OJSC Rosneft Oil Company

Consolidated Financial Statements
Prepared in Accordance with US GAAP

As of and for the Six-Month Period Ended June 30, 2004

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Contents

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Report of Independent Auditors

To the Shareholder and Board of Directors
of OJSC Rosneft Oil Company

We have audited the accompanying consolidated balance sheets of OJSC Rosneft Oil Company, an open joint stock company, and subsidiaries (the "Company") as of June 30, 2004 and December 31, 2003 and the consolidated statements of income, changes in shareholder's equity, and cash flows for the six months ended June 30, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of June 30, 2004 and December 31, 2003, and the consolidated results of its operations and its cash flows for the six months ended June 30, 2004, in conformity with accounting principles generally accepted in the United States of America.

Ernst & Young LLC

December 10, 2004

OJSC Rosneft Oil Company

Consolidated Balance Sheets

as of June 30, 2004 and December 31, 2003

(Currency – thousands of US dollars)

	Notes	June 30, 2004	December 31, 2003
ASSETS			
Current assets:			
Cash and cash equivalents	**3**	**$ 205,508**	$ 235,212
Short-term investments	**4**	**323,350**	290,613
Accounts receivable, net of allowance for doubtful accounts of US$51,606 and US$61,834, respectively	**5**	**1,025,488**	887,312
Inventories	**6**	**367,987**	336,571
Deferred tax assets	**21**	**14,107**	23,494
Prepaid expenses	**7**	**83,140**	67,889
Total current assets		**2,019,580**	1,841,091
Non-current assets:			
Long-term investments	**8**	**373,513**	288,629
Oil and gas properties, net	**9, 12**	**3,351,005**	3,232,261
Property, plant and equipment, net	**10, 12**	**1,060,397**	1,043,539
Construction-in-progress	**11**	**407,234**	368,222
Deferred tax assets	**21**	**4,102**	19,826
Other non-current assets, net of allowance of US$6,904 and US$667, respectively	**13**	**15,189**	3,838
Total non-current assets		**5,211,440**	4,956,315
Total assets		**$ 7,231,020**	$ 6,797,406
LIABILITIES AND SHAREHOLDER'S EQUITY			
Current liabilities:			
Accounts payable and accruals	**14**	**$ 709,147**	$ 698,909
Short-term loans and current portion of long-term debt	**15**	**746,455**	587,830
Accrued income and other taxes	**17**	**167,976**	130,771
Deferred tax liability	**21**	**–**	3,579
Other current liabilities		**6,140**	5,232
Total current liabilities		**1,629,718**	1,426,321
Asset retirement obligations	**18**	**132,961**	126,488
Long-term debt	**15**	**1,791,884**	1,822,047
Deferred tax liability	**21**	**32,511**	70,958
Minority interest	**19**	**806,293**	789,106
Total liabilities		**4,393,367**	4,234,920
Commitments and Contingencies	**22**	**–**	–
Shareholder's equity:			
Preferred stock (shares authorized and outstanding: 1,446,047 in 2004 and 2003)	**16**	**247**	247
Common stock (shares authorized and outstanding: 89,475,693 in 2004 and in 2003)	**16**	**19,454**	19,454
Additional paid-in capital	**16**	**19,157**	19,157
Accumulated other comprehensive income		**–**	12,930
Retained earnings		**2,798,795**	2,510,698
Total shareholder's equity		**2,837,653**	2,562,486
Total liabilities and shareholder's equity		**$ 7,231,020**	$ 6,797,406

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

OJSC Rosneft Oil Company

Consolidated Statement of Income

For the Six-Month Period Ended June 30, 2004

(Currency – thousands of US dollars)

	Notes	For the six-month period ended June 30, 2004
Revenues		
Oil and gas sales	20	$ 1,150,987
Refined products and processing fees	20	1,030,796
Support services and other sales		119,216
Total		2,300,999
Operating and other expenses		
Cost of extraction of oil and gas sold		147,687
Cost of produced and purchased refined products, and processing fees		306,106
Cost of support services and other sales		72,070
Selling and administrative expenses		101,734
Pipeline tariffs and transportation costs		237,579
Exploration expenses		38,584
Depreciation, depletion and amortization		183,201
Accretion expense		3,618
Taxes other than income tax		417,395
Excise tax and export customs duties		266,654
Total		1,774,628
Operating income		526,371
Other income/(expense)		
Interest income		20,118
Interest expense		(71,386)
Loss on disposals of property, plant and equipment		(4,278)
Gain on sale of investments, net		12,430
Earnings from equity investments		25,014
Earnings from joint ventures		22,099
Other expenses, net	22	(80,339)
Currency translation gain		30,139
Total other expenses		(46,203)
Income before income tax		480,168
Income tax expense	21	(118,582)
Income before minority interest		361,586
Minority interest in subsidiaries' earnings		(21,814)
Net income		$ 339,772

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

OJSC Rosneft Oil Company

Consolidated Statement of Changes in Shareholder's Equity

For the Six-Month Period Ended June 30, 2004

(Currency – thousands of US dollars)

	Preferred stock	Common stock	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Shareholder's equity
Balance at December 31, 2003	$ 247	$ 19,454	$ 19,157	$ 12,930	$ 2,510,698	$ 2,562,486
Net income for the period	–	–	–	–	**339,772**	**339,772**
Realized gain from disposal of securities	–	–	–	**(12,930)**	–	**(12,930)**
Dividends declared on common stock	–	–	–	–	**(51,675)**	**(51,675)**
Balance at June 30, 2004	**$ 247**	**$ 19,454**	**$ 19,157**	**$ –**	**$ 2,798,795**	**$ 2,837,653**

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

OJSC Rosneft Oil Company

Consolidated Statement of Cash Flows

For the Six-Month Period Ended June 30, 2004

(Currency – thousands of US dollars)

	For the six-month period ended June 30, 2004
Operating activities	
Net income	**$ 339,772**
Reconciliation of net income to net cash provided by operating activities:	
Non-cash activities	**13,950**
Currency translation (gain) on cash and cash equivalents	**(1,548)**
Depreciation, depletion and amortization	**183,201**
Accretion expense	**3,618**
Exploration expenses	**38,584**
Loss on disposals of property, plant and equipment	**4,278**
Deferred income tax	**(16,915)**
Equity share in affiliates' earnings	**(25,014)**
Decrease in allowance for doubtful accounts	**(4,190)**
Minority interests in subsidiaries' earnings	**21,814**
Changes in operating assets and liabilities net of acquisitions:	
Increase in accounts receivable	**(127,948)**
Increase in inventories	**(31,416)**
Increase in prepaid expenses	**(15,251)**
Increase in other non-current assets	**(17,389)**
Decrease in accounts payable and accruals	**(39,474)**
Increase in accrued income and other taxes	**37,205**
Increase in other current liabilities	**908**
Net cash provided by operating activities	**364,185**
Investing activities	
Capital and exploration expenditures	**(326,538)**
Proceeds from sale of fixed assets	**38,077**
Purchase of equity share in affiliates	**(84,583)**
Acquisitions of short-term investments	**(272,575)**
Proceeds from sale of short-term investments	**168,880**
Proceeds from sale of long-term investments	**15,597**
Purchase of long-term investments	**(75,466)**
Net cash used in investing activities	**(536,608)**
Financing activities	
Proceeds from short-term debt	**948,722**
Repayment of short-term debt	**(1,027,965)**
Proceeds from long-term debt	**657,674**
Repayment of long-term debt	**(430,669)**
Common and preferred dividends paid	**(6,591)**
Net cash provided by financing activities	**141,171**
Decrease in cash and cash equivalents	**(31,252)**
Cash and cash equivalents at beginning of year	**235,212**
Effect of currency translation	**1,548**
Cash and cash equivalents at end of year	**$ 205,508**
Supplemental disclosures of cash flow information	
Cash paid for interest (net of amount capitalized)	**$ 67,772**
Cash paid for income taxes	**$ 114,552**
Supplemental disclosure of non-cash activities	
Income taxes off-sets	**$ 23,538**
Non-cash capital expenditures	**$ (38,730)**
Non-cash disposal of assets	**$ 13,952**

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

1. General

Nature of Operations

OJSC Rosneft Oil Company ("Rosneft") and its subsidiaries, (collectively the "Company"), are principally engaged in exploration, development, production and sale of crude oil and gas, and the refining, transportation and sale of petroleum and gas products in the Russian Federation ("RF") and abroad.

