OAO LUKOIL

CONSOLIDATED FINANCIAL STATEMENTS

(prepared in accordance with US GAAP)

As of December 31, 2012 and 2011
and for each of the years in the three-year period
ended December 31, 2012

ZAO KPMG
10 Presnenskaya Naberezhnaya
Moscow, Russia 123317

Telephone +7 (495) 937 4477
Fax +7 (495) 937 4400/99
Internet www.kpmg.ru

Auditors' Report

To the Board of Directors

OAO LUKOIL

We have audited the accompanying consolidated financial statements of OAO LUKOIL and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the consolidated statements of comprehensive income, stockholders' equity and cash flows for 2012, 2011 and 2010, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the fair presentation of these consolidated financial statements based on our audits. We conducted our audits in accordance with Russian Federal Auditing Standards and auditing standards generally accepted in the United States of America. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to express an opinion on the fair presentation of these consolidated financial statements.

Audited entity: Open Joint Stock Company "Oil company "LUKOIL"

Registered by Moscow Registration Chamber on 22 of April 1993, Registration No. 024020.

Entered in the Unified State Register of Legal Entities on 17 July 2002 by Department of Ministry of Taxes and Duties, Registration No. 1027700035769, Certificate series 77 No 007892347

11, Sretensky Boulevard, Moscow, Russia, 101000

Independent auditor: ZAO KPMG, a company incorporated under the Laws of the Russian Federation, a part of the KPMG Europe LLP group, and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Registered by the Moscow Registration Chamber on 25 May 1992, Registration No. 011.585.

Included in the Unified State Register of Legal Entities on 13 August 2002 by the Moscow Inter-Regional Tax Inspectorate No.39 of the Ministry for Taxes and Duties of the Russian Federation, Registration No. 1027700125628, Certificate series 77 No. 005721432.

Member of the Non-commercial Partnership "Chamber of Auditors of Russia". The Principal Registration Number of the Entry in the State Register of Auditors and Audit Organisations: No.10301000804.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO LUKOIL and its subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for 2012, 2011 and 2010 in accordance with U.S. generally accepted accounting principles.

Other Matter

U.S. generally accepted accounting principles require that the Supplementary Information on Oil and Gas Exploration and Production Activities on pages 41 through 47 be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context.

We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Sloutsky E.A.

Director, power of attorney No. 49/10 dated October 1, 2010

ZAO KPMG

February 22, 2013

Moscow, Russian Federation

OAO LUKOIL
Consolidated Balance Sheets
As of December 31, 2012 and 2011
(Millions of US dollars, unless otherwise noted)

	Note	2012	2011
Assets			
Current assets			
Cash and cash equivalents	3	2,914	2,753
Short-term investments		286	157
Accounts receivable, net	5	8,667	8,921
Inventories	6	8,098	7,533
Prepaid taxes and other expenses		3,541	3,219
Other current assets		767	946
Total current assets		**24,273**	**23,529**
Investments	7	4,124	5,952
Property, plant and equipment	8, 9	66,883	56,803
Deferred income tax assets	13	569	591
Goodwill and other intangible assets	10	1,964	1,344
Other non-current assets		1,148	2,973
Total assets		**98,961**	**91,192**
Liabilities and Equity			
Current liabilities			
Accounts payable		7,263	5,995
Short-term borrowings and current portion of long-term debt	11	658	1,792
Taxes payable		2,802	2,271
Other current liabilities		1,730	1,050
Total current liabilities		**12,453**	**11,108**
Long-term debt	12, 16	5,963	7,300
Deferred income tax liabilities	13	3,651	2,790
Asset retirement obligations	8	2,195	2,120
Other long-term liabilities		511	408
Total liabilities		**24,773**	**23,726**
Equity	15		
OAO LUKOIL stockholders' equity			
Common stock		15	15
Treasury stock, at cost		(5,189)	(4,081)
Equity-linked notes		(2,500)	(980)
Additional paid-in capital		4,734	4,798
Retained earnings		76,216	67,940
Accumulated other comprehensive loss		(69)	(54)
Total OAO LUKOIL stockholders' equity		**73,207**	**67,638**
Non-controlling interests		981	(172)
Total equity		**74,188**	**67,466**
Total liabilities and equity		**98,961**	**91,192**

President of OAO LUKOIL
Alekperov V.Y.

Vice-president – Chief accountant of OAO LUKOIL
Khoba L.N.

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

OAO LUKOIL
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2012, 2011 and 2010
(Millions of US dollars, unless otherwise noted)

	Note	2012	2011	2010
Revenues				
Sales (including excise and export tariffs)	22	139,171	133,650	104,956
Costs and other deductions				
Operating expenses		(9,359)	(9,055)	(8,298)
Cost of purchased crude oil, gas and products		(64,148)	(59,694)	(43,250)
Transportation expenses		(6,171)	(6,121)	(5,608)
Selling, general and administrative expenses		(3,755)	(3,822)	(3,558)
Depreciation, depletion and amortization		(4,832)	(4,473)	(4,154)
Taxes other than income taxes	13	(13,666)	(12,918)	(8,978)
Excise and export tariffs		(22,836)	(22,217)	(18,878)
Exploration expenses		(364)	(532)	(336)
Gain (loss) on disposals and impairments of assets		30	(1,663)	(363)
Income from operating activities		**14,070**	**13,155**	**11,533**
Interest expense		(538)	(694)	(712)
Interest and dividend income		257	211	174
Equity share in income of affiliates	7	518	690	472
Currency translation loss		(512)	(301)	(122)
Other non-operating (expense) income		(72)	58	125
Income before income taxes		**13,723**	**13,119**	**11,470**
Current income taxes		(2,738)	(2,678)	(2,104)
Deferred income taxes		(60)	(615)	(247)
Total income tax expense	13	**(2,798)**	**(3,293)**	**(2,351)**
Net income		**10,925**	**9,826**	**9,119**
Net loss (income) attributable to non-controlling interests		79	531	(113)
Net income attributable to OAO LUKOIL		**11,004**	**10,357**	**9,006**
Earnings per share of common stock attributable to OAO LUKOIL (US dollars):	15			
Basic		14.47	13.30	10.95
Diluted		14.17	13.04	10.94
Other comprehensive income, net of tax:				
Defined benefit pension plan:				
Prior service cost arising during the period		-	22	12
Actuarial loss		(15)	(9)	(4)
Other comprehensive (loss) income		**(15)**	**13**	**8**
Comprehensive income		**10,910**	**9,839**	**9,127**
Comprehensive loss (income) attributable to non-controlling interests		79	531	(113)
Comprehensive income attributable to OAO LUKOIL		**10,989**	**10,370**	**9,014**

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

OAO LUKOIL
Consolidated Statements of Stockholders' Equity
For the years ended December 31, 2012, 2011 and 2010
(Millions of US dollars, unless otherwise noted)

	2012		2011		2010	
	Stockholders' equity	Comprehensive income	Stockholders' equity	Comprehensive income	Stockholders' equity	Comprehensive income
Common stock						
Balance as of January 1	15		15		15	
Balance as of December 31	**15**		**15**		**15**	
Treasury stock						
Balance as of January 1	(4,081)		(3,683)		(282)	
Stock purchased	(128)		(398)		(3,664)	
Stock disposed	-		-		263	
Equity-linked notes conversion	(980)		-		-	
Balance as of December 31	**(5,189)**		**(4,081)**		**(3,683)**	
Equity-linked notes						
Balance as of January 1	(980)		(980)		-	
Equity-linked notes purchased	(2,500)		-		(980)	
Equity-linked notes conversion	980		-		-	
Balance as of December 31	**(2,500)**		**(980)**		**(980)**	
Additional paid-in capital						
Balance as of January 1	4,798		4,700		4,699	
Premium on non-outstanding shares issued	-		-		1	
Effect of stock compensation plan	(197)		98		98	
Convertible bonds issue	-		-		113	
Changes in non-controlling interests	133		-		(141)	
Treasury stock disposed	-		-		(70)	
Balance as of December 31	**4,734**		**4,798**		**4,700**	
Retained earnings						
Balance as of January 1	67,940		59,212		51,634	
Net income	11,004	11,004	10,357	10,357	9,006	9,006
Dividends on common stock	(2,728)		(1,629)		(1,428)	
Balance as of December 31	**76,216**		**67,940**		**59,212**	
Accumulated other comprehensive loss, net of tax						
Balance as of January 1	(54)		(67)		(75)	
Pension benefits:						
Prior service cost	-	-	22	22	12	12
Actuarial loss	(15)	(15)	(9)	(9)	(4)	(4)
Balance as of December 31	**(69)**		**(54)**		**(67)**	
Total comprehensive income		10,989		10,370		9,014
Total OAO LUKOIL stockholders' equity as of December 31	**73,207**		**67,638**		**59,197**	
Non-controlling interests						
Balance as of January 1	(172)		411		388	
Net (loss) income attributable to non-controlling interests	(79)		(531)		113	
Changes in non-controlling interests	1,232		(52)		(90)	
Balance as of December 31	**981**		**(172)**		**411**	
Total equity as of December 31	**74,188**		**67,466**		**59,608**	

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

OAO LUKOIL
Consolidated Statements of Stockholders' Equity
For the years ended December 31, 2012, 2011 and 2010
(Millions of US dollars, unless otherwise noted)

	Share activity		
	2012	**2011**	**2010**
	(thousands of shares)	**(thousands of shares)**	**(thousands of shares)**
Common stock, issued			
Balance as of January 1	850,563	850,563	850,563
Balance as of December 31	**850,563**	**850,563**	**850,563**
Treasury stock			
Balance as of January 1	(76,101)	(69,208)	(3,836)
Purchase of treasury stock	(2,096)	(6,893)	(68,912)
Disposal of treasury stock	-	-	3,540
Equity-linked notes conversion	(17,500)	-	-
Balance as of December 31	**(95,697)**	**(76,101)**	**(69,208)**

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

OAO LUKOIL
Consolidated Statements of Cash Flows
For the years ended December 31, 2012, 2011 and 2010
(Millions of US dollars)

	Note	2012	2011	2010
Cash flows from operating activities				
Net income attributable to OAO LUKOIL		**11,004**	**10,357**	**9,006**
Adjustments for non-cash items:				
Depreciation, depletion and amortization		4,832	4,473	4,154
Equity share in income of affiliates, net of dividends received		102	185	316
Dry hole write-offs		127	417	225
(Gain) loss on disposals and impairments of assets		(30)	1,663	363
Deferred income taxes		60	615	247
Non-cash currency translation loss (gain)		293	(214)	(44)
Non-cash investing activities		(18)	(6)	(67)
All other items – net		153	(447)	167
Changes in operating assets and liabilities:				
Trade accounts receivable		641	(758)	(2,285)
Inventories		(126)	(1,420)	(813)
Accounts payable		1,001	885	1,508
Taxes payable		468	177	274
Other current assets and liabilities		490	(413)	490
Net cash provided by operating activities		**18,997**	**15,514**	**13,541**
Cash flows from investing activities				
Acquisition of licenses		(921)	(25)	(15)
Capital expenditures		(11,647)	(8,249)	(6,596)
Proceeds from sale of property, plant and equipment		412	156	128
Purchases of investments		(453)	(101)	(137)
Proceeds from sale of investments		252	79	126
Sale of subsidiaries and equity method affiliates, net of cash disposed		27	227	130
Acquisitions of subsidiaries and equity method affiliates, net of cash acquired		(886)	(1,100)	(932)
Net cash used in investing activities		**(13,216)**	**(9,013)**	**(7,296)**
Cash flows from financing activities				
Net movements of short-term borrowings		(32)	(633)	(213)
Proceeds from issuance of long-term debt		597	1	2,515
Principal repayments of long-term debt		(1,831)	(1,372)	(2,267)
Dividends paid on Company common stock		(2,800)	(1,714)	(1,471)
Dividends paid to non-controlling interest stockholders		(113)	(116)	(85)
Financing received from non-controlling interest stockholders		2	3	18
Purchase of Company's stock		(128)	(398)	(3,664)
Sale of Company's stock		-	-	193
Purchase of equity-linked notes		(740)	(1,760)	(980)
Purchases of non-controlling interest		(635)	(34)	(192)
Net cash used in financing activities		**(5,680)**	**(6,023)**	**(6,146)**
Effect of exchange rate changes on cash and cash equivalents		60	(93)	(5)
Net increase in cash and cash equivalents		**161**	**385**	**94**
Cash and cash equivalents at beginning of year		2,753	2,368	2,274
Cash and cash equivalents at end of year	3	**2,914**	**2,753**	**2,368**

Supplemental disclosures of cash flow information			
Interest paid	497	683	718
Income taxes paid	1,585	2,508	2,126

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

Note 1. Organization and environment

The primary activities of OAO LUKOIL (the “Company”) and its subsidiaries (together, the “Group”) are oil exploration, production, refining, marketing and distribution. The Company is the ultimate parent entity of this vertically integrated group of companies.

