	Total
At 1 January 2008						
Cost	63,553	377,943	217,909	51,271	216,649	927,325
Accumulated depreciation and impairment	(19,366)	(166,309)	(108,090)	-	-	(293,765)
Net book value at 1 January 2008	**44,187**	**211,634**	**109,819**	**51,271**	**216,649**	**633,560**
Depreciation	(2,268)	(12,622)	(19,643)	-	-	(34,533)
Additions (including prepayments)	-	-	-	7,073	143,098	150,171
Transfers from assets under construction	15,380	92,665	48,188	-	(156,233)	-
Net change in dismantlement provision (see Note 15)	-	7,461	-	-	(984)	6,477
Additional impairment provision	-	(492)	-	-	-	(492)
Disposals/retirements at cost	(516)	(305)	(2,206)	(464)	-	(3,491)
Accumulated depreciation on disposals/retirements and impairment	172	284	1,986	-	-	2,442
Acquisition at cost through business combinations	13,017	25,252	9,784	7,653	22,937	78,643
Accumulated depreciation acquisition and impairment through business combinations	(4,965)	(12,747)	(5,935)	-	-	(23,647)
Net book value at 31 December 2008	**65,007**	**311,130**	**141,993**	**65,533**	**225,467**	**809,130**
At 31 December 2008						
Cost	91,434	503,016	273,675	65,533	225,467	1,159,125
Accumulated depreciation and impairment	(26,427)	(191,886)	(131,682)	-	-	(349,995)
Net book value at 31 December 2008	**65,007**	**311,130**	**141,993**	**65,533**	**225,467**	**809,130**

6 PROPERTY, PLANT AND EQUIPMENT (continued)

	Buildings and facilities	Pipelines and tanks	Plant and equipment	Linefill	Assets under construction including prepayments	Total
At 1 January 2007						
Cost	61,511	349,020	200,913	50,818	102,011	764,273
Accumulated depreciation and impairment	(17,948)	(153,530)	(95,176)	-	-	(266,654)
Net book value at 1 January 2007	**43,563**	**195,490**	**105,737**	**50,818**	**102,011**	**497,619**
Depreciation	(1,609)	(14,072)	(15,423)	-	-	(31,104)
Additions (including prepayments)	-	-	4,267	617	156,958	161,842
Transfers from assets under construction	2,334	26,310	15,258	-	(43,902)	-
Net change in dismantlement provision (see Note 15)	-	3,014	-	-	1,582	4,596
Reversal of impairment provision	-	964	154	-	-	1,118
Disposals/retirements at cost	(292)	(401)	(2,529)	(164)	-	(3,386)
Accumulated depreciation on disposals/retirements and impairment	191	329	2,355	-	-	2,875
Net book value at 31 December 2007	**44,187**	**211,634**	**109,819**	**51,271**	**216,649**	**633,560**
At 31 December 2007						
Cost	63,553	377,943	217,909	51,271	216,649	927,325
Accumulated depreciation and impairment	(19,366)	(166,309)	(108,090)	-	-	(293,765)
Net book value at 31 December 2007	**44,187**	**211,634**	**109,819**	**51,271**	**216,649**	**633,560**

Property, plant and equipment as at 31 December 2008 is presented net of impairment provision of RR 4,078 (as at 31 December 2007 – net of impairment provision of RR 3,586), against specific pipeline assets and machinery.

Linefill represents 27,656 thousand tonnes of crude oil and 1,237 thousand tonnes of oil products as at 31 December 2008 (as at 31 December 2007 – 26,888 thousand tonnes of crude oil) (see Note 4).

During the year ended 31 December 2008, borrowing costs in the amount of RR 14,373 were capitalised as part of cost of assets under construction (see Note 4).

The Group leased certain units (plant and equipment) under a number of finance lease agreements. At the end of each of the leases the Group has the option to purchase the equipment. At 31 December 2008 the net book value of leased property, plant and equipment was RR 7,538 (as at 31 December 2007 – RR 9,365).

7 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	31 December 2008	31 December 2007
Marketable securities	82	604
Investments in other Russian companies	880	998
	962	1,602
Less: short-term available-for-sale financial assets	-	(848)
	962	**754**

Marketable securities mainly include investments in corporate shares.

8 INVENTORIES

	31 December 2008	31 December 200 7
Materials and supplies	6,600	5,477
Sundry goods for resale	2,262	4,197
Other items	42	206
	8,904	**9,880**

Materials and supplies are presented net of provisions for obsolescence of RR 727 as at 31 December 2008 (as at 31 December 2007 – RR 136). Materials are primarily used in the maintenance of pipeline equipment.

Sundry goods for resale, including oil and oil products, were written down below cost to net realisable value, correspondingly the amount of 2,732 RR was recognised as an operating expense in the year ended 31 December 2008 (nil in the year ended 31 December 2007, as crude oil prices declined in the changing economic conditions in 2008 (see Note 2).