State enterprise Rosneft was incorporated as an open joint stock company on December 7, 1995. All assets and liabilities previously managed by the state enterprise Rosneft were transferred to the Company at their book value effective on that date together with the Government of the Russian Federation (the "State") ownership in other privatized oil and gas companies. The transfer of assets and liabilities was made in accordance with Resolution No. 971, "On the transformation of Rosneft into an open joint stock company NK Rosneft", dated September 29, 1995. Such transfers represent a reorganization of assets under the common control of the State and, accordingly, are accounted for at their book value. As of June 30, 2004, the State through the RF Ministry of Property maintains a 100 % interest in Rosneft.

Under Russian legislation, natural resources, including oil, gas, precious metals and minerals and other commercial minerals situated within the territory of the Russian Federation are the property of the State until they are extracted. The Law of the Russian Federation No. 2395-1, "*On Subsurface Resources",* regulates relations arising in connection with the geological study, use and protection of subsurface resources within the territory of the Russian Federation. Pursuant to the Law, subsurface resources may be developed only on the basis of a license. The license is issued by the regional governmental body and contains information on the site to be developed, the period of activity, financial and other conditions. The Company holds several licenses issued by Regional authorities for development of oil and gas blocks and deposits in areas where its subsidiaries are located.

In addition, the Company has been participating in a Production Sharing Agreement (PSA). As a result, Rosneft has certain rights to developing license blocks according to the existing PSA and may receive certain rights in the future.

Due to the limited capacity of OJSC Transneftpipeline system, the Pipeline Commission of the Russian Government sets the export quotas for each oil company based on the legislation on equal access to the oil pipeline system. In addition, the Company exports certain quantity of crude oil bypassing the OJSC Transneft system and thus has more favorable export capacities. In 2003 oil export sales slightly exceeded results of other oil companies. In the first six months of 2004 and in 2003 the Company's export sales have approximated 56% and 51% of production, respectively. The remaining production was processed at the Company's refineries and other Russian refineries for further sales on the domestic and international markets. Generally, export sales result in a higher net realized price than Russian domestic sales after considering related transportation and export duties and other charges.

1. General (continued)

Nature of Operations (continued)

In the course of its ordinary activities the Company regularly carries out transactions with other enterprises directly or indirectly controlled by the RF government. Such enterprises encompass business units of RAO UES, OJSC Gazprom, OJSC Sberbank as well as federal agencies including tax authorities.

Principal subsidiary companies included in the consolidated financial statements and ownership interests of Rosneft as of June 30, 2004 are as follows:

Name	Nature of Business	Total Shares	Voting Shares
		%	%
Exploration and production			
OJSC Rosneft-Purneftegaz	Oil and gas development and production	83.09	90.82
OJSC Rosneft-Sakhalinmorneftegaz	Oil and gas development and production	63.34	84.30
OJSC Rosneft-Krasnodarneftegaz	Oil and gas development and production	51.06	59.29
OJSC Rosneft-Stavropolneftegaz	Oil and gas development and production	71.95	87.75
OJSC Rosneft-Dagneft	Oil and gas development and production	68.70	91.60
OJSC Grozneftegaz	Oil and gas development and production	51.00	51.00
OJSC Rosneft-Termneft	Oil and gas development and production	38.00	50.67
OJSC Rosneft-Sakhalin	Oil and gas exploration and development	55.00	55.00
OJSC Severnaya Neft (Northern Oil)	Oil and gas development and production	100.00	100.00
OJSC Selkupneftegaz	Oil and gas development and production	66.00	66.00
Caspoil LLC	Oil and gas development and production	75.10	75.10
Rosneft International Ltd. LLC	Holding company for investments in oil and gas production entities	100.00	100.00
CJSC Vostokshelf	Field survey and exploration	100.00	100.00
RN- LLC Kazakhstan	Field survey and exploration	99.00	99.00
OJSC Dagneftegaz	Oil and gas development and production	81.22	94.96
CJSC Elvarineftegas	Field survey and exploration	99.00	99.00
RN-Kaiganneftegas LLC	Field survey and exploration	99.00	99.00
Refineries			
OJSC Rosneft-Tuapse Refinery	Petroleum refining	39.53	52.70
OJSC Rosneft-Komsomolsky Refinery	Petroleum refining	77.31	83.31
OJSC Rosneft-MZ Nefteproduct	Petroleum refining	65.42	87.23
Petroleum marketing and distribution			
OJSC Rosneft-ARTAG	Marketing and distribution	38.00	50.67
OJSC Rosneft-Altainefteproduct	Marketing and distribution	64.18	78.59
OJSC Rosneft-Arkhangelsknefteproduct	Marketing and distribution	75.42	84.65
OJSC Rosneft-Kabardino-Balkarskaya Toplivnaya Company	Marketing and distribution	38.00	50.67
OJSC Rosneft-Kubannefteproduct	Marketing and distribution	69.72	90.22
OJSC Rosneft-Karachaevo-Cherkessknefteproduct	Marketing and distribution	85.99	87.46
OJSC Rosneft-Kurgannefteproduct	Marketing and distribution	38.00	50.67
OJSC Rosneft-Murmansknefteproduct	Marketing and distribution	45.36	60.47
OJSC Rosneft-Nakhodkanefteproduct	Marketing and distribution	38.00	50.67
OJSC Rosneft-Smolensknefteproduct	Marketing and distribution	66.67	86.97
OJSC Rosneft-Tuapsenefteproduct	Marketing and distribution	38.00	50.67
OJSC Rosneft-Yamalnefteproduct	Marketing and distribution	49.52	66.03
RN-Vostoknefteproduct LLC	Marketing and distribution	100.00	100.00
OJSC Rosneft-Stavropolye	Marketing and distribution	97.06	97.06

1. General (continued)

Nature of Operations (continued)

Name	Nature of Business	Total Shares	Voting Shares
		%	%
Other			
RN-Teleport LLC	Information technology	99.00	99.00
OJSC All-Russian Bank for Reconstruction and Development of Russian Regions (VBRR) or The Bank	Bank services	50.98	50.98
RN-Perspektiva LLC	Corporate planning	99.00	99.00
Rosneftetrans LLC	Transportation services	95.00	95.00
CJSC RN-Astra	Investment activities	99.00	99.00
CJSC Sakhalinskie Proekty	Corporate planning	100.00	100.00
CJSC Vostochny Neftenalivnoy Terminal	Services	100.00	100.00
Vostochnaya Stroitelnaya Kompania LLC	Construction services	51.23	51.23

All of the above subsidiaries, except for Rosneft International Ltd. LLC, which is registered in Ireland, are incorporated in the Russian Federation.

In the first half of 2004 the Company acquired 100.00% of Losiem Commercial shares for US$ 69 million. The purpose of the transaction was to acquire 100% (approximately 60% was held as of December 31, 2003) control over the LLC Eniseyneft which holds licenses for proved, probable and possible oil and gas reserves in a new prospective region of Russia with no infrastructure and oil and gas transportation systems. According to the report by DeGoyler and MacNaughton, as of December 31, 2003, proved reserves of oil and gas for these companies total 24 million tons, with probable reserves being 41 million tons. The discounted cash flows according to DeGoyler and MacNaughton equals US$ 1,085 million.

