OAO AK TRANSNEFT
CONSOLIDATED FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) FOR THE YEAR ENDED 31 DECEMBER 2006

CONTENTS

STATEMENT OF DIRECTORS' RESPONSIBILITIES
To the Shareholders of OAO AK Transneft

We have prepared the consolidated financial statements for year ended 31 December 2006 which give a true and fair view of the financial position of the OAO AK Transneft (the "Company") and its subsidiaries (the "Group") at the end of the year and of the results of operations and cash flows for the year then ended. Management of the Group is responsible for ensuring that the Group entities keep accounting records which disclose with reasonable accuracy the financial position of each entity and which enable them to ensure that the consolidated financial statements comply with International Financial Reporting Standards and that their statutory accounting reports comply with Russian laws and regulations. Management also has a general responsibility for taking such steps as are reasonably available to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Management considers that, in preparing the consolidated financial statements set out on pages 5 to 30, the Group has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that appropriate International Financial Reporting Standards have been followed.

None of the directors held any shares in Group companies during the year ended 31 December 2006.

The consolidated financial statements, which are based on the statutory consolidated accounting reports for the year ended 31 December 2006, approved by management in April 2006, have been converted in accordance with International Financial Reporting Standards.

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S.M. Vainshtock
President
28 May 2007

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Independent auditor's report

To the Shareholders and Board of Directors of OAO AK Transneft

We have audited the accompanying consolidated financial statements of OAO AK Transneft and its subsidiaries (the 'Group') which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes. The consolidated financial statements of the Group as of December 31, 2005, were audited by another auditor whose report dated May 30, 2006, expressed an unqualified opinion on those statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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. 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 financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Moscow, Russian Federation
29 May 2007

(in millions of Russian roubles)

	Notes	31 December 2006	31 December 2005
ASSETS			
Non-current assets			
Intangible assets		582	458
Property, plant and equipment	6	497,619	335,923
Available-for-sale financial assets	7	1,217	1,315
Total non-current assets		**499,418**	**337,696**
Current assets			
Inventories	8	8,374	11,411
Receivables and prepayments	9	14,546	8,969
VAT assets	9	23,495	29,887
Prepaid profit tax		379	587
Available-for-sale financial assets	7	216	638
Cash and cash equivalents	10	29,293	29,138
Total current assets		**76,303**	**80,630**
Total assets		**575,721**	**418,326**
EQUITY AND LIABILITIES			
Equity			
Share capital	11	307	307
Retained earnings		366,917	316,708
Attributable to the shareholders of OAO AK Transneft		**367,224**	**317,015**
Minority interests	12	17,912	14,650
Total equity		**385,136**	**331,665**
Non-current liabilities			
Borrowings and finance lease obligations	13	1,681	1,649
Deferred profit tax liabilities	14	26,103	25,540
Provisions for liabilities and charges	15	58,100	9,483
Total non-current liabilities		**85,884**	**36,672**
Current liabilities			
Trade and other payables	16	33,657	31,746
Current profit tax payable		1,844	1,953
Borrowings and finance lease obligations	13	69,200	16,290
Total current liabilities		**104,701**	**49,989**
Total liabilities		**190,585**	**86,661**
Total equity and liabilities		**575,721**	**418,326**

Approved on 28 May 2007 by:

S.M. Vainshtock — President

M. D. Mukhamedzhanov — General director of OOO Transneft Finance, a specialized organization, which performs the accounting function for OAO AK Transneft

The accompanying notes set out on pages 9 to 30 are an integral part of these financial statements

(in millions of Russian roubles)

	Notes	Year ended 31 December 2006	Year ended 31 December 2005
Sales	17	202,427	179,697
Operating expenses	18	(114,813)	(104,428)
Net other operating expenses	18	(5,587)	(93)
Operating profit		**82,027**	**75,176**
Financial items, net:			
Exchange losses		(53)	(178)
Interest expense	13	(1,145)	(1,598)
Total financial items		**(1,198)**	**(1,776)**
Profit before profit tax		**80,829**	**73,400**
Current profit tax expense		(25,405)	(21,572)
Deferred profit tax (expense)/benefit		(563)	1,951
Profit tax expense	14	**(25,968)**	**(19,621)**
Profit for the period		**54,861**	**53,779**
Attributable to:			
Shareholders of OAO AK Transneft		51,599	51,511
Minority interests	12	3,262	2,268

Approved on 28 May 2007 by:

S.M. Vainshtock	President
M. D. Mukhamedzhanov	General director of OOO Transneft Finance, a specialized organization, which performs the accounting function for OAO AK Transneft

The accompanying notes set out on pages 9 to 30 are an integral part of these financial statements

(in millions of Russian roubles)

	Notes	Year ended 31 December 2006	Year ended 31 December 2005
Cash flows from operating activities			
Cash receipts from customers		234,693	218,824
Cash paid to suppliers and employees, and taxes other than profit tax		(130,014)	(123,533)
Interest paid		(874)	(1,074)
Profit tax paid		(25,341)	(20,504)
Tax refunds		28,710	11,692
Other cash used in operating activities		(3,555)	(532)
Net cash from operating activities		**103,619**	**84,873**
Cash flows used in investing activities			
Purchase of property, plant and equipment		(151,826)	(66,786)
Proceeds from sales of property, plant and equipment		1,514	439
Interest and dividends received		374	577
Other proceeds/(purchases) from investing activity		404	(556)
Net cash used in investing activities		**(149,534)**	**(66,326)**
Cash flows used in financing activities			
Proceeds from long and short-term borrowings		76,459	7,456
Repayment of long and short-term borrowings		(24,708)	(10,799)
Payment of finance lease obligations		(4,196)	(2,577)
Dividends paid	11	(1,321)	(742)
Net cash from/(used in) financing activities		**46,234**	**(6,662)**
Effects of exchange rate changes on cash and cash equivalents		**(164)**	**33**
Net increase in cash and cash equivalents		**155**	**11,918**
Cash and cash equivalents at the beginning of the period	10	29,138	17,220
Cash and cash equivalents at the end of the period	10	**29,293**	**29,138**

Approved on 28 May 2007 by:

S.M. Vainshtock — President

M. D. Mukhamedzhanov — General director of OOO Transneft Finance, a specialized organization, which performs the accounting function for OAO AK Transneft

(in millions of Russian roubles)

