Tatneft Group

IFRS CONSOLIDATED FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED 31 DECEMBER 2012 AND 2011

Contents

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Independent Auditor's Report

To the Shareholders and Board of Directors of OAO Tatneft

We have audited the accompanying consolidated financial statements of OAO Tatneft and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2012 and the consolidated statements of comprehensive income, changes in equity and cash flows for 2012, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to express an opinion on the fair presentation of these consolidated financial statements.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2012, and its financial performance and its cash flows for 2012 in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit

5 April 2013

Moscow, Russian Federation

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T.S. Medvedeva, Director (licence no. 01-000496), ZAO PricewaterhouseCoopers Audit

Audited entity: OAO Tatneft

State registration certificate № 632, issued by Ministry of Finance of the Republic of Tatarstan on 21 January 1994

Certificate of inclusion in the Unified State Register of Legal Entities № 1021601623702 issued on 18 July 2002

75, Lenina St., Almetyevsk, Tatarstan, Russia, 423400

Independent auditor: ZAO PricewaterhouseCoopers Audit

State registration certificate № 008.890, issued by the Moscow Registration Bureau on 28 February 1992

Certificate of inclusion in the Unified State Register of Legal Entities № 1027700148431 issued on 22 August 2002

Certificate of membership in self regulated organisation non-profit partnership "Audit Chamber of Russia" № 870. ORNZ 10201003683 in the register of auditors and audit organizations

TATNEFT
Consolidated Statements of Financial Position
(In millions of Russian Roubles)

	Note	31 December 2012	31 December 2011	1 January 2011
Assets				
Cash and cash equivalents	6	13,083	16,901	7,977
Restricted cash		1,369	1,178	2,897
Accounts receivable, net	7	53,553	62,094	54,707
Short-term financial assets	8	14,931	19,205	20,831
Inventories	9	28,590	25,238	15,119
Prepaid expenses and other current assets	10	28,806	26,677	27,030
Total current assets		**140,332**	**151,293**	**128,561**
Long-term accounts receivable, net	7	1,530	2,038	2,275
Long-term financial assets	11	25,782	18,439	16,314
Investments in associates and joint ventures	12	6,711	7,419	11,365
Property, plant and equipment, net	13	448,903	417,873	392,458
Deferred income tax assets	19	2,633	3,430	2,980
Other long-term assets	14	4,716	5,085	4,486
Total non-current assets		**490,275**	**454,284**	**429,878**
Non-current assets classified as held for sale	15	-	1,808	-
Total assets		**630,607**	**607,385**	**558,439**
Liabilities and shareholders' equity				
Short-term debt and current portion of long-term debt	16	32,096	41,997	35,620
Accounts payable and accrued liabilities	17	31,019	35,178	29,968
Taxes payable	19	13,435	14,123	10,582
Total current liabilities		**76,550**	**91,298**	**76,170**
Long-term debt, net of current portion	16	37,991	59,747	72,939
Other long-term liabilities	18	3,710	2,744	3,297
Decommissioning provision, net of current portion	13	51,089	53,655	62,324
Deferred tax liability	19	15,034	14,514	11,486
Total non-current liabilities		**107,824**	**130,660**	**150,046**
Total liabilities		**184,374**	**221,958**	**226,216**
Shareholders' equity				
Preferred shares (authorized and issued at 31 December 2012, 2011 and 1 January 2011– 147,508,500 shares; nominal value at 31 December 2012, 2011 and 1 January 2011 – RR1.00)	20	746	746	746
Common shares (authorized and issued at 31 December 2012, 2011 and 1 January 2011 – 2,178,690,700 shares; nominal value at 31 December 2012, 2011 and 1 January 2011 – RR1.00)	20	11,021	11,021	11,021
Additional paid-in capital		87,482	87,482	87,174
Accumulated other comprehensive income		726	1,995	1,932
Retained earnings		333,072	275,675	224,975
Less: Common shares held in treasury, at cost (55,543,000 shares, 55,556,000 shares and 58,641,000 shares at 31 December 2012, 2011 and 1 January 2011, respectively)		(3,093)	(3,094)	(3,252)
Total Group shareholders' equity		**429,954**	**373,825**	**322,596**
Non-controlling interest	20	16,279	11,602	9,627
Total shareholders' equity		**446,233**	**385,427**	**332,223**
Total liabilities and equity		**630,607**	**607,385**	**558,439**

Approved for issue and signed on behalf of the Board of Directors on 5 April 2013.

[Takhautdinov Sh.F.]
[CEO]

[Voskoboinikov V.A.]
[Director of International Reporting]

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

Consolidated Statements of Comprehensive Income

(In millions of Russian Roubles)

	Note	Year ended 31 December 2012	Year ended 31 December 2011
Sales and other operating revenues, net	23	**444,099**	**417,586**
Costs and other deductions			
Operating	21	86,675	74,760
Purchased oil and refined products		53,900	73,827
Exploration		1,740	2,230
Transportation		29,108	21,762
Selling, general and administrative	21	40,910	33,986
Depreciation, depletion and amortization	13	17,770	12,223
Loss on disposals of property, plant and equipment, investments and impairments		1,997	220
Taxes other than income taxes	19	106,293	100,435
Maintenance of social infrastructure and transfer of social assets		4,031	3,561
Total costs and other deductions		**342,424**	**323,004**
Other income (expenses)			
Foreign exchange gain/(loss)		1,665	(3,033)
Interest income	22	3,872	2,656
Interest expense, net of amounts capitalized	22	(6,978)	(5,842)
Earnings/(losses) from equity investments	12	739	(677)
Other income/(expenses), net		845	(1,569)
Total other income/(expenses)		**143**	**(8,465)**
Profit before income taxes		**101,818**	**86,117**
Income taxes			
Current income tax expense		(21,816)	(19,224)
Deferred income tax expense		(1,554)	(2,683)
Total income tax expense	19	**(23,370)**	**(21,907)**
Profit for the year		**78,448**	**64,210**
Foreign currency translation adjustments		(430)	246
Actuarial loss on employee benefit plans		(990)	(16)
Unrealized holding gains/(losses) on available-for-sale securities, including share of associates, net of tax		151	(167)
Other comprehensive (loss)/income		**(1,269)**	**63**
Total comprehensive income for the year		**77,179**	**64,273**
Profit attributable to:			
- Group shareholders		73,473	62,104
- Non-controlling interest		4,975	2,106
		78,448	**64,210**
Total comprehensive income is attributable to:			
- Group shareholders		72,204	62,167
- Non-controlling interest		4,975	2,106
		77,179	**64,273**
Basic and diluted earnings per share (RR)			
Common	20	32.35	27.37
Preferred		32.33	27.34
Weighted average shares outstanding (millions of shares)			
Common		2,123	2,121
Preferred		148	148

TATNEFT
Consolidated Statements of Changes in Equity
(In millions of Russian Roubles)

	Attributable to Group shareholders									Non-con-trolling interest	Total equity
	Number of shares (thousands)	Share capital	Additional paid-in capital	Treasury shares	Actuarial loss on employee benefit plans	Foreign currency translation adjustments	Unrealized holding gain/(losses) on available-for-sale securities, including share of associates, net of tax	Retained earnings	Total shareholders' equity		
At 1 January 2011	**2,267,558**	**11,767**	**87,174**	**(3,252)**	**512**	**938**	**482**	**224,975**	**322,596**	**9,627**	**332,223**
Profit for the year	-	-	-	-	-	-	-	62,104	62,104	2,106	64,210
Other comprehensive (loss)/income for the year	-	-	-	-	(16)	246	(167)	-	63	-	63
Total comprehensive (loss)/income for the year	**-**	**-**	**-**	**-**	**(16)**	**246**	**(167)**	**62,104**	**62,167**	**2,106**	**64,273**
Treasury shares:	3,085	-	308	158	-	-	-	-	466	-	466
- Acquisitions	(2,365)	-	-	(353)	-	-	-	-	(353)	-	(353)
- Disposals	5,450	-	308	511	-	-	-	-	819	-	819
Acquisition of non-controlling interest in subsidiaries	-	-	-	-	-	-	-	-	-	57	57
Dividends declared	-	-	-	-	-	-	-	(11,404)	(11,404)	(188)	(11,592)
Balance at 31 December 2011	**2,270,643**	**11,767**	**87,482**	**(3,094)**	**496**	**1,184**	**315**	**275,675**	**373,825**	**11,602**	**385,427**
Profit for the year	-	-	-	-	-	-	-	73,473	73,473	4,975	78,448
Other comprehensive (loss)/income for the year	-	-	-	-	(990)	(430)	151	-	(1,269)	-	(1,269)
Total comprehensive (loss)/income for the year	**-**	**-**	**-**	**-**	**(990)**	**(430)**	**151**	**73,473**	**72,204**	**4,975**	**77,179**
Treasury shares	13	-	-	1	-	-	-	-	1	-	1
- Acquisitions	(80)	-	-	(15)	-	-	-	-	(15)	-	(15)
- Disposals	93	-	-	16	-	-	-	-	16	-	16
Acquisition of non-controlling interest in subsidiaries	-	-	-	-	-	-	-	-	-	267	267
Dividends declared	-	-	-	-	-	-	-	(16,076)	(16,076)	(565)	(16,641)
Balance at 31 December 2012	**2,270,656**	**11,767**	**87,482**	**(3,093)**	**(494)**	**754**	**466**	**333,072**	**429,954**	**16,279**	**446,233**

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

TATNEFT
Consolidated Statements of Cash Flows
(In millions of Russian Roubles)

	Year ended 31 December 2012	Year ended 31 December 2011
Operating activities		
Profit for the year	78,448	64,210
Adjustments:		
Depreciation, depletion and amortization	17,770	12,223
Income tax expense	23,370	21,907
Loss on disposals of property, plant and equipment, investments and impairments	1,997	220
Transfer of social assets	4	183
Effects of foreign exchange	(4,830)	3,469
Equity investments (earnings)/losses net of dividends received	(724)	1,117
Change provision for impairment of financial assets	655	(245)
Change in fair value of trading securities	(392)	279
Interest income	(3,872)	(2,656)
Interest expense	6,978	5,842
Other	461	385
Changes in operational working capital, excluding cash:		
Accounts receivable	8,550	(6,407)
Inventories	(6,929)	(10,024)
Prepaid expenses and other current assets	(684)	(10)
Trading securities	37	440
Accounts payable and accrued liabilities	(6,397)	3,294
Taxes payable	(439)	3,491
Notes payable	(78)	(9)
Other non-current assets	(399)	(373)
Net cash provided by operating activities before income tax and interest	**113,526**	**97,336**
Income taxes paid	(23,503)	(18,840)
Interest paid	(3,258)	(3,576)
Interest received	3,872	2,656
Net cash provided by operating activities	**90,637**	**77,576**
Investing activities		
Additions to property, plant and equipment	(50,795)	(49,929)
Proceeds from disposal of property, plant and equipment	1,798	3,466
Proceeds from disposal of investments	1,809	806
Purchase of investments	(2,192)	(97)
Proceeds from certificates of deposit, net	1,554	554
Issuance of loans and notes receivable, net	(502)	(887)
Change in restricted cash	(191)	1,719
Net cash used in investing activities	**(48,519)**	**(44,368)**
Financing activities		
Proceeds from issuance of debt	42,278	88,914
Repayment of debt	(71,458)	(101,675)
Repayment of capital lease obligations	-	(34)
Dividends paid to shareholders	(16,070)	(11,404)
Dividends paid to non-controlling shareholders	(565)	(188)
Purchase of treasury shares	(15)	(13)
Proceeds from sale of treasury shares	16	13
Proceeds from issuance of shares by subsidiaries	9	-
Net cash used in financing activities	**(45,805)**	**(24,387)**
Net change in cash and cash equivalents	**(3,687)**	**8,821**
Effect of foreign exchange on cash and cash equivalents	(131)	103
Cash and cash equivalents at the beginning of the period	16,901	7,977
Cash and cash equivalents at the end of the period	**13,083**	**16,901**

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

Note 1: Organisation

OAO Tatneft (the "Company") and its subsidiaries (jointly referred to as "the Group") are engaged in crude oil exploration, development and production principally in the Republic of Tatarstan ("Tatarstan"), a republic within the Russian Federation. The Group also engages in refining and marketing of crude oil and refined products as well as production and marketing of petrochemicals (see Note 23).

The Company was incorporated as an open joint stock company effective 1 January 1994 (the "privatization date") pursuant to the approval of the State Property Management Committee of the Republic of Tatarstan (the "Government"). All assets and liabilities previously managed by the production association Tatneft, Bugulminsky Mechanical Plant, Menzelinsky Exploratory Drilling Department and Bavlinsky Drilling Department were transferred to the Company at their book value at the privatization date in accordance with Decree No. 1403 on Privatization and Restructuring of Enterprises and Corporations into Joint-Stock Companies. Such transfers were considered transfers between entities under common control at the privatization date, and were recorded at book value.

The Group does not have the ultimate controlling party.

As of 31 December 2012, 2011 and 1 January 2011 OAO Svyazinvestneftekhim, a company wholly owned by the government of Tatarstan, together with its subsidiary, holds approximately 36% of the Company's voting stock. These shares were contributed to Svyazinvestneftekhim by the Ministry of Land and Property Relations of Tatarstan in 2003. Tatarstan also holds a "Golden Share", a special governmental right, in the Company (see Note 20). The exercise of its powers under the Golden Share enables the Tatarstan government to appoint one representative to the Board of Directors and one representative to the Revision Committee of the Company as well as to veto certain major decisions, including those relating to changes in the share capital, amendments to the Charter, liquidation or reorganization of the Company and "major" and "interested party" transactions as defined under Russian law. The Golden Share currently has an indefinite term. The Tatarstan government, including through OAO Svyazinvestneftekhim, also controls or exercises significant influence over a number of the Company's suppliers and contractors.

The Company is domiciled in the Russian Federation. The address of its registered office is Lenina St., 75, Almet'evsk, Tatarstan Republic, Russian Federation.

Note 2: Basis of presentation

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The Group first adopted IFRS for the fiscal year ended 31 December 2012, with a date of transition to IFRS on 1 January 2011.

These consolidated financial statements have been prepared on a historical cost basis, except certain financial assets and liabilities measured at fair value.

