

OJSC Rosneft Oil Company

Consolidated Financial Statements

Years ended December 31, 2005, 2004 and 2003

With Report of Independent Auditors

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Report of Independent Auditors

Shareholders and the Board of Directors of OJSC Rosneft Oil Company

We have audited the accompanying consolidated balance sheets of OJSC Rosneft Oil Company, an open joint stock company, and subsidiaries (“the Company”) as of December 31, 2005, 2004 and 2003 and the related consolidated statements of income and comprehensive income, changes in shareholders’ equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

As discussed in Note 18 to the consolidated financial statements, as of December 31, 2004 the Company was not in compliance with certain provisions of debt agreements, which constituted events of default, and as a result the related debt became callable by the respective creditors as of that date. Subsequently the Company has obtained waiver letters from the respective creditors which have provided for a grace period to cure these defaults and this grace period was ultimately extended until December 31, 2006, which is not more than one year from the most recent balance sheet date. Based on the Company’s current strategy towards curing these matters, we do not believe that it is probable that all events of default will be cured before December 31, 2006. The Company continues to classify the related debt in the amount of US\$ 2,803 million as non-current, which is not in compliance with Statement of Financial Accounting Standard (SFAS) No. 78 “*Classification of Obligations That Are Callable by the Creditor*”, which requires classification of such debt as current.

As discussed in Note 4 to the consolidated financial statements, the Company has not presented pro-forma results of operations for the years 2003 and 2004 as though its OJSC Yuganskneftegaz acquisition had been completed as of January 1, 2003. These disclosures are required by SFAS No. 141 "*Business Combinations*".

As discussed in Note 4 to the consolidated financial statements, the value of property, plant and equipment pertaining to non-controlling shareholders in the accounting for minority interests resulting from acquisitions of OJSC YNG has been recorded at appraised values rather than at historical cost as required by SFAS No. 141 "*Business Combinations*".

In our opinion, except for the effects of the matters described in the preceding paragraphs, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2005, 2004 and 2003, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 3 to the consolidated financial statements, effective January 1, 2003, the Company adopted SFAS No. 143 "*Accounting for Asset Retirement Obligations*."

ERNST & YOUNG LLC

May 15, 2006

OJSC Rosneft Oil Company

Consolidated Balance Sheets

(in millions of US dollars, except share amounts)

		As of December 31,		
	Notes	2005	2004	2003
ASSETS				
Current assets:				
Cash and cash equivalents	5	\$ 1,173	\$ 1,033	\$ 228
Restricted cash	5	23	25	7
Short-term investments	6	165	183	315
Accounts receivable, net of allowance for doubtful accounts of US\$ 69, US\$ 75 and US\$ 62, respectively	7	2,858	4,799	753
Inventories	8	814	517	331
Deferred tax assets	24	48	28	23
Prepayments and other current assets	9	897	256	155
Total current assets		5,978	6,841	1,812
Non-current assets:				
Long-term investments	10	436	277	181
Long-term bank loans granted, net of allowance of US\$ 12, US\$ 4 and US\$ 6, respectively		63	40	24
Oil and gas properties, net	11, 14	20,939	16,540	3,292
Property, plant and equipment, net	12, 14	2,030	1,758	1,063
Construction-in-progress	13	509	482	372
Goodwill	15	35	35	–
Deferred tax assets	24	8	5	20
Other non-current assets, net of allowance of US\$ 2, US\$ 0 and US\$ 0, respectively	16	18	34	4
Total non-current assets		24,038	19,171	4,956
Total assets		\$ 30,016	\$ 26,012	\$ 6,768
LIABILITIES AND SHAREHOLDER'S EQUITY				
Current liabilities:				
Accounts payable and accrued liabilities	17	\$ 1,358	\$ 1,386	\$ 670
Short-term loans and current portion of long-term debt	18	4,005	4,720	588
Income and other tax liabilities	20	2,810	1,560	131
Deferred tax liabilities	24	40	–	4
Other current liabilities		32	42	5
Total current liabilities		8,245	7,708	1,398
Asset retirement obligations	21	566	555	126
Long-term debt	18	8,198	9,022	1,820
Deferred tax liabilities	24	3,696	2,854	71
Other non-current liabilities		18	3	2
Total liabilities		20,723	20,142	3,417
Minority interest	22	1,860	2,535	789
Shareholder's equity:				
Common stock par value 0.01 RUR (shares issued and outstanding: 9,092,174,000 as of December 31, 2005, 2004 and 2003)	19	20	20	20
Additional paid-in capital	19	19	19	19
Accumulated other comprehensive income		–	–	13
Retained earnings		7,394	3,296	2,510
Total shareholder's equity		7,433	3,335	2,562
Total liabilities and shareholder's equity		\$ 30,016	\$ 26,012	\$ 6,768

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

OJSC Rosneft Oil Company

Consolidated Statements of Income and Comprehensive Income

(in millions of US dollars, except earnings per share data)

		For the years ended December 31,		
	Notes	2005	2004	2003
Revenues				
Oil and gas sales	27	\$ 16,202	\$ 2,735	\$ 1,714
Petroleum products and processing fees	27	7,374	2,233	1,724
Support services and other revenues		375	307	203
Total		23,951	5,275	3,641
Costs and expenses				
Production and operating expenses		1,623	608	442
Cost of purchased oil and petroleum products		732	547	368
Selling, general and administrative expenses		663	269	305
Pipeline tariffs and transportation costs		2,164	562	452
Exploration expenses		194	51	18
Depreciation, depletion and amortization		1,472	307	302
Accretion expense		35	8	12
Taxes other than income tax	24	5,264	957	642
Excise tax and export customs duty	23	6,281	760	436
Total		18,428	4,069	2,977
Operating income		5,523	1,206	664
Other income /(expenses)				
Interest income		81	65	73
Interest expense		(775)	(159)	(110)
(Loss)/gain on disposal of property, plant and equipment		(74)	121	(21)
(Loss)/gain on disposal of investments		(13)	(30)	5
Gain on disposal of share in CJSC Sevmorneftegaz	10	1,303	–	–
Equity share in affiliates' profits	10	51	52	–
Dividends and income from joint ventures		10	46	16
Other expenses, net		(137)	(196)	(101)
Foreign exchange gain		245	96	63
Total other income/(expenses)		691	(5)	(75)
Income before income tax and minority interest		6,214	1,201	589
Income tax expense	24	(1,609)	(298)	(201)
Income before minority interest		4,605	903	388
Minority interest in subsidiaries' earnings	22	(446)	(66)	(52)
Net income before cumulative effect from change in accounting principle		4,159	837	336
Cumulative effect from change in accounting principle, net of income tax		–	–	50
Net income		4,159	837	386
Other comprehensive income	2	–	–	13
Comprehensive income		\$ 4,159	\$ 837	\$ 399
Earnings per share (in US\$) – basic and diluted		\$ 0.46	\$ 0.09	\$ 0.04
Weighted average number of shares outstanding (in thousands)	19	9,092,174	9,092,174	9,092,174

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

OJSC Rosneft Oil Company
Consolidated Statements of Changes in Shareholders' Equity
for the years ended December 31, 2005, 2004 and 2003
(in millions of US dollars)

	Common stock	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Shareholder's equity
Balance at December 31, 2002	\$ 20	\$ –	\$ –	\$ 2,173	\$ 2,193
Share issue and premium	–	19	–	–	19
Unrealised gains on available- for-sale securities	–	–	13	–	13
Net income for the year	–	–	–	386	386
Dividends declared on common stock	–	–	–	(49)	(49)
Balance at December 31, 2003	\$ 20	\$ 19	\$ 13	\$ 2,510	\$ 2,562
Realized gains on available-for- sale securities	–	–	(13)	–	(13)
Net income for the year	–	–	–	837	837
Dividends declared on common stock	–	–	–	(51)	(51)
Balance at December 31, 2004	\$ 20	\$ 19	\$ –	\$ 3,296	\$ 3,335
Net income for the year	–	–	–	4,159	4,159
Dividends declared on common stock	–	–	–	(61)	(61)
Balance at December 31, 2005	\$ 20	\$ 19	\$ –	\$ 7,394	\$ 7,433

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

OJSC Rosneft Oil Company
Consolidated Statements of Cash Flows

(in millions of US dollars)

	For the years ended December 31,		
	2005	2004	2003
Operating activities			
Net income	\$ 4,159	\$ 837	\$ 386
Reconciliation of net income to net cash provided by operating activities:			
Effect of foreign exchange on cash and cash equivalents and deferred tax	(115)	(24)	(16)
Gain on disposal of share in CJSC Sevmorneftegaz (Note 10)	(1,303)	–	–
Cumulative effect from change in accounting principle, net of income tax	–	–	(50)
Depreciation, depletion and amortization	1,472	307	302
Dry well expenses	17	7	–
Loss / (gain) on disposal of property, plant and equipment	74	(121)	21
Deferred income tax	(79)	(11)	(43)
Accretion expense	35	8	12
Equity share in affiliates' profits	(51)	(52)	–
Increase in allowance for doubtful accounts and bank loans granted	4	11	27
Minority interests in subsidiaries' earnings	446	66	52
Changes in operating assets and liabilities net of acquisitions:			
Decrease / (increase) in restricted cash	2	(4)	–
Increase in accounts receivable	(1,353)	(146)	(114)
Increase in inventories	(297)	(92)	(56)
(Increase) / decrease in prepayments and other current assets	(641)	(100)	42
Decrease / (increase) in other non-current assets	16	(26)	(3)
Increase in long-term bank loans granted	(23)	(16)	(13)
(Decrease) / increase in accounts payable and accrued liabilities	(28)	(44)	169
Increase in income and other tax liabilities	414	34	53
Increase in interest payable	158	35	18
Increase in other current and non-current liabilities	5	38	7
Net cash provided by operating activities	2,912	707	794
Cash flows from investing activities			
Capital expenditures	(2,085)	(853)	(821)
Proceeds from disposals of property, plant and equipment	30	206	6
Acquisition of short-term investments	(693)	(88)	(614)
Proceeds from sale of short-term investments	707	253	449
Acquisition of entities and additional shares in subsidiaries	(366)	(270)	(728)
Acquisition of OJSC Yuganskneftegaz	–	(9,398)	–
Proceeds from sale of long-term investments	147	248	463
Acquisition of long-term investments	(33)	(267)	(315)
Net cash used in investing activities	\$ (2,293)	\$ (10,169)	\$ (1,560)

OJSC Rosneft Oil Company
Consolidated Statements of Cash Flows (continued)

(in millions of US dollars)

	For the years ended December 31,		
	2005	2004	2003
Cash flows from financing activities			
Proceeds from short-term debt	\$ 977	\$ 3,211	\$ 548
Repayment of short-term debt	(2,018)	(132)	(588)
Proceeds from long-term debt	2,547	8,092	1,043
Repayment of long-term debt	(1,829)	(867)	(228)
Dividends paid to minority shareholders of subsidiaries	(74)	(10)	(19)
Common dividends paid	(61)	(51)	(49)
Net cash (used in)/provided by financing activities	<u>(458)</u>	<u>10,243</u>	<u>707</u>
Increase /(decrease) in cash and cash equivalents	161	781	(59)
Cash and cash equivalents at beginning of year	1,033	228	271
Effect of foreign exchange on cash and cash equivalents	(21)	24	16
Cash and cash equivalents at end of year	<u>\$ 1,173</u>	<u>\$ 1,033</u>	<u>\$ 228</u>
Supplementary disclosures of cash flow information			
Cash paid for interest (net of amount capitalized)	\$ 617	\$ 124	\$ 92
Cash paid for income taxes	\$ 1,636	\$ 309	\$ 199
Supplementary disclosure of non-cash activities			
Income tax offsets	\$ 41	\$ 6	\$ 49
Non-cash capital expenditures	\$ (32)	\$ (50)	\$ (61)

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

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements

Years ended December 31, 2005, 2004 and 2003

(all amounts in tables are in millions of US dollars, except as noted otherwise)

1. General

Nature of Operations

Open Joint Stock Company ("OJSC") Rosneft Oil Company ("Rosneft") and its subsidiaries, (collectively the "Company" or the "Group"), are principally engaged in exploration, development, production and sale of crude oil and gas and refining, transportation and sale of petroleum products in the Russian Federation ("RF") and in certain international markets.

Rosneft State Enterprise was incorporated as an open joint stock company on December 7, 1995. All assets and liabilities previously managed by Rosneft State Enterprise were transferred to the Company at their book value effective on that date together with the Government of the RF ("State") ownership in other privatized oil and gas companies. The transfer of assets and liabilities was made in accordance with Resolution No. 971, "On the Transformation of Rosneft State Enterprise into an Open Joint Stock Company "Rosneft Oil Company", dated September 29, 1995. Such transfers represented a reorganization of assets under the common control of the State and, accordingly, were accounted for at their book value. As of December 31, 2004 and 2003, the State maintained a 100% interest in Rosneft. In 2005, the shares of Rosneft were contributed to the share capital of OJSC Rosneftegaz (see Note 19). As of December 31, 2005, 100% of the shares of Rosneft less one share were owned by OJSC Rosneftegaz and one share was owned by the RF Federal Agency for the Management of Federal Property.

Under Russian legislation, natural resources, including oil, gas, precious metals and minerals and other commercial minerals situated within the territory of the RF are the property of the State until they are extracted. The Law of the RF 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 RF. Pursuant to the Law, subsurface resources may be developed only on the basis of a licence. The licence 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 several licences issued by regional authorities for the geological study and development of oil and gas blocks and fields in areas where its subsidiaries are located.

In addition, the Company participates in a number of production sharing agreements (PSAs). As a result, the Company has rights to develop certain licence blocks according to the existing PSAs and may receive similar rights in the future (see Note 11).

Due to the limited capacity of OJSC Transneft's pipeline system, the State Pipeline Commission sets export quotas for each oil company based on the legislation on equal access to the oil pipeline system. In addition, the Company exports certain quantities of crude oil bypassing the Transneft system thus enabling it to increase its export capacities. In 2005, 2004 and 2003 the Company's export sales were approximately 62%, 57% and 51% of production, respectively. The remaining production was processed at the Company's refineries and other Russian refineries for further sales on domestic and international markets. Generally, export sales result in a higher net realized price than Russian domestic sales after considering related transportation and export duties and other charges.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

1. General (continued)

Nature of Operations (continued)

Principal subsidiary companies included in the consolidated financial statements and respective ownership interests of the Company as of December 31, 2005 are as follows:

Name	Nature of Business	Preferred and	Voting
		Common Shares	Shares
		%	%
<u>Exploration and production</u>			
OJSC Yuganskneftegaz (Note 22)	Oil and gas development and production	76.79	100.00
OJSC Rosneft-Purneftegaz	Oil and gas development and production	83.09	90.82
OJSC Rosneft-Sakhalinmorneftegaz	Oil and gas development and production	64.62	84.63
OJSC Rosneft-Krasnodarneftegaz	Oil and gas development and production	95.46	97.91
OJSC Rosneft-Stavropolneftegaz	Oil and gas development and production	75.18	89.33
OJSC Rosneft-Dagneft	Oil and gas development and production	68.70	91.60
OJSC Grozneftegaz	Oil and gas development and production	51.00	51.00
OJSC Rosneft-Sakhalin	Field survey and exploration	55.00	55.00
OJSC Severnaya Neft (Northern Oil)	Oil and gas development and production	100.00	100.00
OJSC Selkupneftegaz	Oil and gas development and production	100.00	100.00
Caspoil LLC	Oil and gas development and production	75.10	75.10
CJSC Vostokshelf	Field survey and exploration	100.00	100.00
RN-Kazakhstan LLC	Field survey and exploration	100.00	100.00
OJSC Dagneftegaz	Oil and gas development and production	81.22	94.96
RN-Kaiganneftegaz LLC	Field survey and exploration	100.00	100.00
CJSC Vostok-Smidt Neftegaz	Field survey and exploration	100.00	100.00
CJSC Zapad-Smidt Neftegaz	Field survey and exploration	100.00	100.00
Vostok Smidt Invest LLC	Field survey and exploration	100.00	100.00
Zapad Smidt Invest LLC	Field survey and exploration	100.00	100.00
Komsomolskoye NGDU LLC	Oil and gas development and production	100.00	100.00
West Kamchatka Holding B.V.	Field survey and exploration	100.00	100.00
Veninneft LLC	Field survey and exploration	100.00	100.00
Kamchatneftegaz LLC	Field survey and exploration	100.00	100.00
CJSC Vankorneft	Field survey and exploration	100.00	100.00
Taymyrneft LLC	Field survey and exploration	60.00	60.00
Eniseineft LLC	Field survey and exploration	99.00	99.00
<u>Refining, marketing and distribution</u>			
OJSC Rosneft-Tuapse Refinery	Petroleum refining	81.23	90.62
OJSC Rosneft-Komsomolsky Refinery	Petroleum refining	79.98	86.86
OJSC Rosneft-MZ Nefteproduct	Petroleum refining	65.42	87.23
OJSC Rosneft-ARTAG	Marketing and distribution	38.00	50.67
OJSC Rosneft-Altainefteproduct	Marketing and distribution	64.18	78.59
OJSC Rosneft-Arkhangelsknefteproduct	Marketing and distribution	75.42	84.65
OJSC Rosneft-Kabardino-Balkarskaya Toplivnaya Company	Marketing and distribution	88.66	92.91
OJSC Rosneft-Kubannefteproduct	Marketing and distribution	89.50	96.61
OJSC Rosneft-Karachaevo-Cherkessknefteproduct	Marketing and distribution	85.99	87.46
OJSC Rosneft-Kurgannefteproduct	Marketing and distribution	83.32	90.33
OJSC Rosneft-Murmansknefteproduct	Marketing and distribution	45.38	60.51
OJSC Rosneft-Nakhodkanefteproduct	Marketing and distribution	40.62	51.53
OJSC Rosneft-Smolensknefteproduct	Marketing and distribution	66.67	86.97
OJSC Rosneft-Tuapsenefteproduct	Marketing and distribution	38.00	50.67
OJSC Rosneft-Yamalnefteproduct	Marketing and distribution	49.52	66.03
RN-Vostoknefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Stavropolye	Marketing and distribution	99.08	99.08
RN-Trade LLC	Marketing and distribution	100.00	100.00

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

1. General (continued)

Nature of Operations (continued)

Name	Nature of Business	Preferred and	Voting
		Common Shares	Shares
		%	%
Other			
Rosneft International Limited	Holding company	100.00	100.00
CJSC Rosneftflot	Transportation services	82.66	82.66
OJSC All-Russian Bank for Reconstruction and Development of Russian Regions (VBRR)	Banking	50.98	50.98
CJSC RN-Astra	Investment activities	100.00	100.00
CJSC Sakhalinskie Proekty	Corporate planning	100.00	100.00
CJSC Vostochny Neftenalivnoy Terminal	Services	100.00	100.00
Baikalfinancegroup LLC	Investment activities	100.00	100.00

All of the above subsidiaries, except for Rosneft International Ltd. and West Kamchatka Holding B.V., are incorporated in the RF. Rosneft International Ltd. is registered in Ireland, West Kamchatka Holding B.V. is registered in the Netherlands.

