

## **JSC Gazprom Neft**

### **Interim Condensed Consolidated Financial Statements**

**As of March 31, 2011 and December 31, 2010 and  
for the three months ended March 31, 2011 and 2010**

**JSC Gazprom Neft**

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## Report of Independent Auditors

To the Board of Directors and Shareholders of JSC Gazprom Neft:

We have reviewed the accompanying interim condensed consolidated balance sheet of JSC Gazprom Neft and its subsidiaries (the "Company") as of March 31, 2011, and the related interim condensed consolidated statements of income for each of the three month periods ended March 31, 2011 and 2010 and the interim condensed consolidated statement of changes in shareholders' equity and of cash flows for the three month periods ended March 31, 2011 and 2010. These interim condensed consolidated financial statements are the responsibility of the Company's management.

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

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

We previously audited in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of the Company as of December 31, 2010, and the related consolidated statements of income, of changes in shareholders' equity, and of cash flows for the year then ended (not presented herein), and in our report dated February 18, 2011 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying interim condensed consolidated balance sheet as of December 31, 2010, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

ZAO PricewaterhouseCoopers Audit

May 10, 2011

JSC Gazprom Neft  
Interim Condensed Consolidated Balance Sheets  
As of March 31, 2011 and December 31, 2010 (Unaudited)

Currency - US\$ millions

	<u>Notes</u>	March 31, 2011	December 31, 2010
<b>Assets</b>			
<b>Current assets:</b>			
Cash and cash equivalents	4	\$ 948	\$ 1,146
Short-term investments		173	110
Short-term loans receivable		113	108
Accounts receivable, net	5	3,500	2,566
Inventories	6	2,234	1,862
Assets held for sale	7	220	189
Other current assets, net	8	1,322	1,112
<b>Total current assets</b>		<b>8,510</b>	<b>7,093</b>
Long-term investments and loans receivable	9	6,961	6,994
Property, plant and equipment, net	10	16,468	15,914
Goodwill and other intangible assets	11	1,270	1,274
Other non-current assets		719	569
Non-current deferred income tax assets		219	220
<b>Total assets</b>		<b>\$ 34,147</b>	<b>\$ 32,064</b>
<b>Liabilities and shareholders' equity</b>			
<b>Current liabilities:</b>			
Short-term loans and current portion of long-term debt	12, 15	\$ 1,949	\$ 1,694
Accounts payable and accrued liabilities	13	1,737	1,856
Income and other taxes payable	14	1,183	874
Dividends payable		161	293
Liabilities associated with assets held for sale	7	148	134
<b>Total current liabilities</b>		<b>5,178</b>	<b>4,851</b>
Long-term debt	15	5,887	4,942
Asset retirement obligations		481	415
Other long-term liabilities		340	280
Deferred income tax liabilities		803	778
<b>Total liabilities</b>		<b>12,689</b>	<b>11,266</b>
<b>Equity:</b>			
Common stock (authorized, issued and outstanding: 4,741,299,639 shares, 0.0016 Ruble par value)		2	2
Additional paid-in-capital		715	507
Retained earnings		19,660	18,223
Less: Common stock held in treasury, at cost (23,359,582 shares as of March 31, 2011)		(45)	(45)
<b>Total shareholders' equity</b>		<b>20,332</b>	<b>18,687</b>
Non-controlling interest		1,126	2,111
<b>Total equity</b>		<b>21,458</b>	<b>20,798</b>
<b>Total liabilities and shareholders' equity</b>		<b>\$ 34,147</b>	<b>\$ 32,064</b>

A. V. Dyukov  
Chief Executive Officer  
JSC Gazprom Neft

V. V. Yakovlev  
Chief Financial Officer  
JSC Gazprom Neft

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

**JSC Gazprom Neft**  
**Interim Condensed Consolidated Statements of Income**  
**For the three months ended March 31, 2011 and 2010 (Unaudited)**

**Currency - US\$ millions**  
**(except per share data)**

	<b>Note</b>	<b>For the three months ended March 31, 2011</b>	<b>For the three months ended March 31, 2010</b>
<i>Revenues</i>			
Refined products and oil and gas sales		\$ 9,676	\$ 7,117
Other		189	179
<b>Total</b>	20	<b>9,865</b>	<b>7,296</b>
<i>Costs and other deductions</i>			
Cost of purchased oil, gas and petroleum products		2,224	1,538
Operating expenses		578	455
Selling, general and administrative expenses		456	360
Transportation expenses		800	687
Depreciation, depletion and amortization		424	352
Export duties		1,766	1,584
Taxes other than income tax	14	1,772	1,207
Exploration expenses		22	23
Cost of other sales		117	86
<b>Total</b>		<b>8,159</b>	<b>6,292</b>
<b>Operating income</b>		<b>1,706</b>	<b>1,004</b>
<i>Other income / (expense)</i>			
Share in income of equity affiliates	9	41	79
Gain on investment		9	-
Interest income		32	19
Interest expense		(93)	(92)
Other income / (expense), net		11	(30)
Foreign exchange gain, net		166	47
<b>Total</b>		<b>166</b>	<b>23</b>
<b>Income before income taxes</b>		<b>1,872</b>	<b>1,027</b>
Provision for income taxes		416	204
Deferred income tax expense / (benefit)		3	(25)
<b>Total</b>		<b>419</b>	<b>179</b>
<b>Net income</b>		<b>\$ 1,453</b>	<b>\$ 848</b>
Less: Net income attributable to non-controlling interest		(16)	(94)
<b>Net income attributable to Gazprom Neft</b>		<b>\$ 1,437</b>	<b>\$ 754</b>
Basic and Diluted Net income per Common Share attributable to Gazprom Neft (US\$ per share)		0.30	0.16
Weighted-average number of common shares outstanding Basic and Diluted (millions)		4,718	4,718

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

**JSC Gazprom Neft**

**Interim Condensed Consolidated Statements of Changes in Shareholders' Equity**

For the three months ended March 31, 2011 and 2010 (Unaudited)

Currency - US\$ millions

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total Shareholders' Equity	Non- controlling Interest	Total Equity
<b>Balance as of December 31, 2010</b>	<b>\$ 2</b>	<b>\$ 507</b>	<b>\$ 18,223</b>	<b>\$ (45)</b>	<b>\$ 18,687</b>	<b>\$ 2,111</b>	<b>\$ 20,798</b>
Net income for the period	-	-	1,437	-	1,437	16	1,453
Changes in non- controlling interest	-	208	-	-	208	(1,001)	(793)
<b>Balance as of March 31, 2011</b>	<b>\$ 2</b>	<b>\$ 715</b>	<b>\$ 19,660</b>	<b>\$ (45)</b>	<b>\$ 20,332</b>	<b>\$ 1,126</b>	<b>\$ 21,458</b>
<b>Balance as of December 31, 2009</b>	<b>\$ 2</b>	<b>\$ 573</b>	<b>\$ 15,621</b>	<b>\$ (45)</b>	<b>\$ 16,151</b>	<b>\$ 2,506</b>	<b>\$ 18,657</b>
Net income for the period	-	-	754	-	754	94	848
Changes in non- controlling interest	-	-	-	-	-	(37)	(37)
<b>Balance as of March 31, 2010</b>	<b>\$ 2</b>	<b>\$ 573</b>	<b>\$ 16,375</b>	<b>\$ (45)</b>	<b>\$ 16,905</b>	<b>\$ 2,563</b>	<b>\$ 19,468</b>