The entities of the Group maintain their accounting records and prepare their statutory financial statements principally in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR"). The accompanying financial statements have been prepared from these accounting records and adjusted as necessary to comply with IFRS. The principal differences between RAR and IFRS relate to: (1) valuation (including indexation for the effect of hyperinflation in the Russian Federation through 2002) and depreciation of property, plant and equipment; (2) foreign currency translation; (3) deferred income taxes; (4) valuation allowances for unrecoverable assets; (5) consolidation; (6) share based payment; (7) accounting for oil and gas properties; (8) recognition and disclosure of guarantees, contingencies and commitments; (9) accounting for decommissioning provision; (10) pensions and other post retirement benefits and (11) business combinations and goodwill.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

Note 2: Basis of presentation (continued)

Transition to IFRS

These consolidated financial statements are the Group's first annual financial statements that comply with IFRS. The accounting policies set out in Note 3 have been applied in preparing the consolidated financial statements for the year ended 31 December 2012, the comparative information presented in these consolidated financial statements for the year ended 31 December 2011 and in the preparation of an opening IFRS consolidated statement of financial position as of 1 January 2011 (the Group's date of transition to IFRS).

The Group has applied IFRS 1 "First time adoption of International Financial Reporting Standards", in preparing these consolidated financial statements. In preparing its opening IFRS statement of financial position, the Group has adjusted amounts reported previously in its consolidated financial statements prepared in accordance with US GAAP. An explanation of how the transition from US GAAP to IFRS has affected the Group's financial position, financial performance and cash flows is set out in the tables and notes that accompany the tables.

Subject to certain exceptions, IFRS 1 requires retrospective application of the version of standards and interpretations effective as of 31 December 2012, the date of the Group's first annual IFRS consolidated financial statements. This version was applied in preparing the opening IFRS consolidated statement of financial position as of 1 January 2011 and in subsequent periods up to the end of the first IFRS reporting period.

In preparing these consolidated financial statements, the Group has applied the relevant mandatory exceptions and certain optional exemptions from full retrospective application of IFRS, as detailed below.

Exceptions from retrospective application, which are mandatory under IFRS 1, are:

- Estimates under IFRS at 1 January 2011 are consistent with estimates made for the same date under US GAAP.
- Hedge accounting exception. The Group does not apply hedge accounting.

Other exceptions were not applicable because there were no significant differences as to management application of US GAAP in these areas.

The Group has applied the following optional exemptions:

- The Group has elected to apply the exemption from full retrospective application of decommissioning provisions as allowed under IFRS 1. As such the Group has measured the provisions according to the US GAAP based on the estimated cost of decommissioning, discounted to its net present value upon recognition. However, adjustments to the discount rate are not reflected in the provisions under US GAAP unless there is a corresponding upward revision in the future costs estimates. The Group has taken the exemption for liabilities to which IFRIC 1, Changes in Existing Decommissioning, Restoration and Similar Liabilities, applies and has remeasured the decommissioning provision as at 1 January 2011 under IAS 37 using a current discount rate as at 1 January 2011. In the subsequent periods the decommissioning provision is remeasured using a current discount rate as at the end of each reporting period.

The Group has early-adopted the following standards, together with the consequential amendments to other IFRSs, for the financial year ended 31 December 2012.

- IFRS 10, "Consolidated financial statements": IFRS 10 was issued in May 2011 and replaces all the guidance on control and consolidation in IAS 27, "Consolidated and separate financial statements", and SIC-1 2, "Consolidation – special purpose entities".
- IFRS 12, "Disclosure of interests in other entities": IFRS 12 was issued in May 2011, and provides disclosure requirements on interests in subsidiaries, associates, joint ventures, and unconsolidated structured entities.
- IAS 27, "Separate financial statements": IAS 27 was amended in May 2011 following the issuance of IFRS 10. The revised IAS 27 deals only with the accounting for subsidiaries, associates and joint ventures in the separate financial statements of the parent company.

(in millions of Russian Roubles)

Note 2: Basis of presentation (continued)

The Group has applied the above standards retrospectively. The above standards did not result in significant changes to the Group's financial statements.

The following reconciliations provide a quantification of the effect of the transition from US GAAP to IFRS at 31 December 2011, 1 January 2011 and for the year ended 31 December 2011:

Total Equity Reconciliation

	Ref	31 December 2011	1 January 2011
Total equity under US GAAP		**403,411**	**350,546**
Effects of transition to IFRS:			
Property, plant and equipment componentisation	(ii)	(9,786)	(9,167)
Property, plant and equipment replacement accounting	(iii)	(509)	(451)
Measurements of financial assets and liabilities at fair value, and accounting at amortised cost	(iv)	(2)	(79)
Capitalisation of foreign exchange differences	(v)	3,898	2,623
Changes in Group structure	(vi)	(2,622)	(2,254)
Decommissioning provision	(vii)	(12,850)	(12,987)
Deferred taxes	(viii)	3,887	3,992
Total equity under IFRS		**385,427**	**332,223**

Total Comprehensive Income Reconciliation

	Ref	Year ended 31 December 2011
Total comprehensive income under US GAAP		**64,035**
Effects of transition to IFRS:		
Property, plant and equipment componentisation	(ii)	(619)
Property, plant and equipment replacement accounting	(iii)	(58)
Measurements of financial assets and liabilities at fair value, and accounting at amortised cost	(iv)	77
Capitalisation of foreign exchange differences	(v)	1,275
Changes in Group structure	(vi)	(469)
Decommissioning provision	(vii)	137
Deferred taxes	(viii)	(105)
Total comprehensive income under IFRS		**64,273**

Cash Flow Data Reconciliation

	Year ended 31 December 2011		
	US GAAP	**IFRS adjustment**	**IFRS**
Net cash provided by operating activities (ix)	80,656	(3,181)	77,475
Net cash used for investing activities (ix)	(47,399)	3,031	(44,368)
Net cash used for financing activities (ix)	(24,293)	110	(24,183)

(in millions of Russian Roubles)

Note 2: Basis of presentation (continued)

The following explains significant differences between the Group's previous US GAAP accounting policies and those applied by the Group under IFRS.

i. Sales and other operating revenues recognition

According to the Group's accounting policy under US GAAP, duties remitted to governmental authorities on export from Russia of crude oil and petroleum products sold internationally were accounted for on a gross basis (included in revenues and costs). Under IFRS, taxes and duties arising on the sale of goods to third parties do not form part of revenue. Accordingly, the Group's Sales are presented net of export duties under IFRS.

For the years ended 31 December 2012 and 2011 sales and other operating revenues are shown net off RR 182,457 million and RR 198,429 million export duties and excises, respectively.

ii. Accounting for significant asset components whose useful life differs from the useful life of other components

IFRS has a specific requirement for 'component' depreciation, as described in IAS 16. Each significant part of an item of property, plant and equipment is depreciated separately. Therefore the Company has segregated its assets into depreciable components upon transition to IFRS. The Company recalculated depreciation to these components and recognized the difference in accumulated depreciation.

iii. Replacement accounting

Under US GAAP, oil and gas assets were accounted for and depleted on a field-by-field basis (or for group of fields) using the unit of production method. No gain or loss was recognised on retirement or disposal of an individual well or an item of equipment. When the last well on an individual property (group of properties) ceased to produce, the entire property (group of properties) was abandoned and the resulting gain or loss was recognised. Under IFRS, if a part of an item is replaced and the new part is capitalized, then the replaced part should be written-off with the resulting gain or loss recognized in the income statement. Upon componetisation the Company identified such items which were replaced before the transition date but remained in accounting and recorded their disposal. IFRS replacement accounting effects are recognised in Loss on disposal and impairment of assets in the consolidated income statement for the relevant period.

iv. Measurements of financial assets and liabilities at fair value, and accounting at amortised cost

Under US GAAP short-term and long-term debt were reported at book value and related transactions costs were accounted for separately. In accordance with IFRS financial liabilities are initially measured at fair value less transaction costs and subsequently, are measured at amortized cost.

v. Borrowing cost capitalization

Under US GAAP, the Group did not capitalize the foreign exchange differences relating to borrowings to the extent that they are regarded as an adjustment to interest costs. As a result of applying the guidance of IAS 23, the Group began to capitalize the foreign exchange differences and recorded an increase of the carrying value of property, plant and equipment with a corresponding increase in the Group's retained earnings as of 1 January 2011.

vi. Changes in Group structure

The Group assessed whether the consolidation conclusion under IFRS 10 differs from US GAAP and determined that the only change relates to deconsolidation of ZAO SK Chulpan and its subsidiaries. This change has been reflected in the consolidated financial statements retrospectively and the impact is presented below:

	At 31 December 2011	**At 1 January 2011**
Total assets	4,515	4,074
Total liabilities	1,893	1,820
Total shareholders' equity	2,622	2,254

Note 2: Basis of presentation (continued)

vii. Measurement of decommissioning provisions

Different discount rates are applied under IFRS and US GAAP for decommissioning provisions. According to US GAAP, these liabilities are not remeasured to reflect current discount rates. Under IFRS, the decommissioning provisions are measured as the best estimate of the expenditure to be incurred using the period end discount rate. The Group was required to remeasure its decommissioning provision upon transition to IFRS and recognise the differences in PPE and retained earnings. Subsequent IFRS remeasurements of decommissioning liabilities are recorded with a corresponding adjustment to property, plant and equipment.

viii. Deferred taxes

Under IFRS, deferred taxes have been recalculated based on the IFRS net book values. The main difference in deferred tax amounts calculated under IFRS and deferred tax amounts calculated under US GAAP is due to the measurement of property, plant and equipment.

ix. Adjustments to the statement of cash flows

The transition from US GAAP to IFRS had no significant impact on the Group's cash flows except that, under IFRS, the amounts of interest paid include the amount of interest capitalised are classified as operating cash flows. Under US GAAP, these payments were classified as investing cash flows.

Reclassifications. Certain reclassifications have been made to previously reported balances to conform to the current year presentation; such reclassifications had no effect on profit for the year, shareholders' equity or cash flows.

Note 3: Summary of Significant Accounting Policies

Functional and Presentation Currency. The presentation currency of the Group is the Russian rouble.

Management has determined the functional currency for each consolidated subsidiary of the Group, except for subsidiaries located outside of the Russian Federation, is the Russian Rouble because the majority of its revenues, costs, property and equipment purchased, debt and trade liabilities are either priced, incurred, payable or otherwise measured in Russian Roubles. Accordingly, transactions and balances not already measured in Russian Roubles (primarily US Dollars) have been re-measured into Russian Roubles in accordance with the relevant provisions of IAS 21 *The Effects of Changes in Foreign Exchange Rates.*

Under IAS 21 revenues, costs, capital and non-monetary assets and liabilities are translated at historical exchange rates prevailing on the transaction dates. Monetary assets and liabilities are translated at exchange rates prevailing on the reporting date. Exchange gains and losses arising from re-measurement of monetary assets and liabilities that are not denominated in Russian Roubles are recognized in the profit or loss for the year.

For operations of subsidiaries located outside of the Russian Federation, that primarily use USD as the functional currency, adjustments resulting from translating foreign functional currency assets and liabilities into Russian Roubles are recorded in a separate component of shareholders' equity entitled accumulated other comprehensive income or loss. Revenues, expenses and cash flows are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions).

The official rate of exchange, as published by the Central Bank of Russia ("CBR"), of the Russian Rouble ("RR") to the US Dollar ("US $") at 31 December 2012, 31 December 2011 and 1 January 2011 was RR 30.37, 32.20 and 30.35 to US $, respectively. Average rate of exchange for the years ended 31 December 2012 and 2011 were RR 31.09 and RR 29.39 per US $, respectively.

Consolidation. Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Note 3: Summary of Significant Accounting Policies (continued)

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition – related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognises any non-controlling interest in the acquiree on an acquisition-by-acquisition basis at the non-controlling interest's proportionate share of the acquiree's net assets.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If the total of consideration transferred, non-controlling interest recognised and previously held interest measured is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

Associates. Associates are entities over which the Group has significant influence (directly or indirectly), but not control, generally accompanying a shareholding of between 20 and 50 percent of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. Dividends received from associates reduce the carrying value of the investment in associates. Other post-acquisition changes in Group's share of net assets of an associate are recognised as follows: (i) the Group's share of profits or losses of associates is recorded in the consolidated profit or loss for the year as share of result of associates, (ii) the Group's share of other comprehensive income is recognised in other comprehensive income and presented separately, (iii); all other changes in the Group's share of the carrying value of net assets of associates are recognised in profit or loss within the share of result of associates.

However, when the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

The Group reviews equity method investments for impairment on an annual basis, and records impairment when circumstances indicate that the carrying value exceeds the recoverable amount.

Current/Non-current Presentation. Group presents current and non-current assets, and current and non-current liabilities, as separate classifications in its Consolidated Statement of Financial Position.

Group discloses for each asset and liability line item that combines amounts expected to be recovered or settled in period no more than 12 months after the reporting period are disclosed as current; and more than 12 months after the reporting period as non-current.

Cash and cash equivalents. Cash represents cash on hand and in bank accounts, which can be effectively withdrawn at any time without prior notice. Cash equivalents include highly liquid short-term investments that can be converted to a certain cash amount and mature within three months or less from the date of purchase. They are recognized based on the cost of acquisition which approximates fair value.

Restricted cash. Restricted cash represents cash deposited under letter of credit arrangements, which are restricted under various contractual agreements. Letters of credit are used to pay contractors for materials, equipment and services provided. Restricted balances are excluded from cash and cash equivalents for the purposes of the consolidated statements of financial position and of the cash flow statements and disclosed separately.

Financial Assets. All financial assets are initially recognised when an entity becomes a party to the contract, they recognised at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group's financial assets include cash and cash equivalents, deposits, securities, trade and other receivables, loans issued.

Financial assets have the following categories: (a) loans and receivables; (b) available-for-sale financial assets; (c) financial assets at fair value through profit or loss.

Note 3: Summary of Significant Accounting Policies (continued)

Loans and receivables. Loans and receivables is a category of financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses. The accrued interest is included in the profit and losses for the year.

Allowances are provided for estimated losses and for doubtful debts based on estimates of uncollectible amounts. These estimates require the exercise of judgment and the use of assumptions.

The losses arising from impairment are recognized as Selling, general and administrative expenses in the Consolidated Statements of Comprehensive Income.

Financial assets at fair value through profit or loss. A financial asset is classified at fair value through profit or loss category if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit and losses for the year.

Available-for-sale financial assets. Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the above categories of financial assets. Available-for-sale financial assets include investment securities which the Group intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses and foreign currency differences on available-for-sale debt instruments, are recognized in other comprehensive income and presented within equity. Unquoted equity instruments whose fair value cannot be measured reliably are carried at cost less any impairment losses. When an investment is derecognized the cumulative gain or loss in equity is also reclassified to profit and loss for the year.