The excess of acquisition cost over the respective share of net liabilities in the amount of US$74.5 million was allocated to capitalized costs related to proved and probable reserves based on the correlation between the future cash flows generated by proved and probable reserves according to the DeGoyler and MacNaughton report with adjustments for certain discount factors. Accordingly, additionally US$ 52.5 million was allocated to proved reserves (US$ 92.3 in total). The total accumulated amount of US$ 132.1 million allocated to capitalized costs is subject to annual impairment review. The Company's management believes that as of June 30, 2004 no write down is necessary.

The Company did not acquire any other significant interest in subsidiaries within the first six months of 2004.

According to the long-term program of selling non-core assets, the Company is selling subsidiaries engaged in non-core businesses. During the first six months of 2004, interests in CJSC FK Rosneft-Finance and SK Neftepolis LLC were sold. The resulting gain from the sale of these interests was recognized in the consolidated financial statements in the amount of US$ 1.4 million.

1. General (continued)

Russian Business Environment

The Russian economy was deemed to be of market status with greater investment potential beginning from 2002. During the first half of 2004 certain main rating agencies and organizations have reported increases to the credit rating of the Russian Federation, which is generally regarded as improving the attitude of investors to the Russian Federation. Increased credit rating cardinally changes the attitude of investors to the Russian Federation. Further, in the first half of 2004 the Russian Federation signed an agreement with the European Union on joining the World Trade Organization (WTO). It is generally understood that the Government activities are intended to stabilize and successfully develop the political and economic situation in Russia.

While there is a general view of an improving environment, the environment does still have certain traits of a market in transition, for example inflation is not low enough, lack of liquidity in the capital markets and the existence of currency controls, which cause the national currency to be illiquid outside of Russia. In addition laws and regulations, including interpretations, enforcement and judicial processes, continue to evolve in Russia. Other laws and regulations and certain other restrictions producing the significant effect on the Company's industry include the following issues: rights of use of subsurface resources, site remediation, transportation and export, corporate governance, taxation, etc.

Currency Exchange and Control

Foreign currencies, in particular the US dollar and Euro, play a significant role in the underlying economics of many business transactions in Russia. For the oil and gas sector in particular, substantial export arrangements as well as investing and financing activities are conducted in hard currencies such as the US dollar.

The Central Bank of Russia (the "CBR") has established currency control regulations for managing ruble supply and demand and available hard currencies. Such regulations place restrictions on the conversion of rubles into hard currencies and retain the CBR's powers to independently impose the quota of mandatory conversion of hard currency sales to rubles in the amount of up to 30% of export revenues. During the second half 2004 the quota of mandatory conversion of hard currency sales to rubles was decreased to 10%.

While in recent years conversion requirements have been reduced, such matters continue to be a substantial consideration for many companies in managing currency risks.

The Company conducts a substantial portion of its commercial activities using US dollar denominated contracts. In addition, substantial financing and investing activities, obligations and commitments are also based on the US dollar. However, many operating and investing expenditures, as well as taxation and statutory actions are conducted in rubles. Due to the $US exchange rate decrease the Company has respective foreign exchange risk, which is currently mitigated by crude oil prices growth. The Company is mitigating this risk by increasing export sales of crude oil and oil products.

2. Summary of Significant Accounting Policies

Form and Content of the Consolidated Financial Statements

The Company maintains its books and records in accordance with accounting and taxation principles and practices mandated by the Russian legislation. The accompanying consolidated financial statements were derived from the Company's Russian statutory books and records with adjustments and reclassifications made to present them in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). These adjustments are standard and are repeated every reporting period.

These consolidated interim financial statements has been prepared in accordance with the Accounting Principle Board (APB 28), "*Interim financial statements*".

None of the preceding interim consolidated financial statements were audited or reviewed; therefore the statements of income, cash flows and changes in shareholders' equity are presented without the comparative information for 2003. The Company's management believes that the information presented in the accompanying financial statements includes all adjustments and disclosures required to present fairly the results of the Group's operations, its financial position and cash flows for the period presented.

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

Certain amounts in the fiscal 2003 consolidated balance sheet, as previously reported, have been reclassified to conform to the presentation for the six-month period ended June 30, 2004.

Management Estimates

The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheet as well as the revenues and expenses during the reporting period. Certain significant estimates and assumptions for the Company include: estimation of economically recoverable oil and gas reserves; rights to and recoverability of long-term assets and investments; provisions for uncollectible accounts receivable; asset retirement obligations; legal and tax contingencies; environmental remediation obligations; recognition and disclosure of guarantees and other contingencies. Management believes it has a reasonable and appropriate basis for its judgment pertaining to its estimates and assumptions. However, actual results could differ from those estimates.

2. Summary of Significant Accounting Policies (continued)

Principles of Consolidation

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

The Company reviewed the application of FIN 46R, "*Consolidation of Variable-Interest Entities (VIEs)*", for potential consolidation of companies. FIN 46R shall be applied in the current reporting period for VIEs created after December 31, 2003, and in the reporting period beginning after December 15, 2004, for all other VIEs. The Company did not identify any VIEs required to be consolidated as of June 30, 2004.

Minority Interest in Subsidiaries

Minority interest in the consolidated balance sheets reflects minority owners' percentage of net assets of 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. Preferred shareholders of the Company's subsidiaries are entitled to a dividend of 10.00 % of statutory net profit, as generally determined under the Charters of Rosneft subsidiaries.

Foreign Currency Translation

On November 25, 2002, the AICPA International Practices Task Force concluded that Russia would no longer be considered a highly inflationary economy for the purposes of Statement of Financial Accounting Standard (SFAS) 52 *"Foreign Currency Translation"* effective January 1, 2003. Accordingly, the Company re-assessed its functional currency and determined that US dollar will continue to be used as the functional currency for the purposes of US GAAP financial statements effective January 1, 2003. Since the US Dollar was the functional currency in prior years, the change from the hyperinflation status did not have a significant effect in comparability.

Since the Company's books of record are maintained in Rubles, it must remeasure those balances under SFAS 52. Monetary assets and liabilities have been translated into US dollars at the exchange rate at balance sheet date. Non-monetary assets and liabilities have been translated at historical rates. Data on revenues, expenses, and cash flows are translated into US dollars at historical exchange rates prevailing on the transactions dates. Gains and losses resulting from the remeasurement into US dollars are included in the consolidated statement of income.

As of June 30, 2004 and December 31, 2003, the official rates of exchange were 29.03 rubles for one US dollar and 29.45 rubles for one US dollar, respectively.

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

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

Accounts Receivable

Accounts receivable are shown at their net realizable value, which approximates fair value, and are presented net of an allowance for doubtful accounts. Management calculates a specific allowance for significant doubtful accounts and estimates the allowance for others based on aging categories and historical write-offs.

Long-term accounts receivable restructured under the amicable agreement is recognized net of the loan loss provision, which was calculated based on SFAS 114, *"Accounting by Creditors for Impairment of a Loan"*. Under this standard, the loan loss provision related to such accounts receivable is calculated based on discounted cash flow, with the interest rate reflecting the cost of raising funds from the debtor taken as a discount rate.

Inventories

Inventories, consisting primarily of crude oil, petroleum products and materials and supplies, are stated at the lower of weighted average cost or net realizable value.

Financial Investments

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

Trading securities are mainly acquired for sale in the near future. Securities held to maturity represent financial instruments which the Company wishes and is able to hold to maturity. All other securities, which do not fall into these two categories, are considered securities available-for-sale.