9 RECEIVABLES AND PREPAYMENTS AND VAT ASSETS

Receivables and prepayments

	31 December 2008	31 December 2007
Trade receivables (net of a provision for doubtful debts of RR 34 at 31 December 2008 (31 December 2007 - RR 16))	1,662	1,933
Prepayments and advances	11,422	10,030
Other receivables (net of a provision for doubtful debts of RR 3,620 at 31 December 2008 (31 December 2007 - RR 94))	5,998	9,072
	19,082	**21,035**

Other receivables primarily include amounts of funds originally transferred to suppliers of capital construction services, and currently are subject to amicable agreements as services were not provided to the Group on the contractual conditions.
The provision for doubtful debt on other receivable primarily consists of amounts provided against advances issued for capital construction which is currently subject to legal proceedings due to non-fulfilment of works under the contract. In the second quarter the Group received of RR 846 in respect of insurance under non-delivery of works under the contact; this is recorded as other income.

9 RECEIVABLES AND PREPAYMENTS AND VAT ASSETS (continued)

The provision for impairment of accounts receivable was calculated based on an analysis of collectability. The movement of the provision is shown in the table below:

	2008		2007	
	Trade receivables	Other receivables	Trade receivables	Other receivables
As at 1 January	16	94	20	341
Addition of provision through acquisition	14	21	-	-
Reversal of provision	(19)	(39)	(8)	(253)
Accrued provision	23	3,544	4	6
As at 31 December	34	3,620	16	94

Management has determined the provision for impairment of accounts receivable based on specific customer identification, customer payment trends, subsequent receipts and settlements and analysis of expected future cash flows.

According to the analysis of accounts receivable in respect to the payment dates the Group has the following overdue balances not included in the provision for accounts receivable as at 31 December 2008 and 2007:

	31 December 2008		31 December 2007	
Overdue period	Trade receivables	Other receivables	Trade receivables	Other receivables
Less than 90 days	176	67	211	63
More than 90 days but less than 365 days	287	217	194	78
Over 365 days	96	162	147	420
	559	446	552	561

Management of the Group believes that Group entities will be able to realize the net receivable amount through direct collections and other non-cash settlements, and therefore the recorded value of accounts receivable approximates their fair value.

Breakdown of accounts receivable by currency is presented in the tables below:

	RUR	**USD**	**EUR**	**Other**	**Total**
31 December 2008					
trade receivables	1, 535	35	-	92	1,662
other receivables	5,788	193	-	17	5,998
	7,323	228	-	109	7,660
31 December 2007					
trade receivables	1,911	18	4	-	1,933
other receivables	8,969	103	-	-	9,072
	10,880	121	4	-	11,005

VAT assets

	31 December 2008	**31 December 2007**
Recoverable VAT related to construction projects	41,898	28,211
Recoverable VAT related to ordinary activity	15,093	22,634
	56,991	50,845
Less: short-term VAT	(46,710)	(50,845)
Long-term VAT	**10,281**	**-**

10 CASH AND CASH EQUIVALENTS

	31 December 2008	31 December 2007
Balances denominated in Russian roubles	41,572	23,464
Balances denominated in US dollars	18,992	34
Balances denominated in euro	1	-
	60,565	**23,498**

In accordance with Russian legislation, the Group selects financial institutions via holding tenders based on certain legally established requirements. As at 31 December 2008, a significant portion of cash was placed with State controlled financial institutions (see Note 21). The remaining cash balance was placed with other financial institutions with Standard and Poor credit ratings not lower than BB-.

11 SHARE CAPITAL, RETAINED EARNINGS AND DIVIDENDS

Share capital

			31 Decembeı			31 December 2007
	Number of shares	**Histori cal cost**	**Inflated cost**	**Number of shares**	**Histori cal cost**	**Inflat ed cost**
Authorised, issued and fully paid shares of par value RR 1 each						
Ordinary:	5,546,847	5.6	231	4,664,627	4.7	230
Preferred:	1,554,875	1.5	77	1,554,875	1.5	77
	7,101,722	**7.1**	**308**	**6,219,502**	**6.2**	**307**

In January 2008 the Group increased its charter capital by 882,220 roubles through the issuance of an additional 882,220 ordinary shares with a nominal value of RR 1 per share. Ordinary shares for total amount of RR 882,220 were paid for in kind by the contribution of 100% of the shares of Transnefteproduct, the value of which was determined by independent appraisers as being equal to RR 52,553,995 thousand.

Share premium of RR 52,553,113 thousand was recognised in respect of the difference between the appraisers' value of the contributions to the share capital and the nominal value of the shares issued.

The difference of RR 13,080,359 thousand between the historic IFRS book value of the Company's share in Transnefteproduct Group net assets (amounting to RR 39,473,636 thousands) and the nominal value of the share capital issued and the share premium (RR 52,553,995 thousands including share premium of RR 52,553,113 thousand), has been recorded as merger reserve within equity.

As described in paragraph "business combination under common control" (Note 3) the Group accounted for this transaction as of 31 January 2008.

The carrying value of the share capital as at 31 December 2008 and as of 31 December 2007 differs from historical cost due to the effect of hyperinflation in the Russian Federation prior to 31 December 2002.

The Russian Federation, through the Federal Agency for the Management of State Property, holds 100% of the ordinary shares of the Company.

Rights attributable to preferred shares

Holders of preferred shares shall receive dividends pursuant to the authorization of dividend payments at the general meeting. The amount of dividends to be paid on preferred shares is established as 10 percent of the net profits of the Company for the most recent financial year. Dividends on the preferred shares are not cumulative.