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities 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 recognized in the other comprehensive income) is recognized in the profit and losses for the year as a reclassification adjustment from other comprehensive income.

Financial liabilities. All financial liabilities are recognised initially at fair value and in the case of loans and borrowings, net of directly attributable transaction costs. The Group's financial liabilities include trade and other payables, loans and borrowings.

Financial liabilities are recognised initially at fair value. The difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised in profit or loss for the year. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest method.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the profit and loss for the year.

The Group does not use derivative financial instruments.

The Group does not offset assets and liabilities unless required or permitted to by an IFRS.

Inventories. Inventories of crude oil, refined oil products, materials and supplies, and finished goods are valued at the lower of cost or net realizable value. The Group uses the weighted-average-cost method. Costs include both direct and indirect expenditures incurred in bringing an item or product to its existing condition and location.

Note 3: Summary of Significant Accounting Policies (continued)

Prepaid expenses. Prepaid expenses include advances for purchases of products and services, insurance fees, prepayments for export duties, VAT and other taxes.

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. Prepayments for services such as insurance, transportation and others are written off to profit or loss when the goods or services relating to the prepayments are received.

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 the profit or loss for the year.

Mineral extraction tax. Mineral extraction tax (MET) on crude oil is defined monthly as an amount of volume produced per fixed tax rate (RR 446 and RR 419 per ton in 2012 and 2011, respectively) adjusted depending on the monthly average market prices of the Urals blend and the RR/USD exchange rate for the preceding month. The base tax rate formula for MET is modified by benefit for fields whose depletion rate exceeds 80% of proved reserves as determined under Russian resource classification. The Company receives a benefit of 3.5% per field for each percent of depletion in excess of the 80% threshold.

The ultimate amount of the MET on crude oil depends also on geographic location of the oil field (for certain regions zero tax rate may be applied depending on the volume of crude oil produced and period of field development). Also a zero MET tax rate applies to the production of highly viscous crude oil (defined as crude oil of more than 200 Megapascal second in reservoir conditions).

MET is recorded within Taxes other than income tax in the Consolidated Statement of Comprehensive Income.

Value added tax. Value added tax (VAT) at a standard rate of 18% is payable on the difference between output VAT on sales of goods and services and recoverable input VAT charged by suppliers. Output VAT is charged on the earliest of the dates: either the date of the shipment of goods (works, services) or the date of advance payment by the buyer. Input VAT can be recovered when purchased goods (works, services) are accounted for and other necessary requirements provided by the tax legislation are met.

Export of goods and rendering certain services related to exported goods are subject to 0% VAT rate upon the submission of confirmation documents to the tax authorities.

VAT related to sales and purchases is recognized in the Consolidated Statements of Financial Position on a gross basis and disclosed separately as Prepaid expenses and other current assets and Taxes payable.

Oil and gas exploration and development cost. Oil and gas exploration and development activities are accounted for using the successful efforts method whereby costs of acquiring unproved and proved oil and gas property as well as costs of drilling and equipping productive wells, including development dry holes, and related production facilities are capitalized.

Other exploration expenses, including geological and geophysical expenses and the costs of carrying and retaining undeveloped properties, are expensed as incurred. The costs of exploratory wells that find oil and gas reserves are capitalized as exploration and evaluation assets on a “field by field” basis pending determination of whether proved reserves have been found. In an area requiring a major capital expenditure before production can begin, exploratory well remains capitalized if additional exploration drilling is underway or firmly planned. Exploration costs not meeting these criteria are charged to expense.

Exploration and evaluation costs are subject to technical, commercial and management review as well as review for impairment at least once a year to confirm the continued intent to develop or otherwise extract value from the discovery. When indicators of impairment are present, resulting impairment loss is measured.

If subsequently commercial reserves are discovered, the carrying value, less losses from impairment of respective exploration and evaluation assets, is classified as development assets. However, if no commercial reserves are discovered, such costs are expensed after exploration and evaluation activities have been completed.

Property, Plant and Equipment. Property, plant and equipment are carried at historical cost of acquisition or construction less accumulated depreciation, depletion, amortization and impairment.

Note 3: Summary of Significant Accounting Policies (continued)

Proved oil and gas properties include the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. The cost of maintenance, repairs and replacement of minor items of property are expensed when incurred within operating expenses; renewals and improvements of assets are capitalised and depreciated during the remaining useful life. Cost of replacing major parts or components of property, plant and equipment items are capitalised and the replaced part is retired.

Advances made on property, plant and equipment and construction in progress are accounted for within Construction in progress.

Long-lived assets, including proved oil and gas properties at a field level, are assessed for possible impairment in accordance with IAS 36 Impairment of assets, which requires long-lived assets with recorded values that are not expected to be recovered through future cash flows to be written down to their recoverable amount which is the higher of fair value less costs to sell and value-in-use.

Individual assets are grouped for impairment purposes at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets - generally on a field-by-field basis for exploration and production assets, at an entire complex level for refining assets or at a site level for service stations. Impairment losses are recognised in the profit or loss for the year.

Impairments are reversed as applicable to the extent that the events or circumstances that triggered the original impairment have changed. The reversal of impairment would be limited to the original carrying value less depreciation which would have been otherwise charged had the impairment not been recorded.

Long-lived assets committed by management for disposal within one year, and meet the other criteria for held for sale, are accounted for at the lower of amortized cost or fair value, less cost to sell. Costs of unproved oil and gas properties are evaluated periodically and any impairment assessed is charged to expense.

The Group calculates depreciation expense for oil and gas proved properties using the units-of-production method for each field based upon proved developed oil and gas reserves, except in the case of significant asset components whose useful life differs from the lifetime of the field, in which case the straight-line method is applied.

Oil and gas licenses for exploration of unproved reserves are capitalised within property, plant and equipment; they are depreciated on straight-line basis over the period of each license validity.

Depreciation of all other property, plant and equipment is determined on the straight-line method based on estimated useful lives which are as follows:

	Years
Buildings and constructions	30-50
Machinery and equipment	10-35

Gains and losses on disposals of property, plant and equipment are determined by comparing proceeds, if any, with the carrying amount. Gains and losses are recorded in Loss on disposals of property, plant and equipment, investments and impairments in the Consolidated Statement of Comprehensive Income.

Non-current Assets (or Disposal Groups) Held for Sale. Non-current assets (or disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable within twelve months after the reporting period. They are stated at the lower of carrying amount and fair value less costs to sell. Assets and liabilities directly associated with the disposed assets are reclassified and presented separately in the Consolidated Statement of Financial Position

Capitalisation of Borrowing Costs. Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets.

The Group capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Group’s average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred less any investment income on the temporary investment of those borrowings are capitalised.

Note 3: Summary of Significant Accounting Policies (continued)

Capitalisation of borrowing costs includes capitalising foreign exchange differences relating to borrowings to the extent that they are regarded as an adjustment to interest costs. The gains and losses that are an adjustment to interest costs include the interest rate differential between borrowing costs that would be incurred if the entity borrowed funds in its functional currency, and borrowing costs actually incurred on foreign currency borrowings.

The portion of the foreign exchange movements is estimated based on interest rates on similar borrowing in the Group's functional currency. The foreign exchange gains and losses eligible for capitalisation are assessed on a cumulative basis.

Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

Employee Benefits, Pension and Other Post-retirement Benefits. Wages, salaries, contributions to the social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and kindergarten services) are accrued in the year in which the associated services are rendered by the employees of the Group. The Group has various pension plans covering substantially all eligible employees and members of management. The pension liabilities are 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. Pension costs are recognised using the projected unit credit method.

The cost of providing pensions is accrued and charged to staff expense within operating expenses in the Consolidated Statement of Comprehensive Income reflecting the cost of benefits as they are earned over the service lives of employees.

Actuarial gains and losses with regard to post employment benefit plans are recognised immediately in other comprehensive income. Actuarial gains and losses related to other long-term benefits are recognised immediately in the profit or loss for the year.

Past service costs with regard to post employment benefit plans are recognised as an expense if benefits are already vested. Part of the past service cost which relate to benefits which are not fully vested is recognised over vesting period. Past service costs with regard to other long-term benefits are recognised as an expense as it occurs.

Plan assets are measured at fair value and are subject to certain limitations. Fair value of plan assets is based on market prices. When no market price is available the fair value of plan assets is estimated by different valuation techniques, including discounted expected future cash flow using a discount rate that reflects both the risk associated with the plan assets and maturity or expected disposal date of these assets.

In the normal course of business the Group contributes to the Russian Federation State Pension Fund on behalf of its employees. Mandatory contributions to the Fund are expensed when incurred and are included within staff costs in operating expenses.

Stock-based compensation. The Company has a share-based compensation plan (the “Plan”) for senior management and directors of the Company. Under the provisions of the Plan, share-based bonus awards (“Awards”) are issued on an annual basis to the Company's directors and senior management as approved by the Board of Directors. Each Award provides a cash payment at the settlement date equal to one of the Company’s common shares multiplied by the difference between the lowest share price for the preceding three years as of the grant date and the highest share price for the preceding three years as of each year-end. Share prices are measured based on the weighted average daily trading price as reported on the Moscow Interbank Currency Exchange (MICEX). Awards are subject to individual annual performance conditions and are generally settled within 90 days after the Company’s Management Committee approval.

The liability at 31 December 2012, 2011 and 1 January 2011 is determined based on the final expected bonus payments. The Awards are recognized as expense over the annual service period, net of forfeitures, with a corresponding liability to accounts payable and accrued liabilities.

Note 3: Summary of Significant Accounting Policies (continued)

Decommissioning provisions. The Group recognizes a liability for the fair value of legally required or constructive decommissioning provisions associated with long-lived assets in the period in which the retirement obligations are incurred. The Group has numerous asset removal obligations that it is required to perform under law or contract once an asset is permanently taken out of service. The Group's field exploration, development, and production activities include assets related to: well bores and related equipment and operating sites, gathering and oil processing systems, oil storage facilities and gathering pipelines. Generally, the Group's licenses and other operating permits require certain actions to be taken by the Group in the abandonment of these operations. Such actions include well abandonment activities, equipment dismantlement and other reclamation activities. The Group's estimates of future abandonment costs consider present regulatory or license requirements, as well as actual dismantling and other related costs. These liabilities are measured by the Group using the present value of the estimated future costs of decommissioning of these assets. The discount rate is reviewed at each reporting date and reflects current market assessments of the time value of money and the risks specific to the liability. Most of these costs are not expected to be incurred until several years, or decades, in the future and will be funded from general Group resources at the time of removal.

The Group capitalizes the associated decommissioning costs as part of the carrying amount of the long-lived assets. Changes in the measurement of an existing decommissioning provision that result from changes in the estimated timing or amount of the outflows, or from changes in the discount rate alter the previously recognised revaluation surplus or deficit for the related asset.

The Group's petrochemical, refining and marketing and distribution operations are carried out at large manufacturing facilities. The nature of these operations is such that the ultimate date of decommissioning of any sites or facilities is unclear. Current regulatory and licensing rules do not provide for liabilities related to the liquidation of such manufacturing facilities or of retail fuel outlets. Management therefore believes that there are no legal or contractual obligations related to decommissioning or other disposal of these assets.

Income Taxes. Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge comprises current tax and deferred tax and is recognised in profit or loss for the year, except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or 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 income tax assets and liabilities are recognised for all taxable temporary differences, except:

- Where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting nor taxable profit or loss;
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future; and
- Where it is not probable that future taxable profit will be available against which the deductible temporary differences and the carry forward of unused tax credits and unused tax losses can be utilised.

Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period, 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.

Income tax penalties expense and income tax penalties payable are included in Taxes other than income tax in the Consolidated Statements of Comprehensive Income and Taxes payable in the Consolidated Statements of Financial Position, respectively. Income tax interest expense and payable are included in Interest expense in the Consolidated Statement of Comprehensive Income and other accounts payable and accrued expenses in the Consolidated Statements of Financial Position, respectively.

Share capital. Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity.

Dividends paid to shareholders are determined by the Board of directors and approved at the annual shareholders' meeting.

Note 3: Summary of Significant Accounting Policies (continued)

Treasury shares. Common shares of the Company owned by the Group at the reporting date are designated as treasury shares and are recorded at cost using the weighted-average method. Gains on resale of treasury shares are credited to additional paid-in capital whereas losses are charged to additional paid-in capital to the extent that previous net gains from resale are included therein or otherwise to retained earnings.

Earnings per share. Preference shares are not redeemable and are considered to be participating shares.

Basic and diluted earnings per share are calculated by dividing profit or loss attributable to ordinary and preference share holders by the weighted average number of ordinary and preferred shares outstanding during the period. Profit or loss attributed to equity holders is reduced by the amount of dividends declared in the current period for each class of shares. The remaining profit or loss is allocated to common and preferred shares to the extent that each class may share in earnings if all the earnings for the period had been distributed. Treasury shares are excluded from calculations. The total earnings allocated to each class of shares are determined by adding together the amount allocated for dividends and the amount allocated for a participation feature.

Revenue recognition. Revenues from the production and sale of crude oil, petroleum and petrochemical products and other products are recognized when title has transferred and collectability is reasonably assured. Revenue is measured at the fair value of the consideration received or receivable taking into account the amount of any discounts and other incentives. Purchases and sales of inventory with the same counterparty that are entered into in contemplation of one another are combined, considered as a single arrangement and netted against each other in the Consolidated Statement of Comprehensive Income. Revenue includes only economic benefits which flow to the Group. Taxes and duties arising on the sale of goods to third parties do not form part of revenue.

Transportation expenses. Transportation expenses recognised in the Consolidated Statement of Comprehensive Income represent all expenses incurred by the Group to transport crude oil and other products to end customers (they may include pipeline tariffs and any additional railroad costs, handling costs, port fees, sea freight and other costs). Compounding fees are included in Selling, General and administrative expenses.

Note 4: Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the amounts recognised in the financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements 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.

Management of the Group also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements 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:

- Estimation of oil and gas reserves;
- Useful life of property, plant and equipment;
- Decommissioning provisions;
- Impairment of long-lived assets;
- Consolidation.

Estimation of oil and gas reserves. Oil and gas development and production assets are depreciated on a unit-of-production (UOP) basis for each field or group of fields with similar characteristics at a rate calculated by reference to proved or proved developed reserves. Estimates of proved reserves are also used in the determination of whether impairments have arisen or should be reversed. Also, exploration drilling costs are capitalized pending the results of further exploration or appraisal activity, which may take several years to complete and before any related proved reserves can be booked.

