

**OAO Gazprom Neft (formerly OAO Siberian Oil Company)**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2005 AND 2004**

**ОАО Gazprom Neft (formerly OAO Siberian Oil Company)**

**Consolidated Financial Statements**

**Years ended December 31, 2005 and 2004**

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**REPORT OF INDEPENDENT AUDITORS**

To the Board of Directors and Shareholders of  
OAO Gazprom Neft (formerly OAO Siberian Oil Company):

We have audited the accompanying consolidated balance sheet of OAO Gazprom Neft (formerly OAO Siberian Oil Company) and its subsidiaries (hereinafter referred to as the "Company") as of December 31, 2005, and the related consolidated statements of income, of changes in shareholders' equity and of cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of OAO NGK Slavneft and its subsidiaries (hereinafter referred to as "Slavneft"), a significant equity investee of the Company, as of December 31, 2005 and for the year then ended. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for the Company's investment in and its share in net earnings of Slavneft as of December 31, 2005 and for the year then ended is based solely on the report of the other auditors. The reported aggregate carrying value of the Company's investment in Slavneft and its subsidiaries as of December 31, 2005 is US\$ 1,971 million, and the Company's reported share in net earnings of Slavneft and its subsidiaries for the year then ended is US\$ 778 million. The financial statements of the Company as of December 31, 2004 and for the year then ended were audited by other auditors whose report dated June 30, 2005 expressed an unqualified opinion on those statements.

We conducted our audit 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the 2005 consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO Gazprom Neft (formerly OAO Siberian Oil Company) and its subsidiaries at December 31, 2005 and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Company has not presented all of the information required by Statement of Financial Accounting Standards No.69 "Disclosures about Oil and Gas Producing Activities" with respect to the oil and gas producing activities of Slavneft and its subsidiaries, an equity investee, and with respect to the presentation of up-to license term, post license term and total proved reserves and related future cash-flow information. The Company discloses total proved reserves only. The Financial Accounting Standards Board has determined such information is necessary to supplement the basic consolidated financial statements.

**OAQ Gazprom Neft (formerly OAQ Siberian Oil Company)**  
**Consolidated Balance Sheets**  
**As of December 31, 2005 and 2004**

**Currency - US\$ thousands**

		December 31:	
	<u>Notes</u>	<u>2005</u>	<u>2004</u>
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	3	\$ 305,247	\$ 1,140,304
Loans receivable	4	106,442	31,129
Accounts receivable, net (less allowance for doubtful accounts of \$47,366 and \$75,666, respectively)	5	2,302,100	1,751,635
Inventories	6	436,584	292,190
Prepaid expenses		82,787	18,858
Deferred income tax assets	18	22,980	-
Total current assets		<u>3,256,140</u>	<u>3,234,116</u>
Long-term investments	7	2,421,911	2,219,507
Oil and gas properties, net	8	3,809,516	3,927,136
Property, plant and equipment, net	9	744,626	691,251
Construction-in-progress	10	255,635	181,250
Other non-current assets		151,738	9,581
Total assets		<u>\$ 10,639,566</u>	<u>\$ 10,262,841</u>
<b>Liabilities and shareholders' equity</b>			
Current liabilities:			
Short-term loans	11	\$ 120,183	\$ 35,480
Accounts payable and accrued liabilities	12	426,259	537,108
Related party payable	12, 20	19,662	163,909
Income and other taxes payable	13	510,960	578,402
Other current liabilities		36,565	64,746
Current portion of long -term debt	15	280,679	344,566
Total current liabilities		<u>1,394,308</u>	<u>1,724,211</u>
Dividends payable		75,129	1,045
Asset retirement obligation	14	260,983	284,023
Long-term debt	15	1,155,066	1,068,197
Deferred income tax liabilities	18	98,192	-
Total liabilities		<u>2,983,678</u>	<u>3,077,476</u>
Commitment and contingencies	19		
Shareholders' equity:			
Common stock (authorized and issued: 4,741,299,639 shares, 0.0016 Ruble par value)	16	1,619	1,619
Additional paid -in capital		858,987	858,987
Reserves	2	1,867,449	1,867,449
Retained earnings		4,927,833	4,457,310
Total shareholders' equity		<u>7,655,888</u>	<u>7,185,365</u>
Total liabilities and shareholders' equity		<u>\$ 10,639,566</u>	<u>\$ 10,262,841</u>

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

**OAQ Gazprom Neft (formerly OAQ Siberian Oil Company)**  
**Consolidated Statement of Income and Comprehensive Income**  
**For the years ended December 31, 2005 and 2004**

Currency - US\$ thousands

	<u>Notes</u>	<u>2005</u>	<u>2004</u>
<b>Revenues</b>			
Refined products and oil and gas sales	21	14,332,133	8,795,845
Other		253,181	90,653
Total		<u>14,585,314</u>	<u>8,886,498</u>
<b>Costs and other deductions</b>			
Operating expenses		3,813,577	1,926,955
Selling, general and administrative expenses		1,547,185	1,368,026
Depreciation and amortization		1,018,433	602,661
Taxes other than income taxes		5,034,010	2,314,482
Cost of other sales		129,561	35,224
Total		<u>11,542,766</u>	<u>6,247,348</u>
Operating income		<u>3,042,548</u>	<u>2,639,150</u>
<b>Other income / (expense)</b>			
Income from equity affiliates	7	782,248	655,449
Loss from equity investments write off		(26,309)	(27,340)
Interest income		32,738	9,175
Interest expense		(119,164)	(114,844)
Other expenses, net		(28,400)	(249,546)
Foreign exchange gain, net		2,335	8,249
Total		<u>643,448</u>	<u>281,143</u>
<b>Income before provision for income taxes</b>		3,685,996	2,920,293
Income tax expense	18	881,050	874,686
<b>Net income</b>		2,804,946	2,045,607
Other comprehensive loss, net		-	2,238
<b>Total comprehensive income</b>		<u><u>2,804,946</u></u>	<u><u>2,047,845</u></u>
Basic and Diluted Earnings per Common Share (US\$ per share)		0.5916	0.4314
Weighted-average number of common shares outstanding (millions)		<u>4,741</u>	<u>4,741</u>

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

**OAQ Gazprom Neft (formerly OAO Siberian Oil Company)  
Consolidated Statement of Changes in Shareholders' Equity  
For the years ended December 31, 2005 and 2004**

**Currency - US\$ thousands**

	<u>Common</u> <u>Stock</u>	<u>Additional</u> <u>Paid-in Capital</u>	<u>Reserves</u>	<u>Retained</u> <u>Earnings</u>	<u>Accumulated</u> <u>Other</u> <u>Comprehensive</u> <u>Loss</u>	<u>Total</u> <u>Shareholders'</u> <u>Equity</u>
Balance at December 31, 2003	\$ 1,619	\$ 858,987	\$ 1,867,449	\$ 2,411,703	\$ (2,238)	5,137,520
Net income for the year	-	-	-	2,045,607	-	2,045,607
Common stock dividends	-	-	-	-	-	-
Other comprehensive loss, net	-	-	-	-	2,238	2,238
Balance at December 31, 2004	1,619	858,987	1,867,449	4,457,310	-	7,185,365
Net income for the year	-	-	-	2,804,946	-	2,804,946
Common stock dividends	-	-	-	(2,334,423)	-	(2,334,423)
Other comprehensive income/(loss)	-	-	-	-	-	-
Balance at December 31, 2005	\$ 1,619	\$ 858,987	\$ 1,867,449	\$ 4,927,833	-	7,655,888

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

**OAQ Gazprom Neft (formerly OAO Siberian Oil Company)**  
**Consolidated Statement of Cash Flow**  
**For the years ended December 31, 2005 and 2004**