11 SHARE CAPITAL, RETAINED EARNINGS AND DIVIDENDS (continued)

Shareholders that hold preferred shares in the Company shall be entitled to participate in the general meeting of shareholders with the right to vote on the following issues:

- on the reorganization and liquidation of the Company;
- on the introduction of amendments and addenda to the Charter of the Company which limit the rights of shareholders that hold preferred shares, including the determination or increase in the amount of dividends and/or determination or liquidation cost to be paid on preferred shares of the previous level of priority;
- on all issues within the competence of the general meeting of shareholders, after an annual general meeting of shareholders where no decision on payment of dividends was adopted or a decision was adopted on partial payment of dividends on preferred shares. This right is terminated from the time of the first full payment of dividends on the indicated shares.

Dividends

In July 2008 the following dividends were approved at the general shareholders meeting for the year ended 31 December 2007:

	Russian roubles per share	Total
Ordinary shares	135.22	750
Preferred shares	258.54	402
		1,152

The dividends were paid in full in December 2008.

In June 2007, the following dividends were approved at the general shareholders meeting for the year ended 31 December 2006:

	Russian roubles per share	Total
Ordinary shares	101.23	472
Preferred shares	225.42	351
		823

The dividends were paid in full in December 2007.

Distributable profits

The statutory accounting reports of the Company are the basis for their respective profit distribution and other appropriations. The statutory profit of the Company was RR 3,682 for the year ended 31 December 2008 (RR 4,018 for the year ended 31 December 2007).

12 MINORITY INTEREST

Minority interest mainly represents the shares in subsidiary entities held by OAO Svayzinvetsneftekhim (36% of OAO SZMN) and the Ministry of Land and Property Relations of the Republic of Bashkortostan (24.5% of OAO Uralsibnefteprovod, 13.8% OAO Uraltransnefteproduct). For other subsidiaries with minority interest refer to Note 19.

13 BORROWINGS AND FINANCE LEASE OBLIGATIONS

	31 December 2008	**31 December 2007**
Borrowings and loans	253,104	157,656
Finance lease obligations	2,633	4,921
Total borrowings and loans	255,737	162,577
Less: current borrowings and loans and current portion of non-current borrowings and loans and finance lease obligations	(64,140)	(91,255)
	191,597	**71,322**
Maturity of non-current borrowings and loans and finance lease obligations		
Due for repayment:		
Between one and five years	122,551	40,752
After five years	69,046	30,570
	191,597	**71,322**

Long-term borrowings include fixed rate loans with a carrying value of RR 190,970 and fair value of RR 144,798 as at 31 December 2008. The fair value of the short-term borrowings and finance lease obligations approximates their carrying amount as at 31 December 2008.

In August 2006, a revolving credit facility amounting to RR 65,000 was made available to a Group company by Sberbank, a state-controlled bank, for the financing of construction of the Eastern Siberia-Pacific Ocean pipeline. Under this agreement the Group obtained access to nonrevolving credit lines individually maturing in one year. In October 2007 the Group signed a supplementary agreement with Sberbank, that stated a period of availability of credit amount attracted under revolving credit facility up to 30 October 2007. In 2008, the Group redeemed RR 35,810 of the borrowed funds under this facility. Liabilities under this agreement as at 31 December 2008 equalled nil (31 December 2007 – RR 35,810). Interest was payable at a fixed rate and was subject to revision if the CBR refinancing rate was in excess of the CBR refinancing rate effective on the date of the credit line agreement by more than 10%.

In October 2007, the Group entered into a further revolving credit facility agreement with Sberbank for up to RR 145,000 to be available until 2014 for the purpose of financing the construction of the Eastern Siberia-Pacific Ocean pipeline. Under this agreement the Group obtained nonrevolving credit lines individually maturing in one or several years. During the year ended 31 December 2008 the Group obtained RR 104,589 of such financing. Liabilities under this agreement as at 31 December 2008 amounted RR 93,565 (31 December 2007 – RR 50,788). Interest is payable at a fixed rate and is subject to revision if the CBR refinancing rate is in excess of the CBR refinancing rate effective on the date of the credit line agreement by more than 10%.
The rates on the above RR loans range from 7% to 12%.

In March 2007, the Group issued Eurobonds in the amount of USD 1.3 billion (RR 38,195 at CBR exchange rate at 31 December 2008, RR 31,910 at CBR exchange rate at 31 December 2007) at an interest rate of 5.67% per annum due in 7 years.

In June 2007, the Group issued Eurobonds in the amount of USD 0.5 billion (RR 14,690 at CBR exchange rate at 31 December 2008, RR 12,273 at CBR exchange rate at 31 December 2007) at an interest rate of 6.103% per annum due in 5 years.

Also in June 2007, the Group issued Eurobonds in the amount of EUR 0.7 billion (RR 29,009 at CBR exchange rate 31 December 2008, RR 25,153 at CBR exchange rate at 31 December 2007) at an interest rate of 5.381% per annum due in 5 years.

13 BORROWINGS AND FINANCE LEASE OBLIGATIONS (continued)

In August 2008, the Group issued Eurobonds in the amount of USD 0.6 billion (RR 17,628 at CBR exchange rate as 31 December 2008) at an interest rate of 7.70% per annum due in 5 years.

Also in August 2008, the Group issued Eurobonds in the amount of USD 1.05 billion (RR 30,849 at CBR exchange rate as 31 December 2008) at an interest rate of 8.70% per annum due in 10 years.

The proceeds from all Eurobonds issues are used to finance the construction of the Eastern Siberia – Pacific Ocean pipeline or for the refinancing of current borrowings, obtained for the same purpose.