(in millions of Russian Roubles)

Note 4: Critical Accounting Estimates and Judgements in Applying Accounting Policies (continued)

Proved and proved developed reserves are estimated by reference to available geological and engineering data and only include volumes for which access to market is assured with reasonable certainty. Estimates of oil and gas reserves are inherently imprecise, require the application of judgment and are subject to regular revision, either upward or downward, based on new information such as from the drilling of additional wells, observation of long-term reservoir performance under producing conditions and changes in economic factors, including product prices, contract terms or development plans. The Group estimates its oil and gas reserves in accordance with rules promulgated by the Oil and Gas Reserves Committee of the Society of Petroleum Engineers (SPE) for proved reserves.

Changes to the Group's estimates of proved and proved developed reserves affect prospectively the amounts of depreciation, depletion and amortization charged and, consequently, the carrying amounts of oil and gas properties. It is expected, however, that in the normal course of business the diversity of the Group's portfolio will limit the effect of such revisions. The outcome of, or assessment of plans for, exploration or appraisal activity may result in the related capitalized exploration drilling costs being written off in the profit and loss for the year.

Useful life of property, plant and equipment. Based on the terms included in the licenses and past experience, management believes hydrocarbon production licenses will be extended past their current expiration dates at insignificant additional costs. As a result of the anticipated license extensions, the assets are depreciated over their useful lives beyond the end of the current license term.

Management assesses the useful life of an asset by considering the expected usage, estimated technical obsolescence, residual value, physical wear and tear and the operating environment in which the asset is located. Differences between such estimates and actual results may have a material impact on the amount of the carrying values of the property, plant and equipment and may result in adjustments to future depreciation rates and expenses for the period.

Other property, plant and equipment are depreciated on a straight-line basis over their useful economic lives. Management periodically, at the end of each reporting period, reviews the appropriateness of the assets useful economic lives and residual values. The review is based on the current condition of the assets, the estimated period during which they will continue to bring economic benefit to the Group and the estimated residual value.

Decommissioning provisions. Management makes provision for the future costs of decommissioning oil and gas production facilities, wells, pipelines, and related support equipment and for site restoration based on the best estimates of future costs and economic lives of the oil and gas assets. Estimating future decommissioning provisions is complex and requires management to make estimates and judgments with respect to removal obligations that will occur many years in the future.

Changes in the measurement of existing obligations can result from changes in estimated timing, future costs or discount rates used in valuation.

The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the reporting date based on current legislation in each jurisdiction where the Group's operating assets are located, and is also subject to change because of revisions and changes in laws and regulations and their interpretation. As a result of the subjectivity of these provisions there is uncertainty regarding both the amount and estimated timing of such costs.

The Group's petrochemical, refining and marketing and distribution operations are carried out at large manufacturing facilities. The nature of these operations is such that the ultimate date of decommissioning of any sites or facilities is unclear. Current regulatory and licensing rules do not provide for liabilities related to the liquidation of such manufacturing facilities or of retail fuel outlets. Management therefore believes that there are no legal or contractual obligations related to decommissioning or other disposal of these assets.

Sensitivity analysis for changes in rates, and other estimates:

		Impact on decommissioning provision		
	Change in	**At 31 December 2012**	**At 31 December 2011**	**At 1 January 2011**
Discount rate	+1%	(22,437)	(19,777)	(13,884)
	-1%	4,814	7,102	18,512

Information about decommissioning provision is presented in Note 13.

Note 4: Critical Accounting Estimates and Judgements in Applying Accounting Policies (continued)

Impairment of Long-lived Assets. The recoverable amounts of cash-generating units and individual assets have been determined based on the higher of value-in-use calculations and fair values less costs to sell. These calculations require the use of estimates and assumptions, including future oil prices, expected production volumes and refining margins appropriate to the local circumstances and environment. It is reasonably possible that these assumptions may change and may then require a material adjustment to the carrying value of the Group's assets.

Consolidation. The Company made significant judgements related to significant subsidiaries which are controlled by the Group, even though the Group holds less than half of the voting rights of these subsidiaries:

The Company considers that the Group has control over several entities even though it has less than 50% of the voting rights. This is because the Company has power over the investee, has rights to variable returns of the investee, and has the power to affect variable returns.

Additional information is disclosed in Note 26.

Note 5: Adoption of New or Revised Standards and Interpretations

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2013 or later, and which the Group has not early adopted.

IFRS 9, Financial Instruments: Classification and Measurement. IFRS 9, issued in November 2009, replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Key features of the standard are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

IFRS 13, Fair value measurement, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its financial statements.

Disclosures – Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

(in millions of Russian Roubles)

Note 5: Adoption of New or Revised Standards and Interpretations (continued)

Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Group is considering the implications of the amendment, the impact on the Group and the timing of its adoption by the Group.

In May 2012, ***IASB issued Improvements to IFRSs introducing amendments to various standards***. The following standards were primarily affected by the amendments: IFRS 1, First–time adoption of International Reporting Standards , IAS 1, Presentation of Financial Statements; IAS 16, Property, Plant and Equipment; IAS 32, Financial Instruments: Presentation; IAS 34, Interim Financial Reporting. The amendments introduced relatively minor changes to clarify guidance in existing standards. The amendments are effective for annual periods beginning on or after 1 January 2013. The Group will adopt the amended standards from 1 January 2013. The Group does not expect these amendments to have a material impact on the Group's financial position or operations.

Amended IAS 19, Employee Benefits (issued in June 2011, effective for periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income. The Group does not expect these amendments to have a material impact on the Group's financial position or operations.

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

Note 6: Cash and cash equivalents

Cash and cash equivalents comprise the following:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Cash on hand and in banks	7,814	9,678	7,045
Term deposits with original maturity of less than three months	5,269	7,223	932
Total cash and cash equivalents	**13,083**	**16,901**	**7,977**

As of 31 December 2012, 2011 and 1 January 2011 the majority of cash and cash equivalents are held in Bank Zenit and its subsidiaries. Bank deposits represent deposits with original maturities of less than three months. The fair value of cash and term deposits approximates their carrying value.

The credit quality of cash and cash equivalents balances may be summarised as follows:

	At 31 December 2012		At 31 December 2011		At 1 January 2011	
	Cash on hand and in banks	Term deposits	Cash on hand and in banks	Term deposits	Cash on hand and in banks	Term deposits
Investment grade rating	496	2,862	562	6,882	124	932
Non-investment grade rating	4,470	2,039	5,980	290	4,480	-
No external rating	2,848	368	3,136	51	2,441	-
Total	**7,814**	**5,269**	**9,678**	**7,223**	**7,045**	**932**

Investment grade ratings classification referred to as Aaa to Baa3 for Moody's Investment Services, as AAA to BBB- for Fitch Rating and as AAA to BBB for Standard and Poor's Rating, respectively.

(in millions of Russian Roubles)

Note 7: Accounts receivable

Short-term and long-term accounts receivable comprise the following:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Short-term accounts receivable:			
Trade receivables	60,940	68,828	57,693
Other financial receivables	3,813	4,287	7,479
Less provision for impairment	(11,200)	(11,021)	(10,465)
Total short-term accounts receivable	**53,553**	**62,094**	**54,707**
Long-term accounts receivable:			
Trade receivables	757	731	541
Other financial receivables	777	1,445	2,098
Less provision for impairment	(4)	(138)	(364)
Total long-term accounts receivable	**1,530**	**2,038**	**2,275**
Total financial assets within trade and other receivables	**55,083**	**64,132**	**56,982**

In accordance with the Group's policies for recorded provision for impairment the Group fully provided for receivables from ChMPKP Avto of US $334 million as of 31 December 2012, 2011 and 1 January 2011, relating to the sale of crude oil to Ukraine (Kremenchug refinery) (Note 25).

The estimated fair value of short-term and long-term accounts receivable approximates their carrying value.

Analysis by credit quality of trade and other receivables is as follows:

	At 31 December 2012		At 31 December 2011		At 1 January 2011	
	Trade receivables	Other financial receivables	Trade receivables	Other financial receivables	Trade receivables	Other financial receivables
Not over due and not impaired	**50,582**	**3,714**	**54,980**	**4,748**	**44,447**	**8,734**
Past due but not impaired						
- less than 90 days overdue	296	158	1,740	209	1,438	46
- 91 to 180 days overdue	156	106	722	108	1,035	184
- over 180 days overdue	13	58	1,121	504	712	386
Total past due but not impaired	**465**	**322**	**3,583**	**821**	**3,185**	**616**
Individually determined to be impaired (gross)						
- less than 90 days overdue	-	-	-	-	-	-
- 91 to 180 days overdue	-	-	-	-	-	-
- over 180 days overdue	10,637	567	10,998	161	10,607	222
Total individually impaired	**10,637**	**567**	**10,998**	**161**	**10,607**	**222**
Less provision for impairment	(10,637)	(567)	(10,998)	(161)	(10,607)	(222)
Total	**51,047**	**4,036**	**58,563**	**5,569**	**47,632**	**9,350**

(in millions of Russian Roubles)

Note 7: Accounts receivable (continued)

Movements in the provision for impairment for trade and other receivables are as follows:

	2012		2011	
	Trade receivables	Other financial receivables	Trade receivables	Other financial receivables
Provision for impairment at 1 January	**(10,998)**	**(161)**	**(10,607)**	**(222)**
(Provision for impairment)/Recovery during the year	(358)	(431)	-	20
Amounts written off during the year as uncollectible	109	25	184	41
Foreign exchange gain/(loss)	610	-	(575)	-
Provision for impairment at 31 December	**(10,637)**	**(567)**	**(10,998)**	**(161)**

Note 8: Short-term financial assets

Short-term financial assets comprise the following:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Loans and receivables:			
Notes receivable (net of provision for impairment of RR 0 million, RR 0 million and RR 60 million as of 31 December 2012, 2011 and 1 January 2011)	2,564	2,147	3,747
Other loans (net of provision for impairment of RR 24 million, RR 148 million and RR 424 million as of 31 December 2012, 2011 and 1 January 2011)	1,752	1,936	2,269
Certificates of deposit	4,251	9,149	8,702
Financial assets at fair value through profit or loss:			
Held-for-trading	6,364	5,973	6,113
Total short-term financial assets	**14,931**	**19,205**	**20,831**

During the year ended 31 December 2012 purchases of certificates of deposit and proceeds from certificates of deposit were RR 28,184 million and RR 29,738 million, respectively.

During the year ended 31 December 2012 issuance of notes receivable and other loans and proceeds from notes receivable and other loans were RR 3,955 million and RR 3,453 million, respectively.

The estimated fair value of loans and receivables approximates their carrying value.

Financial assets at fair value through profit and loss comprise the following:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Held-for-trading:			
Russian government debt securities	185	64	78
Corporate debt securities	2,315	2,257	1,750
Equity securities	3,864	3,652	4,285
Total financial assets at fair value through profit and loss	**6,364**	**5,973**	**6,113**

Information on held for trading securities issued by related parties is disclosed in Note 24.

(in millions of Russian Roubles)

Note 9: Inventories

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Materials and supplies	12,152	9,829	6,427
Crude oil	5,332	6,284	4,564
Refined oil products	6,291	5,373	1,801
Petrochemical supplies and finished goods	4,815	3,752	2,327
Total inventories	**28,590**	**25,238**	**15,119**

Note 10: Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets are as follows:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
VAT recoverable	7,536	5,712	7,267
Advances	5,613	6,126	7,785
Prepaid export duties	11,729	12,393	8,122
Prepaid transportation expenses	551	518	990
Other	3,377	1,928	2,866
Prepaid expenses and other current assets	**28,806**	**26,677**	**27,030**

Note 11: Long-term Financial Assets

Long-term financial assets comprise the following:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Loans and receivables:			
Notes receivable (net of provision for impairment of RR 318 million, RR 318 million and RR 318 million as of 31 December 2012, 2011 and 1 January 2011)	1,909	2,140	361
Loans to employees	2,305	1,095	797
Other loans	2,749	3,372	7,148
Certificates of deposit	14,133	10,789	7,022
Available-for-sale investments	4,686	1,043	986
Total long-term financial assets	**25,782**	**18,439**	**16,314**

The fair value of long-term financial assets is estimated by discounting the future contractual cash inflows at the market interest rate available to the Group at the end of the reporting period. The carrying amounts and fair values of long-term financial assets are as follows:

	Carrying amounts			Fair values		
	At 31 December 2012	At 31 December 2011	At 1 January 2011	At 31 December 2012	At 31 December 2011	At 1 January 2011
Notes receivable	1,909	2,140	361	2,100	2,120	302
Loans to employees	2,305	1,095	797	2,305	1,095	797
Other loans	2,749	3,372	7,148	2,713	3,364	7,547
Certificates of deposit	14,133	10,789	7,022	14,835	11,379	7,860
Total long-term financial assets	**21,096**	**17,396**	**15,328**	**21,953**	**17,958**	**16,506**

(in millions of Russian Roubles)

Note 12: Investments in associates and joint ventures

Investments in associates and joint ventures comprise the following:

Name of an investee	Ownership percentage at			Net book value as			Group's share of profit/(loss) for	
	31 December		1 January	31 December		1 January		
	2012	2011	2011	2012	2011	2011	2012	2011
Associates:								
ZAO Tatex	-	-	50	-	-	2,105	199	133
Bank Zenit	25	25	25	6,455	5,695	5,200	653	619
Osmand Holdings Ltd	-	30	30	-	1,106	2,663	6	(1,187)
MARS Emerging Markets Fund Limited	-	-	33	-	-	580	-	-
Other	20-50	20-50	20-50	256	618	817	(119)	(242)
Total				**6,711**	**7,419**	**11,365**	**739**	**(677)**

The table below summarises the movements in the carrying amount of the Group's investment in associates and joint ventures:

	2012	2011
Net book value at 1 January	**7,419**	**11,365**
Share of profit/(loss) of associates	739	1,059
Impairment of investments in associates	-	(1,736)
Share of result of associates	739	(677)
Share of other comprehensive income of associates	106	(127)
Dividends received from associates	(14)	(440)
Disposal of associates/Reclassification on obtaining control	(1,660)	(948)
Reclassification to assets held for sale	-	(1,808)
Others	121	54
Net book value at 31 December	**6,711**	**7,419**

The condensed financial information of the Group's equity basis investments is as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Sales/interest income	24,150	26,916
Net income	2,451	6,551
Current assets	246,667	220,400
Long-term assets	17,263	43,913
Current liabilities	173,391	169,219
Long-term liabilities	61,493	58,773

As a result of acquisitions in 2012 the accounting treatment for Osmand Holdings Ltd changed from equity to being fully consolidated.

