OAO LUKOIL

CONSOLIDATED FINANCIAL STATEMENTS

(prepared in accordance with US GAAP)

As of December 31, 2007 and 2006
and for each of the years in the three-year period
ended December 31, 2007

Independent Auditors' Report

The Board of Directors of OAO LUKOIL:

We have audited the accompanying consolidated balance sheets of OAO LUKOIL and its subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the management of OAO LUKOIL. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO LUKOIL and its subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

ZAO KPMG

ZAO KPMG
Moscow, Russian Federation
April 7, 2008

OAO LUKOIL
Consolidated Balance Sheets
As of December 31, 2007 and 2006
(Millions of US dollars, unless otherwise noted)

	Note	2007	2006
Assets			
Current assets			
Cash and cash equivalents	3	841	752
Short-term investments		48	44
Accounts and notes receivable, net	5	7,467	5,158
Inventories	6	4,609	3,444
Prepaid taxes and other expenses		4,109	3,693
Other current assets		625	406
Assets held for sale	10	204	75
Total current assets		**17,903**	**13,572**
Investments	7	1,086	1,442
Property, plant and equipment	8	37,930	31,316
Deferred income tax assets	13	490	362
Goodwill and other intangible assets	9	934	791
Other non-current assets		1,289	754
Total assets		**59,632**	**48,237**
Liabilities and Stockholders' equity			
Current liabilities			
Accounts payable		4,554	2,759
Short-term borrowings and current portion of long-term debt	11	2,214	1,377
Taxes payable		2,042	1,663
Other current liabilities		918	1,132
Total current liabilities		**9,728**	**6,931**
Long-term debt	12, 16	4,829	4,807
Deferred income tax liabilities	13	2,079	2,116
Asset retirement obligations	8	811	608
Other long-term liabilities		395	352
Minority interest in subsidiary companies		577	523
Total liabilities		**18,419**	**15,337**
Stockholders' equity	15		
Common stock		15	15
Treasury stock, at cost		(1,591)	(1,098)
Additional paid-in capital		4,499	3,943
Retained earnings		38,349	30,061
Accumulated other comprehensive loss		(59)	(21)
Total stockholders' equity		**41,213**	**32,900**
Total liabilities and stockholders' equity		**59,632**	**48,237**

President of OAO LUKOIL
Alekperov V.Y.

Chief accountant of OAO LUKOIL
Khoba L.N.

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

OAO LUKOIL
Consolidated Statements of Income
For the years ended December 31, 2007, 2006 and 2005
(Millions of US dollars, unless otherwise noted)

	Note	2007	2006	2005
Revenues				
Sales (including excise and export tariffs)	23	81,891	67,684	55,774
Equity share in income of affiliates	7	347	425	441
Total revenues		**82,238**	**68,109**	**56,215**
Costs and other deductions				
Operating expenses		(6,172)	(4,652)	(3,443)
Cost of purchased crude oil, gas and products		(27,982)	(22,642)	(19,590)
Transportation expenses		(4,457)	(3,600)	(3,371)
Selling, general and administrative expenses		(3,207)	(2,885)	(2,578)
Depreciation, depletion and amortization		(2,172)	(1,851)	(1,315)
Taxes other than income taxes	13	(9,367)	(8,075)	(6,334)
Excise and export tariffs		(15,033)	(13,570)	(9,931)
Exploration expenses		(307)	(209)	(317)
(Loss) gain on disposals and impairments of assets		(123)	(148)	52
Income from operating activities		**13,418**	**10,477**	**9,388**
Interest expense		(333)	(302)	(275)
Interest and dividend income		135	111	96
Currency translation gain (loss)		93	169	(134)
Other non-operating expense		(240)	(118)	(44)
Minority interest		(55)	(80)	(121)
Income before income taxes		**13,018**	**10,257**	**8,910**
Current income taxes		(3,410)	(2,906)	(2,301)
Deferred income taxes		(97)	133	(166)
Total income tax expense	13	**(3,507)**	**(2,773)**	**(2,467)**
Net income		**9,511**	**7,484**	**6,443**
Per share of common stock (US dollars):				
Basic	15	11.48	9.06	7.91
Diluted	15	11.48	9.04	7.79

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

OAO LUKOIL
Consolidated Statements of Stockholders' Equity and Comprehensive Income
For the years ended December 31, 2007, 2006 and 2005
(Millions of US dollars, unless otherwise noted)

	2007		2006		2005	
	Stockholders' equity	Comprehen-sive income	Stockholders' equity	Comprehen-sive income	Stockholders' equity	Comprehen-sive income
Common stock						
Balance as of January 1	15		15		15	
Balance as of December 31	**15**		**15**		**15**	
Treasury stock						
Balance as of January 1	(1,098)		(527)		(706)	
Stock purchased	(712)		(782)		-	
Stock disposed	219		211		179	
Balance as of December 31	**(1,591)**		**(1,098)**		**(527)**	
Additional paid-in capital						
Balance as of January 1	3,943		3,730		3,564	
Premium on non-outstanding shares issued	-		22		47	
Effect of stock compensation plan	103		-		-	
Proceeds from sale of treasury stock in excess of carrying amount	453		191		119	
Balance as of December 31	**4,499**		**3,943**		**3,730**	
Retained earnings						
Balance as of January 1	30,061		23,586		17,938	
Net income	9,511	9,511	7,484	7,484	6,443	6,443
Dividends on common stock	(1,223)		(1,009)		(795)	
Balance as of December 31	**38,349**		**30,061**		**23,586**	
Accumulated other comprehensive loss, net of tax						
Balance as of January 1	(21)		-		-	
Pension benefits:						
Prior service cost	(16)	(16)	-	-	-	-
Actuarial loss	(22)	(22)	-	-	-	-
Effect of initial adoption of SFAS No. 158	-		(21)		-	
Balance as of December 31	**(59)**		**(21)**		**-**	
Total comprehensive income for the year		9,473		7,484		6,443
Total stockholders' equity as of December 31	**41,213**		**32,900**		**26,804**	

	Share activity		
	2007	2006	2005
	(thousands of shares)	(thousands of shares)	(thousands of shares)
Common stock, issued			
Balance as of January 1	850,563	850,563	850,563
Balance as of December 31	**850,563**	**850,563**	**850,563**
Treasury stock			
Balance as of January 1	(23,632)	(21,667)	(33,884)
Purchase of treasury stock	(8,756)	(9,017)	-
Disposal of treasury stock	9,067	7,052	12,217
Balance as of December 31	**(23,321)**	**(23,632)**	**(21,667)**

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

OAO LUKOIL
Consolidated Statements of Cash Flows
For the years ended December 31, 2007, 2006 and 2005
(Millions of US dollars)

	Note	2007	2006	2005
Cash flows from operating activities				
Net income		**9,511**	**7,484**	**6,443**
Adjustments for non-cash items:				
Depreciation, depletion and amortization		2,172	1,851	1,315
Equity share in income of affiliates, net of dividends received		209	(106)	(397)
Dry hole write-offs		143	91	170
Loss (gain) on disposals and impairments of assets		123	148	(52)
Deferred income taxes		97	(133)	166
Non-cash currency translation loss (gain)		193	86	(26)
Non-cash investing activities		(36)	(123)	(133)
All other items – net		297	89	258
Changes in operating assets and liabilities:				
Accounts and notes receivable		(2,297)	388	(1,337)
Inventories		(1,148)	(816)	(735)
Accounts payable		1,599	592	245
Taxes payable		386	(430)	705
Other current assets and liabilities		(368)	(1,355)	(418)
Net cash provided by operating activities		**10,881**	**7,766**	**6,204**
Cash flows from investing activities				
Acquisition of licenses		(255)	(7)	(3)
Capital expenditures		(9,071)	(6,419)	(3,979)
Proceeds from sale of property, plant and equipment		72	310	51
Purchases of investments		(206)	(312)	(242)
Proceeds from sale of investments		175	216	234
Sale of interests in subsidiaries and affiliated companies		1,136	71	588
Acquisitions of subsidiaries and minority shareholding interest (including advances related to acquisitions), net of cash acquired		(1,566)	(1,374)	(2,874)
Net cash used in investing activities		**(9,715)**	**(7,515)**	**(6,225)**
Cash flows from financing activities				
Net movements of short-term borrowings		(59)	700	(638)
Proceeds from issuance of long-term debt		2,307	1,092	2,474
Principal repayments of long-term debt		(1,632)	(1,077)	(704)
Dividends paid on company common stock		(1,230)	(1,015)	(800)
Dividends paid to minority		(78)	(119)	(53)
Financing from related party and third party minority shareholders		177	-	101
Purchase of treasury stock		(712)	(782)	-
Proceeds from sale of treasury stock		129	-	46
Other – net		-	15	6
Net cash (used in) provided by financing activities		**(1,098)**	**(1,186)**	**432**
Effect of exchange rate changes on cash and cash equivalents		21	37	(18)
Net increase (decrease) in cash and cash equivalents		**89**	**(898)**	**393**
Cash and cash equivalents at beginning of year		752	1,650	1,257
Cash and cash equivalents at end of year	**3**	**841**	**752**	**1,650**

Supplemental disclosures of cash flow information			
Interest paid	497	377	296
Income taxes paid	2,872	2,980	2,402

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

Note 1. Organization and environment

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

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

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

Business and economic environment

The Russian Federation has been experiencing political and economic change, which has affected and will continue to affect the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks, which do not typically exist in other markets.

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

Basis of preparation

These consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

Note 2. Summary of significant accounting policies

Principles of consolidation

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

Note 2. Summary of significant accounting policies (continued)

Use of estimates

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

Revenue

Revenues from the production and sale of crude oil and petroleum products are recognized when title passes to customers. Revenues include excise on petroleum products sales and duties on export sales of crude oil and petroleum products.

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

Foreign currency translation

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

For operations in the Russian Federation, hyperinflationary economies and other operations where the US dollar is the functional currency, monetary assets and liabilities have been translated into US dollars at the rate prevailing at each balance sheet date. Non-monetary assets and liabilities have been translated into US dollars at historical rates. Revenues, expenses and cash flows have been translated into US dollars at rates, which approximate actual rates at the date of the transaction. Translation differences resulting from the use of these rates are included in the consolidated statement of income.

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

Foreign currency transaction gains and losses are included in the consolidated statement of income.

As of December 31, 2007, 2006 and 2005, exchange rates of 24.55, 26.33 and 28.78 Russian rubles to the US dollar, respectively, have been used for translation purposes.

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

Cash and cash equivalents

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

Note 2. Summary of significant accounting policies (continued)

Cash with restrictions on immediate use

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

Accounts and notes receivable

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

Inventories

Inventories, consisting primarily of stocks of crude oil, petroleum products and materials and supplies, are stated at the lower of cost or market value. Cost is determined using an “average cost” method.

