OAO LUKOIL

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(prepared in accordance with US GAAP)

As of and for the three and six month periods ended June 30, 2004

(unaudited)

These interim consolidated financial statements were prepared by OAO LUKOIL in accordance with US GAAP and have not been audited by our independent auditor. If these financial statements are audited in the future, the audit could reveal differences in our consolidated financial results and we can not assure that any such differences would not be material.

Independent Accountants' Review Report

The Board of Directors of OAO LUKOIL:

We have reviewed the accompanying consolidated balance sheet of OAO LUKOIL and its subsidiaries as of June 30, 2004, the related consolidated statements of income for the three-month and six-month periods ended June 30, 2004 and 2003 and the related consolidated statements of cash flows for the six-month periods ended June 30, 2004 and 2003 in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these consolidated financial statements is the representation of the management of OAO LUKOIL.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

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

KPMG Limited

KPMG Limited
Moscow, Russian Federation
September 24, 2004

OAO LUKOIL
Consolidated Balance Sheets
(Millions of US dollars, unless otherwise noted)

	Note	As of June 30, 2004 (unaudited)	As of December 31, 2003
Assets			
Current assets			
Cash and cash equivalents	6	946	1,435
Short-term investments		276	251
Accounts and notes receivable, net	7	3,639	3,790
Inventories		1,495	1,243
Prepaid taxes and other expenses		913	818
Other current assets		516	334
Assets of bank subject to disposition and assets held for sale	8	1,230	52
Total current assets		**9,015**	**7,923**
Investments		691	594
Property, plant and equipment		18,056	16,859
Non-current deferred income tax assets		103	117
Goodwill and intangible assets		560	523
Non-current assets of bank subject to disposition	8	446	-
Other non-current assets		298	558
Total assets		**29,169**	**26,574**
Liabilities and Stockholders' equity			
Current liabilities			
Accounts payable		1,659	1,564
Short-term borrowings and current portion of long-term debt	9	1,646	1,412
Customer deposits placed in banking subsidiaries		3	1,007
Taxes payable		1,170	943
Other current liabilities		949	345
Liabilities of bank subject to disposition	8	894	-
Total current liabilities		**6,321**	**5,271**
Long-term debt	10	2,542	2,392
Long-term deferred income tax liabilities		544	497
Asset retirement obligation		266	210
Other long-term liabilities		610	249
Minority interest in subsidiary companies		481	483
Total liabilities		**10,764**	**9,102**
Stockholders' equity	13		
Common stock		15	15
Treasury stock, at cost		(556)	(435)
Additional paid-in capital		3,564	3,522
Retained earnings		15,386	14,371
Accumulated other comprehensive loss		(4)	(1)
Total stockholders' equity		**18,405**	**17,472**
Total liabilities and stockholders' equity		**29,169**	**26,574**

President of OAO LUKOIL
Alekperov V.Y.

Chief accountant of OAO LUKOIL
Khoba L.N.

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

(Millions of US dollars, unless otherwise noted)

	Note	For the three months ended June 30, 2004 (unaudited)	For the three months ended June 30, 2003 (unaudited)	For the six months ended June 30, 2004 (unaudited)	For the six months ended June 30, 2003 (unaudited)
Revenues					
Sales (including excise and export tariffs)	18	7,965	5,086	14,477	10,142
Equity share in income of affiliates		62	49	132	91
Total revenues		**8,027**	**5,135**	**14,609**	**10,233**
Costs and other deductions					
Operating expenses		(674)	(693)	(1,334)	(1,361)
Cost of purchased crude oil, petroleum and chemical products		(2,501)	(1,386)	(4,328)	(2,665)
Transportation expenses		(734)	(503)	(1,383)	(939)
Selling, general and administrative expenses		(451)	(429)	(922)	(758)
Depreciation, depletion and amortization		(266)	(226)	(514)	(455)
Taxes other than income taxes		(818)	(530)	(1,558)	(1,140)
Excise and export tariffs		(1,090)	(788)	(1,947)	(1,329)
Exploration expenses		(57)	(28)	(87)	(54)
Gain from sale of interest in Azeri Chirag Guneshli	8	-	1,130	-	1,130
Loss on disposals and impairments of assets		(46)	(28)	(71)	(68)
Income from operating activities		**1,390**	**1,654**	**2,465**	**2,594**
Interest expense		(75)	(78)	(143)	(140)
Interest and dividend income		57	47	99	63
Currency translation (loss) gain		(40)	51	19	84
Other non-operating (expense) income		(42)	28	4	64
Minority interest		(21)	(12)	(37)	(19)
Income before income taxes		**1,269**	**1,690**	**2,407**	**2,646**
Current income taxes		(401)	(130)	(712)	(400)
Deferred income taxes		9	(16)	1	(14)
Total income tax expense	5	**(392)**	**(146)**	**(711)**	**(414)**
Income before cumulative effect of change in accounting principle		**877**	**1,544**	**1,696**	**2,232**
Cumulative effect of change in accounting principle, net of tax	2	-	-	-	132
Net income		**877**	**1,544**	**1,696**	**2,364**
Per share of common stock (US dollars):					
Income before cumulative effect of change in accounting principle					
Basic	13	1.07	1.89	2.07	2.73
Diluted	13	1.06	1.85	2.05	2.68
Net Income					
Basic	13	1.07	1.89	2.07	2.89
Diluted	13	1.06	1.85	2.05	2.84