(in millions of Russian Roubles)

Note 13: Property, plant and equipment

	Oil and gas properties	Buildings and constructions	Machinery and equipment	Construction in progress	Total
Cost					
As of 1 January 2011	**316,473**	**41,524**	**63,067**	**177,067**	**598,131**
Additions	732	265	1,098	53,283	55,378
Disposals	(3,202)	(647)	(8,298)	(273)	(12,420)
Changes in Group structure	(3,333)	-	-	-	(3,333)
Transfers	13,692	93,440	39,975	(147,107)	-
Changes in decommissioning provision	(12,363)	-	-	-	(12,363)
As of 31 December 2011	**311,999**	**134,582**	**95,842**	**82,970**	**625,393**
Depreciation, depletion and amortisation					
As of 1 January 2011	**141,043**	**14,776**	**49,854**	**-**	**205,673**
Depreciation charge	8,050	1,325	2,848	-	12,223
Disposals	(3,080)	(12)	(7,284)	-	(10,376)
As of 31 December 2011	**146,013**	**16,089**	**45,418**	**-**	**207,520**
Net book value					
As of 1 January 2011	**175,430**	**26,748**	**13,213**	**177,067**	**392,458**
As of 31 December 2011	**165,986**	**118,493**	**50,424**	**82,970**	**417,873**
Cost					
As of 31 December 2011	**311,999**	**134,582**	**95,842**	**82,970**	**625,393**
Additions	51	315	386	56,396	57,148
Disposals	(2,143)	(829)	(2,776)	(2,742)	(8,490)
Changes in Group structure	-	1,176	1,949	-	3,125
Transfers	18,717	12,926	12,815	(44,458)	-
Changes in decommissioning provision	(5,995)	-	-	-	(5,995)
As of 31 December 2012	**322,629**	**148,170**	**108,216**	**92,166**	**671,181**
Depreciation, depletion and amortisation					
As of 31 December 2011	**146,013**	**16,089**	**45,418**	**-**	**207,520**
Depreciation charge	7,763	4,640	5,367	-	17,770
Disposals	(2,053)	(252)	(707)	-	(3,012)
As of 31 December 2012	**151,723**	**20,477**	**50,078**	**-**	**222,278**
Net book value					
As of 31 December 2011	**165,986**	**118,493**	**50,424**	**82,970**	**417,873**
As of 31 December 2012	**170,906**	**127,693**	**58,138**	**92,166**	**448,903**

For the years ended 31 December 2012 and 2011 the Group recorded RR 606 million and RR 2,969 million of capitalized interest as property, plant and equipment additions, respectively. The capitalisation rate was 3.5% (2011: 3.8%).

(in millions of Russian Roubles)

Note 13: Property, plant and equipment (continued)

As stated in Note 3, the Group calculates depreciation, depletion and amortization for oil and gas properties using the units-of-production method over proved or proved developed oil and gas reserves depending on the nature of the costs involved. The proved or proved developed reserves used in the units-of-production method assume the extension of the Group's production license beyond their current expiration dates until the end of the economic lives of the fields as discussed below in further detail.

The Group's oil and gas fields are located principally on the territory of Tatarstan. The Group obtains licenses from the governmental authorities to explore and produce oil and gas from these fields. The Group's existing production licenses for its major fields expire, after their recent extension, between 2026 and 2038, with other production licenses expiring between 2012 and 2043. The economic lives of many of the Group's licensed fields extend beyond these dates. Under Russian law, the Group is entitled to renew the licenses to the end of the economic lives of the fields, provided certain conditions are met. Article 10 of the Subsoil Law provides that a license to use a field "shall be" extended at its scheduled termination at the initiative of the subsoil user if necessary to finish production in the field, provided that there are no violations of the conditions of the license. The legislative history of Article 10 indicates that the term "shall" replaced the term "may" in August 2004, clarifying that the subsoil user has the right to extend the license term so long as it has not violated the conditions of the license. In August 2006, the term of the Group's license to produce oil and gas from the Group's largest field, Romashkinskoye, was extended through 2038. And the license to produce oil and gas from the Group's second largest field, Novo-Elkhovskoe, was extended through 2026. The Group's right to extend licenses is, however, dependent on the Group continuing to comply with the terms of the licenses, and management has the ability and intent to do so.

Management plans to request the extension of the licenses that have not yet been extended. The Group's current production plans are based on the assumption, which management considers to be reasonably certain, that the Group will be able to extend all existing licenses.

These plans have been designed on the basis that the Group will be producing crude oil through the economic lives of the fields and not with a view to exploiting the Group's reserves to maximum effect only through the license expiration dates.

Management is reasonably certain that the Group will be allowed to produce oil from the Group's reserves after the expiration of existing production licenses and until the end of the economic lives of the fields. "Reasonable certainty" is the applicable standard for defining proved reserves under the SEC's Regulation S-X, Rule 4-10.

Exploration and evaluation assets included in Oil and Gas assets above, net book value:

At 31 December 2012	**11,285**
Additions	1,764
Reclassification to development assets	(1,108)
At 31 December 2011	**10,629**
Additions	1,513
Reclassification to development assets	(433)
At 1 January 2011	**9,549**

For the years ended 31 December 2012 and 2011, operating and investing cash flows used for exploration and evaluation activities amounted to RR 1,740 million and RR 1,764 million and RR 2,230 million and RR 1,513 million, respectively.

Social assets. During the years ended 31 December 2012 and 2011 the Group transferred social assets with a net book value of RR 4 million and RR 183 million, respectively, to local authorities. At 31 December 2012, 2011 and 1 January 2011 the Group held social assets with a net book value of RR 3,700 million, RR 3,028 million and RR 2,932 million, respectively, all of which were constructed after the privatization date.

The social assets comprise mainly dormitories, hotels, gyms and other facilities. The Group may transfer some of these social assets to local authorities in the future, but does not expect these to be significant. The Group incurred social infrastructure expenses of RR 4,026 million and RR 3,378 million for the years ended 31 December 2012 and 2011, respectively, for maintenance that mainly relates to housing, schools and cultural buildings.

(in millions of Russian Roubles)

Note 13: Property, Plant and Equipment (continued)

Decommissioning provisions.

The following tables summarize the Group's decommissioning provisions and decommissioning costs activities:

	2012	2011
Balance, beginning of period	**55,098**	**63,315**
Unwinding discount	4,790	5,137
New obligations	439	497
Release of existing obligations	(1,443)	(991)
Changes in estimates	(6,434)	(12,860)
Balance, end of period	**52,450**	**55,098**
Less: current portion of decommissioning provisions (Note 17)	(1,361)	(1,443)
Long-term balance, end of period	**51,089**	**53,655**

Key assumptions used for evaluation of decommissioning provision were as follows:

	At 31 December 2012	At 31 December 2011
Discount rate	7.88%	8.73%
Inflation rate	4.83%	5.67%

Note 14: Other long-term assets

Other long-term assets are as follows:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Prepaid computer programs	2,544	2,710	2,655
Prepaid license agreements	379	286	375
Other long-term assets	1,793	2,089	1,456
Total other long-term assets	**4,716**	**5,085**	**4,486**

Note 15: Non-current Assets Classified as Held for Sale

As at 28 December 2011 the Group recognized its equity investment in ZAO Tatex as non-current assets held for sale as all the necessary recognition criteria were met. In March 2012 the shares of ZAO Tatex were sold.

(in millions of Russian Roubles)

Note 16: Debt

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Short-term debt			
Foreign currency denominated debt			
Current portion of long-term debt	18,259	37,652	29,359
Other foreign currency denominated debt	2,328	1,073	970
Rouble denominated debt			
Current portion of long-term debt	5,002	63	60
Other rouble denominated debt	6,507	3,209	5,231
Total short-term debt	**32,096**	**41,997**	**35,620**
Long-term debt			
Foreign currency denominated debt			
US $2.0 bln 2010 credit facility	27,619	50,378	59,321
US $1.5 bln 2009 credit facility	4,551	20,073	35,709
US $550 mln 2011 credit facility	16,582	17,503	-
US $75 mln 2011 credit facility	1,562	2,145	-
US $144.5 mln 2011 credit facility	2,165	-	-
Other foreign currency denominated debt	3,167	1,726	1,814
Rouble denominated debt			
Bonds	4,941	4,941	4,908
Other rouble denominated debt	665	696	606
Total long-term debt	**61,252**	**97,462**	**102,358**
Less: current portion of long-term debt	(23,261)	(37,715)	(29,419)
Total long-term debt, net of current portion	**37,991**	**59,747**	**72,939**

Foreign currency debts are primarily denominated in US Dollars.

Long-term debt had the following maturity profile (based on the discounted contractual cash flows):

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Due for repayment:			
Between one and two years	27,728	23,012	34,509
Between two and five years	7,486	34,615	36,635
After five years	2,777	2,120	1,795
Total long-term debt, net of current portion	**37,991**	**59,747**	**72,939**

The Group does not apply hedge accounting and has not entered into any hedging arrangements in respect of its foreign currency obligations or interest rate exposures.

Short-term foreign currency denominated debt. In December 2003 the Group entered into a US $35 million one month revolving credit facility with Credit Suisse Zurich. In December 2011 this agreement was replaced with new loan agreement totaling up to the US $70 million under the same conditions. The monthly revolving loan bears interest at one month LIBOR plus varying margin of about 1.8% per annum and is collateralized by crude oil sales.

In 2008 and 2009 the Group entered into credit agreements with BNP Paribas Geneva for RR 4,688 million (US $155 million) in aggregate. The loans bear interest from 1.78% to 5.78% per annum and are collateralized by total crude oil sales of 344 million tons. The Group repaid in full the credit agreements in the first quarter 2011.

Short-term Russian rouble denominated debt. In August 2010, the Company entered into a RR 2,500 million credit agreement with Ak Bars Bank. The loan bears interest 8% per annum and matures in March 2011. The loan was repaid in full in February 2011.

Note 16: Debt (continued)

Russian Rouble denominated short-term debt is primarily comprised of loans with Russian banks. Short-term Rouble denominated loans of RR 6,507 million, RR 3,209 million and RR 5,062 million bear contractual interest rates of 7.0% to 8.55% per annum as of 31 December 2012, 2011 and 1 January 2011.

Long-term foreign currency denominated debt. In October 2009, the Company entered into a dual (3 and 5 year) tranches secured syndicated pre-export facility for up to USD 1.5 billion arranged by WestLB AG, Bayerische Hypo-und Vereinsbank AG, ABN AMRO Bank N.V., OJSC Gazprombank, Bank of Moscow and Nordea Bank. This credit facility is collateralized with the contractual rights and receivables under an oil export contract between Tatneft and Tavit B.V. under which Tatneft supplies no less than 360,000 metric tones of oil in a calendar quarter. The loan agreement requires compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth, and interest coverage ratios. The loan bears interest at LIBOR plus 3.10% and 4.10% for the 3 and 5 year tranches, respectively.

In June 2010, the Company entered into a triple (3, 5 and 7 year) tranches secured credit facility for up to USD 2 billion arranged by Barclays Bank PLS, BNP Paribas (Suisse) SA, Bank of Moscow, Bank of Tokyo-Mitsubishi UFJ, LTD, Citibank, N.A., Commerzbank Aktiengesellschaft, ING Bank N.V., Natixis SA, Nordea Bank, The Royal Bank of Scotland N.V., Sberbank, Société Générale, Sumitomo Mitsui Finance Dublin LTD, Unicredit Bank AG, VTB Bank and WestLB AG. Unicredit Bank AG was the lender of record in this credit facility. The loan is collateralized with the contractual rights and receivables under an export contract between Tatneft and Tatneft Europe AG under which Tatneft supplies no less than 750,000 metric tones of oil in a calendar quarter. The loan agreement requires compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth, and interest coverage ratios. Prior to February 2011, the loan bore interest at LIBOR plus 3.10% for the 3-year tranche and 4.10% for the 5-year tranche. The 7-year tranche bears the interest of LIBOR plus 5%. In February 2011 the Company reached an agreement to decrease the margins. The margins were decreased to LIBOR plus 2.40% and 3.40% for the 3 and 5 year tranches, respectively.

In June 2011, the Company entered into a US $550 million unsecured financing with a fixed rate of 3.50% per annum with bullet repayment in three years. The loan was arranged by BNP Paribas (Suisse) SA, The Bank Of Tokyo Mitsubishi UFJ, Ltd., Commerzbank Aktiengesellschaft, ING Bank N.V., Natixis, Open Joint Stock Company Nordea Bank, Sumitomo Mitsui Banking Corporation and WestLB AG, London Branch. The loan agreement requires compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth, and interest coverage ratios

In November 2011, TANECO entered into a US $75 million credit facility with equal semi-annual repayment during ten years. The loan was arranged by Nordea Bank AB (Publ), Société Générale and Sumitomo Mitsui Banking Corporation Europe Limited. The loan bears interest at LIBOR plus 1.1% per annum. The loan agreement requires compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth, and interest coverage ratios.

In November 2011, TANECO entered into a US $144.48 million credit facility with equal semi-annual repayments during ten years this first repayment date as of 15 May, 2014. The loan was arranged by Société Générale, Sumitomo Mitsui Banking Corporation Europe Limited and the Bank of Tokyo-Mitsubishi UFJ, LTD. The loan bears interest at LIBOR plus 1.25% per annum. The loan agreement requires compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth, and interest coverage ratios.

In October 2009, P-D Tatneft-Alabuga Steklovolokno entered into a EUR 44 million credit facility with fourteen equal semi-annual repayments with the first repayment date as of 28 February, 2012. The loan was arranged by Landesbank Baden-Wurttemberg. The loan bears interest at EURIBOR plus 1.5% per annum.

(in millions of Russian Roubles)

Note 16: Debt (continued)

Long-term Russian rouble denominated debt. In September 2010, the Group issued rouble exchange bonds in the amount of RR 5,000 million due in September 2013 at an interest rate of 7.25% per annum.

Management believes that for the year ended 31 December 2012 and 2011 the Group was in compliance with all covenants required by the above loan agreements.