Investments

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

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

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

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

Property, plant and equipment

Oil and gas properties are accounted for using the successful efforts method of accounting whereby property acquisitions, successful exploratory wells, all development costs, and support equipment and facilities are capitalized. Unsuccessful exploratory wells are expensed when a well is determined to be non-productive. Other exploratory expenditures, including geological and geophysical costs are expensed as incurred.

Note 2. Summary of significant accounting policies (continued)

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

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

Production and related overhead costs are expensed as incurred.

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

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

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

Asset retirement obligations

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

Goodwill and other intangible assets

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

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

Note 2. Summary of significant accounting policies (continued)

Impairment of long-lived assets

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

Deferred income taxes

Deferred income tax assets and liabilities are recognized in respect of future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purposes of the consolidated financial statements and their respective tax bases and in respect of operating loss and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse and the assets be recovered and liabilities settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of income in the reporting period which includes the enactment date.

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

Interest-bearing borrowings

Interest-bearing borrowings are initially recorded at the value of net proceeds received. Any difference between the net proceeds and the redemption value is amortized at a constant rate over the term of the borrowing. Amortization is included in the consolidated statement of income each year and the carrying amounts are adjusted as amortization accumulates.

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

Pension benefits

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

Note 2. Summary of significant accounting policies (continued)

Treasury stock

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

Earnings per share

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

Contingencies

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

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

Environmental expenditures

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

Use of derivative instruments

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

Comparative amounts

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

Note 2. Summary of significant accounting policies (continued)

Recent accounting pronouncements

In March 2008, the FASB issued SFAS No. 161, *"Disclosures about Derivative Instruments and Hedging Activities."* This Statement improves financial reporting about derivative instruments and hedging activities by enhanced disclosures of their effects on entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements for fiscal years and interim periods beginning after November 15, 2008, early application is encouraged. The Group is required to adopt the provisions of SFAS No. 161 in the first quarter 2009 and does not expect any material impact on its results of operations, financial position or cash flows upon adoption.

In December 2007, the FASB issued SFAS No. 141 (Revised), *"Business combinations."* This Statement will apply to all transactions in which an entity obtains control of one or more businesses. SFAS No. 141 (Revised) requires an entity to recognize the fair value of assets acquired and liabilities assumed in a business combination; to recognize and measure the goodwill acquired in the business combination or gain from a bargain purchase and modifies the disclosure requirements. The Group is required to prospectively adopt the provisions of SFAS No. 141 (Revised) for business combinations for which the acquisition date is on or after January 1, 2009. Early adoption of SFAS No. 141 (Revised) is prohibited.

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

In February 2007, the FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities."* This Statement expands the possibility of using fair value measurements and permits enterprises to choose to measure certain financial assets and financial liabilities at fair value. Enterprises shall report unrealized gains and losses on items for which the fair value option has been elected in earnings in each subsequent period. The Group is required to adopt the provisions of SFAS No. 159 in the first quarter 2008 and does not expect any material impact on its financial statements upon adoption.

In September 2006, the FASB issued SFAS No. 158, *"Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)."* This Statement requires an employer that sponsors one or more single-employer defined benefit plans to: (a) Recognize the funded status of a benefit plan in its statement of financial position; (b) Recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost; (c) Measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position (with limited exceptions); (d) Disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. The provisions of this Statement were effective December 31, 2006, except for the requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end, which is effective December 31, 2008. The adoption of the provisions of SFAS No. 158 did not have a material impact on the Group's results of operations, financial position or cash flows.

(Millions of US dollars, except as indicated)

Note 2. Summary of significant accounting policies (continued)

In September 2006, the FASB issued SFAS No. 157, *"Fair Value Measurements,"* which establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair value measurements. This Statement does not require any new fair value measurements but is expected to increase the consistency of those measurements. The Group is required to adopt the provisions of SFAS No. 157 in the first quarter 2008 and does not expect any material impact on its financial statements upon adoption.

In June 2006, the FASB issued FASB Interpretation No. 48, *"Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109"* (FIN 48). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *"Accounting for Income Taxes."* The Group adopted the provisions of FIN 48 in the first quarter 2007. The adoption of the provisions of Interpretation No. 48 did not have a material impact on the Group's results of operations, financial position or cash flows.

In June 2006, the FASB ratified the consensus reached by the EITF on Issue No. 06-3, *"How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)."* The consensus requires disclosure of either the gross or net presentation, and any such taxes reported on a gross basis should be disclosed in the interim and annual financial statements. The Group adopted the provisions of EITF Issue No. 06-3 in 2006. The adoption of the Issue did not have a material impact on the Group's financial statements.

In December 2004, the FASB issued SFAS No. 123(R), *"Share-Based Payment,"* which revises SFAS No. 123 and supersedes Accounting Principles Board (APB) Opinion No. 25 regarding stock-based employee compensation plans. SFAS No.123(R) requires liability classified share-based payment awards to employees to be valued at fair value on the date of grant and as of each reporting date and expensed over the vesting period. Equity classified share-based payment awards to employees should be valued at fair value on the date of grant and expensed over the vesting period. The adoption of the provisions of SFAS No. 123(R) during 2006 did not have a material impact on the Group's results of operations, financial position or cash flows.

Note 3. Cash and cash equivalents

	As of December 31, 2007	**As of December 31, 2006**
Cash held in Russian rubles	285	119
Cash held in other currencies	417	321
Cash of a banking subsidiary in other currencies	47	130
Cash held in related party banks in Russian rubles	80	97
Cash held in related party banks in other currencies	12	85
Total cash and cash equivalents	**841**	**752**

Note 4. Non-cash transactions

The consolidated statement of cash flows excludes the effect of non-cash transactions, which are described in the following table:

	Year ended December 31, 2007	**Year ended December 31, 2006**	**Year ended December 31, 2005**
Non-cash investing activity	36	123	133
Settlement of stock-based compensation plan liability	537	-	-
Non-cash acquisition of minority interest in a subsidiary	-	314	-
Settlement of bond liability with the Company's common stock	-	91	300
Total non-cash transactions	**573**	**528**	**433**

(Millions of US dollars, except as indicated)

Note 4. Non-cash transactions (continued)

The following table shows the effect of non-cash transactions on investing activity:

	Year ended December 31, 2007	Year ended December 31, 2006	Year ended December 31, 2005
Net cash used in investing activity	9,715	7,515	6,225
Non-cash acquisition of minority interest in a subsidiary	-	314	-
Non-cash investing activity	36	123	133
Total investing activity	**9,751**	**7,952**	**6,358**

Note 5. Accounts and notes receivable, net

	As of December 31, 2007	As of December 31, 2006
Trade accounts and notes receivable (net of provisions of $69 million and $84 million as of December 31, 2007 and 2006, respectively)	5,962	3,873
Current VAT and excise recoverable	1,196	1,097
Other current accounts receivable (net of provisions of $48 million and $38 million as of December 31, 2007 and 2006, respectively)	309	188
Total accounts and notes receivable	**7,467**	**5,158**

Note 6. Inventories

	As of December 31, 2007	As of December 31, 2006
Crude oil and petroleum products	3,609	2,713
Materials for extraction and drilling	477	323
Materials and supplies for refining	24	28
Other goods, materials and supplies	499	380
Total inventories	**4,609**	**3,444**

Note 7. Investments

	As of December 31, 2007	As of December 31, 2006
Investments in equity method affiliates and joint ventures	836	1,157
Long-term loans given by non-banking subsidiaries	232	261
Other long-term investments	18	24
Total long-term investments	**1,086**	**1,442**

Investments in "equity method" affiliates and joint ventures

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

	Year ended December 31, 2007		Year ended December 31, 2006		Year ended December 31, 2005	
	Total	Group's share	Total	Group's share	Total	Group's share
Revenues	2,930	1,382	2,367	1,251	2,972	1,383
Income before income taxes	1,398	650	1,315	690	1,214	605
Less income taxes	(605)	(303)	(529)	(265)	(338)	(164)
Net income	**793**	**347**	**786**	**425**	**876**	**441**

(Millions of US dollars, except as indicated)

Note 7. Investments (continued)

	As of December 31, 2007		As of December 31, 2006	
	Total	Group's share	Total	Group's share
Current assets	1,320	618	1,668	829
Property, plant and equipment	2,082	1,082	2,140	1,168
Other non-current assets	181	88	53	25
Total assets	3,583	1,788	3,861	2,022
Short-term debt	204	89	161	70
Other current liabilities	682	329	511	264
Long-term debt	1,005	511	1,003	518
Other non-current liabilities	47	23	24	13
Net assets	**1,645**	**836**	**2,162**	**1,157**

Note 8. Property, plant and equipment and asset retirement obligations

	At cost		Net	
	As of December 31, 2007	As of December 31, 2006	As of December 31, 2007	As of December 31, 2006
Exploration and Production:				
Western Siberia	19,424	16,911	10,811	8,673
European Russia	18,776	15,378	13,303	10,277
International	4,360	5,238	3,716	4,594
Total	42,560	37,527	27,830	23,544
Refining, Marketing, Distribution and Chemicals:				
Western Siberia	22	19	16	16
European Russia	9,216	7,281	6,292	4,700
International	4,855	3,988	3,241	2,605
Total	14,093	11,288	9,549	7,321
Other:				
Western Siberia	156	157	69	72
European Russia	399	307	338	267
International	181	140	144	112
Total	736	604	551	451
Total property, plant and equipment	**57,389**	**49,419**	**37,930**	**31,316**

As of December 31, 2007 and 2006, the asset retirement obligations amounted to $821 million and $618 million, respectively, of which $10 million was included in "Other current liabilities" in the consolidated balance sheets as of each balance sheet date. During 2007 and 2006, asset retirement obligations changed as follows:

	2007	2006
Asset retirement obligations as of January 1	618	397
Accretion expense	60	39
New obligations	91	113
Changes in estimates of existing obligations	20	39
Spending on existing obligations	(10)	(8)
Property dispositions	(7)	(3)
Foreign currency translation and other adjustments	49	41
Asset retirement obligations as of December 31	**821**	**618**

(Millions of US dollars, except as indicated)

Note 9. Goodwill and other intangible assets

The carrying value of goodwill and other intangible assets as of December 31, 2007 and 2006 was as follows:

	As of December 31, 2007	**As of December 31, 2006**
Amortized intangible assets		
Software	410	327
Licenses and other assets	56	52
Goodwill	468	412
Total goodwill and other intangible assets	**934**	**791**

All goodwill amounts relate to the refining, marketing and distribution segment. As a result of the acquisition of 376 petrol stations in Europe the Group recognized goodwill in the amount of $64 million during the current year (refer to Note 17. Business combinations).

