

# **Open Joint Stock Company AK TRANSNEFTEPRODUCT**

**International Financial Reporting Standards  
Consolidated Financial Statements and  
Independent Auditor's Report**

**31 December 2006**

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**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors of OJSC AK Transnefteproduct:

1. We have audited the accompanying consolidated financial statements of Open Joint Stock Company AK Transnefteproduct and its subsidiaries (the "Group") which comprise the consolidated balance sheet as at 31 December 2006 and the consolidated income statement, consolidated statement of Cash flows and consolidated statement of changes in equity for the year then ended and a summary of significant accounting policies and other explanatory notes.

*Management's Responsibility for the Financial Statements*

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

*Auditor's Responsibility*

3. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

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

*ZAO PricewaterhouseCoopers Audit*

Moscow, Russian Federation  
09 July 2007



**OJSC AK TRANSNEFTPRODUCT**  
**IFRS Consolidated Balance Sheet**  
(in thousands of Russian roubles unless otherwise stated)

	Notes	31 December 2006	31 December 2005
<b>ASSETS</b>			
<b>Non-current assets</b>			
Investment in associated undertaking	4	680,947	687,173
Financial assets at fair value through profit or loss	4	218,802	163,014
Recoverable VAT and other receivables	7	3,056,236	1,271,842
Property, plant and equipment	5	44,082,860	30,919,295
<b>Total non-current assets</b>		<b>48,038,845</b>	<b>33,041,324</b>
<b>Current assets</b>			
Inventories	6	535,100	529,609
Trade and other receivables	7	655,037	516,471
Recoverable VAT	7	1,381,939	842,212
Financial assets at fair value through profit or loss	4	-	28,076
Cash and cash equivalents	8	2,763,394	3,321,337
<b>Total current assets</b>		<b>5,335,470</b>	<b>5,237,705</b>
<b>Total assets</b>		<b>53,374,315</b>	<b>38,279,029</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity attributable to Company's equity holder</b>			
Share capital	9	1,471,642	1,471,642
Retained earnings		33,598,880	29,551,791
Currency translation reserve	4	(860,785)	(869,850)
<b>Total equity attributable to Company's equity holder</b>		<b>34,209,737</b>	<b>30,153,583</b>
<b>Minority interest</b>		<b>474,653</b>	<b>395,302</b>
<b>Total equity</b>		<b>34,684,390</b>	<b>30,548,885</b>
<b>Non-current liabilities</b>			
Long-term borrowings and loans	10	11,710,784	-
Deferred tax liabilities	12	2,697,263	2,728,816
Provisions for liabilities and charges	13	441,306	397,421
<b>Total non-current liabilities</b>		<b>14,849,353</b>	<b>3,126,237</b>
<b>Current liabilities</b>			
Payables and advances from customers	11	3,492,259	2,312,326
Short-term borrowings and loans	10	207,717	2,070,614
Profit tax and other tax liabilities	12	140,596	220,967
<b>Total current liabilities</b>		<b>3,840,572</b>	<b>4,603,907</b>
<b>Total liabilities</b>		<b>18,689,925</b>	<b>7,730,144</b>
<b>Total equity and liabilities</b>		<b>53,374,315</b>	<b>38,279,029</b>

Signed by the following members of the Company's management

President

S.V. Maslov

09 July 2007

First Vice-President

S.V. Sidorova

The notes on pages 8 to 30 form an integral part of these consolidated financial statements.



**OJSC AK TRANSNEFTPRODUCT**  
**IFRS Consolidated Income Statement**  
(in thousands of Russian roubles unless otherwise stated)

	Notes	Year ended 31 December 2006	Year ended 31 December 2005
Sales	14	15,163,227	13,911,190
Cost of sales	15	(7,255,391)	(6,447,488)
<b>Gross profit</b>		<b>7,907,836</b>	<b>7,463,702</b>
General and administrative expenses	16	(1,364,429)	(1,213,951)
Net other operating expenses	17	(53,086)	(22,539)
<b>Operating profit</b>		<b>6,490,321</b>	<b>6,227,212</b>
Financial income	18	33,867	101,205
Financial expense	18	(652,095)	(283,771)
Share of profit/(loss) of associated undertaking and impairment provision	4	(18,154)	27,299
Net foreign exchange gain		269,655	111
<b>Profit before profit tax</b>		<b>6,123,594</b>	<b>6,072,056</b>
Profit tax expense	12	(1,897,154)	(1,618,078)
<b>Profit for the year</b>		<b>4,226,440</b>	<b>4,453,978</b>
<b>Attributable to:</b>			
Equity holder of the Company		4,147,089	4,433,874
Minority interest		79,351	20,104
<b>Profit for the year</b>		<b>4,226,440</b>	<b>4,453,978</b>