	Attributable to the shareholders of OAO AK Transneft				
	Share capital	**Retained earnings**	**Total**	**Minority interest**	**Total equity**
Balance at 31 December 2004	**307**	**265,912**	**266,219**	**12,382**	**278,601**
Gains arising from change in fair value of available-for-sale financial assets	-	35	35	-	35
Net gain recognised directly in equity	-	35	35	-	35
Profit for the period	-	51,511	51,511	2,268	53,779
Total recognised income for the period	-	**51,546**	**51,546**	**2,268**	**53,814**
Dividends					
-preferred	-	(500)	(500)	-	(500)
-ordinary	-	(250)	(250)	-	(250)
Balance at 31 December 2005	**307**	**316,708**	**317,015**	**14,650**	**331,665**
Losses arising from change in fair value of available-for-sale financial assets	-	(69)	(69)	-	(69)
Net loss recognised directly in equity	-	(69)	(69)	-	(69)
Profit for the period	-	51,599	51,599	3,262	54,861
Total recognised income for the period	-	**51,530**	**51,530**	**3,262**	**54,792**
Dividends					
-preferred	-	(460)	(460)	-	(460)
-ordinary	-	(861)	(861)	-	(861)
Balance at 31 December 2006	**307**	**366,917**	**367,224**	**17,912**	**385,136**

Approved on 28 May 2007 by:

S. M. Vainshtock — President

M. D. Mukhamedzhanov — General director of OOO Transneft Finance, a specialized organization, which performs the accounting function for OAO AK Transneft

1 NATURE OF OPERATIONS

OAO AK Transneft (the "Company") was established as an open joint stock company and incorporated on 14 August 1993 by the Russian Government Resolution No. 810 under Presidential Decree No. 1403 dated 17 November 1992. The Company's registered office is at 119180 Moscow, ul. Bolshaya Polyanka 57, Russian Federation.

The Company and its subsidiaries (the "Group") described in Note 19 operate the largest crude oil pipeline system in the world totalling approximately 47,865 km. During the year ended 31 December 2006, the Group transported 458.5 million tonnes of crude oil to domestic and export markets (year ended 31 December 2005 – 452.2 million tonnes), which represents a substantial majority of the crude oil produced in the territory of the Russian Federation during that period.

The Group is considered by management to have a single main activity and therefore one industry and geographic segment.

2 ECONOMIC ENVIRONMENT IN THE RUSSIAN FEDERATION

Whilst there have been improvements in economic trends in the country, the Russian Federation continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, varying interpretations of tax and customs regulations and relatively high inflation. The Government of the Russian Federation approved amendments to currency regulation that eliminated conversion restrictions on the Russian Rouble as of 1 July 2006.

The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial, and monetary measures undertaken by the Government together with legal and political developments.

3 BASIS OF PRESENTATION

These consolidated financial statements are prepared in accordance with, and comply with, International Financial Reporting Standards (“IFRS”).

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated (see Note 4). The consolidated financial statements of the Group are prepared under the historical cost convention except as described in Notes 4 and 5.

The Company’s functional and presentation currency is the national currency of the Russian Federation; the Russian Rouble (“RR”). The official US dollar (“USD”) to Russian Rouble (“RR”) exchange rates as determined by the Central Bank of the Russian Federation were 26.33 and 28.78 as of 31 December 2006 and 2005, respectively.

Certain reclassifications have been made to previously reported balances to conform to the current period’s presentation; such reclassifications have no material impact on profit for the period or total equity.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following significant accounting policies have been consistently applied by the Group in the preparation of the consolidated final financial statements for year ended 31 December 2006, except for changes resulting from amendments to International Financial Reporting Standards discussed below.

Subsidiary undertakings

Subsidiaries are those companies in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has the power to govern the financial and operating policies of the subsidiary. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

consolidated from the date that control ceases. All inter-company transactions, balances, and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Minority interests at the balance sheet date represents the minority shareholders' portion of the fair values of the identifiable assets and liabilities of the subsidiary at the acquisition date, and the minorities' portion of movements in equity since the date of the acquisition. Minority interest is presented within equity in the consolidated financial statements.

Property, plant and equipment

Property, plant and equipment (in legal ownership) are carried at initial historical cost, including, where appropriate, the net present value of the estimated dismantlement or removal cost of the asset at the end of its estimated useful life, less accumulated depreciation. Assets under construction are carried at historical cost and depreciated from the time the asset is available for use. Depreciation is calculated on the straight-line basis to write down the cost of each asset to its estimated residual value over its estimated useful life as follows:

	Years
Buildings and facilities	8-50
Pipelines and tanks	20-33
Other plant and equipment	5-25

Management approves specific plans for prospective dismantlement or decommissioning of sections of pipeline and related facilities on an annual basis and, at that time, the estimated useful life of the related asset is revised and the annual depreciation charge is amended if applicable.

Renewals and improvements are capitalized and the assets replaced are retired. Maintenance, repairs, and minor renewals are expensed as incurred. Gains and losses arising from the retirements or other disposals of property, plant and equipment are included in the consolidated income statement.

Interest costs on borrowings to finance the construction of property, plant and equipment are expensed as incurred.

Crude oil used for technical operation of the pipeline network (“linefill”) owned by the Group is treated as a separate component of the pipeline class of asset and is not depreciated as it is not physically consumed in the process of providing services to customers. Oil surpluses arising from operations are recognized at market value, deficits – at the weighted average carrying value of linefill and are credited as charged to oil surplus (deficits), a component of net other operating expense, in the consolidated income statement.

Oil surpluses disposals are accounted for as revenues included in sales in the consolidated income statement.

Leased assets

Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and equipment acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at the inception of the lease, less accumulated depreciation and impairment losses. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The property, plant and equipment under finance leases is depreciated over the shorter of the useful life of the asset and the lease term.

Inventories

Inventories are valued at the lower of weighted average cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of assets

At each balance sheet date, management assesses whether there is any indication that the recoverable value of the Group's assets has declined below the carrying value. When such a decline is identified, the carrying amount is reduced to the estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. The amount of the reduction is recorded in the consolidated income statement in the period in which the reduction is identified. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount. Non-financial assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date. A reversal of an impairment loss for a cash-generating unit shall be allocated to the assets of the unit pro rata with the carrying amount of those assets.

Financial assets and liabilities

Financial assets and liabilities carried on the consolidated balance sheet include cash and cash equivalents, available-for-sale financial assets, receivables, borrowings, and trade and other payables. These items are initially recognised at fair value adjusted for transaction costs on the date when the Group becomes a party to the contractual provisions of the instrument. Financial assets are de-recognised only when the rights to the separable benefits under the relevant contract are settled, lost, surrendered, or have expired. Financial liabilities are partially or fully de-recognised only when the obligation specified in the relevant contract is discharged, cancelled, or has expired.