Currency Exchange and Control

Foreign currencies, in particular the US dollar and the 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 foreign currencies, primarily the US dollar.

The Russian Federation has established currency regulation rules designed to stimulate use of the ruble in business operations. Such rules allow the Central Bank of Russia (the "CBR") to place restrictions on the conversion of rubles into foreign currencies and retain the CBR's powers to independently impose the quota of foreign currency to be converted into rubles. In March 2006, mandatory conversion of foreign currency was abolished.

2. Summary of Significant Accounting Policies

Format and Content of Consolidated Financial Statements

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 accompanying consolidated financial statements differ from the financial statements issued for statutory purposes in Russia in that they reflect certain adjustments, not recorded in the Company's statutory books, which are appropriate to present the financial position, results of operations and cash flows in accordance with US GAAP. The principal adjustments relate to: (1) recognition of certain expenses; (2) valuation and depreciation of property, plant and equipment; (3) foreign currency translation; (4) deferred income taxes; (5) valuation allowances for unrecoverable assets; (6) accounting for the time value of money; (7) accounting for investments in oil and gas property and conveyances; (8) consolidation principles; (9) recognition and disclosure of guarantees, contingencies, commitments and certain assets and liabilities; (10) accounting for asset retirement obligations; (11) business combinations and goodwill/negative goodwill.

Certain amounts in the 2003 and 2004 consolidated financial statements were reclassified to conform to the current year presentation.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Format and Content of Consolidated Financial Statements (continued)

As discussed in Note 4, on December 31, 2004 the Company acquired OJSC Yuganskneftegaz. Accordingly, the results of OJSC Yuganskneftegaz operations were included in the Company's consolidated statement of income from January 1, 2005. Consequently, the results of the Company's operations in 2005, 2004 and 2003 are not comparable without considering this matter in 2005. Revenue from sales of crude oil and refined products related to OJSC Yuganskneftegaz in 2005 accounts for approximately 69% of the consolidated revenue of the Company.

Management Estimates

The preparation of the 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 amounts of revenues and expenses recognized during the reporting periods. Certain significant estimates and assumptions for the Company include: estimation of economically recoverable oil and gas reserves; rights to and recoverability and useful lives of long-term assets and investments; impairment of goodwill; allowances for doubtful accounts receivable; asset retirement obligations; legal and tax contingencies; environmental remediation obligations; recognition and disclosure of guarantees and other commitments; fair value measurements; ability to renew operating leases and to enter into new lease agreements; classification of certain debt amounts. Some of the most significant estimates are made in connection with the acquisition of OJSC Yuganskneftegaz. 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.

Principles of Consolidation

The consolidated statements include business transactions of the subsidiaries in which the Company directly or indirectly owns more than 50% of common voting stock, or on which it otherwise exercises control. All intercompany transactions and balances have been eliminated. Investments in other significant entities in which the Company owns between 20% and 50% are generally accounted for under the equity method since the Company does not have absolute control, but rather significant influence. Investments in other companies are accounted for at cost and adjusted for any estimated impairment.

The Company analyzed the application of Financial Accounting Standards Board ("FASB") Interpretation ("FIN") 46R, *Consolidation of Variable-Interest Entities* (VIEs), for potential consolidation of companies. FIN 46R was applied from January 1, 2004 for VIEs created after December 31, 2003, and from January 1, 2005, for all other VIEs. As discussed in Note 3, the application of FIN 46R did not have a significant impact on the Company's operations and financial position.

Minority Interest

Minority interests in the net assets and net results of consolidated subsidiaries are shown under "Minority interest" in the accompanying consolidated balance sheets and statements of income and comprehensive income. For majority-owned subsidiaries that incur losses, the Company recognizes 100% of the losses, after first reducing the related minority interests' balances to zero, unless minority shareholders committed to fund the losses. Further, when a majority-owned subsidiary becomes profitable, the Company recognizes 100% of profits until such time as the excess losses previously recorded have been recovered. Thereafter, the Company recognizes profits in accordance with the underlying ownership percentage. The actual ruble-denominated balances attributable to minority interests may differ from these amounts presented in these consolidated financial statements.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Foreign Currency Translation

The management of the Company has determined the US Dollar as the functional and reporting currency for the purpose of financial reporting under US GAAP.

Monetary assets and liabilities have been translated into US dollars using the exchange rate as of the balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows are translated into US dollars at average exchange rates prevailing on transaction dates. Gains and losses resulting from the re-measurement into US dollars are included in the "Foreign exchange gain" in the consolidated statement of income.

As of December 31, 2005, 2004 and 2003, the official CBR rates of exchange were 28.78 rubles, 27.75 rubles and 29.45 rubles per US dollar, respectively. As of May 15, 2006 the official rate of exchange was 26.94 rubles per US dollar.

The translation of local currency denominated assets and liabilities into US dollars for the purposes of these financial statements does not indicate that the Company could realize or settle, in U.S. dollars, the reported values of these assets and liabilities. Likewise, it does not indicate that the Company could return or distribute the reported US dollar value of capital to its shareholders.

Cash and Cash Equivalents

Cash represents cash on hand and in the Company's bank accounts and interest bearing deposits which can be effectively withdrawn at any time without prior notice or penalties reducing the principal amount of the deposit.

Accounts Receivable

Trade accounts receivable are stated at their principal amounts outstanding net of allowances for doubtful debts. Specific allowances are recorded against trade receivables whose recovery or collection has been identified as doubtful. Estimates of allowances require the exercise of judgment and the use of assumptions.

Earnings Per Share

Basic earnings per share is calculated by dividing net earnings attributable to common shares by the weighted average number of common shares outstanding during the corresponding period. In the absence of any securities-to-shares conversion transactions, the amount of basic earnings per share stated in these financial statements is equal to the amount of diluted earnings per share.

Inventories

Inventories, consisting primarily of crude oil, petroleum products and materials and supplies, are stated at the lower of weighted average cost of acquisition or market value. Market value shall not exceed net realizable value (i.e. the price at which inventories can be sold after allowing for the cost of completion and sale), and shall not be lower than net realizable values less the amount of margin.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Financial Investments

All debt and equity securities held by the Company are classified into one of the following three categories: trading securities; available-for-sale securities; held-to-maturity securities.

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

Trading securities and available-for-sale securities are carried at fair (market) value. Held-to-maturity securities are stated at amortized cost. Unrealized gains or losses on trading securities are included in the consolidated statements of income. Unrealized gains and losses on available-for-sale securities less related tax effects are recorded as a separate component of comprehensive income until the date of disposal.

Realized gains and losses from the sale of available-for-sale securities are reported separately for each type of security. Dividends and interest income are recognized in the consolidated statements of income on an accrual basis.

Investments in shares or interests of companies where the Company has less than 20% equity interest and no significant influence, which are not publicly traded and whose market value is not readily available are carried at cost.

If the decline in fair value of an investment below its carrying value is other than temporary, the carrying value of the investment is reduced and a loss in the amount of any such decline is recorded. Cost method investments are evaluated for impairment when events or changes in circumstances occur which may have a significant effect on the fair value of these investments.

Sale and Repurchase Agreements and Securities Lending

Sale and repurchase agreements are treated as secured financing transactions. Securities sold under sale and repurchase agreements are included in trading securities. The corresponding liability is presented within short-term debt. The difference between the sale and repurchase price is treated as interest and is accrued over the life of repurchased agreements using the effective interest method.

Oil and Gas Properties

In accordance with Statement of Financial Accounting Standard ("SFAS 19"), *Financial Accounting and Reporting by Oil and Gas Producing Companies* (SFAS 19), oil and gas properties and the related expenses are recognized under the successful efforts method. This method prescribes that exploration costs, including geological and geophysical costs and the costs of dry holes, are charged to expense when incurred.

In April 2005, FASB issued FASB Staff Position FSP FAS 19-1, *Accounting for suspended well costs* ("FSP FAS 19-1"), which amends SFAS 19.

FSP FAS 19-1 provides for continued capitalization of exploratory drilling costs past one year if a company is making sufficient progress on assessing the reserves and the economic and operating viability of the project. FSP FAS 19-1 also provides certain disclosure requirements with respect to capitalized exploratory drilling costs. As of January 1, 2005 the Company adopted FSP FAS 19-1.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Oil and Gas Properties (continued)

Exploratory well costs (including costs associated with stratigraphic test wells) are temporarily capitalized pending determination of whether potentially economic oil and gas reserves have been discovered by the drilling effort. The length of time necessary for this determination depends on the specific technical or economic difficulties in assessing the recoverability of the reserves. If a determination is made that the well did not encounter oil and gas in economically viable quantities, the well costs are expensed and are reported in "exploration expenses".

Exploratory drilling costs are temporarily capitalized pending determination of whether the well has found proved reserves if both of the following conditions are met:

- The well has found a sufficient quantity of reserves to justify, if appropriate, its completion as a producing well, assuming that the required capital expenditure is made; and
- Satisfactory progress toward ultimate development of the reserves is being achieved, with the Company making sufficient progress assessing the reserves and the economic and operating viability of the project.

The Company evaluates the progress made on the basis of regular project reviews which take into account the following factors:

- First, if additional exploratory drilling or other exploratory activities (such as seismic work or other significant studies) are either underway or firmly planned, the Company deems there to be satisfactory progress. For these purposes, exploratory activities are considered firmly planned only if they are included in the Company's three-year exploration plan/budget. At December 31, 2005, exploratory drilling costs capitalized on this basis were not material.
- In cases where exploratory activity has been completed, the evaluation of satisfactory progress takes into account indicators such as the fact that costs for development studies are incurred in the current period, or that governmental or other third-party authorizations are pending or that the availability of capacity on an existing transport or processing facility awaits confirmation. At December 31, 2005, exploratory drilling costs capitalized on this basis were not material.

Should the project be deemed economically viable, it is then transferred to the development stage, otherwise the costs are expensed.

Costs, including "internal" costs relating to drilling and equipping of development wells, including development dry holes, as well as costs required for drilling and equipping of injection wells in the process of oil and gas reserves development, are capitalized. These costs are included in oil and gas properties in the consolidated balance sheet.

Property, Plant and Equipment

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

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

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 statement of income.

Depreciation, Depletion and Amortization

Depletion expense of acquisition costs of proved oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalized costs related to oil and gas production is calculated using the unit-of production method based on proved developed reserves. Management of the Company considers each extraction division as the appropriate level for these calculations.

Acquisition costs of unproved properties are not amortized. These costs are reclassified as proved properties when the relevant reserve reclassification is made. Acquisition costs of unproved properties are reviewed for impairment. In case of impairment these costs are expensed when incurred.

Depreciation and amortization charges with respect to property, plant and equipment other than oil and gas properties is computed using the straight-line method and based on their useful lives.

Depreciation rates are applied to similar types of buildings, machinery and equipment having similar economic characteristics, as shown below:

Asset Group	Average Useful Life
Buildings and constructions	30-35 years
Plant and machinery	15 years
Vehicles and other equipment	6 years
Service vessels	20 years
Offshore drilling assets	20 years

Interests in Joint Operations

A joint operation is a contractual arrangement whereby two or more parties (participants) undertake an economic activity that is subject to joint control. Joint control is only exercised when strategic, financial and operating decisions relating to the joint activity are made unanimously by all the parties. A joint venture is as a registered company, partnership or any other legal form for the purposes of handling joint operations.

Financial results, assets and liabilities arising from interests in joint ventures are recognized in these consolidated financial statements using the equity method of accounting. Under the equity method, investments in joint ventures are recognized at the cost of financial investments increased by any change to the share of net assets from the date of inception of a joint venture, less distributed earnings and impairment of financial investments. The consolidated statements of income include the Company's share in gains and losses arising from joint ventures.

The Company discontinues the use of the equity method of accounting from the date on which it ceases to have joint control over, or have significant influence in, a jointly-controlled entity, or when its interest in a jointly-controlled entity is reclassified to assets held for sale.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Interests in Joint Operations (continued)

Certain activities of the Company (mainly oil exploration and production) are conducted through interests in joint projects, where the parties exercise joint control over the assets without a legal entity being established. Income, expenses, assets and liabilities arising from participation in joint projects are included in the consolidated financial statements on a pro rata basis corresponding to the participation share.

A part of an interest in a jointly-controlled oil and gas exploration and production entity may be assigned to other participants or third parties. In which case, in accordance with SFAS 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, such assignment is performed and accounted for under an arrangement called a "carried interest" whereby the assignee agrees to carry all costs of drilling, developing, and operating the property. The assignee is also entitled to all of the revenue from hydrocarbon production from the property, excluding any third party interest, until all of the assignee's costs, including the contractual rate of return, have been recovered, at such time the assignor will resume its participation in operating expenses and income.

Impairment of Long-Lived Assets

Long-lived assets, including blocks with proved oil and gas reserves, are assessed for potential impairment in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

Oil and gas properties are assessed whenever events or circumstances indicate potential impairment. If the carrying value of oil and gas properties is not recoverable through undiscounted cash flows, an impairment is recognized. The impairment is determined on the basis of the estimated fair value of oil and gas properties which, in turn, is measured by discounting future net cash flows or with reference to current market prices of oil and gas properties, if available. Discounted future cash flows from oil and gas fields are based on the most reliable management estimates of future prices that rely on recent actual prices and published prices for forward transactions; such prices are applied to forecast production volumes at particular fields with further discounting for the expected risk level. Forecast production volumes shall be understood as reserves, including probable reserves that are proposed to be extracted using a known amount of capital expenditures. Production volumes and prices correspond to the internal plans and forecasts, as well as other data in the published financial statements. Assumptions regarding future prices and costs used to assess oil and gas properties for impairment differ from those used in the standard procedure for discounting net cash flows from proved oil and gas reserves. In accordance with SFAS 69, *Disclosures about Oil and Gas Producing Activities*, such disclosures should be based on assumptions that use prices and expenses as of the balance sheet date without forecasting future changes.

Grouping of assets for the purpose of depreciation is performed on the basis of the lowest level of identifiable cash flows that are largely independent of the cash flows from other groups of assets – as a rule, for oil and gas properties such level is represented by the field, for refining assets – by the whole refining unit, for service stations – by the facilities. Long-lived assets intended by management for use during a period not exceeding one year are recorded at the lower of depreciated value or fair value, less selling expenses.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Impairment of Long-Lived Assets (continued)

Acquisition costs of unproved oil and gas properties are assessed for impairment on a regular basis and any estimated impairment is charged to expenses.

