

AO SIBERIAN OIL COMPANY

CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 1998 AND 1997
TOGETHER WITH
REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of AO Siberian Oil Company:

We have audited the accompanying consolidated balance sheets of AO Siberian Oil Company, a Russian open joint stock company, and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of operations, changes in shareholders' capital and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AO Siberian Oil Company and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles in the United States.

As explained in Note 3 to the financial statements, the Company has given retroactive effect to the change in accounting for oil and gas properties.

Without qualifying our opinion, we draw your attention to the Year 2000 computer issue of which the impact on the Company's operations in connection with computer systems outside the Company's control, such as infrastructure operated by outside suppliers, but on which the efficient operations of the Company are significantly dependent, has not been identified. Any impact from non-compliance in the operations of entities outside the control of the Company, is not estimatable and no adjustments have been made to the consolidated financial statements.

ARTHUR ANDERSEN ZAO

Moscow, Russia
April 30, 1999

AO Siberian Oil Company
Consolidated Statements of Operations
for the years ended December 31, 1998 and 1997
(Thousands of US Dollars)

	<u>1998</u>	<u>1997</u>
<i>Revenues</i>		
Refined product and oil and gas sales	\$ 1 644 059	\$ 2 616 110
Processing fee	30 143	114 946
Other	106 821	257 646
Total	1 781 023	2 988 702
<i>Expenses</i>		
Production costs	909 441	947 924
Selling, general and administrative	250 943	418 623
Cost of other sales	95 610	169 676
Depreciation, depletion and amortization	316 634	422 073
Exploratory expenses	53 954	73 829
Maintenance and repairs	41 603	49 752
Taxes other than income taxes	218 086	925 496
Total	1 886 271	3 007 373
Operating loss	(105 248)	(18 671)
<i>Other income (expense)</i>		
Interest income	6 832	5 175
Interest expense	(53 309)	(32 525)
Other income, net	1 752	19 195
Minority interest	(81 511)	102 236
Dividends on preferred stock of subsidiaries	(1 826)	(1 529)
Currency translation gain	286 800	31 650
Total	158 738	124 202
Income before provision for income taxes	53 490	105 531
Provision for income taxes	17 345	81 643
Net profit	\$ 36 145	\$ 23 888
Net profit per common share (dollars)	\$ 0,0080	\$ 0,0053
Average number of common shares outstanding (millions)	4 516	4 516

AO Siberian Oil Company
Consolidated Balance Sheets
As of December 31, 1998 and 1997
(Thousands of US Dollars)

	December 31, <u>1998</u>	December 31, <u>1997</u>
<i>Assets</i>		
Current assets:		
Cash and cash equivalents	\$ 65 331	\$ 108 694
Short-term investments	2 359	9 974
Accounts receivable, net of allowance for doubtful accounts	353 346	422 788
Inventories	116 469	398 576
Prepaid expenses	1 877	9 595
Total current assets	<u>539 382</u>	<u>949 627</u>
Long-term investments	21 614	118 019
Net oil and gas properties	3 031 461	3 054 320
Net property, plant and equipment	1 181 591	1 258 434
Construction in progress	213 838	233 678
Other noncurrent assets	<u>6 210</u>	<u>6 074</u>
Total assets	<u><u>\$ 4 994 096</u></u>	<u><u>\$ 5 620 152</u></u>
<i>Liabilities and Shareholders' Capital</i>		
Current liabilities:		
Short-term loans	\$ 320 371	\$ 324 177
Accounts payable and accrued liabilities	318 222	407 609
Estimated income and other taxes	142 681	740 625
Other current liabilities	15 815	12 454
Total current liabilities	<u>797 089</u>	<u>1 484 865</u>
Accrued site restoration	84 102	146 500
Long-term debt	150 000	150 000
Long-term taxes payable	21 017	14 555
Minority interest	2 015 331	1 933 820
Total liabilities	<u>3 067 539</u>	<u>3 729 740</u>
Shareholders' capital:		
Common stock	1 604	1 604
Reserves	1 867 449	1 867 449
Retained earnings	57 504	21 359
Total shareholders' capital	<u>1 926 557</u>	<u>1 890 412</u>
Total liabilities and shareholders' capital	<u><u>\$ 4 994 096</u></u>	<u><u>\$ 5 620 152</u></u>

AO Siberian Oil Company
Consolidated Statements of Cash Flows
for the years ended December 31, 1998 and 1997
(Thousands of US Dollars)

	<u>1998</u>	<u>1997</u>
<i>Operating activities</i>		
Reconciliation of net profit (loss) to net cash provided by operating activities:		
Net profit (loss)	\$ 36 145	\$ 23 888
Depreciation, depletion and amortization	316 634	422 073
Decrease in provision for doubtful accounts	(10 814)	(6 657)
Decrease in provision for materials and supplies	(5 635)	(35 149)
Increase in long-term taxes payable	6 462	555
Minority interest	81 511	(102 236)
Changes in current assets and liabilities:		
Decrease in accounts receivable	80 256	87 272
(Increase)/decrease in inventories	287 742	-20 992
(Increase)/decrease in prepaid expenses	7 718	(5 019)
Increase in other noncurrent assets	(136)	(1 066)
Decrease in accounts payable and accrued liabilities	(161 057)	(55 095)
(Decrease)/increase in estimated income and other taxes	(597 944)	14 931
(Decrease)/increase in other current liabilities	6 531	(41 329)
Net cash provided by operating activities	47 413	281 176
<i>Investing activities</i>		
Net decrease in short-term investments	7 615	73 677
Net (increase)/decrease in long-term investments	96 405	(84 385)
Additions to capital assets, net	(190 990)	(534 760)
Net cash used in investing activities	(86 970)	(545 468)
<i>Financing activities</i>		
Contribution from majority shareholder	27 382	-
Increase in short-term loans	(3 806)	204 191
Increase in long-term debt	-	150 000
Net cash provided by financing activities	23 576	354 191
Increase/(decrease) in cash and equivalents	(15 981)	89 899
Cash and equivalents at beginning of year	108 694	18 796
Cash and equivalents at end of year	\$ 65 331	\$ 108 694
<i>Supplemental disclosures of cash flow information</i>		
Cash paid for interest	\$ 66 269	\$ 44 591
Cash paid for income taxes	\$ 1 379	\$ 103 442