(Millions of US dollars)

	Note	For the six months ended June 30, 2004 (unaudited)	For the six months ended June 30, 2003 (unaudited)
Cash flows from operating activities			
Net income		**1,696**	**2,364**
Adjustments for non-cash items:			
Cumulative effect of change in accounting principle, net of tax		-	(132)
Depreciation, depletion and amortization		514	455
Equity share in income of affiliates		(118)	(91)
Loss (gain) on disposals and impairments of assets		71	(1,062)
Deferred income taxes		(1)	14
Non-cash currency translation (gain) loss		(21)	42
Non-cash investing activities		(13)	(52)
All other items – net		81	51
Changes in operating assets and liabilities:			
Accounts and notes receivable		(424)	(535)
Short-term loans receivable of banking subsidiaries		(9)	(86)
Net movements of customers deposits placed in banking subsidiaries		(153)	64
Inventories		(252)	(3)
Accounts payable		129	119
Taxes payable		228	224
Other current assets and liabilities		(368)	(347)
Net cash provided by operating activities		**1,360**	**1,025**
Cash flows from investing activities			
Capital expenditures		(1,550)	(1,297)
Proceeds from sale of property, plant and equipment		64	37
Proceeds from sale of interest in Azeri Chirag Guneshli	8	-	1,337
Purchases of investments		(473)	(379)
Proceeds from sale of investments		110	245
Acquisitions (net of cash acquired) and additional interests purchased		(292)	(765)
Net cash used in investing activities		**(2,141)**	**(822)**
Cash flows from financing activities			
Net movements of short-term borrowings		330	244
Proceeds from issuance of long-term debt		833	386
Principal payments of long-term debt		(473)	(507)
Dividends paid		(26)	(8)
Purchase of treasury stock		(352)	(86)
Proceeds from sale of treasury stock		273	78
Other – net		(3)	(9)
Net cash provided by financing activities		**582**	**98**
Effect of exchange rate changes on cash and cash equivalents		11	19
Net (decrease) increase in cash and cash equivalents		**(188)**	**320**
Cash and cash equivalents at beginning of the period		1,435	1,252
Less cash and cash equivalents of bank subject to disposition	8	(301)	-
Cash and cash equivalents at end of the period	6	**946**	**1,572**

Supplemental disclosures of cash flow information		
Interest paid	146	140
Income tax paid	671	468

Note 1. Basis of Financial Statement presentation

The accompanying consolidated interim financial statements and notes thereto of OAO LUKOIL (the "Company") and its subsidiaries (the "Group") have not been audited by independent accountants, except for the balance sheet at December 31, 2003. In the opinion of the Company's management, the interim financial information includes all adjustments and disclosures necessary to present fairly the Group's financial position, results of operations and cash flows for the interim periods reported herein. These adjustments were of a normal recurring nature.

These consolidated interim financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). Certain notes and other information have been condensed or omitted from the interim financial statements. Therefore, these financial statements should be read in conjunction with the Group's December 31, 2003 annual consolidated financial statements. The consolidated interim financial statements have been prepared following the accounting policies applied and disclosed in the December 31, 2003 consolidated financial statements, except that during the current period the Group has changed its presentation of advances made for purchases of property, plant and equipment. Previously, these amounts were classified as other non-current assets. The Group now classifies these amounts as property, plant and equipment. Prior period amounts of $220 million have been reclassified to conform with the current period presentation. Certain other prior period amounts have been reclassified to conform with current period presentation.