**Currency - US\$ thousands**

	<u>2005</u>	<u>2004</u>
<b><i>Operating activities</i></b>		
Net income	\$ 2,804,946	\$ 2,045,607
Reconciliation of net income to net cash provided by operating activities:		
Accrued equity accounting income, net of dividends received	(191,183)	(258,537)
Depreciation, depletion and amortization	1,018,433	602,661
Asset retirement obligation accretion expenses	22,462	15,452
Loss on disposal of property, plant and equipment	29,654	2,256
Loss/(gain) on investments write off	26,309	27,340
Changes in assets and liabilities, excluding cash and debt:		
Accounts receivable	(522,165)	(426,455)
Provision for doubtful accounts	(28,300)	(3,773)
Inventories	(144,394)	(4,987)
Prepaid expenses	(63,929)	7,670
Other non-current assets	(165,138)	(4,602)
Accounts payable and accrued liabilities	(255,096)	(145,887)
Income and other taxes payable	(67,442)	389,425
Other current liabilities	(46,009)	(36,557)
Net cash provided by operating activities	<u>2,418,148</u>	<u>2,209,613</u>
<b><i>Investing activities</i></b>		
Investments made	(35,519)	(67,089)
Loans (issued to)/settled by the third parties, net	(75,313)	12,580
Proceeds from disposals of property, plant and equipment	26,314	2,395
Capital expenditures	(1,016,033)	(889,058)
Net cash used in investing activities	<u>(1,100,551)</u>	<u>(941,172)</u>
<b><i>Financing activities</i></b>		
Short- and long-term loans proceeds received	863,848	326,415
Short- and long-term loans repaid	(756,163)	(467,484)
Dividends paid	(2,260,339)	(91,662)
Net cash used in financing activities	<u>(2,152,654)</u>	<u>(232,731)</u>
Increase/(decrease) in cash and equivalents	(835,057)	1,035,710
Cash and equivalents at beginning of year	1,140,304	104,594
Cash and equivalents at end of the period	<u>\$ 305,247</u>	<u>\$ 1,140,304</u>
<b><i>Supplemental disclosures of cash flow information</i></b>		
Cash paid for interest (net of amount capitalized)	\$ 128,545	\$ 123,468
Cash paid for income taxes	\$ 1,124,423	\$ 815,667

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

**AO Gazprom Neft (formerly OAO Siberian Oil Company)**  
**Notes to the Consolidated Financial Statements**  
**December 31, 2005 and 2004**

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**1. General**

Description of Business

AO Gazprom Neft (formerly OAO Siberian Oil Company) and its subsidiaries (the "Company") is a vertically integrated Russian oil company. Its principal activities concern oil and gas exploration, production, refining and marketing.

AO 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 September and October 2005, AO Gazprom acquired a 75.68% stake in Sibneft, becoming a subsidiary of AO Gazprom. On May 30, 2006 Sibneft was renamed into "AO Gazprom Neft".

There are four principal subsidiaries within the Company: Noyabrskneftegaz ("Noyabrsk"), Omsk Refinery ("OR"), Noyabrskneftegasgeophysica ("Geofizika") and Omsknefteprodukt ("Nefteprodukt").

Noyabrsk is primarily engaged in the exploration, production and development of oil and gas from its fields in the south Yamalo-Nentsk autonomous region and the northern part of the Khanti-Mansisk autonomous region. OR's principal activity is the production of refined petroleum products at its refinery in Omsk, Western Siberia. Nefteprodukt carries out marketing operations through its retail outlets in the Omsk region. Geofizika provides exploration and technical services in the Noyabrsk region.

Since 2001, all export trade has been consolidated through a wholly owned subsidiary - Siboil Ltd, and In January 2005 the Company registered new subsidiary Sibneft Oil Trade Company GmbH in Austria proclaiming this entity to be the agent for the Company's export sales.

Under Russian legislation, natural resources, including oil, gas, precious metals and minerals and other commercial minerals situated within the territory of the Russian Federation are the property of the State. The Law of the Russian Federation No. 2395-1, "On Subsurface Resources", regulates relations arising in connection with the geological study, use and protection of subsurface resources within the territory of the Russian Federation. Pursuant to the Law, subsurface resources may be developed only on the basis of a license. The license is issued by the regional governmental body and contains information on the site to be developed, the period of activity, financial and other conditions. The Company holds multiple licenses issued by Regional authorities in areas where its subsidiaries are located.

The Company sells its crude oil under general rules of export quotation applicable for all Russian oil producers. Under the general rules the export quotas for Transneft pipeline system are defined and approved by the Energy Commission of the Russian Government based on the legislation on equal access to the oil pipeline system. In 2005 and 2004 the Company's export sales have approximated 50% and 40% of production, respectively. The remaining production was processed at the Company's refineries and other Russian refineries for further sales on the domestic and international markets.

Russian Business Environment

The Russian economy while deemed to be of market status continues to display certain traits consistent with that of a market in transition. These characteristics have included high inflation, lack of liquidity in the capital markets and the existence of currency controls, which cause the national currency to be illiquid outside of Russia. In addition law and regulations, including interpretations, enforcement and judicial processes, continue to evolve in Russia. Among many elements of legal rights, obligations and restrictions: matters pertaining to mineral rights, environmental protection, property abandonment, transportation and exportation, corporate governance, taxation and others continue to have a significant influence on the Company's industry. The continued success and stability of the Russian business environment will be significantly impacted by the government's continued actions with regard to supervisory, legal, and economic reforms.

**OAQ Gazprom Neft (formerly OAO Siberian Oil Company)**  
**Notes to the Consolidated Financial Statements**  
**December 31, 2005 and 2004**

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

Currency Exchange and Control

Foreign currencies, in particular the US dollar and Euro, play a significant role in the underlying economics of many business transactions in Russia. For the oil and gas sector in particular, substantial export arrangements as well as investing and financing activities are conducted in hard currencies such as the US dollar.

The Central Bank of Russia has established strict currency control regulations for managing Ruble supply and demand and available hard currencies. Such regulations place restrictions on the conversion of Rubles into hard currencies and establish requirements for conversion of hard currency sales to Rubles. While in recent years conversion requirements have been reduced, such matters continue to be a substantial consideration for many companies in managing currency risks.

The Company conducts a substantial portion of its commercial activities using US dollar denominated contracts. In addition, substantial financing and investing activities, obligations and commitments are also based on the US dollar. However, many operating and investing expenditures, as well as taxation and statutory actions are conducted in Rubles. As a result of this and currency controls, the Company's principal currency risk relates to the fluctuations of US dollars to Rubles, as well as maintaining hard currency to pay its US dollar denominated obligations. The Company attempts to manage these risks through maintaining certain levels of product exports and is contractually obligated to do so under certain of its financing agreements.

**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 the Russian legislation. The accompanying consolidated financial statements were derived from the Company's Russian 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 Company uses US dollar as its reporting currency.

Principles of Consolidation and Long-term Investments

The consolidated financial statements of the Company include the accounts of all majority owned subsidiaries where no minority shareholder or group of minority shareholders exercise substantive participating rights. Investments in companies 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 and losses from these companies is included in the consolidated income statement as income from equity affiliates. All other investments in equity securities are recorded at cost. As further discussed in Note 7, the Company has interests in various Russian legal entities, which are accounted for using the cost method. Intercompany profits, transactions and balances have been eliminated in consolidation.

The Company is subject to the full provisions of Financial Interpretation ("FIN") No. 46 "Consolidation of Variable Interest Entities" and FASB Staff Position FIN 46(R)-5, "Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities" ("FSP FIN 46(R)-5"). The Company evaluates its investments and business relationships and consolidates those identified variable interest entities for which the Company is determined to be the primary beneficiary.

**OAQ Gazprom Neft (formerly OAQ Siberian Oil Company)**  
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An assessment of impairment is done annually, or whenever events or circumstances indicate that the investment may be impaired, and a provision is made, if required, to recognize a decline other than temporary in the value of the investments. The amount of the impairment is based on quoted market prices, where available or other valuation techniques, including discounted cash flows. An impairment loss creates a new cost basis and reversal is prohibited.

Reserves and Retained Earnings

Reserves represent the Company's net asset position, excluding common stock at the time of the Company's formation in 1995. Retained earnings represent all cumulative net profit subsequent to formation.

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 lives of long-term assets and investments; provisions for uncollectible accounts receivable; asset retirement obligations; legal and tax contingencies; environmental remediation obligations; recognition and disclosure of guarantees and other commitments. Management believes it has a reasonable and appropriate basis for its judgment pertaining to its estimates and assumptions. However, actual results could differ from those estimates.

Foreign Currency Translation

The functional currency of the Company is the US dollar because the majority of its revenues, costs, property and equipment purchased, debt and trade liabilities are either priced, incurred, payable or otherwise measured in US dollars.

Since the Company's books of record are maintained in Rubles, it must remeasure those balances under SFAS 52. Monetary assets and liabilities have been translated into US dollars at the exchange rate at balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Data on revenues, expenses, and cash flows are translated into US dollars at historical exchange rates prevailing on the transactions dates. Gains and losses resulting from the remeasurement into US dollars are included in the consolidated statement of income.