Note 10. Dispositions of subsidiaries and assets

In December 2007, a Group company committed to a plan to sell 162 petrol stations, located in Pennsylvania and the southern New Jersey of USA, previously acquired from ConocoPhillips in 2004. In February 2008, this company entered into an agreement to sell these petrol stations to a third party investor for $138 million, less estimated amounts to extinguish environmental remediation liabilities of approximately $19 million. The Group will continue to supply petroleum products to these petrol stations under a 15 year supply contract with the new owners. The transaction is expected to be finalized in May 2008. As of December 31, 2007, the Group classified these petrol stations with the carrying value of $134 million as assets held for sale in the consolidated balance sheet, additionally the Group had a liability related to assets held for sale with the carrying value of $14 million included in “Other current liabilities” of the consolidated balance sheet.

In April 2007, a Group company completed the sale of 50% of its interest in Caspian Investment Resources Ltd. (“Caspian”, formerly Nelson Resources Limited), which has exploration and production operations in western Kazakhstan, to Mittal Investments S.A.R.L. for $980 million. In addition, Mittal Investments S.A.R.L. paid a liability in the amount of $175 million, which represented 50% of Caspian’s outstanding debt to Group companies.

In December 2006, a Group company completed the sale of its 100% interest in LUKOIL Shelf Limited and LUKOIL Overseas Orient Limited for $40 million. LUKOIL Shelf Limited and LUKOIL Overseas Orient Limited render drilling services in the Caspian Sea shelf and own the Astra jack-up rig.

In May 2006, the Group completed the sale of its remaining 21% ownership interest in OAO Bank Petrocommerce for $33 million. The sale was made to a related party, whose management and directors include members of the Group’s management and Board of Directors. The carrying value of this investment as of the date of transaction was equal to the selling price.

In December 2005, the Company made a decision to sell ten tankers. A Group company finalized the sale of eight tankers in May 2006 for a price that approximated their carrying value of $190 million. The sale of the remaining two tankers is expected to be finalized in April 2008 for a price that approximates their carrying value of $70 million. As of December 31, 2007 and 2006, the Group classified these tankers as assets held for sale in the consolidated balance sheets.

(Millions of US dollars, except as indicated)

Note 11. Short-term borrowings and current portion of long-term debt

	As of December 31, 2007	As of December 31, 2006
Short-term borrowings from third parties	938	949
Short-term borrowings from related parties	-	52
Current portion of long-term debt	1,276	376
Total short-term borrowings and current portion of long-term debt	**2,214**	**1,377**

Short-term borrowings are unsecured and primarily payable in US dollars. The weighted-average interest rate on short-term borrowings from third parties was 5.97% and 5.64% per annum as of December 31, 2007 and 2006, respectively.

Note 12. Long-term debt

	As of December 31, 2007	As of December 31, 2006
Long-term loans and borrowings from third parties (including loans from banks in the amount of $2,391 million and $3,204 million as of December 31, 2007 and 2006, respectively)	2,439	3,277
Long-term loans and borrowings from related parties	1,745	1,043
3.5% Convertible US dollar bonds, maturing 2007	-	4
6.356% Non-convertible US dollar bonds, maturing 2017	500	-
6.656% Non-convertible US dollar bonds, maturing 2022	500	-
7.25% Russian ruble bonds, maturing 2009	244	228
7.10% Russian ruble bonds, maturing 2011	326	304
7.40% Russian ruble bonds, maturing 2013	244	228
Capital lease obligations	107	99
Total long-term debt	6,105	5,183
Current portion of long-term debt	(1,276)	(376)
Total non-current portion of long-term debt	**4,829**	**4,807**

Long-term loans and borrowings

Long-term loans and borrowings are primarily repayable in US dollars, maturing from 2008 through 2037. Approximately 6% of this debt is secured by export sales and property, plant and equipment. The weighted-average interest rate on long-term loans and borrowings from third parties was 5.77% and 6.23% per annum as of December 31, 2007 and 2006, respectively.

A Group company has an unsecured syndicated loan agreement, arranged by Citibank, ABN AMRO Bank, BNP Paribas, Sumitomo Banking Corporation and Societe Generale with an outstanding amount of $934 million as of December 31, 2007, maturing in 2008. Borrowings under this agreement bear interest at LIBOR plus 0.7% per annum. This loan facility was used for financing the acquisition of Caspian in 2005.

The Company has a loan agreement with European Bank for Reconstruction and Development with an outstanding amount of $250 million as of December 31, 2007, maturing in 2017. Borrowings under this agreement bear interest from LIBOR plus 0.45% to LIBOR plus 0.65% per annum.

The Company has a loan agreement with CALYON with an outstanding amount of $225 million as of December 31, 2007, maturing in 2013. Borrowings under this agreement bear interest at LIBOR plus 0.4% per annum.

A Group company has a loan agreement with ABN AMRO with an outstanding amount of $59 million as of December 31, 2007, maturing in 2016. Borrowings under this agreement bear interest at EURIBOR plus 0.18% per annum.

Note 12. Long-term debt (continued)

A Group company has an unsecured syndicated loan agreement with CALYON and ABN AMRO with an outstanding amount of $221 million as of December 31, 2007. Borrowings under this agreement bear interest at LIBOR plus 0.85% per annum and have maturity dates up to 2010.

A Group company has a secured loan agreement, arranged by Credit Suisse, supported by an Overseas Private Investment Corporation guarantee, with an outstanding amount of $203 million as of December 31, 2007. Borrowings under this agreement bear interest at LIBOR plus 4.8% per annum and have maturity dates up to 2015.

A Group company has a loan agreement with Vnesheconombank with an outstanding amount of $123 million as of December 31, 2007. Borrowings under this agreement bear interest at a fixed rate of 3% per annum and have maturity dates up to 2011.

As of December 31, 2007, the Group has a number of other fixed rate loan agreements with a number of banks and organizations totaling $67 million, maturing from 2008 to 2017. The weighted average interest rate under these loans was 3.88% per annum.

As of December 31, 2007, the Group has a number of other floating rate loan agreements with a number of banks and organizations totaling $357 million, maturing from 2008 to 2018. The weighted average interest rate under these loans was 5.99% per annum.

A Group company has a number of loan agreements with ConocoPhillips, the Group’s related party, with an outstanding amount of $1,745 million as of December 31, 2007. Borrowings under these agreements bear interest at fixed rate ranging from 6.8% to 8.2% per annum and have maturity dates up to 2037. These agreements are a part of the Company’s broad-based strategic alliance with ConocoPhillips and this financing is used to develop oil production and distribution infrastructure in the Timan-Pechora region of the Russian Federation.

Non-convertible US dollar bonds

In June 2007, a Group company issued non-convertible bonds totaling $1 billion. $500 million were placed with a maturity of 10 years and a coupon yield of 6.356% per annum. Another $500 million were placed with a maturity of 15 years and a coupon yield of 6.656% per annum. All bonds were placed at nominal value and have a half year coupon period.

Convertible US dollar bonds

On November 29, 2002, a Group company issued 350,000 3.5% convertible bonds with a face value of $1,000 each, maturing on November 29, 2007, and exchangeable for 12.246 (previously 12.112) global depository receipts (“GDRs”) of the Company per bond. The bonds are convertible into GDRs on, or after, January 9, 2003, up to the maturity dates. The GDRs are exchangeable into four shares of common stock of the Company. Bonds not converted by the maturity date must be redeemed for cash. The redemption price at maturity will be 120.53% of the face value in respect of these bonds. The carrying amount of the bonds is being accreted to their redemption value with the accreted amount being charged to the consolidated statement of income. Prior to the redemption date bondholders had converted 349,250 bonds into 16.9 million shares, remaining bonds were redeemed for cash on November 29, 2007.

Russian ruble bonds

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

(Millions of US dollars, except as indicated)

Note 12. Long-term debt (continued)

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

Maturities of long-term debt

Annual maturities of total long-term debt during the next five years, including the portion classified as current, are $1,276 million in 2008, $502 million in 2009, $384 million in 2010, $516 million in 2011, $144 million in 2012 and $3,283 million thereafter.

Note 13. Taxes

The Group is taxable in a number of jurisdictions within and outside of the Russian Federation and, as a result, is subject to a variety of taxes as established under the statutory provisions of each jurisdiction.

The total cost of taxation to the Group is reported in the consolidated statement of income as “Total income tax expense” for income taxes, as “Excise and export tariffs” for excise taxes, export tariffs and petroleum products sales taxes and as “Taxes other than income taxes” for other types of taxation. In each category taxation is made up of taxes levied at various rates in different jurisdictions.

Operations in the Russian Federation are subject to Federal income tax rate of 6.5% and a regional income tax rate that varies from 13.5% to 17.5% at the discretion of the individual regional administration. The Group’s foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

As of January 1, 2007, and for the 12 months period ended December 31, 2007, the Group does not have any unrecognized tax benefits and thus, no interest and penalties related to unrecognized tax benefits were accrued. The Group’s policy is to record interest and penalties related to unrecognized tax benefits as components of income tax expense. In addition, the Group does not expect that the amount of unrecognized tax benefits will change significantly within the next 12 months.

The Company and its Russian subsidiaries file standalone income tax returns in Russia. With a few exceptions, income tax returns in Russia are open to examination by the Russian tax authorities for the tax years beginning in 2005.

There are not currently, and have not been during the three years ended December 31, 2007, any provisions in the taxation legislation of the Russian Federation to permit the Group to reduce taxable profits in a Group company by offsetting tax losses in another Group company against such profits. Tax losses of a Group company in the Russian Federation may, however, be used fully or partially to offset taxable profits in the same company in any of the ten years following the year of loss.