The results for the three-month and six-month periods ended June 30, 2004 are not necessarily indicative of the results expected for the full year.

Foreign currency translation

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

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

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

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

As of June 30, 2004 and December 31, 2003, exchange rates of 29.03 and 29.45 Russian rubles to the US dollar, respectively, have been used for translation purposes.

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

Note 2. Cumulative effect of change in accounting principle

Effective January 1, 2003, the Group adopted SFAS No. 143, *"Accounting for Asset Retirement Obligations,"* which applies to legal obligations associated with the retirement of tangible long-lived assets. The cumulative effect of the change increased 2003 net income by $132 million (net of income tax of $46 million).

(Millions of US dollars, unless otherwise noted)

Note 3. Recent accounting pronouncements

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46 *"Consolidation of Variable Interest Entities,"* which was amended in December 2003 when FASB Interpretation No. 46 (revised in December 2003) *"Consolidation of Variable Interest Entities"* ("FIN 46 R") was issued. FIN 46 R addresses when a business enterprise should consolidate another entity in which it has a controlling financial interest through means other than voting interests. The provisions of FIN 46R were required to be applied to variable interest entities commonly referred to as "special purpose entities" by December 31, 2003. For all other variable interest entities, implementation was required by March 31, 2004.

The full adoption of FIN 46 R during the period ended June 30, 2004 did not have a material impact on the Group's results of operations, financial position or cash flows.

Note 4. Accounting for drilling and mineral use rights

In 2001, the FASB issued SFAS No. 141, *"Business Combinations,"* and SFAS No. 142 *"Goodwill and Other Intangible Assets,"* which became effective on July 1, 2001, and January 1, 2002, respectively. Recently, the Emerging Issues Task Force ("EITF") was considering the issue of whether, under the provisions of SFAS Nos. 141 and 142, drilling and mineral use rights should be accounted for and classified as intangible assets on the balance sheet of companies in the oil and gas industry. Historically, the Group has capitalized the cost of drilling and mineral use rights and reported these assets as part of tangible exploration and production property, plant and equipment.

On September 2, 2004, the FASB issued FASB Staff Position ("FSP") No. 142-2 on application of SFAS No. 142 to oil and gas producing entities. FSP No. 142-2 does not require oil and gas companies to classify mineral rights as intangible assets.

Note 5. Income taxes

The combined statutory income tax rate in the Russian Federation during the periods ended June 30, 2004 and 2003 was 24%. The Group's effective tax rate for the period ended June 30, 2004 was significantly higher as compared to the period ended June 30, 2003. This was primarily due to the recognition of a non-taxable gain of $1,130 million on the sale of the Group's interest in a production sharing agreement ("PSA") operated by the Azerbaijan International Operating Company in the period ended June 30, 2003 (Note 8 "Assets and liabilities of bank subject to disposition and assets held for sale").

Note 6. Cash and cash equivalents

	As of June 30, 2004	As of December 31, 2003
Cash held in Russian rubles	188	258
Cash held in other currencies	690	510
Cash held in banking subsidiaries in Russian rubles	-	437
Cash held in banking subsidiaries in other currencies	68	230
Total cash and cash equivalents	**946**	**1,435**

(Millions of US dollars, unless otherwise noted)

Note 7. Accounts and notes receivable, net

	As of June 30, 2004	As of December 31, 2003
Trade accounts and notes receivable (net of provisions of \$96 million and \$90 million as of June 30, 2004 and December 31, 2003, respectively)	2,226	1,829
Current VAT and excise recoverable	1,185	1,085
Short-term loans receivable of banking subsidiaries (net of provisions of nil and \$26 million as of June 30, 2004 and December 31, 2003, respectively)	29	549
Other current accounts receivable (net of provisions of \$63 million as of June 30, 2004 and December 31, 2003)	199	327
Total accounts and notes receivable, net	**3,639**	**3,790**

Note 8. Assets and liabilities of bank subject to disposition and assets held for sale

In June 2004, the Company made a decision to sell its 99% ownership interest in OAO Bank Petrocommerce (the "Bank") for \$214 million to a group of companies of a related party, whose management and directors include members of the Group's management and Board of Directors. The Company used an independent valuation in the determination of the selling price. The transaction will be completed in two phases. The first phase, representing the sale of 78% of the Group's ownership interest for \$169 million was completed on September 22, 2004. The second phase in which the Group will sell its remaining 21% of ownership interest in the Bank for \$45 million is expected to be completed by the end of June 2007. During the period ended June 30, 2004, the Group recognized an impairment loss of \$35 million in relation to this transaction.