Loan arrangements on short-term and long-term debt have both fixed and variable interest rates that reflect the currently available terms for similar debt. The carrying value of debt is a reasonable approximation of its fair value. The carrying amounts of long-term debt are as follows:

	Carrying amounts		
	At 31 December 2012	**At 31 December 2011**	**At 1 January 2011**
US$ denominated fixed rate	20,350	19,228	1,814
US$ denominated floating rate	35,296	72,596	95,030
RR denominated fixed rate	5,606	5,638	5,514
Total long-term debt	**61,252**	**97,462**	**102,358**

Note 17: Accounts payable and accrued liabilities

	At 31 December 2012	**At 31 December 2011**	**At 1 January 2011**
Trade payables	16,715	19,466	17,985
Dividends payable	101	95	119
Other payables	1,071	906	632
Total financial liabilities within trade and other payables	**17,887**	**20,467**	**18,736**
Salaries and wages payable	4,093	3,841	3,171
Advances received from customers	1,109	3,639	3,735
Current portion of decommissioning provisions (Note 13)	1,361	1,443	991
Other accounts payable and accrued liabilities	6,569	5,788	3,335
Total non-financial liabilities	**13,132**	**14,711**	**11,232**
Accounts payable and accrued liabilities	**31,019**	**35,178**	**29,968**

The fair value of each class of financial liabilities included in short-term trade and other payables at 31 December 2012, 2011 and 1 January 2011 approximates their carrying value.

(in millions of Russian Roubles)

Note 18: Other long-term liabilities

Other long-term liabilities are as follows:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Pension liability	3,622	2,523	2,614
Other long-term liabilities	88	221	683
Total other long-term liabilities	**3,710**	**2,744**	**3,297**

Pension liabilities

The Group has various pension plans covering substantially all eligible employees and members of management. The amount of contributions, frequency of benefit payments and other conditions of these plans are regulated by the "Statement of Organization of Non-Governmental Pension Benefits for OAO Tatneft Employees" and the contracts concluded between the Company or its subsidiaries, management, and the non-profit organization "National Non-Governmental Pension Fund". In accordance with these contracts the Group is committed to make certain contributions on behalf of all employees and guarantees a minimum benefit upon retirement. Contributions or benefits are generally based upon grade and years until official retirement age (age 60 for men and 55 for women), and in the case of management are based upon years of service. In accordance with the provisions of collective agreements concluded on an annual basis between the Company or its subsidiaries and their employees, the Group is obligated to pay certain post-employment benefits, the amounts of which are generally based on salary grade and years of service at the time of retirement.

Principal actuarial assumptions (expressed as weighted averages) are as follows:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Discount rate	7.2%	8.0%	8.0%
Rate of increase in salary levels	6.2%	7.0%	7.0%
Actuarial rate of NPF	3.0%	4.5%	5.0%
Expected return on plan assets	7.5%	9.0%	9.0%

Amounts recognized in the consolidated statement of financial position:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Present value of defined benefit obligation (DBO)	5,441	4,054	4,065
Less: Fair value of plan assets	(1,819)	(1,531)	(1,451)
Net defined benefit liability	**3,622**	**2,523**	**2,614**

Change in the defined benefit obligation amount:

	2012	2011
Defined benefit obligation (DBO) at beginning year	4,054	4,065
Effect of exchange rate changes	(7)	6
Current service cost	128	126
Interest cost	342	325
Benefits paid	(399)	(360)
Actuarial loss/(gain)	1,066	(103)
Past service cost	47	-
Curtailment/settlement (gain)/loss	(5)	-
Other	215	(5)
Defined benefit obligation at the end of the year	**5,441**	**4,054**

(in millions of Russian Roubles)

Note 18: Other long-term liabilities (continued)

The amounts recognized in profit or loss are as follows:

	2012	2011
Service cost	128	126
Interest cost	342	325
Expected return on plan assets	(115)	(131)
Other	254	(5)
Total included in 'employee benefits expense'	**609**	**315**

Reconciliation of the opening and closing balances of plan assets' fair value:

	2012	2011
Plan assets at beginning of year	1,531	1,451
Contributions	220	202
Benefits paid	(131)	(133)
Actuarial gain/(loss)	76	(119)
Other	123	130
Plan assets at year end	**1,819**	**1,531**

The annual contributions made by the Group are managed by the Fund. The primary investment objectives of the Fund are to achieve the highest rate of total return within prudent levels of risk and liquidity, to diversify and mitigate potential downside risk associated with the investments, and to provide adequate liquidity for benefit payments and portfolio management.

Plan assets structure:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Russian corporate bonds and equity securities of Russian issuers	46.22%	55.41%	60.6%
Russian government and regions bonds	19.01%	29.53%	30.26%
Bank deposits	30.91%	7.99%	6.87%
Other	3.86%	7.07%	2.27%
Total plan assets	**100%**	**100%**	**100%**

Expected contributions to be paid during the next annual reporting period are RR 474 million.

Note 19: Taxes

Income tax expense comprises the following:

	Year ended 31 December 2012	Year ended 31 December 2011
Current income tax expense	21,816	19,224
Deferred income tax expense	1,554	2,683
Income tax expense for the year	**23,370**	**21,907**

Presented below is reconciliation between the provision for income taxes and taxes determined by applying the statutory tax rate to income before income taxes:

	Year ended 31 December 2012	Year ended 31 December 2011
Income before income taxes and non-controlling interest	101,818	86,117
Theoretical income tax expense at statutory rate	20,364	17,223
Increase due to:		
Non-deductible expenses, net	3,006	4,684
Income tax expense	**23,370**	**21,907**

(in millions of Russian Roubles)

Note 19: Taxes (continued)

No provision has been made for additional income taxes of RR 19,366 million on undistributed earnings of certain subsidiaries. These earnings have been and will continue to be reinvested. These earnings could become subject to additional tax of approximately RR 1,219 million if they were remitted as dividends.

Deferred income taxes reflect the impact of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and such amounts recognized for statutory tax purposes. Deferred tax assets (liabilities) are comprised of the following:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Accounts receivable	155	59	106
Obligations under capital leases	-	-	7
Tax loss carry forward	3,924	3,922	3,466
Decommissioning provision	10,490	11,020	12,663
Other	547	640	809
Deferred income tax assets	**15,116**	**15,641**	**17,051**
Property, plant and equipment	(22,690)	(22,006)	(22,784)
Inventories	(2,152)	(1,630)	(1,070)
Long-term investments	(238)	(215)	(128)
Undistributed Earnings	(862)	(789)	(697)
Other liabilities	(1,575)	(2,085)	(878)
Deferred income tax liabilities	**(27,517)**	**(26,725)**	**(25,557)**
Net deferred tax liability	**(12,401)**	**(11,084)**	**(8,506)**

Deferred income taxes are reflected in the Consolidated Statements of Financial Position as follows:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Deferred income tax asset	2,633	3,430	2,980
Deferred income tax liability	(15,034)	(14,514)	(11,486)
Net deferred tax liability	**(12,401)**	**(11,084)**	**(8,506)**

Deferred tax assets are recognized for the carry-forward of unused tax losses and unused tax credits to the extent that it is probable that taxable profits will be available against which the unused tax losses/credits can be utilized.

Tax losses carry forward. At 31 December 2012, the Group had recognized deferred income tax assets of RR 3,924 million (RR 3,922 million and RR 3,466 million at 31 December 2011 and 1 January 2011) in respect of unused tax loss carry forwards of RR 19,620 million (RR 19,610 million and RR 17,330 million at 31 December 2011 and 1 January 2011). Tax losses can be carried forward for relief against taxable profits for 10 years after they are incurred, subject to certain limitations. In determining future taxable profits and the amount of tax benefits that are probable in the future management makes judgments including expectations regarding the Group's ability to generate sufficient future taxable income and the projected time period over which deferred tax benefits will be realized.

The Group doesn't have any unrecognised potential deferred tax assets in respect of deductible temporary differences.

The Company is subject to a number of taxes other than income taxes, which are detailed as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Mineral extraction tax	102,813	96,719
Property tax	2,248	2,085
Penalties and interest	(214)	334
Other	1,446	1,297
Total taxes other than income taxes	**106,293**	**100,435**

(in millions of Russian Roubles)

Note 19: Taxes (continued)

For mineral extraction tax for fields whose depletion rate exceeds a certain threshold the Company received a benefit of approximately RR 21.4 billion and RR 17.0 billion for the years ended 31 December 2012 and 2011, respectively.

At 31 December 2012, 2011 and 1 January 2011 taxes payable were as follows:

	At 31 December 2012	At 31 December 2011	At 1January 2011
Mineral extraction tax	8,457	8,843	6,991
Value Added Tax on goods sold	2,107	1,576	1,430
Income tax	201	410	370
Other	2,670	3,294	1,791
Total taxes payable	**13,435**	**14,123**	**10,582**

Note 20: Shareholders' equity

Authorized share capital. At 31 December 2012 the authorized share capital consists of 2,178,690,700 voting common shares and 147,508,500 non-voting preferred shares; both classes of shares have a nominal value of RR 1.00 per share.

Golden share. OAO Svyazinvestneftekhim, a company wholly owned by the government of Tatarstan, as of 31 December 2012 holds approximately 33.59% of the Company's capital stock (approximately 36% of voting stock). These shares were contributed to Svyazinvestneftekhim by the Ministry of Land and Property Relations of Tatarstan in 2003. Tatarstan also holds a "Golden Share" – a special governmental right – in the Company. The exercise of its powers under the Golden Share enables the Tatarstan government to appoint one representative to the Board of Directors and Revision Commission of the Company and to veto certain major decisions, including those relating to changes in the share capital, amendments to the Charter, liquidation or reorganization and "major" and "interested party" transactions as defined under Russian law.

The Golden Share currently has an indefinite term. The Tatarstan government also controls or exercises significant influence over a number of the Company's suppliers, contractors and customers, such as the electricity producer OAO Tatenergo and the petrochemicals company OAO Nizhnekamskneftekhim (see also Note 1).

Rights attributable to preferred shares. Unless a different amount is approved at the annual shareholders meeting, preferred shares earn dividends equal to their nominal value. The amount of a dividend for a preferred share may not be less than the amount of a dividend for a common share. Preferred shareholders may vote at meetings only on the following decisions:

- the amendment of the dividends payable per preferred share;
- the issuance of additional shares with rights greater than the current rights of preferred shareholders; and
- the liquidation or reorganization of the Company.

The decisions listed above can be made only if approved by 75% of preferred shareholders.

Holders of preferred shares acquire the same voting rights as holders of common shares in the event that dividends are either not declared, or declared but not paid, on preferred shares. On liquidation, the shareholders are entitled to receive a distribution of net assets. Under Russian Joint Stock Companies Law and the Company's charter in case of liquidation, preferred shareholders have priority over shareholders holding common shares to be paid declared but unpaid dividends on preferred shares and the liquidation value of preferred shares, if any.

Amounts available for distribution to shareholders. Amounts available for distribution to shareholders are based on the Company's non-consolidated statutory accounts prepared in accordance with RAR, which differ significantly from IFRS (see Note 2). The statutory accounts are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current period net profit calculated in accordance with RAR. However, this legislation and other statutory laws and regulations dealing with distribution rights are open to legal interpretation. For the years ended 31 December 2012 and 2011, the Company had a statutory current profit of RR 66,707 million and RR 54,881 million, respectively.

(in millions of Russian Roubles)

Note 20: Shareholders' equity (continued)

Earnings per share. Preference shares are not redeemable and are considered to be participating shares.

Basic and diluted earnings per share are calculated by dividing profit or loss attributable to ordinary and preference shareholders by the weighted average number of ordinary and preferred shares outstanding during the period. Profit or loss attributed to equity holders is reduced by the amount of dividends declared in the current period for each class of shares. The remaining profit or loss is allocated to common and preferred shares to the extent that each class may share in earnings if all the earnings for the period had been distributed. Treasury shares are excluded from calculations. The total earnings allocated to each class of shares are determined by adding together the amount allocated for dividends and the amount allocated for a participation feature.

	Year ended 31 December 2012	**Year ended 31 December2011**
Profit attributable to Group shareholders	73,473	62,104
Common share dividends	(15,032)	(10,664)
Preferred share dividends	(1,044)	(740)
Income available to common and preferred shareholders, net of dividends	**57,397**	**50,700**
Basic and diluted:		
Weighted average number of shares outstanding (millions of shares):		
Common	2,123	2,121
Preferred	148	148
Combined weighted average number of common and preferred shares outstanding	2,271	2,269
Basic and diluted earnings per share (RR)		
Common	32.35	27.37
Preferred	32.33	27.34

Non-controlling interest. Non-controlling interest is adjusted by dividends paid by the Group's subsidiaries amounting to RR 565 million, RR 188 million and RR 196 million at 31 December 2012, 2011 and 1 January 2011, respectively.

Note 21: Employee benefit expenses

	Year ended 31 December 2012	**Year ended 31 December 2011**
Wages and salaries	29,814	24,372
Statutory insurance contributions	6,963	6,426
Bonus certificates granted to directors and employees	1,107	1,065
Pension costs – defined benefit plans	609	315
Other employee benefits	2,257	1,905
Total employee benefit expense	**40,750**	**34,083**

Employee benefit expenses are included in operating expenses, selling, general and administrative expenses and Maintenance of social infrastructure and transfer of social assets and other expenses in the Consolidated Statements of Comprehensive Income.

(in millions of Russian Roubles)

Note 22: Interest income and interest expense

Interest income comprises the following:

	Year ended 31 December 2012	Year ended 31 December 2011
Interest income from loans and receivables	3,807	2,544
Unwinding of the present value discount	65	112
Total interest income	**3,872**	**2,656**

Interest expense comprises the following:

	Year ended 31 December 2012	Year ended 31 December 2011
Bank loans	3,063	3,674
RR denominated non-convertible bonds	362	362
Unwinding of the present value discount	4,159	4,775
Total interest expense	**7,584**	**8,811**
Less capitalised interest costs	(606)	(2,969)
Total interest costs recognised in profit or loss	**6,978**	**5,842**

Note 23: Segment information

Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the Board of Directors and the Management Committee and for which discrete financial information is available.

Segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

The Group's business activities are conducted predominantly through three main operating segments:

- Exploration and production consists of exploration, development, extraction and sale of own crude oil. Intersegment sales consist of other goods and services provided to other operating segments,
- Refining and marketing comprises purchases and sales of crude oil and refined products from third parties, own refining activities and retailing operations,
- Petrochemical products include production and sales of tires and petrochemical raw materials and refined products, which are used in production of tires.

Other sales include revenues from ancillary services provided by the specialized subdivisions and subsidiaries of the Group, such as sales of oilfield equipment and drilling services provided to other companies in Tatarstan, revenues from the sale of auxiliary petrochemical related services and materials as well as other business activities, which do not constitute reportable business segments.