The Group was established in accordance with Presidential Decree 1403, issued on November 17, 1992. Under this decree, on April 5, 1993, the Government of the Russian Federation transferred to the Company 51% of the voting shares of fifteen enterprises. Under Government Resolution 861 issued on September 1, 1995, a further nine enterprises were transferred to the Group during 1995. Since 1995, the Group has carried out a share exchange program to increase its shareholding in each of the twenty-four founding subsidiaries to 100%.

From formation, the Group has expanded substantially through consolidation of its interests, acquisition of new companies and establishment of new businesses.

Business and economic environment

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

Basis of preparation

These consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (“US GAAP”).

Note 2. Summary of significant accounting policies

Principles of consolidation

These consolidated financial statements include the financial position and results of the Company, controlled subsidiaries of which the Company directly or indirectly owns more than 50% of the voting interest, unless non-controlling stockholders have substantive participating rights, and variable interest entities where the Group is determined to be the primary beneficiary. Other significant investments in companies of which the Company directly or indirectly owns between 20% and 50% of the voting interest and over which it exercises significant influence but not control, are accounted for using the equity method of accounting. Investments in companies of which the Company directly or indirectly owns more than 50% of the voting interest but where non-controlling stockholders have substantive participating rights are accounted for using the equity method of accounting. Undivided interests in oil and gas joint ventures are accounted for using the proportionate consolidation method. Investments in other companies are recorded at cost. Equity investments and investments in other companies are included in “Investments” in the consolidated balance sheet.

Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying value of oil and gas properties and other property, plant and equipment, goodwill impairment assessment, asset retirement obligations, deferred income taxes, valuation of financial instruments, and obligations related to employee benefits. Eventual actual amounts could differ from those estimates.

Note 2. Summary of significant accounting policies (continued)

Revenue

Revenues are recognized when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed or determinable. Revenues include excise on petroleum products' sales and duties on export sales of crude oil and petroleum products.

Revenues from non-cash sales are recognized at the fair market value of the crude oil and petroleum products sold.

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 the majority of operations in the Russian Federation and outside the Russian Federation, the US dollar is the functional currency. 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 profit or loss.

For certain other operations, where the US dollar is not the functional currency and the economy is not highly inflationary, 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 other comprehensive income.

In all cases, foreign currency transaction gains and losses are included in profit or loss.

As of December 31, 2012, 2011 and 2010, exchange rates of 30.37, 32.20 and 30.48 Russian rubles to the US dollar, respectively, have been used for translation purposes.

Cash and cash equivalents

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less.

Cash with restrictions on immediate use

Cash funds for which restrictions on immediate use exist are accounted for within other non-current assets.

Accounts receivable

Accounts receivable are recorded at their transaction amounts less provisions for doubtful debts. Provisions for doubtful debts are recorded to the extent that there is a likelihood that any of the amounts due will not be collected. Non-current receivables are discounted to the present value of expected cash flows in future periods using the original discount rate.

Inventories

The cost of finished goods and purchased products is determined using the first-in, first-out cost method (FIFO). The cost of all other inventory categories is determined using the "average cost" method.

Note 2. Summary of significant accounting policies (continued)

Investments

Debt and equity securities are classified into one of three categories: trading, available-for-sale, or held-to-maturity.

Trading securities are bought and held principally for the purpose of selling in the near term. Held-to-maturity securities are those securities in which a Group company has the ability and intent to hold until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are included in profit or loss. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are reported as a separate component of other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis. Dividends and interest income are recognized in profit or loss when earned.

A permanent decline in the market value of any available-for-sale or held-to-maturity security below cost is accounted for as a reduction in the carrying amount to fair value. The impairment is charged to profit or loss and a new cost base for the security is established. Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective interest method and such amortization and accretion is recorded in profit or loss.

Property, plant and equipment

Oil and gas properties are accounted for using the successful efforts method of accounting whereby property acquisitions, successful exploratory wells, all development costs (including development dry holes and the Group's share of operators' expenses during the development stage of production sharing and risk service contracts), and support equipment and facilities are capitalized. Unsuccessful exploratory wells are expensed when a well is determined to be non-productive. Other exploratory expenditures, including geological and geophysical costs are expensed as incurred.

The Group continues to capitalize costs of exploratory wells and exploratory-type stratigraphic wells for more than one year after the completion of drilling if the well has found a sufficient quantity of reserves to justify its completion as a producing well and the Company is making sufficient progress towards assessing the reserves and the economic and operating viability of the project. If these conditions are not met or if information that raises substantial doubt about the economic or operational viability of the project is obtained, the well would be assumed impaired, and its costs, net of any salvage value, would be charged to expense.

Depreciation, depletion and amortization of capitalized costs of oil and gas properties is calculated using the unit-of-production method based upon proved reserves for the cost of property acquisitions and proved developed reserves for exploration and development costs.

Production and related overhead costs are expensed as incurred.

Depreciation of assets not directly associated with oil production is calculated on a straight-line basis over the economic lives of such assets, estimated to be in the following ranges:

Buildings and constructions	5 – 40	Years
Machinery and equipment	5 – 20	Years

Note 2. Summary of significant accounting policies (continued)

In addition to production assets, certain Group companies also maintain and construct social assets for the use of local communities. Such assets are capitalized only to the extent that they are expected to result in future economic benefits to the Group. If capitalized, they are depreciated over their estimated economic lives.

Significant unproved properties are assessed for impairment individually on a regular basis and any estimated impairment is charged to expense.

Asset retirement obligations

The Group records the fair value of liabilities related to its legal obligations to abandon, dismantle or otherwise retire tangible long-lived assets in the period in which the liability is incurred. A corresponding increase in the carrying amount of the related long-lived asset is also recorded. Subsequently, the liability is accreted for the passage of time and the related asset is depreciated using the unit-of-production method.

Goodwill and other intangible assets

Goodwill represents the excess of the cost of an acquired entity over the net of the fair value amounts assigned to assets acquired and liabilities assumed. It is assigned to reporting units as of the acquisition date. Goodwill is not amortized, but is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The impairment test requires assessing qualitative factors and then, if it is necessary, estimating the fair value of a reporting unit and comparing it with its carrying amount, including goodwill assigned to the reporting unit. If the estimated fair value of the reporting unit is less than its net carrying amount, including goodwill, then the goodwill is written down to its implied fair value.

Intangible assets with indefinite useful lives are tested for impairment at least annually. Intangible assets that have limited useful lives are amortized on a straight-line basis over the shorter of their useful or legal lives.

Impairment of long-lived assets

Long-lived assets, such as oil and gas properties (other than unproved properties), other property, plant, and equipment, and purchased intangibles subject to amortization, are assessed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future cash flows expected to be generated by that group. If the carrying amount of an asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by writing down the carrying amount to the estimated fair value of the asset group, generally determined as discounted future net cash flows. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale are presented separately in the appropriate asset and liability sections of the balance sheet.

Income taxes

Deferred income tax assets and liabilities are recognized in respect of the future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purposes of the consolidated financial statements and their respective tax bases and in respect of operating loss and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse and the assets be recovered and liabilities settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in profit or loss in the reporting period which includes the enactment date.

Note 2. Summary of significant accounting policies (continued)

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income in the reporting periods in which the originating expenditure becomes deductible. In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that the deferred income tax assets will be realized. In making this assessment, management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies.

An income tax position is recognized only if the uncertain position is more likely than not of being sustained upon examination, based on its technical merits. A recognized income tax position is measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties relating to income tax in income tax expense in profit or loss.

Interest-bearing borrowings

Interest-bearing borrowings from third parties (except convertible notes) are initially recorded at the value of net proceeds received. Any difference between the net proceeds and the redemption value is amortized at a constant rate over the term of the borrowing. Amortization is included in profit or loss and the carrying amounts are adjusted as amortization accumulates.

For borrowings from related parties (except convertible notes) issued with an interest rate lower than the market interest rate, the Group determines book value using market interest rate. The resulting difference is allocated to additional paid-in capital and is amortized at a constant rate over the term of the borrowings. Amortization is included in profit or loss each period and the carrying amounts are adjusted as amortization accumulates.

For convertible notes issued with a cash conversion option, the Group allocates the proceeds from issuance between a liability component and an equity component. The Group records the equity component at an amount equal to the difference between the proceeds received and the fair value of the liability component, measured as the fair value of a similar liability that does not have an associated equity component. The Group recognizes the interest cost in subsequent periods at its borrowing rate for non-convertible debt.

If borrowings are repurchased or settled before maturity, any difference between the amount paid and the carrying amount is recognized in profit or loss in the period in which the repurchase or settlement occurs.

Pension benefits

The expected costs in respect of pension obligations of Group companies are determined by an independent actuary. Obligations in respect of each employee are accrued over the periods during which the employee renders service to the Group.

The Group recognizes the funded status of the postretirement defined benefit plan in the consolidated balance sheet with corresponding adjustments to accumulated other comprehensive income. The adjustment to accumulated other comprehensive income represents the net unrecognized actuarial gains and unrecognized prior service costs. These amounts are subsequently recognized as net periodic benefit cost. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods are recognized as a component of other comprehensive income. These amounts are subsequently recognized as a component of net periodic benefit cost on the same basis as the amounts recognized in accumulated other comprehensive income.

Treasury stock

Purchases by Group companies of the Company’s outstanding stock are recorded at cost and classified as treasury stock within Stockholders’ equity. Shares shown as Authorized and Issued include treasury stock. Shares shown as Outstanding do not include treasury stock.

Note 2. Summary of significant accounting policies (continued)

Earnings per share

Basic earnings per share is computed by dividing net income available to common stockholders of the Company by the weighted-average number of shares of common stock outstanding during the reporting period. A calculation is carried out to establish if there is potential dilution in earnings per share if convertible securities were to be converted into shares of common stock or contracts to issue shares of common stock were to be exercised. If there is such dilution, diluted earnings per share is presented.

Contingencies

Certain conditions may exist as of the balance sheet date, which may result in losses to the Group but the impact of which will only be resolved when one or more future events occur or fail to occur.

If a Group company's assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability is accrued and charged to profit or loss. If the assessment indicates that a potentially material loss is not probable, but is reasonably possible, or is probable, but cannot be reasonably estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, is disclosed in the notes to the consolidated financial statements. Loss contingencies considered remote or related to unasserted claims are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

Environmental expenditures

Estimated losses from environmental remediation obligations are generally recognized no later than completion of remedial feasibility studies. Group companies accrue for losses associated with environmental remediation obligations when such losses are probable and reasonably estimable. Such accruals are adjusted as further information becomes available or circumstances change. Costs of expected future expenditures for environmental remediation obligations are not discounted to their present value.

Use of derivative instruments

The Group's derivative activity is limited to certain petroleum products' marketing and trading operations and hedging of commodity price risks. Currently this activity involves the use of futures and swaps contracts together with purchase and sale contracts that qualify as derivative instruments. The Group accounts for these activities under the mark-to-market methodology in which the derivatives are revalued each accounting period. Resulting realized and unrealized gains or losses are presented in profit or loss on a net basis. Unrealized gains and losses are carried as assets or liabilities on the consolidated balance sheet.

Share-based payments

The Group accounts for liability classified share-based payment awards to employees at fair value on the date of grant and as of each reporting date. Expenses are recognized over the vesting period. Equity classified share-based payment awards to employees are valued at fair value on the date of grant and expensed over the vesting period.

Comparative amounts

Certain prior period amounts have been reclassified to conform with the current period's presentation.