In October 2005, Transnefteproduct signed a long-term loan facility agreement for USD 753 million with Vneshtorgbank, of which USD 753 million had been drawn by 31 December 2007. The loan was used for financing Project "North", the construction of a new oil product pipeline "Kstovo-Yaroslavl-Kirishy-Primorsk". The loan bears interest at an annual rate of 10%, which is paid quarterly. The loan is repayable by April 2013 starting in October 2008. The outstanding liability as at 31 December 2008 was RR 21,389 (RR 18,671 as at 31 December 2007).

All borrowings and loans of the Group are unsecured as at 31 December 2008 and 2007.

Finance lease obligations

Finance lease obligations denominated in nominal unit are payable at CBR exchange USD rate as follows:

	31 December 2008		
	Total minimum lease payments	**Interest**	**Present value of finance lease liability**
Less than one year	2,887	881	2,006
Between one and five years	902	275	627
	3,789	**1,156**	**2,633**

	31 December 2007		
	Total minimum lease payments	**Interest**	**Present value of finance lease liability**
Less than one year	4,165	1,223	2,942
Between one and five years	2,424	445	1,979
	6,589	**1,668**	**4,921**

14 DEFERRED TAX LIABILITIES AND INCOME TAX EXPENSE

Deferred tax liabilities and assets consist of the following:

	1 January 2008	Business combina-tions	(Charged)/ credited to profit or loss	(Charged) /credited directly to equity	31 December 2008
Deferred tax liabilities:					
Carrying value of property, plant and equipment in excess of tax base	(44,790)	(2,335)	5,574	-	(41,551)
Other	(133)	(166)	144	(29)	(184)
	(44,923)	**(2,501)**	**5,718**	**(29)**	**(41,735)**
Deferred tax assets:					
Provisions against inventories, receivables and accruals	261	56	581	-	898
Tax loss carry forward	-	-	1,882	-	1,882
Provisions for dismantlement and other expenses	15,271	109	(1,007)	-	14,373
	15,532	**165**	**1,456**	**-**	**17,153**
Net deferred tax liability	**(29,391)**	**(2,336)**	**7,174**	**(29)**	**(24,582)**

	1 January 2007	(Charged)/credited to profit or loss	31 December 2007
Deferred profit tax liabilities:			
Carrying value of property, plant and equipment in excess of tax base	(40,292)	(4,498)	(44,790)
Other	(327)	194	(133)
	(40,619)	**(4,304)**	**(44,923)**
Deferred profit tax assets:			
Provisions against inventories, receivables and accruals	451	(190)	261
Provisions for dismantlement and other expenses	14,065	1,206	15,271
	14,516	1,016	15,532
Net deferred tax liability	**(26,103)**	**(3,288)**	**(29,391)**

Differences between the recognition criteria in Russian statutory taxation regulations and IFRS give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profit tax purposes. The tax effect of the movement on these temporary differences is recorded at the statutory rate of 20% and 24% for the years ended 31 December 2008 and 2007, respectively.

14 DEFERRED TAX LIABILITIES AND INCOME TAX EXPENSE (continued)

The following is a reconciliation of theoretical profit tax expense computed at the statutory tax rate to the profit tax expense calculated at the expected annual effective rate:

	Year ended 31 December 2008	Year ended 31 December 2007
Profit before income tax	**94,502**	**95,125**
Theoretical income tax expense at 24%	22,681	22,830
Increase due to:		
Items not deductible for income tax	4,191	7,621
Effect of reduction in tax rate to 20% enacted in 2008 with effect from 1 January 2009	(4,895)	-
Actual income tax expense	21,977	30,451

On 26 November 2008, the Russian Federation reduced the standard corporate income tax rate from 24% to 20% with effect with 1 January 2009. The impact of the change in tax rate presented above represents the effect of applying the reduced 20% tax rate to deferred tax balances at 31 December 2008.

The Group has not recognized a deferred tax liability in respect of RR 377,237 as at 31 December 2008 (as at 31 December 2007 - RR 315,453) of taxable temporary differences associated with its investments in subsidiaries as the Company is able to control the timing of their reversal and does not believe they will reverse in the foreseeable future.

15 PROVISIONS FOR LIABILITIES AND CHARGES

	31 December 2008	31 December 2007
Dismantlement provision	69,233	58,708
Pension provision	5,772	4,607
	75,005	**63,315**

Dismantlement provision

The provision is established for the expected cost of dismantling parts of the existing pipeline network based on the average current cost per kilometre of removal according to an estimated plan of replacement over the long term. The provision calculation is based on the assumption that dismantlement activities are expected to cover the same number of kilometres each year over the useful life of the network. The cost of dismantlement is added to the cost of property, plant and equipment and depreciated over the useful economic life of the pipeline network.

Additional provisions are made when the total length of the network increases and reductions occur when sections of the pipeline are decommissioned. Other changes are made when the expected pattern or unit cost of dismantlement is changed. The expected costs at the dates of dismantlement have been discounted to net present value using a nominal average rate of 10.08% per year (31 December 2007 – 6.6% per year).