The Group evaluates performance of its reportable operating segments and allocates resources based on income or losses before income taxes and non-controlling interest not including interest income, expense, and earnings from equity investments, other income and monetary effects. Intersegment sales are at prices that approximate market. Group financing (including interest expense and interest income) and income taxes are managed on a Group basis and are not allocated to operating segments.

(in millions of Russian Roubles)

Note 23: Segment information (continued)

For the year ended 31 December 2012, revenues of RR 93,877 million or 21% and RR 55,960 million or 13% of the Group's total sales and operating revenues are derived from two external customers.

For the year ended 31 December 2011, revenues of RR 122,679 million or 29% and RR 58,034 million or 14% of the Group's total sales and operating revenues are derived from two external customers.

These revenues represent sales of crude oil and are attributable to the exploration and production segment and refining and marketing segment.

Management does not believe the Group is dependent on any particular customer.

Segment sales and other operating revenues. Reportable operating segment sales and other operating revenues are stated in the following table:

	Year ended 31 December 2012	**Year ended 31 December 2011**
Exploration and production		
Domestic own crude oil	61,748	70,299
CIS own crude oil	6,783	3,893
Non – CIS own crude oil	141,743	170,156
Other	3,952	3,359
Intersegment sales	77,189	25,218
Total exploration and production	**291,415**	**272,925**
Refining and marketing		
Domestic sales		
Crude oil purchased for resale	1,313	2,697
Refined products	73,637	52,281
Total Domestic sales	74,950	54,978
CIS sales		
Crude oil purchased for resale	-	20,016
Refined products	28,114	6,716
Total CIS sales[1]	28,114	26,732
Non – CIS sales		
Crude oil purchased for resale	17,578	20,442
Refined products	51,473	17,079
Total Non – CIS sales[2]	69,051	37,521
Other	4,058	2,428
Intersegment sales	3,547	2,701
Total refining and marketing	**179,720**	**124,360**
Petrochemicals		
Tires - domestic sales	27,910	23,556
Tires - CIS sales	7,388	6,519
Tires - non-CIS sales	1,185	1,316
Petrochemical products and other	2,412	2,548
Intersegment sales	880	954
Total petrochemicals	**39,775**	**34,893**
Total segment sales	**510,910**	**432,178**
Corporate and other sales	14,804	14,281
Elimination of intersegment sales	(81,615)	(28,873)
Total sales and other operating revenues	**444,099**	**417,586**

[1] - CIS is an abbreviation for Commonwealth of Independent States (excluding the Russian Federation).
[2] - Non-CIS sales of crude oil and refined products are mainly made to Germany, Switzerland, Netherlands and United Kingdom based traders.

(in millions of Russian Roubles)

Note 23: Segment information (continued)

Segment earnings.

	Year ended 31 December 2012	Year ended 31 December 2011
Segment earnings		
Exploration and production	96,955	92,011
Refining and marketing	9,110	8,205
Petrochemicals	2,105	766
Total segment earnings	**108,170**	**100,982**
Corporate and other	(6,495)	(6,400)
Other income/(expenses)	143	(8,465)
Profit before income tax	**101,818**	**86,117**

Segment assets.

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Assets			
Exploration and production	271,998	279,701	279,490
Refining and marketing	233,994	219,646	184,832
Petrochemicals	29,912	28,181	23,290
Corporate and other	94,703	79,857	70,827
Total assets	**630,607**	**607,385**	**558,439**

As of 31 December 2012 and 2011 corporate and other segment comprised RR 6,711 million and RR 7,419 million, respectively, investments in associates and joint ventures.

The Group's assets and operations are primarily located and conducted in the Russian Federation.

Segment depreciation, depletion and amortisation and additions to property, plant and equipment.

	Year ended 31 December 2012	Year ended 31 December 2011
Depreciation, depletion and amortization		
Exploration and production	11,022	7,851
Refining and marketing	3,397	372
Petrochemicals	1,300	1,333
Corporate and other	2,051	2,667
Total segment depreciation, depletion and amortization	**17,770**	**12,223**
Additions to property, plant and equipment		
Exploration and production	19,689	7,403
Refining and marketing	24,428	30,390
Petrochemicals	317	411
Corporate and other	6,719	4,811
Total additions to property, plant and equipment	**51,153**	**43,015**

For the years ended 31 December 2012 and 31 December 2011 additions to property, plant and equipment of exploration and production segment include a reduction of RR 5,995 million and RR 12,363 million, respectively, associated with changes in the decommissioning provision.

(in millions of Russian Roubles)

Note 24: Related party transactions

Transactions are entered into in the normal course of business with affiliates, government related companies, key management personnel and other related parties. These transactions include sales of crude oil and refined products, purchases of electricity and banking transactions.

Associates and other related parties

The amounts of transactions for each year and the outstanding balances at each year end with affiliates and other related parties are as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Revenues and income		
Sales of refined products	17	17
Other sales	461	421
Costs and expenses		
Purchases of crude oil	4,687	4,076
Other services	1,194	1,111
Other purchases	1,567	741

For the years ended 31 December 2012 and 2011, the Group sold crude oil on a commission basis from related parties for RR 5,075 million and RR 6,573 million, respectively.

At 31 December 2012, 2011 and 1 January 2011 the outstanding balances with related parties were as follows:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Assets			
Accounts receivable	222	490	319
Notes receivable	1,973	1,953	3,117
Short-term certificates of deposit	550	8,734	8,297
Trading securities	307	200	129
Loans receivable	8	344	503
Prepaid expenses and other current assets	83	88	14
Due from related parties short-term	**3,143**	**11,809**	**12,379**
Long-term accounts receivable	2	-	-
Long-term certificates of deposit	14,132	7,563	3,547
Long-term loans receivable	2,569	3,370	5,790
Due from related parties long-term	**16,703**	**10,933**	**9,337**
Liabilities			
Accounts payable and accrued liabilities	(503)	(801)	(390)
Short-term debt	(2,130)	(1,952)	(1,755)
Due to related parties short-term	**(2,633)**	**(2,753)**	**(2,145)**
Long-term debt	(23)	(404)	(485)
Due to related parties long-term	**(23)**	**(404)**	**(485)**

As of 31 December 2012, 2011 and 1 January 2011, the Group had RR 4,542 million, RR 4,643 million and RR 8,490 million, respectively, in loans and notes receivable due from Bank Zenit or its wholly-owned subsidiary Bank Devon Credit. These loans and notes mature between 2013 and 2017, bearing interest between 3.2% and 8.5%. As of 31 December 2012, 2011 and 1 January 2011, the Group has short and long-term certificates of deposit of RR 14,682 million, RR 16,297 million and RR 11,844 million, respectively, held with Bank Zenit or its wholly-owned subsidiary Bank Devon Credit.

In March 2009 the Group placed a long-term deposit with Bank Zenit for RR 2,140 million payable in 10 years bearing interest 10.85%.

(in millions of Russian Roubles)

Note 24: Related party transactions (continued)

Government bodies and state organizations

The amounts of transactions for each year with Government bodies and state organizations are as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Sales of refined products	3,486	3,023
Other sales	267	-
Purchases of refined products	8,349	6,429
Purchases of electricity	9,232	8,463
Purchases of transportation services	21,623	19,004

Compensation to key management personnel

As of 31 December 2012 and 2011 total remuneration, including pension cost, for key management personnel was RR 1,339 million and RR 1,144 million, respectively.

For the year ended 31 December 2012, the Company issued 6,740,800 Awards to senior management and directors, all of which are expected to be settled at a price of RR 168.19 per Award. Final settlement is subject to approval at the Company's Management Committee meeting in July-September 2013. For the year ended 31 December 2011, the Company issued 6,513,000 Awards to senior management and directors, all of which were settled at a price of RR 166.95 per Award. The amount of related compensation expense recognized in Selling, General and administrative expenses of the Consolidated Statements of Comprehensive Income for the years ended 31 December 2012 and 2011 was RR 1,107 million and RR 1,065 million, respectively.

Note 25: Contingencies and commitments

Operating Environment of the Group

The Russian Federation displays certain characteristics of an emerging market. Tax, currency and customs legislation is subject to varying interpretations and contributes to the challenges faced by companies operating in the Russian Federation.

The international sovereign debt crisis, stock market volatility and other risks could have a negative effect on the Russian financial and corporate sectors. Management determined provisions for impairment by considering the economic situation and outlook at the end of the reporting period.

The future economic development of the Russian Federation is dependent upon external factors and internal measures undertaken by the government to sustain growth, and to change the tax, legal and regulatory environment. Management believes it is taking all necessary measures to support the sustainability and development of the Group's business in the current business and economic environment.

Capital commitments. As of 31 December 2012, 2011 and 1 January 2011 the Group has outstanding capital commitments of approximately RR 16,823 million, RR 14,966 million and RR 23,086 million, respectively, for the construction of the TANECO refinery complex. These commitments are expected to be paid between 2013 and 2014.

Management believes the Group's current and long-term capital expenditures program can be funded through cash generated from existing operations as well as lines of credit available to the Company. The TANECO refinery project has been funded from the Company's cash flow with the support of the bank facilities (Note 18). Management believes the Company has the ability to obtain syndicated loans and other financings as needed to continue funding the TANECO refinery project, refinance any maturing debts as well as finance business acquisitions and other transactions that may arise in the future.

Note 25: Contingencies and commitments (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 authorities. The Russian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged.

Amended Russian transfer pricing legislation took effect from 1 January 2012. The new transfer pricing rules appear to be more technically elaborate and, to a certain extent, better aligned with the international transfer pricing principles developed by the Organisation for Economic Cooperation and Development (OECD). The new legislation provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of controlled transactions (transactions with related parties and some types of transactions with unrelated parties), provided that the transaction price is not arm's length.

Management believes that its pricing policy is arm's length and it has implemented internal processes to be in compliance with the new transfer pricing legislation.

Given that the practice of implementation of the new Russian transfer pricing rules has not yet developed, the impact of any challenge of the Group's transfer prices cannot be reliably estimated; however, it may be significant to the financial conditions and/or the overall operations of the Group.

Environmental contingencies. The Group, through its predecessor entities, has operated in Tatarstan for many years without developed environmental laws, regulations and Group policies. Environmental regulations and their enforcement are currently being considered in the Russian Federation and the Group is monitoring its potential obligations related thereto. The outcome of environmental liabilities under proposed or any future environmental legislation cannot reasonably be estimated at present, but could be material. Under existing legislation, however, management believes that there are no probable liabilities, which would have a material adverse effect on the operating results or financial position of the Group.

Legal contingencies. The Group is subject to various lawsuits and claims arising in the ordinary course of business. The outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present. In the case of all known contingencies the Group accrues a liability when the loss is probable and the amount is reasonably estimable. Based on currently available information, management believes that it is remote that future costs related to known contingent liability exposures would have a material adverse impact on the Group's consolidated financial statements.

Social commitments. The Group contributes significantly to the maintenance of local infrastructure and the welfare of its employees within Tatarstan, which includes contributions towards the construction, development and maintenance of housing, hospitals and transport services, recreation and other social needs. Such funding is periodically determined by the Board of Directors after consultation with governmental authorities and recorded as expenditures when incurred.

Guarantees. The Group has no outstanding guarantees at 31 December 2012, 2011 and 1 January 2011.

Transportation of crude oil. The Group benefits from the blending of its crude oil in the Transneft pipeline system since the Group's crude oil production is generally of a lower quality than that produced by some other regions of the Russian Federation (mainly Western Siberia) which supply through the same pipeline system. There is currently no equalization scheme for differences in crude oil quality within the Transneft pipeline system and the implementation of any such scheme is not determinable at present. However, if this practice were to change, the Group's business could be materially and adversely affected.

Note 25: Contingencies and commitments (continued)

Ukrtatnafta. The Group holds 49.6% investment in AmRUZ Trading AG ("AmRUZ") and 100% investment in Seagroup International Inc. ("Seagroup"). These entities primary activities are ownership interests in Closed Joint Stock Company Ukrtatnafta ("Ukrtatnafta"), the owner of the Kremenchug refinery, and their holdings constitute 8.34% and 9.96% of the outstanding common shares in Ukrtatnafta, respectively. Historically, and in particular during the course of 2007, there have been a number of attempts by Ukraine to challenge AmRUZ and Seagroup's acquisition of shares in Ukrtatnafta, and in particular, by the State Property Fund and NJSC Naftogaz of Ukraine ("Naftogaz"). Naftogaz is 100% owned by the Ukrainian Government and also owner of record of 43% Ukrtatnafta's common shares.

The challenges were suspended in April 2006 when the Supreme Court of Ukraine ruled the payment for Ukrtatnafta shares made with promissory notes issued by AmRUZ and Seagroup was lawful. However, in May 2007 the Ministry of Fuel and Energy of Ukraine ("MFEU") resumed its attempts and, as a result, succeeded in obtaining alleged and doubtful court decisions, after which it announced the transfer into Naftogaz's custody the 18.3% of Ukrtatnafta's shares, representing the entire holdings of AmRUZ and Seagroup in Ukrtatnafta. Subsequent to these actions, MFEU effectively began to exclude the Group from exercising their shareholder rights related to Ukrtatnafta.

In October 2007 the existing management of Ukrtatnafta, as appointed by its shareholders, was forcibly removed based on an alleged court order. Subsequently, individuals who obtained the ability to manage Ukrtatnafta took certain actions effectively assisting MFEU in taking control over the shares in Ukrtatnafta owned by SeaGroup and AmRUZ. In addition, Ukrtatnafta subsequently refused to settle its payables to ChMPKP Avto (Note 3), a Ukrainian intermediary that previously purchased crude from the Group for deliveries to Ukrtatnafta. Following this forced change of control of Ukrtatnafta, the Company (originally the key crude supplier to the Kremenchug refinery) suspended its crude oil deliveries to Ukrtatnafta.

Subsequently, the Ukrainian courts also invalided direct purchase of the shares in Ukrtatnafta by Tatneft.

In May 2008, Tatneft commenced international arbitration against Ukraine on the basis of the agreement between the Government of the Russian Federation and the Cabinet of Ministries of Ukraine on the Encouragement and Mutual Protection of Investments of November 27, 1998 ("Russia-Ukraine BIT"). The arbitration concerns losses suffered by Tatneft as a consequence of the forcible takeover of Ukrtatnafta and seizure of shares of the Group in Ukrtatnafta. Tatneft requested the arbitral tribunal declare Ukraine has breached the Russian-Ukraine BIT and to order Ukraine to pay compensation in excess of US$ 2.4 billion. In March 2013 the arbitral tribunal held the hearing on the merits with the award expected by the end of 2013.

As a result of the ongoing legal dispute over shareholding interests, as of 31 December 2012 the Company has fully provided for its investments in Ukrtatnafta.