Trading securities and securities available-for-sale are carried at fair (market) value. Securities held to maturity are carried at cost adjusted for depreciation or increase in premiums or discounts. Unrealized gains or losses on trading securities are included in the consolidated income statement. Unrealized gains and losses on securities available for sale are recorded net as an increased or decreased to accumulated other comprehensive income until the time of sale.

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

2. Summary of Significant Accounting Policies (continued)

Oil and Gas Properties

The Company follows the successful efforts method of accounting for its oil and gas exploration and production activities. Under this method, exploration costs, including geological and geophysical costs and dry hole costs are charged to expenses as incurred. Costs to acquire proved and unproved properties are capitalized and amortized as discussed below. Costs of drilling exploratory wells, including stratigraphic test wells and seismic costs, are capitalized pending determination whether such properties contain or wells have found proved reserves which justify commercial development. If such reserves are not found, the drilling costs are charged to exploration 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. Costs of unproved properties are not amortized, rather are transferred to proved properties when such classification of reserves occurs. Unproved costs that do not result in proven reserves are impaired or written-off to expenses when such determination is made.

As of December 31, 2003 the Company used oil and gas reserves determined in accordance with the US GAAP definitions and independently estimated by DeGoyler and MacNaughton. The Company used the reserve report to calculate the depreciation, depletion and amortization, relating to oil and gas properties for six months of 2004 and 12 months of 2003.

Gains and losses are not recognized for normal retirements or sales of oil and gas related facilities subject to composite depreciation, depletion and amortization. It is assumed that liquidated oil and gas properties are fully depleted.

Investment in Production Sharing Agreements and Mineral Properties

The Company's primary investment in a PSA is through Sakhalin-1 (PSA 1), which is operated by ExxonMobil, one of the PSA participants. In February 2001, the Company signed an agreement with ONGC Videsh Ltd. ("ONGC") in relation to its interest in the PSA 1. Based on the terms of the arrangements and in accordance with SFAS 19 *"Financial Accounting and Reporting by Oil and Gas Producing Companies"* for the accounting for mineral conveyances, the Company treated the arrangement with ONGC as a sale of a partial mineral interest and a "carried interest" for the retained interest in the PSA (see Note 10). The Company carries the investment in its remaining interest at the cost of that investment. Funding payments made by ONGC for the Company's portion of development costs are not recognized by the Company as an obligation and also do not increase assets of the Company. In addition, net funds from operating activities associated with the retained interest will be recognized only to the extent that such funds or interests do not accrue to the benefit of ONGC for recovery of its investment in the carried interest. Due to the participation percentage, the nature of the investment and other arrangements, the Company considers its investment in PSA 1 to be equivalent to an equity interest in a business venture. As a result, it accounts for its investment in accordance with the equity method of accounting.

2. Summary of Significant Accounting Policies (continued)

Investment in Production Sharing Agreements and Mineral Properties (continued)

The Company is party to other projects associated with the development of the Sakhalin shelf. Under those arrangements, other participants have agreed to pay for certain exploration costs on behalf of the Company for the respective projects. The exploration and development of these projects is in the initial stages. Costs incurred by Rosneft associated with these projects are capitalized. The Company does not presently have significant costs associated with these investments. The Company's accounting for its participation in these projects will be evaluated as terms and conditions develop to determine if it accounts for those interests as investments in mineral interest in oil and gas operations or equity investments.

Property, Plant and Equipment

Property, plant and equipment are stated at historical cost translated as at the date of acquisition net of accumulated depreciation. 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.

Impairment of Long-Lived Assets

From January 1, 2002 the Company has adopted SFAS 144 *"Accounting for the Impairment or Disposal of Long-Lived Assets"*. SFAS 144 establishes a probability weighted cash flow estimation approach to deal with situations in which there is a range of cash flows that may be generated by the asset being tested for impairment.

<u>Exploration and Development Assets</u> – The recoverability of oil and gas properties, net of accumulated depreciation, is assessed whenever events or circumstances indicate a potential impairment.

Such assessment includes comparison of the book value of oil and gas properties with estimated non-discounted future cash flows before tax.

Revenues used in calculating future cash flows before tax are determined based on selling prices paid by end users and oil and gas reserves.

The test is performed for each extraction division (NGDU), which is generally the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets.

<u>Refining, Marketing and Distribution</u> – The recoverability of these assets are generally evaluated based on the evaluation of cash flows on the basis of key operating unit, generally legal entities. Because the assets of this segment (particularly the refining units) are largely an integrated set of operations, recognition of this condition is considered in evaluating a particular units value or utilization to generating other cash flows.

2. Summary of Significant Accounting Policies (continued)

Depreciation, Depletion and Amortization

All capitalized costs related to oil and gas producing activities and capitalized interest are depleted using the unit-of-production method. Management of the Company considers each NGDU as a depletable geological structure. The depletion rate per unit of production (ton, barrel) is calculated by dividing the net depletable assets by the remaining estimated economically recoverable proved developed crude oil and gas reserves in respect of production assets. For the cost of acquired proven reserves the unit of production rate is based on total proved reserves. This rate is multiplied by the current year crude oil production to determine the depletion charge for the year.

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 their useful lives.

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

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

Capitalized Interest

Interest is capitalized on expenditures made in connection with the capital projects that, theoretically, could have been avoided if expenditures for the assets had not been made. Interest and investments in unproved properties is only capitalized for the period when activities are in progress to bring these projects to their intended use. The Company capitalized US$12.8 million during the first six months of 2004.

Asset Retirement Obligations

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

- Exploration and Production – The Company's field exploration, development, and production activities includes assets related to: well bores and related equipment and operating sites, gathering and oil processing systems, oil storage and pipelines to main transportation trunks. Generally, its licenses and other operating permits require certain actions to be taken by the Company in the abandonment of these operations after the end of production. Such actions include well abandonment activities, equipment dismantlement and other reclamation activities. The Company's estimates of future abandonment costs consider present regulatory or license requirements and are based upon management's experience of the costs and requirement of such activities. Presently, the Company has not conducted significant offshore drilling and development activities for which it is a responsible party.

2. Summary of Significant Accounting Policies (continued)

Asset Retirement Obligations (continued)

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

  The Company's marine and distribution terminals, as well as retail locations, operate under permits from local regulatory bodies and leasing arrangements. These arrangements generally direct the Company to take certain actions to abandon those operations. Such actions include dismantling of equipment and reclamation of land and other property. The Company's estimate of future abandonment costs considers these requirements.

Inasmuch as the regulatory and legal environment in Russia continues to evolve, there could be future changes to the requirements and contingencies associated with the retirement of long-lived assets.

Fair Value of Financial Instruments

SFAS 107 *"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.

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

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

2. Summary of Significant Accounting Policies (continued)

Income Taxes

The Company is not subject to Russian taxation on a consolidated basis. Current income taxes are provided on the accounting profit as determined under local accounting principles at the applicable local tax rates after adjustments for certain items which are not deductible for taxation purposes, and after consideration of tax allowances. Deferred income taxes are determined using the liability approach in accordance with SFAS 109 *"Accounting for Income Taxes"*. This method gives consideration to the future tax consequences based on the effective tax rate associated with differences between the financial reporting and tax basis of assets and liabilities and gives immediate income statement effect to changes in income tax laws, including changes in the tax rates. A valuation allowance is recorded to reduce deferred tax assets when management believes it is more likely than not that a tax benefit will not be realized.

The Company also applies the provisions of APB 28 *"Interim Financial Reporting"* to arrive at the best estimate of the effective tax rate to be applied to the interim income before tax based on the projection of the effective tax rate for the full fiscal year.