Available-for-sale financial assets are re-measured to fair value at each subsequent balance sheet date, other financial assets and financial liabilities are carried at amortised cost.

The fair values of financial assets and liabilities with a maturity date less than three months from the balance sheet date, including trade and other receivables and payables, are assumed to approximate their carrying amounts unless there is an indication of impairment at the balance sheet date. The fair value of all other financial assets and liabilities is based on the amount receivable or payable at the expected settlement date, discounted to net present value using a rate considered appropriate for the asset or liability.

Available-for-sale financial assets

Fair value of available-for-sale securities is determined using the quoted prices on active market. Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Gains and losses arising from changes in the fair value of the investments classified as available-for-sale are recognised in equity. When the investments classified as available-for-sale are sold or impaired, the fair value adjustments accumulated in equity are included in the consolidated income statement as gains and losses from the investments.

At each balance sheet date the Group assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of financial assets classified as available-for-sale, a significant or prolonged decline in the fair value of the financial assets below its cost is considered in determining whether the financial assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the consolidated income statement.

Cash and cash equivalents

Cash and cash equivalents consist of cash, bank balances, and highly liquid investments which are readily convertible to known amounts of cash, subject to an insignificant risk of changes in value, and which have original maturities of three months or less.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

VAT assets

VAT assets primarily relate to VAT incurred on capital construction, operating and export activities. VAT is included in current assets if the amount is expected to be recovered within 12 months after the reporting date.

Borrowings

Borrowings are recognised initially at the fair value of the proceeds received which is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price, net of transaction costs incurred. In subsequent periods, borrowings are carried at amortised cost, using the effective interest rate method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised as interest expense over the period of the borrowings.

Deferred taxes

Deferred taxes are calculated at currently enacted or substantively enacted rates, using the liability method, for all temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled.

Deferred tax liabilities are recognised in respect of all taxable temporary differences relating to investments in subsidiaries, unless the Company is able to control the timing of the reversal of the temporary difference and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax assets attributable to temporary differences and to unutilised tax losses and credits are recognised only to the extent that it is probable that future taxable profit or temporary differences will be available against which they can be utilised.

State pension fund

The Group makes contributions for the benefit of employees to a State pension fund. The contributions are expensed as incurred.

Provisions (including dismantlement)

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made.

Provisions are reassessed at each balance sheet date, and are included in the consolidated financial statements at their expected net present values using the discount rate appropriate to the Group in the economic environment of the Russian Federation.

Changes in the provisions resulting from the passage of time are reflected in the consolidated income statement each period under financial items. Changes in the provisions resulting from the changes in the discount rate and other changes in provisions, related to a change in the expected pattern or estimated cost of settlement of the obligation, are treated as a change in an accounting estimate in the period of the change by adjusting the corresponding asset or expense.

Pension provision

In addition to contributions to State pension fund, the Group sponsors a defined contribution plan to its employees. The Group's contributions to the defined contribution plan are based upon 12% of accrued annual

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

payroll. The Group's contributions to this plan are expensed when incurred and are included within salaries and pension expense in operating expenses.

The Group also operates a defined benefit plan. Pension costs are recognised using the projected unit credit method. The cost of providing pension contributions is charged to operating expenses in the consolidated income statement so as to spread the regular cost over the service lives of employees. The pension obligation is measured at the present value of the estimated future cash outflows using interest rates of government securities, which have the terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognised in full as they arise in the income statement.

Environmental provision

The Group recognises separately the estimated cost of crude oil spillages, including the cost of the obligation to restore the environment, and the estimated recoveries under applicable insurance policies, at the date of the spillage.

The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised as expenses immediately unless they extend the life of the related property or mitigate or prevent future environmental contamination, in which case they are capitalised.

Revenue recognition

Revenues from transportation services are recognized when the services are provided as evidenced by the delivery of crude oil to the owner or the owner's customer in accordance with the contract. Revenues from oil sales are recognized upon shipment of goods to the customer, when the goods cease to be under physical control of the Group and risks of ownership have been transferred to the buyer.

Share capital and dividends

Ordinary shares and non-redeemable preferred shares with the right to receive discretionary annual fixed dividends are both classified as equity.

Dividends are recognised as a liability and deducted from shareholders' equity on the date on which they are approved. Dividends proposed at any time, and those approved between the balance sheet date and the date of issuing the consolidated financial statements, are disclosed.

New accounting developments

The Group has adopted all IFRS, amendments and interpretations which are effective 1 January 2006 and which are relevant to its operations. All changes in accounting policies were applied retrospectively with adjustments made to retained earnings of prior periods effects, unless otherwise disclosed below.

Amendment to IAS 19 "Employee Benefits - Actuarial Gains and Losses, Group Plans and Disclosures". No changes in respect of the recognition of actuarial gains and losses were made in the Group's accounting policies as a result of this adoption.

IAS 39 (Amendment) "The Fair Value Option". IAS 39 (as revised in 2003) permitted entities to designate irrevocably on initial recognition practically any financial instrument as one to be measured at fair value with gains and losses recognised in profit or loss ('fair value through profit or loss'). The new amendment changes the definition of financial instruments 'at fair value through profit or loss' and restricts the ability to designate financial instruments as part of this category. As the Group does not meet the required criteria, the adoption of IAS 39 (Amendment) resulted in the following changes within the consolidated balance sheet:

(in millions of Russian roubles)

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

	31 December 2005
Non-current assets	
Decrease in financial assets at fair value through profit or loss	(1,315)
Increase in available-for-sale financial assets	1,315
Current assets	
Decrease in financial assets at fair value through profit or loss	(638)
Increase in available-for-sale financial assets	638

and the consolidated income statement:

	Year ended 31 December 2005
Decrease in profit for the period	(35)

and the consolidated statement of equity:

	Year ended 31 December 2005
Decrease in profit for the period	(35)
Increase in net gain recognised directly in equity	35

There is no change in the opening balance of retained earnings and other reserves.

IAS 39 (Amendment) and IFRS 4 (Amended) "Financial Guarantee Contracts". Issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, are to be initially recognised at their fair value, and subsequently measured at the higher of (i) the unamortised balance of the related fees received and deferred and (ii) the expenditure required to settle the commitment at the balance sheet date. Different requirements apply for the subsequent measurement of issued financial guarantees that prevent derecognition of financial assets or result in continuing involvement accounting. The application of IAS 39 (Amendment) and IFRS 4 (Amended) does not affect the Group's financial statements.