Domestic and foreign components of income before income taxes were:

	Year ended December 31, 2007	**Year ended December 31, 2006**	**Year ended December 31, 2005**
Domestic	11,702	9,215	7,992
Foreign	1,316	1,042	918
Income before income taxes	**13,018**	**10,257**	**8,910**

(Millions of US dollars, except as indicated)

Note 13. Taxes (continued)

Domestic and foreign components of income taxes were:

	Year ended December 31, 2007	Year ended December 31, 2006	Year ended December 31, 2005
Current			
Domestic	2,940	2,419	2,194
Foreign	470	487	107
Current income tax expense	3,410	2,906	2,301
Deferred			
Domestic	135	(40)	61
Foreign	(38)	(93)	105
Deferred income tax expense (benefit)	97	(133)	166
Total income tax expense	**3,507**	**2,773**	**2,467**

The following table is a reconciliation of the amount of income tax expense that would result from applying the Russian combined statutory income tax rate to income before income taxes to total income taxes:

	Year ended December 31, 2007	Year ended December 31, 2006	Year ended December 31, 2005
Income before income taxes	13,018	10,257	8,910
Notional income tax at Russian statutory rate	3,124	2,462	2,138
Increase (reduction) in income tax due to:			
Non-deductible items, net	462	476	407
Foreign rate differences	84	47	(12)
Domestic regional rate differences	(237)	(232)	(125)
Foreign currency effect	15	5	(5)
Change in valuation allowance	59	15	64
Total income tax expense	**3,507**	**2,773**	**2,467**

Taxes other than income taxes were:

	Year ended December 31, 2007	Year ended December 31, 2006	Year ended December 31, 2005
Mineral extraction tax	8,482	7,281	5,590
Social taxes and contributions	442	356	324
Property tax	313	247	233
Other taxes and contributions	130	191	187
Taxes other than income taxes	**9,367**	**8,075**	**6,334**

Deferred income taxes are included in the consolidated balance sheets as follows:

	As of December 31, 2007	As of December 31, 2006
Other current assets	73	68
Deferred income tax assets – non-current	490	362
Other current liabilities	(147)	(69)
Deferred income tax liabilities – non-current	(2,079)	(2,116)
Net deferred income tax liability	**(1,663)**	**(1,755)**

(Millions of US dollars, except as indicated)

Note 13. Taxes (continued)

The following table sets out the tax effects of each type of temporary differences which give rise to deferred income tax assets and liabilities:

	As of December 31, 2007	As of December 31, 2006
Accounts receivable	12	27
Long-term liabilities	267	209
Inventories	14	8
Property, plant and equipment	238	141
Accounts payable	39	24
Long-term investments	3	3
Operating loss carry forwards	464	312
Other	136	104
Total gross deferred income tax assets	1,173	828
Less valuation allowance	(208)	(149)
Deferred income tax assets	**965**	**679**
Property, plant and equipment	(2,206)	(2,064)
Accounts payable	(5)	(64)
Accounts receivable	(1)	-
Long-term liabilities	(199)	(162)
Inventories	(65)	(42)
Long-term investments	(4)	(16)
Other	(148)	(86)
Deferred income tax liabilities	**(2,628)**	**(2,434)**
Net deferred income tax liability	**(1,663)**	**(1,755)**

As a result of business combinations during 2007 and 2006, the Group recognized a net deferred tax liability of $158 million and $279 million, respectively.

As of December 31, 2007, retained earnings of foreign subsidiaries included $13,535 million for which deferred taxation has not been provided because remittance of the earnings has been indefinitely postponed through reinvestment and, as a result, such amounts are considered to be permanently invested. The amount of deferred tax liability on this amount is not practicable to calculate.

In accordance with SFAS No. 52, *"Foreign currency translation,"* and SFAS No. 109, *"Accounting for Income Taxes,"* deferred tax assets and liabilities are not recognized for exchange rate effects resulting from the translation of transactions and balances from the Russian ruble to the US dollar using historical exchange rates. Also, in accordance with SFAS No. 109, no deferred tax assets or liabilities are recognized for the effects of the related statutory indexation of property, plant and equipment.

Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred income tax assets are deductible, management believes it is more likely than not that Group companies will realize the benefits of the deductible temporary differences and loss carry forwards, net of existing valuation allowances as of December 31, 2007 and 2006.

As of December 31, 2007, the Group had operating loss carry forwards of $1,791 million of which $15 million expire during 2008, $10 million expire during 2009, $27 million expire during 2010, $4 million expire during 2011, $59 million expire during 2012, $35 million expire during 2013, $13 million expire during 2014, $32 million expire during 2015, $368 million expire during 2016, $386 million expire during 2017, $42 million expire during 2018, $5 million expire during 2025, $67 million expire during 2026, $77 million expire during 2027, $1 million expire during 2035, and $650 million have indefinite carry forward.

(Millions of US dollars, except as indicated)

Note 14. Pension benefits

The Company sponsors a post employment and post retirement benefits program. The primary component of the post employment and post retirement benefits program is a defined benefit pension plan that covers the majority of the Group's employees. This plan is administered by a non-state pension fund, LUKOIL-GARANT, and provides pension benefits primarily based on years of service and final remuneration levels. The Company also provides several long-term employee benefits such as death-in-service benefit and lump-sum payments upon retirement of a defined benefit nature and other defined benefits to certain old age and disabled pensioners who have not vested any pensions under the pension plan.

The Company's pension plan primarily consists of a defined benefit plan enabling employees to contribute a portion of their salary to the plan and at retirement to receive a lump sum amount from the Company equal to all past contributions made by the employee up to 7% of their annual salary. Employees also have the right to receive upon retirement the benefits accumulated under the previous pension plan that was replaced in December 2003. These benefits have been fixed and included in the benefit obligation as of December 31, 2007 and 2006. The amount was determined primarily based on a formula including past pensionable service and relative salaries as of December 31, 2003.

On December 31, 2006, the Group adopted the provisions of SFAS No. 158, *"Employers' Accounting for Defined Benefit Pension and Other Post retirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)."* This Statement requires employers to recognize the funded status of all postretirement defined benefit plans in the statement of financial position with corresponding adjustments to accumulated other comprehensive income. The adjustment to accumulated other comprehensive income at adoption represents the net unrecognized actuarial gains and unrecognized prior service costs, both of which were previously netted against the plan's funded status in the statement of financial position. These amounts will be subsequently recognized as net periodic benefit cost. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods will be recognized as a component of other comprehensive income. These amounts will be subsequently recognized as a component of net periodic benefit cost on the same basis as the amounts recognized in accumulated other comprehensive income at adoption of SFAS No. 158.

The Company uses December 31 as the measurement date for its post employment and post retirement benefits program. An independent actuary has assessed the benefit obligations as of December 31, 2007 and 2006.

The following tables provide information about the benefit obligations, plan assets used as of December 31, 2007 and 2006. The benefit obligations below represent the projected benefit obligation of the pension plan.

	2007	2006
Benefit obligations		
Benefit obligations as of January 1	258	202
Effect of exchange rate changes	20	18
Service cost	15	14
Interest cost	16	19
Plan amendments	29	12
Actuarial loss	30	13
Benefits paid	(40)	(20)
Benefit obligations as of December 31	**328**	**258**

(Millions of US dollars, except as indicated)

Note 14. Pension benefits (continued)

	2007	2006
Plan assets		
Fair value of plan assets as of January 1	94	73
Effect of exchange rate changes	7	6
Return on plan assets	10	9
Employer contributions	37	26
Benefits paid	(40)	(20)
Fair value of plan assets as of December 31	**108**	**94**
Funded status	(220)	(164)
Amounts recognized in the consolidated balance sheet as of December 31, 2007 and 2006		
Accrued benefit liabilities included in “Other long-term liabilities”	(220)	(164)

Weighted average assumptions used to determine benefit obligations as of December 31, 2007 and 2006:

	2007	2006
Discount rate	6.34%	6.60%
Rate of compensation increase	8.12%	7.10%

Weighted average assumptions used to determine net periodic benefit costs for the year ended December 31, 2007 and 2006:

	2007	2006
Discount rate	6.60%	9.18%
Rate of compensation increase	7.10%	9.18%
Expected rate of return on plan assets	9.34%	9.85%

Included in accumulated other comprehensive loss as of December 31, 2007 and 2006, are the following before-tax amounts that have not yet been recognized in net periodic benefit cost:

	2007	2006
Unamortized prior service cost	82	61
Unrecognized actuarial gain	(4)	(34)
Total costs	**78**	**27**

Amounts recognized in other comprehensive loss during the year ended December 31, 2007 and 2006:

	2007	2006
Additional loss (gain) arising during the period	29	(34)
Re-classified gain amortization	1	-
Additional prior service cost from plan amendment	29	61
Re-classified prior service cost amortization	(8)	-
Net amount recognized for the period	**51**	**27**

The real returns on bonds and equities are based on what is observed in the international markets over extended periods of time. In the calculation of the expected return on assets no use is made of the historical returns LUKOIL-GARANT has achieved.

(Millions of US dollars, except as indicated)

Note 14. Pension benefits (continued)

In addition to the plan assets, LUKOIL-GARANT holds assets in the form of an insurance reserve. The purpose of this insurance reserve is to satisfy pension obligations should the plan assets not be sufficient to meet pension obligations. The Group's contributions to the pension plan are determined without considering the assets in the insurance reserve.

The plans are funded on a discretionary basis through a solidarity account, which is held in trust with LUKOIL-GARANT. LUKOIL-GARANT does not allocate separately identifiable assets to the Group or its other third party clients. All funds of plan assets and other individual pension accounts are managed as a pool of investments.

The asset allocation of the investment portfolio maintained by LUKOIL-GARANT for the Group and its clients was as follows:

Type of assets	**As of December 31, 2007**	**As of December 31, 2006**
Promissory notes of Russian issuers	6%	24%
Russian corporate bonds	33%	23%
Bank deposits	8%	9%
Equity securities of Russian issuers	22%	21%
Russian state bonds	2%	2%
Shares of OAO LUKOIL	3%	8%
Shares in investment funds	17%	8%
Russian municipal bonds	-	1%
Other assets	9%	4%
	100%	100%

The investment strategy employed by LUKOIL-GARANT includes an overall goal to attain a maximum investment return, while guaranteeing the principal amount invested. The strategy is to invest with a medium-term perspective while maintaining a level of liquidity through proper allocation of investment assets. Investment policies include rules and limitations to avoid concentrations of investments.

The investment portfolio is primarily comprised of two types of investments: securities with fixed yield and equity securities. The securities with fixed yield include mainly high yield corporate bonds and promissory notes of banks with low and medium risk ratings. Maturities range from one to three years.

Components of net periodic benefit cost were as follows:

	Year ended December 31, 2007	**Year ended December 31, 2006**	**Year ended December 31, 2005**
Service cost	15	14	9
Interest cost	16	19	17
Less expected return on plan assets	(9)	(8)	(6)
Amortization of prior service cost	8	6	5
Actuarial gain	(1)	(2)	(3)
Total net periodic benefit cost	**29**	**29**	**22**

Total employer contributions for 2008 are expected to be $32 million. An amount of $11 million is included in other comprehensive income and expected to be recognized in the net periodic benefit cost in 2008.

Note 14. Pension benefits (continued)

The following benefit payments, which reflect expected future services, as appropriate, are expected to be paid:

	2008	2009	2010	2011	2012	5-year period 2008-2012	5-year period 2013-2017
Pension benefits	54	17	16	15	17	119	71
Other long-term employee benefits	36	19	20	20	21	116	111
Total expected benefits to be paid	**90**	**36**	**36**	**35**	**38**	**235**	**182**

Note 15. Stockholders' equity

Common stock

	As of December 31, 2007 (thousands of shares)	As of December 31, 2006 (thousands of shares)
Authorized and issued common stock, par value of 0.025 Russian rubles each	850,563	850,563
Common stock held by subsidiaries, not considered as outstanding	(1,248)	(1,268)
Treasury stock	(23,321)	(23,632)
Outstanding common stock	**825,994**	**825,663**

Dividends and dividend limitations

Profits available for distribution to common stockholders in respect of any reporting period are determined by reference to the statutory financial statements of the Company prepared in accordance with the laws of the Russian Federation and denominated in Russian rubles. Under Russian Law, dividends are limited to the net profits of the reporting year as set out in the statutory financial statements of the Company. These laws and other legislative acts governing the rights of shareholders to receive dividends are subject to various interpretations.