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**OJSC AK TRANSNEFTPRODUCT**  
**IFRS Consolidated Statement of Cash Flows**  
(in thousands of Russian roubles unless otherwise stated)

	Notes	Year ended 31 December 2006	Year ended 31 December 2005
<b>Cash flows from operating activities</b>			
Cash receipts from customers		17,803,252	16,510,275
Cash paid to suppliers and employees, and taxes other than profit tax		(10,423,135)	(9,045,016)
Interest paid		(540,903)	(195,737)
Profit tax paid		(2,184,166)	(2,001,421)
<b>Net cash from operating activities</b>		<b>4,655,048</b>	<b>5,268,101</b>
<b>Cash flows from investing activities</b>			
Proceeds from sale of property, plant and equipment		19,777	7,573
Purchase of property, plant and equipment		(15,304,516)	(6,239,247)
Purchase and sale of long-term investments		27,206	(4,622)
Interest received		35,024	214,243
Repayments of the commodity loan		-	602,000
<b>Net cash used in investing activities</b>		<b>(15,222,509)</b>	<b>(5,420,053)</b>
<b>Cash flows from financing activities</b>			
Repayments of long and short-term borrowings		(3,827,570)	(586,900)
Proceeds from long and short-term borrowings		14,063,990	1,033,967
Dividends paid	9	(100,000)	(100,000)
<b>Net cash from financing activities</b>		<b>10,136,420</b>	<b>347,067</b>
Net (decrease)/increase in cash and cash equivalents before effects of exchange rate changes		(431,041)	195,115
Effects of exchange rate changes		(126,902)	12,009
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(557,943)</b>	<b>207,124</b>
Cash and cash equivalents at the beginning of the year		3,321,337	3,114,213
<b>Cash and cash equivalents at the end of the year</b>		<b>2,763,394</b>	<b>3,321,337</b>

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09 July 2007

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**OJSC AK TRANSNEFTPRODUCT**  
**IFRS Consolidated Statement of Changes in Equity**  
(in thousands of Russian roubles unless otherwise stated)

	Attributable to equity holder of the Company					Total Equity
	Notes	Share capital	Retained earnings	Currency translation reserve (Note 4)	Minority interest	
<b>Balance at 1 January 2005</b>		<b>1,471,642</b>	<b>25,217,917</b>	<b>(813,515)</b>	<b>375,198</b>	<b>26,251,242</b>
Currency translation differences		-	-	(56,335)	-	(56,335)
Profit for the period		-	4,433,874	-	20,104	4,453,978
<b>Total recognized income for the period</b>		-	4,433,874	(56,335)	20,104	4,397,643
Dividends	9	-	(100,000)	-	-	(100,000)
<b>Balance at 31 December 2005</b>		<b>1,471,642</b>	<b>29,551,791</b>	<b>(869,850)</b>	<b>395,302</b>	<b>30,548,885</b>
Currency translation differences		-	-	9,065	-	9,065
Profit for the period		-	4,147,089	-	79,351	4,226,440
<b>Total recognized income for the period</b>		-	4,147,089	9,065	79,351	4,235,505
Dividends	9	-	(100,000)	-	-	(100,000)
<b>Balance at 31 December 2006</b>		<b>1,471,642</b>	<b>33,598,880</b>	<b>(860,785)</b>	<b>474,653</b>	<b>34,684,390</b>

Signed by the following members of the Company's management

President

S.V. Maslov

09 July 2007

First Vice-President

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## **OJSC AK TRANSNEFTEPRODUCT**

### **Notes to the IFRS Consolidated Financial Statement – 31 December 2006**

(in thousands of Russian roubles unless otherwise stated)

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#### **1. OPERATING ACTIVITIES**

OJSC AK Transnefteproduct (the “Company”) was incorporated on 30 August 1993 by Resolution of the Russian Federation (“RF”) Government No. 871 under RF Presidential Decree No. 1403 dated 17 November 1992. The only shareholder of the Company is the Federal Agency for Administration of Federal Property of Russia. The Company’s registered office is at 14/1 Kollontai Street, Saint-Petersburg, Russia, 193318. In 2006 the Group’s principal place of business was Moscow (2 Vishnyakovsky Pereulok, Moscow, Russia, 115184).