As of December 31, 2005 and 2004, the official rates of exchange were 28.7825 Rubles = US\$ 1 and 27.7487 Rubles = US\$1, respectively.

Future movements in the exchange rates between the Ruble and the US dollar will affect the carrying value of the Company's Ruble denominated monetary assets and liabilities. Such movements may also affect the Company's ability to realize non-monetary assets represented in US dollars in these consolidated financial statements. Any translation of Ruble amounts to US dollars should not be construed as a representation that such Ruble 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

The Company classifies as cash and cash equivalents, amounts on deposit in banks, letters of credit and all highly liquid investments with original maturities of three months or less from the date of purchase.

Trade Receivables

Trade receivables are presented at net realizable value. Allowances are provided for estimated 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. The past due status of receivable is determined based on contractual obligations. Changes in allowances for uncollectible amounts are recorded in income within selling, general and administrative expenses.

**OAQ Gazprom Neft (formerly OAQ Siberian Oil Company)**  
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**December 31, 2005 and 2004**

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VAT Receivable

Value added tax ("VAT") paid in connection with the export of crude oil and oil products relates to exempt activities and is eligible for refunds upon completion of each transaction. VAT paid in connection with capital construction is recoverable upon capital construction completion and placing such assets into operation.

Loans Receivable

Loans receivables are presented at net realizable value. Allowances are provided for estimated losses. Estimation is made based on past history of settlements with the borrower and existing economic conditions. The past due status of a receivable is determined based on contractual obligations. Interest income is accrued when it is due and recorded as a part of interest received and other income.

Inventories

Inventories of crude oil, refined oil products, materials and supplies, and finished goods are valued at the lower of cost or net realizable value. For inventories valued at cost, the Company uses the weighted-average-cost method. Costs include both direct and indirect expenditures incurred in bringing an item or product to its existing condition and location, but not unusual/non-recurring costs or research and development costs.

Oil and Gas Properties

The Company follows the successful efforts method of accounting for its oil and gas exploration and production activities.

Lease acquisition costs related to properties held for oil and gas production are capitalized when incurred. Unproved properties with acquisition costs, which are individually significant, are assessed on a property-by-property basis, and a loss is recognized, by provision of a valuation allowance, when the assessment indicates impairment in value.

Exploratory costs, excluding the costs of exploratory wells, are charged to expenses as incurred. Costs of drilling exploratory wells, including stratigraphic test wells, are capitalized pending determination whether such wells have found proved reserves, which justify commercial development. If such reserves are not found, the drilling costs are charged to exploratory expenses. Intangible drilling costs applicable to productive wells and to development dry holes, as well as tangible equipment costs and costs of injection wells related to development of oil and gas reserves are capitalized.

Russian financial information is maintained in historic Ruble terms. However, the US dollar historic cost of oil and gas properties in the accompanying consolidated balance sheets were obtained using the same methodology applied to property, plant and equipment, as discussed below in "Property, Plant and Equipment".

Property, Plant and Equipment

As discussed above, Russian financial information is maintained in historic Ruble terms. In years prior to 1992, exchange rates were fixed by the government and did not necessarily correspond to the real market value of the Ruble. In addition, certain purchases were made through central purchasing authorities and values transferred to receiving organizations were determined by the government. During 1992, fixed assets were revalued in accordance with Government Decree Number 595 dated August 14, 1992. Similar revaluations took place as of January 1, 1994, January 1, 1997 and January 1, 1998. Indexes used for these revaluations did not necessarily reflect the changes in the Ruble's value, nor did they result in the value of the underlying fixed assets to which they were applied being revalued to a current market value.

**OAQ Gazprom Neft (formerly OAQ Siberian Oil Company)**  
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As a result, it was not possible to determine from the statutory accounting records an appropriate carrying value of property, plant and equipment for US GAAP reporting purposes. Accordingly, an independent appraisal company, American Appraisal (AAR) Inc., was engaged to perform an historic cost valuation of property, plant and equipment, together with related accumulated depreciation as of December 31, 1996.

In performing a valuation of property, plant and equipment, the independent appraisal company employed appraisal techniques to determine both the historic cost and fair market value (in-use) for the appraised property in US dollar terms. The first step in estimating the historic cost and fair market value of the fixed assets entailed estimating the cost new, which is either cost of reproduction new ("CRN") or, where CRN data was not available due to technical and/or design changes, the cost of replacement ("COR"). The CRN reflects the cost to reproduce the existing property in like kind while the COR reflects the cost to replace the existing property using current technology and materials. Cost data from both Russian and foreign producers of equipment was taken into account.

To arrive at an appropriate estimate of original historic cost, the CRN/COR was back-trended according to the actual age of the asset using historic western inflation adjustments. The historic cost of the assets was then depreciated using estimates of economic useful lives as outlined in "Depreciation, Depletion and Amortization" below.

The results of this work were used to determine the carrying values of property, plant and equipment for US GAAP purposes as of December 31, 1996. Since that date, disposals of property, plant and equipment have been accounted for at their historic cost while additions to property, plant and equipment have been recorded at cost using exchange rates as of the transaction dates.

The cost of maintenance, repairs, and replacement of minor items of property is charged to operating 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 included in the determination of net income.

Depreciation, Depletion and Amortization

Depreciation, depletion and amortization of oil and gas properties are provided on the unit-of-production method based on the ratio of current year production to total estimated future production from proved developed reserves.

The provision for depreciation and amortization with respect to operations other than oil and gas producing activities is computed using the straight-line method based on estimated economic lives. Composite 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 land improvements	8-35 years
Machinery and equipment (including refinery assets)	8-30 years
Vehicles and other	3-10 years

Impairment of Long-lived Assets

Long-lived assets, including proved oil and gas properties at a field level, are assessed for possible impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Property, plant and equipment used in operations are assessed for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recovered. If the carrying amounts are not expected to be recovered by undiscounted pretax future cash flows, the assets are impaired and an impairment loss is recorded in the amount by which the asset's carrying value exceeds its fair value.

**OAQ Gazprom Neft (formerly OAO Siberian Oil Company)**  
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The recoverability of refining, marketing and distribution assets are generally evaluated based on the evaluation of cash flows on the basis of key operating unit, generally legal entities. Because the assets of this segment (particularly the refining units) are largely an integrated set of operations, recognition of this condition is considered in evaluating a particular unit's value or utilization to generating other cash flows. No impairment has been recognized for the years ended December 31, 2005 and 2004.

Maintenance and Repair

Maintenance and repairs, which are not significant improvements, are expensed when incurred.

Capitalized Interest

Interest is capitalized on expenditures made in connection with capital projects (exclusive of oil and gas properties) that, theoretically, could have been avoided if expenditures for the assets had not been made. Interest is only capitalized for the period that activities are in progress to bring these projects to their intended use. During 2005 and 2004, interest capitalized related to capital projects amounted to US\$ 12.6 million and US\$ 9.7 million, respectively.

Minority Interest in Subsidiary Companies

Minority interest in the consolidated balance sheets reflects minority owners' percent share of shareholders' capital in subsidiaries. The minority interest is calculated based on the shareholders' equity of each subsidiary as determined under US GAAP. The actual Ruble denominated balance attributable to minority interests may differ from this amount.

Minority owners' interest in the Company's subsidiaries is as follows:

	<u>December 31, 2005</u>		<u>December 31, 2004</u>	
	<u>Voting</u>	<u>Total</u>	<u>Voting</u>	<u>Total</u>
Geofizika	19%	19%	19%	19%
Meretoyahaneftegas	33%	33%	33%	33%
Sibneft-Ugra	1%	1%	1%	1%

Income Taxes

The Company is not subject to taxation on a consolidated basis. Current income taxes are provided on the accounting profit as determined under the local accounting principles at a rate of 24%, as of December 31, 2005 and 2004, after adjustments for certain items which are not deductible for taxation purposes, and after consideration of different tax credits.

Deferred income taxes are determined using the asset and liability approach in accordance with SFAS No. 109, "Accounting for Income Taxes". This method gives consideration to the future tax consequences based on the enacted tax rate associated with differences between the financial reporting and tax basis of assets and liabilities. A valuation allowance is recorded to reduce deferred tax assets when management believes it is more likely than not that a tax benefit will not be realized.

Comprehensive Income

SFAS No. 130, "Reporting Comprehensive Income", defines standards for the reporting and display of comprehensive income (net income plus all other changes in net assets from non-owner sources) and its components in financial statements.