The Company's net profits were 64,917 million Russian rubles, 55,130 million Russian rubles and 66,327 million Russian rubles respectively for 2007, 2006 and 2005, pursuant to the statutory financial statements, which at the US dollar exchange rates as of December 31, 2007, 2006 and 2005, amounted to $2,645 million, $2,094 million and $2,304 million, respectively.

At the annual stockholders' meeting on June 28, 2007, dividends were declared for 2006, in the amount of 38 Russian rubles per common share, which at the date of the meeting was equivalent to $1.47. Dividends payable of $35 million and $7 million are included in "Other current liabilities" in consolidated balance sheet as of December 31, 2007 and 2006, respectively.

At the annual stockholders' meeting on June 28, 2006, dividends were declared for 2005, in the amount of 33 Russian rubles per common share, which at the date of the decision was equivalent to $1.22.

At the annual stockholders' meeting on June 28, 2005, dividends were declared for 2004, in the amount of 28 Russian rubles per common share, which at the date of the decision was equivalent to $0.98.

Note 15. Stockholders' equity (continued)

Earnings per share

The calculation of diluted earnings per share for these years was as follows:

	Year ended December 31, 2007	Year ended December 31, 2006	Year ended December 31, 2005
Net income	9,511	7,484	6,443
Add back interest on 3.5% Convertible US dollar bonds, maturing 2007 (net of tax at effective rate)	-	4	26
Total diluted net income	9,511	7,488	6,469
Weighted average number of outstanding common shares (thousands of shares)	828,335	826,131	814,417
Add back treasury shares held in respect of convertible debt (thousands of shares)	166	2,557	15,957
Weighted average number of outstanding common shares, after dilution (thousands of shares)	828,501	828,688	830,374

Note 16. Financial and derivative instruments

Commodity derivative instruments

The Group uses derivative instruments in its international petroleum products marketing and trading operations. The types of derivative instruments used include futures and swap contracts, used for hedging purposes, and purchase and sale contracts that qualify as derivative instruments. The Group maintains a system of controls over these activities that includes policies covering the authorization, reporting and monitoring of derivative activity. The Group recognized the following financial results from the use of derivative instruments: expense of $575 million, income of $183 million and expense of $171 million during 2007, 2006 and 2005, respectively. The result is included in "Cost of purchased crude oil, gas and products" in the consolidated statements of income. The fair value of derivative contracts outstanding and recorded on the consolidated balance sheets was a net liability of $50 million and a net asset of $43 million as of December 31, 2007 and 2006, respectively.

Fair value

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

The fair value of long-term receivables included in other non-current assets approximates the amounts disclosed in the consolidated financial statements as a result of discounting using estimated market interest rates for similar financing arrangements. The fair value of long-term debt differs from the amount disclosed in the consolidated financial statements. The estimated fair value of long-term debt as of December 31, 2007 and 2006, was $6,250 million and $5,299 million, respectively, as a result of discounting using estimated market interest rates for similar financing arrangements. These amounts include all future cash outflows associated with the long-term debt repayments, including the current portion, and interest.

Note 17. Business combinations

In June 2007, the Group acquired a 100% interest in companies owning 376 petrol stations in Europe for $442 million from ConocoPhillips, its related party. The Group acquired these petrol stations to expand its presence in the European market. The results of operations of these petrol stations are included in the Group's consolidated statements of income from the date of acquisition. The Group made an estimation of the fair value of the assets acquired and liabilities assumed at the date of acquisition. As a result the Group recognized goodwill, property, plant and equipment, other assets and liabilities amounting to $64 million, $413 million, $203 million and $238 million, respectively. Goodwill relates to the refinery, marketing and distribution segment and is non-deductible for tax purposes.

(Millions of US dollars, except as indicated)

Note 17. Business combinations (continued)

In January 2007, a Group company acquired the remaining 34% of the share capital of OOO Geoilbent for $300 million. The acquisition increased the Group's ownership to 100%. Prior to this acquisition the Group accounted for its investment using the equity method of accounting due to the fact that minority shareholder held substantive participating rights. OOO Geoilbent was an exploration and production company operating in the West Siberian region of the Russian Federation.

During 2007, the Group acquired 7.65% of the share capital of OAO "LUKOIL-Nizhegorodnefteorgsintez" from minority shareholders for $154 million, increasing the Group's ownership to 96.91%. OAO "LUKOIL-Nizhegorodnefteorgsintez" is a refinery plant located in European Russia.

In June 2006, a Group company acquired 100% of the share capital of Khanty-Mansiysk Oil Corporation ("KMOC") from Marathon Oil Corporation for $847 million (including $249 million repayment of KMOC debt). At the purchase date KMOC owned 95% of the share capital of OAO Khantymansiysk-neftegazgeologia and 100% of the share capital of OAO Paitykh Oil and OAO Nazymgeodobycha ("KMOC subsidiaries"). KMOC's subsidiaries operate oil and gas fields in the West Siberian region of the Russian Federation.

KMOC's results of operations are included in the Group's consolidated statement of income from June 2006.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition.

Current assets	91
Property, plant and equipment	897
Other non-current assets	38
Total assets acquired	1,026
Current liabilities	(23)
Non-current deferred tax liabilities	(133)
Long-term debt	(249)
Minority interest	(14)
Other long-term liabilities	(9)
Total liabilities assumed	(428)
Net assets acquired	**598**

In September 2006, a Group company acquired the remaining 40% of share capital of Chaparral Resources Inc., Caspian group company and the owner of 60% interest in the Karakuduk field, for $89 million. The acquisition increased the Group's ownership stake in Chaparral Resources Inc. and effective interest in the Karakuduk field to 100%.

In May 2006, a Group company acquired the remaining 49% of the share capital of OAO Primorieneftegaz for 4.165 million shares of common stock of the Company (at a market value of approximately $314 million), thereby increasing the Group's ownership stake in OAO Primorieneftegaz to 100%. OAO Primorieneftegaz is a Russian oil and gas exploration company operating in European Russia.

The acquisition of the petrol stations, interests in Geoilbent, KMOC and Chaparral Resources Inc. did not have a material impact on the Group's consolidated operations for the period ended December 31, 2007 and 2006. Therefore, no pro-forma income statement information has been provided.

(Millions of US dollars, except as indicated)

Note 18. Consolidation of Variable Interest Entity

The Company formed a joint venture with ConocoPhillips within the framework of their broad-based strategic alliance in June 2005. This joint venture was created by selling ConocoPhillips an interest in the Company’s wholly owned subsidiary OOO Narianmarneftegaz (“NMNG”) for $529 million. The purpose of the joint venture is to develop oil reserves in the Timan-Pechora region of the Russian Federation. The Group and ConocoPhillips have equal voting rights over the joint venture’s activity and effective ownership interests of 70% and 30%, respectively. NMNG’s total assets were approximately $5.1 billion and $3.0 billion as of December 31, 2007 and 2006, respectively.

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

As a result of the transaction, the Group recognized a gain of $152 million which is included in the consolidated statement of income for the year ended December 31, 2005.

The Group and ConocoPhillips provide financing to NMNG by means of long-term loans in the proportion of their effective ownership interests. The loan maturities are 30 years, with the option to be extended for a further 35 years with the agreement of both parties. These loans bore an initial interest rate of 0.1% per annum. The loan proceeds were originally accounted for by NMNG primarily as equity contributions as a result of recording the loan obligations at their present value based on market interest rates. The difference between the proceeds and the present value represented contributions to NMNG’s equity.

In the second quarter of 2006, the Group and ConocoPhillips reached an agreement to amend the contractual interest rates of the loans. Borrowings under these agreements bear fixed interest at a range from 6.8% to 8.2% per annum. As a result of the amendment, the financing received from the Group and ConocoPhillips was transferred from equity to long-term debt.

As of December 31, 2007, the outstanding amount due to ConocoPhillips from NMNG was $1,397 million, which consists of a number of loans with a weighted-average interest rate of 7.84% per annum. This amount is presented within “Long-term loans and borrowings from related parties.”

Note 19. Financial guarantees

The Group has entered into various guarantee arrangements. These arrangements arose in transactions related to enhancing the credit standing of an affiliated companies and borrowings of the Group’s suppliers.

The following table provides the undiscounted maximum amount of potential future payments for each major group of guarantees:

	As of December 31, 2007	As of December 31, 2006
Guarantees of equity investees’ debt	361	410
Guarantees of third parties’ debt	-	8
Total	**361**	**418**

Note 19. Financial guarantees (continued)

Guarantees on debt

LUKARCO, an investee recorded under the equity method of accounting has a loan facility on which $610 million was drawn as of December 31, 2007. Borrowings under this loan bear interest at LIBOR plus 2.5% per annum, maturing by May 1, 2012. To enhance the credit standing of LUKARCO, the Company guarantees 54% of the interest payment as well as the repayment of 54% of the loan at maturity. As of December 31, 2007, the total amount of the Company's guarantee was $348 million, which includes $19 million related to accrued interest on the outstanding amount. Payments are due if the Company is notified that LUKARCO is not able to fulfill its obligations at maturity date. The Company's guarantee is secured by its 54% interest in LUKARCO with the carrying value of $462 million and $358 million as of December 31, 2007 and 2006, respectively. There are no material amounts being carried as liabilities for the Group's obligations under this guarantee.

Note 20. Commitments and contingencies

Capital expenditure, exploration and investment programs

The Group owns and operates refineries in Bulgaria (LUKOIL Neftochim Bourgas AD) and Romania (Petrotel-LUKOIL). As a result of Bulgaria and Romania joined the European Union in 2007, LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL are required to upgrade their refining plants to comply with the requirements of European Union legislation in relation to the quality of produced petroleum products and environmental protection. These requirements are stricter than existed Bulgarian and Romanian legislation. The Group estimates the amount of future capital commitment required to upgrade LUKOIL Neftochim Bourgas AD and Petrotel-LUKOIL to be approximately $878 million and $59 million, respectively.

Group companies have commitments under the terms of existing license agreements in the Russian Federation of $1,561 million over the next 5 years and of $46 million thereafter. Management believes that a significant portion of these commitments will be fulfilled by the services to be provided by Eurasia Drilling Company and ZAO Globalstroy-Engineering as discussed below.

In connection with the sale of LUKOIL-Burenie in 2004 the Group signed a five year contract for drilling services. Under the terms of the contract, drilling services of $1,211 million and $753 million will be provided by LUKOIL-Burenie (now Eurasia Drilling Company) during 2008 and 2009, respectively.