The following are the major classes of assets and liabilities of the Bank subject to disposition as of June 30, 2004.

Cash and cash equivalents	301
Short-term investments	344
Short-term loans and other accounts receivable	585
Total current assets due from third parties	1,230
Current assets due from Group companies	75
Total current assets of the Bank	**1,305**
Investments	86
Property, plant and equipment	20
Other non-current assets	340
Total non-current assets due from third parties	446
Non-current assets due from Group companies	29
Total non-current assets of the Bank	**475**
Customer deposits	851
Other current liabilities	43
Total current liabilities due to third parties	894
Liabilities due to Group companies	332
Total current liabilities of the Bank	**1,226**
Long-term debt	302
Total non-current liabilities due to third parties	302
Non-current liabilities due to Group companies	23
Total non-current liabilities of the Bank	**325**
Net assets of the Bank	**229**
Minority interest	(15)
Group's ownership in net assets of the Bank	214

(Millions of US dollars, unless otherwise noted)

Note 8. Assets and liabilities of bank subject to disposition and assets held for sale (continued)

Non-current liabilities due to third parties are included in “Other long-term liabilities” in the consolidated balance sheet as of June 30, 2004.

In December 2003, a Group company entered into a contract to sell 5 tanker vessels for $52 million to a related party, which was controlled by a member of the Group’s management. As of December 31, 2003, the Group classified these assets with a net book value of $52 million as held for sale in the consolidated balance sheet. The sale was completed in February 2004.

In April 2003 a Group company completed the sale of its 10% interest in the PSA operated by the Azerbaijan International Operating Company for net $1,337 million cash, resulting in the recognition of a net gain of $1,130 million during the three months ended June 30, 2003. This gain is included in the “Exploration and production” operating segment and “International” geographical segment in Note 18 “Segment information.”

Note 9. Short-term borrowings and current portion of long-term debt

	As of June 30, 2004	As of December 31, 2003
Short-term borrowings	1,332	1,001
Current portion of long-term debt	314	411
Total short-term borrowings and current portion of long-term debt	**1,646**	**1,412**

Short-term borrowings are loans from various third parties and are generally secured by export sales, property, plant and equipment and securities.

Note 10. Long-term debt

	As of June 30, 2004	As of December 31, 2003
Long-term loans and borrowings from third parties	2,364	2,322
3.5% Convertible US dollar bonds, maturing 2007	373	366
Capital lease obligation	119	115
Total long-term debt	2,856	2,803
Current portion of long-term debt	(314)	(411)
Total non-current portion of long-term debt	**2,542**	**2,392**

Long-term loans and borrowings

Long-term loans and borrowings are primarily repayable in US dollars, maturing from 2004 through 2027 and are generally secured by export sales, property, plant and equipment and securities.

Convertible US dollar bonds

On November 29, 2002, a Group company issued 350,000 3.5% convertible bonds with a face value of $1,000 each, maturing on November 29, 2007, and exchangeable for 12.112 (previously 11.948) global depository receipts (“GDRs”) of the Company per bond. The bonds are convertible into GDRs on or after January 9, 2003 up to the maturity dates. The GDRs are exchangeable into four shares of common stock of the Company. Bonds not converted by the maturity date must be redeemed for cash. The redemption price at maturity will be 120.53% of the face value in respect of these bonds. A Group company may redeem the bonds for cash prior to maturity, subject to certain restrictions and early redemption charges. The carrying amount of the bonds is being accreted to their redemption value with the accreted amount being charged to the consolidated statement of income.

Group companies held sufficient treasury stock to permit the full conversion of the bonds to GDRs.