During 2004 the Company used derivative instruments qualified as cash flow hedges to reduce risk associated with the volatility of crude oil and petroleum products world prices. The Company does not enter into derivative transactions for speculative or trading purposes.

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These instruments are intended to compensate for the difference between fixed price at the moment when the instruments are sold and actual selling price at the moment when physical quantities are shipped.

All instruments were settled before December 31, 2004 and the unrecognized loss of US\$ 2.2 million accumulated other comprehensive income was recognized in income during 2004. The Company has no outstanding derivatives at December 31, 2005.

Earnings per Share

Basic and diluted earnings per common share have been determined by dividing the available income to common shareholders by the weighted average number of shares outstanding during the year. There are no potentially dilutive securities.

Accounting for Contingencies

Certain conditions may exist as of the date these financial statements are issued, which may result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company's management and legal counsel assess such contingent liabilities. The assessment of loss contingencies necessarily involves an exercise of judgment and is a matter of opinion. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the 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 would be accrued in the Company's financial statements. If the assessment indicates that a potentially material loss contingency 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 if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed. However, in some instances in which disclosure is not otherwise required, the Company may disclose contingent liabilities of an unusual nature which, in the judgment of management and its legal counsel, may be of interest to shareholders or others.

Recognition of Revenues

Revenues from the production and sale of crude oil, petroleum and chemical products 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 and utilities and are recognised 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.

Revenues are stated net of VAT and excises on the oil products.

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Transportation Costs

The Company incurred US\$ 963 million and US\$ 783 million on delivering of crude oil and refined products to its customers for the years ended December 31, 2005 and 2004, respectively. Shipping and handling costs are included within selling, general and administrative expenses in the consolidated statements of income and comprehensive income.

Retirement and Other Benefit Obligations

The Company and its subsidiaries do not have any substantial pension arrangements separate from the State pension scheme of the Russian Federation, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such contributions are charged to expense as incurred. In addition, the Company has no post-retirement benefits or significant other compensated benefits requiring accrual.

Recent Accounting Standards

**Accounting changes:** In March 2005, the Financial Accounting Standards Board (“FASB”) issued FIN No. 47, Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143. This interpretation clarifies that an entity is required to recognize a liability for a legal obligation to perform asset retirement activities when the retirement is conditional on a future event if the liability’s fair value can be reasonably estimated. If the liability’s fair value cannot be reasonably estimated, then the entity must disclose (1) a description of the obligation, (2) the fact that a liability has not been recognized because the fair value cannot be reasonably estimated, and (3) the reasons why the fair value cannot be reasonably estimated. FIN No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The adoption of this standard as of 31 December 2005 did not have a material impact on the Company’s financial statements.

**Inventory costs:** In November 2004, FASB Statement No. 151, “Inventory Costs”, an Amendment of ARB No. 43, (SFAS 151) was issued and became effective for the Company on 1 January 2006. The standard amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and spoilage. In addition, the standard requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of this standard will not have a material effect of the Company's results of operations, financial position or liquidity.

**Suspended Well Costs:** In April 2005, the FASB issued FASB Staff Position (“FSP”) No. FAS 19-1, Accounting for Suspended Well Costs, which amended the guidance for suspended exploratory well costs in SFAS No. 19, Financial Accounting and Reporting by Oil and Gas Producing Companies. SFAS No. 19 requires costs of drilling exploratory wells be capitalized pending determination of whether the well has found proved reserves. When a classification of proved reserves cannot yet be made, FSP No. FAS 19-1 allows exploratory well costs to continue to be capitalized when (1) the well has found a sufficient quantity of reserves to justify its completion as a producing well and (2) the enterprise is making sufficient progress assessing the reserves and the economic and operating viability of the project. FSP No. FAS 19-1 also requires provision of certain disclosures regarding capitalized exploratory well costs. FSP No. FAS 19-1 is effective for the year ended 31 December 2006. Management expects that the adoption of this pronouncement will not have a material impact on the Company's results of operations, financial position or liquidity.

**Exchanges of Non-monetary Assets:** In December 2004, the FASB issued SFAS No. 153, “Exchanges of Non-monetary Assets”. This Statement amends APB Opinion 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. The Statement specifies that a non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change. The provisions of SFAS 153 are effective for financial statements for fiscal years beginning after

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June 15, 2005. The adoption of the provisions of SFAS 153 is not expected to have a material impact on the Company's results of operations, financial position or cash flow.

**Accounting changes and error correction:** In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." SFAS No. 154 requires companies to recognize (1) voluntary changes in accounting principles and (2) changes required by a new accounting pronouncement, when the pronouncement does not include specific transition provisions, retrospectively to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of the provisions of SFAS No. 154 is not expected to have a material impact on the Company's results of operations, financial position or cash flow.

**Reclassifications**

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

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**3. Cash and Cash Equivalents**

Cash and cash equivalents as of December 31, comprise the following (in US\$ thousands):

	<u>2005</u>	<u>2004</u>
Cash in bank – Rubles	145,731	439,005
Cash in bank – foreign currency	137,401	342,670
Bank deposits	21,455	358,108
Cash on hand	660	521
Total cash and cash equivalents	<u><u>305,247</u></u>	<u><u>1,140,304</u></u>

Bank deposits represent cash deposited in major western banks for a period less than three months of US\$ 21 million bearing a weighted average interest rate of 4% per annum on US dollars deposit.

The majority of foreign currency cash in bank is represented by US dollars.

**4. Loans Receivable**

The Company provided Ruble loans to third parties at a maturity of one month to one year and bearing no interest as of December 31, 2005 and 2004.

The fair values of loans provided are approximately equal to their carrying value in the consolidated financial statements.

**5. Accounts Receivable**

The composition of accounts receivable is as follows as of December 31, (in US\$ thousands):

	<u>2005</u>	<u>2004</u>
Trade receivables	737,308	815,742
Advances paid to suppliers	433,976	364,982
Value added tax receivable	858,210	545,580
Other	319,972	100,997
Less allowance for doubtful accounts	(47,366)	(75,666)
Total accounts receivable	<u><u>2,302,100</u></u>	<u><u>1,751,635</u></u>

Trade receivables are represented by amounts due from regular customers in the ordinary course of business and are short-term in nature.

Management has provided a specific allowance on amounts due from commercial and industrial customers principally based on the overall delinquency in customer payments. The Company's trade receivables are denominated primarily in US dollars and are short-term in nature.

## 6. Inventories

The following are the major components of inventory as of December 31, (in US\$ thousands):

	2005	2004
Crude oil	46,381	36,201
Petroleum products	150,308	64,303
Materials and supplies	182,842	166,568
Other	57,053	25,118
Total inventories	436,584	292,190

## 7. Long-Term Investments

None of the companies listed below are publicly traded in Russia and due to the nature of the financial markets it is not possible to obtain a current market price for these investments. However, management believes that the costs of these investments approximate their fair values. The significant equity and other long-term investments are summarized below as of December 31, 2005 and 2004 (in US\$ thousands):

	2005	2004
Investments in Russian companies		
Investments in associated undertakings		
- Oil and gas producing	1,971,251	1,767,695
- Refining	300,199	295,535
- Marketing	56,018	56,018
Total associated undertakings	2,327,468	2,119,248
Other equity investments carried at cost		
- Marketing	56,781	77,792
- Other	37,662	22,467
Total long-term investments	2,421,911	2,219,507

Investments in oil and gas producing associated companies, as of December 31, 2005 represent a 49.852% interest in AO NGK Slavneft and various minority stakes in Slavneft' subsidiaries held through investment trust arrangement (49.716% in 2004). In October 2005 the Company bought additional stock of Slavneft's share equals to a 0.136% of US\$ 16 million. During 2005 the Company and TNK-BP agreed to jointly manage the refineries of Slavneft group and work out the split of production flows.

The purchase cost of these investments is US\$ 1,278 million (US\$ 1,262 million in 2004). Based on consolidated financial statements and management estimates the Company's share of Slavneft's earnings for 2005 amounted to US\$ 778 million (US\$ 654 million for 2004 earnings) and is reflected in income from equity affiliates. During 2005 Slavneft announced and paid to the Company US\$ 591 million of dividends (US\$ 397 million in 2004).