Recoverability of oil and gas properties attributable to the refining, marketing and distribution segment is generally assessed on the basis of expected future cash flows from key operating units, usually entire legal entities. Since assets of this segment (particularly refining units) represent an integrated set of operations, this condition is taken into account in measuring the value of particular units or the extent of their utilization to generate other cash flows.

Business Combinations

The Company accounts for its business acquisitions under the purchase method of accounting. The total cost of acquisitions is allocated to the underlying assets, including intangible assets, and liabilities based on their respective estimated fair values. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, licence and other asset lives and market multiples, among other items.

As discussed further in Note 4, the Company's December 2004 acquisition of OJSC Yuganskneftegaz resulted in the fair value of the underlying net assets acquired exceeding the purchase price and thus resulted in negative goodwill. The negative goodwill reduced, on a pro rata basis, amounts assigned to the acquired non-current assets.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the acquisition cost over the fair value of net assets acquired. The excess of the fair value of the acquired share of net assets over their acquisition cost represents negative goodwill and is allocated among the non-current assets acquired, excluding investments and deferred tax assets, which may result in their value being reduced to zero.

For investees accounted for under the equity method, the excess of the cost to acquire a share in those entities over the fair value of the acquired share of net assets as of the acquisition date is treated as embedded goodwill and is considered in computing the Company's equity share in income/loss of equity investees.

In accordance with requirements of SFAS 142, *Goodwill and Other Intangible Assets*, goodwill and intangible assets with indefinite useful lives are not amortized. Instead, they are tested at least annually for impairment.

Intangible assets that have a finite useful life are amortized using the straight-line method over the shorter of their useful life or the term established by legislation.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Capitalized Interest

Interest expense related to the use of borrowed funds used for capital construction projects and acquisition of properties, plant and equipment is capitalized provided such interest expense could have been avoided if the Company had not made capital investments. Interest is capitalized only during the period when construction activities are actually in progress and until the resulting properties are put into operation. The Company capitalized US\$ 79 million, US\$ 22 million and US\$ 34 million of interest expenses on loans and borrowings in 2005, 2004 and 2003, respectively.

Leasing Agreements

Capital leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the interest charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liabilities. Interest charges are charged directly to the consolidated statements of operation and comprehensive income.

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term unless leased assets are capitalized because the terms of the lease agreement grant the Company ownership rights over the leased assets by the end of the lease term or containing a bargain purchase option. In the latter cases capitalized assets are depreciated over the estimated useful life of the asset regardless of the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statements of operation and comprehensive income on a straight-line basis over the lease term.

Asset Retirement Obligations

The Company has conditional asset retirement obligations associated with its core business activities. The nature of the assets and potential obligations are as follows:

Exploration and Production – The Company's exploration, development and production activities involve the use of the following assets: wells, related equipment and operating sites, oil gathering and treatment facilities, tank farms and in-field pipelines. Generally, licences and other regulatory acts require that such assets be decommissioned upon the completion of production. According to these requirements, the Company is obliged to decommission wells, dismantle equipment, restore the sites and perform other related activities. The Company's estimates of these obligations are based on current regulatory or licence requirements, as well as actual dismantling and other related costs. Asset retirement obligations are calculated in accordance with the provisions of SFAS 143, *Accounting for Asset Retirement Obligations*.

Refining, Marketing and Distribution – This business segment covers refining operations, marine and other distribution terminals, and retail sales. The Company's refining operations consist of major petrochemical operations and industrial complexes. These industrial complexes have been in operation for several decades. The Company's management believes that given the nature of the operations, the useful lives of these industrial complexes are indeterminable, while certain of their operating components and equipment have definite useful lives. Legal or contractual asset retirement obligations related to petrochemical, oil refining, marketing and distribution activities are not recognized due to the limited history of such activities in these segments, the lack of clear legal requirements as to the recognition of obligations, as well as the fact that useful lives of such assets are not determinable.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Asset Retirement Obligations (continued)

The Company's marine and other distribution terminals, including its retail network, operate under the regulatory requirements of local authorities and lease arrangements. These requirements generally provide for elimination of the consequences of the use of those assets, including dismantling of equipment, restoration of land, etc. The Company's estimate of conditional asset retirement obligations takes into account the above requirements.

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 has few examples of credit-worthy third parties which 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 SFAS 143 estimates.

Due to continuous changes in the Russian regulatory and legal environment, there could be future changes to the requirements and contingencies associated with the retirement of long-lived assets.

Fair Value of Financial Instruments

SFAS 107, *Disclosures about Fair Value of Financial Instruments*, defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Financial assets and financial liabilities recognized in the accompanying consolidated balance sheets include cash and cash equivalents, short-term and long-term investments, accounts receivable and payable, short-term debt and other current and non-current assets and liabilities. The accounting policies with respect to the recognition and measurement of these items are disclosed in the respective accounting policies in Note 28.

The Company, using available market information, management's estimates and appropriate valuation methodologies, has determined the approximate fair values of financial instruments.

Income Taxes

Russian legislation does not contain the concept of a 'consolidated tax payer' and, accordingly, the Company is not subject to Russian taxation on a consolidated basis but rather on an individual company basis. Income taxes are provided on taxable profit as determined under the Russian Federation Tax Code. Deferred income tax assets and liabilities are recognized in the accompanying consolidated financial statements in the amount determined by the Company using the liability method in accordance with SFAS 109, *Accounting for Income Taxes*. This method takes into account future tax consequences, based on the effective tax rate, associated with differences between the carrying values of assets and liabilities and their taxable base, which gives immediate income statement effect to changes in income tax laws, including changes in the tax rates.

A valuation allowance for a deferred tax asset is recorded when management believes that it is more likely than not that this tax asset will not be realized.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Recognition of Revenues

Revenues are recognized when title passes from the seller to the customer, the contract price is fixed or determinable and collectibility of the receivable is reasonably assured. Specifically, domestic sales of crude oil and gas, as well as petroleum products and materials are recognized when title passes. For export sales, title generally passes at the border of the Russian Federation and the Company covers transportation expenses, duties and taxes on those sales. Revenues include excise taxes and custom duties (see Note 23).

Sales of support services are recognized as services performed provided that the service price can be determined and no significant uncertainties regarding the receipt of revenues exist.

Revenues are shown net of value added tax.

Transportation Expenses

Transportation expenses recognized in the consolidated statement of income represent all expenses incurred in the transportation of crude oil and petroleum products via the Transneft pipeline network, as well as by railway and other transport means.

Refinery Maintenance Costs

The Company recognizes the costs of overhauls and preventive maintenance performed with respect to oil refining assets as expenses when incurred.

Environmental Liabilities

Environmental expenditures are expensed or capitalized, depending upon their future economic benefit. Expenditures that relate to an existing condition caused by past operations, and do not have a future economic benefit, are expensed. Liabilities for these expenditures are recorded on an undiscounted basis when environmental assessments or clean-ups are probable and the costs can be reasonably estimated.

Guarantees

The fair value of a guarantee is determined and recorded as a liability at the time when the guarantee is issued. The initial guarantee amount is subsequently remeasured to reflect the changes in the underlying liability. The expense is included in the related line items of the consolidated income statement, based on the nature of the guarantee. When the likelihood of performing on a guarantee becomes probable, a liability is accrued, provided it is reasonably determinable on the basis of the facts and circumstances at that time.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Comprehensive Income

The Company applies SFAS 130, *Reporting Comprehensive Income*, which establishes standards for the calculation and reporting of the Company's comprehensive income (net income plus all other changes in net assets from non-owner sources) and its components in consolidated financial statements.

As of December 31, 2003, the Company recorded other accumulated comprehensive income in the amount of US\$ 13 million that includes an unrealized holding gain resulting from appreciation of available-for-sale securities to their market value. There was no tax effect as a result of this appreciation.

In the first six months of 2004, the securities were sold and an unrealized gain on these securities was recognized as other income together with the gain from the sales of the securities.

As of December 31, 2005 and 2004, there are no material comprehensive income items and, therefore, comprehensive income for 2005 and 2004 equals net income.

Accounting for Contingencies

Certain conditions may exist as of the date of these consolidated financial statements which may further 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 makes an assessment of such contingent liabilities which is based on assumptions and is a matter of opinion. In assessing loss contingencies relating to legal or tax proceedings that involve the Company or unasserted claims that may result in such proceedings, the Company, after consultation with legal or tax advisors, evaluates the perceived merits of any legal or tax 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 loss will be incurred and the amount of the liability can be estimated, then the estimated liability is accrued in the Company's consolidated 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 or other uncertainties of an unusual nature which, in the judgment of management after consultation with its legal or tax counsel, may be of interest to shareholders or others.

Recent Accounting Standards

In November 2004, the FASB issued SFAS 151, *Inventory Costs*, an amendment of the Accounting Research Bulletin ("ARB") 43, Chapter 4. The standard provides that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company will apply this standard with respect to inventory costs incurred during the fiscal year beginning from January 1, 2006. The management of the Company has not identified the impact this standard will have on the Company's financial position and results of operations.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Standards (continued)

In May 2005, the FASB issued SFAS 154, *Accounting Changes and Error Corrections*. SFAS 154 replaces Accounting Principles Board Opinion 20, *Accounting Changes* ("APB 20"), and SFAS 3, *Reporting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principles. SFAS 154 requires retrospective application to prior period's financial statements of all changes in accounting principle, unless it is impractical to determine either the period-specific effects or the cumulative effect of the change, if a pronouncement which requires the change in accounting principle does not include specific transition provisions. SFAS 154 carries forward without change the guidance contained in APB 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimates. The Company currently cannot estimate the impact the adoption of FAS 154 will have on its consolidated financial statements as no such accounting changes are currently expected.

In June 2005, the FASB's Emerging Issues Task Force ("EITF") reached a consensus on Issue 05-6 ("EITF 05-6"), *Determining the Amortization Period for Leasehold Improvements*. EITF 05-6 requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of the operating lease should be amortized over the lesser of the useful life of the asset or the lease term that includes reasonably assured lease renewals as determined on the date of the acquisition of the leasehold improvement. EITF 05-6 is effective during reporting periods beginning after June 15, 2005 and is not expected to have a material impact on the Company's results and financial position.

On September 15, 2005 FASB issued EITF Issue No. 04-13 *Accounting for Purchases and Sales of Inventory with the Same Counterparty*. This EITF addresses the following issues: determining whether two or more exchange transactions involving inventory with the same counterparty are entered into in contemplation of one another and should be viewed as a single exchange transaction for purposes of evaluating the effect of APB 29, *Accounting for Nonmonetary Transactions*; determining whether nonmonetary exchanges of inventory in the same line of business should be recognized at fair value. This EITF should be applied to new arrangements entered into in reporting periods beginning after March 15, 2006 and to modifications or renewals of existing arrangements after that date. The Company does not expect that the application of EITF 04-13 will have a material impact on its "Sales" and "Operating expenses" accounts in 2006. The Company has identified no material exchanges of inventory that should be recognized at fair value according to EITF 04-13.

3. Changes in Accounting Principles

SFAS 143, Accounting for Asset Retirement Obligations

Since January 1, 2003, the Company has been applying SFAS 143, *Accounting for Asset Retirement Obligations*. This statement applies to obligations associated with the retirement of tangible long-lived assets upon expiration of their useful lives. In accordance to SFAS 143, fair value of asset retirement obligations should be recognized in the period when the obligations occurred if the fair value could be reasonably determined. Costs associated with asset retirement are capitalized within the net book value of long-lived assets.

As of January 1, 2003, the Company recorded an adjustment for the accumulated effect of the change in accounting principle as a result of adoption of this statement that increased net profit by US\$ 50 million, net of income tax. The effect of the adoption of this statement includes an increase in the net book value of oil and gas properties of US\$ 23 million, a decrease in asset retirement obligations of US\$ 42 million, and an increase in deferred tax liability of US\$ 16 million.

The effect of this accounting change on basic and diluted earning per share for the year ended December 31, 2003 is presented below (in US\$):

Earnings per share before cumulative effect of change in accounting principle	\$ 0.037
Cumulative effect of change in accounting principle,	0.005
Earnings per share – basic and diluted	<u>\$ 0.042</u>

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

3. Changes in Accounting Principles (continued)

FIN 46R, Consolidation of Variable-Interest Entities

FIN 46R was applied from January 1, 2004 for VIEs created after December 31, 2003, and from January 1, 2005, for all other VIEs.

In 2005 the Company consolidated certain VIEs to which it provided financing in order to construct offshore drilling assets. This consolidation did not have a material effect on the financial position and results of operations of the Company.

The Company did not identify any VIEs where it holds a significant variable interest (including a significant implicit variable interest) but is not the primary beneficiary.

The Company did not identify any subsidiaries which would need to be deconsolidated based on the FIN 46(R) guidance.

No entities requiring consolidation were identified in 2004.

4. Significant Acquisitions

OJSC Yuganskneftegaz and Baikalfinancegroup LLC

In late December 2004, the Company acquired a 100% interest in Baikalfinancegroup LLC, which a few days earlier had won an auction for the sale of a 76.79% interest in OJSC Yuganskneftegaz, which represents 100% of the common shares of OJSC Yuganskneftegaz. Following payment of the auction price the shares were registered in the name of Baikalfinancegroup LLC on December 31, 2004. The minority interest in the share capital OJSC Yuganskneftegaz amounts to 23.21% and is held by Yukos Oil Company. Yukos Oil Company is both the previous owner of the common shares and also the current owner of preferred shares comprising the minority interest. An open auction of OJSC Yuganskneftegaz's common shares was conducted by the Russian bailiff service in order to recover a portion of the unpaid taxes due to the Russian tax authorities by Yukos Oil Company. This transaction has been accounted for as a purchase of OJSC Yuganskneftegaz from Yukos Oil Company, in accordance with SFAS 141, *Business Combinations*.

OJSC Yuganskneftegaz is engaged in exploration, development, field facilities construction, and production of hydrocarbons in West Siberia. The purpose of the transaction was to acquire the oil and gas properties held by OJSC Yuganskneftegaz. The fields held by OJSC Yuganskneftegaz are located in Khanty-Mansi Autonomous Area, with well developed infrastructure and are close to Transneft's pipeline network.

The auction price (purchase price) paid for OJSC Yuganskneftegaz shares was RUR 260,782 million (US\$ 9,398 million at the CBR exchange rate in effect on the settlement date).

As discussed in Note 26 the Company's acquisition of OJSC Yuganskneftegaz is currently subject to court challenges in the RF and in the USA.

The Company consolidated the balance sheet of OJSC Yuganskneftegaz as of December 31, 2004 and the results of operations of OJSC Yuganskneftegaz from January 1, 2005. No results of operations are consolidated during the year ended December 31, 2004 given that the acquisition occurred on December 31, 2004.