IAS 39 (Amendment) - "Cash Flow Hedge Accounting of Forecast Intragroup Transactions". The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. The application of IAS 39 (Amendment) - "Cash Flow Hedge Accounting of Forecast Intragroup Transactions" does not affect the Group's financial statements.

The adoption of amendment to IAS 21 "The Effects of Changes in Foreign Exchange Rates: Net Investment in a Foreign Operation" had no material effect on the Group's financial position, statements of income or of cash flows.

In addition to the new standards and interpretations summarised above, interpretations adopted by the Group on 1 January 2006 are as follows: IFRIC 4 "Determining whether an Arrangement contains a Lease" and IFRIC 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds". The adoption of these interpretations did not have a material impact on the Group's financial position, statements of income or of cash flows.

The Group has early adopted the following interpretation:

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

In November 2005, the International Financial Reporting Interpretations Committee ("IFRIC") issued an interpretation IFRIC 7 "Applying the Restatement Approach under IAS 29", for application as from the commencement date of a company's 2006 financial year at the latest, except for companies with a January or February commencement date where it should be applied as from the commencement date of the company's 2007 financial year at the latest. The Interpretation clarifies application of IAS 29 in the reporting period in which hyperinflation is first identified. It states that IAS 29 should initially be applied as if the economy has always been hyperinflationary. It further clarifies that the calculation of deferred income taxes in the opening balance sheet should be restated for hyperinflation in accordance with IAS 29. The application of IFRIC 7 does not affect the Group's financial statements.

In July 2006, the International Financial Reporting Interpretations Committee ("IFRIC") issued an interpretation IFRIC 10 "Interim Financial Reporting and Impairment" ("IFRIC 10"), which is effective for annual periods beginning on or after 1 November 2006, but may be adopted earlier. IFRIC 10 states that an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost should not be reversed in subsequent interim or annual financial statements. The Group has early adopted this interpretation IFRIC 10; adoption of the Interpretation which had no material effect on the Group's financial statements.

The following new Standards and Interpretations are not yet effective and have not been applied in preparing these IFRS financial statements:

Amendment to IAS 23 "Borrowing costs", which is effective for annual periods beginning on or after 1 January 2009. The Standard will eliminate the option of recognizing the borrowing costs immediately as an expense to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. The management is currently estimating the effect of the adjustment to the Group's financial statements.

IFRS 7 "Financial Instruments: Disclosures", which is effective for annual periods beginning on or after 1 January 2007. The Standard may require increased disclosure in respect of the Group's financial instruments.

IFRS 8 "Operating Segments", which is effective for annual periods beginning on or after 1 January 2009. The application of IFRS 8 is not expected to affect the Group's financial statements.

Amendment to IAS 1 "Presentation of Financial Statements – Capital Disclosures", which is effective for annual periods beginning on or after 1 January 2007. The Standard may require increased disclosure in respect of the Group's capital.

IFRIC 8 "Scope of IFRS 2", which is effective for annual periods beginning on or after 1 May 2006. The interpretation explains that, if the identifiable consideration given appears to be less than the fair value of the equity instruments granted or liability incurred, this typically indicates that other consideration has been or will be received and thus IFRS 2 "Share-based payments" applies. The application of IFRIC 8 is not expected to affect the Group's financial statements.

IFRIC 9 "Reassessment of Embedded Derivatives". The interpretation clarifies application of IAS 39 (Amended) for reassessment of the requirement to separate the embedded derivative from the host contract. It states that subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. The application of IFRIC 9 is not expected to affect the Group's financial statements.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

IFRIC 11 "IFRS 2—Group and Treasury Share Transactions" ("IFRIC 11"). The Interpretation requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity-instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments needed are obtained. The Interpretation also provides guidance on whether share-based payment arrangements, in which suppliers of goods or services of an entity are provided with equity instruments of the entity's parent, should be accounted for as cash-settled or equity-settled in the entity's financial statements. The application of IFRIC 11 is not expected to affect the Group's financial statements.

IFRIC 12 "Service Concession Arrangements" ("IFRIC 12"). Service concessions are arrangements whereby a government or other public sector entity grants contracts for the supply of public services —such as roads, airports and other facilities—to private sector operators. The interpretation addresses how service concession operators should apply existing IFRSs to account for the obligations they undertake and rights they receive in service concession arrangements. The application of IFRIC 12 is not expected to affect the Group's financial statements.

5 CRITICAL ESTIMATES IN APPLYING ACCOUNTING POLICIES

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results could differ from these estimates and judgments. Management also makes certain judgments, apart from those involving estimations, in the process of applying the accounting policies. Judgments that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Taxation

Russian tax and customs legislation is subject to varying interpretations (see Note 20).

Provision assessment

Impairment of assets and accounting for provisions

At each balance sheet date the Group assesses whether there is any indication that the recoverable amount of the Group's assets has declined below the carrying value. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. When such a decline is identified, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recorded in the consolidated income statement in the period in which the reduction is identified. If conditions change and management determines that the asset value has increased, the impairment provision will be fully or partially reversed.

Accounting for impairment includes provisions against capital construction projects and other long-term assets. The provisions for liabilities and charges primarily include provisions for dismantlement and pension liabilities. The Group records impairment or accrues these provisions when its assessments indicate that it is probable that a liability has been incurred or an asset will not be recovered, and an amount can be reasonably estimated.

The Group's estimates for provisions for liabilities and charges are based on currently available facts and the Group's estimates of the ultimate outcome or resolution of the liability in the future. Actual results may differ from the estimates, and the Group's estimates can be revised in the future, either negatively or positively, depending upon the outcome or expectations based on the facts surrounding each exposure.

Useful lives of property, plant and equipment

Items of property, plant and equipment are stated at cost less accumulated depreciation. The estimation of the useful life of an item of property, plant and equipment is a matter of management judgment based upon experience with similar assets. In determining the useful life of an asset, management considers the expected

(in millions of Russian roubles)

5 CRITICAL ESTIMATES IN APPLYING ACCOUNTING POLICIES (continued)

usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any of these conditions or estimates may result in adjustments to future depreciation rates.

Dismantlement provision

Provisions are established for the expected cost of dismantling parts of the existing pipeline network based on the average current cost per kilometre of removal according to an estimated plan of replacement over the long term. The provision calculation is based on the assumption that dismantlement activities are expected to cover the same number of kilometres each year over the useful life of the network. Changes in this assumption or assumptions with regard to expected costs, technical change, and discount rate may result in adjustments to the established provisions (see Note 15) and assets.