Libya. As a result of the political situation in Libya, in February 2011 the Group had to entirely suspend its operations there and evacuate all its personnel. From February 2013 the Group has started the process of resuming its operations in Libya, including the return of some of its personnel to a branch in Tripoli. However, as of the date of this report the Group is not certain when it would be able to return to full operational activity in Libya. As of 31 December 2012 the company had approximately RR 5,681 million of assets associated with its Libyan operations of which RR 5,451 million is related to capitalized exploration costs, RR 208 million of inventories and RR 22 million of cash. As of 31 December 2011 and 1 January 2011 the company had approximately RR 5,692 million and RR 5,224 million of assets associated with its Libyan operations, correspondingly, of which RR 5,392 million and RR 4,781 million are related to capitalized exploration costs, RR 216 million and RR 219 million of inventories and RR 84million and 224 million of cash.

(in millions of Russian Roubles)

Note 26: Principal subsidiaries

Set out below are the Group's principal subsidiaries at 31 December 2012. Unless otherwise stated, the subsidiaries as listed below have share capital consisting solely of ordinary shares, which are held directly by the Group and the proportion of ownership interests held equals to the voting rights held by Group. The country of incorporation or registration is also their principal place of business.

Name of entity	% of ownership Interest held by the Group	% of ownership Interest held by the NCI	Principal activity
Tatneft-Europe AG	100	-	Export oil sales
Taneco OAO	91	9	Oil refinery
TMS group UK OOO	-	100	Oil lifting services
Burenie OOO	-	100	Drilling services
Nizhnekamskshina OAO	76	24	Tires production
Nizhnekamskiy zavod shin CMK OOO	100	-	Tires production
Trade House Kama OOO	100	-	Tires sales
Tatneft AZS-Centr OOO	100	-	Oil products sales
Tatneft AZS-Zapad OOO	100	-	Oil products sales

The total non-controlling interest for the year ended 31 December 2012 is RR 4,975 million, of which RR 2,091 million is attributed to TMS group UK OOO and Burenie OOO.

Note 27: Financial risk management

Financial risk management objectives and policies.

The accounting policies for financial instruments, as described in Note 3, have been applied to the financial statements line items below:

	At 31 December 2012	At 31 December 2011	At 1 January 2011
Financial assets			
Current			
Cash and cash equivalents	13,083	16,901	7,977
Restricted cash	1,369	1,178	2,897
Accounts receivable	53,553	62,094	54,707
Short-term financial assets	14,931	19,205	20,831
Non-current			
Long-term accounts receivable	1,530	2,038	2,275
Long-term financial assets	25,782	18,439	16,314
Total financial assets	**110,248**	**119,855**	**105,001**
Financial liabilities			
Current			
Trade and other payable	(17,887)	(20,467)	(18,736)
Short-term debt and current portion of long-term debt	(32,096)	(41,997)	(35,620)
Non-current			
Long-term debt, net of current portion	(37,991)	(59,747)	(72,939)
Total financial liabilities	**(87,974)**	**(122,211)**	**(127,295)**

The Group‘s activities expose it to a variety of financial risks: market risk (including foreign currency risk, interest rate risk and commodity price risk), credit risk and liquidity risk. The Group‘s overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group‘s financial performance. The Group has introduced a risk management system and developed a number of procedures to measure, assess and monitor risks and select the relevant risk management techniques.

(in millions of Russian Roubles)

Note 27: Financial risk management (continued)

Market risk

Market risk is the risk or uncertainty arising from possible market price movements and their impact on the future performance of a business.

The Group takes on exposure to market risks. Market risks arise from open positions in (a) foreign currencies, (b) interest rate risk and (c) commodity price risk.

a) Currency risk

The Group operates internationally and is exposed to currency risk arising from various currency exposures primarily with respect to the US dollar and the Euro. Foreign exchange risk arises from assets, liabilities, commercial transactions and financing denominated in foreign currencies.

The table below summarises the Group's exposure to foreign currency exchange rate risk at the end of the reporting period:

At 31 December 2012	**Russian Rouble**	**US dollar**	**Other**	**Total**
Financial assets				
Current				
Cash and cash equivalents	9,400	3,585	98	13,083
Restricted cash	941	113	315	1,369
Accounts receivable	19,729	33,091	733	53,553
Short-term financial assets	12,389	2,542	-	14,931
Non-current				
Long-term accounts receivable	1,052	-	478	1,530
Long-term financial assets	22,755	3,027	-	25,782
Total financial assets	**66,266**	**42,358**	**1,624**	**110,248**
Financial liabilities				
Current				
Trade and other payable	(14,096)	(3,549)	(242)	(17,887)
Short-term debt and current portion of long-term debt	(11,509)	(20,355)	(232)	(32,096)
Non-current				
Long-term debt, net of current portion	(605)	(36,150)	(1,236)	(37,991)
Total financial liabilities	**(26,210)**	**(60,054)**	**(1,710)**	**(87,974)**

(in millions of Russian Roubles)

Note 27: Financial risk management (continued)

At 31 December 2011	Russian Rouble	US dollar	Other	Total
Financial assets				
Current				
Cash and cash equivalents	14,594	2,307	-	16,901
Restricted cash	816	124	238	1,178
Accounts receivable	25,617	35,797	680	62,094
Short-term financial assets	16,713	2,492	-	19,205
Non-current				
Long-term accounts receivable	2,038	-	-	2,038
Long-term financial assets	13,436	5,003	-	18,439
Total financial assets	**73,214**	**45,723**	**918**	**119,855**
Financial liabilities				
Current				
Trade and other payable	(16,587)	(3,283)	(597)	(20,467)
Short-term debt and current portion of long-term debt	(3,273)	(38,724)	-	(41,997)
Non-current				
Long-term debt, net of current portion	(5,575)	(54,172)	-	(59,747)
Total financial liabilities	**(25,435)**	**(96,179)**	**(597)**	**(122,211)**

At 1 January 2011	Russian Rouble	US dollar	Other	Total
Financial assets				
Current				
Cash and cash equivalents	6,136	1,758	83	7,977
Restricted cash	301	1,231	1,365	2,897
Accounts receivable	25,737	28,729	241	54,707
Short-term financial assets	17,875	2,956	-	20,831
Non-current				
Long-term accounts receivable	2,241	-	34	2,275
Long-term financial assets	13,281	3,033	-	16,314
Total financial assets	**65,571**	**37,707**	**1,723**	**105,001**
Financial liabilities				
Current				
Trade and other payable	(14,516)	(2,772)	(1,448)	(18,736)
Short-term debt and current portion of long-term debt	(5,291)	(30,329)	-	(35,620)
Non-current				
Long-term debt, net of current portion	(5,514)	(67,425)	-	(72,939)
Total financial liabilities	**(25,321)**	**(100,526)**	**(1,448)**	**(127,295)**

(in millions of Russian Roubles)

Note 27: Financial risk management (continued)

Effect on pre-tax profit	**Increase/decrease in exchange rate**	**Year ended 31 December 2012**	**Year ended 31 December 2011**
US $/RR loss	+10%	(1,770)	(5,046)
US $/RR gain	-10%	1,770	5,046

b) Interest rate risk.

The majority of the Group's borrowings is at variable interest rates (linked to the LIBOR rate). To mitigate the risk of significant changes in the LIBOR rate, the Group's treasury function performs periodic analysis of the interest rate environment. The Group does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, the Group performs periodic analysis of the current interest rate environment and depending on that analysis at the time of raising new debts management makes decisions whether to obtain financing on fixed-rate or variable-rate basis would be more beneficial to the Group over the expected period until maturity.

Effect on pre-tax profit	**Year ended 31 December 2012**
Increase by 100 basis points	(617)
Decrease by 100 basis points	115

[*] - floating rate decrease capped at zero.

The sensitivity analysis is limited only to variable rate loans and borrowings and is conducted with all other variables held constant. The analysis is prepared assuming the amount of variable rate liability outstanding at the reporting date was outstanding for the whole year. Interest rate on variable rate loans and borrowings will effectively change throughout the year in response to fluctuations in market interest rates.

As the Group receives bank loans for financing its investment projects, the main part of borrowing costs in 2011 were capitalised into qualifying assets. Therefore, changes in interest rates would have no significant effect on profit or loss and equity in 2011.

The impact measured through the sensitivity analysis does not take into account other potential changes in economic conditions, which may accompany the relevant changes in market interest rates.

c) Commodity price risk

Commodity price risk is the risk or uncertainty arising from possible movements in prices for crude oil and related products, and their impact on the Group's future performance and results of the Group's operations. A decline in the prices could result in a decrease in net income and cash flows. The Group's overall strategy in production and sales of crude oil and related products is centrally managed. Substantially all the Group's crude oil export sales to Europe are sold under long-term contracts.

The Group assesses on a regular basis potential scenarios for future fluctuation in commodity prices and their impacts on operational and investment decisions.

However, in the current environment management estimates may materially differ from actual future impact on the Group's financial position. Actual results, and the impact on the Group's operations and financial position, may differ from management's estimates of potential scenarios.

Note 27: Financial risk management (continued)

Credit risk

Credit risk refers to the risk exposure that a potential financial loss to the Group may occur if a counterparty defaults on its contractual obligations. The Group's exposure to credit risk is limited to the carrying amount of financial assets recognized in the Consolidated Statement of Financial Position.

Credit risk arises from cash and cash equivalents, certificates of deposits, loans and notes receivables, as well as credit exposures to customers including outstanding trade and other receivables.

Credit risks related to accounts receivable are systematically monitored taking into account the customer's financial position, past experience and other factors. Management systematically reviews ageing analysis of receivables and uses this information for calculation of provision for impairment. A significant portion of the Group's accounts receivable is due from domestic and export trading companies. The Group does not always require collateral to limit the exposure to loss; however, in most cases letters of credit and prepayments are used, especially with respect to accounts receivables from non-CIS sales of crude oil. The Group operates with various customers and a substantial part of its sales relate to major customers. Although collection of accounts receivable could be influenced by economic factors affecting these customers, management believes there is no significant risk of loss to the Group beyond the provisions already recorded.

The Company performs an ongoing assessment and monitoring of the risk of default.

In addition, as part of its cash management and credit risk function, the Company regularly evaluates the creditworthiness of financial and banking institutions where it deposits cash.

The Group deposits available cash mostly with financial institutions in the Russian Federation. To manage this credit risk, the Group allocates its available cash to a variety of Russian banks. Management periodically reviews the credit worthiness of the banks in which it deposits cash. As of 31 December 2012, 31 December 2011 and 1 January 2011 the majority of loans and receivables (Note 8, Note 11) are held in Bank Zenit which is related party to the Group (Note 24) and other non-investment grade entities with credit rating not less than BB- according to Standard and Poor's.

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 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. In managing its liquidity risk, the Group maintains adequate cash reserves and debt facilities, continuously monitors forecast and actual cash flows and matches the maturity profiles of financial assets and liabilities.

The Group prepares various financial plans (monthly, quarterly and annually) which ensures that the Group has sufficient cash on demand to meet expected operational expenses, financial obligations and investing activities for a period of 30 days or more. To fund cash requirements of a more permanent nature, the Group will normally raise long-term debt in available international and domestic markets.

All of the Group's financial liabilities represent non-derivative financial instruments.

(in millions of Russian Roubles)

Note 27: Financial risk management (continued)

The following tables summarise the maturity profile of the Group's financial liabilities based on contractual undiscounted payments, including interest payments:

At 31 December 2012	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	Over 5 years	Total
Short-term debt, current portion of long-term and long-term debt	34,509	29,001	8,654	3,643	75,807
Trade and other payable	17,887	-	-	-	17,887

At 31 December 2011	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	Over 5 years	Total
Short-term debt, current portion of long-term and long-term debt	45,813	25,469	37,420	3,092	111,794
Trade and other payable	20,467	-	-	-	20,467

At 1 January 2011	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years	Over 5 years	Total
Short-term debt, current portion of long-term and long-term debt	40,023	37,726	39,787	2,699	120,235
Trade and other payable	18,736	-	-	-	18,736

As the amounts included in the table are contractual undiscounted cash flows which include future interest payments, these amounts will not reconcile to the amounts disclosed in the consolidated statement of financial position for borrowings.

Fair value hierarchy

Fair values. The estimated fair values of financial instruments are determined with reference to various market information and other valuation techniques as considered appropriate. IFRS 7, Financial Instruments: Disclosures, requires an entity to maximise its use of observable inputs when measuring fair value. In the absence of observable inputs, considerable judgment is required in interpreting market data to develop these estimates. Accordingly, the estimates are not necessarily indicative of the amounts that the Group could realise or settle in a market transaction. Certain of these financial instruments are with major financial institutions and expose the Group to market and credit risk. The creditworthiness of these institutions is routinely reviewed and full performance is anticipated. The Group is also exposed to a credit risk in the event of non-payment by counterparties. The creditworthiness of customers and other counterparties is continually reviewed.
IFRS 7 prioritises the inputs to valuation techniques into three levels as follows:

Level 1 – Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to assess at the measurement date. For the Group, Level 1 inputs include held-for-trading financial assets that are actively traded on the Russian domestic markets.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. For the Group, Level 2 inputs include observable market value measures applied to available for sale securities.

Level 3 – Unobservable inputs for the asset or liability. These inputs reflect the Company's own assumptions about the assumptions a market participant would use in pricing the asset or liability. The Group does not use Level 3 inputs for any of its recurring fair-value measurements.

(in millions of Russian Roubles)

Note 27: Financial risk management (continued)

Management of Capital

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and increase shareholder value. The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions.

The Group considers equity and debt to be the principal elements of capital management. In order to maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, revise its investment program, attract new or settle existing debt or sell certain non-core businesses.

The Group monitors capital on the basis of its gearing ratio.

Description	**Year ended 31 December 2012**	**Year ended 31 December 2011**	**Year ended 1 January 2011**
Consolidated total borrowings:	**70,092**	**101,873**	**108,695**
- Short-term debt and current portion of long-term debt	32,096	41,997	35,620
- Long-term debt, net of current portion	37,991	59,747	72,939
- Notes payable	5	129	136
Consolidated tangible net worth	**429,954**	**373,825**	**322,596**
Debt to capital employed ratio, % (Consolidated total borrowings/ Consolidated tangible net worth)	**16%**	**27%**	**34%**

Note 28: Subsequent events

The Group entered into a subordinated deposit agreement with Bank Zenit in January 2013 in the amount of RR 3,600 million payable in 10 years bearing interest of 9% per year.