

**ОАО Gazprom Neft**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
AS OF SEPTEMBER 30, 2007 AND 2006**

**ОАО Gazprom Neft**

**Interim Consolidated Financial Statements**

**For the nine-months ended September 30, 2007 and 2006**

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**OAO Gazprom Neft**  
**Interim Consolidated Balance Sheets**  
**As of September 30, 2007 and December 31, 2006**

Currency - US\$ thousands

	Notes	September 30, 2007 (unaudited)	December 31, 2006
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	2	\$ 3,750,755	\$ 1,334,733
Short-term investments		-	100,000
Loans receivable	11	146,014	125,798
Accounts receivable, net		2,485,376	2,451,988
Inventories	3	962,879	781,710
Other current assets		347,759	620,567
Current deferred income tax assets	9	31,724	28,343
Total current assets		<u>7,724,507</u>	<u>5,443,139</u>
Long-term investments	4	3,025,396	2,760,443
Long-term loans receivable	11	86,203	128,134
Oil and gas properties, net		5,088,673	4,569,144
Property, plant and equipment, net		931,337	852,205
Construction-in-progress		201,407	161,202
Other non-current assets		45,670	55,109
Non-current deferred income tax assets	9	173,677	132,742
Total assets		<u><u>17,276,870</u></u>	<u><u>14,102,118</u></u>
<b>Liabilities and shareholders' equity</b>			
Current liabilities:			
Short-term loans	5	\$ 236,202	\$ 56,157
Accounts payable and accrued liabilities		763,241	648,524
Income and other taxes payable		588,143	497,392
Dividends payable		1,224,839	893,044
Current portion of long-term debt	7	734,962	638,363
Total current liabilities		<u>3,547,387</u>	<u>2,733,480</u>
Asset retirement obligation	6	359,984	287,731
Long-term debt	7	1,946,620	977,402
Deferred income tax liabilities	9	160,108	173,206
Total liabilities		<u>6,014,099</u>	<u>4,171,819</u>
Commitments and contingencies	10		
Shareholders' equity:	8		
Common stock (authorized, issued and outstanding: 4,741,299,639 shares, 0.0016 Ruble par value)		1,619	1,619
Additional paid-in capital		858,987	858,987
Reserves		1,867,449	1,867,449
Retained earnings		8,534,716	7,202,244
Total shareholders' equity		<u>11,262,771</u>	<u>9,930,299</u>
Total liabilities and shareholders' equity		<u><u>\$ 17,276,870</u></u>	<u><u>\$ 14,102,118</u></u>

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

**OAO Gazprom Neft**  
**Interim Consolidated Statements of Income**  
**For the nine-months ended September 30, 2007 and 2006**

Currency - US\$ thousands

	Notes	September 30, 2007 (unaudited)	September 30, 2006 (unaudited)
<b>Revenues</b>			
Refined products and oil and gas sales		\$ 14,321,502	\$ 15,375,911
Other		355,539	154,918
Total	12	14,677,041	15,530,829
<b>Costs and other deductions</b>			
Crude oil, petroleum and other products purchased		2,550,712	3,121,749
Operating expenses		1,759,283	1,253,861
Selling, general and administrative expenses		1,313,190	1,334,017
Depreciation, depletion and amortization		820,108	738,892
Export duties		2,377,731	3,475,894
Taxes other than income taxes		2,293,418	2,324,769
Cost of other sales		223,432	44,410
Total		11,337,874	12,293,592
Operating income		3,339,167	3,237,237
<b>Other income (expense)</b>			
Income from equity affiliates	4	324,547	481,907
Loss from equity investments write off		-	(13,026)
Interest income		85,391	19,869
Interest expense		(98,436)	(85,001)
Other income (expenses), net		(28,536)	4,828
Foreign exchange gain, net		106,179	66,162
Total		389,145	474,739
<b>Income before provision for income taxes</b>		3,728,312	3,711,976
Current income tax expense	9	966,715	911,585
Deferred income tax benefit	9	(57,413)	(26,445)
Total		909,302	885,140
<b>Net income</b>		\$ 2,819,010	\$ 2,826,836
Basic and Diluted Earnings per Common Share (US\$ per share)		\$ 0.5946	\$ 0.5963
Weighted-average number of common shares outstanding Basic and Diluted (millions)		4,741	4,741