6 PROPERTY, PLANT AND EQUIPMENT

	Buildings and facilities	Pipelines and tanks	Other plant and equipment	Linefill	Assets under construction including prepayments	Total
At 1 January 2006						
Cost	53,355	274,715	165,973	50,111	38,914	583,068
Accumulated depreciation	(16,742)	(145,286)	(85,117)	-	-	(247,145)
Net book value at 1 January 2006	**36,613**	**129,429**	**80,856**	**50,111**	**38,914**	**335,923**
Depreciation	(1,515)	(8,389)	(13,110)	-	-	(23,014)
Additions (including prepayments)	-	-	3,483	890	140,705	145,078
Transfers from assets under construction	8,818	27,534	35,652	-	(72,004)	-
Net change in dismantlement provision (see Note 15)	-	46,963	-	-	-	46,963
Disposals/retirements at cost	(662)	(192)	(4,195)	(183)	(5,604)	(10,836)
Accumulated depreciation on disposals/retirements	309	145	3,051	-	-	3,505
Net book value at 31 December 2006	**43,563**	**195,490**	**105,737**	**50,818**	**102,011**	**497,619**
At 31 December 2006						
Cost	61,511	349,020	200,913	50,818	102,011	764,273
Accumulated depreciation	(17,948)	(153,530)	(95,176)	-	-	(266,654)
Net book value at 31 December 2006	**43,563**	**195,490**	**105,737**	**50,818**	**102,011**	**497,619**

(in millions of Russian roubles)

6 PROPERTY, PLANT AND EQUIPMENT (continued)

	Buildings and facilities	Pipelines and tanks	Other plant and equipment	Linefill	Assets under construction including prepayments	Total
At 1 January 2005						
Cost	47,583	249,233	143,088	49,255	33,062	522,221
Reclassification	218	1,054	(1,272)	-	-	-
Accumulated depreciation	(15,598)	(138,154)	(76,480)	-	-	(230,232)
Net book value at 1 January 2005	**32,203**	**112,133**	**65,336**	**49,255**	**33,062**	**291,989**
Depreciation	(1,346)	(7,902)	(10,597)	-	-	(19,845)
Additions (including prepayments)	-	-	4,397	1,020	59,576	64,993
Transfers from assets under construction	6,070	25,216	21,906	-	(53,192)	-
Disposals/retirements at cost	(516)	(788)	(2,146)	(164)	(532)	(4,146)
Accumulated depreciation on disposals/retirements	202	770	1,960	-	-	2,932
Net book value at 31 December 2005	**36,613**	**129,429**	**80,856**	**50,111**	**38,914**	**335,923**
At 31 December 2005						
Cost	53,355	274,715	165,973	50,111	38,914	583,068
Accumulated depreciation	(16,742)	(145,286)	(85,117)	-	-	(247,145)
Net book value at 31 December 2005	**36,613**	**129,429**	**80,856**	**50,111**	**38,914**	**335,923**

Property, plant and equipment as of 31 December 2006 is presented net of impairment provision of RR 4,704 (as of 31 December 2005 – net of impairment provision of RR 4,704), against specific pipeline assets and machinery.

Linefill represents 26,872 thousand tonnes of crude oil as of 31 December 2006 (31 December 2005 – 26,791 thousand tonnes) (see Note 4).

7 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	31 December 2006	31 December 2005
Marketable securities	961	1,452
Investments in other Russian companies	472	501
	1,433	1,953
Less: short-term available-for-sale financial assets	(216)	(638)
	1,217	1,315

(in millions of Russian roubles)

8 INVENTORIES

	31 December 2006	31 December 2005
Materials and supplies	5,216	6,488
Sundry goods for resale	3,052	4,648
Other items	106	275
	8,374	11,411

Inventories are presented net of provisions for obsolescence of RR 147 as of 31 December 2006 (31 December 2005 – RR 374). Materials are primarily used in the maintenance of pipeline equipment.

9 RECEIVABLES AND PREPAYMENTS AND VAT ASSETS

Receivables and prepayments

	31 December 2006	31 December 2005
Trade receivables (net of a provision for doubtful debts of RR 133 at 31 December 2006 (31 December 2005 - RR nil))	2,115	2,420
Prepayments and advances	10,488	5,068
Other receivables (net of a provision for doubtful debts of RR 106 at 31 December 2006 (31 December 2005 - RR 47))	1,943	1,481
	14,546	8,969

VAT assets

	31 December 2006	31 December 2005
Recoverable VAT related to construction projects	9,975	9,368
Tax on advances received for transportation of export	10,185	20,064
Other VAT receivable	3,335	455
	23,495	29,887

In July 2005, new amendments to the Tax Code of the Russian Federation were adopted changing the tax rules with respect to VAT. Effective 1 January 2006, VAT balances become payable or eligible for recovery on an accrual basis subject to certain transitional provisions. Additionally, the requirement to defer the recovery of VAT on capital expenditures until which time as the related assets are put in use was withdrawn.

10 CASH AND CASH EQUIVALENTS

	31 December 2006	31 December 2005
Balances denominated in Russian roubles	27,661	26,633
Balances denominated in US dollars	1,632	2,505
	29,293	29,138

(in millions of Russian roubles)

11 SHARE CAPITAL, RETAINED EARNINGS

Share capital

	Total RR million (historical)	31 December 2006 and 2005
Authorised, issued and fully paid shares of par value RR 1 each		
Ordinary: 4,664,627 shares	4.7	230
Preferred: 1,554,875 shares	1.5	77
6,219,502 shares	6.2	307

The carrying value of the share capital differs from historical cost due to the effect of hyperinflation in the Russian Federation.

The Government of the Russian Federation, through the Federal Agency for the Management of Federal Property, holds 100% of ordinary shares of OAO AK Transneft.

Rights attributable to preferred shares

Holders of preferred shares shall receive dividends pursuant to the authorization of dividend payments at the general meeting. The amount of dividends to be paid on each preferred share is established as 10 percent of the net profits of the Company for the most recent financial year. Dividends on the preferred shares are not cumulative.