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

**JSC Gazprom Neft**  
**Interim Condensed Consolidated Statements of Cash Flows**  
**For the three months ended March 31, 2011 and 2010 (Unaudited)**

Currency - US\$ millions

	<b>For the three months ended March 31, 2011</b>	<b>For the three months ended March 31, 2010</b>
<i>Operating activities</i>		
Net income	\$ 1,453	\$ 848
Reconciliation of net income to net cash provided by operating activities:		
Share in income of equity affiliates, net of dividends received	57	(74)
Foreign exchange gain	(135)	(45)
Deferred income tax expense / (benefit)	3	(25)
Depreciation, depletion and amortization	424	352
Asset retirement obligation accretion expense, net of spending on existing obligations	8	7
Allowance for doubtful accounts	-	(38)
Allowance for inventory obsolescence	(14)	-
Loss on disposal of property, plant and equipment	5	8
Gain on disposal of investments	(9)	-
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	(728)	(26)
Inventories	(480)	(238)
Other current assets	(49)	65
Other non-current assets	30	(60)
Accounts payable, accrued and other long-term liabilities	(191)	(14)
Income and other taxes payable	247	121
<b>Net cash provided by operating activities</b>	<b>621</b>	<b>881</b>
<i>Investing activities</i>		
Purchase of investments, net of cash acquired (Note 3)	(827)	(122)
Acquisition of investments held-to-maturity	(81)	-
Proceeds from sales of investments held-to-maturity	24	2
Loans issued	(91)	(20)
Loan proceeds received	1	73
Proceeds from disposals of property, plant and equipment	2	2
Proceeds from sales of investments	9	-
Capital expenditures	(612)	(608)
<b>Net cash used in investing activities</b>	<b>(1,575)</b>	<b>(673)</b>
<i>Financing activities</i>		
Short and long-term loan proceeds received	1,310	433
Short and long-term loans repaid	(413)	(495)
Dividends paid	(150)	(220)
<b>Net cash provided by / (used in) financing activities</b>	<b>747</b>	<b>(282)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(207)</b>	<b>(74)</b>
Cash and cash equivalents as of the beginning of the period	1,146	868
Effect of foreign exchange on cash and cash equivalents	9	26
<b>Cash and cash equivalents as of the end of the period</b>	<b>\$ 948</b>	<b>\$ 820</b>
<i>Supplemental disclosures of cash flows information</i>		
Cash paid for interest, net of amount capitalized	63	80
Cash paid for income taxes	408	161

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

**JSC Gazprom Neft**  
**Notes to Interim Condensed Consolidated Financial Statements (Unaudited)**  
**(in millions of US Dollars)**

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**1. General**

Description of Business

JSC Gazprom Neft (formerly OAO Siberian Oil Company) and its subsidiaries (the "Company") is a vertically integrated oil company operating in the Russian Federation, CIS and Europe. The Company's principal activities include exploration, production and development of crude oil and gas, production of refined petroleum products and distribution and marketing operations through its retail outlets.

OAO Siberian Oil Company ("Sibneft") was created by Presidential Decree Number 872 dated August 24, 1995. On September 29, 1995 Sibneft's charter was approved when the Government of the Russian Federation issued Resolution Number 972. The Omsk Registration Chamber officially registered Sibneft on October 6, 1995. In October 2005 OAO Gazprom ("Gazprom") completed its acquisition of a 75.68% stake in Sibneft which became a subsidiary of Gazprom. On May 30, 2006 Sibneft was renamed "JSC Gazprom Neft". In April 2009, Gazprom acquired an additional 20.00% interest in the Company and increased its interest to 95.68%.

**2. Summary of Significant Accounting Policies**

Basis of Presentation

The Company maintains its books and records in accordance with accounting and taxation principles and practices mandated by legislation in the countries in which it operates (primarily the Russian Federation). The accompanying interim condensed consolidated financial statements were primarily derived from the Company's statutory books and records with adjustments and reclassifications made to present them in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

The interim condensed consolidated financial statements are unaudited and have been prepared in accordance with US GAAP for interim financial reporting of public companies and do not include all disclosures necessarily required by US GAAP. The Company omitted disclosures which would substantially duplicate the disclosures contained in its 2010 audited consolidated financial statements, such as accounting policies and details of accounts which have not changed significantly in amount or composition. Management believes that the disclosures are adequate to make the information presented not misleading if these interim condensed consolidated financial statements are read in conjunction with the Company's 2010 audited consolidated financial statements and the notes related thereto. In the opinion of the Company's management, the unaudited interim condensed consolidated financial statements and notes thereto reflect all known adjustments of a normal and recurring nature necessary to fairly state the Company's financial position, results of operations and cash flows for the interim periods. Subsequent events occurring after March 31, 2011 were evaluated through May 10, 2011, the date these financial statements were available to be issued.

The results for the three months ended March 31, 2011 are not necessarily indicative of the results expected for the full year.



**JSC Gazprom Neft**  
**Notes to Interim Condensed Consolidated Financial Statements (Unaudited)**  
**(in millions of US Dollars)**

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Management 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 in the balance sheet as well as the revenues and expenses during the reporting periods. Certain significant estimates and assumptions for the Company include: recoverability and useful lives of long-term assets and investments; identifying assets acquired and liabilities assumed in business combinations and determining fair value; allowances for doubtful accounts receivable and inventory obsolescence; asset retirement obligations; legal and tax contingencies; depreciation, depletion and amortization; environmental remediation obligations; oil reserves; and recognition and disclosure of guarantees and other commitments. While management uses its best estimates and judgments, actual results could differ from those estimates and assumptions used.

Foreign Currency Translation

The management of the Company has determined the US Dollar is the functional and reporting currency of the Company as the majority of its revenues, debt and trade liabilities are either priced, incurred, payable or otherwise measured in US Dollars. Monetary assets and liabilities have been translated into US Dollars at the exchange rate as of the balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows are translated into US Dollars at average rates for the period or exchange rates prevailing on the transaction dates where practicable. Gains and losses resulting from the re-measurement into US Dollars are included in the interim condensed consolidated statements of income.

The official exchange rates of the Ruble to the US Dollar as of March 31, 2011 and December 31, 2010 were 28.43 Rubles and 30.48 Rubles per US \$1.00, respectively.

The translation of local currency denominated assets and liabilities into US Dollars for the purpose of these interim condensed consolidated financial statements does not indicate that the Company could realize or settle, in US Dollars, the reported values of these assets and liabilities. Likewise, it does not indicate that the Company could return or distribute the reported US Dollar value of capital to its shareholders.

Principles of Consolidation

The accompanying interim condensed consolidated financial statements include the accounts of majority-owned subsidiaries where no minority shareholder or group of minority shareholders exercise a majority of the substantive participating rights, and variable interest entities for which the Company is determined to be the primary beneficiary. Investments in entities that the Company does not control, but has the ability to exercise significant influence over their operating and financial policies, are accounted for under the equity method. Accordingly, the Company's share of net earnings from these companies is included in the interim condensed consolidated statements of income as share in income from equity affiliates. All other investments are recorded at cost and adjusted for impairment, as appropriate.