AO Siberian Oil Company
Statement of Changes in Shareholders' Capital
for the years ended December 31, 1998 and 1997
(Thousands of US Dollars)

	Common Stock	Additional paid-in capital	Reserves	Retained Earnings (Accumulated Deficit)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance at December 31, 1996, as previously reported	\$ 1 604	\$ -	\$ 2 343 024	\$ (3 681)
Cumulative effect of accounting change			(475 575)	1 152
Balance at December 31, 1996, as adjusted	<u>\$ 1 604</u>	<u>\$ -</u>	<u>\$ 1 867 449</u>	<u>\$ (2 529)</u>
Net profit				23 888
Balance at December 31, 1997	<u>\$ 1 604</u>	<u>\$ -</u>	<u>\$ 1 867 449</u>	<u>\$ 21 359</u>
Net profit				36 145
Balance at December 31, 1998	<u>\$ 1 604</u>	<u>\$ -</u>	<u>\$ 1 867 449</u>	<u>\$ 57 504</u>

1. The Company

Description of Business

AO Siberian Oil Company (the "Company" or "Sibneft") is a vertically integrated Russian oil company. Its principal activities concern oil and gas exploration, production, refining and marketing.

The Company was created by Presidential Decree Number 872 dated August 24, 1995. On September 29, 1995 Sibneft's charter was approved when the Government of the Russian Federation issued Resolution Number 972. The Omsk Registration Chamber officially registered Sibneft on October 6, 1995.

Under the terms of the Presidential Decree, Sibneft received 51 percent of the voting common shares (38 percent of the charter capital) belonging to the Russian Federation in four companies: Noyabrskneftegaz ("Noyabrsk"), Omsk Refinery ("OR"), Noyabrskneftegasgeophysica ("Geofizika") and Omsknefteprodukt ("Nefteprodukt").

Noyabrsk is primarily engaged in the exploration, production and development of oil and gas from its fields in the south Yamalo-Nentsk autonomous region and the northern part of the Khanti-Mansisk autonomous region. OR's principal activity is the production of refined petroleum products at its refinery in Omsk, Western Siberia. Nefteprodukt carries out marketing operations through its retail outlets in the Omsk region. Geofizika provides exploration and technical services in the Noyabrsk region. Historically, Noyabrsk had close business relationships with both Geofizika and OR, while OR had close business links not only with Noyabrsk but also Nefteprodukt. The consolidation of these companies under Sibneft's control has had a significant impact on the method of operation of each of the companies.

Severe Economic Conditions in Russia

During recent years, Russia has undergone substantial political, economic and social change. As an emerging market, Russia does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature free market economy. As a result, operations carried out in Russia involve significant risks that are not typically associated with those in developed markets. Instability in market reform could subject the Company to unpredictable changes in the basic business infrastructure under which it currently carries out its operations. Uncertainties regarding the political, legal, tax or regulatory environment, including the potential for adverse changes in any of these factors could significantly affect the Company's ability to operate commercially. Changes that may occur or the resulting effect of any such changes on the Company's financial condition or future results of operations are not estimable.

During 1998, the Russian economy has been characterized by declining industrial production, significant inflation, rising unemployment and underemployment, an unstable currency, high government debt relative to gross domestic product, high levels of inter-company debt and high levels of corporate insolvency.

Over recent years, Russia has received substantial financial assistance from several foreign governments and international organizations. On July 20, 1998, the International Monetary Fund ("IMF") announced a US Dollar (US\$) 22.6 billion financial rescue package, which included an US\$ 11.2 billion financial facility for stabilization purposes to be released in several tranches, subject to the satisfaction of certain conditions relating primarily to the budget revenue performance of the Russian government. On July 29, 1998, the IMF released US\$ 4.8 billion of the first tranche of the rescue package.

Prior to August 17, 1998, the ruble corridor (in reference to its exchange for US\$) was set between 5.27 rubles per US dollar and 7.13 rubles per US dollar. On August 17, 1998, due to the burden of short-term debt and falling Central Bank reserves, the Russian government withdrew its support for the falling

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

ruble. As of December 31, 1998 the exchange rate was 20.65 rubles to US\$ 1. Subsequent to the year-end the exchange rate has continued to fall. As of April 30, 1999, the exchange rate was 24.23 rubles to US\$ 1. As a consequence of the current economic and political situation in Russia, it is uncertain whether Russia will be able to draw upon international organizations such as the IMF for additional financing.

The Company and its subsidiaries will continue to be affected, for the foreseeable future, by Russia's unstable economy. As a result, there are significant uncertainties that may affect future operations, the recoverability of the Company's assets, and the ability of the Company to maintain or pay its debts as they mature. Continued economic instability in Russia could significantly affect the Company's ability to obtain permanent or term financing under commercially viable terms.

It is not clear what action the Russian government will take as a result of the current economic situation. Further, it is not possible to determine the future effect a continuation of the economic crisis may have on the Company's liquidity and earnings, including the effect on transactions with the Company's investees, customers, and suppliers. The ultimate outcome of this matter cannot presently be determined. As a result, the financial statements do not include any adjustment that may result from these uncertainties. Related effects, if any, will be reported in the financial statements, as they become known and estimable.

Despite the economic crisis, Sibneft has continued to service all of its debt obligations and during the first four months of 1999 has reduced its levels of hard currency borrowings by more than US\$ 200 million. During 1998, the company has maximised its exports to 33% of crude production and 17% of product sales (compared to 29% and 16% in 1997, respectively) in order to maximise the benefit of the Ruble devaluation. Management's strategy has been to reduce costs in US\$ terms, when commercially possible to levels significantly below pre-crisis expenditures in order to sustain a long term competitive advantage from the re-alignment of the currency.

Establishment of Prices

Prior to 1995, the Russian government determined the domestic price for the sale of crude oil that was significantly lower than the price for which the same crude could be sold on the world market. During 1995, the government withdrew its price control of domestic crude allowing the price to increase. As of December 31, 1998, the domestic crude and refined product prices were approximately 35% and 69% of the respective world market price for equivalent crude and refined products (75% and 48%, respectively, as of December 31, 1997). In addition, the amount of oil that Noyabrsk is allowed to export is also limited by government restrictions.