Note 11. Comprehensive income

	For the three months ended June 30, 2004	For the three months ended June 30, 2003	For the six months ended June 30, 2004	For the six months ended June 30, 2003
Net income	877	1,544	1,696	2,364
Other comprehensive loss:				
Foreign currency translation adjustment	(6)	-	(3)	(1)
Comprehensive income	**871**	**1,544**	**1,693**	**2,363**

Note 12. Pension benefits

Components of net periodic benefit cost were as follows:

	For the three months ended June 30, 2004	For the three months ended June 30, 2003	For the six months ended June 30, 2004	For the six months ended June 30, 2003
Service cost	1	1	2	2
Interest cost	8	8	16	16
Less expected return on plan assets	(2)	(2)	(4)	(4)
Amortization of prior service cost	5	4	10	8
Actuarial gain	(1)	(1)	(2)	(2)
Total net periodic benefit cost	**11**	**10**	**22**	**20**

Note 13. Stockholders' equity

Earnings per share

The calculation of diluted earnings per share for the reporting periods was as follows:

	For the three months ended June 30, 2004	For the three months ended June 30, 2003	For the six months ended June 30, 2004	For the six months ended June 30, 2003
Income before cumulative effect of change in accounting principle	877	1,544	1,696	2,232
Cumulative effect of change in accounting principle	-	-	-	132
Net income related to common shares	877	1,544	1,696	2,364
Add back convertible debt interest (net of tax at effective rate)				
1% Convertible US dollar bonds, maturing 2003	-	5	-	10
3.5% Convertible US dollar bonds, maturing 2007	7	7	13	13
Total diluted income before cumulative effect of change in accounting principle	884	1,556	1,709	2,255
Total diluted net income	884	1,556	1,709	2,387
Weighted average number of outstanding common shares (thousands of shares)	816,902	818,139	817,674	817,049
Add back treasury shares held in respect of convertible debt (thousands of shares)	16,727	23,356	16,727	23,569
Weighted average number of outstanding common shares, after dilution (thousands of shares)	833,629	841,495	834,401	840,618

Note 13. Stockholders' equity (continued)

Common stock

	As of June 30, 2004 (millions of shares)	As of December 31, 2003 (millions of shares)
Authorized and issued common stock, par value of 0.025 Russian rubles each	850	850
Common stock held by subsidiaries not considered as outstanding	(5)	(5)
Treasury stock	(29)	(26)
Outstanding common stock	816	819

Dividends

At the annual stockholders' meeting on June 24, 2004, dividends were declared for 2003 in the amount of 24.00 Russian rubles per common share, which at the date of the meeting was equivalent to $0.83. Dividends payable of $687 million are included in other current liabilities as of June 30, 2004.

Note 14. Financial guarantees

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

	As of June 30, 2004	As of December 31, 2003
Guarantees of equity investees' debt	728	718
Guarantees of third parties' debt	54	63
Total	**782**	**781**

Guarantees issued in regard to equity investees relate to their borrowings obtained to finance capital projects and for general corporate purposes. The Group entered into these guarantees to enhance the credit standing of affiliated companies (LUKARCO, ZAO Sever-TEK and ZAO LUKOIL-Neftegazstroy). Under the terms of the guarantees the Group would be required to perform should an affiliate be in default of its loan terms, generally for the full amount as disclosed in the table above. There are no provisions for recourse to third parties and no assets are held as collateral for the obligations of affiliates. One of the guarantees is secured by the shares of an affiliated company held by the Group, the carrying amount of which was approximately $21 million and $8 million as of June 30, 2004 and December 31, 2003, respectively. No collateral secures other guarantees. As of June 30, 2004, it is not probable that the Group will be required to make payments under these guarantees, and, therefore, no liability has been accrued related to these guarantees.

Note 15. Business combinations

On January 26, 2004, a Group company entered into an agreement with ConocoPhillips to purchase 308 gas stations and contracts to supply petroleum products to an additional 471 gas stations in the Northeast of the United States of America for $270 million. The transaction was finalized in May 2004.

Note 16. Related party transactions

In the rapidly developing business environment in the Russian Federation, companies and individuals have frequently used nominees and other forms of intermediary companies in transactions. The senior management of the Company consider that the Group has appropriate procedures in place to identify and properly disclose transactions with related parties in this environment and has disclosed all of the relationships identified which it deemed to be significant. Related party sales and purchases of oil and oil products as well as purchases of construction services were primarily to and from affiliated companies.