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The following table represents the Company's proportional interest in the summarized financial information of Slavneft based on consolidated financial statements:

	2005	2004
Total assets	2,744,696	2,597,388
Total liabilities	845,627	826,044
Net Income	777,542	654,177

Investments in refining represent a 38.8% voting interest in Moscow Oil Refining Plant (MNPZ). The purchase cost of these investments is US\$ 280 million as of December 31, 2005 and 2004. Based on financial statements and management estimates the Company's share of MNPZ's earnings for 2005 amounted to US\$ 4.7 million (US\$ 2.1 million in 2004) and is reflected in income from equity affiliates. During 2004 MNPZ announced and paid to the Company US\$ 0.9 million of dividends.

The following table represents the Company's proportional interest in the summarized financial information of MNPZ based on statutory translated financial statements:

	2005	2004
Total assets	166,910	125,847
Total liabilities	56,531	20,132
Net Income	4,663	2,127

Investments in marketing companies include various wholesale and retail distribution companies. The Company holds a 27.4% voting interest (27.4% in 2004) in OAO Mosnefteproduct carried at cost of US\$ 56 million, as of December 31, 2005 and 2004.

## **8. Oil and Gas Properties**

Oil and gas properties as of December 31, are as follows (in US\$ thousands):

	2005	2004
Oil and gas properties	9,695,022	9,148,407
Less: Depreciation, depletion and amortization	(5,885,506)	(5,221,271)
Total oil and gas properties, net	3,809,516	3,927,136

The Company's oil and gas fields and related hydrocarbons belong to government authorities. The Company obtains licenses from such government authorities and pays royalties to explore and produce from these fields. These licenses expire between 2013 and 2050. During 2005 management was successful in extending several licences and believes the remaining licences may be extended at the initiative of the Company and management intends to extend such licenses for properties expected to produce subsequent to their original license expiry dates.

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**9. Property, Plant and Equipment**

Property, plant and equipment as of December 31, is as follows (in US\$ thousands):

	2005	2004
Buildings	2,729,568	1,800,898
Machinery and equipment	1,127,461	1,587,204
Vehicles and other equipment	71,715	94,714
	<u>3,928,744</u>	<u>3,482,816</u>
Less: Accumulated depreciation	<u>(3,184,118)</u>	<u>(2,791,565)</u>
Total property, plant and equipment, net	<u><u>744,626</u></u>	<u><u>691,251</u></u>

**10. Construction-in-Progress**

Construction-in-progress includes various construction projects and machinery and equipment delivered but not yet installed. As of December 31, 2005, detail of construction in progress is as follows (in US\$ thousands):

	Construction Work in Progress	Machinery/ Equipment To be installed	Total
Buildings	84,453	-	84,453
Plant and machinery	92,184	-	92,184
Vehicles and other equipment	49,838	29,160	78,998
Total	<u>226,475</u>	<u>29,160</u>	<u>255,635</u>
Comparative balance at December 31, 2004	<u><u>133,602</u></u>	<u><u>47,648</u></u>	<u><u>181,250</u></u>

**11. Short-Term Loans**

As of December 31, the Company had short-term loans outstanding as follows (in US\$ thousands):

	2005	2004
Banks	105,861	20,000
Related parties	46	1,384
Other	14,276	14,096
Total	<u>120,183</u>	<u>35,480</u>

Bank loans are comprised of (1) export financing loan facilities in US dollars from major western banks and their affiliates, secured by Noyabrsk crude production and (2) unsecured loans from Russian banks, denominated in US dollars and Rubles with fixed terms of repayment.

In general, short-term loans are used for the provision of working capital needs. As of December 31, 2005 more than 50% of the loans were provided in US dollars.

At December 31, 2005 the Company has a US\$ 20 million unsecured loan outstanding from Citibank. The loan bears interest of 5.39%.

At December 31, 2005 the Company has a US\$ 40 million secured loan outstanding from Raiffeisenbank. The loan bears a floating interest at rate of LIBOR plus 1.65%.

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At December 31, 2005 the Company has an unsecured loan from Gazprombank repayable in Rubles amounting to US\$ 46 million. The loan bears an interest at rate of 8%.

Other short-term loans were represented by a number of Ruble denominated non-banking borrowings totaling US\$ 14 million bearing no interest.

Weighted average interest rates related to the short-term loans outstanding as of December 31, 2005 for US dollar and Ruble denominated loans equal 5.82% and 6.20%, respectively. During the year ended December 31, 2005, the weighted average US dollar and Ruble denominated short-term debt balances outstanding were US\$ 35 million and US\$ 17 million, respectively, with weighted average interest rates of 5 and 1 percent, respectively. During the year ended December 31, 2004, the weighted average US dollar and Ruble denominated short-term debt balances outstanding were US\$ 84 million and US\$ 15 million, respectively, with weighted average interest rates of 4 and 1 percent, respectively.

**12. Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities as of December 31, 2005, comprise the following (in US\$ thousands):

	2005	2004
Trade accounts payable	394,386	511,182
Related party accounts payable	19,662	163,909
Other accounts payable	31,873	25,926
Total accounts payable	<u>445,921</u>	<u>701,017</u>

**13. Income and Other Taxes**

Income and other taxes payable comprise the following, as of December 31 (in US\$ thousands):

	2005	2004
Value added tax	288,337	312,655
Mineral extraction tax	182,200	141,291
Property tax	11,701	10,311
Excise tax	10,063	6,104
Income tax	6,291	96,245
Other	12,368	11,796
Total income and other taxes payable	<u>510,960</u>	<u>578,402</u>

The Russian government has recently revised the Russian tax system. The new tax system is intended to reduce the number of taxes and the overall tax burden on businesses and to simplify the tax laws. However, the revised tax system relies heavily on the judgments of local tax officials and fails to address many of the existing problems. Even in the event of further reforms to tax legislation, they may not result in a reduction of the tax burden on Russian companies and the establishment of a more efficient tax system. Conversely, they may introduce additional tax collection measures. Accordingly, the Company may have to pay significantly higher taxes, which could have a material adverse effect on its business.

#### **14. Asset Retirement Obligation**

According to Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"), the Company has potential asset retirement obligations associated with the conduct of its business activities. The accounting standard applies to legal obligations associated with the retirement of tangible long-lived assets. SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Subsequently, the liability is accreted for the passage of time and the related asset is depreciated over its estimated useful life. The nature of the assets and potential obligations are as follows:

##### Exploration and Production

The Company's field exploration, development, and production activities include assets related to: well bores and related equipment and operating sites, gathering and oil processing systems, oil storage and pipelines to main transportation trunks. Generally, its licenses and other operating permits require certain actions to be taken by the Company in the abandonment of these operations after the end of production. Such actions include well abandonment activities, equipment dismantlement and other reclamation activities. The Company's estimates of future abandonment costs consider present regulatory or license requirements and are based upon management's experience of the costs and requirement of such activities.

Management believes that present regulatory and permitting activities do not stipulate an obligation associated with abandoning of gathering and oil processing systems, oil storage and pipelines to main transportation trunks. As a result, the Company believes that it does not have clear or definitive legal or contractual obligations associated with activities to retire or otherwise abandon those assets.

##### Refining, Marketing and Distribution

This business segment covers refining operations and retail networks. The Company's refining operations consist of major industrial complexes. These industrial complexes have been in operation for several decades. Because of the nature of the operation of these complexes, management believes that these industrial complexes have indeterminable lives, while certain operating components and equipment have definite lives.

Management believes that present regulatory and permitting activities do not stipulate an obligation associated with abandoning these industrial complexes. As a result, the Company believes that it does not have clear or definitive legal or contractual obligations associated with activities to retire or otherwise abandon those assets.

Inasmuch as the regulatory and legal environment in Russia continues to evolve, there could be future changes to the requirements and costs associated with abandoning long-lived assets.

The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. An entity measures changes in the liability for an asset retirement obligation due to passage of time by applying an interest method of allocation to the amount of the liability at the beginning of the period. The interest rate used to measure that change is the credit-adjusted risk-free rate that existed when the liability was initially measured. That amount is recognized as an increase in the carrying amount of the liability and as an expense classified as an operating item in the statement of income.

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The following summarizes the activity of the asset retirement obligations (in US\$ thousands)

	2005	2004
Beginning balance as of January 1,	284,023	193,297
Revision in the estimated cash flows	70,520	75,274
Amount spent in the current period	(116,022)	-
Accretion expense	22,462	15,452
Ending balance as of December 31,	<u>260,983</u>	<u>284,023</u>

**15. Long-Term Debt**

As of December 31, 2005, the Company had outstanding loans as follows (in US\$ thousands):

	2005	2004
Bank loans outstanding	487,763	465,258
Bonds	943,399	942,462
Other borrowings	4,583	5,043
Less current portion of long- term debt	(280,679)	(344,566)
Total long-term debt	<u>1,155,066</u>	<u>1,068,197</u>

Bank loans are comprised of loan facilities in US dollars from major western banks and their affiliates.