Significant changes in the structure of business transactions

In prior year operations, significant portions of Noyabrsk crude production was delivered to Omsk Refinery for processing and eventual distribution to customers through the Company's sales system, with no significant involvement from third parties. During 1998 for cash flow optimization purposes, the Company made a change in the formal structure of its internal production process, involving several third party legal entities as intermediaries. Starting from April 1998, these third parties purchase crude from Noyabrsk and other independent producers for processing at Omsk Refinery under tolling agreements. Sibneft undertakes this process through a series of commission agreements (both for crude and tolling) and buys back 100% of refined products.

For the purposes of these consolidated financial statements, these separate transactions have been grouped together in accordance with their substance as one transaction. Additionally, the Company has calculated combined net payables of approximately US\$ 105 million to cover the third parties' purchases of crude from independent producers, transportation costs, tax liabilities and margin of profit.

2. Summary of Significant Accounting Policies

Form and Content of the Consolidated Financial Statements

The Company and its subsidiaries maintain their books and records in accordance with accounting principles and practices mandated by Russian Accounting Regulations (RAR). These regulations are principally structured for the preparation of information for taxation reporting. Accordingly, tax considerations embodied within the regulations result in significant departures from generally accepted accounting principles in the United States (US GAAP).

The financial statements presented herein have been reformatted for international presentation from the Russian statutory financial statements of the Company and its subsidiaries for the years ended December 31, 1998 and 1997 and adjusted to comply with US GAAP.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary companies, Noyabrsk, OR, Geofizika, and Nefteprodukt (together referred to as "the Group"), in which the Company owns more than 50 percent of the voting common stock. All significant intercompany balances and transactions have been eliminated. Acquisitions of additional shares in subsidiaries are accounted for by the purchase method for business combinations.

As further discussed in Note 7, the Company has interests in various Russian legal entities, which are accounted for using the cost method due to their insignificance to the Company's operations.

Common Stock

The Presidential Decree establishing Sibneft stated that the charter capital of the Company would be equal to 38 percent of the aggregate of the charter capitals of its four subsidiaries at the date of formation. The 38 percent of the aggregate of the Charter capitals of the four subsidiaries also gave Sibneft 51 percent of the voting common stock in each of the subsidiaries and represented the Government's ownership in these companies. This consolidation of the Government's ownership into one company established the share capital of Sibneft at 4,516,396,250 shares of .0016 rubles each. For the purposes of these financial statements, the ruble value of the shares has been translated into US\$ at the exchange rate prevailing at that date.

Reserves and Retained Earnings

Reserves represent the Company's net asset position, excluding common stock at the time of the Company's formation in 1995. Retained earnings represent all cumulative net profit subsequent to formation.

Management Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheet as well as the revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Foreign Currency Translation

Translation (remeasurement) of the Company's ruble denominated financial statements into US\$ has been performed in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation", as they relate to hyperinflationary economies. The objective of this remeasurement process is to produce the same results that would have been reported if

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

the accounting records had been kept in US\$. In 1998, 1997 and 1996, Russia experienced cumulative inflation in excess of 100 percent over a three-year period, as determined by government statistics.

Monetary assets and liabilities have been translated at the rate prevailing at each balance sheet date. Non-monetary assets (other than oil and gas properties and property, plant and equipment - See "Property, Plant and Equipment" below) and liabilities have been translated at historical rates. Revenues, expenses and cash flows have been translated at monthly average rates. Translation differences resulting from the use of these rates have been accounted for in currency translation gains in the accompanying consolidated statements of operations.

The Group's principal future operating cash flows (revenues, production costs and general and administrative expenses) will be generated in rubles. As a result, future movements in the exchange rate between the ruble and the US\$ will affect the carrying value of the Company's monetary assets and liabilities. Such changes may also affect the Company's ability to realize non-monetary assets as represented in terms of US\$ in the accompanying financial statements.

Cash and Cash Equivalents

Cash represents cash on hand and in the Group's bank accounts and cash equivalents represent deposits, letters of credit and check books. Ruble deposits are translated at year-end exchange rates.

Inventories

Inventories, consisting primarily of crude oil, petroleum products and materials and supplies, are stated at the lower of average cost or market. A general reserve is established against slow moving and obsolete material and supplies.

Oil and Gas Properties

Sibneft follows the successful efforts method of accounting for its oil and gas exploration and production activities (see Note 3).

Lease acquisition costs related to properties held for oil and gas production are capitalized when incurred. Unproved properties with acquisition costs, which are individually significant, are assessed on a property-by-property basis, and a loss is recognized, by provision of a valuation allowance, when the assessment indicates impairment in value.

Exploratory costs, excluding the costs of exploratory wells, are charged to expenses as incurred. Costs of drilling exploratory wells, including stratigraphic test wells, are capitalized pending determination whether such wells have found proved reserves which justify commercial development. If such reserves are not found, the drilling costs are charged to exploratory expenses. Intangible drilling costs applicable to productive wells and to development dry holes, as well as tangible equipment costs and costs of injection wells related to development of oil and gas reserves are capitalized.

In accordance with SFAS 121 "Accounting for Impairment of Long-Lived Assets to Be Disposed Of", the Company assesses permanent impairment of long-lived assets to be held and used by comparing the carrying value against the undiscounted projection of net future pre-tax cash flows. For oil and gas properties, the test is performed on a field-by-field basis. Where an assessment indicates impairment in value, the oil and gas properties are written down to their fair value, as determined by the discounted projection of net future pre-tax cash flows. Oil and gas reserves for this purpose have been determined in accordance with the Society of Petroleum Engineers of the United States' definitions and were independently estimated by Miller and Lents, Ltd. As a result of this evaluation, no writedown was required for the year ended December 31, 1998 or 1997.

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

Depreciation and depletion of capitalized costs of proved oil and gas properties is calculated using the unit-of-production method for each field based upon proved developed reserves. Estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, are reserved using the unit-of-production method and included as a component of depreciation, depletion and amortization.

Russian financial information is maintained in historic ruble terms. However, the US\$ historic cost of oil and gas properties in the accompanying consolidated balance sheets were obtained using the same methodology applied to property, plant and equipment, as discussed below in "Property, Plant and Equipment".

Gains or losses arising from the sale of proved and unproved properties are recognized in income.