	2008	2007
At 1 January	58,708	54,228
Additions to property, plant and equipment	782	1,914
Changes in estimates adjusted against property, plant and equipment	5,695	3,372
Utilised in the period	(2,085)	(1,765)
Unwinding of the present value discount	5,686	959
Acquisition through business combinations	447	-

At 31 December	**69,233**	**58,708**

15 PROVISIONS FOR LIABILITIES AND CHARGES (continued)

Pension provision

Under collective agreements with the employees, an amount ranging from one to five months final salary is payable upon retirement to those who have worked for the Group for more than three years. Also under collective agreements with the employees, an amount ranging from one to eight months minimal salary is payable on an annual basis until the death of employees to those retired employees who have not entered in an agreement with the Non-state pension fund of the Group, and regular payments for retired employees to jubilees and funeral grant. Management has assessed the net present value of these obligations, following the guidelines set out in IAS 19 "Employee Benefits". Under this method, a provision has been established having regard to employee life expectancy.

Movements in the net liability recognised in the balance sheet are as follows:

	2008	2007
At 1 January	4,607	3,761
Interest cost	322	263
Service cost	271	221
Actuarial loss	925	648
Benefits paid	(353)	(286)
At 31 December	**5,772**	**4,607**

Interest cost, services cost and actuarial loss amounting to RR 1,518 and RR 1,132 for the years ended 31 December 2008 and 2007, respectively, are included in staff costs in the consolidated income statement (see Note 18).

The amounts associated with pension provision recognized in the balance sheet are as follows:

	31 December 2008	31 December 2007
Present value of provision (unfunded)	5,772	4,607
Liability	5,772	4,607

Principal actuarial assumptions used (expressed as weighted average):

	As at 31 December 2008	As at 31 December 2007
Average nominal discount rate	9.67%	7.00%
Future salary increases (nominal)	9.50%	7.00%
Employees average remaining working life (years)	12	12

16 TRADE AND OTHER PAYABLES

	31 December 2008	31 December 2007
Trade payables	14,057	15,500
Advances received for oil and oil product transportation services	17,584	12,844
Accruals	6,335	2,301
VAT output tax payable	4,910	1,229
Payables to employees	1,434	1,057
Other taxes payable	755	770
Other payables	1,558	2,286
	46,633	**35,987**

16 TRADE AND OTHER PAYABLES (continued)

Breakdown of accounts payable by currency is presented in the table below:

	RUR	USD	EUR	Other	Total
31 December 2008					
trade payables	13,984	25	-	48	14,057
other payables	1,313	216	-	29	1,558
	15,297	241	-	77	15,615
31 December 2007					
trade payables	15,480	-	20	-	15,500
other payables	2,269	17	-	-	2,286
	17,749	17	20	-	17,786

17 SALES

	Year ended 31 December 2008	Year ended 31 December 2007
Revenues from crude oil transportation		
Domestic tariff	106,617	80,845
Export tariff	137,370	117,589
Total revenues from crude oil transportation services	**243,987**	**198,434**
Revenues from oil products transportation services	17,101	885
Revenues from crude oil sales	2,142	16,383
Revenues from oil products sales	3,494	-
Other revenues	8,253	6,240
	274,977	**221,942**

The Group revenues from crude oil transportation services on the domestic pipeline network comprise:

- revenues for transportation of crude oil to destinations in the Russian Federation and the Custom Union countries, based on distance-related tariffs denominated and payable in RR and revised periodically after approval by the Federal Tariff Agency ("domestic tariff");
- revenues for transportation of crude oil which is destined for export (outside of the Russian Federation and the Custom Union countries), based on distance-related tariffs denominated in RR and payable in RR and revised periodically after approval by the Federal Tariff Agency ("export tariff").

Other amounts included in export tariffs are:

- a fixed tariff denominated and payable in USD, under intergovernmental agreements for the transportation of crude oil from Azerbaijan over the territory of the Russian Federation, for export at the port of Novorossiysk;
- a distance-related tariff denominated and payable in RR (until 2008 denominated and payable in USD), set by the Federal Tariff Agency for transit of Kazakhstan crude oil over the territory of the Russian Federation, except for the Makhachkala – Novorossiysk pipeline, and
- a fixed tariff denominated and payable in RR (until 2008 denominated and payable in USD), set by the Federal Tariff Agency for transit of Kazakhstan crude oil through the Makhachkala – Novorossiysk pipeline.

17 SALES (continued)

Revenues from oil products transportation services are earned by Transnefteproduct and are derived from distance-related tariffs, which are denominated and payable in RR and revised periodically after approval by the Federal Tariffs Service for transportation of oil products to destinations in Russia, Belarus and Ukraine on the pipeline networks in those countries. The tariffs set by the Federal Tariffs Service represent the maximum amount that may be charged for each journey, and the actual tariffs are frequently lower.

Other Group's revenues mainly comprise oil blending, oil and oil product storage, construction, rent, and communication services.

18 OPERATING EXPENSES AND NET OTHER OPERATING INCOME

	Year ended 31 December 2008	Year ended 31 December 2007
Depreciation	34,067	30,892
Staff costs:		
Salaries and pension expense	39,815	23,967
Unified Social Fund contributions	6,208	4,120
Key management personnel compensation (see Note 21)	279	227
Social expenses	3,087	2,072
Energy	22,452	20,097
Materials	11,999	8,525
Cost of crude oil sold	2,274	14,977
Cost of oil products sold	3,228	-
Insurance expense	3,190	6,410
Net change in doubtful debt provision	3,544	(251)
Reduction of inventory to net realisable value	2,894	-
Net change in impairment provision of property, plant and equipment	492	(1,118)
Repairs and maintenance services	6,634	6,535
Business trip expense	3,297	2,348
Transport expense	1,839	1,884
Taxes other than profit tax:		
Property tax	1,585	1,451
Other taxes	379	159
Other	10,221	12,553
	157,484	**134,848**

Property tax is assessed at a maximum of 2.2% on the average annual net book value of property, plant and equipment. Specific legislation provides for the exclusion of trunk pipelines and related constructions from the taxable base.