In general, long-term loans are used for the provision of capital expenditures and investment needs. The Company has secured bank loans outstanding as of December 31, 2005 from Citibank N.A., Raiffeisen Zentralbank Oesterreich (RZB), ABN-AMRO Bank N.V. and BNP Paribas S.A., and also two unsecured loans from Salomon Brothers. As of December 31, 2004 the Company had secured bank loans outstanding from Raiffeisen Zentralbank Oesterreich (RZB), Westdeutsche Landesbank Vostok (West LB), ABN-AMRO Bank N.V. and BNP Paribas S.A., and also two unsecured loans from Salomon Brothers.

In December 2002, the Company placed US\$ 500 million in 7-year Eurobonds on the Luxemburg Stock Exchange. The bonds bear interest of 10.75% per year. The bonds have a semi-annual coupon. Accrued interest for the bonds of US\$ 25.4 million is included in current portion of long-term debt (US\$ 24.8 million as of December 31, 2004).

In January 2002, the Company placed US\$ 250 million in 5-year Eurobonds on the Luxemburg Stock Exchange. The bonds bear interest of 11.5% per year. Subsequently, in March 2002, the Company extended the issue up to US\$ 400 million. All bonds have a semi-annual coupon. Accrued interest for the bonds of US\$ 18.0 million is accounted in current portion of long-term debt (US\$ 17.6 million as of December 31, 2004).

The Company has a US\$ 45.3 million (including a US\$ 45.3 million current portion) secured by Noyabrsk export proceeds loan from ABN AMRO Bank N.V. The loan is due July 2006 and bears floating interest at rates of LIBOR plus 1.40%.

The Company has a US\$ 110,5 million (including a US\$ 73.9 million current portion) secured loan from BNP Paribas S.A. maturing in June 2007, bearing floating interest at rates of LIBOR plus 3.0%. This loan is secured by Noyabrsk export proceeds. As of December 31, 2004 the Company had a US\$ 123.6 million (including a US\$ 13.1 million current portion) secured loan from BNP Paribas S.A. due June 2007, bearing floating interest at rates of LIBOR plus 3.0%.

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The Company has a US\$ 180.0 million (including a US\$ 80.1 million current portion) secured loan from RZB, bearing floating interest at rates of LIBOR plus 1.6%. This loan is secured by Noyabrsk export proceeds.

The Company has a US\$ 150.0 million (including a US\$ 37.6 million current portion) secured loan from Citibank, bearing floating interest at rates of LIBOR plus 1.0%. This loan is secured by Noyabrsk export proceeds.

At December 31, 2004 the Company had a US\$ 117.0 million (all current) secured loan from West LB. The loan bears floating interest at rates of LIBOR plus 2.15% and was fully repaid in December 2005.

At December 31, 2004 the Company had a US\$ 64.3 million (all current) secured loan from RZB. The loan bears floating interest at rates of LIBOR plus 3.25% and was fully repaid in December 2005.

Other borrowings represents a number of Ruble denominated unsecured borrowings from non-banking organizations totaling US\$ 5.0 million (including a US\$ 0.3 million current portion) with maturity dates from 2006 to 2011 bearing nil interest rate. As of December 31, 2004 other borrowings represented a number of Ruble denominated unsecured borrowings from non-banking organizations totaling US\$ 5.0 million (including a US\$ 0.6 million current portion) with maturity dates from 2006 to 2011 bearing nil interest rate.

The loan agreements contain covenants that require the Company's ratios of net sales to debt payments, EBITDA to total debt payments, and total exports to total US dollar-denominated debt to be within certain limits, and its total debt to total assets ratio to be no greater than 70%. Management believes the Company is in compliance with these covenants as of December 31, 2005.

Maturities of long-term - loans as of December 31, 2005 are as follows (in US\$ thousands):

<u>Year due</u>	<u>Amount due</u>
2006	280,679
2007	436,820
2008	215,140
2009	500,000
2010 and later	3,106
	<u>1,435,745</u>

## **16. Shareholders equity**

The Presidential Decree establishing Sibneft stated that the charter capital of the Company would be equal to 38 percent of the aggregate of the charter capitals of its four subsidiaries at the date of formation. The 38 percent of the aggregate of the Charter capitals of the four subsidiaries also gave the Company 51 percent of the voting common stock in each of the subsidiaries and represented the Government's ownership in these companies. This consolidation of the Government's ownership into one company established the share capital of Sibneft at 4,516,396,250 shares of 0.0016 Rubles each. On December 16, 1998 the Company issued additionally 224,903,389 shares of 0.0016 Rubles each. For the purposes of these financial statements, the Ruble value of the shares has been translated into US dollars at the historical exchange rate.

The shareholders' capital account represents the authorized capital of the Company, as stated in its charter document. The common shareholders are allowed one vote per share. Dividends paid to shareholders are determined by the directors and approved at the annual shareholders' meeting.

US\$ 1,386 million dividends have been declared for the year ended December 31, 2005 (US\$ 2,334 million dividends have been declared for the year ended December 31, 2004).

In accordance with Russian accounting standards, earnings available for dividends are limited to profits, retained earnings and other income, denominated in Rubles, after certain deductions.

## **17. Fair Value of Financial Instruments, Including Derivative Activity**

### Fair values

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 net carrying values of cash and cash equivalents, other short-term investments, loans receivable, accounts receivable and payable, taxes payable and accrued liabilities approximate their fair values because of the short maturities of these instruments.

As discussed in Note 7, the Company has investments in certain Russian companies. There are no quoted market prices for these instruments and a precise estimate of fair value could not be made without incurring excessive costs. However, management believes that the carrying value of these investments does not differ substantially from their fair value.

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

### Credit risk

Company's financial instruments that are potentially exposed to concentrations of credit risk consist primarily of accounts receivables, cash and cash equivalents, prepaid VAT as well as loans receivable and advances. A significant portion of the Company's accounts receivable is due from domestic and export trading companies. The Company does not generally require collateral to limit the exposure to loss; however, sometimes letters of credit and prepayments are used. Although collection of these receivables could be influenced by economic factors affecting these entities, management believes there is no significant risk of loss to the Company beyond provisions already recorded.

The Company deposits available cash mostly with a variety of Russian banks and Russian affiliates of international banks. Deposit insurance is not offered to financial institutions operating in Russia. Management periodically reviews the credit worthiness of the banks in which it deposits cash.

Prepaid VAT, representing amounts payable or paid to suppliers, is recoverable from the tax authorities via offset against VAT payable to the tax authorities on the Company's revenue or direct cash receipts from the tax authorities. Management periodically reviews the recoverability of the balance of prepaid VAT and believes it is fully recoverable within one year.

## **18. Income Taxes**

The Company's provision for income taxes as reported in the accompanying consolidated income statements is as follows (in US\$ thousands):

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	<u>2005</u>	<u>2004</u>
Current income taxes	949,310	842,122
Deferred income taxes	(68,260)	32,564
Total provision for income taxes	<u>881,050</u>	<u>874,686</u>

The current portion of income taxes represents the total income tax expense for the Company and each of its subsidiaries.