Note 2. Summary of significant accounting policies (continued)

Changes in accounting policy

In September 2011, the FASB issued Accounting Standards Update ("ASU") No. 2011-08, *"Testing Goodwill for Impairment,"* which allows an entity to use a qualitative approach to test goodwill for impairment. This ASU permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount and hence whether it is necessary to perform the two-step goodwill impairment test as required by the provisions of Topic 350 of the Codification. ASU No. 2011-08 is effective for annual and interim goodwill impairment tests performed for the fiscal years beginning after December 15, 2011. The Group adopted the requirements of ASU No. 2011-08 starting from the first quarter of 2012. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

In June 2011, the FASB issued ASU No. 2011-05, *"Presentation of comprehensive income,"* which amends Topic 220 of the Codification. This ASU increases the prominence of other comprehensive income in financial statements. Under this ASU, an entity has the option to present the components of net income and comprehensive income in either one or two statements. The ASU eliminates the option in US GAAP to present other comprehensive income in the statement of changes in equity. ASU No. 2011-05 is effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011 (except those reclassification adjustments deferred by ASU No. 2011-12) and should be applied retrospectively. The Group adopted the requirements of ASU No. 2011-05 starting from the first quarter of 2012. This adoption changed the presentation of net and comprehensive incomes and stockholders' equity, but did not have any impact on the Group's results of operations, financial position or cash flows.

In May 2011, the FASB issued ASU No. 2011-04, *"Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs,"* which amends Topic 820 of the Codification. This ASU provides guidance for fair value measurements and disclosure requirements and clarifies the Board's intent about the application of existing fair value measurement requirements. The new standard does not extend the use of fair value but, rather, provides guidance about how fair value should be applied where it already is required or permitted under US GAAP. ASU No. 2011-04 is effective for public entities during interim and annual periods beginning after December 15, 2011 and should be applied prospectively. The Group adopted the requirements of ASU No. 2011-04 starting from the first quarter of 2012. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In April 2011, the FASB issued ASU No. 2011-02, *"A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring,"* which amends Topic 310 of the Codification. This ASU provides additional guidance in considering whether a restructuring constitutes a troubled debt restructuring and helps creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties. ASU No. 2011-02 is effective starting from the first interim or annual period beginning on or after June 15, 2011. The Group adopted the requirements of ASU No. 2011-02 starting from the third quarter of 2011. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

Recent accounting pronouncements

In December 2011, the FASB issued ASU No. 2011-11, *"Disclosures about Offsetting Assets and Liabilities."* This ASU requires entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. ASU No. 2011-11 is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods, and should be applied retrospectively.

(Millions of US dollars, except as indicated)

Note 2. Summary of significant accounting policies (continued)

In January 2013, the FASB issued ASU No. 2013-01 *"Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities,"* which clarifies that ordinary trade receivables and receivables are not in the scope of ASU No. 2011-11. The Group is evaluating the effect of the adoption of ASU No. 2011-11 and does not expect any material impact on its results of operations, financial position or cash flows.

Note 3. Cash and cash equivalents

	As of December 31, 2012	As of December 31, 2011
Cash held in Russian rubles	571	926
Cash held in US dollars	1,816	1,224
Cash held in other currencies	403	271
Cash held in related party banks in Russian rubles	117	309
Cash held in related party banks in other currencies	7	23
Total cash and cash equivalents	**2,914**	**2,753**

Note 4. Non-cash transactions

The consolidated statement of cash flows excludes the effect of non-cash transactions, which are described in the following table:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Non-cash investing activity	18	6	67
Total non-cash transactions	**18**	**6**	**67**

The following table shows the effect of non-cash transactions on investing activity:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Net cash used in investing activity	13,216	10,773	7,296
Non-cash investing activity	18	6	67
Total investing activity	**13,234**	**10,779**	**7,363**

Note 5. Accounts receivable, net

	As of December 31, 2012	As of December 31, 2011
Trade accounts receivable (net of provisions of $247 million and $179 million as of December 31, 2012 and 2011, respectively)	6,431	7,209
Current VAT and excise recoverable	1,862	1,333
Other current accounts receivable (net of provisions of $57 million and $54 million as of December 31, 2012 and 2011, respectively)	374	379
Total accounts receivable, net	**8,667**	**8,921**

(Millions of US dollars, except as indicated)

Note 6. Inventories

	As of December 31, 2012	As of December 31, 2011
Crude oil and petroleum products	6,765	6,265
Materials for extraction and drilling	387	321
Materials and supplies for refining	93	57
Other goods, materials and supplies	853	890
Total inventories	**8,098**	**7,533**

Note 7. Investments

	As of December 31, 2012	As of December 31, 2011
Investments in equity method affiliates and joint ventures	2,794	4,887
Long-term loans to equity method affiliates and joint ventures	1,312	1,001
Other long-term investments	18	64
Total long-term investments	**4,124**	**5,952**

Investments in "equity method" affiliates and joint ventures

The summarized financial information below is in respect of equity method affiliates and corporate joint ventures. The companies are primarily engaged in crude oil exploration, production, marketing and distribution operations in the Russian Federation, crude oil production and marketing in Kazakhstan, and refining operations in Europe.

	Year ended December 31, 2012		Year ended December 31, 2011		Year ended December 31, 2010	
	Total	Group's share	Total	Group's share	Total	Group's share
Revenues	29,618	4,160	32,770	4,777	24,348	3,672
Income before income taxes	13,617	945	13,832	1,005	9,187	675
Less income taxes	(5,387)	(427)	(4,241)	(315)	(2,682)	(203)
Net income	**8,230**	**518**	**9,591**	**690**	**6,505**	**472**

	As of December 31, 2012		As of December 31, 2011	
	Total	Group's Share	Total	Group's share
Current assets	6,399	983	7,379	1,406
Property, plant and equipment	18,738	4,015	19,064	5,587
Other non-current assets	523	167	1,454	462
Total assets	25,660	5,165	27,897	7,455
Short-term debt	1,182	277	1,100	223
Other current liabilities	3,409	496	3,703	668
Long-term debt	7,717	1,256	7,461	1,069
Other non-current liabilities	1,406	342	1,581	608
Net assets	**11,946**	**2,794**	**14,052**	**4,887**

(Millions of US dollars, except as indicated)

Note 7. Investments (continued)

In April 2011, the Company and OAO ANK Bashneft signed an agreement to establish a joint venture and to develop two oil fields named after R.Trebs and A.Titov, located in the Nenets Autonomous District of Russia. According to the agreement, the mineral rights for the development of the fields were re-issued by OAO ANK Bashneft in favor of its 100% subsidiary OOO Bashneft-Polus. In December 2011, the Company acquired 25.1% of OOO Bashneft-Polus for $153 million, and OOO Bashneft-Polus acquired 29 exploration wells located on these fields from a Group company for $60 million. The parties agreed to transport oil extracted from the fields via the Group’s transportation infrastructure and to consider the exploitation of certain other nearby infrastructure owned by the Group. In May 2012, state authorities cancelled the order to transfer the mineral rights for the development of the fields named after R.Trebs and A.Titov to the joint venture and the license was returned to OAO ANK Bashneft. Management does not believe that this matter will have a material adverse effect on the Group’s financial condition. The Company and OAO ANK Bashneft are continuing their cooperation within the project and are carrying out actions for re-issuance of the mineral rights by the state authorities in favor of OOO Bashneft-Polus.

Note 8. Property, plant and equipment and asset retirement obligations

	At cost		Net	
	As of December 31, 2012	**As of December 31, 2011**	**As of December 31, 2012**	**As of December 31, 2011**
Exploration and Production:				
Russia	61,123	54,269	39,092	34,415
International	9,700	8,138	7,487	6,376
Total	70,823	62,407	46,579	40,791
Refining, Marketing, Distribution and Chemicals:				
Russia	13,600	12,133	8,140	7,395
International	10,297	6,903	7,375	4,282
Total	23,897	19,036	15,515	11,677
Power generation and other:				
Russia	5,621	4,890	4,501	4,026
International	429	406	288	309
Total	6,050	5,296	4,789	4,335
Total property, plant and equipment	**100,770**	**86,739**	**66,883**	**56,803**

The Company performs a regular annual impairment test of its assets. The test is based on geological models and development programs, which are revised on a regular basis, at least annually. The fair value of tested assets is determined using the present value of the expected cash flows. Fair value measurements models used in the impairment tests were Level 3 (unobservable inputs) fair value measurements.

During the year ended December 31, 2011, the Company recognized an impairment loss on exploration and production assets of OOO Narianmarneftegaz (“NMNG”) in the amount of $1,175 million, as well as an impairment loss of $175 million for assets related to the international refining, marketing and distribution segment.

The following tables set out values of property, plant and equipment measured at fair value on a nonrecurring basis in periods subsequent to their initial recognition:

	Fair value	**Level 3 fair value measurements**	**Before-tax loss**
Year ended December 31, 2011			
Property, plant and equipment	1,195	1,195	1,350

(Millions of US dollars, except as indicated)

Note 8. Property, plant and equipment and asset retirement obligations (continued)

As of December 31, 2012 and 2011, the asset retirement obligations amounted to $2,200 million and $2,126 million, respectively, of which $5 million and $6 million was included in "Other current liabilities" in the consolidated balance sheets as of each balance sheet date.

During 2012 and 2011, asset retirement obligations changed as follows:

	2012	2011
Asset retirement obligations as of January 1	2,126	1,798
Accretion expense	172	158
New obligations	147	172
Changes in estimates of existing obligations	(263)	173
Spending on existing obligations	(5)	(5)
Property dispositions	(10)	(5)
Foreign currency translation and other adjustments	33	(165)
Asset retirement obligations as of December 31	**2,200**	**2,126**

The asset retirement obligations incurred during 2012 and 2011 were Level 3 (unobservable inputs) fair value measurements.

Note 9. Suspended wells

Net changes in capitalized exploratory suspended well costs during 2012, 2011 and 2010 were as follows:

	2012	2011	2010
Balance as of January 1	542	478	479
Additions pending the determination of proved reserves	25	97	156
Charged to expenses	-	-	(94)
Reclassification to proved properties	(43)	(33)	(63)
Balance as of December 31	**524**	**542**	**478**

Aging of capitalized suspended exploratory well costs were as follows:

	As of December 31, 2012	As of December 31, 2011	As of December 31, 2010
Exploratory well costs capitalized			
for a period of one year or less	21	78	148
for two years	66	144	72
for three years	133	72	89
for four years	67	82	155
for five years or more	237	166	14
for a period of greater than one year	503	464	330
Total exploratory well costs capitalized	**524**	**542**	**478**
Number of projects that have exploratory well costs capitalized for a period greater than one year	8	14	11

(Millions of US dollars, except as indicated)

Note 9. Suspended wells (continued)

Aging of the exploratory wells that have been capitalized for more than one year since completion of drilling as of December 31, 2012:

Project name (field name)	**Location**	**As of December 31, 2012**	**Years wells drilled**
Block A	Saudi Arabia	255	2007-2010
Cape Three Points Deep Water	Ghana	92	2010
Centralno-Astrakhanskoe	European Russia	80	2007-2009
Independence	Cote d’Ivoire	66	2011
Aral	Uzbekistan	5	2010
3 projects of less than $4 million each	European Russia	5	2002-2009
Total of 8 projects		**503**	

Capitalized exploratory well costs of $255 million that are related to two fields in the “Block A” area in Saudi Arabia are represented by four wells drilled in 2007-2010. The wells were suspended pending final assessment of the operational and economic viability of the project. During 2011, to assess the required technology for the development and extraction of the tight gas reservoirs, the Group engaged an international engineering survey company to evaluate recompletion options for the wells, to prove the commercialization potential of the appraisal area and to optimize the stimulation technology for its development. These evaluations were completed in December 2011. During 2012, the Group held several meetings with the project partner, Saudi Arabian Oil Company, to confirm a common position for negotiations of amendments to the current Upstream Agreement with the government of Saudi Arabia. As a result of these meetings, the partners agreed the approach to reserves estimation, products yield as well as pricing and marketing matters and possible ways of project cost efficiency improvement. During 2013, the partners will submit the proposals on field evaluation and project implementation measures for consideration and approval by the Saudi Arabian Government with the view of taking a decision on further project development.

Capitalized exploratory well costs of $92 million that are related to block “Cape Three Points Deep Water” in Ghana are represented by one exploratory well which discovered an oil and gas condensate field and confirmed the presence of reserves within the block. One appraisal well was drilled in 2011, which was unsuccessful and written off. The Group extended the exploratory period until 2013. Additionally, according to signed contract for rig rental one exploratory well will be drilled during 2013.

Capitalized exploratory well costs of $80 million that are related to Centralno-Astrakhanskoe gas field in European part of Russia are represented by two exploratory wells drilled in 2007-2009. Seismic and geophysical works, as well as drilling of structural wells are planned on the field during 2013-2015 in order to determine the position of future exploratory wells.

Capitalized exploratory well costs of $66 million that are related to block “CI-401” in Cote d’Ivoire are represented by one exploratory well. During 2012, the Group and other participants entered into the appraisal period till June 30, 2014. According to signed contract for rig rental one appraisal well will be drilled during 2013.