The Company has signed a four-year agreement for the provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for 2008 to be approximately $706 million.

A Group company has commitment to purchase equipment for modernization of the petrochemical refinery in Ukraine over the next 2 years. As of December 31, 2007, this commitment was approximately $160 million.

Group companies have commitments for capital expenditure contributions in the amount of $357 million related to various production sharing agreements over the next 30 years.

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

(Millions of US dollars, except as indicated)

Note 20. Commitments and contingencies (continued)

Operating lease obligations

A Group company has commitments of $1,782 million primarily for the lease of vessels and petroleum distribution outlets. Commitments for minimum rentals under these leases as of December 31, 2007 are as follows:

	As of December 31, 2007
2008	500
2009	426
2010	235
2011	155
2012	133
beyond	333

Insurance

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

Environmental liabilities

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

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

Social assets

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

Note 20. Commitments and contingencies (continued)

Taxation environment

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

The tax authorities in each region may have a different interpretation of similar taxation issues which may result in taxation issues successfully defended by the Group in one region being unsuccessful in another region. There is some direction provided from the central authority based in Moscow on particular taxation issues.

The Group has implemented tax planning and management strategies based on existing legislation at the time of implementation. The Group is subject to tax authority audits on an ongoing basis, as is normal in the Russian environment and other republics of the former Soviet Union, and, at times, the authorities have attempted to impose additional significant taxes on the Group. Management believes that it has adequately met and provided for tax liabilities based on its interpretation of existing tax legislation. However, the relevant tax authorities may have differing interpretations and the effects on the financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

Litigation and claims

On November 27, 2001, Archangel Diamond Corporation (“ADC”), a Canadian diamond development company, filed a lawsuit in the District Court of Denver, Colorado against OAO “Arkhangelskgeoldobycha” (“AGD”), a Group company, and the Company (together the “Defendants”). ADC alleged that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. ADC claimed total damages of approximately $4.8 billion, including compensatory damages of $1.2 billion and punitive damages of $3.6 billion. On October 15, 2002, the District Court dismissed the lawsuit for lack of personal jurisdiction. This ruling was upheld by the Colorado Court of Appeals on March 25, 2004. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts’ ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was dismissed from the lawsuit. The Supreme Court found, however, that the trial court made a procedural error by not holding an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company, which is whether the Company had systematic and continuous contacts in the State of Colorado at the time the lawsuit was filed. In a modified opinion dated December 19, 2005, the Colorado Supreme Court remanded the case to the Colorado Court of Appeals (instead of the District Court) to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). On June 29, 2006, the Colorado Court of Appeals declined to dismiss the case based on forum non conveniens. The Company filed a petition for certiorari on August 28, 2006, asking the Colorado Supreme Court to review this decision. This petition has been rejected. On March 5, 2007, the Colorado Supreme Court remanded the case to the District Court. On June 11, 2007, the District Court ruled it would conduct an evidentiary hearing on the issue of whether the Company is subject to general personal jurisdiction in the State of Colorado. A status conference with the Court is scheduled for June 13, 2008. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group’s financial condition.

Note 20. Commitments and contingencies (continued)

On February 20, 2004, the Stockholm District Court overturned the decision of the Arbitral Tribunal of the Arbitration Institute of the Stockholm Chamber of Commerce ("Arbitration Tribunal"), made on June 25, 2001, dismissing ADC's action against AGD based on lack of jurisdiction. ADC's lawsuit against AGD was initially filed with the Arbitral Tribunal claiming alleged non-performance under an agreement between the parties and its obligation to transfer the diamond exploration license to Almazny Bereg. This lawsuit claimed compensation of damages amounting to $492 million. In March 2004, AGD filed an appeal against the Stockholm District Court decision with the Swedish Court of Appeals. On November 15, 2005, the Swedish Court of Appeals denied AGD's appeal and affirmed the Stockholm District Court decision. On December 13, 2005, AGD filed an appeal against the Swedish Court of Appeals decision with the Swedish Supreme Court. On April 13, 2006, the Swedish Supreme Court denied the application of AGD for appeal against the Swedish Court of Appeal's decision dated November 15, 2005. On May 6, 2006, a Notice of Arbitration was received on behalf of ADC. On December 20, 2006, the first session of the Arbitration Tribunal with participation of both parties took place in order to define procedural issues related to the tribunal. As a result of the hearing the Arbitration Tribunal issued a detailed procedural order setting out the rules and timetable for the conduct of the arbitration. In May 2007, ADC filed a statement of claim that requested the Tribunal to require AGD to transfer the diamond exploration license to Almazny Bereg. On October 22, 2007, AGD submitted a statement of defense. On December 21, 2007, the Arbitration Tribunal issued a procedural order on suspension of the arbitration for four months. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

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

Note 21. Related party transactions

In the rapidly developing business environment in the Russian Federation, companies and individuals have frequently used nominees and other forms of intermediary companies in transactions. The senior management of the Company considers that the Group has appropriate procedures in place to identify and properly disclose transactions with related parties in this environment and has disclosed all of the relationships identified which it deemed to be significant. Related party sales and purchases of oil and oil products were primarily to and from affiliated companies and the Company's shareholder ConocoPhillips. Insurance services are provided by the related parties, whose management and directors include members of the Group's management. Purchases of construction services were primarily from affiliated companies.

Below are related party transactions not disclosed elsewhere in the financial statements. Refer also to Notes 3, 4, 7, 10, 11, 12, 14, 17, 18, 19 and 22 for other transactions with related parties.

Sales of oil and oil products to related parties were $652 million, $754 million and $605 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Other sales to related parties were $77 million, $19 million and $58 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Purchases of oil and oil products from related parties were $1,333 million, $1,739 million and $2,248 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Purchases of construction services from related parties were $30 million, $13 million and $378 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Other purchases from related parties were $26 million, $49 million and $54 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Note 21. Related party transactions (continued)

Purchases of insurance services from related parties were $143 million, $133 million and $133 million during the years ended December 31, 2007, 2006 and 2005, respectively.

Amounts receivable from related parties, including loans and advances, were $563 million and $121 million as of December 31, 2007 and 2006, respectively. Amounts payable to related parties were $139 million and $89 million as of December 31, 2007 and 2006, respectively.

Note 22. Compensation plan

During the period from 2003 to 2006, the Company had a compensation plan available to certain members of management, which provided compensation based upon share appreciation rights on the Company's common stock. The number of shares or rights allocated to individuals under the plan was 8.8 million shares. These rights vested in December 2006. In February 2007, the Group settled the plan. As a result of this settlement employees purchased 8.8 million shares held by the Group as treasury stock at the grant price for $129 million and resold 1.5 million shares back to the Group for $134 million. The accrued liability in relation to this plan of $537 million was extinguished through the issuance of 7.3 million shares.

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

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

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

Related to this plan the Group recorded $125 million of compensation expense during the period ended December 31, 2007, of which $103 million is recognized as an increase in additional paid-in capital and $22 million is included in "Other long-term liabilities" of the consolidated balance sheet as of December 31, 2007. The total recognized tax benefit related to this accrual is $30 million.

As of December 31, 2007, there was $186 million of total unrecognized compensation cost related to unvested benefits. This cost is expected to be recognized periodically by the Group up to December 2009.

Note 23. Segment information

Presented below is information about the Group's operating and geographical segments for the years ended December 31, 2007, 2006 and 2005, in accordance with SFAS No. 131, *"Disclosures about Segments of an Enterprise and Related Information."*

(Millions of US dollars, except as indicated)

Note 23. Segment information (continued)

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

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

Operating segments

2007	**Exploration and production**	**Refining, marketing and distribution**	**Chemicals**	**Other**	**Elimination**	**Consolidated**
Sales						
Third parties	1,527	77,960	2,348	56	-	81,891
Inter-segment	22,331	2,191	19	325	(24,866)	-
Total sales	23,858	80,151	2,367	381	(24,866)	81,891
Operating expenses and total cost of purchases	3,813	52,032	1,904	206	(23,801)	34,154
Depreciation, depletion and amortization	1,427	663	28	54	-	2,172
Interest expense	611	621	4	218	(1,121)	333
Income tax expense	1,838	1,642	23	4	-	3,507
Net income	4,686	4,770	148	243	(336)	9,511
Total assets	43,395	41,091	1,004	8,412	(34,270)	59,632
Capital expenditures	7,262	1,822	171	117	-	9,372

2006	**Exploration and production**	**Refining, marketing and distribution**	**Chemicals**	**Other**	**Elimination**	**Consolidated**
Sales						
Third parties	1,659	64,116	1,869	40	-	67,684
Inter-segment	18,989	1,786	22	216	(21,013)	-
Total sales	20,648	65,902	1,891	256	(21,013)	67,684
Operating expenses and total cost of purchases	3,232	43,098	1,561	138	(20,735)	27,294
Depreciation, depletion and amortization	1,269	542	19	21	-	1,851
Interest expense	451	341	2	187	(679)	302
Income tax expense	1,617	1,129	23	4	-	2,773
Net income	3,578	3,652	96	272	(114)	7,484
Total assets	34,152	32,168	794	7,340	(26,217)	48,237
Capital expenditures	5,120	1,475	172	119	-	6,886

(Millions of US dollars, except as indicated)

Note 23. Segment information (continued)

2005	**Exploration and production**	**Refining, marketing and distribution**	**Chemicals**	**Other**	**Elimination**	**Consolidated**
Sales						
Third parties	1,047	53,064	1,628	35	-	55,774
Inter-segment	14,821	1,041	22	138	(16,022)	-
Total sales	15,868	54,105	1,650	173	(16,022)	55,774
Operating expenses and total cost of purchases	2,602	34,800	1,314	126	(15,809)	23,033
Depreciation, depletion and amortization	824	464	15	12	-	1,315
Interest expense	73	335	2	50	(185)	275
Income tax expense	1,111	1,317	35	4	-	2,467
Net income	3,362	3,059	122	52	(152)	6,443
Total assets	25,480	23,682	586	5,130	(14,533)	40,345
Capital expenditures	2,918	1,129	77	53	-	4,177

Geographical segments

	2007	**2006**	**2005**
Sales of crude oil within Russia	440	376	120
Export of crude oil and sales of crude oil by foreign subsidiaries	19,258	17,649	16,367
Sales of petroleum products within Russia	9,583	8,151	6,725
Export of petroleum products and sales of petroleum products by foreign subsidiaries	47,154	37,459	29,216
Sales of chemicals within Russia	733	569	469
Export of chemicals and sales of chemicals by foreign subsidiaries	1,569	1,260	1,134
Other sales within Russia	1,644	1,167	821
Other export sales and other sales by foreign subsidiaries	1,510	1,053	922
Total sales	**81,891**	**67,684**	**55,774**