Although the Company does not pay tax on a consolidated basis, a reconciliation of expected income tax expense to the actual tax expense, for the years ended December 31, 2005, is as follows (in US\$ thousands):

	<u>2005</u>	<u>2004</u>
Income before income taxes	3,685,996	2,920,293
Statutory income tax rate	24%	24%
"Expected" income tax expense	<u>884,639</u>	<u>700,870</u>
Add (deduct) tax effect of:		
Benefit of income taxed at lower rate	(51,330)	(4,118)
Difference between enacted tax rate and taxes to be withheld from dividends	(43,740)	(58,596)
Change in valuation allowance		32,564
Change in deferred tax for previous years	(36,866)	
Non-deductible expenses and other permanent accounting differences	<u>128,347</u>	<u>203,966</u>
Income taxes	<u>881,050</u>	<u>874,686</u>
Effective tax rate	<u>25%</u>	<u>30%</u>

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Temporary differences between the Russian statutory accounts and these financial statements give rise to the following deferred tax assets and liabilities for the period ended December 31, 2005 and 2004 (in US\$ thousands):

	2005	2004
Assets arising from the tax effect of:		
Allowance for doubtful accounts	12,564	15,803
Inventories	10,416	8,373
Current deferred tax assets	<u>22,980</u>	<u>24,176</u>
Long-term investments	-	9,512
Asset retirement obligation	62,627	68,166
Tax loss carryforward	79,143	28,311
Fixed assets	1,702	1,282
	<u>143,472</u>	<u>107,271</u>
Valuation allowance	-	(40,533)
Non-current deferred tax assets	<u>143,472</u>	<u>66,738</u>
Equity Investment and other investments	(21,961)	-
Fixed assets	(76,231)	(89,462)
Long-term debt	-	(1,452)
Non-current deferred tax liability	<u>(98,192)</u>	<u>(90,914)</u>
Net deferred tax asset	68,260	-

For Russian income tax purposes, certain subsidiaries of the Company have accumulated tax losses totalling US\$ 330 million, resulting in associated deferred tax assets of US\$ 79 million. In accordance with Tax Code, such tax losses may be carried forward for a period of ten years for use against future income, although deductibility is restricted to a maximum of 50% of taxable income in any single year. Tax losses carried forward at December 31, 2005, expire between 2006 and 2016.

At December 31, 2004, the Company had provided an allowance for US\$ 28 million against the recoverability of all of its tax loss carryforwards and US\$ 13 million on other deferred tax assets. During 2005, management reassessed its position and reversed the allowance in full. The comparative numbers in the table above are stated after reassessment and reclassification. At December 31, 2004, the Company disclosed the net deferred tax asset in the balance sheets.

Deferred income taxes have not been provided on the undistributed earnings of subsidiaries and other investments in equity affiliates. The amount of such earnings included in consolidated retained earnings at December 31, 2005 was approximately US\$ 580 million. These earnings have been permanently reinvested and management does not plan to initiate any action that would precipitate the payment of income taxes thereon. It is not practicable to estimate the amount of additional tax that might be payable on such amounts.

## **19. Commitments and Contingencies**

### Tax Audit

The tax authorities are currently reviewing the operation of the Company and its subsidiaries for the years 2003-2004. The review is in process; the impact of the result of the tax review is not determinable, however management believes that the ultimate resolution of this matter will not have a material impact on the Company's financial position, results of operations and cash flows.

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Russian tax legislation is subject to varying interpretations and constant changes. Further, the interpretations of tax legislation by tax authorities as applied to the transactions and activities of the Group may not coincide with that of management. Also interpretations on the application of the tax legislation may vary between regional and Federal tax authorities. As a result, transactions may be challenged by tax authorities and the Company may be assessed for additional taxes, penalties and interest. Consolidated tax returns are not required under existing Russian tax legislation and tax audits are performed on an individual entity basis only. Tax periods remain open to review by the tax authorities for three years.

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 relatively high 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.

Construction and Exploration Programs

The Company is engaged in continuous construction and exploration programs, currently estimated to total US\$ 1,397 million (including Noyabrsk in amount of US\$ 816 million; unaudited) over the next year and US\$ 87 million (unaudited) over 2006 for OR. The construction and exploration programs are subject to periodic reviews and actual expenditures may vary from the above estimates. At December 31, 2005, no significant purchase commitments were outstanding in connection with the construction programs.

Financing for all of the future costs has not yet been secured, and the Company is actively pursuing various financing opportunities. It is the opinion of management that the Company will be able to obtain all necessary financing to complete the construction programs.

Environmental Matters

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 current environmental liabilities.

**20. Related Party Transactions**

OAo Moscow Oil Refining Plant (MNPZ)

During the year 2005 the Company processed 3.1 million tons of crude oil (3.3 million tons in 2004) at MNPZ based on processing agreements. Such transactions are in the ordinary course of business and in terms available to other suppliers. Total cost of processing for 2005 was US\$ 49.1 million (US\$ 41.1 million for 2004). The Company has US\$ 4.7 million and US\$ 2.1 million of net payables to MNPZ as of December 31, 2005 and 2004, respectively.

Slavneft Group (Slavneft)

During 2005 the Company conducted numerous transactions with Slavneft group companies. The Company sold directly and under agent agreements 2.3 million tons of crude oil (3.0 million tons in 2004) to Slavneft amounting to US\$ 501 million (US\$ 464 million in 2004) and 0.1 million tons of oil products (0.1 million tons of oil products in 2004) amounting to US\$ 25.1 million (US\$ 4.1 million in 2004). The Company operated as an agent for crude and products export sales of Slavneft. The total amount of proceeds under the agent agreement is US\$ 400 million and US\$ 582 million for crude and

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products, respectively (in 2004 US\$ 848 million and US\$ 627 million, respectively). During 2005 and 2004 the Company earned US\$ 0.1 million and US\$ 2.3 million in commission fees related to this agent agreement. The Company and TNK-BP have in principle agreed to split Slavneft's business and product flows. During 2005 the Company bought from Slavneft 2.7 million tons of crude and 2.5 million tons of products amounting to US\$ 434 million and US\$ 655 million, respectively. From late December 2002 the Company started processing in Yaroslavl Oil Refining Plant (Slavneft's subsidiary) based on processing agreements. During the year 2004 the Company re-processed 0.4 million tons of crude fractions for the total cost of processing amounting to US\$ 3.1 million. The Company has US\$ 18 million and US\$ 162 million of net payables to Slavneft as of December 31, 2005 and 2004, respectively. All the above transactions are in the ordinary course of business at negotiated prices comparable to those with other customers and suppliers.

**21. Segment Information**

The Company has two operating segments – exploration and production and manufacturing, marketing and distribution. Segments were determined based upon the Company's internal organization and reporting and upon the information that management uses to make operating decisions and assess performance. The exploration and production segment explores for, develops, produces and sells crude oil. The refining, marketing and distribution segment processes crude oil into refined products and purchases, sells and transports refined petroleum products.

Geographical segments have not been determined as the area of operations includes Russia only. Export sales are generally destined for European markets.

The accounting policies of the business segments are the same as those described in the Summary of Significant Accounting Policies (Note 2). Revenues from the transfer of crude oil from the exploration and production segment to the manufacturing, marketing and distribution segment are stated at contractual amounts.

Operating Segments 2005 (in US\$ thousands):

	Exploration and Production	Manufacturing, Marketing and Distribution	Consolidated
Revenues			
Total	9,117,953	7,317,309	16,435,262
Inter-segment revenues	(1,849,948)	-	(1,849,948)
Revenues from external customers	7,268,005	7,317,309	14,585,314
Operating income	1,103,329	1,939,219	3,042,548
Capital expenditures, net	970,930	45,102	1,016,032
Depreciation, depletion and amortization	925,687	92,746	1,018,433
Interest income	1	32,737	32,738
Interest expense	5	119,159	119,164
Share in the net income of equity investees	777,543	4,705	782,248
Income tax expense	473,419	407,631	881,050
Investment in equity method investees	1,971,251	450,660	2,421,911
Segment assets	6,711,180	3,928,386	10,639,566

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Operating Segments 2004 (in US\$ thousands):

	Exploration and Production	Manufacturing, Marketing and Distribution	Consolidated
Revenues			
Total	5,583,086	4,579,027	10,162,113
Inter-segment revenues	(1,275,615)	-	(1,275,615)
Revenues from external customers	4,307,471	4,579,027	8,886,498
Operating income	1,121,534	1,517,616	2,639,150
Capital expenditures, net	804,383	84,675	889,058
Depreciation, depletion and amortization	517,180	85,481	602,661
Interest income	3	9,172	9,175
Interest expense	1,248	113,596	114,844
Share in the net income of equity investees	654,178	1,271	655,449
Income tax expense	449,326	425,360	874,686
Investment in equity method investees	1,767,695	451,812	2,219,507
Segment assets	5,562,296	4,700,545	10,262,841

No individual customer comprised more than 10 percent of the Company's sales during 2005 or 2004. Management does not believe that the Company is reliant on any particular customer. The geographical segmentation the Company's revenue is presented below (in US\$ thousands):

	2005	2004
Revenues from export operations	10,352,211	5,867,258
Revenues within Russia and CIS	4,233,103	3,019,240
Total revenues from external customers	<u>14,585,314</u>	<u>8,886,498</u>

## 22. Subsequent Events

In May 2006 the Company received a US\$ 370 million loan from ABN AMRO and Citibank maturing in June 2009 and bearing interest rates at LIBOR plus 0.6%, secured by Noyabrsk sales proceeds.