Below are related party transactions not disclosed elsewhere in the financial statements. Refer also to Note 8 for transactions with related parties.

Note 16. Related party transactions (continued)

Sales of oil and oil products to related parties were $24 million, $36 million, $43 million and $64 million for the three months ended June 30, 2004 and 2003 and for the six months ended June 30, 2004 and 2003, respectively.

Other sales to related parties were $15 million, $33 million, $26 million and $50 million for the three months ended June 30, 2004 and 2003 and for the six months ended June 30, 2004 and 2003, respectively.

Purchases of oil and oil products from related parties were $6 million, $105 million, $200 million and $196 million for the three months ended June 30, 2004 and 2003 and for the six months ended June 30, 2004 and 2003, respectively.

Purchases of construction services from related parties were $117 million, $148 million, $240 million and $233 million for the three months ended June 30, 2004 and 2003 and for the six months ended June 30, 2004 and 2003, respectively.

Purchases of insurance services from related parties were $39 million, $46 million, $75 million and $89 million during the three months ended June 30, 2004 and 2003 and during the six months ended June 30, 2004 and 2003, respectively.

Other purchases from related parties were $19 million, $33 million, $32 million and $41 million for the three months ended June 30, 2004 and 2003 and for the six months ended June 30, 2004 and 2003, respectively.

Amounts receivable from related parties, including loans and advances, were $319 million and $243 million as of June 30, 2004 and December 31, 2003, respectively. Amounts payable to related parties were $117 million and $128 million as of June 30, 2004 and December 31, 2003, respectively.

As of June 30, 2004 and December 31, 2003 the Government of the Russian Federation owned 8% of the shares of the common stock of the Company. The Russian Federation also owns, controls, or has significant influence over the operations of many other companies and enterprises in the Russian Federation and has a significant influence on the operation of business and the economic environment. A significant part of the activity of Group companies is linked to companies belonging to or controlled by the Russian Federation. The Russian Federation is a customer and supplier of the Group through numerous affiliated and other related organizations. Management consider such trading relationships as part of the normal course of conducting business in the Russian Federation and consider that such relationships will remain for the foreseeable future. Accordingly, information on these transactions is not disclosed as related party transactions.

Note 17. Compensation plan

During 2003, the Company introduced a compensation plan available to certain members of management, which provides compensation based upon share appreciation rights on the Company's common stock. The number of shares, or rights, allocated to the plan is approximately 11 million shares. These rights vest in December 2006. In connection with the plan through June 30, 2004 a Group company purchased approximately 11 million treasury shares at a total cost of $269 million. The Group has accrued a liability of $34 million as of June 30, 2004 and recorded $31 million of compensation expense during the six months ended June 30, 2004. The Group also recorded compensation of $30 million during the six months ended June 30, 2003 in relation to a previous existing plan that expired in 2003.

Note 18. Segment information

Presented below is information about the Group’s operating and geographical segments for the periods ended June 30, 2004 and 2003, in accordance with SFAS No. 131, *“Disclosures about Segments of an Enterprise and Related Information.”*

(Millions of US dollars, unless otherwise noted)

Note 18. Segment information (continued)

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

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

Operating segments

For the three months ended June 30, 2004

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
Sales						
Third parties	399	7,225	317	24	-	7,965
Inter-segment	1,935	310	3	6	(2,254)	-
Total sales	2,334	7,535	320	30	(2,254)	7,965
Operating expenses and total cost of purchases	697	4,422	254	10	(2,208)	3,175
Depreciation, depletion and amortization expense	168	90	3	5	-	266
Interest expense	11	94	-	33	(63)	75
Income tax expense	133	255	5	(1)	-	392
Net income	259	639	41	(16)	(46)	877
Total assets	16,683	15,842	278	4,660	(8,294)	29,169
Capital expenditures	513	312	9	1	-	835

For the three months ended June 30, 2003

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
Sales						
Third parties	365	4,480	230	11	-	5,086
Inter-segment	1,247	83	1	9	(1,340)	-
Total sales	1,612	4,563	231	20	(1,340)	5,086
Operating expenses and total cost of purchases	536	2,704	188	10	(1,359)	2,079
Depreciation, depletion and amortization expense	157	67	1	1	-	226
Interest expense	24	54	1	20	(21)	78
Income tax expense	42	100	2	2	-	146
Net income	1,296	192	17	42	(3)	1,544
Total assets	14,874	10,805	246	4,272	(4,996)	25,201
Capital expenditures	551	241	6	-	-	798