The Company is evaluating the development plans for the other projects.

(Millions of US dollars, except as indicated)

Note 10. Goodwill and other intangible assets

The carrying value of goodwill and other intangible assets as of December 31, 2012 and 2011 was as follows:

	As of December 31, 2012	As of December 31, 2011
Amortized intangible assets		
Software	419	389
Licenses and other assets	276	343
Goodwill	1,269	612
Total goodwill and other intangible assets	**1,964**	**1,344**

All goodwill amounts relate to the refining, marketing and distribution segment. In the third quarter of 2012, the Group obtained control over the joint venture which operates the ISAB refinery (Priolo, Italy) and recognized goodwill in the amount of $646 million (refer to Note 17. Business combinations). Additional goodwill in the amount of $11 million relates to other acquisitions.

Note 11. Short-term borrowings and current portion of long-term debt

	As of December 31, 2012	As of December 31, 2011
Short-term borrowings from third parties	113	118
Short-term borrowings from related parties	13	30
Current portion of long-term debt	532	1,644
Total short-term borrowings and current portion of long-term debt	**658**	**1,792**

Short-term borrowings from third parties are unsecured and include amounts repayable in US dollars of $54 million and $56 million, amounts repayable in Euros of $11 million and $17 million and amounts repayable in other currencies of $48 million and $45 million as of December 31, 2012 and 2011, respectively. The weighted-average interest rate on short-term borrowings from third parties was 5.75% and 4.93% per annum as of December 31, 2012 and 2011, respectively.

Note 12. Long-term debt

	As of December 31, 2012	As of December 31, 2011
Long-term loans and borrowings from third parties (including loans from banks in the amount of $885 million and $1,120 million as of December 31, 2012 and 2011, respectively)	1,287	2,652
6.375% non-convertible US dollar bonds, maturing 2014	898	897
2.625% convertible US dollar bonds, maturing 2015	1,436	1,412
6.356% non-convertible US dollar bonds, maturing 2017	500	500
7.250% non-convertible US dollar bonds, maturing 2019	596	596
6.125% non-convertible US dollar bonds, maturing 2020	998	998
6.656% non-convertible US dollar bonds, maturing 2022	500	500
13.35% Russian ruble bonds, maturing 2012	-	776
9.20% Russian ruble bonds, maturing 2012	-	311
7.40% Russian ruble bonds, maturing 2013	198	186
Capital lease obligations	82	116
Total long-term debt	6,495	8,944
Current portion of long-term debt	(532)	(1,644)
Total non-current portion of long-term debt	**5,963**	**7,300**

Note 12. Long-term debt (continued)

Long-term loans and borrowings

Long-term loans and borrowings from third parties include amounts repayable in US dollars of $1,037 million and $834 million, amounts repayable in Euros of $230 million and $284 million, amounts repayable in Russian rubles of $1 million and $1,514 million, and amounts repayable in other currencies of $19 million and $20 million as of December 31, 2012 and 2011, respectively. This debt has maturity dates from 2013 through 2023. The weighted-average interest rate on long-term loans and borrowings from third parties was 2.28% and 5.39% per annum as of December 31, 2012 and 2011, respectively. A number of long-term loan agreements contain certain financial covenants which are being met by the Group. Approximately 33% of total long-term loans and borrowings from third parties are secured by export sales and property, plant and equipment.

A Group company has a secured loan agreement with Asian Development bank, BNP Paribas (Suisse), Credit Agricole Corporate and Investment bank, the Korea Developmet bank and Islamic Development bank with an outstanding amount of $197 million as of December 31, 2012. Borrowings under this agreement bear interest at three month LIBOR plus 3.00% per annum and have maturity dates up to 2020.

The Company has an unsecured syndicated loan agreement with the European Bank for Reconstruction and Development with an outstanding amount of $126 million as of December 31, 2012, maturing up to 2017. Borrowings under this agreement bear interest from six month LIBOR plus 0.45% to six month LIBOR plus 0.65% per annum.

A Group company has a secured loan agreement with Credit Suisse, supported by an Overseas Private Investment Corporation guarantee, with an outstanding amount of $111 million as of December 31, 2012. Borrowings under this agreement bear interest at six month LIBOR plus 4.8% per annum and have maturity dates up to 2015.

A Group company has an unsecured syndicated loan agreement with an outstanding amount of $105 million as of December 31, 2012, with maturity dates up to 2013. The loan was arranged by ABN AMRO Bank, Banco Bilbao Vizcaya Argentaria, BNP Paribas, The Bank of Tokyo-Mitsubishi UFJ, ING Bank, Mizuho Corporate Bank and WestLB. Borrowings under this agreement bear interest from three month LIBOR plus 0.85% to three month LIBOR plus 0.95% per annum.

As of December 31, 2012, the Group has a number of other loan agreements with fixed rates with a number of banks and other organizations totaling $407 million, maturing from 2013 to 2023. The weighted average interest rate under these loans was 2.76% per annum.

As of December 31, 2012, the Group has a number of other floating rate loan agreements with a number of banks and other organizations totaling $341 million, maturing from 2013 to 2020. The weighted average interest rate under these loans was 0.88% per annum.

US dollar convertible bonds

In December 2010, a Group company issued unsecured convertible bonds totaling $1.5 billion with a coupon yield of 2.625% and maturity in June 2015. The bonds were placed at face value. The bonds are convertible into LUKOIL ADRs (each representing one ordinary share of the Company) and currently have a conversion price of $71.08 per ADR. Bondholders have the right to convert the bonds into LUKOIL ADRs during the period starting from 40 days after the issue date and ending 6 dealing days before the maturity date. The issuer has the right to redeem the bonds after December 31, 2013.

Note 12. Long-term debt (continued)

US dollar non-convertible bonds

In November 2010, a Group company issued two tranches of non-convertible bonds totaling $1.0 billion with a coupon yield of 6.125% and maturity in 2020. The first tranche totaling $800 million was placed at a price of 99.081% of the bond's face value with a resulting yield to maturity of 6.250%. The second tranche totaling $200 million was placed at a price of 102.44% of the bond's face value with a resulting yield to maturity of 5.80%. These tranches have a half year coupon period.

In November 2009, a Group company issued two tranches of non-convertible bonds totaling $1.5 billion. The first tranche totaling $900 million with a coupon yield of 6.375% per annum was placed with a maturity of 5 years at a price of 99.474% of the bond's face value with a resulting yield to maturity of 6.500%. The second tranche totaling $600 million with a coupon yield of 7.250% per annum was placed with a maturity of 10 years at a price of 99.127% of the bond's face value with a resulting yield to maturity of 7.375%. These tranches have a half year coupon period.

In June 2007, a Group company issued non-convertible bonds totaling $1.0 billion. $500 million were placed with a maturity of 10 years and a coupon yield of 6.356% per annum. Another $500 million were placed with a maturity of 15 years and a coupon yield of 6.656% per annum. All bonds were placed at their face value and have a half year coupon period.

Russian ruble bonds

In December 2009, the Company issued 10 million stock exchange bonds with a face value of 1,000 Russian rubles each. The bonds were placed at face value with a maturity of 1,092 days. The bonds had a 182 days' coupon period and bore interest at 9.20% per annum. In December 2012, the Company redeemed all issued bonds in accordance with the conditions of the bond issue.

In August 2009, the Company issued 25 million stock exchange bonds with a face value of 1,000 Russian rubles each. The bonds were placed at face value with a maturity of 1,092 days. The bonds had a 182 days' coupon period and bore interest at 13.35% per annum. In August 2012, the Company redeemed all issued bonds in accordance with the conditions of the bond issue.

In December 2006, the Company issued 14 million non-convertible bonds with a face value of 1,000 Russian rubles each. Eight million bonds were placed with a maturity of 5 years and a coupon yield of 7.10% per annum and six million bonds were placed with a maturity of 7 years and a coupon yield of 7.40% per annum. All bonds were placed at their face value and have a half year coupon period. In December 2011, the Company redeemed all issued bonds with a maturity of five years in accordance with the conditions of bond issue.

Maturities of long-term debt

Annual maturities of total long-term debt during the next five years, including the portion classified as current, are $532 million in 2013, $1,521 million in 2014, $1,602 million in 2015, $117 million in 2016, $589 million in 2017 and $2,134 million thereafter.

Note 13. Taxes

The Group is taxable in a number of jurisdictions within and outside of the Russian Federation and, as a result, is subject to a variety of taxes as established under the statutory provisions of each jurisdiction.

The total cost of taxation to the Group is reported in the consolidated statements of comprehensive income as "Total income tax expense" for income taxes, as "Excise and export tariffs" for excise taxes, export tariffs and petroleum products sales taxes and as "Taxes other than income taxes" for other types of taxation. In each category taxation is made up of taxes levied at various rates in different jurisdictions.

(Millions of US dollars, except as indicated)

Note 13. Taxes (continued)

Operations in the Russian Federation are subject to a Federal income tax rate of 2.0% and a regional income tax rate that varies from 13.5% to 18.0% at the discretion of the individual regional administration. The Group’s foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

As of January 1, 2012 and 2011, and during 2012, 2011 and 2010, the Group did not have any unrecognized tax benefits and thus, no interest and penalties related to unrecognized tax benefits were accrued.

The Company and its Russian subsidiaries file income tax returns in Russia. With a few exceptions, income tax returns in Russia are open to examination by the Russian tax authorities for tax years beginning in 2010. Tax losses may be fully or partially used to offset taxable profits in the same company in any of the ten years following the year of loss. Until January 1, 2012, there were no provisions in the tax legislation of the Russian Federation to permit the Group to reduce taxable profits of a Group company by offsetting tax losses of another Group company against such profits.

Starting from January 1, 2012, if certain conditions are met, taxpayers are able to pay income tax as a consolidated taxpayers’ group (“CTG”). This allows taxpayers to offset taxable losses generated by certain participants of a CTG against taxable profits of other participants of the CTG. Certain Group companies met the legislative requirements and paid income tax as a CTG starting from the first quarter of 2012.

Losses generated by a taxpayer before joining a CTG are not available for offset against taxable profits of other participants of the CTG. However, if a taxpayer leaves a CTG, such losses again become available for offset against future profits generated by the same taxpayer. The expiration period of the losses is extended to take account of any time spent within a CTG when the losses were unavailable for use.

Domestic and foreign components of income before income taxes were:

	Year ended December 31, 2012	**Year ended December 31, 2011**	**Year ended December 31, 2010**
Domestic	12,458	12,561	10,569
Foreign	1,265	558	901
Income before income taxes	**13,723**	**13,119**	**11,470**

Domestic and foreign components of income taxes were:

	Year ended December 31, 2012	**Year ended December 31, 2011**	**Year ended December 31, 2010**
Current			
Domestic	2,178	2,159	1,693
Foreign	560	519	411
Current income tax expense	2,738	2,678	2,104
Deferred			
Domestic	131	581	299
Foreign	(71)	34	(52)
Deferred income tax expense	60	615	247
Total income tax expense	**2,798**	**3,293**	**2,351**

(Millions of US dollars, except as indicated)

Note 13. Taxes (continued)

The following table is a reconciliation of the amount of income tax expense that would result from applying the Russian combined statutory income tax rate of 20% applicable to the Company to income before income taxes to total income taxes:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Income before income taxes	13,723	13,119	11,470
Notional income tax at the Russian statutory rate	2,745	2,624	2,294
Increase (reduction) in income tax due to:			
Non-deductible items, net	227	693	266
Foreign rate differences	(60)	169	(4)
Domestic regional rate differences	(311)	(328)	(226)
Change in valuation allowance	197	135	21
Total income tax expense	**2,798**	**3,293**	**2,351**

Taxes other than income taxes were:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Mineral extraction tax	12,354	11,594	7,864
Social taxes and contributions	604	587	429
Property tax	535	573	518
Other taxes and contributions	173	164	167
Taxes other than income taxes	**13,666**	**12,918**	**8,978**

Deferred income taxes are included in the consolidated balance sheets as follows:

	As of December 31, 2012	As of December 31, 2011
Other current assets	153	127
Deferred income tax assets – non-current	569	591
Other current liabilities	(284)	(216)
Deferred income tax liabilities – non-current	(3,651)	(2,790)
Net deferred income tax liability	**(3,213)**	**(2,288)**

(Millions of US dollars, except as indicated)

Note 13. Taxes (continued)

The following table sets out the tax effects of each type of temporary differences which give rise to deferred income tax assets and liabilities:

	As of December 31, 2012	As of December 31, 2011
Accounts receivable	4	5
Long-term liabilities	399	398
Inventories	6	13
Property, plant and equipment	344	207
Accounts payable	5	5
Operating loss carry forwards	758	646
Other	195	229
Total gross deferred income tax assets	1,711	1,503
Less valuation allowance	(750)	(553)
Deferred income tax assets	**961**	**950**
Property, plant and equipment	(3,751)	(2,870)
Accounts payable	(50)	(39)
Accounts receivable	(143)	(91)
Long-term liabilities	(39)	(38)
Inventories	(103)	(63)
Investments	(38)	(33)
Other	(50)	(104)
Deferred income tax liabilities	**(4,174)**	**(3,238)**
Net deferred income tax liability	**(3,213)**	**(2,288)**

As a result of acquisitions during 2012 the Group recognized a net deferred tax liability of $240 million.