Property, Plant and Equipment

As discussed above, Russian financial information is maintained in historic ruble terms. In years prior to 1992, exchange rates were fixed by the government and did not necessarily correspond to the real market value of the ruble. In addition, certain purchases were made through central purchasing authorities and values transferred to receiving organizations were determined by the government. During 1992, fixed assets were revalued in accordance with Government Decree Number 595 dated August 14, 1992. Similar revaluations took place as of January 1, 1994, January 1, 1997 and January 1, 1998. Indexes used for these revaluations did not necessarily reflect the changes in the ruble's value, nor did they result in the value of the underlying fixed assets to which they were applied being revalued to a current market value.

As a result, it was not possible to determine from the statutory accounting records an appropriate carrying value of property, plant and equipment for US GAAP reporting purposes. Accordingly, an independent appraisal company, American Appraisal (AAR) Inc., was engaged to perform an historic cost valuation of property, plant and equipment, together with related accumulated depreciation as of December 31, 1996.

In performing a valuation of property, plant and equipment, the independent appraisal company employed appraisal techniques to determine both the historic cost and fair market value (in-use) for the appraised property in US\$ terms. The first step in estimating the historic cost and fair market value of the fixed assets entailed estimating the cost new, which is either cost of reproduction new (CRN) or, where CRN data was not available due to technical and/or design changes, the cost of replacement (COR). The CRN reflects the cost to reproduce the existing property in like kind while the COR reflects the cost to replace the existing property using current technology and materials. Cost data from both Russian and foreign producers of equipment was taken into account.

To arrive at an appropriate estimate of original historic cost, the CRN/COR was back-trended according to the actual age of the asset using historic western inflation adjustments. The historic cost of the assets was then depreciated using estimates of economic useful lives as outlined in "Depreciation, Depletion and Amortization" below.

The results of this work were used to determine the carrying values of property, plant and equipment for US GAAP purposes as of December 31, 1996. Since that date, disposals of property, plant and equipment have been accounted for at their historic cost while additions to property, plant and equipment have been recorded at cost using exchange rates as of the transaction dates.

As with oil and gas properties, significant property, plant and equipment have been evaluated in accordance with SFAS 121. As a result of this evaluation, no writedown was required for the year ended December 31, 1998 or 1997.

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

The cost of maintenance, repairs, and replacement of minor items of property is charged to maintenance expense. Renewals and betterments of assets are capitalized. Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are included in the determination of net income.

Depreciation, Depletion and Amortization

Depreciation, depletion and amortization of oil and gas properties, including the estimated future costs to develop proved reserves, is provided on the unit-of-production method based on the ratio of current year production to total estimated future production from proved reserves.

The provision for depreciation and amortization with respect to operations other than oil and gas producing activities is computed using the straight-line method based on estimated economic lives. Composite depreciation rates are applied to similar types of buildings and equipment having similar economic characteristics, as shown below:

<u>Asset Group</u>	<u>Average Life</u>
Buildings and land improvements	15-45 years
Machinery and Equipment (including refinery assets)	20-30 years
Vehicles and other	3-10 years

Capitalized Interest

Interest is capitalized on expenditures made in connection with capital projects (exclusive of oil and gas properties) that, theoretically, could have been avoided if expenditures for the assets had not been made. Interest is only capitalized for the period that activities are in progress to bring these projects to their intended use. During 1998, US\$ 13.5 million in interest costs were capitalized (US\$ 14.6 million during 1997).

Minority Interest in Subsidiary Companies

Minority interest in the consolidated balance sheets reflects minority owners' percent share of shareholders' capital in subsidiaries. The minority interest is calculated based on the shareholders' equity of each subsidiary as determined under US GAAP. The actual ruble denominated balance attributable to minority interests may differ from this amount. Minority owners' interest in the Company's subsidiaries, is as follows:

	<u>December 31, 1998</u>		<u>December 31, 1997</u>	
	<u>Voting</u>	<u>Total</u>	<u>Voting</u>	<u>Total</u>
Noyabrsk	21%	35%	21%	35%
OR	49%	62%	49%	62%
Geofizika	32%	49%	32%	49%
Nefteprodukt	49%	62%	49%	62%

Income Taxes

The Company is not subject to taxation on a consolidated basis. Current income taxes are provided on the accounting profit as determined under RAR at a rate of 35 percent, for the periods ended December 31, 1998 and 1997, after adjustments for certain items which are not deductible for taxation purposes, and after consideration of capital investment tax credits.

The accompanying consolidated financial statements reflect deferred income taxes of the Company and its subsidiaries using the liability method, which requires that deferred tax assets and liabilities be

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

recorded for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and loss or tax credit carryforwards (see Note 18).

Comprehensive Income

The Company adopted SFAS No. 130, "Reporting Comprehensive Income," effective January 1, 1998. This statement establishes standards for the reporting and display of comprehensive income (net income plus all other changes in net assets from non-owner sources) and its components in financial statements. For the years ended December 31, 1998 and 1997, comprehensive income equaled net profit.

Earnings per share

Earnings per common share have been determined using the weighted average number of shares outstanding during the year. Treasury shares are not considered to be outstanding for the purpose of such determination. There are no potentially dilutive securities.

Fair value of financial instruments

The following table presents the carrying amounts and approximate fair values of the Company's significant financial instruments at December 31, 1998 and 1997 (in US\$ millions). The carrying amount of all other financial instruments approximates fair value. SFAS No. 107, "Disclosure about Fair Value of Financial Instruments," defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

	<u>1998</u>		<u>1997</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Long - Term Debt	<u>US\$ 150</u>	<u>US\$ 43</u>	<u>US\$ 150</u>	<u>US\$ 91</u>

The Company has significant investments in trade and other accounts receivable for which a reasonable approximation of fair value is not practical. Management expects such receivables, net of allowances for doubtful accounts, to be settled as more fully described in Note 5.

As discussed in Note 7, the Company has investments in certain Russian companies carried at cost. There are no quoted market prices for these instruments and a reasonable estimate of fair value could not be made without incurring excessive costs. Management believes that carrying value is a reasonable approximation of fair value. If management becomes aware the fair value of certain investments is materially exceeded by carrying value, a specific valuation allowances will be recorded to provide for the specific investments.