Shareholders that hold preferred shares in the Company shall be entitled to participate in the general meeting of shareholders with the right to vote on the following issues:

on the reorganization and liquidation of the Company;

on the introduction of amendments and addenda to the Charter of the Company which limit the rights of shareholders that hold preferred shares, including the determination or increase in the amount of dividends and/or determination or liquidation cost to paid on preferred shares of the previous level of priority;

on all issues within the competence of the general meeting of shareholders, after an annual general meeting of shareholders where no decision on payment of dividends was adopted or a decision was adopted on partial payment of dividends on preferred shares. This right is terminated from the time of the first full payment of dividends on the indicated shares.

Dividends

The following dividends were approved in respect of the year ended 31 December 2005:

	Russian roubles per share	Total
Ordinary shares	184.52	861
Preferred shares	296.36	460
		1,321

The approved dividends were paid in full in 2006.

Distributable profits

The statutory accounting reports of the Company and each subsidiary are the basis for their respective profit distribution and other appropriations. The statutory profit of the Company was RR 3,505 for the year ended

31 December 2006 (RR 4,608 for the year ended 31 December 2005).

(in millions of Russian roubles)

12 MINORITY INTERESTS

Minority interests represent the shares in subsidiary entities held by OAO Soyuzinvetsneftekhim (36% of OAO Severo-Zapadnye MN) and Ministry of State Property of the Republic of Bashkortostan (24.5% of OAO Uralsibnefteprovod) (see Note 19).

13 BORROWINGS, FINANCIAL LEASE OBLIGATIONS AND INTEREST EXPENSE

	31 December 2006	31 December 2005
Secured borrowings	-	480
Unsecured borrowings	66,504	13,938
Finance lease obligations	4,377	3,521
Total borrowings	70,881	17,939
Less: current borrowings and current portion of non-current borrowings and finance lease obligations	(69,200)	(16,290)
	1,681	1,649
Maturity of non-current borrowings and finance lease obligations		
Due for repayment:		
Between one and five years	1,621	1,647
After five years	60	2
	1,681	1,649

As at 31 December 2006, no borrowings were denominated in foreign currencies (as at and 31 December 2005 – RR 7,200 was denominated in US dollars).

The fair value of the borrowings and finance lease obligations approximates their carrying amount as obligations are primarily short-term.

Interest expense

	Year 2006	Year 2005
Interest expense	1,923	1,216
Interest income	(778)	(344)
Effect of change in discount rate	-	726
Net interest expense	1,145	1,598

In August 2006, a revolving credit facility amounting to RR 65,000 was made available to a Group company by Sberbank, a state-controlled bank, for the financing of construction of the Eastern Siberia-Pacific Ocean pipeline. The credit facility expires in 2012. In August 2006, as part of this credit facility, the Group completed an agreement to receive a nonrevolving credit line of RR 20,000 due in August 2007, of which the full amount was drawn down. In October 2006, as part of this credit facility, the Group completed agreements to receive nonrevolving credit lines of RR 35,000 and RR 10,000 due in October 2007, of which the full amount was drawn down. Interest is payable at a fixed rate and is subject to revision if the Central Bank of the Russian Federation increases interest rates by more than 10% of that rate.

In November 2006, a Group company entered into a seven year credit facility with Sberbank, a state-controlled bank, which provided for up to RR 15,000 to be available for the purpose of financing the construction of the Eastern Siberia-Pacific Ocean pipeline. Under this credit facility agreement, two loan agreements have been signed for one year non-revolving credit lines in the amounts of RR 10,000 due in January 2008 and RR 5,000 due in December 2007. As at 31 December 2006, RR 1,221 of this credit facility had been drawn down. Interest is payable on the same terms as the RR 65,000 credit facility discussed above.

(in millions of Russian roubles)

13 BORROWINGS, FINANCIAL LEASE OBLIGATIONS AND INTEREST EXPENSE (continued)

In May 2006, a credit line of RR 20,000 was made available to a Group company by Sberbank, a state-controlled bank, for the construction of the Eastern Siberia-Pacific Ocean pipeline, of which RR 9,510 had been drawn down. The credit line was paid in full in August 2006. Interest was payable at fixed rates.

In May 2003, A credit line of RR 10,000 (RR 5,000 and US$ 163 mln.) was made available to a Group company by a Russian bank for the construction of the Baltic Pipeline System, of which the full amount was drawn down. The credit line was repaid in full in February 2006. Interest was payable at fixed rates.

In October 2003, a credit line of RR 10,000 was made available to a Group company by a Russian bank for the construction of the Baltic Pipeline System, of which RR 7,390 had been drawn down by 31 December 2005. The credit line was repayable in four unequal instalments commencing in July 2005 to February 2006. Partial repayment of this credit line was made in 2005 of RR 5,833. The remaining balance of RR 1,557 was repaid in February 2006. Interest was payable at fixed rates.

The rates on the above RR loans range from 7% to 12%.

In April 2005, a credit line of US$ 250 million was made available to a Group company by international consortium of banks for the expansion of the Baltic Pipeline System, partial refinancing of existing liabilities and general corporate purposes. In May 2005 US$ 250 million of the credit line had been drawn down. The credit line was to be repaid in three unequal instalments commencing in April 2007 to April 2008. The loan was repaid in advance in February 2006. Interest was payable monthly at the rate of LIBOR plus 1.15% per annum.

Finance lease obligations

Finance lease obligations are payable as follows:

	31 December 2006		
	Payments	**Interest**	**Present value of finance lease liability**
Less than one year	3,146	412	2,734
Between one and five years	1,909	326	1,583
After five years	70	10	60
	5,125	748	4,377

	31 December 2005		
	Payments	**Interest**	**Present value of finance lease liability**
Less than one year	2,070	180	1,890
Between one and five years	1,772	141	1,631
After five years	-	-	-
	3,842	321	3,521

(in millions of Russian roubles)

14 DEFERRED TAX LIABILITIES AND PROFIT TAX EXPENSE

Deferred tax liabilities and assets consist of the following:

	31 December 2006	31 December 2005
Deferred tax liabilities:		
Carrying value of property, plant and equipment in excess of tax base	(40,292)	(28,376)
Other	(327)	(288)
	(40,619)	(28,664)
Deferred tax assets:		
Provisions against inventories, receivables and accruals	451	654
Provisions for dismantlement and other expenses	14,065	2,470
	14,516	3,124
Net deferred tax liability	(26,103)	(25,540)

Differences between the recognition criteria in Russian statutory taxation regulations and IFRS give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profit tax purposes. The tax effect of the movement on these temporary differences is recorded at the statutory rate of 24%.