2007	**Western Siberia**	**European Russia**	**International**	**Elimination**	**Consolidated**
Sales					
Third parties	118	13,226	68,547	-	81,891
Inter-segment	14,045	31,781	30	(45,856)	-
Total sales	14,163	45,007	68,577	(45,856)	81,891
Operating expenses and total cost of purchases	1,995	17,323	59,692	(44,856)	34,154
Depletion, depreciation and amortization	649	969	554	-	2,172
Interest expense	22	244	239	(172)	333
Income taxes	988	2,087	432	-	3,507
Net income	3,587	5,341	884	(301)	9,511
Total assets	16,227	32,764	20,805	(10,164)	59,632
Capital expenditures	2,253	5,448	1,671	-	9,372

(Millions of US dollars, except as indicated)

Note 23. Segment information (continued)

2006	**Western Siberia**	**European Russia**	**International**	**Elimination**	**Consolidated**
Sales					
Third parties	318	10,693	56,673	-	67,684
Inter-segment	11,673	26,773	33	(38,479)	-
Total sales	11,991	37,466	56,706	(38,479)	67,684
Operating expenses and total cost of purchases	1,751	14,038	49,757	(38,252)	27,294
Depletion, depreciation and amortization	568	781	502	-	1,851
Interest expense	17	104	234	(53)	302
Income taxes	849	1,530	394	-	2,773
Net income	2,769	4,117	978	(380)	7,484
Total assets	12,967	25,483	18,921	(9,134)	48,237
Capital expenditures	1,487	3,944	1,455	-	6,886

2005	**Western Siberia**	**European Russia**	**International**	**Elimination**	**Consolidated**
Sales					
Third parties	250	8,656	46,868	-	55,774
Inter-segment	8,947	21,098	31	(30,076)	-
Total sales	9,197	29,754	46,899	(30,076)	55,774
Operating expenses and total cost of purchases	1,372	10,925	40,642	(29,906)	23,033
Depletion, depreciation and amortization	389	618	308	-	1,315
Interest expense	17	160	133	(35)	275
Income taxes	539	1,716	212	-	2,467
Net income	2,116	4,015	925	(613)	6,443
Total assets	9,301	21,207	14,361	(4,524)	40,345
Capital expenditures	1,100	2,146	931	-	4,177

The Group’s international sales to third parties include sales in Switzerland of $35,868 million, $31,037 million and $25,652 million for the years ended December 31, 2007, 2006 and 2005, respectively. The Group’s international sales to third parties include sales in USA of $11,481 million, $9,112 million and $8,937 million for the years ended December 31, 2007, 2006 and 2005, respectively. These amounts are attributed to individual countries based on the jurisdiction of subsidiaries making the sale.

Note 24. Subsequent events

Business combinations

In March 2008, a Group company acquired 100% of the share capital of the SNG Holdings Ltd. Group for $578 million. The purchase agreement provides for an additional two components of contingent purchase consideration.

- An amount of $100 million payable if an agreed level of proved and probable hydrocarbon reserves are verified by an independent petroleum engineer by June 2008;
- An amount of $100 million payable upon approval of the agreed development program by the Uzbekistan authorities and an agreed minimum production volume of crude oil is achieved by March 2009.

The SNG Holdings Ltd. Group holds a 100% interest in a production sharing agreement in oil and gas condensate fields located in the South-Western Gissar and Ustyurt regions of Uzbekistan. The purpose of the acquisition was to increase the Group's presence in the Uzbekistan oil and gas sector.

In March 2008, a Group company entered into an agreement with a related party, whose management and directors include members of the Group's management and Board of Directors, to acquire a 64.3% interest in OAO "UGK TGK-8" for approximately $2,117 million. The agreement purchase consideration consists of 23.55 million shares of common stock of the Company (at a market value of approximately $1,620 million) and a cash payment of approximately $497 million. As of March 31, 2008, a Group company had acquired 29.99% of OAO "UGK TGK-8". The transaction is expected to be finalized in the second quarter of 2008. OAO "UGK TGK-8" is a power generation company which owns power plants located in Astrakhan, Volgograd and Rostov regions, Krasnodar and Stavropol Districts, and the Republic of Dagestan of the Russian Federation. This acquisition is made in accordance with the Company's plans to develop its electric power business.

(Millions of US dollars, except as indicated)

This section provides unaudited supplemental information on oil and gas exploration and production activities in accordance with SFAS No. 69, *"Disclosures About Oil and Gas Producing Activities"* in six separate tables:

I. Capitalized costs relating to oil and gas producing activities
II. Costs incurred in oil and gas property acquisition, exploration, and development activities
III. Results of operations for oil and gas producing activities
IV. Reserve quantity information
V. Standardized measure of discounted future net cash flows
VI. Principal sources of changes in the standardized measure of discounted future net cash flows

Amounts shown for equity companies represent the Group's share in its exploration and production affiliates, which are accounted for using the equity method of accounting.

I. Capitalized costs relating to oil and gas producing activities

As of December 31, 2007	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**	**Total**
Unproved oil and gas properties	454	446	900	20	920
Proved oil and gas properties	3,906	36,664	40,570	677	41,247
Accumulated depreciation, depletion, and amortization	(644)	(13,813)	(14,457)	(164)	(14,621)
Net capitalized costs	3,716	23,297	27,013	533	27,546

Net capitalized costs related to asset retirement obligations in the amount of $406 million, as of December 31, 2007, was included in net capitalized costs.

As of December 31, 2006	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**	**Total**
Unproved oil and gas properties	351	511	862	13	875
Proved oil and gas properties	4,887	30,817	35,704	746	36,450
Accumulated depreciation, depletion, and amortization	(644)	(13,125)	(13,769)	(166)	(13,935)
Net capitalized costs	4,594	18,203	22,797	593	23,390

Net capitalized costs related to asset retirement obligations in the amount of $310 million, as of December 31, 2006, was included in net capitalized costs.

As of December 31, 2005	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**	**Total**
Unproved oil and gas properties	196	531	727	17	744
Proved oil and gas properties	4,331	26,951	31,282	786	32,068
Accumulated depreciation, depletion, and amortization	(377)	(12,691)	(13,068)	(173)	(13,241)
Net capitalized costs	4,150	14,791	18,941	630	19,571

Net capitalized costs related to asset retirement obligations in the amount of $151 million, as of December 31, 2005, was included in net capitalized costs.

(Millions of US dollars, except as indicated)

II. Costs incurred in oil and gas property acquisition, exploration, and development activities

Year ended December 31, 2007	International	Russia	Total consolidated companies	Group's share in equity companies	Total
Acquisition of properties - proved	-	393	393	-	393
Acquisition of properties - unproved	27	486	513	-	513
Exploration costs	180	366	546	12	558
Development costs	670	5,887	6,557	103	6,660
Total costs incurred	877	7,132	8,009	115	8,124

Year ended December 31, 2006	International	Russia	Total consolidated companies	Group's share in equity companies	Total
Acquisition of properties - proved	50	529	579	-	579
Acquisition of properties - unproved	5	769	774	-	774
Exploration costs	192	276	468	11	479
Development costs	594	3,901	4,495	157	4,652
Total costs incurred	841	5,475	6,316	168	6,484

Year ended December 31, 2005	International	Russia	Total consolidated companies	Group's share in equity companies	Total
Acquisition of properties - proved	1,726	183	1,909	80	1,989
Acquisition of properties - unproved	690	370	1,060	100	1,160
Exploration costs	171	252	423	3	426
Development costs	260	2,235	2,495	124	2,619
Total costs incurred	2,847	3,040	5,887	307	6,194

(Millions of US dollars, except as indicated)

III. Results of operations for oil and gas producing activities

The Group's results of operations for oil and gas producing activities are presented below. In accordance with SFAS No. 69, sales and transfers to Group companies are based on market prices. Income taxes are based on statutory rates. The results of operations exclude corporate overhead and interest costs.

Year ended December 31, 2007	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**	**Total**
Revenue					
Sales	1,351	15,232	16,583	883	17,466
Transfers	-	15,444	15,444	79	15,523
Total revenues	1,351	30,676	32,027	962	32,989
Production costs (excluding production taxes)	(140)	(2,638)	(2,778)	(76)	(2,854)
Exploration expense	(158)	(149)	(307)	(13)	(320)
Depreciation, depletion, and amortization	(259)	(1,130)	(1,389)	(33)	(1,422)
Accretion expense	-	(21)	(21)	-	(21)
Taxes other than income taxes	(7)	(17,087)	(17,094)	(134)	(17,228)
Related income taxes	(384)	(2,378)	(2,762)	(336)	(3,098)
Total results of operations for producing activities	403	7,273	7,676	370	8,046

Year ended December 31, 2006	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**	**Total**
Revenue					
Sales	1,207	14,241	15,448	714	16,162
Transfers	-	11,747	11,747	374	12,121
Total revenues	1,207	25,988	27,195	1,088	28,283
Production costs (excluding production taxes)	(151)	(2,161)	(2,312)	(97)	(2,409)
Exploration expense	(52)	(157)	(209)	(5)	(214)
Depreciation, depletion, and amortization	(261)	(973)	(1,234)	(50)	(1,284)
Accretion expense	-	(29)	(29)	-	(29)
Taxes other than income taxes	(17)	(15,644)	(15,661)	(258)	(15,919)
Related income taxes	(316)	(1,659)	(1,975)	(322)	(2,297)
Total results of operations for producing activities	410	5,365	5,775	356	6,131

Year ended December 31, 2005	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**	**Total**
Revenue					
Sales	620	12,327	12,947	720	13,667
Transfers	-	8,072	8,072	268	8,340
Total revenues	620	20,399	21,019	988	22,007
Production costs (excluding production taxes)	(93)	(1,672)	(1,765)	(137)	(1,902)
Exploration expense	(192)	(125)	(317)	(1)	(318)
Depreciation, depletion, and amortization	(106)	(718)	(824)	(60)	(884)
Accretion expense	-	(30)	(30)	-	(30)
Taxes other than income taxes	(6)	(11,160)	(11,166)	(285)	(11,451)
Related income taxes	(160)	(1,548)	(1,708)	(181)	(1,889)
Total results of operations for producing activities	63	5,146	5,209	324	5,533

IV. Reserve quantity information

Proved reserves are the estimated quantities of oil and gas reserves which geological and engineering data demonstrate will be recoverable with reasonable certainty in future years from known reservoirs under existing economic and operating conditions (i.e. prices and costs as of the date the estimate is made). Proved reserves do not include additional quantities of oil and gas reserves that may result from applying secondary or tertiary recovery techniques not yet tested and determined to be economic.

Reserves are estimated using the definitions of reserves prescribed by the US Society of Petroleum Engineers and the World Petroleum Congress requirements. The proved reserves include volumes which are recoverable up to and after license expiry dates.