Business Combinations

The Company accounts for its business combinations according to FASB ASC 805, *Business Combinations*, and FASB ASC 810, *Consolidation*. The Company applies the acquisition method of accounting and recognizes the assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often involves the use of significant estimates and assumptions.

Investments in shares or interests in companies where the Company has less than 20% equity interest and does not have significant influence, which are not publicly traded, and their market value cannot be calculated directly, are recorded at cost and adjusted for impairment, as appropriate.

**JSC Gazprom Neft**  
**Notes to Interim Condensed Consolidated Financial Statements (Unaudited)**  
**(in millions of US Dollars)**

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Goodwill and Other Intangible Assets

Goodwill represents the excess of acquisition cost over the fair value of net assets acquired. The excess of the fair value of net assets acquired over acquisition cost represents negative goodwill which is recognized as a gain in the interim condensed consolidated statement of income during the period of the acquisition.

In accordance with FASB ASC 350, *Intangibles – “Goodwill and Other”*, goodwill and intangible assets with indefinite useful lives are not amortized. Instead, they are tested for impairment at least on an annual basis. An impairment loss is recognized when the carrying value of goodwill exceeds its fair value. Impairment testing is a two-step process. The first step compares the fair value of the reporting unit with its carrying value, including goodwill. If the fair value of the reporting unit exceeds its carrying value, no impairment is recognized. Otherwise, the second step of the goodwill impairment test shall be performed to measure the amount of impairment loss resulting from the excess of the reporting unit's carrying value over its fair value. The loss recognized cannot exceed the carrying amount of goodwill. Subsequent reversal of previously recognized goodwill impairment loss is prohibited.

Intangible assets that have limited useful lives are amortized on a straight-line basis over the shorter of their useful lives or the period set by legislation. Useful lives with respect to intangible assets are determined as follows:

<u>Intangible Asset Group</u>	<u>Average Life</u>
Licenses and software	1-5 years
Land rights	25 years

Non-Controlling Interest

Certain changes in a parent's ownership interest are to be accounted for as equity transactions and when a subsidiary is deconsolidated, any non-controlling equity investment in the former subsidiary will be initially measured at fair value. In addition ownership interests in the Company's subsidiaries held by parties other than the parent are presented separately from the parent's equity on the interim condensed consolidated balance sheet. The amount of consolidated net income attributable to the parent and the non-controlling interests are both presented on the face of the interim condensed consolidated statements of income.

Cash and Cash Equivalents

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

Loans and Accounts Receivable

Loans and accounts receivable are stated at net realizable value. Allowances are provided for estimated losses and for doubtful debts based on estimation of uncollectible amounts. Estimation is made based on aging of the receivable, past history of settlements with the debtor and existing economic conditions. Estimates of allowances require the exercise of judgment and the use of assumptions.

**JSC Gazprom Neft**  
**Notes to Interim Condensed Consolidated Financial Statements (Unaudited)**  
**(in millions of US Dollars)**

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Inventories

Inventories, consisting primarily of crude oil, refined oil products and materials and supplies are stated at the lower of weighted average cost or market value. Market value should not exceed net realizable value (i.e. estimated selling price less reasonable predictable costs of completion and disposal), and should not be less than net realizable value reduced by an allowance for an estimated normal profit margin. Costs include both direct and indirect expenditures and charges incurred in bringing an item or product to its existing condition and location.

Financial Investments

In accordance with FASB ASC 825, "*Fair value option for financial assets and financial liabilities*" including amendment to ASC 320, financial investments are recorded at fair value. The fair value of investments is based on market quotes, if any, or on present value of expected cash flow with discount rates applied for their calculation in accordance with the level of risks associated with these investments.

All debt and equity securities held by the Company are classified as follows: trading securities, available-for-sale securities or held-to-maturity securities.

Trading securities are purchased and held primarily for resale in the nearest future. Held-to-maturity securities represent financial instruments that the Company has both the intent and the ability to hold to maturity. All other securities, which do not fall into these two categories, are classified as available-for-sale securities.

Unrealized gains or losses on trading securities and held-to-maturity securities are included in the interim condensed consolidated statements of income. Unrealized gains or losses on available-for-sale securities less the related tax effect are recorded up to the date of their sale as a separate element of comprehensive income. Realized gains and losses on sale of securities designated as available-for-sale are determined separately for each type of security. Dividends and interest receivable are recorded on an accrual basis.

Oil and Gas Properties

In accordance with FASB ASC 932, "*Extractive Activities - Oil and Gas*", oil and gas acquisition, exploration and development costs are recognized under the successful efforts method.

Acquisition costs include amounts paid for the acquisition of exploration and development licenses.

Exploration costs include:

- Costs of topographical, geological, and geophysical studies, rights of access to properties to conduct those studies;
- Costs of carrying and retaining undeveloped properties;
- Bottom hole contribution;
- Dry hole contribution; and
- Costs of drilling and equipping exploratory wells.

Exploration drilling costs are capitalized until it is determined that the well has proved oil and gas reserves and the reserves found are sufficient to justify its development. If the well is determined to be successful, the capitalized drilling costs will be reclassified as part of the cost of the well. The field is a cost centre. If proved reserves are not found, the capitalized drilling costs are charged to exploration expenses incurred in the period when it is determined that such cost would not bring additional proved oil and gas reserves.

Other exploration costs are charged to expense when incurred.

**JSC Gazprom Neft**  
**Notes to Interim Condensed Consolidated Financial Statements (Unaudited)**  
**(in millions of US Dollars)**

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Development costs, which are capitalized within property plant and equipment, include expenditures incurred to:

- Gain access to and prepare well locations for drilling;
- Drill and equip development wells and service wells;
- Acquire, construct, and install production facilities; and
- Provide improved recovery systems.

Property, Plant and Equipment

Property, plant and equipment is stated at historical cost, net of accumulated depreciation. The cost of maintenance, repairs and replacement of minor items of property is charged to expense; renewals and betterments of assets are capitalized.

Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are recorded in the interim condensed consolidated statements of income.

Depreciation, Depletion and Amortization

Depletion of acquisition and development costs of proved oil and gas properties is calculated using the unit-of-production method based on the proved reserves and proved developed reserves, respectively. Acquisition costs of unproved properties are not amortized. These costs are reclassified as proved properties when the relevant reserve reclassification is made.

The provision for depreciation and amortization with respect to operations other than oil and gas producing activities is calculated using the straight-line method based on estimated economic lives. Depreciation rates are applied to similar types of buildings and equipment having similar economic characteristics, as shown below:

<u>Asset Group</u>	<u>Average Life</u>
Buildings and constructions	8-35 years
Machinery and equipment	8-20 years
Vehicles and other equipment	3-10 years

Income Taxes

Russian legislation does not contain the concept of a “consolidated tax-payer” and, accordingly, the Company is not subject to taxation on a consolidated basis. Current income taxes are provided on taxable profit of each subsidiary as determined under mostly the Russian Federation Tax Code at a rate of 20% after adjustments for certain items which are not deductible for taxation purposes. Subsidiaries operating in countries other than the Russian Federation are chargeable to income at the applicable statutory rate in the country in which they operate.