The following is a reconciliation of theoretical profit tax expense computed at the statutory tax rate to the actual profit tax expense:

	Year ended 31 December 2006	Year ended 31 December 2005
Profit before profit tax	80,829	73,400
Theoretical profit tax expense at 24%	19,399	17,616
Increase due to:		
Items not deductible for profit tax purposes	6,569	2,005
Actual profit tax expense	25,968	19,621

(in millions of Russian roubles)

15 PROVISIONS FOR LIABILITIES AND CHARGES

	31 December 2006	31 December 2005
Dismantlement provision	54,228	6,774
Pension provision	3,761	2,574
Other provisions	111	135
	58,100	9,483

Dismantlement provision

The provision is established for the expected cost of dismantling parts of the existing pipeline network based on the average current cost per kilometre of removal according to an estimated plan of replacement over the long term. The provision calculation is based on the assumption that dismantlement activities are expected to cover the same number of kilometres each year over the useful life of the network. The cost of dismantlement is added to the cost of property, plant and equipment and depreciated over the useful economic life of the pipeline network.

Additional provisions are made when the total length of the network increases, and reductions occur when sections of the pipeline are decommissioned. Other changes are made when the expected pattern or unit cost of dismantlement is changed. The expected costs at the dates of dismantlement have been discounted to net present value using a nominal rate of 7% per year (31 December 2005 – 7% per year).

In 2006, the Group's dismantlement provision was increased by RR 46,963 primarily as a result of changes in estimates in the expected cost of dismantling pipeline per 1 km.

	2006	2005
At 1 January	6,774	5,440
Net change in provision	46,963	1,334
Accretion of interest	491	-
At 31 December	54,228	6,774

Pension provision

Under collective agreements with the employees, an amount ranging from one to five months final salary is payable upon retirement to those who have worked for the Group for more than five years. Also under collective agreements with the employees, an amount ranging from one to eight months minimal salary is payable on an annual basis until the death of employees to those retired employees who have not entered in an agreement with the Non-state pension fund of OAO AK Transneft. Management has assessed the net present value of these obligations, following the guidelines set out in IAS 19 "Employee Benefits". Under this method, a provision has been established having regard to employee life expectancy.

In 2006, the Group's pension provision was increased by RR 1,228 primarily as a result of change in actuarial assumptions. The change was accounted for as actuarial losses and recognized as an expense in the consolidated income statement (see Note 4).

The amounts recognized in the income statement are as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Current service cost	45	19
Interest cost	168	67
Recognised actuarial losses	1,228	786

Net expense included in staff costs in the consolidated income statement (see Note 18)	1,441	872

(in millions of Russian roubles)

15 PROVISIONS FOR LIABILITIES AND CHARGES (continued)

Movements in the net liability recognised in the balance sheet are as follows:

	2006	2005
At 1 January	2,574	1,793
Net expense recognised in the consolidated income statement	1,441	872
Benefits paid	(254)	(91)
At 31 December	3,761	2,574

The amounts associated with pension provision recognized in the balance sheet are as follows:

	31 December 2006	31 December 2005
Present value of provision (unfunded)	3,761	2,574
Liability	3,761	2,574

Principal actuarial assumptions used (expressed as weighted average):

	Year ended 31 December 2006	Year ended 31 December 2005
Discount rate (nominal)	7%	7%
Future salary increases (nominal)	7%	0%
Employees average remaining working life (years)	13	14

16 TRADE AND OTHER PAYABLES

	31 December 2006	31 December 2005
Trade payables	14,647	9,361
Advances received for oil transportation services	13,146	10,604
Accruals and deferred income	2,023	1,875
VAT output tax payable	815	758
Deferred VAT	77	5,808
Other taxes payable	752	551
Other payables	2,197	2,789
	33,657	31,746

17 SALES

	Year ended 31 December 2006	Year ended 31 December 2005
Revenues from oil transportation services		
Domestic tariff	74,074	64,374
Export tariff	109,942	99,544
Total revenues from oil transportation services	184,016	163,918
Revenues from oil sales (net of custom duties)	9,465	5,718

Other revenues	8,946	10,061
	202,427	179,697

(in millions of Russian roubles)

17 SALES (continued)

The Group revenues for oil transportation services on the domestic pipeline network comprise:

revenues for transportation of crude oil to destinations in the Russian Federation and the Custom Union countries, based on distance-related tariffs denominated and payable in RR and revised periodically after approval by the Federal Tariff Agency ("domestic tariff");

revenues for transportation of crude oil which is destined for export (outside of the Russian Federation and the Custom Union countries), based on distance-related tariffs denominated in US$ and in RR but payable in RR and revised periodically after approval by the Federal Tariff Agency ("export tariff").

Other amounts included in export tariffs are:

a fixed tariff denominated and payable in US$, under intergovernmental agreements for the transportation of crude oil from Azerbaijan over the territory of the Russian Federation, for export at the port of Novorossiysk;

a distance-related tariff denominated and payable in US$, set by the Federal Tariff Agency for transit of Kazakhstan crude oil over the territory of the Russian Federation, except for the Makhachkala – Novorossiysk pipeline, and

a fixed tariff denominated and payable in US$, set by the intergovernmental arrangement for transit of Kazakhstan crude oil through the Makhachkala – Novorossiysk pipeline.

Revenue from oil sales primarily relate to proceeds from the sale on the export market of crude oil that had been received by the Group in payment of an outstanding receivable.

18 OPERATING EXPENSES AND NET OTHER OPERATING EXPENSES

	Year ended 31 December 2006	Year ended 31 December 2005
Operating expenses		
Depreciation	21,868	19,441
Staff costs:		
Salaries and pension expense	20,056	18,764
Unified Social Fund contributions	4,049	3,794
Key management personnel compensation (see Note 21)	238	154
Social expenses	3,718	2,882
Energy	16,277	15,690
Materials	10,151	9,011
Cost of oil sold	8,558	5,099
Insurance expense	6,011	5,213
Repairs and maintenance	7,867	10,294
Administrative expense	3,511	2,927
Transport expense	1,489	1,856
Taxes other than profit tax:		
Property tax	1,192	887
Other taxes	251	237
Other	9,577	8,179
	114,813	104,428

(in millions of Russian roubles)

18 OPERATING EXPENSES AND NET OTHER OPERATING EXPENSES (continued)

Property tax is assessed at a maximum of 2.2% on the average annual net book value of property, plant and equipment. Specific legislation provides for the exclusion of trunk pipelines and related constructions from the taxable base.

Unified Social Fund contributions include Group expenses in relation to the State Pension Fund, which is a defined contribution plan, for the year ended 31 December 2006 in amount of RR 2,131 (for the year ended 31 December 2005 – RR 2,008).