The principal activity of the Company and its subsidiaries (the “Group”) is the transportation of oil products via trunk pipelines. Other activities include trading, storage and loading of oil products. The Group operates a large oil products pipeline system in the Russian Federation and in the Republics of Belarus and Ukraine totalling approximately 19.1 thousand kilometers. Its associated undertaking operates an interconnected system in the Latvian Republic.

#### **2. BASIS OF PRESENTATION AND ACCOUNTING POLICIES**

##### **2.1 Basis of presentation**

These consolidated financial statements are prepared in accordance with, and comply with, International Financial Reporting Standards, including International Accounting Standards and Interpretations issued by the International Accounting Standards Board (“IFRS”).

The consolidated financial statements of the Group are prepared under the historical cost convention except as described further in Notes 2 and 3. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

##### **2.2 Group accounting**

###### ***Subsidiary undertakings***

Subsidiary undertakings that are controlled by the Group have been consolidated. Control occurs when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

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

###### ***Purchases of subsidiaries from parties under common control***

Purchases of subsidiaries from parties under common control are accounted for using the pooling of interests method.

The assets and liabilities of the subsidiaries transferred under common control are recorded in these consolidated financial statements at the historical cost of the controlling shareholder. Any difference between the total book value of net assets and the consideration paid is accounted for in these consolidated financial statements as an adjustment to equity.



## **2. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)**

### ***Investments in associated undertakings***

Associated undertakings are undertakings over which the Group has significant influence and that are neither a subsidiary nor an interest in a joint venture. Significant influence occurs when the Group has the power to participate in the financial and operating policy decisions of an entity but has no control or joint control over those policies. Associated undertakings are accounted for using the equity method.

### **2.3 Property, plant and equipment**

#### ***Basis of valuation***

All property, plant and equipment is initially recorded at historical cost, including, where appropriate, the net present value of the estimated dismantlement or removal cost of the asset at the end of its estimated useful life, less accumulated depreciation. Assets under construction are carried at historical cost and depreciated from the time the Group begins to benefit from their use.

Management approves specific plans for prospective dismantlement or decommissioning of sections of pipeline and related facilities on an annual basis and, at that time, the estimated useful life of the related asset is revised and the annual depreciation charge is amended, if applicable. In the event that a decision is made to abandon a construction project in progress or to significantly postpone its planned completion date, or if there are other indications of potential impairment, the carrying value of the asset is reviewed.

#### ***Depreciation***

Depreciation is calculated on the historic amounts of property, plant and equipment on a straight-line basis. The depreciation periods, which approximate to the estimated useful economic lives of the respective assets, are as follows:

Buildings, constructions and fixed equipment	8-50 years
Machinery and mobile equipment	2-20 years
Oil product pipelines	45 years
Crude oil pipelines (in associated undertaking)	40-47 years
Other, including transport vehicles	3-25 years

#### ***Disposals and liquidation***

The gain or loss arising on the disposal or liquidation of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in the consolidated income statement.

#### ***Renewal, improvement, repairs and maintenance costs***

Major renewals and improvements are capitalised and the assets replaced are retired. Major spare parts and stand-by equipment are capitalised as items of property, plant and equipment. Maintenance and repairs and minor renewals are expensed as incurred. Minor renewals include all expenditures which do not result in a technical enhancement of the asset beyond its original capability.

#### ***Borrowing costs***

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

#### ***Linefill***

Oil products used for technical operation of the pipeline network (“linefill”) owned by the Group are treated as a



## **OJSC AK TRANSNEFTPRODUCT**

### **Notes to the IFRS Consolidated Financial Statement – 31 December 2006**

(in thousands of Russian roubles unless otherwise stated)

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## **2. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)**

separate component of the pipeline class of asset, which is not depreciated as it is not physically consumed in the process of providing services to customers. Any additions to linefill over the period are recognized at market value, and any disposals are recognized at the weighted average carrying value of linefill, and both are charged or credited to the consolidated income statement.