Deferred income tax assets and liabilities are recognized in the accompanying interim condensed consolidated financial statements in the amounts determined by the Company using the liability method in accordance with FASB ASC 740 “Income Taxes”. This method takes into account future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purpose of the interim condensed consolidated financial statements and their respective tax bases and in respect of operating loss and tax credit carry-forwards. 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 recovered and liabilities settled. A valuation allowance for deferred tax asset is recorded when management believes that it is more likely than not that this tax asset will not be realized in the future.

**JSC Gazprom Neft**  
**Notes to Interim Condensed Consolidated Financial Statements (Unaudited)**  
**(in millions of US Dollars)**

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Derivative Instruments

The Company uses derivative instruments to manage its exposure to changes in foreign currency exchange rates. A substantial portion of the Company's sales revenues are received in US Dollars. Additionally, a significant portion of the Company's financing and investing activities is also undertaken in US Dollars. However, the Company's operating expenditures and capital spending are primarily denominated in Russian Rubles. Accordingly, a decline in the value of the US Dollar against the Russian Ruble will negatively impact the Company's operating results and cash flows. Therefore the Company enters into forward contracts to manage this risk.

Derivative instruments are recorded at fair value in either other assets or liabilities on the interim condensed consolidated balance sheet. Realized and unrealized gains and losses are presented in the interim condensed consolidated statements of income on a net basis. These transactions are not accounted for as hedges pursuant to FASB ASC 815 *"Derivatives and Hedging"*.

Stock-Based Compensation

In accordance with ASC 718-30 *"Compensation – Stock Compensation, Awards Classified as Liabilities"*, the Company accounts for its best estimate of the obligation under cash-settled stock-appreciation rights ("SARs") granted to employees at fair value on the date of grant. The estimate of the final liability is re-measured to fair value at each reporting date and the compensation charge recognized in respect of SARs in the income statement is adjusted accordingly. Expenses are recognized over the vesting period.

Recognition of Revenues

Revenues from the sales of crude oil, petroleum products, gas and all other products are recognized when deliveries of products to final customers are made, title passes to the customer, collection is reasonably assured and sales price to final customers is fixed or determinable. Specifically, domestic crude oil sales and petroleum product and materials sales are recognized when they are shipped to customers, which is generally when title passes. For export sales, title generally passes at the border of the Russian Federation and the Company is responsible for transportation, duties and taxes on those sales.

Other revenues consist primarily of sales of services such as processing services, transportation, construction, utilities and other services and are recognized when goods are provided to customers and services are performed providing that the price for the service can be determined and no significant uncertainties regarding realization exist.

Buy/Sell Transactions

The Company accounts for buy/sell transactions in accordance with FASB ASC 845-10-15 *"Non-monetary Transactions"* which requires that two or more legally separate exchange transactions with the same counterparty, including buy/sell transactions, should be combined and considered as a single arrangement. The Company accounts for matching buy/sell arrangements entered into as exchanges of inventory.

**JSC Gazprom Neft**  
**Notes to Interim Condensed Consolidated Financial Statements (Unaudited)**  
**(in millions of US Dollars)**

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Accounting Standards Adopted

In January 2010 the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards updated 2010-06 Fair Value Measurements and Disclosures (Topic 820). The new provisions require that a reporting entity disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. Furthermore in reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). The amendments also clarify the existing disclosures as to the requirement for management of a reporting entity to use judgment in determining the appropriate classes of assets and liabilities. The new provisions also require a reporting entity to provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements in either Level 2 or Level 3. The provisions are effective for annual and interim reporting periods beginning after December 15, 2009, except for the requirement to provide the Level 3 disclosure. This requirement is effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. Adoption of the second part of the update did not have an effect on the Company’s interim condensed consolidated financial statements.

In December 2010, the Financial Accounting Standards Board (“FASB”) issued ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts, (Topic 350 Intangibles – Goodwill and Other). ASU 2010-28 amends Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment exists. The amendments are effective for interim and annual reporting periods beginning after December 15, 2010. Early adoption is prohibited. The management does not believe the adoption will have a significant impact on the Company’s financial position, results of operations and cash flows.

In December 2010, the Financial Accounting Standards Board (“FASB”) issued ASU 2010-29, Disclosure of Supplementary Pro Forma Information for Business Combinations (Topic 805 Business Combinations). ASU 2010-29 specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures under Topic 805 to include a description and amount of material, non recurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The management does not believe the adoption will have a significant impact on the Company’s financial position, results of operations and cash flows.

#### Recently Issued Accounting Standards

In July 2010, the Financial Accounting Standards Board ("FASB") issued ASU 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses that amends Topic 310, Receivables, of the FASB Codification. ASU 2010-20 amends existing disclosures and requires the entity to provide the following additional disclosures about its financing receivables: 1) credit quality indicators of financing receivables at the end of the reporting period by class of financing receivables; 2) the aging of past due financing receivables at the end of the reporting period by class of financing receivables; 3) the nature and extent of troubled debt restructurings that occurred during the period by class of financing receivables and their effect on the allowance for credit losses; 4) the nature and extent of financing receivables modified as troubled debt restructurings within the previous 12 months that defaulted during the reporting period by class of financing receivables and their effect on the allowance for credit losses; 5) significant purchases and sales of financing receivables during the reporting period disaggregated by portfolio segment. For nonpublic entities the disclosures about activity that occurs during a reporting period are effective for annual reporting periods beginning on or after December 15, 2011. The amendments in ASU 2010-20 encourage, but do not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, an entity should provide comparative disclosures for those reporting periods ending after initial adoption. Adoption of the update did not have an effect on the Company's interim condensed consolidated financial statements.

In January 2011, the Financial Accounting Standards Board ("FASB") issued ASU 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in ASU 2010-20 (Topic 310 Receivables). The amendments temporarily delay the effective date of the disclosures about troubled debt restructurings in ASU 2010-20. Currently, that guidance is anticipated to be effective for interim and annual periods ending after December 15, 2011.

#### Reclassifications

Certain reclassifications have been made to previously reported amounts to conform to the current year's presentation; such reclassifications have no effect on net income, net cash flow or shareholders' equity.

### **3. Business Combinations**

#### Acquisition of non-controlling interest in NIS

On March 18, 2011 the Company finalized its offer made in January 2011 to buy out the free float shares in NIS (a maximum 19.12% of the NIS equity was available for purchase). 8.4 million NIS shares were submitted for purchase amounting to 5.15% of NIS authorized share capital. Based on the previously announced offer price the Company paid US\$ 58 million for acquiring these shares increasing its interest in NIS from 51% to 56.15%.

The Company has accounted for the acquisition of the additional interest in NIS as an acquisition of non-controlling interest where control is maintained. As a result of the transaction the Company recognized a credit of US\$ 17 million in additional paid-in-capital in the period ended March 31, 2011. The US\$ 17 million represents the excess of the carrying value of the investments acquired of US\$ 75 million over the consideration paid.