The fair value of net assets acquired amounted to US\$ 12,204 million primarily based on a report of an independent appraiser. Because the fair value of the net assets acquired exceeded the purchase price, negative goodwill existed which has been allocated proportionately between oil and gas properties and mineral rights. Subsequent to the Company's preliminary December 31, 2004 purchase price allocation, adjustments were made as of September 30, 2005 so as to reflect the Company's revised estimate of the ultimate resolution of pre-acquisition contingencies. Significant changes in the preliminary purchase price allocation are discussed in further detail below.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

4. Significant Acquisitions (continued)

OJSC Yuganskneftegaz and Baikalfinancegroup LLC (continued)

The following table summarizes the Company's allocation of the assets acquired and liabilities assumed:

	Final allocation	Initial allocation
ASSETS		
Current assets:		
Restricted cash	\$ 14	\$ 14
Short-term investments	22	22
Accounts receivable	606	3,900
Inventories	94	94
Prepaid expenses	1	1
Total current assets	737	4,031
Oil and gas properties, net	7,276	6,017
Mineral rights	9,786	6,837
Property, plant and equipment, net	370	370
Construction-in-progress	41	41
Deferred tax assets	3	3
Leased equipment	175	137
Other non-current assets	4	4
Total non-current assets	17,655	13,409
Total assets	\$ 18,392	\$ 17,440
LIABILITIES		
Accounts payable	\$ (760)	\$ (760)
Short-term loans and borrowings and current portion long-term debt	(385)	(385)
Accrued income and other taxes	(2,231)	(1,395)
Other current liabilities	(6)	(6)
Total current liabilities	(3,382)	(2,546)
Long-term loans and borrowings net of current liabilities	(625)	(625)
Asset retirement obligations	(387)	(387)
Deferred tax liability	(3,834)	(2,759)
Total non-current liabilities	(4,846)	(3,771)
Total liabilities	(8,228)	(6,317)
Total net assets	\$ 10,164	\$ 11,123
Minority interest	\$ (766)	\$ (1,725)
Purchase price	\$ 9,398	\$ 9,398

While preparing its interim consolidated financial statements for the third quarter of 2005, the Company revised its previous estimates of certain pre-acquisitions contingencies and made the following significant adjustments to the preliminary purchase price allocation:

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

4. Significant Acquisitions (continued)

OJSC Yuganskneftegaz and Baikalfinancegroup LLC (continued)

- As of December 31, 2004, a total of US\$ 3,881 million was due from Yukos Oil Company and its affiliates for oil supplied prior to the acquisition of OJSC Yuganskneftegaz. The Company's preliminary allocation of the purchase price at December 31, 2004 considered these amounts to be fully recoverable within a one year period based on the then considered prospects of (i) amicable settlement with Yukos Oil Company's previous common shareholders, (ii) an offset against related liabilities to Yukos Oil Company and its affiliates, (iii) gaining control of certain other valuable assets of Yukos Oil Company to directly settle the receivables, and/or (iv) other means which might have been supported by the Company's shareholder. This view was based on preliminary information available to the Company immediately subsequent to its acquisition of OJSC Yuganskneftegaz. Throughout the first nine months of 2005, the Company continued to evaluate each of these options. Ultimately, the Company concluded while preparing its September 30, 2005 consolidated financial statements that its previous estimates should be revised. The Company continues to believe that it has legally valid claims over these assets and that the amounts should be recoverable at some point in the future. However, the Company now realizes that it cannot reasonably estimate the timing and the precise amount of any recovery. Accordingly, the Company has fully provided for these amounts as of September 30, 2005 through an adjustment to the purchase price allocation, after netting the receivables in the amount of US\$ 588 million with related payables of Yukos Oil Company and its affiliates, where the legal right to offset existed.
- As of September 30, 2005 the Company accrued approximately US\$ 836 million of a tax contingency reflecting its then anticipated settlement of OJSC Yuganskneftegaz's 1999 – 2003 tax obligations to the Russian tax authorities. As discussed in Notes 26 and 29 final resolution of this matter occurred in April 2006.

As a result of the above adjustments and their related impact on both deferred taxes and minority interest accounts, the acquired net assets (and, accordingly, negative goodwill) were decreased by US\$ 4,246 million as of September 30, 2005. In the final purchase price allocation negative goodwill of US\$ 2,806 million was allocated proportionally between oil and gas properties and mineral rights. The impact on the consolidated statement of income of this purchase price allocation adjustment has been accounted for retrospectively from January 1, 2005.

Other significant elements of the Company's purchase price allocation include:

- For the purposes of valuation of oil and gas properties, property, plant and equipment, and construction-in-progress which relate to minority interest, the Company used their appraised fair values as the previous controlling shareholder did not provide the records of the historical cost of these non-current assets. Minority interest which relates to other assets and liabilities was determined on the basis of historical cost.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

4. Significant Acquisitions (continued)

OJSC Yuganskneftegaz and Baikalfinancegroup LLC (continued)

- OJSC Yuganskneftegaz in its operating activities enters into short-term lease contracts for a significant number of wells and related equipment and facilities. These agreements are entered into with the owners of the wells, equipment and facilities, which are Yukos Oil Company and certain of its subsidiaries. All of the lease agreements are cancellable in nature and most expire within one year (see Note 14). The inability of the Company to extend these lease agreements and/or otherwise obtain rights to use the wells and related facilities in the oil production may have material adverse consequences for the Company's ability to extract and recover a portion of the carrying value of the \$7,276 million in oil and gas properties and the \$9,786 million in mineral rights acquired in the business combination. During 2005, all the expired lease contracts were extended for a period of up to one year. The Company's management plans to attempt to further extend the above leases and believes that given Yukos Oil Company's current bankruptcy proceedings, that the administrator of Yukos Oil Company is likely to be inclined to do the same. Following a claim brought by OJSC Yuganskneftegaz in March 2006, the Moscow Arbitration Court ruled that the 100% ownership interest in one of the subsidiaries, which is the most significant lessor, should be transferred from Yukos Oil Company to OJSC Yuganskneftegaz. This ruling is subject to further appeals and the Company has not yet assessed the impact of such transfer, if any, on the financial position or results of operations. While the Company believes that it will likely be able either to renew the above leases and/or otherwise continue to extract minerals from the related sites, no assurances can be provided in this regard.
- The deferred tax liability presented in the above allocation represents the difference between fair values of assets and liabilities of OJSC Yuganskneftegaz and their respective tax basis.

Pro forma financial information assuming that the acquisition of OJSC Yuganskneftegaz had occurred as of the beginning of 2003 has not been presented herein as is required by SFAS 141. This information is not presented as the Company does not have access to reliable US GAAP financial information for OJSC Yuganskneftegaz for periods prior to acquisition.

OJSC Northern Oil

In June 2003 the Company acquired a 100% interest in OJSC Northern Oil. OJSC Northern Oil is engaged in exploration, development field facilities construction and production of hydrocarbons in the Timan-Pechora region in the northern part of the Russian Federation.

The purpose of this transaction was to acquire the oil and gas properties held by OJSC Northern Oil with a developed infrastructure and proximity to the OJSC Transneft pipeline system.

The total purchase price which was paid in cash amounted to 18,990 million rubles (US\$ 623 million at the CBR exchange rate in effect on the settlement dates).

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

4. Significant Acquisitions (continued)

OJSC Northern Oil (continued)

The purchase price was fully allocated to the assets acquired and liabilities assumed as follows:

	Final allocation
ASSETS	
Current assets:	\$ 88
Oil and gas properties, net	233
Mineral rights	533
Other non-current assets	4
Total non-current assets	770
Total assets	\$ 858
LIABILITIES	
Current liabilities	(235)
Non-current liabilities	–
Total liabilities	(235)
Total net assets acquired	\$ 623
Minority interest	\$ –
Purchase price	\$ 623

The results of operations of OJSC Northern Oil are consolidated from July 1, 2003 and are not material to warrant pro-forma presentation.

OJSC Verkhnechonskneftegaz

In the fourth quarter of 2005, the Company acquired 7,781,449 common shares (25.94% of the total number of common shares) of OJSC Verkhnechonskneftegaz. OJSC Verkhnechonskneftegaz holds the licence for the development of the Verkhnechonskoye oil and gas condensate deposit, which is the largest oil deposit in the Irkutsk region.

The purchase price amounted to US\$ 230 million and was paid in cash. The acquisition price was fully allocated to the fair values of the acquired assets and liabilities. In these consolidated financial statements, the Company's interest in OJSC Verkhnechonskneftegaz shares is accounted for using the equity method (see Note 10).

Acquisition of Additional Interests

Eniseineft LLC and Taymyrneft LLC

In 2003, Rosneft acquired a 100% interest in Anglo-Siberian Oil Company ("ASOC") for US\$ 76 million. The purpose of the transaction was to acquire control over Taimyrneft LLC and Eniseineft LLC, which hold exploration and production licences for the North-Vankor and Vankor oilfields respectively. As a result, the Company effectively acquired 60% of Taimyrneft LLC and 59% of Eniseineft LLC. The acquisition price was fully allocated to the fair value of assets acquired and liabilities assumed.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

4. Significant Acquisitions (continued)

Acquisition of Additional Interests (continued)

Eniseineft LLC and Taymyrneft LLC (continued)

In the first half of 2004, the Company acquired a 100% interest in Losiem Commercial for US\$ 69 million. As a result of this transaction, the Company's share in Eniseineft LLC reached 95%. The acquisition price was fully allocated to the fair value of assets acquired and liabilities assumed. Subsequently, the Company's share in Eniseineft LLC increased to 99%.

OJSC Rosneft-Tuapse Refinery

In December 2004, the Company acquired 2,152,314 common shares (39.38% of the total number of common shares) and 907,038 preferred shares (49.79% of the total number of preferred shares) in OJSC Rosneft – Tuapse Refinery through its overseas subsidiary RN–International, thus increasing its share in the share capital of OJSC Rosneft – Tuapse Refinery to 81.23%. The purchase price of the above shares amounted to US\$ 184 million and was paid in cash. The excess of the purchase price over the fair value of net assets amounted to US\$ 35 million and was recorded as goodwill (See Note 15).

In connection with the acquisition of the additional share in OJSC Rosneft – Tuapse Refinery, the Company also purchased 62% of the shares of OJSC Moto for US\$ 2 million and 67% of the shares of CJSC Tuapse-Kemoil for US\$ 4 million. Both companies provide petroleum refining, marketing and distribution services.

OJSC Rosneft-Krasnodarneftegaz

In December 2004, OJSC Rosneft-Termneft ("Termneft"), which was the Company's subsidiary, merged with OJSC Krasnodarneftegaz ("Krasnodarneftegaz") by way of conversion of Termeft shares into Krasnodarneftegaz shares. The merger did not have any significant impact on the consolidated financial statements.

In the first half of 2005, the Company acquired 33,337,187 common shares (38.66% of the total number of common shares) and 17,633,509 preferred shares (61.63% of the total number of preferred shares) in OJSC Rosneft-Krasnodarneftegaz, thus increasing its share in the share capital of OJSC Rosneft-Krasnodarneftegaz to 95.46%. The purchase price of the above shares amounted to US\$ 110 million and was paid in cash. The purchase price was fully allocated to the fair values of the acquired assets and liabilities. This allocation is preliminary and will be adjusted upon completion of the valuation of mineral rights.

OJSC Selkupneftegaz

In the third quarter of 2005, the Company acquired 34 common shares (34% of the total number of common shares) in OJSC Selkupneftegaz, thus increasing its share in the share capital of OJSC Selkupneftegaz to 100%. The purchase price of these shares amounted to US\$ 20 million and was paid in cash. The purchase price was fully allocated to the fair values of the acquired assets and liabilities. This allocation is preliminary and will be adjusted upon completion of the valuation of mineral rights.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

4. Significant Acquisitions (continued)

Other Changes to the Structure of the Company

In accordance with its long-term program for the disposal of non-core assets, the Company is selling its subsidiaries engaged in non-core businesses. Interests in CJSC FK Rosneft-Finance and SK Neftepolis LLC were sold during 2004 and 2005, respectively. The resulting gain from the sale of these interests was recognized in the consolidated financial statements for the year ending December 31, 2004 in the amount of US\$ 1 million.

The Company also sold its share of CJSC Sevmorneftegaz (see Note 10).

5. Cash and Cash Equivalents

Cash and cash equivalents as of December 31 comprise the following:

	2005	2004	2003
Cash at hand and cash in bank in RUR	\$ 414	\$ 721	\$ 86
Cash at hand and cash in bank – foreign currencies	394	283	100
Deposits and cash in transit	365	29	42
Total cash and cash equivalents	\$ 1,173	\$ 1,033	\$ 228

Restricted cash as of December 31 comprises the following:

	2005	2004	2003
Obligatory reserve with the CBR	\$ 13	\$ 11	\$ 7
Other restricted cash	10	14	–
Total restricted cash	\$ 23	\$ 25	\$ 7

The obligatory reserve of VBRR with the CBR represents the amounts deposited with the CBR for securing the current operating activity of the bank. Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBR, the amount of which depends on the level of funds attracted by the credit institution and this amount has certain restrictions for use.

Cash accounts denominated in foreign currencies represent primarily cash in US\$.

Deposits represent bank deposits that may be readily convertible into cash and may be withdrawn by the Company at any time without prior notice or penalties.

As part of its cash management and credit risk function, the Company regularly evaluates the creditworthiness of financial and banking institutions where it places its deposits. Banking relationships are primarily with Russian subsidiaries of international banking institutions and certain large Russian banks.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

6. Short-Term Investments

Short-term investments as of December 31 comprise the following:

	2005	2004	2003
Short-term loans granted	\$ 27	\$ 28	\$ 51
Loans to related parties	32	–	199
Trading securities			
Short-term promissory notes	7	15	10
Corporate and state bonds	74	50	20
Other	10	14	14
Settlements on notes with related party	7	26	–
Bank deposits	3	3	19
Short-term assignment agreements	–	22	–
Investments for resale	2	13	–
Other	3	12	2
Total short-term investments	\$ 165	\$ 183	\$ 315

State bonds primarily represent federal loan bonds issued by the Ministry of Finance of the Russian Federation with maturity ranging from June 2007 to November 2021, coupon yields in 2005 ranging from 8.0% to 11.0% p.a. and yields to maturity ranging from 6.2% to 7.9% p.a. depending on the issue.

Corporate bonds represent bonds issued by large Russian corporations with maturity ranging from July 2007 to February 2010 and interest rates ranging from 11.00% to 14.65%.

Unrealized gains and losses on available-for-sale securities are not significant.

7. Accounts Receivable, Net

Accounts receivable as of December 31 comprise the following:

	2005	2004	2003
Trade receivables	\$ 935	\$ 3,982	\$ 196
Value added tax receivable	1,477	518	382
Other taxes	88	35	20
Banking loans to customers	305	241	139
Other	122	98	78
Less: allowance for doubtful accounts	(69)	(75)	(62)
Total accounts receivable, net	\$ 2,858	\$ 4,799	\$ 753

The Company's trade accounts receivable are denominated primarily in US dollars. Credit risk is managed through the use of letters of credit, and requesting advance payments from customers for the majority of sales.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

7. Accounts Receivable, Net (continued)

Value added tax receivable (VAT) primarily includes VAT related to export sales, which is reimbursed from the budget in accordance with Russian tax legislation.

As of December 31, 2004, trade receivables included Yukos Oil Company payables to OJSC Yuganskneftegaz in the amount of US\$ 3,881 million for oil supplied during 2004. Following the recoverability analysis, the above receivables were fully written down considering significant uncertainties regarding the timing and amount of repayment. The write down was made after offsetting liabilities against these receivables in the amount of US\$ 588 million. (See Note 29 for the discussion of Yukos Oil Company bankruptcy proceedings).

8. Inventories

Inventories as of December 31 comprise the following:

	2005	2004	2003
Materials and supplies	\$ 332	\$ 276	\$ 190
Crude oil and gas	300	115	70
Petroleum products	182	126	71
Total inventories	\$ 814	\$ 517	\$ 331

Materials and supplies mostly include spare parts, construction materials and pipes. Petroleum products also include those designated for sale as well as for own use.

9. Prepayments and Other Current Assets

Prepayments and other current assets as of December 31 comprise the following:

	2005	2004	2003
Prepayments to suppliers	\$ 381	\$ 180	\$ 126
Insurance prepayments	46	8	13
Customs	451	41	2
Other	19	27	14
Total prepayments and other current assets	\$ 897	\$ 256	\$ 155

Customs primarily represent export duty prepayments related to the export of crude oil and petroleum products (see Note 23).

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

10. Long-Term Investments

Long-term investments as of December 31 comprise the following:

	2005	2004	2003
Equity method investments			
Polar Lights Company LLC	\$ 94	\$ 65	\$ 29
CJSC Kaspiy-1	29	29	16
JV Rosneft-Shell Caspian Ventures Limited	21	–	–
OJSC Daltransgaz	11	11	9
CJSC Sevmorneftegaz	–	–	36
JV Aday Petroleum Company	2	2	2
OJSC Verkhnechonskneftegaz	231	–	–
Other	2	1	–
Total	<u>390</u>	<u>108</u>	<u>92</u>
<i>Available for sale securities</i>			
Russian government bonds	2	9	3
Long-term promissory notes	7	98	1
<i>Held-to-maturity securities</i>			
Long-term loans granted	2	5	21
Long-term loans to equity investees	21	36	17
Investments in joint operations	4	4	12
Cost method investments	10	17	35
Total long-term investments	<u>\$ 436</u>	<u>\$ 277</u>	<u>\$ 181</u>

Equity share in income/(loss) of material investments recorded using the equity method:

	Participation interest (percentage) as of December 31, 2005	Share in income/(loss) of equity investees		
		2005	2004	2003
Polar Lights Company LLC	50.00	\$ 42	\$ 50	\$ 1
CJSC Sevmorneftegaz	–	–	(3)	–
OJSC Daltransgaz	25.00	–	–	–
JV Rosneft-Shell Caspian Ventures Limited	51.00	26	–	–
Rosneft-Stroytransgaz LLC	50.00	(17)	–	(7)
CJSC Kaspiy-1	45.00	–	(1)	–
JV Aday Petroleum Company	50.00	–	–	–
OJSC Verkhnechonskneftegaz	25.94	1	–	–
Other		(1)	6	6
Total equity share		<u>\$ 51</u>	<u>\$ 52</u>	<u>\$ –</u>

CJSC Sevmorneftegaz

In January 2002, the Company, through OJSC Rosneft-Purneftegaz, and OJSC Gazprom, through CJSC Rosshelf jointly established CJSC Sevmorneftegaz with equal shares in equity. The cost of investment in CJSC Sevmorneftegaz was US\$ 17 thousand. CJSC Sevmorneftegaz is primarily engaged in exploration and production activities on the Prirazlomnoye and Shtokmanovskoye oil and gas condensate fields.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

10. Long-Term Investments (continued)

CJSC Sevmorneftegaz (continued)

In December 2004, it was resolved to sell the Company's share in the project to the other participant (the "Buyer") and full payment was received under the share purchase agreement. At December 31, 2004 and 2003 this investment was classified under equity method investments. Title to shares in CJSC Sevmorneftegaz was transferred to the Buyer in the first half of 2005. Under the share purchase provisions, the Buyer had the right to notify the Company in writing, not later than the end of June 2005, of its intention to sell the acquired share back to the Company and the Company was obliged to take back and pay for such share. The Buyer did not exercise its right to repurchase at the time stipulated in the contract, therefore in June 2005 the Company recorded a gain on the sale of the interest in CJSC Sevmorneftegaz in the amount of US\$ 1,303 million.