(Millions of US dollars, unless otherwise noted)

Note 18. Segment information (continued)

For the six months ended June 30, 2004

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
Sales						
Third parties	831	12,998	613	35	-	14,477
Inter-segment	3,665	395	5	19	(4,084)	-
Total sales	4,496	13,393	618	54	(4,084)	14,477
Operating expenses and total cost of purchases	1,329	7,856	494	18	(4,035)	5,662
Depreciation, depletion and amortization expense	325	178	4	7	-	514
Interest expense	21	132	1	58	(69)	143
Income tax expense	250	444	8	9	-	711
Net income	545	1,130	71	(6)	(44)	1,696
Total assets	16,683	15,842	278	4,660	(8,294)	29,169
Capital expenditures	1,021	552	17	6	-	1,596

For the six months ended June 30, 2003

	Exploration and production	Refining, marketing and distribution	Chemicals	Other	Elimination	Consolidated
Sales						
Third parties	746	8,956	425	15	-	10,142
Inter-segment	2,458	140	3	19	(2,620)	-
Total sales	3,204	9,096	428	34	(2,620)	10,142
Operating expenses and total cost of purchases	1,094	5,209	350	16	(2,643)	4,026
Depreciation, depletion and amortization expense	306	145	2	2	-	455
Interest expense	48	103	2	34	(47)	140
Income tax expense	88	316	4	6	-	414
Net income	1,491	753	27	49	44	2,364
Total assets	14,874	10,805	246	4,272	(4,996)	25,201
Capital expenditures	942	409	10	5	-	1,366

(Millions of US dollars, unless otherwise noted)

Note 18. Segment information (continued)

Geographical segments

	For the three months ended June 30, 2004	**For the three months ended June 30, 2003**	**For the six months ended June 30, 2004**	**For the six months ended June 30, 2003**
Sales of crude oil within Russia	33	100	101	151
Export of crude oil and sales of oil of foreign subsidiaries	2,611	1,467	4,868	3,106
Sales of refined product within Russia	1,074	743	1,930	1,582
Export of refined product and sales of refined products of foreign subsidiaries	3,625	2,281	6,323	4,358
Sales of chemicals within Russia	82	49	154	84
Export of chemicals and sales of chemicals by foreign subsidiaries	232	154	451	314
Other sales within Russia	150	174	341	327
Other export sales and other sales of foreign subsidiaries	158	118	309	220
Total sales	**7,965**	**5,086**	**14,477**	**10,142**

For the three months ended June 30, 2004

	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	94	1,641	6,230	-	7,965
Inter-segment	1,110	2,794	6	(3,910)	-
Total sales	1,204	4,435	6,236	(3,910)	7,965
Operating expenses and total cost of purchases	297	1,583	5,197	(3,902)	3,175
Depletion, depreciation and amortization expense	96	130	40	-	266
Interest expense	9	57	24	(15)	75
Income tax expense	38	321	33	-	392
Net income	72	725	126	(46)	877
Total assets	6,932	17,914	9,895	(5,572)	29,169
Capital expenditures	227	461	147	-	835

For the three months ended June 30, 2003

	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	97	1,184	3,805	-	5,086
Inter-segment	712	1,679	5	(2,396)	-
Total sales	809	2,863	3,810	(2,396)	5,086
Operating expenses and total cost of purchases	219	1,155	3,118	(2,413)	2,079
Depletion, depreciation and amortization expense	77	118	31	-	226
Interest expense	1	67	18	(8)	78
Income tax expense	29	105	12	-	146
Net income	142	314	1,191	(103)	1,544
Total assets	6,194	14,811	6,774	(2,578)	25,201
Capital expenditures	165	455	178	-	798

(Millions of US dollars, unless otherwise noted)

Note 18. Segment information (continued)

For the six months ended June 30, 2004

	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	239	3,089	11,149	-	14,477
Inter-segment	2,114	5,110	10	(7,234)	-
Total sales	2,353	8,199	11,159	(7,234)	14,477
Operating expenses and total cost of purchases	598	2,978	9,309	(7,223)	5,662
Depletion, depreciation and amortization expense	182	256	76	-	514
Interest expense	13	118	42	(30)	143
Income tax expense	92	576	43	-	711
Net income	246	1,277	218	(45)	1,696
Total assets	6,932	17,914	9,895	(5,572)	29,169
Capital expenditures	491	826	279	-	1,596