#### Acquisition of non-controlling interest in Sibir Energy

On February 14, 2011 the Board of Directors of Sibir Energy adopted a resolution to reduce the share capital by 86.25 million shares (22.39%). Central Fuel Company, an affiliate to the Moscow Government, made a decision to withdraw membership in Sibir Energy for a compensation of US\$ 740 million. Starting from February 15, 2011 the Company has 100% interest in Sibir.

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As a result of the transaction the Company recognized a credit of US\$ 21 million in additional paid-in-capital in the period ended March 31, 2011. The US\$ 21 million represents the excess of the carrying value of the investments acquired of US\$ 761 million over the consideration paid to Central Fuel Company.

Following the reduction in share capital of Sibir Energy the Company has increased its effective interest in Moscow refinery from 69.02% to 77.72%. As a result of the increase in effective interest in Moscow refinery the Company recognized a credit of approximately US\$ 177 million in additional paid-in-capital in the period ended March 31, 2011.

#### 4. Cash and Cash Equivalents

Cash and cash equivalents as of March 31, 2011 and December 31, 2010 comprise the following:

	2011	2010
Cash in bank – Rubles	\$ 351	\$ 120
Cash in bank – foreign currency	353	101
Bank deposits and other cash equivalents	232	918
Cash on hand	12	7
<i>Total cash and cash equivalents</i>	<u>\$ 948</u>	<u>\$ 1,146</u>

As of March 31, 2011 and December 31, 2010 the majority of bank deposits are held in US Dollars and Russian Rouble, respectively. Bank deposits represent deposits with original maturities of less than three months.

#### 5. Accounts Receivable, net

Accounts receivable as of March 31, 2011 and December 31, 2010 comprise the following:

	2011	2010
Trade receivables	\$ 2,319	\$ 1,616
Value added tax receivable	875	682
Related party receivables	132	83
Other receivables	565	541
Less allowance for doubtful accounts	(391)	(356)
<i>Total accounts receivable</i>	<u>\$ 3,500</u>	<u>\$ 2,566</u>

Trade receivables represent amounts due from customers in the ordinary course of business, denominated primarily in US Dollars, and are short-term in nature. Other receivables consist of taxes receivable and other miscellaneous receivables.

#### 6. Inventories

Inventories as of March 31, 2011 and December 31, 2010 consist of the following:

	2011	2010
Crude oil	\$ 450	\$ 339
Petroleum products	1,083	807
Materials and supplies	502	575
Other	199	141
<i>Total inventories</i>	<u>\$ 2,234</u>	<u>\$ 1,862</u>



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As part of the management of crude inventory, the Company may enter transactions to buy and sell crude oil from the same counterparty. Such transactions are referred to as buy/sell transactions and are undertaken in order to reduce transportation costs or to obtain alternate quality grades of crude oil. The total value of buy / sell transactions undertaken for the three months ended March 31, 2011 and March 31, 2010 is as follows:

	<b>2011</b>	<b>2010</b>
Buy/sell crude oil transactions	\$ 597	\$ 364

**7. Assets held for sale**

In April 2010, the Company's management approved the decision to sell the Company's oil field services business. In July 2010 the Company started the marketing stage of the process and as a result, the assets of oil field services entities and liabilities associated with these assets were classified as held for sale for the purposes of these interim condensed consolidated financial statements.

In January 2011 the Company sold 100% interest in Muravlenkovskaya Transportnaya Kompaniya for the consideration of US\$ 9 million.

As of March 31, 2011 the oil field services business of the Group consists of one holding company Gazpromneft-Nefteservice LLC and eight subsidiaries.

The following table summarizes the financial information of oil field services business as of March 31, 2011 and December 31, 2010:

	<b>2011</b>	<b>2010</b>
Accounts receivable, net	27	22
Inventories	41	36
Other current assets	20	22
Property, plant and equipment, net	130	108
Other intangible assets	2	1
<i>Assets held for sale</i>	<u>\$ 220</u>	<u>\$ 189</u>
Accounts payable and accrued liabilities	120	106
Income and other taxes	24	24
Deferred income tax liabilities	4	4
<i>Liabilities associated with assets held for sale</i>	<u>\$ 148</u>	<u>\$ 134</u>

**8. Other Current Assets, net**

Other current assets as of March 31, 2011 and December 31, 2010 consist of the following:

	<b>2011</b>	<b>2010</b>
Prepaid customs duties	\$ 512	\$ 499
Advances paid	583	476
Prepaid expenses	37	28
Other assets	190	109
<i>Total other current assets</i>	<u>\$ 1,322</u>	<u>\$ 1,112</u>

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**9. Long-Term Investments and Loans Receivable**

Long-Term Investments

None of the companies listed below are publicly traded in Russia. The significant equity and other long-term investments as of March 31, 2011 and December 31, 2010 are summarized below:

<i>Investments in equity affiliates:</i>	<b>Ownership Percentage</b>	<b>Net book value as of</b>	
		<b>March 31, 2011</b>	<b>December 31, 2010</b>
JSC Slavneft	49.9	\$ 2,703	\$ 2,798
JSC Tomskneft VNK	50.0	1,331	1,334
Salym Petroleum Development N.V.	50.0	1,336	1,287
SeverEnergy	25.5	877	894
Others		89	59
<i>Total investments in equity affiliates</i>		<u>\$ 6,336</u>	<u>\$ 6,372</u>
<i>Total long-term investments, at cost</i>		270	290
<i>Long-term loans receivable</i>		355	332
<i>Total long-term investments</i>		<u>\$ 6,961</u>	<u>\$ 6,994</u>

The Company's share in income of equity affiliates including share in non-controlling interest consists of the following for the periods ended March 31:

	<b>For the three months ended March 31, 2011</b>	<b>For the three months ended March 31, 2010</b>
<i>Equity affiliates:</i>		
JSC Slavneft	\$ 2	\$ 9
JSC Tomskneft VNK	(3)	54
Salym Petroleum Development N.V.	49	16
SeverEnergy	(17)	-
Others	10	-
<i>Total share of income in equity affiliates</i>	<u>\$ 41</u>	<u>\$ 79</u>

The Company's investment in JSC Slavneft and various minority stakes in Slavneft subsidiaries ("Slavneft") are held through a series of off-shore entities and an investment trust. During 2005, the Company and TNK-BP agreed to jointly manage the production and the refineries of the Slavneft group with each party purchasing its share of production, refer also to Note 19 "Related Party Transactions".

The following table summarizes the financial information of Slavneft as of March 31, 2011 and December 31, 2010 and for the three months ended March 31, 2011 and 2010:

	<b>2011</b>	<b>2010</b>
Current assets	\$ 1,282	\$ 1,158
Long-term assets	6,919	6,807
Total liabilities	2,787	2,589
Revenues	1,354	1,093
Net income	4	17

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In December 2007 the Company acquired a 50% equity interest in JSC Tomskneft VNK (“Tomskneft”) and its subsidiaries from a subsidiary of OJSC Oil Company Rosneft (“Rosneft”). As part of this transaction, the Company and Rosneft agreed to jointly manage the business operations of Tomskneft and to each purchase their respective share of Tomskneft’s annual production.