Polar Lights Company LLC ("PLC")

PLC is a limited liability company owned 50% by Conoco Phillips Timan-Pechora Inc., and 50% by the Company. PLC is primarily engaged in the development of the Ardalin and satellite fields in the Timan-Pechora Basin located 125 kilometers south of the Barents Sea above the Arctic Circle. Development of the Ardalin field commenced in late 1992 and the first oil was produced in 1994.

JV Rosneft-Shell Caspian Ventures Limited

JV Rosneft-Shell Caspian Ventures Limited ("JV") is a joint venture in which the Company holds a 51% interest. The Articles of Incorporation of this joint venture stipulate, however, that key decisions regarding its business shall be subject to unanimous approval by both participants and none of the participants has a preferential voting right.

On February 6, 1997, the Company, through the JV, signed an agreement with eight oil and gas companies and government agencies of the Russian Federation and the Republic of Kazakhstan for the establishment of Caspian Pipeline Consortium ("CPC"). The purpose of the consortium is to design, finance, construct and operate a pipeline from the oil fields located in Western Kazakhstan through Russia to the port of Novorossiysk. The interest of the JV in the CPC is 7.5%. In October 2001, the CPC pipeline was put in operation.

OJSC Daltransgaz

OJSC Daltransgaz is an operator for the program to supply gas to the Sakhalin Region and the Khabarovsk and Primorye Territories.

CJSC Kaspiy-1

In 1997, a subsidiary of the Company made a contribution to the share capital of CJSC Kaspiy-1, which was founded to construct an oil refinery in Makhachkala (Dagestan Republic). The refinery is planned to be commissioned in 2006.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

11. Oil and Gas Properties, Net

Oil and gas properties as of December 31 comprise the following:

	2005	2004	2003
Wells and related facilities	\$ 12,606	\$ 10,524	\$ 4,754
Mineral rights	10,723	7,562	712
Pipelines	1,057	802	293
Equipment under capital lease (Note 14)	214	144	53
Total	24,600	19,032	5,812
Less: accumulated depletion	(3,661)	(2,492)	(2,520)
Net oil and gas properties	\$ 20,939	\$ 16,540	\$ 3,292

Mineral rights include costs to acquire unproved properties in the amount of US\$ 1,382 million as of December 31, 2005, US\$ 1,051 million as of 2004, and US\$ 266 million as of December 31, 2003. The Company plans to explore and develop the respective fields. The Company's management believes these costs are recoverable.

For the purposes of evaluation of the reserves as of December 31, 2005, 2004 and 2003, the Company used oil and gas reserves data prepared by DeGolyer and MacNaughton, independent reservoir engineers. The Company used the reserve report to calculate depreciation, depletion and amortization relating to oil and gas properties for 2005, 2004 and 2003. The reserve report was also used for the assessment of impairment of long-lived assets and for the required supplemental disclosure for oil and gas activities (see supplementary oil and gas disclosure).

As described in the "Depreciation, depletion and amortization" section of Note 2, the Company calculates depletion using the unit-of-production method over proved or proved developed oil and gas reserves depending on the nature of the costs involved. The proved or proved developed reserves used in the unit of production method assume the extension of the Company's production licences beyond their current expiration dates until the end of the economic lives of the fields as discussed below in further detail.

The Company's oil and gas fields are located principally in the territory of the Russian Federation. The Company obtains licences from the governmental authorities to explore and produce oil and gas from these fields. The Company's existing production licences generally expire during the period 2006 to 2026, Expiration dates of licences for the most significant fields are between 2013 and 2019, and the licence for the largest field, Priobskoye, expires in 2019. The economic lives of the licensed fields extend significantly beyond these dates. Under Russian law, the Company is entitled to renew the licences to the end of the economic lives of the fields, provided certain conditions are met. Article 10 of the Subsoil Law, *Concerning Subsurface Resources*, provides that a licence to use a field "shall be" extended at its scheduled termination at the initiative of the subsoil user if necessary to finish production of the field, provided that there are no violations of the conditions of the licence.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

11. Oil and Gas Properties, Net (continued)

The legislative history of Article 10 indicates that the term "shall" replaced the term "may" in August 2004, clarifying that the subsoil user has an absolute right to extend the licence term so long as it has not violated the conditions of the licence. In 2005 the Company extended the terms of 39 of its production licences for the period equivalent to the expected life of the fields. There were no unsuccessful licence renewal applications.

The Company's current production plans are based on the assumption, which management considers to be reasonably certain, that the Company will be able to extend all other existing licences. These plans have been designed on the basis that the Company will be producing crude oil through the economic lives of the fields and not with a view to exploiting the Company's reserves to maximum effect only through the licence expiration dates. Accordingly, management has included in proved reserves in the supplementary information on oil and gas exploration and production activities of the consolidated financial statements as of and for the year ended December 31, 2005 all reserves that otherwise meet the standards for being characterized as "proved" and that the Company estimates the Company can produce through the economic lives of Company's licensed fields.

Proved reserves should generally be limited to those that can be produced through the licence expiration date unless there is a long and clear track record which supports the conclusion that extension of the license will be granted as a matter of course. The Company believes that extension of the licences will occur as a matter of course as fully described above.

Sakhalin-1

The Company's primary investment in a PSA is through the Sakhalin-1 project (PSA 1), which is operated by ExxonMobil, one of the PSA participants. In February 2001, the Company signed an agreement with Oil and Natural Gas Corporation ("ONGC") in relation to its interest in the PSA 1 which reduced the Company's interest to 20%. The Company records the investment in its retained share under the "carried interest" method. Commercial hydrocarbon production under PSA 1 commenced in October 2005. Accordingly, the Company's share in hydrocarbon reserves was reclassified as proved developed reserves.

Sakhalin-5

The participants of the project are subsidiaries of the Company and BP p.l.c. In March 2004, the licence for geological study of the Kaigansko-Vasyukansky block held by the Company was transferred to CJSC Elvari Neftegaz, which is a 100% subsidiary of Elvary Neftegaz Holdings B.V., jointly established by the participants of the project.

The Shareholders and Operating Agreement was signed between the participants and the operator in June 2004. In accordance with the terms of the agreement, during the exploration stage project funding will be fully provided by BP p.l.c., while during the development stage BP p.l.c. will carry a portion of payments due from the Company and will provide credit support to obtain project funding.

If the project proves to be unsuccessful, BP p.l.c. bears all losses incurred. The Company recognizes this investment as an equity interest in a related company under the equity method of accounting.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

11. Oil and Gas Properties, Net (continued)

Other Projects

The Company is a party to other projects associated with the development of the Sakhalin shelf (Zapadno-Shmidtovsky and Vostochno-Shmidtovsky blocks). Under those arrangements, the other participant (BP p.l.c.) has agreed to pay for exploration costs on behalf of the Company. Exploration and development of these projects is at an early stage. The Company's costs (currently insignificant) associated with these projects were capitalized.

In July 2005, the Company entered into a PSA agreement with the Kazakhstan Government for the joint development of Kurmangazy oil and gas field. The participants of the project are a subsidiary of the Company, OJSC "NK Rosneft – RN Kazakhstan" ("RN Kazakhstan") and a subsidiary of Kazakhstan State JSC KazMunaiGaz, JSC "NK KazMunaiGaz – KazMunaiTeniz", with equal shares of 50%. The agreement provides for a signing bonus in the amount of US\$ 50 million. The Company's share of US\$ 25 million is recognized within mineral rights. In accordance with the terms of the agreement, upon commercial discovery the RF has an option to buy a 25% share in the project at a future market price, by reducing the share of the Company's subsidiary in the project. If the RF does not exercise its option, this share shall be sold to 3rd parties at a market price or redistributed between the participants in equal parts. If the share is sold, the proceeds from the sale shall cover the expenses already incurred, including those suffered by RN Kazakhstan and related to the sold share. The excess of the proceeds from the sale of share over the expenses shall be equally distributed between the participants.

12. Property, Plant and Equipment, Net

Property, plant and equipment as of December 31 comprise the following:

	2005	2004	2003
Offshore drilling assets	\$ –	\$ –	173
Service vessels	8	13	97
Buildings and constructions	1,941	1,729	1,277
Plant and machinery	1,096	1,037	568
Vehicles and other equipment	356	314	312
Assets under capital lease (Note 14)	12	43	35
Total	3,413	3,136	2,462
Less: accumulated depreciation	(1,383)	(1,378)	(1,399)
Property, plant and equipment, net	\$ 2,030	\$ 1,758	\$ 1,063

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

13. Construction-in-Progress

Construction-in-progress includes various construction projects as well as machinery and equipment delivered but not yet installed. Construction-in-progress as of December 31 comprises the following:

	2005	2004	2003
Equipment to be installed	\$ 100	\$ 61	\$ 40
Buildings and constructions	303	273	224
Plant and machinery	106	148	108
Total construction-in-progress	\$ 509	\$ 482	\$ 372

14. Leased Property, Plant and Equipment

Since 2003, the Company has entered into a number of agreements for the lease of equipment and other assets.

The following is the analysis of the property, plant and equipment under capital leases as of December 31:

	2005	2004	2003
Oil and gas properties	\$ 214	\$ 144	\$ 53
Less: accumulated depletion	(10)	(2)	(2)
Oil and gas properties, net	204	142	51
<i>Other property, plant and equipment</i>			
Buildings and constructions	1	1	–
Plant and machinery	5	16	12
Vehicles	6	26	23
Total	12	43	35
Less: accumulated depreciation	(3)	(8)	(2)
Property, plant and equipment, net	9	35	33
Total net book value of leased assets	\$ 213	\$ 177	\$ 84

Below is the analysis of the repayment of capital lease obligations as of December 31:

	2005
2006	\$ 24
2007	7
2008	5
2009	6
	42
Imputed interest	(4)
Present value of capital lease payments	\$ 38

Operating Lease

The Company has obligations which are primarily related to the operating lease of oil and gas facilities in the amount of US\$ 62 million for the subsequent year. See Note 4.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

14. Leased Property, Plant and Equipment (continued)

Operating Lease (continued)

The total amount of operating lease expenses was as follows:

	2005	2004	2003
Total lease expenses	\$ 120	\$ 16	\$ 40
Total sublease revenues	\$ 3	\$ –	\$ –

15. Goodwill

Goodwill in the amount of US\$ 35 million represents the excess of the purchase price of a share in OJSC Rosneft-Tuapse Refinery ("TNPZ") over the fair value of the corresponding share in net assets (See Note 4). As of December 31, 2005, no impairment of goodwill arising from the acquisition of an additional share in TNPZ was identified.

16. Other Non-Current Assets

Other non-current assets include a loan to OJSC Sibur-Tumen in the amount of US\$ 4 million and US\$ 16 million as of December 31, 2005 and December 31, 2004, respectively, which was restructured under an amicable agreement. As of December 31, 2003, this loan was stated within accounts receivable (see Note 7). This loan receivable is recorded at fair value which has been calculated based on the repayment schedule, and will be fully repaid in 2013. A portion of the loan receivable from OJSC Sibur-Tyumen in the amount of RUR 417 million (US\$ 15 million) was sold to a third party in August 2005 under an assignment agreement and was repaid in equal monthly installments by the end of 2005.

17. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities as of December 31 comprise the following:

	2005	2004	2003
Trade accounts payable	\$ 649	\$ 875	\$ 255
Salary and other benefits payable	157	81	51
Advances received	192	66	48
Dividends payable	60	16	22
Promissory notes payable	2	3	94
Banking customer accounts	252	245	70
Payables under licence agreements (Note 26)	–	30	19
Deferred income	3	3	–
Yukos Oil Company debt acquisition liability (Note 26)	27	–	–
Other	16	67	111
Total Accounts payable and accrued liabilities	\$ 1,358	\$ 1,386	\$ 670

The Company's accounts payable are denominated primarily in RUR. Dividends payable represent dividends on shares payable to subsidiaries' minority shareholders.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

18. Short-Term Loans and Long-Term Debt

Short-term loans and borrowings as of December 31 comprise the following:

	2005	2004	2003
Loans and borrowings - US\$ denominated			
Bank loans	\$ 794	\$ 347	\$ 63
Bank loans raised for funding the acquisition of OJSC Yuganskneftegaz	–	701	–
Other loans for funding the acquisition of OJSC Yuganskneftegaz	–	63	–
Customer deposits	42	30	6
Other borrowings	3	19	23
Loans and borrowings – RUR denominated			
Bank loans	9	3	8
Bank loans raised for funding the acquisition of OJSC Yuganskneftegaz	–	678	–
Promissory notes payable	657	382	–
Customer deposits	96	135	155
Other borrowings	453	20	3
	2,054	2,378	258
Current portion on long-term debt	1,951	998	330
CJSC Sevmorneftegaz share repurchase liability	–	1,344	–
Total short-term loans and current portion of long-term debt	\$ 4,005	\$ 4,720	\$ 588

The Company's short-term bank loans denominated in US\$ were from LIBOR plus 1.0% to 3.32% p.a. The RUR denominated loans bear interest rates of 1.25% to 9% p.a.

Promissory notes are primarily payable on demand and bear an interest rate ranging from 0% to 18%. Interest free promissory notes are recorded at amortized cost.

Customer deposits represent fixed-term deposits placed by customers with the Company's subsidiary bank, denominated in RUR and foreign currencies. Customer deposits denominated in RUR bear an interest rate ranging from 2.5 to 12.6 % p.a. Customer deposits denominated in foreign currencies bear an interest rate ranging from 2.0 to 12.0% p.a.

The CJSC Sevmorneftegaz share repurchase liability represented a prepayment received under the CJSC Sevmorneftegaz share purchase agreement (see Note 10).

Other RUR-denominated borrowings primarily include four loans provided to OJSC Yuganskneftegaz by YUKOS Capital S.a.r.l., which bear interest of 9% p.a. and mature in 2007. As of December 31, 2005 these loans are classified as current since the creditor obtained the right to demand early repayment of these loans due to non-compliance with the terms of loan agreements.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

18. Short-Term Loans and Long-Term Debt (continued)

Long-term debt as of December 31, 2005, comprises the following:

	2005	2004	2003
Bank loans – US\$ denominated	\$ 4,220	\$ 2,759	\$ 2,103
Bank loans raised for funding the acquisition of OJSC Yuganskneftegaz – US\$ denominated	5,743	6,465	–
Borrowings – US\$ denominated	49	67	2
Customer deposits – US\$ denominated	8	9	–
Borrowings – RUR denominated	9	430	9
Customer deposits – RUR denominated	60	24	2
Bonds of the subsidiary bank – RUR denominated	20	21	19
Other long-term liabilities	40	245	15
	10,149	10,020	2,150
Current portion of long-term debt	(1,951)	(998)	(330)
Total long-term debt	\$ 8,198	\$ 9,022	\$ 1,820

The rates of interest on the Company's bank loans denominated in US\$ were 4.35% - 12.92% p.a. Weighted average interest rates on these loans were 6.58%, 5.50% and 5.37% (LIBOR plus 2.19%, LIBOR plus 3.10%, LIBOR plus 4.25%) as of December 31, 2005, 2004 and 2003 respectively. These bank loans are primarily secured by contracts for the export of crude oil.

In the third quarter of 2005, the Company received a 5-year loan from a syndicate of major foreign banks in the amount of US\$ 2,000 million at a rate of LIBOR plus 1.8% repayable in equal monthly installments. The loan is secured by contracts for the export of crude oil. This loan was used for refinancing short-term loans in the amount of US\$ 1,335 million and a number of long-term loans in the amount of US\$ 594 million at more favourable terms.