### **2.4 Provisions**

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

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

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

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

### **2.5 Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method. Net realisable value is the estimated selling price in the ordinary course of business, less related selling expenses.

### **2.6 Financial assets and liabilities**

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

Financial assets are re-measured to fair value at each subsequent balance sheet date, unless they are loans or receivables originated by the Group, in which case they are measured at amortised cost if they have a fixed maturity date, or otherwise at cost. Financial liabilities with fixed maturity dates are re-measured at each subsequent balance sheet date to amortised cost.

Financial liabilities with fixed maturity dates are re-measured at each subsequent balance sheet date to amortised cost.

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



## **OJSC AK TRANSNEFTPRODUCT**

### **Notes to the IFRS Consolidated Financial Statement – 31 December 2006**

(in thousands of Russian roubles unless otherwise stated)

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## **2. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)**

### **2.7 Financial assets at fair value through profit or loss**

This category mainly includes financial assets designated by management at fair value through profit or loss at inception.

Financial assets intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or as a result of a change in interest rates are classified as financial assets at fair value through profit or loss. Such investments are included in non-current assets unless management has the express intention of holding the investments for less than 12 months from the reporting date, or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Realised and unrealised gains and losses arising from changes in the fair value of the financial assets at fair value through profit or loss category are included in the income statement in the period in which they arise.

The fair value of marketable securities and quoted investments is based on quoted market values at each balance sheet date. In assessing the fair value of securities and investments which are not publicly traded, the Group uses a variety of methods and assumptions based on market conditions and risk existing at each balance sheet date, including quoted market prices for similar investments, discounted value of estimated future cash flows, and replacement cost. Estimated cash flows are discounted at current market rates available to the Group for similar financial instruments.

### **2.8 Accounts receivable**

Accounts receivable are carried at original invoice amount less provision made for impairment. A provision for impairment is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the contract. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers.

### **2.9 Cash and cash equivalents**

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

### **2.10 Deferred taxes**

Deferred tax assets and liabilities are calculated in respect of temporary differences using the balance sheet liability method. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. The principal temporary differences arise from the inflationary difference resulting from the application of IAS 29 Financial Reporting in Hyperinflationary Economies (IAS 29), depreciation on property, plant and equipment, and income, provisions and expenses which are included in the consolidated income statement before they become taxable or deductible for tax purposes.

A deferred income tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and an associate, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.



## **OJSC AK TRANSNEFTPRODUCT**

### **Notes to the IFRS Consolidated Financial Statement – 31 December 2006**

(in thousands of Russian roubles unless otherwise stated)

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## **2. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)**

If the tax relates to items that are credited or charged directly to the consolidated statement of changes in equity, corresponding deferred tax is also charged or credited directly to the consolidated statement of changes in equity.

### **2.11 Foreign currency transactions**

Items included in the financial statements of each of the Group companies are measured using the currency of the primary economic environment in which the entity operates (“the functional currency”). The functional currency for all Group companies and the presentation currency for the consolidated financial statements is the Russian rouble, (“RR”).

The results and financial position of the associated undertakings (which did not operate in a hyperinflationary economic environment during the years ended 31 December 2006 and 2005) that have a functional currency different from the presentation currency adopted by the Group for these financial statements are translated into the presentation currency as follows:

- assets and liabilities in each balance sheet presented are translated at the exchange rate at the date of that balance sheet;
- income and expenses in each statement of income (and cash flows in each statement of cash flows) presented are translated at the average exchange rates for the year;
- all resulting exchange differences are recognized in equity.

Monetary assets and liabilities held by Group entities denominated in foreign currencies are translated into RR at the exchange rate prevailing at the balance sheet date. Foreign currency transactions are accounted for at the exchange rate prevailing at the date of the transaction. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currency are recognized in the consolidated income statement.

### **2.12 Revenue recognition**

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

Revenues are shown net of value added tax and discounts.