The following table summarizes the financial information of Tomskneft as of March 31, 2011 and December 31, 2010 and for the three months ended March 31, 2011 and 2010:

	<b>2011</b>	<b>2010</b>
Current assets	\$ 798	\$ 631
Long-term assets	3,474	3,420
Total liabilities	2,322	2,093
Revenues	852	604
Net (loss)/ income	(6)	107

As part of the acquisition of Sibir Energy in June 2009 the Company acquired a 50.0% equity interest in Salym Petroleum Development N.V. (“Salym”). Salym is owned 50.0% by Sibir and 50.0% by Shell Salym Development B.V., a member of the Royal Dutch/Shell group of companies. The operations of Salym relate to the development of the Salym group of oil fields located in the Khanti-Mansiysky autonomous region of the Russian Federation.

The following table summarizes the financial information of Salym as of March 31, 2011 and December 31, 2010. Revenue and net income are shown for the three months ended March 31, 2011 and 2010:

	<b>2011</b>	<b>2010</b>
Current assets	\$ 429	\$ 294
Long-term assets	936	934
Total liabilities	832	798
Revenues	530	417
Net income	99	32

In December 2010 Yamal Razvitie LLC (a joint venture between the Company and JSC Novatek) acquired a 51% equity interest in SeverEnergy LLC (SeverEnergy) from JSC Gazprom for US\$ 1.9 billion. The respective purchase price paid by the Company comprised US\$ 898 million. SeverEnergy is developing through its subsidiaries the Samburgskoye and Evo-Yakhinskoye oil fields and some other small oil and gas fields located in the Yamalo-Nenetskiy autonomous region of the Russian Federation.

The following table summarizes the financial information of SeverEnergy as of March 31, 2011 and December 31, 2010 and for the period ended March 31, 2011:

	<b>2011</b>	<b>2010</b>
Current assets	\$ 195	\$ 162
Long-term assets	5,082	4,671
Total liabilities	1,429	1,232
Net loss	(21)	-

The purchase price allocation is preliminary as the Company is in the process of finalizing the fair value estimates for certain assets and liabilities, primarily for property, plant and equipment and determining the completeness of liabilities recorded. The purchase price allocation should be finalized during 2011.

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Long-Term Loans Receivable

Long-term loans receivable of US\$ 355 million and US\$ 332 million are mostly due from related parties as of March 31, 2011 and December 31, 2010, respectively. These loans bear interest at rates ranging from nil to 15.0%. The fair value of these loans is approximately US\$ 304 million and US\$ 279 million as of March 31, 2011 and December 31, 2010 assuming an average discount rate of 7.83% and 8.03% for the periods ended March 31, 2011 and December 31, 2010, respectively (CBR interbank refinancing rate).

**10. Property, Plant and Equipment**

As of March 31, 2011 property, plant and equipment comprise the following:

	<b>Cost</b>	<b>Accumulated DD&amp;A</b>	<b>Net book value</b>
Exploration and production	\$ 22,555	\$ (11,940)	\$ 10,615
Refining	4,879	(1,990)	2,889
Marketing and distribution	1,955	(308)	1,647
Other	215	(17)	198
Assets under construction	1,119	-	1,119
<i>Total</i>	<u>\$ 30,723</u>	<u>\$ (14,255)</u>	<u>\$ 16,468</u>
<b>Comparative balance as of December 31, 2010</b>	<u>\$ 29,789</u>	<u>\$ (13,875)</u>	<u>\$ 15,914</u>

**11. Goodwill and intangible assets**

The goodwill balance of US\$ 523 million as of March 31, 2011 and December 31, 2010 relates to acquisitions of NIS, Sibir Energy and Orton for which goodwill in the amount of US\$ 349 million, US\$ 140 million and US\$ 34 million, was recognized, respectively.

Other intangible assets as of March 31, 2011 and December 31, 2010 comprise the following:

	<b>2011</b>	<b>2010</b>
Licenses	\$ 20	\$ 20
Software	165	172
Land rights	527	535
Other intangible assets	35	24
<i>Total other intangible assets</i>	<u>\$ 747</u>	<u>\$ 751</u>

Land rights relate to the right to use land plots at the Moscow Refinery location and certain other retail and wholesale sites in Moscow and the Moscow region where the Company owns and operates refining and other assets. Accumulated depreciation with respect to land rights is US\$ 38 million and US\$ 33 million as of March 31, 2011 and December 31, 2010.

**12. Short-Term Debt**

As of March 31, 2011 and December 31, 2010 the Company has short-term loans outstanding as follows:

	<b>2011</b>	<b>2010</b>
Banks	\$ 157	\$ 25
Related parties	329	244
Other	17	10
<i>Total short-term loans</i>	<u>\$ 503</u>	<u>\$ 279</u>

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As of March 31, 2011 short-term loans were provided by international banks for funding of working capital and consisted of unsecured facilities.

As of March 31, 2011 and December 31, 2010 the Company has several interest-free loans from Tomskneft in the amount of US\$ 302 million (US\$ 231 million as of December 31, 2010), repayable in Rubles which mature in the period to March 2012. Tomskneft is a related party to the Company.

**13. Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities as of March 31, 2011 and December 31, 2010 comprise the following:

	2011	2010
Trade accounts payable	\$ 799	\$ 853
Advances received from customers	240	342
Related party accounts payable	259	156
Accrued interest	78	46
Other payables	361	459
<i>Total accounts payable</i>	<u>\$ 1,737</u>	<u>\$ 1,856</u>

**14. Income and Other Taxes Payable**

Income and other taxes payable as of March 31, 2011 and December 31, 2010 comprise the following:

	2011	2010
Mineral extraction tax	\$ 423	\$ 336
Value added tax	391	207
Excise tax	169	99
Income tax	94	137
Property tax	46	46
Other taxes	60	49
<i>Total income and other taxes payable</i>	<u>\$ 1,183</u>	<u>\$ 874</u>

Taxes other than income tax expense for the three months ended March 31 comprise the following:

	For the three months ended March 31, 2011	For the three months ended March 31, 2010
Mineral extraction tax	\$ 1,020	\$ 697
Excise tax	599	387
Property tax	52	42
Other taxes	101	81
<i>Total taxes other than income tax expense</i>	<u>\$ 1,772</u>	<u>\$ 1,207</u>

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**15. Long-Term Debt**

As of March 31, 2011 and December 31, 2010 the Company has long-term outstanding loans as follows:

<b>Bonds and Bank Loans:</b>	<b>March 31, 2011</b>	<b>December 31, 2010</b>
Russian Ruble bonds	\$ 2,392	\$ 1,247
Pre-Export Finance	1,500	1,500
Other bank loans outstanding	3,305	3,455
Other borrowings	136	155
Less current portion of long- term debt	(1,446)	(1,415)
<b>Total Bonds and Bank Loans</b>	<b>\$ 5,887</b>	<b>\$ 4,942</b>

On April 21, 2009, the Company placed ten-year Ruble Bonds (04 series) with the total par value of RUR 10 billion (US\$ 352 million as of March 31, 2011 and US\$ 328 million as of December 31, 2010, all current). The bonds bear interest of 16.7% per year with a two year put option and have semi-annual coupon payments.