Accounting for Contingencies

Certain conditions may exist as of the date these financial statements are issued, which may result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company's management and legal counsel assess such contingent liabilities. The assessment of loss contingencies necessarily involves an exercise of judgment and is a matter of opinion. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed. However, in some instances in which disclosure is not otherwise required, the Company may disclose contingent liabilities of an unusual nature which, in the judgment of management and its legal counsel, may be of interest to shareholders or others.

Revenue

Noyabrsk follows the policy of recognizing sales at the point its produced oil enters the transportation network.

Petroleum product sales are recognized when finished products are shipped to customers.

Retirement and Other Benefit Obligations

The Company and its subsidiaries do not have any substantial pension arrangements separate from the State pension scheme of the Russian Federation, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such contributions are charged to expense as incurred. In addition, the Company has no post-retirement benefits or significant other compensated benefits requiring accrual.

3. Change in Accounting Policy

During the year ended December 31, 1998, the Company retroactively changed its method of accounting for oil and gas properties from full cost to the successful efforts method. The change in method was made to improve comparability of the Company's financial statements with the financial statements of other major companies in the industry.

As a result of the change, net profit for the year ended December 31, 1998, was approximately US\$ 10.7 million less than it would have been if the change had not been made. The financial statements for the year ended December 31, 1997, have been retroactively restated for this change, which decreased previously reported net income and the beginning balance of accumulated deficit and reserves for that year by approximately US\$ 44.3 million, US\$ 1.2 million and US\$ 475.6 million, respectively.

4. Cash and Cash Equivalents

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

	1998	1997
Cash in bank - rubles	4,847	69,847
Cash in bank - hard currency	25,183	32,725
Cash equivalents	35,256	3,569
Cash on hand	45	2,553
Total cash and cash equivalents	<u>65,331</u>	<u>108,694</u>

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

As of December 31, 1998, the Company had a balance of US\$ 7 thousand with Noyabrskneftecombank, a related party (12% ownership). As of December 31, 1997, the Company had balances with related parties of US\$ 68.6 million, US\$ 128 thousand and US\$ 14 thousand in Obedineny Bank (19% ownership), Neftechimbank Bank (10% ownership) and Noyabrskneftecombank (12% ownership), respectively.

Cash equivalents as of December 31, 1998 include a US\$ 32 million deposit with Menatep Bank that has been guaranteed by AO Yukos, a major Russian integrated oil company.

5. Accounts Receivable

The composition of accounts receivable is as follows as of December 31, (in US\$ thousands):

	1998	1997
Trade receivables	157,943	266,244
Advances paid to suppliers	140,050	86,226
Value Added Tax receivable	30,261	85,362
Other	79,889	50,567
Less allowance for doubtful accounts	(54,797)	(65,611)
Total	<u>353,346</u>	<u>422,788</u>

In prior years, and due to government involvement in the subsidiaries, organizations in certain sectors of the economy were supplied with product irrespective of their ability to make repayments. Significant market reforms within Russia have reduced the availability of budgetary funds to many governmental and recently privatized enterprises. These budget deficits have further hindered the ability of large industrial and governmental organizations to make payment to suppliers on a timely basis.

For many industrial customers, amounts due can be offset against payables for services received. In order to further reduce a portion of the risk associated with customer non-payments, in certain circumstances, arrangements have been negotiated whereby payment is made in goods and services which are utilized in core business activities, promissory notes and government securities.

Management has provided a general allowance on amounts due from commercial and industrial customers principally based on the overall delinquency in customer payments. The Group's trade receivables are denominated primarily in rubles and are short-term in nature. However, in US\$ terms, due to significant delays in collection, the Company is subject to the economic risk of currency movements between the time of billing and the receipt of payment.

6. Inventories

The following are the major components of inventory as of December 31, (in US\$ thousands):

	1998	1997
Crude oil	8,440	12,206
Petroleum products	32,250	108,511
Materials and supplies	60,374	215,835
Other	29,140	81,394
Less reserve for materials and supplies	(13,735)	(19,370)
Total	<u>116,469</u>	<u>398,576</u>

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

7. Long-Term Investments

The Group owns equity interests in various Russian entities. These investments have been accounted for at cost, less any provisions for permanent diminution in value, regardless of ownership interest. US GAAP requires that investments in entities not controlled by the holding company, but in which the holding company's ownership percentage is greater than 20 percent, be accounted for using the equity method and that investments in entities controlled by the holding company be consolidated. The impact of the departure from US GAAP, concerning certain investments held at December 31, 1997, is not significant to the overall financial presentation.

None of the companies listed below are traded on the Russian Stock Exchange and due to the nature of the financial markets it is not possible to obtain a current market price for these investments, however, management believes that the costs of these investments approximate their fair value. The significant equity and other long-term investments in Russian companies are summarized below as of December 31, 1998 and 1997 (in US\$ thousands):

Name	Nature of Business	Ownership Percentage at December 31, 1998	1998	Ownership Percentage at December 31, 1997	1997
OOO Kapital	Investment	-	-	100%	53,727
OOO Vklad	Investment	-	-	89%	24,563
Neftechimbank	Bank	-	-	10%	10,000
Mosnefteproduct	Marketing	15%	9,223	15%	9,223
KOPF Bank	Bank	-	-	-	2,100
OOO Stolichnye Ivestitsii	Investment	-	-	24%	5,192
Vnesheconombank bonds	Bonds	N/A	5,498	N/A	4,974
Eastern Siberian Oil Co.	Oil & Gas	15%	2,907	15%	2,915
Noyabrskneftecombank	Bank	12%	1,580	12%	1,580
Other			2,406		3,745
			<u>21,614</u>		<u>118,019</u>

The Company disposed of its holdings in OOO Kapital, OOO Vklad and OOO Stolichnye Investitsii during the first half of 1998. As of December 31, 1998 the Company has not received payment and the balance receivable is denominated in rubles and presented in other accounts receivable.