Unified Social Fund contributions include Group expenses in relation to the State Pension Fund, which is a defined contribution plan, for the year ended 31 December 2008 in amount of RR 3,972 (for the year ended 31 December 2007 – RR 2,784).

Salaries and pension expense include Group expenses in relation to the non-state defined contribution plan for the year ended 31 December 2008 in amount of RR 3,248 (for the year ended 31 December 2007 – RR 2,127).

18 OPERATING EXPENSES AND NET OTHER OPERATING INCOME (continued)

The following amounts are included in net other operating income:

	Year ended 31 December 2008	Year ended 31 December 2007
Oil surplus	9,728	15,970
Loss on disposal of property, plant and equipment	(940)	(536)
Charitable contribution	(1,004)	(7,193)
Gain on insurance received	1,029	-
Gain/ (loss) on available-for-sale investments	425	(38)
	9,238	**8,203**

19 SUBSIDIARIES AND ASSOCIATES

The following are the principal subsidiaries which have been consolidated and associates accounted for using equity method in these consolidated financial statements:

	Country of incorporation	Percentage (%) of ownership interest at 31 December 2008
Regional crude oil pipeline operators		
OAO Sibnefteprovod	Russia	100.0
OAO Chernomortransneft	Russia	100.0
OAO MN Druzhba	Russia	100.0
OAO Privolzhsknefteprovod	Russia	100.0
OAO Transsibneft	Russia	100.0
OAO Verkhnevolzhsknefteprovod	Russia	100.0
OAO Tsentrsibnefteprovod	Russia	100.0
OAO SMN	Russia	100.0
OOO Baltnefteprovod	Russia	100.0
OAO Uralsibnefteprovod	Russia	75.5
OAO SZMN	Russia	64.0
OOO Vostoknefteprovod	Russia	100.0
Other services for crude oil pipeline operators		
OAO Giprotruboprovod	Russia	100.0
OAO Svyaztransneft	Russia	100.0
OAO CTD Diascan	Russia	100.0
OAO Volzhsky Podvodnik	Russia	100.0
ZAO Centre MO	Russia	100.0
OOO Spetsmornefteport Primorsk	Russia	100.0
OOO TransPress	Russia	100.0
OOO TsUP VSTO	Russia	100.0
OOO Transneft Finance	Russia	100.0
OOO Spetsmornefteport Kozmino	Russia	100.0
OOO Transneft-Servis	Russia	75.0
OOO Transneft-Terminal	Russia	75.0
OOO Energoterminal	Russia	51.0
Fenti Development Limited	Cyprus	100

19 CONSOLIDATED SUBSIDIARIES AND ASSOCIATES (continued)

	Country of incorporation	Percentage (%) of ownership interest at 31 December 2008
Regional oil product pipeline operators		
OAO Mostransnefteproduct	Russia	100.0
OAO Yugo-Zapad transnefteproduct	Russia	100.0
OAO Sredne-VolzhskyTransnefteproduct	Russia	100.0
OAO PeterburgTransnefteproduct	Russia	100.0
OAO Ryazantransnefteproduct	Russia	100.0
OAO Severo-Kavkazsky transnefteproduct	Russia	100.0
OAO Sibtransnefteproduct	Russia	100.0
ChUP Zapad-Transnefteproduct	Belarus	100.0
DP Prikarpatzapadtrans	Ukraine	100.0
OOO Balttransnefteproduct	Russia	100.0
OAO Uraltransnefteproduct	Russia	86.2
Other services for oil product pipeline operators		
OAO AK Transnefteproduct	Russia	100.0
OOO ChOP Spetstransnefteproduct	Russia	100.0
OAO Trade House Transnefteproduct	Russia	100.0
OAO Telecomnefteproduct	Russia	100.0
OAO Podvodspetstransnefteproduct	Russia	100.0
OAO Institute Nefteproductproect	Russia	100.0
OOO Sot-Trans	Russia	100.0
OOO BalttransServis	Russia	100.0
Equity accounted associates		
SIA LatRosTrans	Latvia	34.0
OOO TK-BA	Russia	33.3
ZAO Promsfera	Russia	50.0
OOO Impex-Plus	Russia	50.0
OOO Tikhoretsk -Nafta	Russia	50.0

20 CONTINGENT LIABILITIES, COMMITMENTS AND OTHER RISKS

Legal proceedings

In 2008, the Group was involved in a number of court proceedings arising in the ordinary course of business. In the opinion of management the Group, there are no current legal proceedings or claims outstanding at 31 December 2008, which could have a material adverse effect on the results of operations or financial position of the Group.

Management assesses an unfavorable outcome of the matters discussed below as possible.

As of the date of issuing these consolidated financial statements the courts of the first to third instances confirmed the right of certain entities of the Group (the Company and Transnefteproduct) to claim RR 6,493 of VAT paid during the period January 2004 – September 2007 at a rate of 18% to their transportation subsidiaries for oil and oil products transportation services.