Recognition of Revenues

Revenues are recognized when title passes to the customer, the selling price is fixed or determinable and collectibility is reasonably assured. Specifically, domestic crude oil sales and petroleum product and materials sales are recognized when they are shipped to customers, which is generally when title passes. For export sales, title generally passes at the border of the Russian Federation and the Company is responsible for transportation, duties and taxes on those sales. Therefore, revenues include excise taxes and custom duties. Sales of support services are recognized as services are performed providing that the price for the service can be determined and no significant uncertainties regarding realization exist.

Refinery Shutdown Costs

The Company recognizes costs of overhauls and preventive maintenance as expenses when incurred.

Comprehensive Income

The Company applies SFAS 130 *"Reporting Comprehensive Income"* which 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 consolidated financial statements. As of December 31, 2003 the Company recorded other accumulated comprehensive income in the consolidated financials in the amount of US$ 13 million related to unrealized holding gain resulting from valuation of securities available-for-sale at their market value. There was no tax effect as a result of this transaction.

In the first six months of 2004 the securities were sold, and unrealized gain of these securities was recognized as other income together with the gain from sales of securities. There are no other comprehensive income items in the six-month period ended June 30, 2004 and, therefore, comprehensive income equals net income.

2. Summary of Significant Accounting Policies (continued)

Accounting for Contingencies

Certain conditions may exist as of the date these consolidated 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 assesses 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 or tax proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal or tax counsel evaluates the perceived merits of any legal or tax proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

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

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

3. Cash and Cash Equivalents

Cash and cash equivalents as of June 30, 2004, and December 31, 2003, comprise the following:

	June 30, 2004	**December 31, 2003**
Cash in bank and on hand – rubles	**$ 119,164**	$ 93,002
Cash in bank – hard currency	**52,289**	100,125
Interest bearing deposits – hard currency	**689**	12,630
Cash equivalents and other	**33,366**	29,455
Total cash and cash equivalents	**$ 205,508**	$ 235,212

Cash in bank and on hand in rubles includes obligatory reserve of the Company's bank placed with the CBR in the amount of 680,295 thousand rubles (US$ 23,436 thousand) and 218,975 thousand rubles (US$ 7,434 thousand) as of June 30, 2004 and December 31, 2003, respectively. The obligatory reserve placed by the Company's bank with the CBR includes amounts deposited with the CBR relating to daily settlements and other activities. Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBR, the amount of which depends on the level of funds attracted by the credit institution, and this amount has certain restrictions for use.

Cash accounts denominated in hard currency represent primarily cash in US$.

3. Cash and Cash Equivalents (continued)

Interest bearing deposits represent bank deposits readily convertible to known amount of cash and may be withdrawn by the Company at any time without prior notice or penalties.

Other cash is mainly represented by cash balances on special accounts in banks and cash-in-transit.

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

4. Short-Term Investments

Short-term investments as of June 30, 2004, and December 31, 2003, comprise the following:

	June 30, 2004	**December 31, 2003**
Short-term loans issued	**$ 4,414**	$ 50,881
Short-term loans to related parties (see Note 8)	**202,333**	199,399
Short-term promissory notes	**15,702**	830
Trading portfolio of the Bank		
Short-term promissory notes	**27,253**	8,977
Corporate bonds	**34,791**	11,038
Other	**12,246**	–
Settlements on notes with related parties	**16,606**	–
Bank deposits	**3,000**	18,665
Other	**7,005**	823
Total short-term investments	**$ 323,350**	$ 290,613

The promissory notes, included in the trading portfolio of the Bank represent promissory notes of top Russian banks.

Corporate bonds represent bonds from large Russian corporations with interest rates ranging from 10% to 24.1% and maturities between 2004 and 2006.

Unrealised gains and losses on trading securities of the Bank are not significant.

5. Accounts Receivable, Net

Accounts receivable as of June 30, 2004, and December 31, 2003, comprise the following:

	June 30, 2004	December 31, 2003
Trade receivables	**$ 237,377**	$ 196,026
Value added tax receivable	**430,318**	339,837
Advances to suppliers	**143,582**	104,605
Other taxes	**16,817**	47,712
Banking loans to customers	**146,237**	138,065
Other	**102,763**	122,901
Less allowance for doubtful accounts	**(51,606)**	(61,834)
Total accounts receivable, net	**$ 1,025,488**	$ 887,312

The Company's accounts receivables are denominated primarily in US dollars. Credit risk is managed through use of letters of credit.

Value added tax receivable (VAT) includes VAT related to construction-in-progress, which in accordance with Russian tax legislation will be reimbursed from the budget after the completion of construction.

6. Inventories

Inventories as of June 30, 2004, and December 31, 2003, comprise the following:

	June 30, 2004	December 31, 2003
Materials and supplies	**$ 239,109**	$ 196,004
Crude oil and gas	**52,409**	70,035
Petroleum products	**76,469**	70,532
Total inventories	**$ 367,987**	$ 336,571

Materials and supplies are mostly comprised of spare parts, construction materials and pipes.

7. Prepaid Expenses

	June 30, 2004	December 31, 2003
Information systems development	**$ 26,499**	$ 20,111
Insurance payments	**13,464**	12,822
Customs	**11,039**	2,025
Other expenses	**32,138**	32,931
Total prepaid expenses	**$ 83,140**	$ 67,889

Expenses on information systems development relate to the implementation of computer information systems and equipment installation.

8. Long-Term Investments

Long-term investments as of June 30, 2004, and December 31, 2003, comprise the following:

	June 30, 2004	December 31, 2003
Equity investments		
Sakhalin-1 PSA	**$ 59,384**	$ 59,384
LLC Polar Lights Company	**54,274**	29,260
CJSC Sevmorneftegaz	**73,704**	36,108
CJSC Kaspiy-1	**17,040**	17,040
Total equity investments	**$ 204,402**	$ 141,792
Russian government bonds	**1,226**	3,533
Long-term loans	**52,369**	61,622
Long-term loan to related party	**12,384**	12,204
Investments in joint venture	**12,773**	11,896
Settlements on notes with related party	**64,830**	–
Other	**25,529**	57,582
Total long-term investments	**$ 373,513**	$ 288,629

Sakhalin-1 PSA

The terms of CJSC Rosneft-Astra and CJSC Rosneft-Sakhalinmorneftegaz-Shelf, the Company's subsidiaries' (hereinafter the "PSA Subsidiaries") share in Sakhalin-1 PSA include funding of the PSA Subsidiaries' carried interests by ONGC. In accordance with the share purchase agreement, ONGC undertakes to provide funding in the amount as per the agreement with the agreed-upon rate of return.

The terms of the carried interest agreements provide that the PSA Subsidiaries will maintain their operations and protect their respective interests in the Sakhalin-1 PSA for the benefit of ONGC. Failure to do so could allow ONGC to cease funding of the carried interests. Further, ONGC is entitled to 90% of the net funds associated with the sale of hydrocarbons due to retained interests of the PSA Subsidiaries in the development of the PSA. Rosneft has agreed to indemnify ONGC for losses or damages sustained by ONGC for failure of the PSA Subsidiaries to, in effect, maintain the retained interests and has further pledged the shares in the PSA Subsidiaries in support of the indemnity. The PSA Subsidiaries are entitled to 10% of the net funds associated with the interests until such time as ONGC's investment and rate of return is recovered. At such point, the PSA Subsidiaries' shares in the PSA revert back to PSA Subsidiaries in their entirety. As of June 30, 2004, ONGC has provided approximately US$ 431 million toward the funding of the PSA Subsidiaries' retained interest in the project costs.