As of December 31, 2012, retained earnings of foreign subsidiaries included $18,753 million for which deferred taxation has not been provided because remittance of the earnings has been indefinitely postponed through reinvestment and, as a result, such amounts are considered to be indefinitely invested. It is not practicable to estimate the amount of additional taxes that might be payable on such undistributed earnings.

In accordance with Topic 830, *"Foreign currency matters"* of the Codification and Topic 740, "*Income Taxes*" of the Codification deferred tax assets and liabilities are not recognized for the changes in exchange rate effects resulting from the translation of transactions and balances from the Russian ruble to the US dollar using historical exchange rates. Also, in accordance with Topic 740 of the Codification, no deferred tax assets or liabilities are recognized for the effects of the related statutory indexation of property, plant and equipment.

Based upon the levels of historical taxable income and projections for future taxable income over the periods in which the deferred income tax assets are deductible, management believes it is more likely than not that Group companies will realize the benefits of the deductible temporary differences and loss carry forwards, net of existing valuation allowances as of December 31, 2012 and 2011.

As of December 31, 2012, the Group had operating loss carry forwards of $2,490 million of which $566 million expire during 2013, $119 million expire during 2014, $1 million expire during 2015, $1 million expire during 2016, $1 million expire during 2018, $2 million expire during 2019, $2 million expire during 2020, $712 million expire during 2021, $10 million expire during 2022, $11 million expire during 2035 and $1,065 million have an indefinite carry forward.

(Millions of US dollars, except as indicated)

Note 14. Pension benefits

The Group sponsors a postretirement defined benefit pension program that covers the majority of the Group's employees. One type of pension plan is based on years of service, final remuneration levels as of the end of 2003 and employee gratitude, received during the period of work. The other type of pension plan is based on the salary. These plans are solely financed by Group companies. Simultaneously employees have the right to receive pension benefits with a share-based payment by the Group (up to 4% of the annual salary of the employee). Plan assets and pensions payoffs are managed by a non-state pension fund, LUKOIL-GARANT.

The Group also provides several long-term social benefits, including lump-sum death-in-service benefit, in case of disability and upon retirement payments. Also certain payments are received by retired employees upon reaching a certain old age and invalidity.

The Company uses December 31 as the measurement date for its post employment and post retirement benefits program. An independent actuary has assessed the benefit obligations as of December 31, 2012 and 2011.

The following table provides information about the benefit obligations and plan assets as of December 31, 2012 and 2011. The benefit obligations below represent the projected benefit obligation of the pension plan.

	2012	2011
Benefit obligations		
Benefit obligations as of January 1	260	296
Effect of exchange rate changes	17	(14)
Service cost	14	15
Interest cost	19	22
Plan amendments	12	(4)
Actuarial loss	18	-
Benefits paid	(45)	(52)
Curtailment gain	(1)	(3)
Benefit obligations as of December 31	**294**	**260**
Plan assets		
Fair value of plan assets as of January 1	105	112
Effect of exchange rate changes	7	(6)
Return on plan assets	8	2
Employer contributions	45	49
Benefits paid	(45)	(52)
Fair value of plan assets as of December 31	**120**	**105**
Funded status	(174)	(155)
Amounts recognized in the consolidated balance sheet as of December 31, 2012 and 2011		
Accrued benefit liabilities included in "Other long-term liabilities"	(158)	(128)
Accrued benefit liabilities included in "Other current liabilities"	(16)	(27)

Weighted average assumptions used to determine benefit obligations as of December 31, 2012 and 2011:

	2012	2011
Discount rate	7.10%	7.80%
Rate of compensation increase	7.10%	7.30%

(Millions of US dollars, except as indicated)

Note 14. Pension benefits (continued)

Weighted average assumptions used to determine net periodic benefit costs for the year ended December 31, 2012 and 2011:

	2012	2011
Discount rate	7.80%	7.80%
Rate of compensation increase	7.30%	7.70%
Expected rate of return on plan assets	8.63%	8.95%

Included in accumulated other comprehensive loss as of December 31, 2012 and 2011, are the following before-tax amounts that have not yet been recognized in net periodic benefit cost:

	2012	2011
Unamortized prior service cost	59	61
Unrecognized actuarial loss	21	4
Total costs	**80**	**65**

Amounts recognized in other comprehensive loss during the year ended December 31, 2012 and 2011:

	2012	2011
Additional loss arising during the period	15	9
Additional prior service cost from plan amendment	10	(4)
Re-classified prior service cost amortization	(10)	(18)
Net amount recognized for the period	**15**	**(13)**

The real returns on bonds and equities are based on what is observed in the international markets over extended periods of time. In the calculation of the expected return on assets no use is made of the historical returns LUKOIL-GARANT has achieved.

In addition to the plan assets, LUKOIL-GARANT holds assets in the form of an insurance reserve. The purpose of this insurance reserve is to satisfy pension obligations should the plan assets not be sufficient to meet pension obligations. The Group’s contributions to the pension plan are determined without considering the assets in the insurance reserve.

The plans are funded on a discretionary basis through a solidarity account, which is held in trust with LUKOIL-GARANT. LUKOIL-GARANT does not allocate separately identifiable assets to the Group or its other third party clients. All funds of plan assets and other individual pension accounts are managed as a pool of investments.

The asset allocation of the investment portfolio maintained by LUKOIL-GARANT for the Group and its clients was as follows:

Type of assets	As of December 31, 2012	As of December 31, 2011
Eurobonds	8%	4%
Russian corporate bonds	4%	28%
Bank deposits	74%	44%
Equity securities of Russian issuers	-	6%
Shares of OAO LUKOIL	-	2%
Shares in investment funds	11%	13%
Cash	1%	-
Other assets	2%	3%
	100%	100%

Note 14. Pension benefits (continued)

The investment strategy employed by LUKOIL-GARANT includes an overall goal to attain a maximum investment return, while guaranteeing the principal amount invested. The strategy is to invest with a medium-term perspective while maintaining a level of liquidity through proper allocation of investment assets. Investment policies include rules and limitations to avoid concentrations of investments.

The investment portfolio is primarily comprised of investments: bank deposits and securities with fixed yield. The securities with fixed yield include mainly high yield corporate bonds with low and medium risk ratings. Maturities range from one to three years.

Components of net periodic benefit cost were as follows:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Service cost	14	15	16
Interest cost	19	22	23
Less expected return on plan assets	(9)	(10)	(11)
Amortization of prior service cost	13	17	18
Curtailment gain	-	(2)	(3)
Total net periodic benefit cost	**37**	**42**	**43**

Total employer contributions for 2013 are expected to be $49 million. An amount of $16 million before-tax is included in other comprehensive income and expected to be recognized in the net periodic benefit cost in 2013.

The following benefit payments, which reflect expected future services, as appropriate, are expected to be paid:

	2013	2014	2015	2016	2017	5-year period 2013-2017	5-year period 2018-2022
Pension benefits	17	15	15	15	15	77	61
Other long-term employee benefits	32	17	17	16	17	99	75
Total expected benefits to be paid	**49**	**32**	**32**	**31**	**32**	**176**	**136**

Note 15. Stockholders' equity

Common stock

	As of December 31, 2012 (thousands of shares)	As of December 31, 2011 (thousands of shares)
Authorized and issued common stock, par value of 0.025 Russian rubles each	850,563	850,563
Treasury stock	(95,697)	(76,101)
Outstanding common stock	**754,866**	**774,462**

Dividends and dividend limitations

Profits available for distribution to common stockholders in respect of any reporting period are determined by reference to the statutory financial statements of the Company prepared in accordance with the laws of the Russian Federation and denominated in Russian rubles. Under Russian Law, dividends are limited to the net profits of the reporting year as set out in the statutory financial statements of the Company. These laws and other legislative acts governing the rights of shareholders to receive dividends are subject to various interpretations.

Note 15. Stockholders' equity (continued)

The Company's net profits were 217,807 million Russian rubles, 271,934 million Russian rubles and 139,853 million Russian rubles respectively for 2012, 2011 and 2010, pursuant to the statutory financial statements, which at the US dollar exchange rates as of December 31, 2012, 2011 and 2010, amounted to $7,171 million, $8,446 million and $4,589 million, respectively.

At the extraordinary stockholders' meeting on December 18, 2012, interim dividends were declared for 2012 in the amount of 40.00 Russian rubles per common share, which at the date of the meeting was equivalent to $1.30. Dividends payable of $12 million and $10 million are included in "Other current liabilities" in the consolidated balance sheets as of December 31, 2012 and 2011, respectively.

At the annual stockholders' meeting on June 27, 2012, dividends were declared for 2011 in the amount of 75.00 Russian rubles per common share, which at the date of the meeting was equivalent to $2.26.

At the annual stockholders' meeting on June 23, 2011, dividends were declared for 2010 in the amount of 59.00 Russian rubles per common share, which at the date of the meeting was equivalent to $2.11.

Earnings per share

The calculation of diluted earnings per share for these years was as follows:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Net income	11,004	10,357	9,006
Add back interest and accretion on 2.625% convertible US dollar bonds, maturing 2015 (net of tax at effective rate)	64	63	3
Total diluted net income	11,068	10,420	9,009
Weighted average number of outstanding common shares (thousands of shares)	760,588	778,964	822,359
Add back treasury shares held in respect of convertible debt (thousands of shares)	20,509	20,383	892
Weighted average number of outstanding common shares, assuming dilution (thousands of shares)	781,097	799,347	823,251
Earnings per share of common stock attributable to OAO LUKOIL (US dollars):			
Basic	14.47	13.30	10.95
Diluted	14.17	13.04	10.94

Note 16. Financial and derivative instruments

Fair value

The fair values of cash and cash equivalents (Level 1), current and long-term accounts receivable (Level 3) are approximately equal to their value as disclosed in the consolidated financial statements. The fair value of long-term receivables was determined by discounting with estimated market interest rates for similar financing arrangements.

The fair value of long-term debt (Level 3) differs from the amount disclosed in the consolidated financial statements. The estimated fair value of long-term debt as of December 31, 2012 and 2011 was $7,035 million and $8,666 million, respectively, as a result of discounting using estimated market interest rates for similar financing arrangements. These amounts include all future cash outflows associated with the long-term debt repayments, including the current portion and interest. Market interest rates mean the rates of raising long-term debt by companies with a similar credit rating for similar tenors, repayment schedules and similar other main terms. During the year ended December 31, 2012, the Group did not have significant transactions or events that would result in nonfinancial assets and liabilities measured at fair value on a nonrecurring basis.

(Millions of US dollars, except as indicated)

Note 16. Financial and derivative instruments (continued)

Derivative instruments

The Group uses financial and commodity-based derivative contracts to manage exposures to fluctuations in foreign currency exchange rates, commodity prices, or to exploit market opportunities. Since the Group is not currently using hedge accounting, defined by Topic 815, *"Derivative and hedging,"* of the Codification, all gains and losses, realized or unrealized, from derivative contracts have been recognized in profit or loss.

Topic 815 of the Codification requires purchase and sales contracts for commodities that are readily convertible to cash (e.g., crude oil, natural gas and gasoline) to be recorded on the balance sheet as derivatives unless the contracts are for quantities the Group expects to use or sell over a reasonable period in the normal course of business (i.e., contracts eligible for the normal purchases and normal sales exception). The Group does apply the normal purchases and normal sales exception to certain long-term contracts to sell oil products. This normal purchases and normal sales exception is applied to eligible crude oil and refined product commodity purchase and sales contracts. However, the Group may elect not to apply this exception (e.g., when another derivative instrument will be used to mitigate the risk of a purchase or sale contract but hedge accounting will not be applied; in which case both the purchase or sales contract and the derivative contract mitigating the resulting risk will be recorded on the balance sheet at fair value).