On July 21, 2009, the Company placed seven-year Ruble Bonds (03 series) with the total par value of RUR 8 billion (US\$ 281 million as of March 31, 2011 and US\$ 263 million as of December 31, 2010, all non-current). The bonds bear interest of 14.75% per year with three year put option and have semi-annual coupon payments.

On April 13, 2010, the Company placed three-year Ruble Bonds (05 and 06 series) with the total par value of RUR 20 billion (US\$ 703 million as of March 31, 2011 and US\$ 656 million as of December 31, 2010, all non-current). The bonds bear interest of 7.15% per year and have semi-annual coupon payments.

On February 08, 2011, the Company placed five-year Ruble Bonds (08 series) with the total par value of RUR 10 billion (US\$ 352 million as of March 31, 2011, non-current). The bonds bear interest of 8.5% per year and have semi-annual coupon payments.

On February 08, 2011, the Company placed ten-year Ruble Bonds (09 series) with the total par value of RUR 10 billion (US\$ 352 million as of March 31, 2011, non-current). The bonds bear interest of 8.5% per year with a five year put option and have semi-annual coupon payments.

On February 08, 2011, the Company placed ten-year Ruble Bonds (10 series) with the total par value of RUR 10 billion (US\$ 352 million as of March 31, 2011, non-current). The bonds bear interest of 8.9% per year with a seven year put option and have semi-annual coupon payments.

In July 2010 the Company completed the Senior Syndication under the five-year Pre-Export Finance Facility for the amount of up to US\$ 1.5 billion. The Bank of Tokyo-Mitsubishi UFJ, Natixis SA and Societe Generale were appointed as Initial Mandated Lead Arrangers and Bookrunners. The facility bears an interest rate of LIBOR plus 1.6% and matures in July 2015. As of March 31, 2011 and December 31, 2010 the Company has US\$ 1.5 billion outstanding under the loan (all non-current).

As of March 31, 2011 the Company has US\$ 3,305 million in long term loans from a number of banks, primarily denominated in US Dollars (including current portion of US\$ 1,066). As of December 31, 2010 the Company had US\$ 3,455 million in long term loans from a number of banks (including current portion of US\$ 1,059). Interest rates under the loans varied from LIBOR plus 0.5% to fixed interest rate of 6.5%.

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The loan agreements contain financial covenants that require the Company's ratios of Consolidated EBITDA to Consolidated Interest Payable, Consolidated Indebtedness to Consolidated Tangible Net Worth and Consolidated Indebtedness to Consolidated EBITDA. Management believes the Company is in compliance with these covenants as of March 31, 2011 and December 31, 2010, respectively.

Maturities of long-term loans as of March 31, 2011 are as follows:

<u>Year due</u>	<u>Amount due</u>
2012	\$ 1,446
2013	1,999
2014	2,099
2015	478
2016 and further	1,311
	<u>\$ 7,333</u>

#### **16. Cash-settled Stock Appreciation Rights**

On January 12, 2010 the Board approved the implementation of a cash-settled stock appreciation rights (SAR) compensation plan. The plan forms part of the long term growth strategy of the Company and is designed to reward management for increasing shareholder value over a specified period. The awards are subject to certain market and service conditions that determine the amount that may ultimately be paid to eligible employees. The expense recognized is based on the vesting period which expires on December 31, 2011.

The fair value of the liability under the plan is estimated using the Black-Scholes-Merton option-pricing model by reference primarily to the Company's share price, historic volatility in the share price, dividend yield and interest rates for periods comparable to the remaining life of the award. Any changes in the estimated fair value of the liability award will be recognized in the period the change occurs subject to the vesting period.

In the interim condensed consolidated statement of income for the three months ended March 31, 2011 and 2010 the Company recognized compensation expense, net of the deferred tax benefit, of US\$ 35 million and US\$ 24 million related to the SAR plan, accordingly. This expense is included within selling, general and administrative expenses. A provision of US\$ 90 million and US\$ 47 million has been recorded within other long-term liabilities in respect of the Company's estimated obligations under the plan as of March 31, 2011 and December 31, 2010. The difference between the provision as of March 31, 2011 and the expected liability at the conclusion of the plan of US\$ 54 million, based on March 31, 2011 valuation, related to unvested SAR awards will be recognized in the year to December 31, 2011.

#### **17. Fair Value of Financial Instruments**

The estimated fair values of financial instruments are determined with reference to various market information and other valuation methodologies as considered appropriate, however considerable judgment is required in interpreting market data to develop these estimates. Accordingly, the estimates are not necessarily indicative of the amounts that the Company could realize in a current market situation. Certain of these financial instruments are with major financial institutions and expose the Company to market and credit risk. The creditworthiness of these institutions is routinely reviewed and full performance is anticipated.

The Company's only assets and liabilities measured at fair value on a recurring basis are its derivative financial instruments and the obligation under SAR's, which have been valued using Level 2 inputs under the fair value hierarchy.

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The Company uses derivative financial instruments to manage its exposure to changes in foreign currency exchange rates. A majority of Company's revenues are received in US Dollars, a growth or a decline in the value of the US Dollar against the Russian Ruble impacts the Company's operating results and cash flows. These transactions are not accounted for as hedges pursuant to the Fair Value Measurements and Disclosures Topic of the Codification.

The Company does not purchase, hold or sell derivative financial instruments unless it has an existing asset or obligation or anticipates a future activity that is likely to occur that will result in an exposure to foreign exchange risk. The Company does not enter into any derivative instruments for speculative purposes. As of March 31, 2011 and December 31, 2010 the Company has outstanding currency exchange derivative contracts for a total notional value of US\$ 2,518 million and US\$ 1,265 million respectively.

The following table presents the fair values and corresponding balance sheet captions of the Company's derivative instruments as of March 31, 2011 and December 31, 2010:

	<b>2011</b>	<b>2010</b>
Assets		
Other current assets	\$ 182	\$ 96
Other non-current assets	250	97
<b>Total assets</b>	<b>\$ 432</b>	<b>\$ 193</b>
Unrealized gain for the three months ended March 31	\$ 239	45

## **18. Commitments and Contingencies**

### Taxes

During 2008, the Russian Tax Authorities completed reviews over the operations of the Company and its Russian subsidiaries for the year ended December 31, 2008. There were no significant findings as a result of these reviews.

Russian tax and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation, including the allocation of tax payments to the Federal and Regional budgets, as applied to the transactions and activity of the Group may be challenged by the relevant authorities. The Russian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. The Supreme Arbitration Court issued guidance to lower courts on reviewing tax cases providing a systemic roadmap for anti-avoidance claims, and it is possible that this will significantly increase the level and frequency of tax authorities scrutiny. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for the preceding three calendar years. Under certain circumstances reviews by tax authorities may cover longer periods. The years 2009, 2010 and 2011 are currently open for review. Management believes it has adequately provided for any probable losses that might arise from these matters.



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Operating Environment

While there have been improvements in the economic situation in the Russian Federation in recent years, the country continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in any countries outside of the Russian Federation, restrictive currency controls, and a high level of inflation. The prospects for future economic stability in the Russian Federation are largely dependent upon the effectiveness of economic measures undertaken by the government, together with legal, regulatory, and political developments.