### **2.13 Value added tax**

Output value added tax is payable to tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the balance sheet on a gross basis and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

### **2.14 Retirement benefit obligations**

The Group makes all statutory payments, which are calculated as a percentage of current gross salary payments, to the State Pension Scheme of the Russian Federation in respect of its employees and such expense is charged to the consolidated income statement.



## OJSC AK TRANSNEFTPRODUCT

### Notes to the IFRS Consolidated Financial Statement – 31 December 2006

(in thousands of Russian roubles unless otherwise stated)

## 2. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

Any discretionary payments to retired employees are recognized as expenses in the period in which they are incurred.

### 2.15 Social commitments

Expenses for the support of the housing fund stipulated by agreements with local governments are provided for in accordance with the provisions of respective annual agreements. Voluntary contributions to finance and support social programs and other similar expenses are recognized as incurred.

The Group incurs costs related to the provision of benefits to employees such as health services and kindergartens. These amounts are charged to cost of sales as they are considered a cost of employment.

### 2.16 Share capital and dividends

Ordinary shares are classified as equity. Dividends are recognized as a liability and deducted from equity on the date on which they are approved. Dividends proposed or approved between the balance sheet date and the date of issuing the consolidated financial statements are disclosed.

### 2.17 Segment reporting

The Group's risks and rates of return are affected predominantly by the nature of services it provides; therefore the primary format for reporting segment information is reportable business segments. The Group is considered by management to have a single main activity and its activities comprise one business segment.

Other sales and cost of sales are shown separately in the relevant notes, but these activities do not result in significant assets and liabilities and do not constitute a primary reportable segment as defined by IAS 14, *Segment reporting* (IAS 14).

The main activity is performed in Russian Federation. Operations of subsidiaries located in foreign countries are not significant and do not satisfy the disclosure requirements of secondary reportable segment as defined by IAS 14.

### 2.18 Recent accounting pronouncements

One new IFRS and five amendments to existing standards became effective from 1 January 2006. In addition, the IFRIC issued three new interpretations.

Effective 1 January 2006 the Group adopted all of those IFRS, amendments and interpretations, which are relevant to its operations. The adoption of IFRS, amendments and interpretations effective 1 January 2006 did not result in substantial changes to the Group's accounting policies and financial position.

#### *New or revised standards not yet effective*

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2007 or later periods and which the Group has not early adopted:

IFRS 7 *Financial Instruments: Disclosures* and a complementary Amendment to IAS 1 *Presentation of Financial Statements - Capital Disclosures* (effective from 1 January 2007);

IFRS 8, *Operating Segments* (effective for annual periods beginning on or after 1 January 2009);

IFRIC 7, *Applying the Restatement Approach under IAS 29* (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007);

IFRIC 8, *Scope of IFRS 2* (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007);

IFRIC 9, *Reassessment of Embedded Derivatives* (effective for annual periods beginning on or after 1 June 2006);



## OJSC AK TRANSNEFTPRODUCT

### Notes to the IFRS Consolidated Financial Statement – 31 December 2006

(in thousands of Russian roubles unless otherwise stated)

## 2. BASIS OF PRESENTATION AND ACCOUNTING POLICIES (CONTINUED)

IFRIC 10, *Interim Financial Reporting and Impairment* (effective for annual periods beginning on or after 1 November 2006);

IFRIC 11, *IFRS 2 — Group and Treasury Share Transactions* (effective for annual periods beginning on or after 1 March 2007);

IFRIC 12, *Service Concession Arrangements* (effective for annual periods beginning on or after 1 January 2008).

These new standards and interpretations are not expected to significantly affect the Group's financial statements.

In 2007, an amendment to IAS 23 *Borrowing costs* ("IAS 23") was made with an effective date of periods after 1 January 2009. The amendment removes the option of immediately recognizing as an expense borrowing costs that relate to assets that take substantial period of time to get ready for use or sale. Accordingly, the Group's accounting policy for Property, plant and equipment – Borrowing costs is expected to change upon adoption.

## 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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

### Useful lives of property, plant and equipment

The Group applies a range of useful lives to the pipelines, buildings, machinery and equipment which are classified as property, plant and equipment. Items of property, plant and equipment are stated at cost less accumulated depreciation. The estimation of the useful life of an item of property, plant and equipment is a matter of management judgment based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any of these conditions or estimates may result in adjustments to future depreciation rates and may increase or decrease annual depreciation charges.