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

OAO Gazprom Neft  
Interim Consolidated Statements of Changes in Shareholders' Equity  
As of September 30, 2007

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>Total</u> <u>Shareholders'</u> <u>Equity</u>
Balance as of December 31, 2006	\$ 1,619	\$ 858,987	\$ 1,867,449	\$7,202,244	\$9,930,299
Net income	-	-	-	2,819,010	2,819,010
Common stock dividends	-	-	-	(1,486,538)	(1,486,538)
Balance as of September 30, 2007 (unaudited)	\$ 1,619	\$ 858,987	\$ 1,867,449	\$8,534,716	\$11,262,771

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

**OAO Gazprom Neft**  
**Interim Consolidated Statements of Cash Flows**  
**For nine-months ended September 30, 2007 and 2006**

**Currency - US\$ thousands**

	September 30, 2007 <u>(unaudited)</u>	September 30, 2006 <u>(unaudited)</u>
<b><i>Operating activities</i></b>		
Net income	\$ 2,819,010	\$ 2,826,836
Reconciliation of net income to net cash provided by operating activities:		
Income from equity affiliates, net of dividends received	(263,606)	(316,975)
Deferred income tax benefit	(57,413)	(26,445)
Depreciation, depletion and amortization	820,108	738,892
Asset retirement obligation accretion expense	17,095	15,389
Provision for doubtful accounts	(4,636)	(5,210)
Loss on disposal of property, plant and equipment	6,119	4,175
Loss on sales of investments	-	13,026
Changes in assets and liabilities, excluding cash and debt:		
Accounts receivable	(28,752)	(703,493)
Inventories	(181,169)	(239,148)
Other current assets	272,808	61,219
Other non-current assets	9,439	7,944
Accounts payable and accrued liabilities	114,717	(10,390)
Income and other taxes payable	90,751	54,156
Net cash provided by operating activities	<u>3,614,471</u>	<u>2,419,976</u>
<b><i>Investing activities</i></b>		
Purchase of investments in associated entities	(1,347)	(115,558)
Loans and short-term investments proceeds received	150,801	33,261
Loans issued	(29,086)	(126,948)
Proceeds from disposals of property, plant and equipment	28,823	27,340
Capital expenditures	(1,438,759)	(1,013,818)
Net cash used in investing activities	<u>(1,289,568)</u>	<u>(1,195,723)</u>
<b><i>Financing activities</i></b>		
Short and long-term loans proceeds received	4,105,351	714,715
Short and long-term loans repaid	(2,859,489)	(631,166)
Dividends paid	(1,154,743)	(270,507)
Net cash provided by (used in) financing activities	<u>91,119</u>	<u>(186,958)</u>
Increase in cash and equivalents	2,416,022	1,037,295
Cash and equivalents at beginning of year	1,334,733	305,247
Cash and equivalents at end of year	<u>\$ 3,750,755</u>	<u>\$ 1,342,542</u>

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

**OAO Gazprom Neft**  
**Notes to Interim Consolidated Financial Statements - Unaudited**  
**As of September 30, 2007 and 2006**

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**1. General**

Description of Business

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

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

Basis of Financial Statements Preparation

The Company maintains its books and records in accordance with accounting and taxation principles and practices mandated by 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 the US Dollar as its reporting currency.

The interim consolidated financial statements are unaudited and have been prepared in accordance with US GAAP for interim financial reporting of public companies (primarily Accounting Principles Board Opinion 28 ("APB 28") "*Interim Financial Reporting*" and do not include all disclosures necessary required by US GAAP. The Company omitted disclosures which would substantially duplicate the disclosures contained in its 2006 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 consolidated financial statements are read in conjunction with the Company's 2006 audited consolidated financial statements and the notes related thereto. In the opinion of the Company's management, the unaudited interim consolidated financial statements and notes thereto reflect all known adjustments of a normal and recurring nature necessary to present fairly the Company's financial position, results of operations and cash flows for the interim periods.