As of December 31, 2005 the bank loans raised for funding the acquisition of OJSC Yuganskneftegaz represent a long-term loan obtained through a government-owned bank at a rate of LIBOR plus 3% p.a. repayable in equal monthly installments. It is scheduled for repayment in 2011 and is secured by pledging the Company's receivables under a long-term contract for the supply of crude oil (see Note 26).

Weighted average interest rates on US\$ denominated borrowings were 8.54%, 8.79% and 6.12% as of December 31, 2005, 2004 and 2003 respectively.

Customer deposits include fixed-term RUR and foreign currency denominated customer deposits placed with the Company's subsidiary bank which mature primarily at the end of 2006. The RUR-denominated deposits bear an interest rate ranging from 4% to 12.5% p.a. Deposits denominated in foreign currencies bear an interest rate ranging from 4% to 9% p.a.

As of December 31, 2005, other long-term liabilities include interest-free promissory notes which mature at the end of 2006. The promissory notes are stated at amortized cost and are included in the current portion of long-term debt.

As discussed in Note 29, the interest rate on certain borrowings was reduced.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

18. Short-Term Loans and Long-Term Debt (continued)

As of December 31, 2005, 2004 and 2003, the Company's collateral for short-term and long-term loans were oil and gas properties in the amount of nil, RUR 2,394 million and RUR 4,073 million, respectively (US\$ 86 million and US\$ 138 million at the exchange rate as of December 31, 2004 and 2003, respectively). The decrease is attributable to the repayment of the loan against which the assets were collateralized. Generally, long-term loans are secured by oil export contracts. Usually, under the terms of such contracts, the lender is provided with an express right of claim for contractual revenue which must be remitted directly to transit currency (US\$ denominated) accounts with those banks, should the Company fail to repay its debt in time.

The Company is obliged to comply with a number of restrictive financial and other covenants contained within its borrowing agreements. Restrictive financial covenants include maintaining certain financial ratios. As a result of the Company's acquisition of OJSC Yuganskneftegaz on December 31, 2004, and the resulting debt incurred and assets and liabilities, including contingent liabilities, consolidated, the Company was not in compliance with various financial and other covenants of existing loan agreements as of that date.

As of December 31, 2004, the long-term portion of the debt outstanding under loan agreements which were in default amounted to US\$ 1,661 million. This debt continued to be reflected as long-term in nature in the December 31, 2004 consolidated balance sheet. In July 2005, the creditors waived violations related to restrictive financial ratios and agreed to amend the financial ratio covenants in line with the Company's new structure and new scope of activities. The creditors also waived other events of default arising from the breach of other covenant provisions. To date, the creditors have provided waivers relating to these provisions which have been granted on condition that the Company furnishes to the creditors, by no later than December 31, 2006, acceptable evidence that the Company has:

1. Discharged in full, or restructured, OJSC Yuganskneftegaz's tax liabilities for 2004 (which should not be in excess of a set limit),
2. Discharged in full, or restructured, OJSC Yuganskneftegaz's tax liabilities for the periods 1999 to 2003,
3. Discharged in full, or restructured, the indebtedness to YUKOS Capital S.a.r.l. in the amount of US\$ 445 million, and,
4. Discharged in full, or restructured, the guarantee claims of Societe General S.A. related to a US\$ 1,600 million loan (see Note 26).

These conditions also apply to certain new borrowings obtained throughout 2005 and also subsequent to that date. Thus, as of December 31, 2005, long-term borrowings, for which creditors waived events of default arising from the breach of certain covenant provisions, amounted to US\$ 2,831 million. This debt continues to be reflected as long-term in nature in the December 31, 2005 consolidated balance sheet. As discussed in Note 26, the guarantee claim related to the US\$ 1,000 million loan, which was previously a condition, was discharged in full in December 2005 to the satisfaction of the creditor banks. The Company's management believes that the other conditions referred to above will be fulfilled (see Notes 26 and 29).

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

18. Short-Term Loans and Long-Term Debt (continued)

The aggregate maturity of long-term debt outstanding as of December 31, 2005 is as follows (assuming the debt will not be called by creditors ahead of scheduled maturities):

	<u>2005</u>
2006	\$ 1,951
2007	1,979
2008	2,035
2009	1,990
2010	2,079
2011 and after	<u>115</u>
Total long-term debt	<u>\$ 10,149</u>

To finance its current operations and refinance its short-term loans, the Company continues to raise external funding. Operating income depends heavily on oil prices and oil export quotas available to the Company. In the event of a long-term drop in crude oil prices and a failure to raise external funding, the Company may be compelled to reduce its capital expenditures thus limiting its ability to maintain or increase the current level of oil production.

19. Shareholder's Equity

As of December 31, 2004 and 2003, 100% shares of the Company were held by the Government of the Russian Federation. In June 2005, the Company's entire shares were contributed to the share capital of OJSC Rosneftegaz, wholly owned by the State represented by the Federal Agency for Federal Property Management. In the third quarter of 2005, one share in Rosneft was transferred to the Federal Agency for Federal Property Management.

Amounts Available for Distribution to Shareholders

Amounts available for distribution to shareholders are based on the Company's unconsolidated statutory accounts prepared in accordance with Russian accounting standards, which differ significantly from US GAAP (see Note 2). Russian legislation identifies the basis of distribution as the current period net profit calculated in accordance with statutory accounting standards. According to Russian legislation, dividends cannot exceed the accounting income for the reporting year. However, this legislation and other statutory laws and regulations dealing with distribution rights are open to different legal interpretation.

In June 2005, the annual general meeting of shareholders declared dividends on common shares of RUR 1,755 million or US\$ 61 million for 2004 at the exchange rate on the date of that decision, or US\$ 0.007 per share.

In the third quarter of 2005, Rosneft increased the number of common shares by splitting one common share with par value of RUR 1 into 100 common shares with par value of RUR 0.01. As a result the total number of shares became 9,092,174,000. Net earnings per share for 2005 and the comparable data for 2004 and 2003 were calculated retrospectively based on the new number of outstanding shares.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

20. Accrued Income and Other Taxes

Accrued income and other taxes as of December 31 comprise the following:

	2005	2004	2003
Mineral extraction tax	\$ 1,158	\$ 994	\$ 47
Value added tax	776	282	34
Excise tax	62	14	14
Personal income tax	19	13	6
Property tax	18	24	12
Income tax	644	216	8
Other	133	17	10
Total accrued income and other taxes	<u>\$ 2,810</u>	<u>\$ 1,560</u>	<u>\$ 131</u>

21. Asset Retirement Obligations

The movement of asset retirement obligations is as follows:

	2005	2004	2003
Asset retirement obligations as of the beginning of the reporting period	\$ 555	\$ 126	\$ 140
Cumulative effect of adopting SFAS 143 at January 1, 2003	–	–	(42)
Recognition of additional obligations for new wells	5	5	16
Accretion expense	35	8	12
(Decrease) / increase as a result of change in estimates	(27)	29	–
Assumed OJSC Yuganskneftegaz obligations	–	387	–
Spending on existing obligations	(2)	–	–
Asset retirement obligations as of the end of the reporting period	<u>\$ 566</u>	<u>\$ 555</u>	<u>\$ 126</u>

22. Minority Interest

Minority owners' interests in the Company subsidiaries as of December 31 comprise the following:

Company	2005		2004		2003	
	Minority interest	Minority interest share in net assets	Minority interest	Minority interest share in net assets	Minority interest	Minority interest share in net assets
	%		%		%	
OJSC Rosneft-Purneftegaz	16.91	\$ 317	16.91	\$ 194	16.91	\$ 158
OJSC Rosneft-Sakhalinmorneftegaz	35.38	218	35.63	221	36.66	231
OJSC Rosneft-Krasnodarneftegaz	4.54	16	49.22	101	48.94	85
OJSC Rosneft-Stavropolneftegaz	24.82	21	28.05	19	28.05	23
OJSC Rosneft-Tuapse Nefteproduct	62.00	133	62.00	130	62.00	115
OJSC Rosneft-Komsomolsky Refinery	20.02	11	22.69	13	22.69	12
OJSC Rosneft-Tuapse Refinery	18.77	12	18.49	10	60.47	30
OJSC Yuganskneftegaz	23.21	1,000	23.21	1,725	–	–
Other		132		122		135
Total		<u>\$ 1,860</u>		<u>\$ 2,535</u>		<u>\$ 789</u>

To a significant extent, minority interest in subsidiaries is represented by preferred shares.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

22. Minority Interest (continued)

Rights Attributable to Preferred Shares

Unless a different amount is approved at the annual shareholders meeting, preferred shares earn dividends equal to their nominal value. The amount of a dividend for a preferred share may not be less than the amount of a dividend for a common share.

Preferred shareholders may vote at meetings only on the following decisions: the amendment of the dividends payable per preferred share; the issuance of additional shares with rights greater than the current rights of preferred shareholders; and the liquidation or reorganization of the Company.

The decisions listed above, except for the liquidation or reorganization of the Company, can be made only if approved by 75% of all shareholders.

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

Dividends on preferred shares of OJSC Yuganskneftgaz have not been paid since 1998. Therefore preferred shareholders have equal rights with common shareholders with respect to questions raised at annual shareholders' meetings.

According to the charters of the majority of the Company subsidiaries, dividends on preferred shares generally amount to 10% of net income determined in accordance with Russian accounting legislation.

23. Revenues and Related Taxes

Revenues include the following taxes and duties:

	2005	2004	2003
<i>Oil and gas sales</i>			
Export customs duty	\$ 5,322	\$ 535	\$ 272
Excise	–	–	5
<i>Petroleum products sales and processing fees</i>			
Export customs duty	942	171	134
Excise	17	46	25
<i>Support services and other sales</i>			
Export customs duty	–	–	–
Excise	–	8	–
Total	\$ 6,281	\$ 760	\$ 436

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

24. Taxes

Income taxes for the years ended December 31 comprise the following:

	2005	2004	2003
Current income tax expense	\$ 1,688	\$ 309	\$ 244
Deferred income tax benefit	(79)	(11)	(43)
Total	\$ 1,609	\$ 298	\$ 201

The Company does not file a consolidated tax return, rather each legal entity files separate tax returns with various authorities, primarily in the Russian Federation.

Temporary differences between these consolidated financial statements and tax records gave rise to the following deferred income tax assets and liabilities as of December 31:

	2005	2004	2003
Deferred income tax asset arising from tax effect of:			
PSA 1 deferred deductible expenses	\$ 101	\$ –	\$ –
Asset retirement obligations	54	36	30
Property, plant and equipment	75	74	54
Prepayments and other current assets	14	–	–
Accounts receivable	9	15	15
Accounts payable and accruals	32	8	–
Inventories	12	9	6
Long-term investments	5	6	2
Short-term investments	3	1	3
Other	22	–	–
Total	327	149	110
Valuation allowance for deferred income tax asset	(271)	(116)	(67)
Deferred income tax asset	56	33	43
Deferred income tax liability arising from tax effect of:			
Long-term liabilities	–	–	(7)
Mineral rights	(2,172)	(1,641)	–
Property, plant and equipment	(1,564)	(1,213)	(68)
Deferred income tax liability	(3,736)	(2,854)	(75)
Net deferred income tax liability	\$ (3,680)	\$ (2,821)	\$ (32)

Deferred income tax liability related to mineral rights and property, plant and equipment includes the deferred tax liability assumed as a result of the purchase of OJSC Yuganskneftegaz in the amount of US\$ 3,590 million and the acquisition of additional shares in OJSC Rosneft-Tuapse Refinery in the amount of US\$ 38 million.

Classification of deferred taxes:

	2005	2004	2003
Current deferred tax assets	\$ 48	\$ 28	\$ 23
Long-term deferred tax assets	8	5	20
Current deferred tax liabilities	(40)	–	(4)
Long-term deferred tax liabilities	\$ (3,696)	\$ (2,854)	\$ (71)

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

24. Taxes (continued)

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 is as follows:

	2005	2004	2003
Income before income taxes	\$ 6,214	\$ 1,201	\$ 589
Statutory income tax rate	24.00%	24.00%	24.00%
Theoretical income tax expense	1,491	288	141
Add / (deduct) tax effect of:			
Income tax interest	66	–	–
Change in valuation allowance	155	44	8
Effect of the income tax preferences	(128)	–	–
Previously unrecognized deferred tax asset	(24)	–	–
Permanent accounting differences arising from:			
Non-deductible items, net	45	4	70
Foreign exchange effects, net	(59)	(23)	(15)
Other permanent differences	63	(15)	(3)
Income taxes	\$ 1,609	\$ 298	\$ 201

OJSC Yuganskneftegaz and OJSC Rosneft-Purneftegaz paid income tax during 2005 at lower rates subject to a 3.5% - 4% income tax exemption under the regional laws. These laws provide that the income tax exemptions are granted to the oil and gas producing companies, which make capital investments, agreed with regional administrations, within the respective region and participate in various social projects, therefore increasing benefits to the regional budget. These exemptions are granted on an annual basis.

In addition to income tax, the Company pays other taxes as follows:

	2005	2004	2003
Mineral extraction tax	\$ 4,716	\$ 739	\$ 461
Excise tax	224	34	–
Social security	118	98	69
Property tax	73	40	42
Land tax	14	13	9
Transport tax	2	1	1
Tax interest and penalties	64	16	7
Other taxes and payments	53	16	53
Taxes, other than income tax	\$ 5,264	\$ 957	\$ 642

25. Related Party Transactions

In the course of its usual activity, the Company regularly enters into transactions with other enterprises which are directly or indirectly controlled by the Russian Government. Such enterprises are business units of RAO UES, OJSC Gazprom, OJSC Russian Railways, OJSC Sberbank, OJSC Vnesheconombank, OJSC Vneshtorgbank, OJSC Gazprombank, OJSC Transneft and federal agencies including tax authorities. Management considers these business relations as part of regular activities in the Russian Federation and believes that they will remain unchanged in the foreseeable future.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

25. Related Party Transactions (continued)

Total amounts of transactions with companies controlled by the Government of the Russian Federation for each of the reporting periods ending December 31, as well as related party balances are provided in the table below:

	2005	2004	2003
Revenues			
Sales of petroleum products	\$ 195	\$ 78	\$ 53
Sales of gas	19	12	7
Sales of share in CJSC Sevmorneftegaz (see Note 10)	1,303	–	–
Other revenues	2	1	–
	\$ 1,519	\$ 91	\$ 60
Costs and expenses			
Transportation expenses	\$ 1,305	\$ 430	\$ 361
Other expenses	1	–	10
	\$ 1,306	\$ 430	\$ 371
Other operations			
Purchases of property, plant and equipment	\$ 9	\$ 1	\$ 2
Purchases of investments	38	294	128
Sales of investments	38	725	128
Borrowings issued	574	–	214
Borrowings repaid	574	–	313
Loans received	1,527	9,479	513
Loans repaid	3,458	192	305
Deposits placed	1,945	226	82
Deposits paid	1,762	226	83
Interest accrued on loans	487	56	52
Interest accrued on deposits	–	1	–
Banking fees	\$ 12	\$ 2	\$ 1
Assets			
Cash at bank	\$ 376	\$ 702	\$ 28
Trade receivables	23	2	5
Prepayments	154	14	7
Borrowings receivable	–	–	1
Deposits payable	180	–	–
	\$ 733	\$ 718	\$ 41
Liabilities			
Advances received	\$ 4	\$ 2	\$ 3
Loans and borrowings payable (including interest)	6,890	10,506	858
	\$ 6,894	\$ 10,508	\$ 861

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

25. Related Party Transactions (continued)

Total amounts of transactions with other related parties, primarily equity investees and joint ventures, for each of the reporting periods ending December 31, as well as related party balances are provided in the table below:

	2005	2004	2003
<i>Revenues</i>			
Oil sales	\$ 27	\$ 2	\$ 2
Sales of petroleum products	50	4	1
Sales of gas	–	–	4
Inventory sales	1	2	7
Sales of services	56	34	6
Other income	3	–	1
	\$ 137	\$ 42	\$ 21
<i>Costs and expenses</i>			
Purchase of oil	\$ –	\$ –	\$ 4
Purchase of petroleum products	1	6	–
Cost of services	55	22	12
Purchase of inventory	1	1	1
Other expenses	8	3	2
	\$ 65	\$ 32	\$ 19
<i>Other operations</i>			
Acquisitions of property, plant and equipment	\$ 73	\$ 21	\$ 29
Lease payments	29	14	8
Purchase of promissory notes	345	756	1
Proceeds from promissory notes	514	809	43
Dividends received	19	13	–
Borrowings issued	61	63	52
Borrowings repaid	46	52	–
Loans received	–	612	–
Loans repaid	\$ 8	\$ 664	\$ –

To manage its liquidity the Company purchased and sold promissory notes from and to a related finance company for the purpose of using them in settlements with suppliers and contractors.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

25. Related Party Transactions (continued)

	2005	2004	2003
<i>Assets</i>			
Trade receivables	\$ 12	\$ 14	\$ 3
Prepayments	–	4	5
Promissory notes receivable	30	142	199
Loans and borrowings	98	90	36
Other accounts receivable	1	1	1
	\$ 141	\$ 251	\$ 244
<i>Liabilities</i>			
Trade accounts payable	\$ 7	\$ 8	\$ 3
Advances received	1	–	–
Promissory notes payable	12	15	–
Loans and borrowings payable (including interest)	2	23	27
Cash at Company's banks	3	6	3
Deposits at Company's banks	1	1	21
Other accounts payable	–	–	1
	\$ 26	\$ 53	\$ 55

26. Commitments and Contingencies

Russian Business Environment

The Russian economy, while deemed to be of market status, continues to display certain traits of a market in transition, for example inflation is relatively high and the existence of currency controls, which cause the national currency to be illiquid outside Russia. In addition laws and regulations, including interpretations, enforcement and judicial processes, continue to evolve in Russia. Other laws and regulations and certain other restrictions producing a significant effect on the Company's industry, including, but not limited to the following issues: rights to use subsurface resources, environmental matters, site restoration, transportation and export, corporate governance, taxation, etc.