8. Oil and Gas Properties

Oil and gas properties as of December 31, are as follows (in US\$ thousands):

	1998	1997
Oil and gas properties	7,500,612	7,354,883
Less: Depreciation, depletion and amortization	<u>(4,469,151)</u>	<u>(4,300,563)</u>
Net oil and gas properties	<u>3,031,461</u>	<u>3,054,320</u>

9. Property, Plant and Equipment

Property, plant and equipment as of December 31, is as follows (in US\$ thousands):

	1998	1997
Buildings	1,082,119	1,087,101
Machinery and equipment	1,664,707	1,651,328
Vehicles and other equipment	206,485	216,277
	<u>2,953,311</u>	<u>2,954,706</u>
Less: Accumulated depreciation	<u>(1,771,720)</u>	<u>(1,696,272)</u>
Net property, plant and equipment	<u>1,181,591</u>	<u>1,258,434</u>

10. Construction in Progress

Construction in progress includes various construction projects and machinery and equipment delivered but not yet installed. As of December 31, 1998, detail of construction in progress is as follows (in US\$ thousands):

	Construction Work in Progress	Machinery/ Equipment to be Installed	Total
Buildings	73,211	-	73,211
Plant and machinery	62,227	35,320	97,547
Vehicles and other equipment	26,702	16,378	43,080
Total	<u>162,140</u>	<u>51,698</u>	<u>213,838</u>
Comparative balance at December 31, 1997	<u>155,165</u>	<u>78,513</u>	<u>233,678</u>

11. Short-term Loans

As of December 31, the Group had outstanding loans as follows (in US\$ thousands):

	1998	1997
Banks	137,014	296,503
Related parties	183,357	27,674
Total	<u>320,371</u>	<u>324,177</u>

Bank loans are comprised of (1) export financing loan facilities in US\$ from major Western banks and their affiliates, secured by Noyabrsk crude production and (2) unsecured loans from Russian banks, denominated in rubles with fixed terms of repayment. Related party loans as of December 31, 1998 consist of amounts received from Runicom Ltd. and Noyabrskneftecombank of US\$ 176,025 and US\$ 7,332. The loan from Runicom Ltd. does not have an interest charge and was repaid prior to April 1, 1999. The interest rates on the loans from Noyabrskneftecombank range from 27% to 63%. Related party loans outstanding at December 31, 1997 consist of amounts due to Noyabrskneftecombank and Neftechimbank of US\$ 14,492 and US\$ 13,182, respectively. The interest rates on loans outstanding at the end of 1997 ranged from 24% to 31%.

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

In general, short-term loans are used for the provision of working capital needs. As of December 31, 1998 more than 95 percent of loans were provided in hard currency. The largest bank loans outstanding as of December 31, 1998 are amounts from "Credit Lyonnais Russie" and "Westduetsche Landesbank Dusseldorf". Sibneft has two lines of credit with "Credit Lyonnais Russie" with a total of US\$ 67 million outstanding at December 31, 1998. This balance is secured by crude oil production of Noyabrsk, bears interest at an annual rate of LIBOR plus 3% and is repayable from export proceeds on a month-to-month basis. The Company also has a short-term loan of US\$ 69 million from "Westduetsche Landesbank Dusseldorf." This loan bears floating interest at rates from LIBOR plus 5.75% and is secured by Noyabrsk export proceeds. The majority of the remaining balances of loans outstanding, at December 31, 1998, are denominated in rubles.

Weighted average interest rates related to the short-term loans outstanding as of December 31, 1998 for hard currency and ruble denominated loans equal 11 percent and 50 percent, respectively (10 and 25 percent, respectively for December 31, 1997). During the year ended December 31, 1998, the weighted average hard currency and ruble denominated short-term debt balances outstanding were US\$ 280 million and US\$ 0.2 million, respectively, with weighted average interest rates of 11 and 41 percent, respectively. During 1997, the weighted average hard currency and ruble denominated short-term debt balances outstanding were US\$ 122 million and US\$ 108 million, respectively, with weighted average interest rates of 10 and 30 percent, respectively.

12. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities as of December 31, comprise the following (in US\$ thousands):

	<u>1998</u>	<u>1997</u>
Trade accounts payable	176,480	228,707
Other accounts payable	134,083	160,114
Accrued liabilities	7,659	18,788
Total	<u>318,222</u>	<u>407,609</u>

Included in other accounts payable are promissory notes the Company issues to settle debts in the ordinary course of business. Balances outstanding as of December 31, 1998 and 1997 are US\$ 111,596 and US\$ 150,336, respectively. Notes payable are issued at face value, are ruble denominated, bear no interest, are transferable from one party to another, and have maturities ranging from three to six months. The Company will still honor notes payable past their original maturity.

13. Income and Other Taxes

Income and other taxes payable comprise the following as of December 31, (in US\$ thousands):

	<u>1998</u>	<u>1997</u>
<i>Amounts falling due within one year</i>		
Lubricant tax	37,954	159,433
VAT	8,142	84,596
Excise tax	18,647	84,461
Royalties	15,222	66,914
Road Users tax	16,760	63,818
Mineral Replenishment tax	4,697	18,079
Profits tax	818	17,003
Property tax	5,986	15,281
Other taxes payable	20,274	95,040

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

Fines, penalties and interest	14,181	136,000
Estimated income and other taxes payable	<u>142,681</u>	<u>740,625</u>
<i>Amounts falling due after one year</i>		
Long-term taxes payable (see below)	<u>21,017</u>	<u>14,555</u>

On December 31, 1997, in accordance with Decision No. 254 of March 5, 1997, the Prime Minister granted Noyabrsk approval for the deferral of principal tax debt payable to the federal budget as of January 1, 1997.

The deferral is made up of four separate decisions, providing for four payment periods of six, twelve, eighteen and twenty-four months. During November 1998, Noyabrsk registered tax bonds payable to the Government of the Russian Federation for a total of 868 million Rubles (US\$ 42,034), due in four equal installments throughout the deferral period. Interest is payable on the bonds at one quarter of the prevailing Central Bank rate at the time of bond repayment. The deferral arrangements are supported by a guarantee from Sibneft. Eighteen and twenty-four month bonds are represented within long-term taxes payable.

Noyabrsk has also successfully negotiated an agreement with the local tax inspectorate, whereby Noyabrsk's total fines, penalties and interest outstanding to the federal budget as of January 1, 1997 amounting to approximately 582 million rubles have been deferred over a 10 year period. As this long-term payable is denominated in rubles, the estimated net present value in US\$ terms is not significant and no related costs have been accrued have been made in these consolidated financial statements.

This agreement is subject to the continuing fulfillment of current tax obligations, and certain other obligations including the requirements of the deferral issued under Decision 254.

If any of the deferral schemes described above were withdrawn, the relevant sums together with a charge for penalties and interest arising as a result of the default would become payable immediately.