The results for the nine-months ended September 30, 2007 are not necessarily indicative of the results expected for the full year.

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 of the Company's significant estimates and assumptions include: recoverability and lives of long-term assets and investments; provisions for uncollectible accounts receivable; asset retirement obligations; legal and tax contingencies; depreciation, depletion and amortization; environmental remediation obligations; oil reserves; 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.

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**Notes to Interim Consolidated Financial Statements - Unaudited**  
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Foreign Currency Translation

Management of the Company has determined the US Dollar is the functional and reporting currency for the purpose of financial reporting under US GAAP. Monetary assets and liabilities have been translated into US Dollars at the exchange rate at 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 historical exchange rates prevailing on the transaction dates. Gains and losses resulting from the remeasurement into US Dollars are included in "Foreign exchange gain (loss), net" in the consolidated statement of income.

As of September 30, 2007 and December 31, 2006 the Central Bank of the Russian Federation ("CBR") official rates of exchange were 24.95 Rubles and 26.33 Rubles per US Dollar, respectively. Average rates of exchange for the nine-months ended September 30, 2007 and 2006 were 25.89 Rubles and 27.39 Rubles per US Dollar, 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 above or at any other exchange rate.

Income Taxes

The Company follows the provisions of APB 28 to arrive at the effective tax rate. The effective tax rate is based on the best estimate of the expected annual tax rate to be applied to the taxable income for the current reporting period. The rate is based on the currently enacted tax rate of 24% and includes estimates for the annual tax effect of permanent differences and realization of deferred tax assets.

Recent Accounting Standards

The Company adopted FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109," ("FIN 48") effective January 1, 2007. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The adoption of FIN 48 did not have a material impact on the Company's results of operations, financial position or cash flow.

**2. Cash and Cash Equivalents**

Cash and cash equivalents as of September 30, 2007 and December 31, 2006 comprise the following (in US\$ thousands):

	<u>2007</u>	<u>2006</u>
Cash in bank and cash equivalents - Rubles	\$ 3,423,409	\$ 346,266
Cash in bank - foreign currency	235,833	274,581
Bank deposits	89,780	712,336
Cash on hand	1,733	1,550
Total cash and cash equivalents	<u>\$ 3,750,755</u>	<u>\$ 1,334,733</u>

The majority of cash in bank - foreign currency is primarily represented by US Dollars.

As of September 30, 2007 the Company has no bank deposits with maturities at the date of purchase in excess of 90 days.

**OAQ Gazprom Neft**  
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**3. Inventories**

The following are the major components of inventories as of September 30, 2007 and December 31, 2006 (in US\$ thousands):

	2007	2006
Crude oil	\$ 104,721	\$ 101,571
Petroleum products	277,782	269,108
Materials and supplies	426,184	290,226
Other	154,192	120,805
Total inventories	<u>\$ 962,879</u>	<u>\$ 781,710</u>

**4. 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. The significant equity and other long-term investments are summarized below as of September 30, 2007 and December 31, 2006 (in US\$ thousands):

	Ownership percentage at	Net book value at		Group's share of income for the nine months ended September 30	
		September 30, 2007	September 30, 2007	December 31, 2006	2007
Investments in equity affiliates:					
AO NGK Slavneft	49.9	\$ 2,417,152	\$ 2,186,742	\$ 291,351	\$ 479,430
Moscow Oil Refining Plant	38.8	337,792	304,596	33,196	2,477
<b>Total investments in equity affiliates / income</b>		<u>2,754,944</u>	<u>2,491,338</u>	<u>324,547</u>	<u>481,907</u>
Long-term investments, at cost:					
Mosneftproduct	27.4	56,018	56,018		
Other various marketing entities		160,950	160,808		
Other entities		53,484	52,279		
<b>Total long-term investments, at cost</b>		<u>270,452</u>	<u>269,105</u>		
<b>Total long-term investments</b>		<u>\$ 3,025,396</u>	<u>\$ 2,760,443</u>	<u>\$ 324,547</u>	<u>\$ 481,907</u>

The Company's investment in AO NGK Slavneft ("Slavneft") and various minority stakes in Slavneft subsidiaries are held through a series of off-shore entities and an investment trust. During 2006, Slavneft announced and paid dividends to the Company of US\$ 287.1 million.