However, the tax authorities filed an appeal application to the Supreme Arbitration Court of the Russian Federation. Resulting from the hearing of this applications on 25 February 2009, the Presidium of the Supreme Arbitration Court invalidated the decisions of the lower courts with regard to one of the litigations amounting to RR 69 and transferred the case to the court of the first instance. In May 2009, the Moscow region court invalidated the decisions of the lower courts with regard to certain litigations amounting to RR 1,397 and in a part of RR 701 transferred the case to the court of the first instance.

20 CONTINGENT LIABILITIES, COMMITMENTS AND OTHER RISKS (continued)

Taxation

Russian tax and customs legislation is subject to varying interpretations and changes which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. The Russian tax authorities may be taking a more assertive and sophisticated approach in their interpretation of the legislation and tax examinations. In particular, it is possible that transactions and activities that have not been challenged in the past may be challenged in the future. As a result, additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Environmental matters

The Group is subject to various environmental laws regarding handling, storage, and disposal of certain products and is subject to regulation by various governmental authorities.

The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

21 RELATED PARTIES AND KEY MANAGEMENT PERSONNEL COMPENSATION

The Russian Federation, through the Federal Agency for the Management of Federal Property, owns 100% of the ordinary shares of the Company and controls its operations through Board members represented by the Ministry of Energy, other Federal bodies, and independent companies. The Government also appoints the members of the Federal Tariff Agency which sets the tariff rates.

The Company holds in trust on behalf of the Russian Government 24% of the shares of the Caspian Pipeline Consortium-R 24% of the shares of the Caspian Pipeline Consortium – K as at 31 December 2008 and 2007. These interests are not recognised in these consolidated financial statements as the Company is acting as an agent on behalf of the Russian Government.

The Group's transactions with other state-controlled entities occur in the normal course of business and include, but are not limited to the following: purchase of electricity for production needs, transportation of oil produced by state-owned entities, and transactions with state-controlled banks.

The Group had the following significant transactions and balances with state-controlled entities:

	Year ended 31 December 2008	Year ended 31 December 2007
Revenue from oil transportation services	69,711	60,046
Revenue from oil products transportation services	6,020	-
Electricity expenses	(1,420)	(1,815)
Interest expenses	(9,717)	(4,799)

21 RELATED PARTIES AND KEY MANAGEMENT PERSONNEL COMPENSATION (continued)

	31 December 2008	31 December 2007
Receivables and prepayments	770	235
Cash	29,083	6,915
Advances received for oil transportation services	4,083	2,989
Advances received for oil product transportation services	1,044	-
Non-current and current borrowings	118,111	86,656

Transactions with the state include taxes which are detailed in the consolidated balance sheet, income statement and Notes 9, 16, 17 and 18.

Key management personnel compensation

Short-term compensation payable to the key management personnel of the Company and its subsidiaries consists of contractual remuneration for their services in full time executive positions. Compensation amounts were as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
Salaries and bonuses	260	197
Termination benefits	9	7
Other	10	23
	279	**227**

According to Russian legislation, the Group makes contributions to the Russian Federation State pension fund for all of its employees including key management personnel. Key management personnel also participate in certain post-retirement compensation programs. The programs include pension benefits provided by the non-governmental pension fund, NPF Transneft, and a one-time payment from the Group at their retirement date.

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK

The accounting policies for financial instruments have been applied to the items below:

	Loans and receivables	Available-for-sale financial assets
Assets as per balance sheet		
31 December 2008		
Cash and cash equivalents (Note 10)	60,565	-
Available-for-sale financial assets (Note 7)	-	962
Other financial assets	1,505	-
Accounts receivable (trade and other) (Note 9)	7,660	-
	69,730	**962**
31 December 2007		
Cash and cash equivalents (Note 10)	23,498	-
Available-for-sale financial assets (Note 7)	-	1,602
Accounts receivable (trade and other) (Note 9)	11,005	-
	34,503	**1,602**

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK (continued)

	31 December 2008	31 December 2007
Liabilities as per balance sheet		
Accounts payable (trade and other) (Note 16)	15,615	17,886
Borrowings and finance lease obligations (Note 13)	255,737	162,577
	271,352	**180,363**

The Group's activities expose it to a variety of financial risks: foreign exchange risk, interest rate risk, commodity price risks, credit risk and liquidity risk.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities.

Foreign exchange risk

The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble, the US dollar or the EURO. The Group does not use foreign exchange or forward contracts. The Group's foreign exchange exposure mainly arises on US dollar and EURO-denominated borrowings, which the Group obtained in 2007-2008 (see Note 13). Assets and liabilities denominated in Ukrainian hryvna or the Belarusian rouble which give rise to foreign currency exchange exposure are insignificant.

As at 31 December 2008, if the US dollar had strengthened / weakened by 20% against the Russian rouble, with all other variables held constant, post tax profit and equity would have been RR 20,752 (for the year ended 31 December 2007 – RR 7,460) lower / higher, mainly as a result of foreign exchange losses / gains on translation of US dollar-denominated borrowings less US dollar-denominated cash balances.

As at 31 December 2008, if the EURO had strengthened / weakened by 20% against the Russian rouble, with all other variables held constant, post tax profit and equity would have been RR 5,802 (for the year ended 31 December 2007 – RR 3,824) lower / higher as a result of foreign exchange losses / gains on translation of EURO-denominated borrowings.