Taxation

Legislation and regulations regarding taxation in Russia continue to evolve. The various legislation and regulations are not always clearly written and their interpretation is subject to the opinions of the local, regional and national tax authorities. Instances of inconsistent opinions are not unusual.

The current regime of penalties and interest related to reported and discovered violations of Russia's laws, decrees and related regulations is severe. Interest and penalties are levied when an understatement of a tax liability is discovered. As a result, penalties and interest can result in amounts higher than unreported taxes.

In Russia tax declarations remain open and subject to inspection for a period of up to three years. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review during the three-year period.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

26. Commitments and Contingencies (continued)

Taxation (continued)

Russian transfer pricing rules were introduced in 1999, giving Russian tax authorities the right to make transfer pricing adjustments and impose additional tax liabilities in respect of all controlled transactions, provided that the transaction price differs from the market price by more than 20%. Controlled transactions include transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions with significant (by more than 20%) price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and courts. Due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge the Group's prices and propose adjustments. If such price adjustments are upheld by the Russian courts and implemented, the Group's future financial results could be adversely affected. In addition, the Group could face significant losses associated with the assessment of prior tax underpaid and related interest and penalties, which could have an adverse effect on the Group's financial condition and results of operations. The Group believes that such transfer pricing related tax contingencies are remote rather than possible or probable and cannot be reasonably estimated.

During 2004 several tax audits of OJSC Yuganskneftegaz for 1999-2003 years took place and their results have been appealed in court (see the "Litigation" caption below).

During 2005 tax audits of several subsidiaries for the years 2002-2003 took place. The results of these tax audits are currently being appealed with the tax authorities. The Company believes that the resolution of these matters will not result in any material tax payments.

Overall, management believes that the Group has paid or accrued all taxes that are applicable. Where uncertainty exists, the Group has accrued tax liabilities based on management's best estimate of the probable outflow of resources embodying economic benefits, which will be required to settle these liabilities. Possible liabilities which were identified by management at the balance sheet date as those that can be subject to different interpretations of the tax laws and regulations are not accrued in the consolidated financial statements.

Capital Projects for Exploration and Development of Production Facilities, and Modernization of Refineries and Distribution Network

The Company and its subsidiaries are engaged in ongoing capital projects for exploration and development of production facilities and modernization of refineries and the distribution network. The budgets for these projects are generally set on an annual basis. Depending on the current market situation, actual expenditures may vary from the budgeted amounts.

Following the acquisition of the additional share of 40% in TNPZ, 100% of the refinery's crude oil supplies come from the Company. This also facilitated the launch of large-scale work aimed at the modernization of the refinery. The modernization is aimed at increasing commercial efficiency, capacity of the refinery and the petroleum product yield ratio.

It is planned that future costs will be primarily self-financed. In addition, the Company is seeking external sources of financing. Management believes that the Company will receive all the finance required to complete both existing and scheduled projects.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

26. Commitments and Contingencies (continued)

Environmental Matters

Due to the nature of its business, Rosneft and its subsidiaries are subject to legislation regulating environmental protection and the conservation of natural resources. The majority of its liabilities entailed through violation of this legislation arise as a result of accidental oil spills and leaks that pollute land, water and the environment in general beyond the allowable level. The Company considers fines paid and other environmental liabilities as immaterial, given the scale of its operations.

In the course of its operations, the Company seeks to comply with international environmental standards and monitors compliance therewith on a regular basis. With a view to improve environmental activities, the Company takes a number of measures to mitigate the adverse impact of its current operations on the environment. Thus, the Company has developed a Comprehensive Environmental and Production Safety Program. In 2000, Rosneft signed an agreement with the RF Ministry for Emergencies that provides for the establishment of Environment Protection Centers to reduce the risk of pollution in the regions where Rosneft operates.

Legislation that regulates environmental protection in the Russian Federation is evolving, and the Company evaluates its liabilities in accordance therewith. Currently it is not possible to reasonably estimate the liabilities of the Company which may be incurred should the legislation be amended (if amended at all).

The management believes that, based on the existing legislation, the Company is unlikely to have liabilities that need to be accrued in addition to the amounts already recognized in the consolidated financial statements and that may have a material adverse effect on the operating results or financial position of the Company.

See also Note 29.

Pension Plans

The Company and its subsidiaries make contributions to the State Pension Fund 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.

The Company participates in a corporate pension fund to finance non-government pensions for its employees. The fund operates the defined contribution pension plan.

The Company contributed to the corporate pension fund US\$ 16 million, US\$ 13 million, and US\$ 17 million in 2005, 2004 and 2003, respectively.

Insurance

The Company insures its assets through the insurance company SK Neftepolis LLC, a related party.

As of December 31, 2005, 2004 and 2003, the amount of coverage on assets for such insurance was US\$ 1,420 million, US\$ 661 million and US\$ 2,264 million, respectively.

Russian insurance providers do not offer business interruption insurance. Currently, it is not common practice in Russia to obtain such insurance.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

26. Commitments and Contingencies (continued)

Social Commitments

The Company possesses social infrastructure assets for use by employees. In accordance with the Presidential Edict on privatization in Russia, the Company is required to transfer social infrastructure assets to the relevant local city administrations without significant consideration. Accordingly, as the Company does not have ownership of these assets, they are not recorded in the consolidated financial statements. However, the Company is required to maintain these assets.

The Company incurred US\$ 66 million, US\$ 81 million and US\$ 81 million in social infrastructure and similar expenses in 2005, 2004 and 2003, respectively. These expenses are presented as other expenses in the consolidated statement of income and comprehensive income.

Charity and Sponsorship

During 2005, 2004 and 2003, the Company made donations of US\$ 25 million, US\$ 44 million and US\$ 53 million, respectively, for charity and sponsorship in various regions of Russia where the Company operates. These expenses are presented as other expenses in the consolidated statement of income and comprehensive income.

Guarantees and Indemnity

As of December 31, 2005, the Company has provided guarantees for certain debt agreements. In accordance with the loan agreements, the Company is obliged to perform on the guarantee and to pay the bank all amounts of outstanding guaranteed liabilities, including interest, upon the bank's request.

The Company cannot substitute guarantees issued by any novation agreement or mutual offset. The Company's obligations under guarantees issued are valid in case of any change in loan agreements.

After the full payment and settlement of all obligations under the guarantees, the Company has the right to subrogate its respective part of all bank claims against the debtor in accordance with the loan agreement. In the event the Company makes payments under guarantees issued, it has a right to claim the amounts paid from the debtor.

The Company and a group of banks led by Societe Generale S.A. entered into an agreement granting the Company the right to claim the outstanding balance due from Yukos Oil Company under the syndicated loan of US\$ 1,000 million. Under the above agreement, the right to claim the debt was transferred from the banks to the Company in March 2006 upon the payment of the outstanding loan principal, accrued interest, legal and other fees in the amount totaling US\$ 483 million. As of December 31, 2005 the Company's obligation to the banks under the above agreement was recorded within accounts payable as Yukos Oil Company debt acquisition liability (Note 17) in the amount of the probable loss element on the transaction. The Company estimates the acquired debt will be repaid or otherwise recovered by early 2007.

Payments were made under this agreement during March 2006. As a result, the guarantee obligations of OJSC Yuganskneftegaz with respect to the loan described above have become intercompany in nature.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

26. Commitments and Contingencies (continued)

Guarantees and Indemnity (continued)

The Company's other outstanding guarantees as of December 31, 2005 are as follows:

Beneficiary Bank	Loan debtor	Maturity date	Contractual principal amount	Amount of outstanding liability (principal amount) as of December 31, 2005
Societe Generale S.A (as Facility Agent)	Yukos Oil Company	May 29, 2009	\$ 1,600	\$ 656
ABN AMRO	OJSC Rosneftegaz	December 30, 2008	\$ 7,500	\$ 7,227

In May 2005, Moravel Investments Limited, an affiliate of Yukos Oil Company, filed an arbitral claim against OJSC Yuganskneftegaz in the London Court of International Arbitration for the recovery of US\$ 662 million pertaining to the loan of US\$ 1,600 million from Societe Generale S.A. The Company is contesting the claim vigorously. The case will be heard in July 2006. The Company believes that the probability of any payments under the above guarantee is remote. On March 17, 2006 the Moscow Arbitration Court ruled that the guarantee agreement signed by OJSC Yuganskneftegaz with respect to Yukos Oil Company loan received from Societe Generale S.A. in the amount of US\$ 1,600 million was invalid. Though this resolution will be challenged by Yukos Oil Company in accordance with generally accepted legal practices the management believes that this ruling supports the Company's position in the London Court of International Arbitration.

The Company agreed to indemnify ONGC for losses in the event the Russian PSA Participants lose their equity interest in the project.

Litigation, Claims and Assessments

In April 2004, the Nenets Autonomous Area ("NAA") Administration filed a lawsuit in the Moscow Arbitration Court against OJSC Northern Oil for the recovery of US\$ 19 million relating to an unfunded obligation to NAA (which was recorded in the financial statement as of December 31, 2004) and a US\$ 11 million penalty for the late payment of contributions to the social and economic development of the NAA under the licence agreement with OJSC Northern Oil.

Following a number of court hearings and appeals the licence agreement clauses dealing with contributions to the NAA Administration were determined to be void. Based on this, all previously accrued liabilities and penalties were reversed in the consolidated financial statements.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

26. Commitments and Contingencies (continued)

Litigation, Claims and Assessments (continued)

As of December 31, 2005, OJSC Yuganskneftegaz had unresolved disputes with the tax authorities on decisions issued as a result of tax audits for 1999-2003 in the total amount of US\$ 4,676 million. As described in Note 29, as a result of court hearings the amount of such taxes claimed was subsequently reduced to US\$ 760 million. These court decisions can be appealed before May 25, 2006, however the Company's management believes that the probability of the appeal (if any) not being upheld is remote. Based on the above court decisions the estimated tax liabilities (including fines) accrued as of September 30, 2005 were decreased by RUR 1.3 billion (US\$ 45 million at December 31, 2005 CBR rate), but the additional interest in the amount of RUR 4.6 billion (US\$ 160 million at December 31, 2005 CBR rate) have been accrued. Such additional penalties include both the interest calculated based on the final amount of 1999-2003 tax liabilities and also the interest relating to 2004 tax liabilities of OJSC Yuganskneftegaz which were outstanding as of December 31, 2004. Accordingly, the total additional income tax and other tax liabilities relating to OJSC Yuganskneftegaz accrued as of December 31, 2005 amounted to US\$ 922 million.

In 2002 an option agreement was entered into between Total E&P Vankor (Total) and Anglo-Siberian Oil Company Limited (ASOC) (see Note 4) under which Total had a conditional option to buy the latter's 60% stake in Taymyrneft LLC which ASOC held through Anglo-Siberian Oil Company Limited (Cyprus) (ASOC Cyprus) for US\$ 1 million. ASOC and ASOC Cyprus belong to the Rosneft International Group (see Note 1). Total obtained injunctions in various jurisdictions to prevent ASOC Cyprus from trading in the shares of Taymyrneft LLC. In 2005 Total filed for arbitration under the option agreement requesting the specific performance under the option agreement or alternatively damages of US\$ 430 million. The Company's management believes that the claim is without merit and the option is not exercisable. Beyond professional fees, which are not material to the Company, it is unclear whether any further liabilities will be incurred but the Company's management does not believe these will be material.

During 2004 Total E&P Vankor filed a claim against ASOC Cyprus for US\$ 640 million under the sale and purchase agreement for 52% in Eniseineft LLC. Total alleged that under the terms of a sale agreement, the shareholding in Eniseineft LLC should have been sold to them. The Company has contested this on the grounds that the relevant conditions precedent to the sale had not been met. The arbitration proceedings were completed during late 2005 and a decision is expected in June 2006 .

The Company is a co-defendant in the litigation in the USA in respect of the acquisition of OJSC Yuganskneftegaz. This litigation was brought by certain holders of American Depositary Receipts ("ADRs") of Yukos Oil Company seeking US\$ 3 million in damages due to the fall in market value of the ADRs. The Company believes that this claim is without merit.

The Company is also a co-defendant in litigation in the Moscow Arbitration Court with respect to the auction for the common shares of OJSC Yuganskneftegaz. This litigation was brought by Yukos Oil Company. The claimant is seeking to recover all the common shares of OJSC Yuganskneftegaz and also damages in the total amount of RUR 388 billion (approximately US\$ 13 billion at the CBR rate as of December 31, 2005). The court hearings have been postponed for an indefinite period. The Company believes that this claim is without merit.

The Company's subsidiaries are involved in other litigations which arise from time to time in the course of their business activities. The Company's management believes that the ultimate result of these litigations will not significantly affect the operating results or financial position of the Company.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

26. Commitments and Contingencies (continued)

License Agreements

In accordance with certain licence agreements or separate agreements concluded from time to time with the local and regional authorities the Company is required to maintain certain levels of expenditures for health, safety and environmental protection, as well as maintain certain level of capital expenditures. Generally these expenditures are within the normal operating and capital budgets and are accounted for when incurred in accordance with existing accounting policies for respective costs and expenses.

Oil Supplies

In January 2005, the Company entered into a long-term contract until 2010 with China National United Oil Corporation for export supplies of crude oil in the total amount of 48.4 million tonnes to be delivered in equal annual amounts. The prices are determined based on usual commercial terms for crude oil deliveries.

27. Segment Information

Presented below is information about the Company's operating segments in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company determines its operating segments based on differences in the nature of their operations. The performance of these operating segments is assessed by management on a regular basis. The exploration and production segment is engaged in field exploration and development and production of crude oil and natural gas. The refinery, marketing and distribution segment is engaged in processing crude oil and other hydrocarbons into petroleum products, as well as purchasing, sale and transportation of crude oil and petroleum products. The other activities segment consists of banking, finance services, drilling services, construction services and other activities. Substantially all of the Company's operations are conducted in the Russian Federation. Further, the geographical regions within the Russian Federation have substantially similar economic and regulatory conditions. Therefore, the Company has not presented any separate geographical disclosure.