### Impairment of assets

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

Accounting for impairment includes provisions against construction projects, investments, including investments in the Group's associated undertaking, unrecoverable accounts receivable and inventory obsolescence. The Group records impairment when its assessments indicate that it is probable that an asset will not be recovered, and an amount can be reasonably estimated. Actual results may vary from the estimates, and the Group's estimates can be revised in the future, either negatively or positively, depending upon the outcome or expectations based on the facts surrounding each exposure.



## OJSC AK TRANSNEFTPRODUCT

### Notes to the IFRS Consolidated Financial Statement – 31 December 2006

(in thousands of Russian roubles unless otherwise stated)

#### 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

##### Dismantlement provision

Group provides for prospective dismantlement or decommissioning of specific underground storage reservoirs, pipelines and related infrastructure. Estimating the amounts and timing of those obligations that should be recorded requires significant judgment. This judgment is based on anticipated cost using currently available technology, timing of the dismantlement in accordance with the Group's current and long-term plans and is based on current economic conditions.

##### Tax legislation

Russian tax, currency and customs legislation is subject to varying interpretations. Refer to Note 20.

#### 4. STRUCTURE OF THE GROUP AND INVESTMENTS

The consolidated subsidiaries and an associate of the Company at 31 December 2006 are as follows:

<b>Name</b>	<b>Country of incorporation</b>	<b>Percentage of ownership</b>
<b>Consolidated subsidiaries</b>		
OAo Mostransnefteproduct	Russia	100
OAo Yugo-Zapad Transnefteproduct	Russia	100
OAo Sredne-Volzhsky Transnefteproduct	Russia	100
OAo PeterburgTransnefteproduct	Russia	100
OAo Ryazantransnefteproduct	Russia	100
OAo Severo-Kavkazsky Transnefteproduct	Russia	100
OAo Sibtransnefteproduct	Russia	100
ChUP Zapad-Transnefteproduct	Belarus	100
DP Prikarpatzapadtrans	Ukraine	100
DP Rovensky Tsekh Elektrosvyazi	Ukraine	100
ChUP Zapad-Telecomnefteproduct	Belarus	100
OOO ChOP Spetstransnefteproduct	Russia	100
OAo Trade House Transnefteproduct	Russia	100
OAo Telecomnefteproduct	Russia	100
OAo Podvodspetstransnefteproduct	Russia	100
OAo Institute Nefteproductproect	Russia	100
OOO Sot-Trans	Russia	100
OOO Balttransnefteproduct	Russia	100
OOO BalttransServis	Russia	100
OOO ChOP Spetstransnefteproduct Severo-Zapad	Russia	100
OOO ChOP Spetstransnefteproduct – Ryazan	Russia	100
OOO ChOP Spetstransnefteproduct – Ural	Russia	100
OOO Spetstransnefteproduct – Yugo-Zapad	Russia	100
OOO Spetstransnefteproduct – Zapad	Russia	100
OOO ChOP Spetstransnefteproduct – Sibir	Russia	100
OOO ChOP Spetstransnefteproduct – Kstovo	Russia	100
OOO Spetstransnefteproduct – Volga	Russia	100
OAo Uraltransnefteproduct	Russia	86.2
<b>Equity accounted associated undertaking</b>		
SIA LatRosTrans	Latvia	34

Minority interests represent a 13.8% share at 31 December 2006 and 2005 in the consolidated subsidiary OAo Uraltransnefteproduct held by the State Committee of the Republic of Bashkortostan for Administration of State Property.