Interest rate risk

Management does not have a formal policy of determining how much the Group's exposure should be to fixed or variable rates. However, at the time of raising new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

As the Group has no significant interest-bearing assets, the Group's income and operating cash flows are substantially independent of changes in market interest rates on assets.

Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The Group obtains borrowings from banks at current market interest rates and does not use any hedging instruments to manage its exposure to changes in interest rates. The Group does not account for any of its fixed rate financial assets and liabilities at fair value through the profit and loss. Therefore, a change in interest rates at the reporting date would not affect profit or equity.

Commodity price risk

The Group's main activity requires it to maintain and replace the existing pipeline network and to construct new pipelines. This necessitates the purchase of significant amounts of steel pipe each year for new and replacement pipelines. The Group does not have long-term contracts with the manufacturers of pipe or the producers of crude oil and crude oil products and does not use derivative contracts to manage its exposure to fluctuations in the price of steel or crude oil or oil products.

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK (continued)

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers and investments.

The Group's policy is generally to transact with its customers on a prepayment basis. The Group does not hold or issue financial instruments for hedging or trading purposes and its trade accounts receivable are unsecured. Being a natural state monopoly, Group ensures equal access to the oil and oil product pipeline for all Russian oil and oil products companies. The majority of the Group's customers are the major oil companies of the Russian Federation including those controlled by the State. The Group has no material concentrations of credit risk or any material past due accounts receivable. Historically, the Group did not have significant bad debts on its trade accounts receivable.

Credit risk is managed on a Group basis. For wholesale customers there is no independent rating and therefore Group assesses the credit quality of the customer, taking into account its financial position, past experience and other factors.

The Group's suppliers of assets and services are selected mainly through tenders. The criteria for the bidders include both technical and financial indicators (availability of production facilities, skilled personnel, relevant experience, cost of assets and services etc.) and reliability (financial position, professional and ethical image of the bidders, whether quality control of the assets and services is established). The tender approach is designed to ensure the selection of suppliers with a low risk of failure to discharge their contractual obligations.

Cash and bank deposits mainly are placed with State controlled financial institutions, which are considered to have minimal risk of default.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

Prudent liquidity risk management includes maintaining sufficient cash and availability of funding from an adequate amount of committed credit facilities. Group maintains flexibility in funding by maintaining availability under committed credit lines.

The following are the contractual undiscounted cash flows of financial liabilities, including estimated interest payments:

31 December 2008:

		Contractual cash flows				
	Carrying amount	**Total**	**12 months or less**	**1-2 years**	**2-5 years**	**More than 5 years**
Borrowings and loans	253,104	325,537	74,986	65,548	101,466	83,537
Trade and other payables	15,615	15,615	15,615	-	-	-
Finance lease liabilities	2,633	3,789	2,887	864	18	20
	271,352	**344,941**	**93,488**	**66,412**	**101,484**	**83,557**

22 FINANCIAL INSTRUMENTS AND FINANCIAL RISK (continued)

31 December 2007:

		Contractual cash flows				
	Carrying amount	Total	12 months or less	1-2 years	2-5 years	More than 5 years
Borrowings and loans	157,656	182,612	96,604	3,912	48,059	34,037
Trade and other payables	17,786	17,786	17,786	-	-	-
Finance lease liabilities	4,921	6,589	4,166	2,098	325	-
	180,363	**206,987**	**118,556**	**6,010**	**48,384**	**34,037**

Fair values

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. The fair value of the trade receivables and payables approximates their carrying amounts at 31 December 2008 and 31 December 2007. The fair value of loans, borrowings and finance lease obligations disclosed in Note 13.

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital. For this purpose, the Group's capital is considered to be equity attributable to the shareholders of the Company and the long-term and short-term debt. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, issue new shares, attract new or repay existing loans and borrowings.

Within the framework of capital management for the purpose of maintaining major debt parameters at the optimal level, the Group's management monitors its key financial indicators, such as total debt/EBITDA, total debt/equity and cash from operating activities/total debt; that allows Group to maintain its credit ratings at a high level, but not less than BBB- by Standard & Poor's and Baa3 on the Moody's scale. The current credit Group's ratings were fixed at the level BBB by Standard & Poor's and Baa1 by Moody's.

There were no changes in the Group's approach to capital management during the year.

23 POST BALANCE SHEET EVENTS

In February 2009, the Group signed a facility agreement with China Development Bank Corporation for USD 10 billion, at a floating LIBOR-based rate, due in 20 years and repayable by equal installments, starting from the fifth year after the credit agreement date. Interest on the credit agreement is payable once every six months until 1 January 2011 and on a monthly basis after 1 January 2011. By the date of singing these financial statements, the Group received USD 5.0 billion under the facility agreement; the remaining loan portion will be drawn down over the period 2009-2010. The proceeds will be used to for the construction of the Eastern Siberia-Pacific Ocean pipeline system including the section of the pipeline to Skovorodino which and borders the People's Republic of China.

In June 2009, the Company placed nonconvertible interest bearing documentary bonds in total amount of RR 35,000 with a nominal value of one thousand roubles each, due in 10 years. There is an option to redeem the bonds earlier at the request of the bearer and at the discretion of the issuer, but not earlier than 6 years after the placement.