Proved developed reserves are the quantities of proved reserves expected to be recovered through existing wells with existing equipment and operating methods.

Due to the inherent uncertainties and the necessarily limited nature of reservoir data, estimates of reserves are inherently imprecise, require the application of judgment and are subject to change as additional information becomes available.

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. These licenses expire between 2011 and 2026, with the most significant expiring between 2011 and 2014. Management believes the licenses will be extended to produce subsequent to their current expiry dates. The Group is in the process of extending all of its production licenses in the Russian Federation. The Group has already extended a portion of these licenses and expects to extend the remaining licenses for indefinite periods. To date there have been no unsuccessful license renewal applications.

Estimated net proved oil and gas reserves and changes thereto for the years 2007, 2006 and 2005, are shown in the tables set out below.

(Millions of US dollars, except as indicated)

Millions of barrels	**Consolidated subsidiaries**			**Group's share in equity companies**	**Total**
	International	Russia	Total		
Crude oil					
January 1, 2005	264	15,252	15,516	456	15,972
Revisions of previous estimates	(43)	29	(14)	(6)	(20)
Purchase of hydrocarbons in place*	174	266	440	(86)	354
Extensions and discoveries	28	472	500	6	506
Production	(15)	(619)	(634)	(30)	(664)
Sales of reserves	-	(34)	(34)	-	(34)
December 31, 2005	408	15,366	15,774	340	16,114
Revisions of previous estimates	15	(278)	(263)	12	(251)
Purchase of hydrocarbons in place	-	226	226	-	226
Extensions and discoveries	14	527	541	10	551
Production	(27)	(648)	(675)	(28)	(703)
Sales of reserves	-	(10)	(10)	-	(10)
December 31, 2006	410	15,183	15,593	334	15,927
Revisions of previous estimates	2	35	37	(23)	14
Purchase of hydrocarbons in place*	-	178	178	(104)	74
Extensions and discoveries	20	463	483	35	518
Production	(26)	(668)	(694)	(19)	(713)
Sales of reserves	(105)	-	(105)	-	(105)
December 31, 2007	**301**	**15,191**	**15,492**	**223**	**15,715**
Proved developed reserves					
December 31, 2005	255	10,070	10,325	258	10,583
December 31, 2006	217	9,714	9,931	245	10,176
December 31, 2007	**164**	**9,715**	**9,879**	**180**	**10,059**

* Purchase of hydrocarbons in place for equity companies includes transfers of reserves to the consolidated group upon those equity companies becoming subject to consolidation.

The minority interest share included in the above total proved reserves was 559 million barrels, 563 million barrels and 580 million barrels as of December 31, 2007, 2006 and 2005, respectively. The minority interest share included in the above proved developed reserves was 228 million barrels, 191 million barrels and 172 million barrels as of December 31, 2007, 2006 and 2005, respectively. Substantially all minority interests relate to the reserves in the Russian Federation.

(Millions of US dollars, except as indicated)

Billions of cubic feet	**Consolidated subsidiaries**			**Group's share in equity companies**	**Total**
	International	Russia	Total		
Natural gas					
January 1, 2005	3,029	21,356	24,385	213	24,598
Revisions of previous estimates	402	(520)	(118)	(4)	(122)
Purchase of hydrocarbons in place*	-	8	8	(6)	2
Extensions and discoveries	273	742	1,015	5	1,020
Production	(35)	(155)	(190)	(10)	(200)
December 31, 2005	3,669	21,431	25,100	198	25,298
Revisions of previous estimates	667	795	1,462	5	1,467
Purchase of hydrocarbons in place	-	3	3	-	3
Extensions and discoveries	-	398	398	1	399
Production	(60)	(494)	(554)	(11)	(565)
Sales of reserves	-	(5)	(5)	-	(5)
December 31, 2006	4,276	22,128	26,404	193	26,597
Revisions of previous estimates	506	550	1,056	(2)	1,054
Purchase of hydrocarbons in place*	-	19	19	(14)	5
Extensions and discoveries	207	630	837	7	844
Production	(87)	(482)	(569)	(10)	(579)
December 31, 2007	**4,902**	**22,845**	**27,747**	**174**	**27,921**
Proved developed reserves:					
December 31, 2005	1,102	4,834	5,936	153	6,089
December 31, 2006	1,108	6,234	7,342	138	7,480
December 31, 2007	**1,369**	**6,553**	**7,922**	**133**	**8,055**

* Purchase of hydrocarbons in place for equity companies includes transfers of reserves to the consolidated group upon those equity companies becoming subject to consolidation.

The minority interest share included in the above total proved reserves was 49 billion cubic feet, 43 billion cubic feet and 23 billion cubic feet as of December 31, 2007, 2006 and 2005, respectively. The minority interest share included in the above proved developed reserves was 30 billion cubic feet, 27 billion cubic feet and 15 billion cubic feet as of December 31, 2007, 2006 and 2005, respectively. Substantially all minority interests relate to the reserves in the Russian Federation.

(Millions of US dollars, except as indicated)

V. Standardized measure of discounted future net cash flows

The standardized measure of discounted future net cash flows, related to the above oil and gas reserves, is calculated in accordance with the requirements of SFAS No. 69. Estimated future cash inflows from production are computed by applying year-end prices for oil and gas to year-end quantities of estimated net proved reserves. Adjustment in this calculation for future price changes is limited to those required by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future pre-tax net cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a ten percent discount factor. Discounting requires a year-by-year estimate of when future expenditures will be incurred and when reserves will be produced.

The information provided in the tables set out below does not represent management’s estimate of the Group’s expected future cash flows or of the value of the Group’s proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations. The arbitrary valuation prescribed under SFAS No. 69 requires assumptions as to the timing and amount of future development and production costs. The calculations should not be relied upon as an indication of the Group’s future cash flows or of the value of its oil and gas reserves.

	International	Russia	Total consolidated companies	Group’s share in equity companies	Total
As of December 31, 2007					
Future cash inflows	34,051	660,363	694,414	17,892	712,306
Future production and development costs	(13,015)	(442,801)	(455,816)	(4,639)	(460,455)
Future income tax expenses	(2,414)	(48,552)	(50,966)	(3,568)	(54,534)
Future net cash flows	18,622	169,010	187,632	9,685	197,317
Discount for estimated timing of cash flows (10% p.a.)	(9,576)	(106,185)	(115,761)	(4,857)	(120,618)
Discounted future net cash flows	9,046	62,825	71,871	4,828	76,699
Minority share in discounted future net cash flows	-	1,379	1,379	-	1,379

Included as a part of the $460 billion of future production and development costs are $7.8 billion of future dismantlement, abandonment and rehabilitation costs.

(Millions of US dollars, except as indicated)

	International	Russia	Total consolidated companies	Group's share in equity companies	Total
As of December 31, 2006					
Future cash inflows	24,767	421,215	445,982	13,896	459,878
Future production and development costs	(9,476)	(284,993)	(294,469)	(5,699)	(300,168)
Future income tax expenses	(2,867)	(30,307)	(33,174)	(2,271)	(35,445)
Future net cash flows	12,424	105,915	118,339	5,926	124,265
Discount for estimated timing of cash flows (10% p.a.)	(6,282)	(66,489)	(72,771)	(3,038)	(75,809)
Discounted future net cash flows	6,142	39,426	45,568	2,888	48,456
Minority share in discounted future net cash flows	-	1,158	1,158	-	1,158

Included as a part of the $300 billion of future production and development costs are $6.6 billion of future dismantlement, abandonment and rehabilitation costs.

	International	Russia	Total consolidated companies	Group's share in equity companies	Total
As of December 31, 2005					
Future cash inflows	21,028	375,279	396,307	12,290	408,597
Future production and development costs	(9,471)	(200,288)	(209,759)	(4,513)	(214,272)
Future income tax expenses	(3,563)	(40,135)	(43,698)	(2,220)	(45,918)
Future net cash flows	7,994	134,856	142,850	5,557	148,407
Discount for estimated timing of cash flows (10% p.a.)	(4,140)	(86,622)	(90,762)	(2,898)	(93,660)
Discounted future net cash flows	3,854	48,234	52,088	2,659	54,747
Minority share in discounted future net cash flows	-	1,730	1,730	-	1,730

Included as a part of the $214 billion of future production and development costs are $5.6 billion of future dismantlement, abandonment and rehabilitation costs.

(Millions of US dollars, except as indicated)

VI. Principal sources of changes in the standardized measure of discounted future net cash flows

Consolidated companies	**2007**	**2006**	**2005**
Discounted present value as at January 1	45,568	52,088	35,106
Net changes due to purchases and sales of minerals in place	(46)	571	1,761
Sales and transfers of oil and gas produced, net of production costs	(11,848)	(9,014)	(7,771)
Net changes in prices and production costs estimates	75,908	17,496	24,556
Net changes in mineral extraction taxes	(43,384)	(30,592)	(5,770)
Extensions and discoveries, less related costs	2,947	1,753	2,619
Development costs incurred during the period	2,308	2,383	2,495
Revisions of previous quantity estimates	980	223	(320)
Net change in income taxes	(6,562)	4,002	(5,346)
Other changes	185	(300)	149
Accretion of discount	5,815	6,958	4,609
Discounted present value at December 31	**71,871**	**45,568**	**52,088**

Group's share in equity companies	**2007**	**2006**	**2005**
Discounted present value as at January 1	2,888	2,659	1,940
Net changes due to purchases and sales of minerals in place	(367)	-	(473)
Sales and transfers of oil and gas produced, net of production costs	(739)	(728)	(565)
Net changes in prices and production costs estimates	3,622	906	2,389
Net changes in mineral extraction taxes	(643)	(632)	(455)
Extensions and discoveries, less related costs	1,020	45	62
Development costs incurred during the period	74	47	124
Revisions of previous quantity estimates	(716)	153	(82)
Net change in income taxes	(629)	(13)	(432)
Other changes	(38)	104	(88)
Accretion of discount	356	347	239
Discounted present value at December 31	**4,828**	**2,888**	**2,659**

Total	**2007**	**2006**	**2005**
Discounted present value as at January 1	48,456	54,747	37,046
Net changes due to purchases and sales of minerals in place	(413)	571	1,288
Sales and transfers of oil and gas produced, net of production costs	(12,587)	(9,742)	(8,336)
Net changes in prices and production costs estimates	79,530	18,402	26,945
Net changes in mineral extraction taxes	(44,027)	(31,224)	(6,225)
Extensions and discoveries, less related costs	3,967	1,798	2,681
Development costs incurred during the period	2,382	2,430	2,619
Revisions of previous quantity estimates	264	376	(402)
Net change in income taxes	(7,191)	3,989	(5,778)
Other changes	147	(196)	61
Accretion of discount	6,171	7,305	4,848
Discounted present value at December 31	**76,699**	**48,456**	**54,747**