LLC Polar Lights Company ("PLC")

PLC is a limited liability company owned 50% by Conoco-Phillips Timan-Pechora Ltd., and 50% by the Company as of June 30, 2004. PLC's primary emphasis has been the development of the Ardalin and satellite fields in the Timan-Pechora Basin located 125 kilometers south of the Barents Sea above the Arctic Circle. Development work on the Ardalin field began in late 1992 and the first oil was produced in 1994.

8. Long-Term Investments (continued)

LLC Polar Lights Company ("PLC") (continued)

As a result of the PLC acquisition, Rosneft's equity share in the underlying net assets of PLC exceeds its investment by approximately US$ 45.8 million. Rosneft attributes this excess to a favorable purchase of PLC's interest in reserves, therefore the positive difference will be accreted to income proportional to the depletion of oil and gas properties, which totaled US$ 2.6 million in the first six months of 2004.

CJSC Sevmorneftegaz

In January 2002, Rosneft, through OJSC Rosneft-Purneftegas, and OJSC Gazprom, through CJSC Rosshelf, jointly established CJSC Sevmorneftegaz ("Sevmorneftegaz") with equal shares in equity. The cost of investment in Sevmorneftegas was US$ 0.017 million. Sevmorneftegaz is primarily engaged in exploration and production activity on Prirazlomnoye oil field, Shtokmanovskoye, Etypurovskoe and Vyngoyahinskoe gas-condensate fields, and Kharampurskoe oil and gas-condensate field.

At the moment, Prirazlomnoye oil field is being actively prepared for exploration and development. The project is planned to be conducted under a PSA. During 2002 Sevmorneftegaz acquired an off-shore platform, which was delivered to the Sevmash plant in Severodvinsk for reconstruction. During 2003 and the first six months of 2004, the platform reconstruction was being performed and work was being undertaken to re-equip and build the platform deck and caisson.

For the above activities Rosneft provided US$ 276 million to Sevmorneftegaz for these purposes, US$ 202 million under loan agreement secured by short-term promissory notes (see Note 4) and US$ 74 million in contributions to joint venture.

As of June 30, 2004 shares of Sevmorneftegaz, owned by the Company, are pledged for the loan, provided to Sevmorneftegaz for the purpose of financing of the development of Prirazlomnoye oil field.

CJSC Kaspiy-1

In 1997 subsidiary of the Company made contribution in the charter capital of CJSC Kaspiy-1, which was founded for the construction of oil refinery in the Makhachkala (Dagestan Republic). Primarily construction works are completed as of June 30, 2004. The refinery will be put into operation during 2004; production activity will start in 2005.

Long-Term Loans

Long-term loans represent loans issued by the Company to the third parties for more than 12 months that are primarily used for joint activities. Long-term loans issued also includes long-term portion of loans payable by the Company's bank. Long-term loans are accounted for in the financial statements as financial instruments held to maturity. Their maturities vary from 2005 to 2014. These loans bear interest rates from 5% to 14%.

8. Long-Term Investments (continued)

Long-Term Loan to Related Party

Long-term loan to related party represents interest-free loan to CJSC Kaspiy-1 with maturity in 2007 (see above).

Investments in Joint Ventures

Investments in joint ventures represent certain projects of the Company, primarily related to exploration and pre-development at Sakhalin shelf fields.

Settlements on Notes with Related Party

Related party promissory notes represent interest free notes used by the Company to settle trade payables and lease obligations, which were accounted for in accordance with FIN 39 *"Offsets of obligations under contracts"*. Most of these promissory notes mature in 2008 – 2010. Related party promissory notes are accounted for in the financial statements as securities available-for-sale. Unrealized holding gains and losses on these securities are not significant.

Other Investments

Other investments represent shares, equity and other long-term investments, which are individually insignificant. These investments are accounted at cost.

9. Oil and Gas Properties, Net

Oil and gas properties as of June 30, 2004, and December 31, 2003, comprise the following:

	June 30, 2004	**December 31, 2003**
Oil and gas properties	**$ 5,623,286**	$ 5,406,903
Pipelines	**296,636**	291,770
Equipment under capital lease	**12,717**	53,471
Total cost	**5,932,639**	5,752,144
Less: accumulated depletion	**(2,581,634)**	(2,519,883)
Net oil and gas properties	**$ 3,351,005**	$ 3,232,261

Oil and gas properties include costs to acquire unproved properties in the amount of US$ 267.3 million and US$ 242.9 million as of June 30, 2004, and December 31, 2003. The Company has certain plans to develop and assess the respective fields. The Company's management believes these costs are recoverable.

10. Property, Plant and Equipment and Leased Property, Net

Property, plant and equipment as of June 30, 2004, and December 31, 2003, comprises the following:

	June 30, 2004	December 31, 2003
Offshore drilling assets	**$ 113,415**	$ 173,265
Service vessels	**43,836**	96,532
Buildings and constructions	**1,316,562**	1,277,286
Plant and machinery	**575,943**	568,511
Vehicles and other equipment	**296,095**	292,354
Equipment under capital lease	**44,939**	34,985
Total cost	**2,390,790**	2,442,933
Less: accumulated depreciation	**(1,330,393)**	(1,399,394)
Net property, plant and equipment	**$ 1,060,397**	$ 1,043,539

11. Construction-in-Progress

Construction-in-progress includes various construction projects and machinery and equipment delivered but not yet installed. Construction-in-progress as of June 30, 2004, and December 31, 2003, comprise the following:

	June 30, 2004	December 31, 2003
Equipment to be installed	**$ 57,143**	$ 40,446
Buildings and constructions	**267,153**	223,770
Plant and machinery	**48,217**	75,270
Vehicles and other equipment	**34,721**	28,736
Total construction-in-progress	**$ 407,234**	$ 368,222

12. Capital Lease

In 2003 the Company started to participate in the development of capital leasing activities in the Russian Federation. In 2003-2004 the Company entered into several leasing agreements for equipment and other assets. Equipment received under those leasing agreements is depreciated using the same methods of depreciation as used for the property, plant and equipment and oil and gas properties, which are owned by the Company.

12. Capital Lease (continued)

The following is the analysis of the property, plant and equipment under capital lease:

	June 30, 2004	December 31, 2003
Oil and gas properties	**$ 12,717**	$ 53,471
Less: accumulated depletion	**(2,713)**	(2,423)
Oil and gas properties, net	**$ 10,004**	$ 51,048
Property, Plant and Equipment		
Buildings and constructions	**$ 984**	$ –
Plant and machinery	**18,682**	11,729
Vehicles and other equipment	**25,084**	23,186
Other	**189**	70
Total	**44,939**	34,985
Less: accumulated depreciation	**(6,515)**	(2,363)
Property, plant and equipment, net	**$ 38,424**	$ 32,622
Total carrying value of leased assets	**$ 48,428**	$ 83,670

The aggregate maturity of capital lease payments outstanding is as follows:

	June 30 2004
2004	**$ 11,469**
2005	**14,776**
2006	**7,654**
2007	**2,469**
2008	**1,875**
2009 and after	**5,592**
	43,835
Imputed interest	**(4,243)**
Net discounted lease payments	**$ 39,592**

Primarily all lease transactions are conducted through a single leasing company. The Company provides financing to the leasing company for the purchase of equipment, which is then leased to the Company. Under the agreement, the Company has the right to offset the lease obligations against promissory notes receivable. As of June 30, 2004 lease obligations in the amount of US$ 39.59 million were netted against Related Party promissory notes (see Note 8).

13. Other Non-Current Assets

Other non-current assets mainly include the loan to OJSC Sibur-Tumen in the amount of US$ 15 million restructured under amicable agreement and previously recognized as accounts receivable. This loan receivable is stated at fair value net of allowance for loan losses in the amount of US$ 6 million and is scheduled to be settled in 2010.