On May 13, 2006, OAO Siberian Oil Company's board of directors decided to rename the Company as OAO Gazprom Neft from June 1, 2006.

On June 22, 2006 at the Gazprom Neft's shareholder meeting, annual dividends were approved by the shareholders for the year ended December 31, 2005, amounting to 7.9 Rubles per share or total dividends of US\$ 1,386 million. Dividend payments will be made through May 31, 2007.

On June 29, 2006 at the Slavneft's shareholder meeting, annual dividends were approved by the shareholders for the year ended December 31, 2005, amounting to 6.74 Ruble per share or total dividends of US\$ 1,183 million, of which US\$ 862 million of intermediate dividends were accrued and collected by the Company during 2005.

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As required by SFAS No. 69, "Disclosures about Oil and Gas Producing Activities", the Company is making certain supplemental disclosures about its oil and gas exploration and production operations. While this information was developed with reasonable care and disclosed in good faith, it is emphasized that some of the data is necessarily imprecise and represents only approximate amounts because of the subjective judgments involved in developing such information. Accordingly, this information may not necessarily represent the current financial condition of the Company or its expected future results.

The Company's exploration and development activities are exclusively within the Russian Federation; therefore, all of the information provided in this section pertains entirely to this region.

The supplemental disclosure below does not include the information required by SFAS No. 69 related to the Company's investment in Slavneft, which is accounted for by the equity method.

Capitalized Costs Relating to Oil and Gas Producing Activities

The following tables set forth information regarding oil and gas exploration and development costs. The amounts reported as costs incurred include both capitalized costs and costs charged to expense during the period ended December 31, 2005 and 2004, respectively (in US\$ thousands):

	<u>2005</u>	<u>2004</u>
Capitalized costs of proved oil and gas properties	9,695,022	9,036,855
Capitalized costs of unproved oil and gas properties	-	111,552
Total capitalized costs of oil and gas properties	<u>9,695,022</u>	<u>9,148,407</u>
Less: Accumulated depreciation, depletion and amortization	<u>(5,885,506)</u>	<u>(5,221,271)</u>
Total net capitalized costs of oil and gas properties	<u><u>3,809,516</u></u>	<u><u>3,927,136</u></u>
	<u>2005</u>	<u>2004</u>
Costs incurred in oil and gas properties acquisitions, exploration and development activities		
Exploration costs	-	18,859
Development costs	<u>970,930</u>	<u>785,525</u>
Total costs incurred in oil and gas properties acquisitions, exploration and development activities	<u><u>970,930</u></u>	<u><u>804,384</u></u>

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Results of Operations from Oil and Gas Producing Activities

The Company's results of operations from oil and gas producing activities are shown below. Natural gas production does not represent a material portion of the Company's total oil and gas production.

Results of operations for oil and gas producing activities do not include general corporate overhead and monetary effects, or their associated tax effects. Income tax is based on statutory rates for the years ended, respectively, adjusted for tax deductions, tax credits and allowances. For the period ended December 31, 2005 and 2004, respectively (in US\$ thousands):

	2005	2004
Revenues from net production		
Sales	6,664,056	3,980,532
Transfers	1,838,373	1,323,966
Total revenues	8,502,429	5,304,498
Production costs	(624,667)	(577,649)
Exploration expenses	-	-
Depreciation, depletion and amortization	(1,001,133)	(586,535)
Taxes, other than income tax	(2,450,231)	(1,253,430)
Pretax income from producing activities	4,426,398	2,886,884
Income tax expenses	(908,514)	(514,571)
Results of oil and gas producing activities	3,517,884	2,372,313

Proved Oil and Gas Reserve Quantities

Proved reserves are defined as the estimated quantities of oil and gas, which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic conditions. In some cases, substantial new investment in additional wells and related support facilities and equipment will be required to recover such proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to change over time as additional information becomes available.

Management believes that proved reserves should include quantities, which are expected to be produced after the expiry dates of the Company's production licenses. These licenses expire between 2013 and 2050, with the most significant licenses expiring in 2013 and 2014. Management believes the licenses may be extended at the initiative of the Company and management intends to extend such licenses for properties expected to produce subsequent to their license expiry dates. The Company has disclosed information on total proved oil and condensate and gas reserve quantities and standardized measure of discounted future net cash flows.

Proved developed reserves are those reserves, which are expected to be recovered through existing wells with existing equipment and operating methods. Undeveloped reserves are those reserves which are expected to be recovered as a result of future investments to drill new wells, to recomplete existing wells and/or install facilities to collect and deliver the production.

"Net" reserves exclude quantities due to others when produced.

The reserve quantities shown below include 100 percent of the net reserve quantities attributable to the Company's consolidated subsidiaries.

The prices used in the forecast of future net revenues are the year-end weighted average of the prices received for sales domestically, for exports to CIS countries and for exports to non-CIS countries. Due to the absence of a developed market for crude oil in Russia, the Company employs a "net-back" method to estimate a price for transfer.

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As determined by the Company's independent reservoir engineers, DeGolyer and MacNaughton (Miller and Lents in 2004), the following information presents the balances of proved oil and gas reserve quantities as of December 31, 2005 and 2004, respectively.

Total net proved reserves of crude oil and condensate are presented below (in millions of barrels):

	2005	2004
Proved Reserves at January 1,	4,119	3,968
Production	(265)	(250)
Purchase of reserves in place	-	-
Revision of previous estimates and improved recovery	(456)	401
Proved reserves at December 31,	<u>3,398</u>	<u>4,119</u>
Minority's share included in the above proved reserves	<u>(19)</u>	<u>(12)</u>
Proved reserves, adjusted for minority interest	<u>3,379</u>	<u>4,107</u>
Proved developed reserves	<u>1,670</u>	<u>3,121</u>
Proved developed reserves, adjusted for minority interest	<u>1,667</u>	<u>3,118</u>

Net proved reserves of natural gas are presented below (in billions of cubic feet):

	2005	2004
Proved Reserves at January 1,	933	839
Production	-	-
Purchase of reserves in place	-	-
Revision of previous estimates and improved recovery	1,425	94
Proved reserves at December 31,	<u>2,358</u>	<u>933</u>
Minority's share included in the above proved reserves	<u>(10)</u>	<u>-</u>
Proved reserves, adjusted for minority interest	<u>2,348</u>	<u>933</u>
Proved developed reserves	<u>1,424</u>	<u>751</u>
Proved developed reserves, adjusted for minority interest	<u>1,423</u>	<u>751</u>

Standardized measure of discounted future net cash flows and changes therein relating to proved oil and gas reserves

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 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 period. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end 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 cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a 10% 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 tables set out below does not represent management's estimate of the Company's expected future cash flows or of the value Company's proved oil and gas reserves. Estimates of proved reserves quantities are imprecise and change over time, as new information

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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 the amount of future development and production costs. The calculations should not be relied upon as an indication of the Company's future cash flows or of the value of its oil and gas reserves.

	2005 <u>(in US\$ thousands)</u>	2004 <u>(in US\$ thousands)</u>
Future cash inflows	83,694,589	71,949,188
Future production and development costs	(39,051,566)	(38,647,330)
Future income tax expenses	<u>(9,259,590)</u>	<u>(6,030,146)</u>
Future net cash flows	35,383,433	27,271,712
Future net cash flow 10% annual discount for estimated timing of cash flow	<u>(17,195,668)</u>	<u>(14,962,261)</u>
Standardized measure of discounted future net cash flows	<u><u>18,187,765</u></u>	<u><u>12,309,451</u></u>

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

	2005 <u>(in US\$ thousands)</u>	2004 <u>(in US\$ thousands)</u>
Discounted present value as of beginning of year	<u>12,309,451</u>	<u>12,619,034</u>
Sales and transfers of oil and gas produced, net of production costs and taxes other than income taxes	(4,426,398)	(2,886,884)
Extension, discoveries and changes in estimates	8,587,104	(959,439)
Changes in future development costs	(2,677,573)	(572,205)
Development costs incurred during the period	970,930	785,525
Revisions of previous quantity estimates	(886,995)	1,644,574
Net change in income taxes	3,229,444	(579,778)
Accretion of discount	2,233,407	(1,541,370)
Other	<u>(1,151,606)</u>	<u>3,799,994</u>
Discounted present value as of end of year	<u><u>18,187,764</u></u>	<u><u>12,309,451</u></u>