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**As of September 30, 2007 and 2006**

The following table summarizes Slavneft's financial information based on the Company's ownership interest as of September 30, 2007 and December 31, 2006 (in US\$ thousands):

	2007	2006
Current assets	\$ 547,226	\$ 489,856
Long-term assets	2,610,138	2,349,099
Current liabilities	457,099	309,616
Long-term liabilities	333,335	349,258
Sales	2,209,912	3,282,469
Net Income	291,351	502,546

The following table summarizes Moscow Oil Refining Plant's financial information based on the Company's ownership interest as of September 30, 2007 and December 31, 2006 (in US\$ thousands):

	2007	2006
Current assets	\$ 80,736	\$ 61,425
Long-term assets	120,324	114,626
Current liabilities	52,942	61,232
Long-term liabilities	147	43
Sales	110,833	101,512
Net Income	33,196	4,397

The 27.4% interest in Mosnefteproduct is accounted for as a cost basis investment as the Company does not have the ability to exercise significant influence over this entity as a result of its limited participation on Mosnefteproduct's board of directors.

#### **5. Short-Term Loans**

As of September 30, 2007 and December 31, 2006 the Company had short-term loans outstanding as follows (in US\$ thousands):

	2007	2006
Banks	\$ 58,185	\$ 40,385
Related parties	162,543	731
Other	15,474	15,041
Total	<u>\$ 236,202</u>	<u>\$ 56,157</u>

In general, short-term loans are used for the provision of working capital needs. As of September 30, 2007 the majority of the loans were provided in Rubles.

In June 2007 the Company obtained a series of short-term Ruble denominated promissory notes payable to Gazprombank amounting US\$ 2,285 million bearing interest at 5% interest rate and repayable on demand but not earlier than on August 21, 2007. In September 2007 the Company paid US\$ 2,124 million of these promissory notes.

As of September 30, 2007 the Company has a US\$ 40.0 million loan outstanding from Raiffeisen Bank repayable in US Dollars. The loan bears a floating interest rate of LIBOR plus 0.5% and matures in 2008. As of December 31, 2006 the Company had a US\$ 40.0 million loan from Raiffeisen Bank which bore interest at LIBOR plus 0.5%.

Weighted average interest rates related to the short-term loans outstanding as of September 30, 2007 for US Dollar and Ruble denominated loans equal 4.2% and 4.6%, respectively. Weighted average interest rates related to the short-term loans outstanding as of December 31, 2006 for US Dollar and Ruble denominated loans equal 5.8% and 1%, respectively.

## **6. Asset Retirement Obligation**

According to Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143") and FIN No. 47, "Accounting for Conditional Asset Retirement Obligations" ("FIN 47"), 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 and FIN 47 require 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. Most of these costs are not expected to be incurred until several years, or decades, in the future and will be funded from general Company resources at the time of removal.

SFAS 143 calls for measurements of asset retirement obligations to include, as a component of expected costs, an estimate of the price that a third party would demand, and could expect to receive, for bearing the uncertainties and unforeseeable circumstances inherent in the obligations, sometimes referred to as a market-risk premium. To date, the oil and gas industry in Russia has few examples of credit-worthy third parties who are willing to assume this type of risk, for a determinable price, on major oil and gas production facilities and pipelines. Therefore, because determining such a market-risk premium would be an arbitrary process, it has been excluded from the Company's SFAS 143 estimates.

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 a 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.

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**As of September 30, 2007 and 2006**

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 operating expense in the statement of income.