The fair value hierarchy for the Group's derivative assets and liabilities accounted for at fair value on a recurring basis was:

	As of December 31, 2012				As of December 31, 2011			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets								
Commodity derivatives	-	417	-	**417**	-	575	-	**575**
Total assets	**-**	**417**	**-**	**417**	**-**	**575**	**-**	**575**
Liabilities								
Commodity derivatives	-	(459)	-	**(459)**	-	(599)	-	**(599)**
Total liabilities	**-**	**(459)**	**-**	**(459)**	**-**	**(599)**	**-**	**(599)**
Net liabilities	**-**	**(42)**	**-**	**(42)**	**-**	**(24)**	**-**	**(24)**

The derivative values above are based on an analysis of each contract as the fundamental unit of account as required by Topic 820, *"Fair Value Measurements and Disclosures,"* of the Codification. Therefore, derivative assets and liabilities with the same counterparty are not reflected net where the legal right of offset exists. Gains or losses from contracts in one level may be offset by gains or losses on contracts in another level or by changes in values of physical contracts or positions that are not reflected in the table above.

Commodity derivatives are valued using quotations provided by brokers and price index developers. These quotes are corroborated with market data and are classified as Level 2. Commodity derivatives are valued using industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and contractual prices for the underlying instruments, as well as other relevant economic measures.

Commodity derivative contracts

The Group operates in the worldwide crude oil, refined product, natural gas and natural gas liquids markets and is exposed to fluctuations in the prices for these commodities. These fluctuations can affect the Group's revenues as well as the cost of operating, investing and financing activities. Generally, the Group's policy is to remain exposed to the market prices of commodities. However, the Group uses futures, forwards, swaps and options in various markets to balance physical systems, meet customer needs, manage price exposures on specific transactions, and do an immaterial amount of trading not directly related to the Group's physical business. These activities may move the Group's profile away from market average prices.

(Millions of US dollars, except as indicated)

Note 16. Financial and derivative instruments (continued)

The fair value of commodity derivative assets and liabilities as of December 31, 2012 was:

	As of December 31, 2012
Assets	
Accounts receivable	417
Liabilities	
Accounts payable	(459)

Hedge accounting has not been used for items in the table.

As required under Topic 815 of the Codification the amounts shown in the preceding table are presented gross (i.e., without netting assets and liabilities with the same counterparty where the right of offset and intent to net exist). Derivative assets and liabilities resulting from eligible commodity contracts have been netted in the consolidated balance sheet and are recorded as accounts receivable in the amount of $55 million and accounts payable in the amount of $97 million.

Financial results from commodity derivatives were included in the consolidated statements of comprehensive income in “Cost of purchased crude oil, gas and products”. Realized losses were $300 million and unrealized losses were $21 million for the year ended December 31, 2012 and realized losses were $667 million and unrealized gains were $10 million for the year ended December 31, 2011.

As of December 31, 2012, the net position of outstanding commodity derivative contracts, primarily to manage price exposure on underlying operations, was not significant.

Currency exchange rate derivative contracts

The Group has foreign currency exchange rate risk resulting from its international operations. The Group does not comprehensively hedge the exposure to currency rate changes, although the Group selectively hedges certain foreign currency exchange rate exposures, such as firm commitments for capital projects or local currency tax payments and dividends.

The fair value of foreign currency derivatives assets and liabilities open as of December 31, 2012 was not significant.

The impact from foreign currency derivatives during the year ended December 31, 2012 on the consolidated statements of comprehensive income was not significant. The net position of outstanding foreign currency swap contracts as of December 31, 2012 also was not significant.

Credit risk

The Group’s financial instruments that are potentially exposed to concentrations of credit risk consist primarily of cash equivalents, over-the-counter derivative contracts and trade receivables. Cash equivalents are placed in high-quality commercial paper, money market funds and time deposits with major international banks and financial institutions.

The credit risk from the Group’s over-the-counter derivative contracts, such as forwards and swaps, derives from the counterparty to the transaction, typically a major bank or financial institution. Individual counterparty exposure is managed within predetermined credit limits and includes the use of cash-call margins when appropriate, thereby reducing the risk of significant non-performance. The Group also uses futures contracts, but futures have a negligible credit risk because they are traded on the New York Mercantile Exchange or the ICE Futures.

Note 16. Financial and derivative instruments (continued)

Certain of the Group's derivative instruments contain provisions that require the Group to post collateral if the derivative exposure exceeds a threshold amount. The Group has contracts with fixed threshold amounts and other contracts with variable threshold amounts that are contingent on the Group's credit rating. The variable threshold amounts typically decline for lower credit ratings, while both the variable and fixed threshold amounts typically revert to zero if the Group's credit rating falls below investment grade. Cash is the primary collateral in all contracts; however, many contracts also permit the Group to post letters of credit as collateral.

There were no derivative instruments with such credit-risk-related contingent features that were in a liability position on December 31, 2012. The Group posted $12 million in collateral in the normal course of business for the over-the-counter derivatives. If the Group's credit rating were lowered one level from its "BBB-" rating (per Standard and Poors) on December 31, 2012, and it would be below investment grade, the Group would be required to post additional collateral of $5 million to the Group's counterparties for the over-the-counter derivatives, either with cash or letters of credit. The maximum additional collateral based on the lowest downgrade would be $14 million in total.

Note 17. Business combinations

In January 2012, the Group received a notice that the Board of Directors of ERG S.p.A. ("ERG") decided to exercise its option to sell to the Group a further 20% interest in the joint venture which operates the ISAB refining complex (Priolo, Italy). The notice was received in accordance with the initial agreement on the establishment of the joint venture signed in 2008. This agreement gave the second investor – ERG a step-by-step put option to sell its share in the joint venture to the Group. The transaction was approved by European regulatory authorities and was completed in September 2012. After final adjustments, its amount totaled €494 million (approximately $621 million). Accordingly, the Group's stake in the joint venture increased from 60% to 80% and in accordance with the initial agreement on the establishment of the joint venture the Group obtained control and consolidated this joint venture. The Group allocated $646 million to goodwill, $2,914 million to property, plant and equipment, $747 million to deferred tax liability, $1,024 million to current assets and $444 million to current liabilities. The value of property, plant and equipment was determined by an independent appraiser.

The acquisition-date fair value of the equity interest in ISAB held by the Group immediately before the acquisition date was $2,074 million. As a result of remeasuring the equity interest in ISAB held immediately before the business combination to fair value the Group recognized a gain of $3 million as other non-operating income. To measure the acquisition-date fair value a present value technique (level 3) was employed.

This business combination did not have a material impact on the Group's consolidated operations for the year ended December 31, 2012. Therefore, no pro-forma income statement information has been provided.

Note 18. Consolidation of Variable Interest Entity

The Group and ConocoPhillips had a joint venture NMNG which develops oil reserves in the Timan-Pechora region of the Russian Federation. The Group and ConocoPhillips had equal voting rights over the joint venture's activity and effective ownership interests of 70% and 30%, respectively. In August 2012, the Group acquired ConocoPhillips' investment in NMNG and certain assets related to NMNG for $604 million. The acquisition brought the Group's total ownership interest in NMNG to 100%.

Up until the date of acquisition of the 30% interest, the Group consolidated NMNG due to the fact that NMNG was a variable interest entity and the Group was considered to be the primary beneficiary.

(Millions of US dollars, except as indicated)

Note 19. Commitments and contingencies

Capital expenditure, exploration and investment programs

Under the terms of existing exploration and production license agreements in Russia the Group has to fulfill certain obligations: oil and gas exploration, wells drilling, fields development, etc., and the Group also has commitments to reach a defined level of extraction on the fields. Management believes that the Group's approved annual capital expenditure budgets fully cover all the requirements of the described license obligations.

In 2012, a construction agreement for a heavy-residue hydrocracking complex at Group refinery LUKOIL Neftochim Bourgas AD in Bulgaria was signed. Commissioning of the complex is expected in 2015. The amount of capital commitment under this agreement is approximately $1.1 billion.

Group companies have commitments for capital expenditure contributions in the amount of $363 million related to various production sharing agreements over the next 25 years.

The Company signed a strategic agreement for the ongoing provision of construction, engineering and technical services with ZAO Globalstroy-Engineering. The volume of these services is based on the Group's capital construction program, which is re-evaluated on an annual basis. The Group estimates the amount of capital commitment under this agreement for 2013 to be approximately $232 million.

The Group signed a number of agreements for 2012-2015 for construction of offshore platforms in the Caspian region. As of December 31, 2012, the Group estimates the amount of this commitment to be approximately $1,346 million (net of advances).

The Group has a commitment to execute the capital construction program of its power generation segment and under the terms of this program power plants with a total capacity of 890 MW should be constructed. Currently the Group is approving certain amendments to the capital construction program, including its extension to the end of 2014. As of December 31, 2012, the Group estimates the amount of this commitment to be approximately $303 million.

Operating lease obligations

Group companies have commitments of $475 million primarily for the lease of vessels and petroleum distribution outlets. Operating lease expenses were $218 million, $175 million and $155 million during the years ended December 31, 2012, 2011 and 2010, respectively. Commitments for minimum rentals under these leases as of December 31, 2012 are as follows:

	As of December 31, 2012
2013	119
2014	106
2015	73
2016	48
2017	34
beyond	95

Note 19. Commitments and contingencies (continued)

Insurance

The insurance industry in the Russian Federation and certain other areas where the Group has operations is in the course of development. Management believes that the Group has adequate property damage coverage for its main production assets. In respect of third party liability for property and environmental damage arising from accidents on Group property or relating to Group operations, the Group has insurance coverage that is generally higher than insurance limits set by the local legal requirements. Management believes that the Group has adequate insurance coverage of the risks, which could have a material effect on the Group's operations and financial position.

Environmental liabilities

Group companies and their predecessor entities have operated in the Russian Federation and other countries for many years and, within certain parts of the operations, environmental related problems have developed. Environmental regulations are currently under consideration in the Russian Federation and other areas where the Group has operations. Group companies routinely assess and evaluate their obligations in response to new and changing legislation.

As liabilities in respect of the Group's environmental obligations are able to be determined, they are charged against income. The likelihood and amount of liabilities relating to environmental obligations under proposed or any future legislation cannot be reasonably estimated at present and could become material. Under existing legislation, however, management believes that there are no significant unrecorded liabilities or contingencies, which could have a materially adverse effect on the operating results or financial position of the Group.

Social assets

Certain Group companies contribute to Government sponsored programs, the maintenance of local infrastructure and the welfare of their employees within the Russian Federation and elsewhere. Such contributions include assistance with the construction, development and maintenance of housing, hospitals and transport services, recreation and other social needs. The funding of such assistance is periodically determined by management and is appropriately capitalized (only to the extent that they are expected to result in future economic benefits to the Group) or expensed as incurred.

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 frequently 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, who are enabled by law to impose severe fines, penalties and interest charges. In the Russian Federation a tax year remains open for review by the tax authorities during the three subsequent calendar years. However, under certain circumstances a tax year may remain open longer. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation. Such factors may create substantially more significant taxation risks in the Russian Federation and other emerging markets where Group companies operate, than those in other countries where taxation regimes have been subject to development and clarification over long periods.

Note 19. Commitments and contingencies (continued)

The tax authorities in each region may have a different interpretation of similar taxation issues which may result in taxation issues successfully defended by the Group in one region being unsuccessful in another region. There is some 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 on the financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

Litigation and claims

On November 27, 2001, Archangel Diamond Corporation ("ADC"), a Canadian diamond development company, filed a lawsuit in the Denver District Court, Colorado against OAO Arkhangelskgeoldobycha ("AGD"), a Group company, and the Company (together the "Defendants"). ADC alleged that the Defendants interfered with the transfer of a diamond exploration license to Almazny Bereg, a joint venture between ADC and AGD. ADC claimed compensatory damages of $1.2 billion and punitive damages of $3.6 billion. On October 15, 2002, the District Court dismissed the lawsuit for lack of personal jurisdiction. This ruling was upheld by the Colorado Court of Appeals on March 25, 2004. On November 21, 2005, the Colorado Supreme Court affirmed the lower courts' ruling that no specific jurisdiction exists over the Defendants. By virtue of this finding, AGD (the holder of the diamond exploration license) was dismissed from the lawsuit. The Colorado Supreme Court found, however, that the trial court made a procedural error by failing to hold an evidentiary hearing before making its ruling concerning general jurisdiction regarding the Company and remanded the case to the Colorado Court of Appeals to consider whether the lawsuit should have been dismissed on alternative grounds (i.e., forum non conveniens). The Colorado Court of Appeals declined to dismiss the case based on forum non conveniens and the case was remanded to the District Court. In June 2009, three creditors of ADC filed an Involuntary Bankruptcy Petition putting ADC into bankruptcy. In November 2009, after adding a claim, ADC removed the case from the District Court to the US Bankruptcy Court. On October 28, 2010, the Bankruptcy Court granted the Company's Motion for Remand and Abstention and remanded the case to the Denver District Court. On October 20, 2011, the Denver District Court dismissed all claims against the Company for lack of jurisdiction. ADC filed notice of appeal on April 17, 2012. On August 23, 2012, the Court of Appeals affirmed the Denver District Court's dismissal for lack of jurisdiction. ADC filed a Petition for Rehearing which was denied on September 20, 2012. ADC then filed a petition for Writ of Certiorari in the Colorado Supreme Court on October 18, 2012. The Company filed its Response to the Writ on November 1, 2012. The Colorado Supreme Court has not indicated yet if it will consider this case. Management does not believe that the ultimate resolution of this matter will have a material adverse effect on the Group's financial condition.