The segments are combinations of subsidiaries (see Note 1). The significant accounting policies applied to each segment are consistent with those applied to the consolidated financial statements. Sales transactions for goods and services between the segments are carried out using prices agreed upon between the Company and its subsidiaries.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

27. Segment Information (continued)

Operating segments in 2005:

	Exploration and production	Refining, marketing and distribution	Other activities	Total Elimination	Consolidated
Revenues from external customers	\$ 378	\$ 23,239	\$ 334	\$ –	\$ 23,951
Intersegmental revenues	9,534	797	297	(10,628)	–
Total revenues	<u>\$ 9,912</u>	<u>\$ 24,036</u>	<u>\$ 631</u>	<u>\$ (10,628)</u>	<u>\$ 23,951</u>
Operating expenses and cost of purchased oil and petroleum products	\$ 1,303	\$ 988	\$ 64	\$ –	\$ 2,355
Depreciation, depletion and amortization	\$ 1,320	\$ 143	\$ 9	\$ –	\$ 1,472
Operating income	\$ 1,781	\$ 13,903	\$ 467	\$ (10,628)	\$ 5,523
Total other income, net					691
Income before income tax					<u>\$ 6,214</u>
Total assets	\$ 23,005	\$ 5,841	\$ 1,170	\$ –	\$ 30,016

Operating segments in 2004:

	Exploration and production	Refining, marketing and distribution	Other activities	Total Elimination	Consolidated
Revenues from external customers	\$ 226	\$ 4,818	\$ 231	\$ –	\$ 5,275
Intersegmental revenues	1,899	317	275	(2,491)	–
Total revenues	<u>\$ 2,125</u>	<u>\$ 5,135</u>	<u>\$ 506</u>	<u>\$ (2,491)</u>	<u>\$ 5,275</u>
Operating expenses and cost of purchased oil and petroleum products	\$ 344	\$ 682	\$ 129	\$ –	\$ 1,155
Depreciation, depletion and amortization	\$ 193	\$ 103	\$ 11	\$ –	\$ 307
Operating income	\$ 590	\$ 2,818	\$ 289	\$ (2,491)	\$ 1,206
Total other expenses, net					(5)
Income before income tax					<u>\$ 1,201</u>
Total assets	\$ 21,282	\$ 3,653	\$ 1,077	\$ –	\$ 26,012

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

27. Segment Information (continued)

Operating segments in 2003:

	Exploration and production	Refining, marketing and distribution	Other activities	Total Elimination	Consolidated
Revenues from external customers	\$ 383	\$ 3,104	\$ 154	\$ –	\$ 3,641
Intersegmental revenues	1,069	202	218	(1,489)	–
Total revenues	<u>\$ 1,452</u>	<u>\$ 3,306</u>	<u>\$ 372</u>	<u>\$ (1,489)</u>	<u>\$ 3,641</u>
Operating expenses and cost of purchased oil and petroleum products	\$ 270	\$ 481	\$ 59	\$ –	\$ 810
Depreciation, depletion and amortization	\$ 225	\$ 67	\$ 10	\$ –	\$ 302
Operating income	\$ 191	\$ 1,734	\$ 228	\$ (1,489)	\$ 664
Total other expenses, net					(75)
Income before income tax					<u>\$ 589</u>
Total assets	\$ 1,880	\$ 4,577	\$ 311	\$ –	\$ 6,768

Below is a breakdown of revenues by domestic and export sales, with a classification of export sales based on the country of incorporation of the foreign customer.

Oil and gas sales	2005	2004	2003
Domestic sales of crude oil	\$ 600	\$ 104	\$ 71
Domestic sales of gas	175	118	79
Export sales of crude oil – CIS	1,491	411	177
Export sales of crude oil – Europe	11,539	1,689	1,091
Export sales of crude oil – Asia	2,303	353	246
Export sales of crude oil – other directions	94	60	50
Total oil and gas sales	<u>\$ 16,202</u>	<u>\$ 2,735</u>	<u>\$ 1,714</u>
Petroleum products and processing fees	2005	2004	2003
Domestic sales of petroleum products and processing fees	\$ 2,865	\$ 1,249	\$ 913
Export sales of petroleum products – CIS	64	–	–
Export sales of petroleum products – Europe	3,726	506	427
Export sales of petroleum products – South-East Asia	719	478	384
Total petroleum products and processing fees	<u>\$ 7,374</u>	<u>\$ 2,233</u>	<u>\$ 1,724</u>

In 2005, 2004 and 2003, different single customers in each year, which are international oil traders accounted for revenues of US\$ 5,041 million, US\$ 831 million and US\$ 543 million or 21%, 16% and 15% of gross revenues, respectively. These revenues are recognized mainly under the Refining, Marketing and Distribution segment. Management does not believe that the Company is dependent on any particular customer.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

28. Fair Value of Financial Instruments and Risk Management

The Company, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks.

The Company manages these risks and monitors its exposure on a regular basis. The Company does not use hedge or derivative financial instruments.

The fair value of cash and cash equivalents, accounts receivable and accounts payable, promissory notes receivable and liquid securities approximates their carrying value recognized in these financial statements. The Company's management believes that accounts receivable recorded net of allowance for doubtful accounts will be recovered in full during an acceptable time period. The fair value of long-term accounts receivable included in other non-current assets approximates the discounted amounts recognized in these financial statements and is calculated using the estimated market interest rate for similar operations. The fair value of long-term debt differs from amounts recognized in the consolidated financial statements. The estimated fair value of long-term debt discounted using the estimated market interest rate for similar financial liabilities amounted to US\$ 10,026 million, US\$ 10,012 million and US\$ 2,153 million as of December 31, 2005, 2004 and 2003, respectively. These amounts include all future cash outflows related to the repayment of long-term loans, including their current portion and interest expenses.

A substantial portion of the Company's sales revenues is received in US dollars. In addition, substantial financing and investing activities, obligations and commitments are also undertaken in US dollars. However, some operating and investing expenditures, other obligations and commitments as well as tax liabilities are undertaken in rubles. As a result of the US dollar drop against the ruble, the Company is exposed to the corresponding currency risk, which is considerably mitigated by the recent increase in oil prices.

29. Subsequent Events

In January 2006, the Company, through one of its subsidiaries, purchased an additional share of the 39.26% of voting stock (30.24% of the share capital) of OJSC Rosneft – Tuapse Nefteproduct. The purchase price amounted to US\$ 100 million. After the purchase, the Company's share in OJSC Rosneft – Tuapse Refinery amounts to 89.93% of voting shares (68.24% of the share capital).

In January 2006, a subsidiary of the Company registered in Cyprus signed a loan agreement with a major Western bank for an amount up to EUR 188 million or US\$ 223 million using the CBR rate as of the balance sheet date. The loan bears an interest rate of EURIBOR plus 0.35%. The first drawdown was made during February-March 2006 in the amount of EUR 90 million or US\$ 107 million using the CBR rate as of the balance sheet date. Funds borrowed are to be invested in the construction of ice-reinforced tankers for crude oil transportation purposes in north-western regions of the Russian Federation. The loan is scheduled to be repaid within the twelve years following the completion of tanker construction.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

29. Subsequent Events (continued)

In February 2006, the Company signed a loan agreement with a syndicate of Western banks for US\$ 2,000 million with a term of 5 years. The loan bears interest at LIBOR plus 0.65% p.a. In March 2006, the Company received US\$ 575 million under this loan agreement and used these funds to repay loans with less favourable terms.

In March 2006, a production licence for the Vostochno-Sugdinskoe oil field located in the Irkutsk region was purchased as a result of an auction won by the Company in December 2005. The outstanding portion of the purchase consideration for this license was paid in the amount of RUR 7,170 million (US\$ 249 million at the CBR rate as of December 31, 2005).

In March 2006, a banking consortium led by Societe Generale S.A. filed a petition with the Moscow Arbitration Court for the bankruptcy of Yukos Oil Company. On March 28, 2006, the Moscow Arbitration Court introduced a three-month temporary external observation procedure for Yukos Oil Company and appointed an Interim Receiver. Also in March 2006 following the Company's acquisition of Yukos Oil Company's debts in the amount of US\$ 483 million from the banking consortium, the Moscow Arbitration court approved the replacement of the claimant with respect to this debt. The first meeting of the creditors is currently scheduled for June, 2006.

During January-April 2006 the Company prematurely redeemed bank loans from a State owned bank in the amount of US\$ 944 million and bank loans from Russian commercial and international banks in the amount of US\$ 453 million.

In April 2006, the Company executed several agreements granting it a decrease in the interest rate to LIBOR plus 0.7% p.a. for outstanding loans totalling US\$ 5,730 million as of December 31, 2005 and to LIBOR plus 0.65% p.a. for outstanding loans totalling US\$ 3,177 million as of December 31, 2005.

In April 2006, the Moscow Arbitration Court ruled to reduce the total amount of tax claims to OJSC Yuganskneftegaz to US\$ 760 million including interest and penalties. This ruling may be subject to further appeal by the tax authorities, however the Company believes that no further claims will be imposed, and amounts already accrued in the consolidated financial statements are appropriate. (See Note 26).

On May 5, 2006 the Rosneft Board of Directors recommended to shareholders' meeting to declare annual dividends for common stock in the amount of RUR 11,336 million (US\$ 394 million at the CBR rate as of December 31, 2005). This amount is approximately US\$ 0.04 per share at the CBR rate as of December 31, 2005.

In the first half of 2006 the Company won a number of auctions for the exploration and development of oil and gas fields in the Krasnoyarsk and Irkutsk regions. The total cost of acquisitions amounted to RUR 7.9 billion (US\$ 274 million at the CBR rate as of December 31, 2005).

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

Supplementary Oil and Gas Disclosure (unaudited)

In accordance with SFAS 69, *Disclosures about Oil and Gas Producing Activities*, the Company makes 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 the data represents management's best estimates. Accordingly, this information may not necessarily represent the current financial condition of the Company and its expected future financial results.

All of the Company's activities are conducted in Russia, which is considered as one geographic area.

Capitalized costs relating to oil and gas producing activities

	As of December 31,		
	2005	2004	2003
Oil and gas properties related to proved reserves	\$ 23,218	\$ 17,991	\$ 5,546
Oil and gas properties related to unproved reserves	1,382	1,041	266
Total	24,600	19,032	5,812
Accumulated depreciation, depletion and amortization, and valuation allowances	(3,661)	(2,492)	(2,520)
Net capitalized costs	\$ 20,939	\$ 16,540	\$ 3,292

The share of the Company in the capitalized costs of equity investees was immaterial during 2005, 2004 and 2003.

Cost incurred in oil and gas property acquisition, exploration and development activities

	2005	2004	2003
Acquisition of proved oil and gas properties	\$ 3,475	\$ 11,877	\$ 512
Acquisition of unproved oil and gas properties	341	775	266
Exploration costs	194	51	18
Development costs	1,752	568	577
Total costs incurred	\$ 5,762	\$ 13,271	\$ 1,373

Acquisition costs of oil and gas properties in 2005 include the effect of the purchase price adjustment related to OJSC Yuganskneftegaz (see Note 4).

The share of the Company in acquisition, exploration and development expenditures of its equity investees was immaterial during 2005, 2004 and 2003.

Results of operations for oil & gas producing activities

	2005	2004	2003
Revenues:			
External sales	\$ 378	\$ 226	\$ 383
Transfers to other operating segments	9,534	1,899	1,069
Total revenues	9,912	2,125	1,452
Production costs (excluding production taxes)	1,303	344	271
Selling, general and administrative expenses	266	77	146
Pipeline tariffs and transportation costs	28	7	22
Exploration expense	194	51	18
Accretion expense	35	8	12
Depreciation, depletion and amortization	1,320	193	225
Taxes other than income tax	4,985	855	567
Income tax	777	68	(12)
Results of operation for producing activities	\$ 1,004	\$ 522	\$ 203

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Results of operation for oil & gas producing activities (continued)

Transfers represent crude oil transferred between the operating segments. Such amounts are valued using prices agreed upon between the Company and its subsidiaries based on domestic prices for crude oil.

The Company's share in the results of operations for oil and gas production of equity investees was immaterial during 2005, 2004 and 2003.

Reserve quantity information

For the purposes of evaluation of reserves as of December 31, 2005, 2004 and 2003 the Company used the oil and gas reserve information prepared by DeGolyer & MacNaughton, independent reservoir engineers, prepared in accordance with United States Securities and Exchange Commission definitions. Proved reserves are those estimated quantities of crude oil and gas which, by analysis of geological and engineering data, demonstrate with reasonable certainty to be recoverable in the future from existing reservoirs under the existing economic and operating conditions. In certain cases, recovery of such reserves may require considerable investments in wells and related equipment. Proved reserves also include additional oil and gas reserves that will be extracted after the expiry date of licence agreements or may be discovered as a result of secondary and tertiary extraction which have been successfully tested and checked for commercial benefit. Proved developed reserves are the quantities of crude oil and gas expected to be recovered from existing wells using existing equipment and operating methods.

Proved undeveloped oil and gas reserves are reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage are limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Proved reserves for other undrilled units can be claimed only where it can be demonstrated with certainty that there is continuity of production from the existing productive formation. Under no circumstances are estimates of proved undeveloped reserves attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless those techniques have been proved effective by actual tests in the area and in the same reservoir. Net reserves include quantities of reserves attributable to the Company's share in deposits. Due to inherent industry uncertainties and the limited nature of deposit data, estimates of reserves are subject to change as additional information becomes available.

The Company included in proved reserves those reserves which the Company intends to extract after the expiry of the current licences. The licences for the development and production of hydrocarbons currently held by the Company expire between 2006 and 2026, and the licences for the most important deposits expire between 2013 and 2019. In accordance with the effective version of the law of the Russian Federation, *On Subsurface Resources* (the "Law"), licences are currently granted for a production period determined on the basis of technological and economic criteria applied to the development of a mineral deposit which guarantee rational use of subsurface resources and necessary environmental protection. In accordance with the Law and upon gradual expiration of old licences issued under the previous version of the Law, the Company extends its hydrocarbon production licences for the whole productive life of the fields. Extension of the licences depends on both current and future compliance with the terms set forth in the licence agreements. As of the date of these financial statements, the Company is generally in compliance with all the terms of the licence agreements and intends to continue complying with such terms in the future (see Note 11).

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

Supplementary Oil and Gas Disclosure (unaudited) (continued)

Reserve quantity information (continued)

The Company's estimates of net proved oil and gas reserves and changes thereto for the years ended December 31, 2005, 2004 and 2003 are shown in the table below (oil production data was recalculated from tonnes to barrels using a ratio of 7.3 barrels per tonne, gas production data was recalculated from cubic meters to barrels of oil equivalent using a ratio of 35.3/6 cubic meters per barrel):

	2005	2004	2003
	<i>mln. bbl.</i>	<i>mln. bbl.</i>	<i>mln. bbl.</i>
Beginning of year reserves	12,744	3,346	3,399
Revisions of previous estimates	(373)	330	(294)
Increase and discovery of new reserves	63	–	–
Acquisitions of new properties	–	9,216	374
Production	(621)	(148)	(133)
End of year reserves	11,813	12,744	3,346
Proved developed reserves	8,507	8,355	2,307
Minority interest in total proved reserves	2,393	2,728	587
Minority interest in proved developed reserves	1,732	1,847	461

The minority interest in proved developed and total proved reserves mainly relates to OJSC Yuganskneftegaz.

The increase in acquisition of new properties primarily relates to proved reserves of OJSC Yuganskneftegaz.

The Company's share in the proved reserves of equity investees was immaterial during 2005, 2004 and 2003.

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 69. Estimated future cash inflows from oil and gas production are computed by applying year-end prices for oil and gas to year-end quantities of estimated net proved reserves. Adjustment in this calculation for future price changes is limited to those required by contractual arrangements in existence at the end of each reporting period. Future development and production costs are those estimated future expenditures necessary to develop and produce estimated proved reserves as of year-end based on year-end cost indices and 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 net pre-tax cash flows, net of the tax bases of related assets.

Discounted future net cash flows are calculated using a 10% discount factor. Discounting requires a year-by-year estimates of future expenditures to be incurred in the periods when the reserves will be extracted.

OJSC Rosneft Oil Company

Notes to Consolidated Financial Statements (continued)

Supplementary Oil and Gas Disclosure (unaudited) (continued)

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

The information provided in the tables below does not represent management's estimates of the Company's expected future cash flows or of the value of its proved oil and gas reserves. Estimates of proved reserves change over time as new information becomes available. Moreover, probable and possible reserves which may become proved in the future are excluded from the calculations. The arbitrary valuation prescribed under SFAS 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	2004	2003
Future cash inflows	\$ 274,619	\$ 214,887	\$ 51,708
Future development costs	(12,507)	(22,170)	(3,767)
Future production costs	(80,564)	(79,302)	(25,180)
Future income tax expenses	(43,291)	(27,740)	(5,673)
Future net cash flows	138,257	85,675	17,088
Discount of estimated timing of cash flows	(87,100)	(56,499)	(10,020)
Discounted value of future cash flows as of the end of year	\$ 51,157	\$ 29,176	\$ 7,068
	2005	2004	2003
Discounted value of future cash flows as of the beginning of year	\$ 29,176	\$ 7,068	\$ 6,661
Sales and transfers of oil and gas produced, net of production costs and taxes other than income taxes	(8,131)	(1,536)	(1,261)
Changes in price estimates, net	26,798	3,808	(1,313)
Changes in future development costs	3,471	(2,751)	(825)
Development costs incurred during the period	1,752	568	577
Revisions of previous reserves estimates	953	415	(436)
Discovery of new reserves, less respective expenses	115	–	–
Net change in income taxes	(5,224)	(389)	138
Accretion of discount	2,918	707	666
Purchase of new oil and gas fields	–	22,143	873
Other	(671)	(857)	1,988
Discounted value of future cash flows as of the end of year	\$ 51,157	\$ 29,176	\$ 7,068

Discounted value of future cash flows as of December 31, 2005, 2004 and 2003 includes the interest of other (minority) shareholders in the amount of US\$ 10,574 million, US\$ 6,431 million and US\$ 1,375 million, respectively.