The following summarizes the activity of the asset retirement obligations as of September 30, 2007 and December 31, 2006 (in US\$ thousands)

	2007	2006
Beginning balance as of January 1,	\$ 287,731	\$ 260,983
New obligations	55,158	5,817
Accretion expense	17,095	20,931
Ending balance as of September 30, 2007	<u>\$ 359,984</u>	
Ending balance as of December 31, 2006		<u>\$ 287,731</u>

**7. Long-term Debt**

As of September 30, 2007 and December 31, 2006 the Company had outstanding long-term loans as follows (in US\$ thousands):

	2007	2006
Bonds	\$ 500,000	\$ 900,000
Bank loans outstanding	2,166,981	681,696
Other borrowings	14,601	34,069
Less current portion of long- term debt	<u>(734,962)</u>	<u>(638,363)</u>
Total long-term debt	<u>\$ 1,946,620</u>	<u>\$ 977,402</u>

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

In December 2002, the Company placed US\$ 500.0 million in 7-year Eurobonds on the Luxemburg Stock Exchange. The bonds bear interest of 10.75% per year and have semi-annual coupon payments due on January, 15 and July, 15 of each year. Accrued interest for the bonds was US\$ 11.8 million at September 30, 2007 and US\$ 25.4 as of December 31, 2006.

In January 2002, the Company placed US\$ 250.0 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\$ 400.0 million. All bonds have semi-annual coupon payments due on February, 13 and August, 18 of each year. Accrued interest for the bonds was US\$ 18.0 million at December 31, 2006. On February 12, 2007, the Company fully repaid these Eurobonds for US\$ 400.0 million, including accrued interest of US\$ 23.0 million. As the amount was repaid in February 2007, these bonds were included in the current portion of long-term debt as of December 31, 2006.

During 2006, the Company obtained a US\$ 630 million syndicated loan from Citibank and ABN-AMRO Bank maturing in July 2009, bearing floating interest at rates of LIBOR plus 0.6%. As of September 30,

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2007, the amount outstanding under this syndicated loan was US\$ 513.3 mill (including current portion of US\$ 280 million).

In September 2007 the Company obtained the first US\$ 1,650 million tranche of a US\$ 2.2 billion syndicated loan from Calyon, ABN- AMRO, Commerzbank and Citibank (including current portion of US\$ 450 million). This syndicated loan matures in September 2010 and bears interest at a rate of LIBOR plus 0.75%.

As of September 30, 2007 the Company also had a loan from Gazprombank repayable in Rubles amounting to US\$ 3.6 million (all current). The loan bears interest at a rate of 6.0%. Gazprombank is also a related party to the Company.

As of September 30, 2007 and December 31, 2006 other borrowings represent a number of Ruble denominated interest-free loans with maturity dates in 2008 and 2012.

The loan agreements contain financial covenants including maintaining certain ratios of Consolidated EBITDA to Consolidated Interest Payable, Consolidated Indebtedness to Consolidated Tangible Net Worth, and Consolidated Total Indebtedness to Consolidated EBITDA. Management believes the Company is in compliance with these covenants as of September 30, 2007.

Maturities of long-term - loans as of September 30, 2007 are as follows (in US\$ thousands):

<u>Year due</u>	<u>Amount due</u>
2008	\$ 734,962
2009	1,339,952
2010	600,000
2011	3,085
2012	3 583
	<u>\$ 2,681,582</u>

## **8. 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 common stock 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.

On May 18, 2007 the Company's Board of Directors recommended annual dividends for the year ended December 31, 2006 of 8.1 Rubles per common share (approximately US\$ 1,485 million) to be approved by the shareholders.

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**9. Income Taxes**

The Company's provision for income taxes as reported in the accompanying consolidated income statements is as follows (in US\$ thousands) for the nine-months ended September 30, 2007 and September 30, 2006 respectively:

	2007	2006
Current income tax expense	\$ 966,715	\$ 911,585
Deferred income tax (benefit) expense	(57,413)	(26,445)
Total provision for income taxes	<u>\$ 909,302</u>	<u>\$ 885,140</u>

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

Temporary differences between the Russian statutory accounts and these US GAAP financial statements give rise to the following deferred tax assets and liabilities as of September 30, 2007 and December 31, 2006 (in US\$ thousands):