14. Accounts Payable and Accruals

Accounts payable and accruals as of June 30, 2004 and December 31, 2003 comprise the following:

	June 30, 2004	December 31, 2003
Trade accounts payable	**$ 280,030**	$ 245,837
Salaries and other benefits payable	**52,547**	51,190
Advances received	**53,797**	47,507
Dividends payable	**78,224**	22,077
Promissory notes payable	**16,914**	94,216
Banking customers deposits	**161,806**	98,771
Obligatory insurance and pension accounts	**–**	61,980
Other	**65,829**	77,331
Total accounts payable and accruals	**$ 709,147**	$ 698,909

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

15. Short-Term Loans and Long-Term Debt

Short-term loans from banks and other organizations as of June 30, 2004 and December 31, 2003 comprise the following:

	June 30, 2004	December 31, 2003
US$ denominated		
Bank loans	**$ 21,134**	$ 63,168
Other borrowings	**6,385**	29,554
Ruble denominated		
Bank loans	**5,833**	7,796
Other borrowings	**126,172**	157,549
	159,524	258,067
Current portion of long-term debt	**586,931**	329,763
Total short-term loans and current portion of long-term debt	**$ 746,455**	$ 587,830

Other rubles denominated borrowings include primarily certified debt of the Bank with the average interest rate of 3.2%.

The rate of interest on the Company's short-term loans denominated in US dollars was from LIBOR plus 2.75 to 7 %. The ruble-denominated loans generally bear interest at approximately 8% in 2004.

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

Long-term debt as of June 30, 2004 and December 31, 2003 comprises the following:

	June 30, 2004	**December 31, 2003**
Bank loans – US$ denominated	**$ 2,296,584**	$ 2,102,625
Long-term debt of the Bank	**9,175**	19,522
Other borrowings	**73,056**	29,663
	2,378,815	2,151,810
Less current portion of long-term debt	**(586,931)**	(329,763)
Non-current portion of long-term debt	**$ 1,791,884**	$ 1,822,047

The interest rate on US$-denominated long-term loans and borrowings was primarily from LIBOR plus 1.25% to 4%. The interest rate applicable to the syndicated loans, raised in 2001 as a result of Eurobonds placement, with maturity date in November 2006, equals 12.92%. The balance of these syndicated loans as of June 30, 2004 is US$ 150.83 million (US$ 150.89 million as of December 31, 2003).

As of June 30, 2004 and December 31, 2003 the Company's collateral for short-term and long-term bank loans were oil and gas properties and other fixed assets in the amount of 873 million rubles and 4,072.5 million rubles, respectively (US$ 30 million and US$ 138.3 million at the exchange rates as of June 30, 2004 and December 31, 2003 respectively).

Loan agreements contain a number of covenants, which the Company is obliged to comply with. Those covenants include the Company's obligations to maintain certain financial ratios at an agreed level, maintain main operations at a certain level, not to default on certain other debt agreements and others.

Under certain loan agreements, the Company must maintain an export contract/aggregate debt outstanding ratio, i.e. Coverage Ratio, ranging from 125% to 130%. This requirement applies to outstanding debt of approximately US$ 2,318 and 1,132 million as of June 30, 2004 and December 31, 2003, respectively. The above covenant obliges the Company to maintain firm sales contracts settled in US dollars for which committed export volumes are calculated on the basis of minimum prices stipulated by the loan documentation. Such export volumes should correspond to the coverage ratio. As a requirement, the terms of concluding such covered contracts give the lender an express right of claim for contractual revenue which must be remitted directly to transit currency (US$-denominated) accounts with those banks in case of the Company's default on timely repayment of debt.

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

The long-term liabilities as of June 30, 2004 will be settled as follows:

	June 30, 2004
2004	**$ 170,723**
2005	**717,735**
2006	**697,990**
2007	**436,781**
2008	**281,822**
2009 and after	**73,764**
Total long-term debt	**$ 2,378,815**

16. Shareholder's Equity

The shareholder's capital account represents the authorized capital of the Company, as stated in its Charter. If dividends are paid on common shares, dividend rate per one preferred share may not be less than common share dividend rate.

As of June 30, 2004 and December 31, 2003, 100 % the Company's entire common and preferred shares were held by the Government of the Russian Federation. In accordance with the Russian Accounting Regulations, earnings available for dividends are limited to current-year income and retained earnings, denominated in rubles, as determined in accordance with statutory requirements, after certain deductions.

The Annual Shareholders Meeting declared dividends on common shares of US$ 1,500 million rubles or US$ 51.68 million at the exchange rate as of the date of declaration relating to fiscal year 2003.

17. Accrued Income and Other Taxes

Accrued income and other taxes as of June 30, 2004 and December 31, 2003 comprise the following:

	June 30, 2004	December 31, 2003
Mineral extraction tax	**$ 51,267**	$ 46,641
Value added tax	**54,161**	33,773
Excise tax	**15,863**	13,901
Property tax	**9,809**	11,542
Corporate income tax	**18,450**	8,140
Other taxes	**18,426**	16,774
Total accrued income and other taxes	**$ 167,976**	$ 130,771

18. Asset Retirement Obligations

The movement of asset retirement obligations is as follows:

	June 30, 2004
Asset retirement obligation as of beginning of reporting period	**$ 126,488**
Recognition of additional liabilities for new wells	**2,855**
Accretion expense	**3,618**
Asset Retirement Obligation as of end of reporting period	**$ 132,961**

19. Minority Interests

Minority owners' interests in the Company's subsidiaries as of June 30, 2004 and December 31, 2003 are the following:

	June 30, 2004		December 31, 2003	
Name	**Minority interest**	**Minority interest share in net assets**	**Minority interest**	**Minority interest share in net assets**
	%		%	
OJSC Rosneft-Purneftegaz	**16.91**	**$ 167,643**	16.91	$ 158,132
OJSC Rosneft-Sakhalinmorneftegaz	**36.66**	**222,709**	36.66	231,242
OJSC Rosneft-Krasnodarneftegaz	**48.94**	**87,118**	48.94	84,686
OJSC Rosneft-Stavropolneftegaz	**28.05**	**22,191**	28.05	23,048
OJSC Rosneft-Tuapse Nefteproduct	**62.00**	**122,219**	62.00	114,839
OJSC Rosneft-Komsomolsky Refinery	**22.69**	**12,160**	22.69	12,063
OJSC Rosneft-Tuapse Refinery	**60.47**	**30,678**	60.47	29,711
Other		**141,575**		135,385
Total		**$ 806,293**		$ 789,106

20. Revenues

Oil and gas sales include excise tax on gas of US$ 0.039 million and export customs duty of US$ 169 million for the first six months of 2004. Refined products and processing fees include excise tax of US$ 29 million and export customs duty of US$ 70 million for the first six months of 2004.

21. Income Taxes

Income taxes for the first six months of 2004 comprise the following:

	2004
Current income tax expense	**$ 135,497**
Deferred income tax benefit	**(16,915)**
Total income tax	**$ 118,582**

The income tax represents the total income tax expense for the Company and each of its subsidiaries. The Company does not file a consolidated tax return, rather each legal entity files separate tax returns with various authorities.

21. Income Taxes (continued)

Temporary differences between the Russian statutory accounts, tax records and these consolidated financial statements give rise to the following deferred tax assets and liabilities as of June 30, 2004 and December 31, 2003:

	June 30, 2004	December 31, 2003
Deferred tax asset arising from tax effect of:		
Asset retirement obligations	**$ 31,911**	$ 30,158
Property, plant and equipment	**24,493**	53,928
Accounts receivable	**9,020**	15,440
Accounts payable and accruals	**6,813**	–
Inventory obsolescence	**2,716**	5,771
Long-term investments	**496**	2,592
Short-term investments	**706**	2,673
	76,155	110,562
Valuation allowance for deferred tax assets	**(57,946)**	(67,242)
Deferred tax asset	**18,209**	43,320
Deferred tax liability arising from tax effect of:		
Long-term liabilities	–	(7,492)
Property, plant and equipment	**(32,511)**	(67,045)
Deferred tax liability	**(32,511)**	(74,537)
Net deferred tax liability	**$ (14,302)**	$ (31,217)

Expected income tax expense differs from the actual tax expense mainly due to non-deductible expenses and foreign currency translation differences.