For the six months ended June 30, 2003

	Western Siberia	European Russia	International	Elimination	Consolidated
Sales					
Third parties	199	2,465	7,478	-	10,142
Inter-segment	1,387	3,639	12	(5,038)	-
Total sales	1,586	6,104	7,490	(5,038)	10,142
Operating expenses and total cost of purchases	483	2,377	6,227	(5,061)	4,026
Depletion, depreciation and amortization expense	153	238	64	-	455
Interest expense	5	116	31	(12)	140
Income tax expense	39	358	17	-	414
Net income	204	1,019	1,262	(121)	2,364
Total assets	6,194	14,811	6,774	(2,578)	25,201
Capital expenditures	264	816	286	-	1,366

Note 19. Contingencies

Litigation and claims

On November 27, 2001, Archangel Diamond Corporation (“ADC”), a Canadian diamond development company, filed a lawsuit in the district court of Denver, Colorado, against OAO “Arkhangelskgeoldobycha” (“AGD”), a Group company, and the Company (together the “Defendants”) claiming compensation for damage allegedly caused by the Defendants relating to Almazny Bereg, a joint venture between AGD and ADC. ADC claims, among other things, that the Defendants interfered with the transfer of a diamond exploration license which was subject to an agreement between ADC and AGD. The total damages claimed by ADC are $4.8 billion, including compensatory damages of $1.2 billion and punitive damages of $3.6 billion. On October 15, 2002, the District Court of Denver, Colorado dismissed ADC’s action against the Defendants based on lack of jurisdiction. On November 22, 2002, the Denver District Court denied ADC’s request for reconsideration of the Court’s October 15th order dismissing the case. ADC subsequently filed an appeal on November 27, 2002 with the Court of Appeals in the State of Colorado. On March 25, 2004, the Court of Appeals in the State of Colorado upheld the October 15, 2002 decision. ADC’s motion for rehearing by the Court of Appeals was denied on June 17, 2004. ADC filed a petition for re-examination with the Colorado Supreme Court on July 16, 2004, asking that court to hear the case. The Company filed a brief in opposition to ADC’s petition on July 29, 2004. ADC’s petition is currently pending. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group’s financial condition.

Note 19. Contingencies (continued)

In July 2004 a Group company received the results of a tax audit undertaken by the tax authorities in Kazakhstan for 2000 to 2003 tax years related to activities undertaken within its production sharing agreement. The tax authorities have assessed additional taxes, fines and penalties to the Group company and its partners, of which the Group company's share of the claims amounts to approximately $120 million. The Group believes it has paid all taxes in accordance with legislation and the terms and conditions of the production sharing agreement applicable during the period for which these claims are being made. Management does not believe that the outcome of this matter will have a material adverse effect on the Group's financial condition.

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

Taxation environment

The taxation systems in the Russian Federation and other emerging markets where Group companies operate are relatively new and are characterized by numerous taxes and changing legislation, which is often unclear, contradictory, and subject to interpretation. Often, differing interpretations exist among different tax authorities within the same jurisdictions and among taxing authorities in different jurisdictions. Taxes are subject to review and investigation by a number of authorities, which are enabled by law to impose severe fines, penalties and interest charges. Such factors may create taxation risks in the Russian Federation and other countries where Group companies operate substantially more significant than those in other countries where taxation regimes have been subject to development and clarification over long periods.

The regional organizational structure of the Russian Federation tax authorities and the regional judicial system can mean that taxation issues successfully defended in one region may be unsuccessful in another region. The tax authorities in each region may have a different interpretation of similar taxation issues. There is however some degree of direction provided from the central authority based in Moscow on particular taxation issues.

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

Other matters

During July 2001, the Group temporarily shut down operations of the Petrotel refinery due to the economic conditions in Romania. The refinery remains closed as of the date of these consolidated financial statements. Management has completed and approved the results of a feasibility study and investment program to upgrade the Petrotel refinery and resume operations during 2004. The Group has been implementing the investment program and upgrade of the refinery during 2003 and 2004.