	2007	2006
Assets arising from the tax effect of:		
Allowance for doubtful accounts	\$ 4,814	\$ 5,581
Inventories	7,218	9,269
Prepaid expenses	19,692	13,493
Current deferred tax assets	<u>\$ 31,724</u>	<u>\$ 28,343</u>
Asset retirement obligation	\$ 86,396	\$ 69,047
Tax loss carry forward	58,573	55,498
Fixed assets	28,707	8,197
Non-current deferred tax assets	<u>\$ 173,676</u>	<u>\$ 132,742</u>
Equity Investment and other investments	(15,358)	(12,499)
Fixed assets	(144,750)	(160,707)
Non-current deferred tax liability	<u>\$ (160,108)</u>	<u>\$ (173,206)</u>
Net deferred tax asset (liability)	<u>\$ 45,292</u>	<u>\$ (12,121)</u>

For Russian income tax purposes, certain subsidiaries of the Company have accumulated tax losses totaling US\$ 244.1 million, resulting in associated deferred tax assets of US\$ 58.6 million. In accordance with the 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 as of September 30, 2007 expire between 2012 - 2017.

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 as of September 30, 2007 and December 31, 2006 was approximately US\$ 1,701 million and US\$ 1,485

million, respectively. 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 should circumstances change.

## **10. Commitments and Contingencies**

### Taxes

Tax authorities recently completed a review of the operations of the Company and its significant subsidiaries for the year 2004. The results of these tax reviews did not have a material impact on the Company's financial position, results of operations and cash flows.

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the 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. 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 three calendar years proceeding the year of review. Under certain circumstances reviews may cover longer periods. The years 2005 and 2006 have not been subject to a review.

As of September 30, 2007 Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained.

### 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 most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

Whilst there have been improvements in the economic trends, the future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory, and political developments.

### 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 currently does not have any material environmental liabilities.

## **11. Related Parties**

### OAQ Moscow Oil Refining Plant (MNPZ)

During the period ended September 30, 2007 the Company processed 2.6 million tons of crude oil (2.4 million tons of crude oil for nine months ended September 30, 2006) at MNPZ based on processing

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agreements. Such transactions are in the ordinary course of business and on terms available to other suppliers. Total cost of processing for the period ended September 30, 2007 was US\$ 71.9 million (US\$ 41.8 million for the nine-months ended September 30, 2006). The Company has US\$ 12.9 million and US\$ 2.3 million of net payables to MNPZ as of September 30, 2007 and December 31, 2006, respectively.

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Slavneft Group (Slavneft)

During the period ended September 30, 2007 and 2006 the Company conducted numerous transactions with Slavneft group companies.

The Company sold directly 0.5 million tons of crude oil (1.7 million tons for the nine-months ended September 30, 2006) to Slavneft amounting to US\$ 163.3 million (US\$ 479.2 million for the nine-months ended September 30, 2006) and 0.4 million tons of oil products (0.1 million tons of oil products for the nine-months ended September 30, 2006) amounting to US\$ 164.7 million (US\$ 70.6 million for the nine-months ended September 30, 2006). The Company and TNK-BP have in principle agreed to split Slavneft's production based on each party's respective interest. During the period ended September 30, 2007 the Company bought from Slavneft 7.9 million tons of crude oil and 0.6 million tons of oil products amounting to US\$ 1,466.2 million and US\$ 235.3 million, respectively. During the period ended September 30, 2007 the Company processed 4.8 million tons of crude oil at Slavneft's Yaroslavl Oil Refining Plant for processing costs of US\$ 148.1 million. During the period ended September 30, 2007 the Company bought 0.3 billion cubic meters of gas amounting to US\$ 2.5 million from Slavneft. The Company has US\$ 86.3 million payables to Slavneft and US\$ 12.5 million receivables from Slavneft as of September 30, 2007.

Gazprom Group (Gazprom)

The Company conducted numerous transactions with Gazprom, its primary shareholder. During the period ended September 30, 2007 the Company bought from Gazprom 0.4 billion cubic meters of gas amounting to US\$ 24.0 million and sold to Gazprom 1.3 billion cubic meters of gas amounting to US\$ 12.4 million. During the period ended September 30, 2007 Gazprom performed construction works for the Company amounting to US\$ 12.2 million and sold other products amounting to US\$ 4.4 million. The Company sold oil products and rendered various services to Gazprom amounting to US\$ 97.7 million. The Company has US\$ 29.1 million payables to Gazprom and US\$ 10.8 million receivables from Gazprom as of September 30, 2007.