During February 1999, the Tax Ministry of the Russian Federation issued an order to reimburse Noyabrsk an amount of 588 million rubles (US\$ 28 million) related to VAT on "self-constructed assets", which had been previously accrued in the financial statements. Noyabrsk received permission to decrease its tax payments to the Federal budget during the first quarter 1999 by this amount. No accrual for this refund has been made in these consolidated financial statements as of December 31, 1998.

The information provided above should be read in conjunction with the following comments in relation to the general Russian taxation environment. Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax, corporate income tax (profits tax), a number of turnover based taxes, and payroll (social) taxes, together with others. In addition, the subsidiaries of the group are also subject to various industry taxes including excise and mineral replenishment taxes. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, implementing regulations are often unclear or nonexistent. Accordingly, few precedents with regard to issues have been established. Often, differing opinions regarding legal interpretation exist both among and within government ministries and organizations (like the State Tax Service and its various inspectorates); thus creating uncertainties and areas of conflict. Tax declarations, together with other legal compliance areas (as examples, customs and currency control matters) are subject to review and investigation by a number of authorities, who are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia substantially more significant than typically found in countries with more developed tax systems.

Generally, tax declarations remain open and subject to inspection for a period of six years. As of 31 December 1998, a substantial proportion of the tax declarations of the Company have been reviewed through to 1997. Management believes that the Company is in substantial compliance with the tax laws affecting its operations; however, the risk remains that the relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review during the six year period.

14. Accrued Site Restoration

Future site restoration costs represent the estimated future cost to abandon wells and production facilities. During 1998 and 1997, the Company has included US\$ 6.1 million and US\$ 11.5, respectively, of such costs as components of depreciation, depletion and amortization expense. The charge to depreciation, depletion and amortization during 1998 was offset by significant benefits arising from the devaluation of the ruble, resulting in a net decrease in the liability balance as of December 31, 1998.

The Company has estimated its liability based on site restoration costs incurred during 1998 and 1997 and will continue to update its estimates in the future. However, Russian environmental regulations and their enforcement can have a significant impact on these costs and, as governmental authorities are continually considering such regulations, the future costs associated with these liabilities may differ from the recorded amounts.

15. Long-Term Debt

During August 1997, Sibneft issued US\$ 150 million in Eurobonds, unconditionally guaranteed by the Company, Noyabrsk, OR, Geofizika, and Nefteprodukt. The Eurobonds bear interest from the date of issue (August 14, 1997) at a rate of 4% above the London Interbank Market rate for US\$ deposits, payable quarterly, commencing on November 14, 1997. Interest is payable in US\$. The maturity date of the notes is August 14, 2000.

Proceeds received by the Company totaled approximately US\$ 147.8 million, which is net of original issue discount and fees and commissions associated with the placement of the notes.

16. Capitalization

The shareholders' capital account represents the authorized capital of the Company, as stated in its charter document. The common shareholders are allowed one vote per share. Dividends paid to shareholders are determined by the directors and approved at the annual shareholders' meeting.

The following comprises the share structure of the Company, as of December 31, 1998:

	Number of Shares (millions)	Ownership Percentage
Finansovaya Neftyanaya Korporatsiya	2,303	51.0%
SINS (Siberian Investors)	858	19.0%
Refine Oil	677	15.0%
Runicom Ltd.	553	11.8%
Other Investors	125	3.2%
Total	<u>4,516</u>	<u>100.0%</u>

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

The following represents a reconciliation between total capitalization determined under RAR and US GAAP. For reconciliation purposes, the total capitalization in accordance with RAR, approximating 19,448 million rubles and 27,651 million rubles as of December 31, 1998 and 1997, respectively, were converted into US\$ at the year end exchange rates (in US\$ thousands).

	<u>1998</u>	<u>1997</u>
Russian Accounting Regulations	941,778	4,341,733
<i>Increase/(decrease) due to effect of:</i>		
Minority interest effects	(2,015,331)	(1,933,820)
Fixed assets valuation	3,496,136	(117,343)
Tax contingencies and other tax	-	(158,051)
Accrued site restoration	(84,102)	(146,500)
Allowance for bad debts	(54,797)	(65,611)
Inventory valuation	(18,246)	(19,370)
Investments valuation	(84,300)	(715)
Capitalized interest	28,101	14,571
Capitalized repair costs	4,087	4,087
Loans valuation	(226,636)	-
Net other income and expense adjustments	(12,564)	(41,882)
Other	(47,569)	13,313
US GAAP	<u>1,926,557</u>	<u>1,890,412</u>

The significant difference between the years regarding fixed asset valuation is principally attributable to the use of year-end exchange rates to translate RAR equity and the use of historical rates in the financial statements.

The following represents a reconciliation between earnings determined under RAR and US GAAP. For reconciliation purpose, net statutory income for years 1998 and 1997 in accordance with RAR, approximating 650,764 million rubles and 1,121 million rubles, respectively, were converted into US\$ at the year average exchange rates (in US\$ thousands).

	<u>1998</u>	<u>1997</u>
Pre-tax income per the statutory financial Statements	67,020	191,383
<i>Reconciling items:</i>		
Revenue and operating expense accruals, net	6,717	(62,773)
Other income and expense adjustments, net	(2,095)	11,344
Statutory expenses recorded to equity	(250,077)	(115,824)
Differences in depreciation	(142,462)	(28,093)
Bad debt provision, net impact	(19,498)	6,657
Tax contingencies reserve, net impact	126,720	(71,050)
Capitalized interest	13,530	14,571
Capitalized repair expenditures	-	4,087
Equity investments written off	(1,135)	(28,037)
Inventory obsolescence reserve, net impact	5,635	35,169
Site restoration provision	6,102	(11,500)
Foreign currency gain	286,800	31,650
Effect of Minority Interest	(81,511)	102,236
Other differences	37,744	25,711
US GAAP pre-tax income	<u>53,490</u>	<u>105,531</u>

17. Dividends

In accordance with RAR, earnings available for dividends are limited to profits, retained earnings and other income, denominated in rubles, after certain deductions.

The Company to date has not declared any common stock dividends. Dividends accrued by the subsidiaries relating to 1998, on preferred shares included 43 million rubles at Noyabrsk, 5 million rubles at Omsk Refinery and 5 million rubles at Nefteprodukt. Dividends declared by the subsidiaries in 1998, relating to 1997, on preferred shares included 6 million rubles at Noyabrsk, 3 million rubles at Omsk Refinery and 5 million rubles at Nefteprodukt.