Salaries and pension expense include Group expenses in relation to the non-state defined contribution plan for the year ended 31 December 2006 in amount of RR 2,133 (for the year ended 31 December 2005 – RR 1,854).

The following amounts are included in net other operating expense:

	Year ended 31 December 2006	**Year ended 31 December 2005**
Oil surplus (deficits)	7,103	2,308
Loss on disposal of property, plant and equipment	(797)	(806)
Charitable contributions	(5,280)	(1,595)
Charge due to change in the route of the East Siberia – the Pacific Ocean pipeline	(6,613)	-
	(5,587)	(93)

In 2006, due to a Russian Government mandated change in the planned route of the East Siberia – Pacific Ocean pipeline, the Group has charged to expense RR 6,613 of previously capitalized costs related to the original route planning and design.

19 CONSOLIDATED SUBSIDIARIES

	Percentage (%) of ownership interest at 31 December 2006
Regional pipeline operators	
OAO Sibnefteprovod	100.0
OAO Chernomortransneft	100.0
OAO MN Druzhba	100.0
OAO Privolzhsknefteprovod	100.0
OAO Transsibneft	100.0
OAO Verkhnevolzhsknefteprovod	100.0
OAO Tsentrsibnefteprovod	100.0
OAO Severnye MN	100.0
OOO Baltnefteprovod	100.0
OAO Uralsibnefteprovod	75.5
OAO Severo-Zapadnye MN	64.0
OOO Vostoknefteprovod	100.0
Other services	
OAO Giprotruboprovod	100.0
OAO Svyaztransneft	100.0
OAO CTD Diascan	100.0
OAO Volzhsky Podvodnik	100.0
ZAO Centre MO	100.0
OOO Trade House Transneft	100.0

(in millions of Russian roubles)

19 CONSOLIDATED SUBSIDIARIES (continued)

	Percentage (%) of ownership interest at 31 December 2006
OAO TsUP Stroineft	100.0
OOO Spetsmornefteport Primorsk	100.0
OOO TransPress	100.0
OOO TsUP VSTO	100.0
OOO Transneft Finance	100.0

All of the consolidated subsidiaries are incorporated in the Russian Federation. There were no material changes in the structure of the Group during the years ended 31 December 2006 and 2005.

20 CONTINGENT LIABILITIES, COMMITMENTS AND OTHER RISKS

Contingent liabilities

Legal proceedings

The Group is a party to certain legal proceedings arising in the ordinary course of business.

In the opinion of management of the Group, there are no current legal proceedings threatened or outstanding which could have a material adverse effect on the results of operations or financial position of the Group.

Taxation

Russian tax and customs legislation is subject to varying interpretations and changes which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and it is possible that transactions and activities that have not been challenged in the past may be challenged in the future. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

21 RELATED PARTIES AND KEY MANAGEMENT PERSONNEL COMPENSATION

The Government of the Russian Federation, through the Federal Agency for the Management of Federal Property, owns 100% of the ordinary shares of the Company and controls its operations through Board members representing certain Ministries and other Federal bodies. The Government also appoints the members of the Federal Tariff Agency which sets the tariff rates.

The Group's transactions with other state-controlled entities occur in the normal course of business and include, but are not limited to the following: purchase of electricity for production needs, transportation of oil produced by state-owned entities, and transactions with state-controlled banks.

The Group had the following significant transactions and balances with state-controlled entities:

	Year ended 31 December 2006	**Year ended 31 December 2005**
Revenue from oil transportation services	50,912	27,834
Electricity expenses	(2,800)	(6,429)
Interest expenses	(976)	(782)
Customs duties on oil sales	-	(1,835)

(in millions of Russian roubles)

21 RELATED PARTIES AND KEY MANAGEMENT PERSONNEL COMPENSATION (continued)

	31 December 2006	31 December 2005
Receivables and prepayments	20	519
Cash	1,157	12,487
Trade and other payables	3,570	1,564
Non-current and current borrowings	66,260	6,925

Transactions with the state include taxes which are detailed in the balance sheet, income statement and Notes 9, 14, 16 and 18.

Key management personnel compensation

Compensation payable to the key management personnel of OAO AK Transneft and its subsidiaries consists of contractual remuneration for their services in full time executive positions. Compensation amounts were as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Salaries and bonuses	192	126
Termination benefits	4	4
Other	27	24
	223	154

22 FINANCIAL RISKS FACTORS

Foreign exchange risk

The Group's overall strategy is to have no significant net exposure in currencies other than the Russian rouble or the US dollar. Furthermore, the Group does not use foreign exchange or forward contracts.

Interest rate risk

Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The Group obtains borrowings from banks at current market interest rates and does not use any hedging instruments to manage its exposure to changes in interest rates. Changes in interest rates may occur but they are not expected to have a material impact.

Commodity price risk

The Group's main activity requires it to maintain and replace the existing pipeline network and to construct new pipelines. This necessitates the purchase of significant amounts of steel pipe each year for new and replacement pipelines and of crude oil as linefill. The Group does not have long-term contracts with the manufacturers of pipe or the producers of crude oil and does not use derivative contracts to manage its exposure to fluctuations in the price of steel or crude oil.

Credit risk and contract performance

The Group does not hold or issue financial instruments for hedging or trading purposes and its trade accounts receivable are unsecured. The Group has no material concentrations of credit risk.

23 POST BALANCE SHEET EVENTS

In March 2007, the Company received a loan from TransCapitalInvest Limited in the amount of USD 1.3 billion at an interest rate of 5.67% due in 7 years. For the purpose of financing the loan to the Company, TransCapitalInvest Limited had issued Eurobonds for the same amount and for the same terms. The Group used proceeds from the loan received to finance the construction of the East Siberia – Pacific Ocean pipeline.

In April 2007, the President of the Russian Federation signed a decree No. 473 authorising the Company to acquire 100% of the ordinary shares of OAO AK Transnefteproduct. The transaction is expected to be effected by September 2007. OAO AK Transnefteproduct is 100% owned by the Russian Federation.

In April 2007, the President of the Russian Federation signed Presidential decree No. 565 authorising the transfer of the 24 per cent. stake in the Caspian Pipeline Consortsium-R and Caspian Pipeline Consortsium-K stock companies held by the Russian Government to Transneft in trust. In order to execute this decree, the Federal Agency for the Management of Federal Property (‘‘Rosimushchestvo’’) and Transneft as trustee will sign a trust agreement. The exact form of this agreement is still being discussed within the Russian Government.