Refer also to Note 5 Short-term Loans and Note 7 Long-term Debt.

Other Related Party Transactions

Current loans receivable of US\$ 146.0 million and US\$ 125.8 million are mostly due from related parties as of September 30, 2007 and December 31, 2006, respectively. These Ruble denominated loans mature between one month and one year.

Long-term loans receivable of US\$ 86.2 million and US\$ 128.1 million are mostly due from related parties as of September 30, 2007 and December 31, 2006, respectively. These loans mature between 2008 and 2011.

**12. Segments**

Presented below is information about the Company's operating segments for the nine-months ended September 30, 2007 and 2006. The Company determined its operating segments based on differences in the nature of their operations. The exploration and production segment explores, develops and produces crude oil and natural gas. The marketing and distribution segment purchases, sells and transports refined petroleum products and the refining segment process crude oil into refined products.

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Operating Segments for nine months ended September 30, 2007 (in US\$ thousands):

	Exploration and Production	Marketing and Distribution	Refining	Other	Consolidated
Revenues					
Total	\$ 7,604,717	\$ 8,715,515	\$ 356,211	\$ 355,539	\$ 17,031,982
Inter-segment revenues	(1,990,415)	(8,315)	(356,211)	-	(2,354,941)
Revenues from external customers	5,614,302	8,707,200	-	355,539	14,677,041
Operating income	1,616,180	1,654,212	62,095	6,680	3,339,167
Capital expenditures	1,319,177	41,494	76,378	1,710	1,438,759
Depreciation, depletion and amortization	752,908	10,383	55,694	1,123	820,108
Interest income	-	4,518	48	80,825	85,391
Interest expense	-	1,537	93	96,806	98,436
Share in the net income of equity investees	291,351	-	33,196	-	324,547
Income tax expense	348,905	525,778	32,807	1,812	909,302
Investment in equity method investees at September 30, 2007	2,417,152	-	337,792	-	2,754,944
Segment assets at September 30, 2007	12,746,915	2,656,462	1,852,469	21,024	17,276,870

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Operating Segments for nine months ended September 30, 2006 (in US\$ thousands):

	Exploration and Production	Marketing and Distribution	Refining	Other	Consolidated
Revenues					
Total	\$ 8,732,198	\$ 8,440,536	\$ 397,836	\$ 154,918	\$ 17,725,488
Inter-segment revenues	(1,787,028)	(9,795)	(397,836)	-	(2,194,659)
Revenues from external customers	6,945,170	8,430,741	-	154,918	15,530,829
Operating income	1,492,317	1,615,915	124,976	4,029	3,237,237
Capital expenditures	915,204	56,555	40,480	1,579	1,013,818
Depreciation, depletion and amortization	673,676	8,450	55,587	1,179	738,892
Interest income	-	4,223	57	15,589	19,869
Interest expense	3	1,833	43	83,122	85,001
Share in the net income of equity investees	479,430	-	2,477	-	481,907
Income tax expense	441,607	372,511	63,107	7,915	885,140
Investment in equity method investees at December 31, 2006	2,186,742	-	304,596	-	2,491,338
Segment assets at December 31, 2006	9,811,019	2,542,974	1,731,896	16,229	14,102,118

For nine months ended September 30, 2007, the Company had one customer which accounted for approximately 25% of the Company's crude oil and petroleum product sales. Management does not believe that the Company is reliant on any particular customer. The geographical segmentation the Company's revenue for nine months ended September 30, 2007 and 2006 is presented below (in US\$ thousands):

	2007	2006
Export	\$ 9,060,820	\$ 11,091,274
Domestic	4,505,535	3,523,121
CIS	1,110,686	916,434
Total revenues from external customers	<u>14,677,041</u>	<u>\$ 15,530,829</u>

Substantially all of the Company's long-lived assets are located in the Russian Federation.

### 13. Subsequent Events

In November, 2007 the Company closed a transaction to attract US\$ 2.2 billion unsecured syndicated loan facility bearing interest at LIBOR plus 0.75% for the term of three years.