**OJSC AK TRANSNEFTPRODUCT****Notes to the IFRS Consolidated Financial Statement – 31 December 2006**

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**4. STRUCTURE OF THE GROUP AND INVESTMENTS (CONTINUED)****Investment in associated undertaking**

	<b>Year ended 31 December 2006</b>	<b>Year ended 31 December 2005</b>
At 1 January	687,173	734,000
(Loss)/Profit for the year	(18,154)	27,299
Currency translation differences	11,928	(74,126)
Impairment provision	-	-
At 31 December	<b>680,947</b>	<b>687,173</b>

Summarised financial information of an associate at 31 December 2006 and 2005 was as follows:

	<b>Name</b>	<b>Country of incorporation</b>	<b>Assets</b>	<b>Liabilities</b>	<b>Revenue</b>	<b>Loss for the year</b>	<b>% interest held</b>
<b>2005</b>							
	SIA LatRosTrans	Latvia	5,980,894	111,225	928,422	356,053*	34
<b>2006</b>							
	SIA LatRosTrans	Latvia	5,801,865	70,032	809,553	238,635*	34

\* Loss for the year per SIA LatRosTrans stand-alone financial statements includes the effect from the recognition of impairment provision in relation to SIA LatRosTrans property, plant and equipment, which was recognised in the Group consolidated financial statements in prior years.

Management of the Group at each balance sheet date assesses whether there is an indication that impairment provision may no longer exist or may have decreased. No strong indications exist at 31 December 2006.

**Currency translation reserve**

The conversion of SIA LatRosTrans' financial statements into Russian roubles results in a currency translation reserve. This reserve was a debit at both the beginning and end of the year, as the inflation indices used to restate the Group's consolidated financial statements in years up to and including 2002 (the last year, when Latvian economy was considered hyperinflationary and subject to IAS 29) were greater than the movement in the foreign exchange rates between the Russian rouble and the Latvian Lat for the period over which the investment has been held.

The cumulative effects of the movements in foreign exchange rates and inflation and the associated deferred taxation at the end of each year are shown below:

	<b>31 December 2006</b>	<b>31 December 2005</b>
Exchange rates	2,085,067	2,073,139
Inflation	(3,217,679)	(3,217,679)
Deferred taxation	271,827	274,690
Currency translation reserve	<b>(860,785)</b>	<b>(869,850)</b>

The exchange rates of the Central Bank of the Russian Federation at 31 December 2006 and 2005 were RR 49.67 and RR 48.80 per 1 Latvian Lat, respectively.



**OJSC AK TRANSNEFTPRODUCT**

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(in thousands of Russian roubles unless otherwise stated)

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**4. STRUCTURE OF THE GROUP AND INVESTMENTS (CONTINUED)**

**Financial assets at fair value through profit or loss**

	<b>31 December 2006</b>	<b>31 December 2005</b>
<b>Long-term financial assets</b>		
Marketable securities	208,883	142,332
Investments in other Russian companies	9,919	20,682
	<b>218,802</b>	<b>163,014</b>
<b>Short-term financial assets</b>		
Marketable securities	-	28,076
	-	28,076

Marketable securities include investments in corporate shares and government currency bonds.



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**5. PROPERTY, PLANT AND EQUIPMENT**