Environmental Matters

The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Company periodically evaluates its potential obligations under environmental regulation. Management is of the opinion that the Company has met the government's requirements concerning environmental matters, and therefore believes that the Company does not have any material environmental liabilities.

**19. Related Party Transactions**

Slavneft Group (Slavneft)

The Company conducts a number of transactions with Slavneft or its subsidiaries. The Company and TNK-BP have split Slavneft's production based on each party's respective interest. The information on transactions with Slavneft for the three months ended March 31 is presented below:

	<b>For the three months ended March 31, 2011</b>	<b>For the three months ended March 31, 2010</b>
Processing fees	\$ 67	\$ 63
Crude, gas and oil products purchased	573	499
Crude and oil products sales	242	246

As of March 31, 2011 the Company has US\$ 67 million in payables to Slavneft and US\$ 37 million in receivables from Slavneft. As of December 31, 2010 the Company had US\$ 46 million in payables to Slavneft and US\$ 41 million in receivables from Slavneft.

Gazprom Group (Gazprom)

The Company conducted a number of transactions with Gazprom, the primary shareholder of the Company, or its subsidiaries. The information on transactions with Gazprom for the three months ended March 31 is presented below:

	<b>For the three months ended March 31, 2011</b>	<b>For the three months ended March 31, 2010</b>
Oil products sales	\$ 14	\$ 14

As of March 31, 2011 the Company has US\$ 21 million in payables to Gazprom and US\$ 44 million in receivables from Gazprom. As of December 31, 2010 the Company had US\$ 9 million in payables to Gazprom and US\$ 27 million in receivables from Gazprom.

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The Company has cash in Gazprombank of US\$ 99 million and US\$ 176 million as of March 31, 2011 and as of December 31, 2010, respectively.

As of March 31, 2011 and December 31, 2010 a loan facility of US\$ 624 million included in long-term bank loans outstanding is obtained from Gazprombank (Switzerland) Ltd. which is a related party to the Company.

Tomskneft Group (Tomskneft)

The Company conducted a number of transactions with Tomskneft and its subsidiaries. The information on transactions with Tomskneft for the three months ended March 31 is presented below:

	<b>For the three months ended March 31, 2011</b>	<b>For the three months ended March 31, 2010</b>
Crude, gas and oil products purchased	\$ 377	\$ 267

As of March 31, 2011 the Company has US\$ 22 million in payables to Tomskneft and US\$ 5 million in receivables from Tomskneft. As of December 31, 2010 the Company had US\$ 15 million in payables to Tomskneft and US\$ 11 million in receivables from Tomskneft.

Salym Petroleum Development (SPD)

Since June 23, 2009 (the date of acquisition of Sibir), the Company conducts a number of transactions with Salym Petroleum development (SPD). The information on transactions with SPD for the three months ended March 31 is presented below:

	<b>For the three months ended March 31, 2011</b>	<b>For the three months ended March 31, 2010</b>
Crude purchased	\$ 288	\$ 220

As of March 31, 2011 the Company has US\$ 121 million in payables to SPD. As of December 31, 2010 the Company had US\$ 86 million in payables to SPD and US\$ 4 million in receivables from SPD.

**20. Segment Information**

Presented below is information about the Company's operating segments for the three months ended March 31, 2011 and 2010. The Company determined its operating segments based on differences in the nature of their operations considering the regular review by the Company's Chief Executive Office to make decisions about resources to be allocated and to assess performance of the Company.

The exploration and production segment explores, develops and produces crude oil and natural gas and sells its production to the refining, marketing and distribution segment. The refining, marketing and distribution segment processes crude oil into refined products and purchases, sells and transports crude oil and refined petroleum products.

Adjusted EBITDA represents the Company's EBITDA and its share in equity affiliates' EBITDA. Management believes that adjusted EBITDA represents useful means of assessing the performance of the Company's ongoing operating activities, as it reflects the Company's earnings trends without showing the impact of certain charges. EBITDA represents earnings before interest, income tax, depreciation and amortization. EBITDA (Earnings Before Interest, Income Tax, Depreciation and Amortization) is a supplemental non-GAAP financial measure used by management to evaluate operations.

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Operating Segments as of and for the three months ended March 31, 2011 are presented below:

	Exploration and Production	Refining, Marketing and Distribution	Elimination	Consolidated
Revenues from external customers	\$ 46	\$ 9,819	-	\$ 9,865
Inter-segment revenues	2,653	33	(2,686)	-
<b>Total</b>	2,699	9,852	(2,686)	9,865
Adjusted EBITDA	1,391	1,076	-	2,467
Capital expenditures	495	117	-	612
Depreciation, depletion and amortization	334	90	-	424
Income tax expense	75	344	-	419
Segment assets as of March 31, 2011	19,290	27,125	(12,268)	34,147

Operating Segments for the three months ended March 31, 2010 and as of December 31, 2010 are presented below:

	Exploration and Production	Refining, Marketing and Distribution	Elimination	Consolidated
Revenues from external customers	\$ 23	\$ 7,273	-	\$ 7,296
Inter-segment revenues	1,644	21	(1,665)	-
<b>Total</b>	1,667	7,294	(1,665)	7,296
Adjusted EBITDA	743	843	-	1,586
Capital expenditures	484	124	-	608
Depreciation, depletion and amortization	266	86	-	352
Income tax expense	25	154	-	179
Segment assets as of December 31, 2010	18,071	24,921	(10,928)	32,064

Adjusted EBITDA for the three months ended March 31, 2011 and 2010 is reconciled below:

	For the three months ended March 31, 2011	For the three months ended March 31, 2010
<b>Adjusted EBITDA</b>	\$ 2,467	\$ 1,586
The Company's share in EBITDA of equity affiliates	(337)	(230)
Gain on investment	9	-
Share in income of equity affiliates	41	79
Foreign exchange gain, net	166	47
Other income / (expense), net	11	(30)
Interest expense	(93)	(92)
Interest income	32	19
Depreciation, depletion and amortization	(424)	(352)
<b>Income before income taxes</b>	\$ 1,872	\$ 1,027

For the three months ended March 31, 2011 and 2010 the Company had one customer which accounted for approximately 12.6% and 18.8% of the Company's sales, respectively. Management does not believe the Company is reliant on any particular customer.

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The geographical segmentation of the Company's revenue for the period ended March 31 is presented below:

	<b>For the three months ended March 31, 2011</b>	<b>For the three months ended March 31, 2010</b>
Export and international sales	\$ 5,561	\$ 4,452
Domestic	3,674	2,387
CIS	630	457
<i>Total revenues from external customers</i>	<u>\$ 9,865</u>	<u>\$ 7,296</u>

The Company's long-lived assets are mostly located in the Russian Federation.

**21. Subsequent Events**

In April 2011 the Company agreed on a club term loan facility with Bank of America N.A., Citibank N.A., HSBC Bank PLC, ING Bank N.V., Mizuho Corporate Bank Nederland N.V. and Sumitomo Mitsui Banking Corporation Europe Limited. The five-year unsecured loan for an amount of US\$ 600 million bears an interest of LIBOR + 1,5%.