22. Commitments and Contingencies

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

The Company and its subsidiaries are engaged in continuous capital projects for exploration and development of production facilities and modernization of refineries and distribution network. Management estimates the total cost of such programs to be US$ 189.8 million during the second half of 2004. Depending on the current market situation actual expenditures may vary from the above estimates.

The Company plans to finance a significant portion of these projects internally. At the same time, the Company is looking for external sources of financing. It is the opinion of management that the Company will be able to obtain all necessary financing to complete the existing and planned capital projects.

The Company has commitments jointly with OJSC Gazprom to finance the Prirazlomnoye project in accordance with the annually approved budget by CJSC Sevmorneftegas (see Note 8). The total capital expenditure to reach the maximum capacity of this project by 2006 is US$ 1,227 million, including Rosneft's share of US$ 633 million. Currently the Company is negotiating with various banks to obtain financing for this project instead of financing by the Company.

22. Commitments and Contingencies (continued)

Taxation Contingencies

Legislation and regulations regarding taxation and foreign currency transactions in Russia continue to evolve as a new market-oriented economy.

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

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

The Company believes that it has paid or accrued all taxes that are applicable. Where practice concerning the provision of taxes was unclear, the Company has accrued tax liabilities based on management's best estimate. The Company's policy is to accrue for contingencies in the accounting period in which a loss is deemed probable and the amount is reasonably determinable.

Environmental Matters

Companies operating in the oil and gas and downstream energy industry are continuously subject to environmental risk. Management is of the opinion that the Company has met the requirements of environmental legislation, and, therefore, believes that the Company does not have any material current environmental liabilities other than those provided. However, legislation and other regulatory matters will continue to evolve and therefore will affect the Company's compliance expenditures.

Pension Plans

The Company and its subsidiaries make contributions to the State Pension Fund of the Russian Federation, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such contributions are charged to expense as incurred.

In 2000, the Company created a Pension Fund to finance non-government pensions for its employees. The Pension Fund requires monthly contributions by the employer calculated based on statutory minimal payroll payment.

Payments from the Pension Fund to eligible participants are based on amount accumulated in the individuals' pension account and the Company has no post-retirement costs that require to be accumulated.

This pension plan falls under the definition of SFAS 87 *"Employers' Accounting for Pensions"* as a defined contribution plan.

In the first six months of 2004 the Company paid US$ 6 million to the Pension Fund.

22. Commitments and Contingencies (continued)

Insurance

The Company insures its assets through SK Neftepolis LLC (see Note 1).

Social Commitments

The Company possesses certain social infrastructure assets for the use of employees. The Company has incurred US$ 39.02 million in expenses related to social infrastructure assets during the first six months of 2004.

Charity Expenses

During the first six months of 2004 Rosneft incurred US$ 25.68 million of charity expenses in various regions of Russia where the Company operates. Charity expenses are included as other expenses in the consolidated statements of income.

Guarantees and Indemnity

As of June 30, 2004, the Company issued a guarantee to CJSC Sevmorneftegaz as collateral against bank loans received. Under the guarantee agreement the Company is obliged to repay the whole amount of bank loans together with interest and other fees upon the bank's request in case the borrower cannot satisfy such amounts payable.

The Company cannot substitute guarantees issued by any novation agreement or mutual offset. The Company's obligations under guarantees issued are valid in case of any change in loan agreements. The Company does not have the first right of demand.

After the full payment of all obligations under the guarantee the Company has the right to subrogate its respective part of all bank claims against the debtor in accordance with the loan agreement. In case the Company makes payments under guarantees issued it has a right to claim the amount from the debtor.

The maximum potential amount of future payments under guarantees issued by the Company includes the outstanding principal amount, interest payable and penalties envisaged in the loan agreements.

Bank - lender	Loan debtor	Guaranteed amount of principal	Current carrying amount of outstanding liability as of June 30, 2004
RF Savings Bank	CJSC Sevmorneftegaz	**$ 57,000**	**$ 53,712**

As described in Note 8, the Company has agreed to indemnify ONGC for losses in certain circumstances.

22. Commitments and Contingencies (continued)

Litigation

In April 2004, the Nenets Autonomous Area ("NAA") Administration filed a suit to the Moscow Arbitration Court against OJSC Northern Oil about recovery of US$ 19 million principal obligation (which is a recorded obligation) and US$ 12 million penalty for the late payment of contributions to the social and economic development of the NAA under the license agreement with OJSC Northern Oil.

In February 2003 OJSC Northern Oil signed an addendum to the license agreement on restructuring of contributions to the social and economic development of NAA. By the Ruling of the Moscow Arbitration Court the company shall pay to the NAA Administration US$ 19 million of the principal amount and penalty of US$ 1 million. The rest of the claim was rejected. The company prepared an appeal to be submitted to the Arbitration Court in order to challenge the ruling of the first instance court. The decision of appeals instance of Moscow's Arbitration Court was to reject the complaint. The appeal on error was claimed again. The amount of liabilities related to this case was reflected in other accounts payable in financial statements.

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

License Agreements

In accordance with license agreements the Company's subsidiary is obliged to conduct various environmental programs. For these purposes the Company has to expend at least US$ 78 million over the period of development of oil fields. In addition, it is obligated to make annual contributions to a Regional Authority for social obligations in the annual amount of US$ 5 million through 2019.

Other Contingencies

The Company's management believes that any other existing contingencies not recorded in the accompanying consolidated financial statements are not significant and will not affect the future financial position of the Company.

23. Fair Value of Financial Instruments and Credit Risk Management

Management believes that a reasonable approximation of fair value of accounts receivable is not practical due to unavailability of their fair (market) estimates. Management expects such accounts receivable, net of allowances for doubtful accounts, to be settled in full within reasonable period of time. The carrying amount of all other financial instruments approximates their fair value.

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

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

24. Subsequent Events

In September 2004, the Company obtained a loan from an international bank in the amount of US$ 700 millions to refinance the liabilities under the previous loans of the same bank.

Before the end of September 2004 the Company agreed with the creditors some changes in the covenants of the loan agreements with international banks bringing them in line with the covenants of the loan agreements signed in May and September 2004.

In September 2004 the RF Government announced a 100% swap of the Company shares for the amount of Gazprom shares necessary to obtain the controlling stake in OJSC Gazprom.

There were no other significant events at the date of financial statements related to the disposal of the Company's assets, which could have resulted in significant adjustments and would have been necessary for the fair presentation in the consolidated statements.

Auditing Chamber of Russia and Ministry for Taxes and Levies of Russia continued audits of the Company in the second half of 2004. As of the date of the financial statements, the audits are still underway. The Company expects that the audit findings will not result in material negative effects on the financial position or results of operations of the Company.

In November 2004, the Company's Board of Directors decided to place additional common stock of the Company by means of converting the convertible preferred stock based on the ratio of one preferred share at 1 ruble par value for one common share at 1 ruble par value. All preferred shares of the Company are subject to conversion.

In October 2004, the Company decided to acquire the additional shares of its subsidiary, OJSC Rosneft Oil Company – Tuapse Refinery, equaling 40.2% of the charter capital. This transaction is to be completed by the end of 2004.