On January 6, 2012, ADC filed a lawsuit in the US District Court for the District of Colorado (federal court) reasserting almost identical claims asserted in the aforementioned lawsuit and dismissed by the Denver District Court (state court) notwithstanding ADC's appeal of the state court's decision. In Federal Court case, the Company has filed a Motion to Dismiss and discovery has been stayed pending further action. The Company plans to seek dismissal of the case and vigorously defend the matter. Management does not believe that the ultimate resolution 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.

Note 20. 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 believes 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 were primarily to and from affiliated companies. Related party processing services were provided by affiliated refineries.

Below are related party transactions not disclosed elsewhere in the financial statements. Refer also to Notes 3, 7, 11, 14 and 21 for other transactions with related parties.

Sales of oil and oil products to related parties were $1,038 million, $1,298 million and $2,383 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Other sales to related parties were $50 million, $54 million and $134 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Purchases of oil and oil products from related parties were $409 million, $374 million and $521 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Purchases of processing services from related parties were $702 million, $901 million and $719 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Other purchases from related parties were $92 million, $73 million and $39 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Amounts receivable from related parties, including advances, were $496 million and $339 million as of December 31, 2012 and 2011, respectively. Amounts payable to related parties were $85 million and $115 million as of December 31, 2012 and 2011, respectively.

Note 21. Compensation plan

During the period from 2010 to 2012, the Company had a compensation plan available to certain members of management, which was based on assigned shares and provides compensation consisting of two parts.

The first part represented annual bonuses that were based on the number of assigned shares and amount of dividend per share. The payment of these bonuses were contingent on the Group meeting certain financial KPIs in each financial year. The second was based upon the Company’s common stock appreciation from 2010 to 2012, with rights vested in December 2012. The number of assigned shares for this compensation plan was approximately 17.3 million shares.

For the first part of the share plan the Group recognized a liability based on expected dividends and number of assigned shares.

The second part of the share plan originally was classified as equity settled. The grant date fair value of the plan was estimated at $295 million using the Black-Scholes-Merton option-pricing model, assuming a risk-free interest rate of 8.0% per annum, an expected dividend yield of 3.09% per annum, an expected term of three years and a volatility factor of 34.86%. The expected volatility factor was estimated based on the historical volatility of the Company’s shares for the previous five year period up to January 2010. In December 2012, this compensation plan was amended in relation to all participants, which resulted in reclassification of the second part of the plan as a liability. As a result of this amendment the Group recorded an additional expense in the fourth quarter of 2012 in the amount of $33 million.

(Millions of US dollars, except as indicated)

Note 21. Compensation plan (continued)

Related to this plan the Group recorded $182 million, $137 million and $129 million of compensation expense during the years ended December 31, 2012, 2011 and 2010 respectively, of which $98 million was initially recognized as an increase in additional paid-in capital in each year correspondingly. As a result of the plan amendments that took place in the fourth quarter of 2012 $295 million was reclassified from additional paid-in capital to liabilities. As of December 31, 2012 and 2011, $380 million and $28 million related to this plan are included in "Other current liabilities" of the consolidated balance sheets, respectively. The total recognized tax benefits related to these accruals were $37 million, $20 million and $21 million during the years ended December 31, 2012, 2011 and 2010.

In late December 2012, the Company introduced a new compensation plan to certain members of management for the period from 2013 to 2017. Its conditions are similar to the conditions of the previous compensation plan after modification. The number of assigned shares is approximately 19 million. The Group is currently finalizing the calculation of the grant date fair value of the new plan.

Note 22. Segment information

Presented below is information about the Group's operating and geographical segments for the years ended December 31, 2012, 2011 and 2010, in accordance with Topic 280, "*Segment reporting,*" of the Codification.

The Group has the following operating segments – exploration and production; refining, marketing and distribution; chemicals; power generation 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 chemical products. The power generation segment produces steam and electricity, distributes them and provides related services. The activities of the other business operating segment include businesses beyond the Group's traditional operations.

Geographical segments are based on the area of operations and include two segments: Russia and International.

Operating segments

2012	**Exploration and production**	**Refining, marketing and distribution**	**Chemicals**	**Power generation**	**Other**	**Elimination**	**Consolidated**
Sales							
Third parties	3,130	133,139	1,362	1,411	129	-	139,171
Inter-segment	43,959	1,738	307	1,557	2,926	(50,487)	-
Total sales	47,089	134,877	1,669	2,968	3,055	(50,487)	139,171
Operating expenses	5,210	3,565	568	1,867	2,299	(4,150)	9,359
Depreciation, depletion and amortization	3,061	1,371	65	248	124	(37)	4,832
Interest expense	850	691	47	73	557	(1,680)	538
Income tax expense	1,920	711	57	34	52	24	2,798
Net income (net loss)	8,326	3,639	(279)	(278)	(363)	(41)	11,004
Total assets	67,523	70,120	1,166	4,530	20,512	(64,890)	98,961
Capital expenditures	8,902	2,078	90	503	277	-	11,850

(Millions of US dollars, except as indicated)

Note 22. Segment information (continued)

2011	**Exploration and production**	**Refining, marketing and distribution**	**Chemicals**	**Power generation**	**Other**	**Elimination**	**Consolidated**
Sales							
Third parties	3,449	126,665	1,944	1,472	120	-	133,650
Inter-segment	41,409	1,884	500	1,520	2,467	(47,780)	-
Total sales	44,858	128,549	2,444	2,992	2,587	(47,780)	133,650
Operating expenses	4,347	3,975	459	2,098	2,029	(3,853)	9,055
Depreciation, depletion and amortization	2,865	1,248	63	224	129	(56)	4,473
Interest expense	732	709	20	47	505	(1,319)	694
Income tax expense	2,106	1,060	43	(5)	10	79	3,293
Net income (net loss)	6,665	3,687	(27)	(127)	(370)	529	10,357
Total assets	60,311	62,173	1,488	4,220	21,201	(58,201)	91,192
Capital expenditures	6,629	1,354	89	196	224	-	8,492

2010	**Exploration and production**	**Refining, marketing and distribution**	**Chemicals**	**Power generation**	**Other**	**Elimination**	**Consolidated**
Sales							
Third parties	3,012	99,064	1,331	1,416	133	-	104,956
Inter-segment	33,511	1,182	271	1,277	1,937	(38,178)	-
Total sales	36,523	100,246	1,602	2,693	2,070	(38,178)	104,956
Operating expenses	3,965	3,771	294	1,901	1,628	(3,261)	8,298
Depreciation, depletion and amortization	2,773	1,033	40	183	126	(1)	4,154
Interest expense	806	859	26	38	405	(1,422)	712
Income tax expense	1,449	874	37	(14)	4	1	2,351
Net income (net loss)	6,139	3,330	101	(167)	(317)	(80)	9,006
Total assets	57,280	56,908	1,249	4,338	15,390	(51,148)	84,017
Capital expenditures	4,908	1,320	76	420	120	-	6,844

Geographical segments

	2012	**2011**	**2010**
Sales of crude oil within Russia	1,634	1,571	956
Export of crude oil and sales of crude oil by foreign subsidiaries	26,036	32,522	26,342
Sales of refined products within Russia	16,803	15,242	10,928
Export of refined products and sales of refined products by foreign subsidiaries	86,604	76,335	60,018
Sales of chemicals within Russia	418	914	728
Export of chemicals and sales of chemicals by foreign subsidiaries	992	1,095	642
Other sales within Russia	3,281	3,213	2,881
Other export sales and other sales by foreign subsidiaries	3,403	2,758	2,461
Total sales	**139,171**	**133,650**	**104,956**

(Millions of US dollars, except as indicated)

Note 22. Segment information (continued)

2012	**Russia**	**International**	**Elimination**	**Consolidated**
Sales				
Third parties	25,370	113,801	-	139,171
Inter-segment	39,355	200	(39,555)	-
Total sales	64,725	114,001	(39,555)	139,171
Operating expenses	7,333	2,113	(87)	9,359
Depletion, depreciation and amortization	3,834	998	-	4,832
Interest expense	194	504	(160)	538
Income tax expense	2,316	489	(7)	2,798
Net income	10,238	776	(10)	11,004
Total assets	78,515	36,108	(15,662)	98,961
Capital expenditures	9,343	2,507	-	11,850

2011	**Russia**	**International**	**Elimination**	**Consolidated**
Sales				
Third parties	24,674	108,976	-	133,650
Inter-segment	39,567	143	(39,710)	-
Total sales	64,241	109,119	(39,710)	133,650
Operating expenses	6,999	2,094	(38)	9,055
Depletion, depreciation and amortization	3,692	781	-	4,473
Interest expense	338	477	(121)	694
Income tax expense	2,715	554	24	3,293
Net income	9,769	4	584	10,357
Total assets	73,150	34,384	(16,342)	91,192
Capital expenditures	6,516	1,976	-	8,492

2010	**Russia**	**International**	**Elimination**	**Consolidated**
Sales				
Third parties	17,615	87,341	-	104,956
Inter-segment	34,599	37	(34,636)	-
Total sales	52,214	87,378	(34,636)	104,956
Operating expenses	6,334	2,005	(41)	8,298
Depletion, depreciation and amortization	3,393	761	-	4,154
Interest expense	415	427	(130)	712
Income tax expense	1,993	359	(1)	2,351
Net income (net loss)	8,542	542	(78)	9,006
Total assets	74,033	30,225	(20,241)	84,017
Capital expenditures	5,333	1,511	-	6,844

The Group’s international sales to third parties include sales in Switzerland of $67,057 million, $66,884 million and $53,245 million for the years ended December 31, 2012, 2011 and 2010, respectively. The Group’s international sales to third parties include sales in the USA of $12,649 million, $9,496 million and $8,595 million for the years ended December 31, 2012, 2011 and 2010, respectively. These amounts are attributed to individual countries based on the jurisdiction of subsidiaries making the sale.

Note 23. Subsequent events

In accordance with the requirements of Topic 855, *“Subsequent events,”* of the Codification, the Group evaluated subsequent events through the date the financial statements were available to be issued. Therefore subsequent events were evaluated by the Group up to February 22, 2013.

(Millions of US dollars, except as indicated)

This section provides unaudited supplemental information on oil and gas exploration and production activities in accordance with Topic 932, *"Disclosures About Oil and Gas Producing Activities,"* of the Codification in six separate tables:

I. Capitalized costs relating to oil and gas producing activities.
II. Costs incurred in oil and gas property acquisition, exploration, and development activities.
III. Results of operations for oil and gas producing activities.
IV. Reserve quantity information.
V. Standardized measure of discounted future net cash flows.
VI. Principal sources of changes in the standardized measure of discounted future net cash flows.

Amounts shown for equity companies represent the Group's share in its exploration and production affiliates, which are accounted for using the equity method of accounting.