18. Income Taxes

The Group's provision for income taxes as reported in the accompanying consolidated statements of operations is as follows (in US\$ thousands):

	1998	1997
Current income taxes	17,345	81,643
Deferred income taxes	-	-
Total provision for income taxes	<u>17,345</u>	<u>81,643</u>

The provision for income taxes represents the total income tax expense for the Company and each of its subsidiaries. In all cases deferred income taxes were calculated for each as an asset. Due to the Russian environment described in Note 1 and the corresponding uncertainty of realization, all of these assets have been fully reserved.

Although the Company does not pay tax on a consolidated basis, a reconciliation of expected income tax expense to the actual tax expense, for the years ended December 31, is as follows (in US\$ thousands):

	1998	1997
Income before income taxes	53,490	105,531
Statutory income tax rate	35%	35%
"Expected" income tax expense	<u>18,722</u>	<u>36,936</u>
Add (deduct) tax effect of:		
Minority interest effect on income	28,529	(35,783)
Dividends on preferred stock of subsidiaries	733	178
Temporary accounting differences, resulting in a net deferred tax asset which has been reserved	(45,419)	10,036
Permanent accounting differences	<u>14,780</u>	<u>70,276</u>
Income taxes	<u>17,345</u>	<u>81,643</u>
Effective tax rate	<u>32%</u>	<u>77%</u>

19. Commitments and Contingencies

Construction and Exploration Programs

The Group is engaged in continuous construction and exploration programs, currently estimated to total US\$ 668 million over the next five years at Noyabrsk and US\$ 32 million over the next two years for Omsk. The construction and exploration programs are subject to periodic reviews and actual expenditures may vary from the above estimates. At December 31, 1998, no significant purchase commitments were outstanding in connection with the construction programs.

Financing for all of the future costs has not yet been secured, and Sibneft is actively pursuing various financing opportunities. It is the opinion of management that the Company will be able to obtain all necessary financing to complete the construction programs.

Environmental Matters

Management is of the opinion that the Group has met the government's requirements concerning environmental matters, and therefore believes that the Group does not have any material current environmental liabilities.

Insurance Matters

The Group maintains only minimal levels of insurance on its existing asset base, or in certain cases self-insures, and as a result is subject to significant uninsured exposures in the event of loss or destruction of principal operating assets. In addition, Russian insurance providers do not offer business interruption insurance.

Social Assets

The Group possesses significant social assets for the use of employees. These assets were contributed by the State in years prior to the inception of the Company. In accordance with the Presidential Decree on privatization in Russia, the Group is required to transfer the social assets to the relevant local city administrations. Accordingly, as the Group does not have ownership of these assets, they are not recorded in these financial statements.

With respect to these social assets, the Group has incurred US\$ 35 million and US\$ 138 million in expenses for the years ended December 31, 1998 and 1997, respectively.

20. Related Party Transactions

Transactions with Shareholders

During 1998, approximately 12% of sales (15% during 1997) were made to a shareholder, Runicom Ltd. who principally exports refined product. As of December 31, 1998, the Group had outstanding trade receivables from the shareholder totaling US\$ 30 million (US\$ 45 million as at December 31, 1997), representing amounts outstanding in connection with these export sales.

As of December 31, 1998, the Group had prepaid a delivery of the equipment from Runicom Ltd., totaling US\$ 124 million. During the first quarter 1999, Runicom Ltd. has returned this prepayment.

21. Segment Information

Presented below is information about the Company's operating segments for the years ended December 31, 1998 and 1997, in accordance with SFAS 131, "Disclosures about Segments of an Enterprise and Related Information", which was adopted this year. The Company determined its operating segments based on differences in the nature of their operations. The exploration and production segments explore, find, develop and produce crude oil and natural gas. The manufacturing, marketing and distribution segments process crude oil and other feedstock into refined products and purchase, sell and transport crude oil and refined petroleum products.

AO Siberian Oil Company
Notes to the Consolidated Financial Statements
December 31, 1998

Operating Segments 1998

	Exploration and Production	Manufacturing, Marketing and Distribution	Consolidated
Revenues			
Total	942,608	1,789,816	2,732,424
Inter-segment eliminations	(477,584)	(473,817)	(951,401)
Outside	465,024	1,315,999	1,781,023
Operating profit (loss)	(132,274)	27,026	(105,248)
Capital expenditures, net	147,724	43,266	190,990
Depreciation, depletion and amortization	218,378	98,256	316,634
Total assets	3,200,354	1,793,742	4,994,096

Operating Segments 1997

	Exploration and Production	Manufacturing, Marketing and Distribution	Consolidated
Revenues			
Total	1,757,882	2,668,301	4,426,183
Inter-segment eliminations	(853,081)	(584,400)	(1,437,481)
Outside	904,801	2,083,901	2,988,702
Operating profit (loss)	(2,154)	(16,517)	(18,671)
Capital expenditures, net	447,733	87,027	534,760
Depreciation, depletion and amortization	328,290	93,783	422,073
Total assets	3,441,415	2,178,737	5,620,152

22. Subsequent Events

Issuance American Depository Receipts

On April 20, 1999 the Company launched a series of Level 1 American Depository Receipts ("ADR") after receiving permission from the U.S. Securities and Exchange Commission. 20 million ADRs, in units of 10 shares each, have been authorized for trade on the over-the-counter market, with the Bank of New York as the depository bank. The ADR's represent approximately 4.2 percent of the Company's total share capital.

Level One ADRs do not involve issuing new shares or raising capital. Instead they are market instruments to encourage liquidity in trade in a given company, and are usually issued as a first step towards a full exchange-listed Level 3 ADR. The Company has a stated long-term goal of issuing a full Level 3 ADR listed on the New York Stock Exchange, and is planning to accomplish this goal by 2002.

Acquisition of Additional Shares in Noyabrsk

During the first four months of 1999, the Company increased its ownership share of Noyabrsk and Geophysica to exceed 95% through several share swaps with previous Noyabrsk minority shareholders. The Company plans to complete similar share acquisitions concerning Omsk Refinery and Nefteprodukt by the end of 1999.