I. Capitalized costs relating to oil and gas producing activities

As of December 31, 2012	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**
Unproved oil and gas properties	1,145	2,393	3,538	551
Proved oil and gas properties	8,555	58,408	66,963	2,436
Accumulated depreciation, depletion, and amortization	(2,213)	(21,803)	(24,016)	(838)
Net capitalized costs	7,487	38,998	46,485	2,149

As of December 31, 2011	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**
Unproved oil and gas properties	659	1,192	1,851	166
Proved oil and gas properties	7,479	52,330	59,809	2,315
Accumulated depreciation, depletion, and amortization	(1,762)	(19,527)	(21,289)	(718)
Net capitalized costs	6,376	33,995	40,371	1,763

As of December 31, 2010	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**
Unproved oil and gas properties	536	1,050	1,586	274
Proved oil and gas properties	6,578	49,914	56,492	2,111
Accumulated depreciation, depletion, and amortization	(1,490)	(18,530)	(20,020)	(597)
Net capitalized costs	5,624	32,434	38,058	1,788

(Millions of US dollars, except as indicated)

II. Costs incurred in oil and gas property acquisition, exploration, and development activities

Year ended December 31, 2012	International	Russia	Total consolidated companies	Group's share in equity companies
Acquisition of properties – proved	97	-	97	-
Acquisition of properties – unproved	37	937	974	-
Exploration costs	144	525	669	16
Development costs	1,621	6,489	8,110	490
Total costs incurred	1,899	7,951	9,850	506

Year ended December 31, 2011	International	Russia	Total consolidated companies	Group's share in equity companies
Acquisition of properties – proved	-	41	41	-
Acquisition of properties – unproved	70	164	234	-
Exploration costs	507	358	865	8
Development costs	968	4,726	5,694	123
Total costs incurred	1,545	5,289	6,834	131

Year ended December 31, 2010	International	Russia	Total consolidated companies	Group's share in equity companies
Acquisition of properties – proved	113	-	113	-
Acquisition of properties – unproved	-	15	15	122
Exploration costs	199	220	419	16
Development costs	685	3,686	4,371	115
Total costs incurred	997	3,921	4,918	253

III. Results of operations for oil and gas producing activities

The Group's results of operations for oil and gas producing activities are presented below. In accordance with Topic 932 of the Codification, sales and transfers to Group companies are based on market prices. Income taxes are based on statutory rates. The results of operations exclude corporate overhead and interest costs.

Year ended December 31, 2012	International	Russia	Total consolidated companies	Group's share in equity companies
Revenue				
Sales	2,910	23,011	25,921	1,728
Transfers	-	17,165	17,165	34
Total revenues	2,910	40,176	43,086	1,762
Production costs (excluding production taxes)	(299)	(3,562)	(3,861)	(126)
Exploration expense	(159)	(205)	(364)	(6)
Depreciation, depletion, and amortization, and valuation provision	(500)	(2,544)	(3,044)	(126)
Taxes other than income taxes	(399)	(24,247)	(24,646)	(564)
Related income taxes	(428)	(1,618)	(2,046)	(423)
Total results of operations for producing activities	1,125	8,000	9,125	517

(Millions of US dollars, except as indicated)

Year ended December 31, 2011	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**
Revenue				
Sales	2,656	25,373	28,029	1,924
Transfers	-	14,107	14,107	14
Total revenues	2,656	39,480	42,136	1,938
Production costs (excluding production taxes)	(242)	(3,529)	(3,771)	(93)
Exploration expense	(439)	(93)	(532)	(2)
Depreciation, depletion, and amortization, and valuation provision	(324)	(2,511)	(2,835)	(125)
Taxes other than income taxes	(460)	(23,817)	(24,277)	(640)
Related income taxes	(531)	(1,824)	(2,355)	(407)
Total results of operations for producing activities	660	7,706	8,366	671

Year ended December 31, 2010	**International**	**Russia**	**Total consolidated companies**	**Group's share in equity companies**
Revenue				
Sales	1,926	20,003	21,929	1,350
Transfers	-	12,395	12,395	13
Total revenues	1,926	32,398	34,324	1,363
Production costs (excluding production taxes)	(218)	(3,212)	(3,430)	(113)
Exploration expense	(240)	(96)	(336)	(2)
Depreciation, depletion, and amortization, and valuation provision	(306)	(2,504)	(2,810)	(127)
Taxes other than income taxes	(257)	(17,872)	(18,129)	(321)
Related income taxes	(314)	(1,807)	(2,121)	(275)
Total results of operations for producing activities	591	6,907	7,498	525

IV. Reserve quantity information

Proved reserves are the estimated quantities of oil and gas reserves which geological and engineering data demonstrate will be recoverable with reasonable certainty in future years from known reservoirs under existing economic and operating conditions. In accordance with Topic 932 of the Codification existing economic and operating conditions are based on the 12-months average price and the year-end costs. Proved reserves do not include additional quantities of oil and gas reserves that may result from applying secondary or tertiary recovery techniques not yet tested and determined to be economic.

Proved developed reserves are the quantities of proved reserves expected to be recovered through existing wells with existing equipment and operating methods.

Due to the inherent uncertainties and the necessarily limited nature of reservoir data, estimates of reserves are inherently imprecise, require the application of judgment and are subject to change as additional information becomes available.

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. The Subsoil Law of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. Since the law applies both to newly issued and old licenses and the Group has currently renewed more than 50% of its licenses, management believes that licenses will be renewed upon their expiration for the remainder of the economic life of each respective field.

(Millions of US dollars, except as indicated)

Estimated net proved oil and gas reserves and changes thereto for the years ended December 31, 2012, 2011 and 2010, are shown in the tables set out below.

Millions of barrels	Consolidated subsidiaries			Group's share in equity companies
	International	Russia	Total	
Crude oil				
January 1, 2010	329	13,054	13,383	313
Revisions of previous estimates	(4)	(279)	(283)	(5)
Purchase of hydrocarbons in place	62	-	62	-
Extensions and discoveries	10	550	560	10
Production	(26)	(671)	(697)	(24)
December 31, 2010	371	12,654	13,025	294
Revisions of previous estimates	(12)	246	234	7
Purchase of hydrocarbons in place	-	7	7	-
Extensions and discoveries	4	515	519	1
Production	(26)	(636)	(662)	(22)
December 31, 2011	337	12,786	13,123	280
Revisions of previous estimates	(1)	67	66	(1)
Purchase of hydrocarbons in place	42	-	42	-
Extensions and discoveries	40	511	551	2
Production	(25)	(631)	(656)	(21)
Sales of reserves	(2)	(3)	(5)	-
December 31, 2012	**391**	**12,730**	**13,121**	**260**
Proved developed reserves				
December 31, 2010	207	8,401	8,608	182
December 31, 2011	197	8,397	8,594	178
December 31, 2012	**136**	**8,241**	**8,377**	**160**

The non-controlling interest share included in the above total proved reserves was 71 million barrels, 163 million barrels and 187 million barrels as of December 31, 2012, 2011 and 2010, respectively. The non-controlling interest share included in the above proved developed reserves was 43 million barrels, 96 million barrels and 132 million barrels as of December 31, 2012, 2011 and 2010, respectively. Substantially all non-controlling interests relate to the reserves in the Russian Federation.

(Millions of US dollars, except as indicated)

Billions of cubic feet	Consolidated subsidiaries			Group's share in equity companies
	International	Russia	Total	
Natural gas				
January 1, 2010	6,631	15,933	22,564	286
Revisions of previous estimates	(35)	1,198	1,163	11
Extensions and discoveries	98	226	324	4
Production	(187)	(524)	(711)	(26)
December 31, 2010	6,507	16,833	23,340	275
Revisions of previous estimates	(487)	253	(234)	25
Purchase of hydrocarbons in place	-	1	1	-
Extensions and discoveries	240	309	549	1
Production	(189)	(545)	(734)	(27)
December 31, 2011	6,071	16,851	22,922	274
Revisions of previous estimates	(155)	602	447	12
Purchase of hydrocarbons in place	1	-	1	-
Extensions and discoveries	93	595	688	5
Production	(248)	(571)	(819)	(26)
Sales of reserves	(17)	-	(17)	-
December 31, 2012	**5,745**	**17,477**	**23,222**	**265**
Proved developed reserves:				
December 31, 2010	2,715	6,024	8,739	143
December 31, 2011	3,250	6,065	9,315	163
December 31, 2012	**2,505**	**6,066**	**8,571**	**156**

The non-controlling interest share included in the above total proved reserves was 23 billion cubic feet, 31 billion cubic feet and 34 billion cubic feet as of December 31, 2012, 2011 and 2010, respectively. The non-controlling interest share included in the above proved developed reserves was 14 billion cubic feet, 21 billion cubic feet and 24 billion cubic feet as of December 31, 2012, 2011 and 2010, respectively. Substantially all non-controlling interests relate to the reserves in the Russian Federation.

V. Standardized measure of discounted future net cash flows

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 Topic 932 of the Codification. Estimated future cash inflows from production are computed by applying the 12-months average price for oil and gas to year-end quantities of estimated net proved reserves. Adjustments in this calculation for future price changes are limited to those required by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future pre-tax net cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a ten percent discount factor. Discounting requires a year-by-year estimate of when future expenditures will be incurred and when reserves will be produced.
The information provided in the tables set out below does not represent management's estimate of the Group's expected future cash flows or of the value of the Group's proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and 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.

(Millions of US dollars, except as indicated)

The arbitrary valuation, prescribed under Topic 932 of the Codification, requires assumptions as to the timing and amount of future development and production costs. The calculations should not be relied upon as an indication of the Group's future cash flows or of the value of its oil and gas reserves.

	International	**Russia**	**Total consolidated companies**	**Group's share in equity companies**
As of December 31, 2012				
Future cash inflows	58,747	619,743	678,490	24,279
Future production and development costs	(36,468)	(424,260)	(460,728)	(12,469)
Future income tax expenses	(4,156)	(34,573)	(38,729)	(2,592)
Future net cash flows	18,123	160,910	179,033	9,218
Discount for estimated timing of cash flows (10% p.a.)	(9,964)	(96,015)	(105,979)	(4,723)
Discounted future net cash flows	8,159	64,895	73,054	4,495
Non-controlling share in discounted future net cash flows	-	397	397	-

	International	**Russia**	**Total consolidated companies**	**Group's share in equity companies**
As of December 31, 2011				
Future cash inflows	51,665	616,290	667,955	25,773
Future production and development costs	(26,242)	(416,403)	(442,645)	(12,897)
Future income tax expenses	(6,056)	(35,768)	(41,824)	(2,896)
Future net cash flows	19,367	164,119	183,486	9,980
Discount for estimated timing of cash flows (10% p.a.)	(10,930)	(97,394)	(108,324)	(5,145)
Discounted future net cash flows	8,437	66,725	75,162	4,835
Non-controlling share in discounted future net cash flows	-	937	937	-

	International	**Russia**	**Total consolidated companies**	**Group's share in equity companies**
As of December 31, 2010				
Future cash inflows	40,871	432,401	473,272	18,629
Future production and development costs	(23,193)	(313,375)	(336,568)	(9,503)
Future income tax expenses	(3,843)	(19,775)	(23,618)	(2,107)
Future net cash flows	13,835	99,251	113,086	7,019
Discount for estimated timing of cash flows (10% p.a.)	(8,641)	(60,808)	(69,449)	(3,656)
Discounted future net cash flows	5,194	38,443	43,637	3,363
Non-controlling share in discounted future net cash flows	-	963	963	-

(Millions of US dollars, except as indicated)

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

Consolidated companies	**2012**	**2011**	**2010**
Discounted present value as at January 1	75,162	43,637	45,597
Net changes due to purchases and sales of minerals in place	256	39	(193)
Sales and transfers of oil and gas produced, net of production costs	(14,215)	(13,515)	(12,454)
Net changes in prices and production costs estimates	(8,480)	69,089	22,241
Net changes in mineral extraction taxes	627	(32,678)	(23,976)
Extensions and discoveries, less related costs	3,174	3,492	1,886
Previously estimated development cost incurred during the period	7,241	6,182	5,565
Revisions of previous quantity estimates	377	620	(433)
Net change in income taxes	1,337	(7,467)	407
Other changes	(735)	224	(141)
Accretion of discount	8,310	5,539	5,138
Discounted present value at December 31	**73,054**	**75,162**	**43,637**

Group's share in equity companies	**2012**	**2011**	**2010**
Discounted present value as at January 1	4,835	3,363	2,622
Sales and transfers of oil and gas produced, net of production costs	(1,066)	(1,203)	(927)
Net changes in prices and production costs estimates	(101)	3,820	2,296
Net changes in mineral extraction taxes	(7)	(1,720)	(985)
Extensions and discoveries, less related costs	20	8	53
Previously estimated development cost incurred during the period	88	66	120
Revisions of previous quantity estimates	(3)	179	(56)
Net change in income taxes	139	(365)	(294)
Other changes	17	267	234
Accretion of discount	573	420	300
Discounted present value at December 31	**4,495**	**4,835**	**3,363**