	<b>Buildings and constructions</b>	<b>Machinery and equipment</b>	<b>Pipelines</b>	<b>Linefill</b>	<b>Assets under construction including prepayments</b>	<b>Other</b>	<b>TOTAL</b>
<b>Cost at 1 January 2005</b>	<b>8,623,450</b>	<b>6,881,697</b>	<b>19,182,713</b>	<b>5,232,967</b>	<b>6,517,108</b>	<b>417,939</b>	<b>46,855,874</b>
Additions	-	-	-	42,571	5,649,886	-	5,692,457
Transfers	526,044	615,670	2,046,992	-	(3,239,587)	50,881	-
Disposals	(61,542)	(227,644)	(332)	(22,622)	-	(69,390)	(381,530)
<b>Cost at 31 December 2005</b>	<b>9,087,952</b>	<b>7,269,723</b>	<b>21,229,373</b>	<b>5,252,916</b>	<b>8,927,407</b>	<b>399,430</b>	<b>52,166,801</b>
<b>Accumulated depreciation at 1 January 2005</b>	<b>(4,389,082)</b>	<b>(4,226,001)</b>	<b>(11,564,298)</b>	-	-	<b>(173,517)</b>	<b>(20,352,898)</b>
Depreciation for the period	(184,873)	(534,227)	(375,838)	-	-	(42,855)	(1,137,793)
Disposals	56,076	157,069	283	-	-	29,757	243,185
<b>Accumulated depreciation at 31 December 2005</b>	<b>(4,517,879)</b>	<b>(4,603,159)</b>	<b>(11,939,853)</b>	-	-	<b>(186,615)</b>	<b>(21,247,506)</b>
<b>Net book value at 1 January 2005</b>	<b>4,234,368</b>	<b>2,655,696</b>	<b>7,618,415</b>	<b>5,232,967</b>	<b>6,517,108</b>	<b>244,422</b>	<b>26,502,976</b>
<b>Net book value at 31 December 2005</b>	<b>4,570,073</b>	<b>2,666,564</b>	<b>9,289,520</b>	<b>5,252,916</b>	<b>8,927,407</b>	<b>212,815</b>	<b>30,919,295</b>
<b>Cost at 1 January 2006</b>	<b>9,087,952</b>	<b>7,269,723</b>	<b>21,229,373</b>	<b>5,252,916</b>	<b>8,927,407</b>	<b>399,430</b>	<b>52,166,801</b>
Additions	-	-	-	51,709	14,613,285	-	14,664,994
Transfers	335,477	687,446	271,134	-	(1,313,074)	19,017	-
Disposals	(86,269)	(136,720)	(275,509)	(87,734)	(248,079)	(5,916)	(840,227)
<b>Cost at 31 December 2006</b>	<b>9,337,160</b>	<b>7,820,449</b>	<b>21,224,998</b>	<b>5,216,891</b>	<b>21,979,539</b>	<b>412,531</b>	<b>65,991,568</b>
<b>Accumulated depreciation at 1 January 2006</b>	<b>(4,517,879)</b>	<b>(4,603,159)</b>	<b>(11,939,853)</b>	-	-	<b>(186,615)</b>	<b>(21,247,506)</b>
Depreciation for the period	(356,677)	(561,653)	(143,037)	-	-	(45,460)	(1,106,827)
Change in impairment provision for fixed assets	57,916	6,432	-	-	-	91	64,439
Disposals	60,156	113,095	204,018	-	-	3,917	381,186
<b>Accumulated depreciation at 31 December 2006</b>	<b>(4,756,484)</b>	<b>(5,045,285)</b>	<b>(11,878,872)</b>	-	-	<b>(228,067)</b>	<b>(21,908,708)</b>
<b>Net book value at 31 December 2006</b>	<b>4,580,676</b>	<b>2,775,164</b>	<b>9,346,126</b>	<b>5,216,891</b>	<b>21,979,539</b>	<b>184,464</b>	<b>44,082,860</b>

**OJSC AK TRANSNEFTPRODUCT****Notes to the IFRS Consolidated Financial Statement – 31 December 2006**

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**5. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

The assets transferred to the Group companies upon privatisation did not include the land on which the Group's buildings and constructions, and under which its pipelines, are located. Many of the assets above ground are situated on land which is leased for an indefinite period from federal, regional and municipal authorities. The rights to use the tracts of land under which pipelines are located are typically contained in similar leases of indefinite duration, or in some cases are not presently defined in any legal documents. The Group companies have the option, which must have been exercised by 1 January 2006, to purchase or lease this land upon application to the state registration body or to continue occupying this land under a rental agreement. However the deadline of application to the state registration body for the Group companies was prolonged until 1 January 2008 in accordance with the state law amendments issued 31 December 2005.

**6. INVENTORIES**

	<b>31 December 2006</b>	<b>31 December 2005</b>
Materials and supplies	337,090	376,923
Oil products for resale	174,994	125,087
Other	23,016	27,599
	<b>535,100</b>	<b>529,609</b>

**7. TRADE AND OTHER RECEIVABLES**

	<b>31 December 2006</b>	<b>31 December 2005</b>
<b>Long-term receivables</b>		
Long-term recoverable VAT	2,983,179	1,188,511
Other receivables	73,057	83,331
	<b>3,056,236</b>	<b>1,271,842</b>

	<b>31 December 2006</b>	<b>31 December 2005</b>
<b>Current receivables</b>		
Trade receivables	107,937	88,621
Advances to suppliers	104,856	92,879
Profit tax assets	378,451	284,335
Other tax assets	15,051	23,434
Other receivables	48,742	27,202
	<b>655,037</b>	<b>516,471</b>

Receivables are stated net of a provision for impairment of RR 40,431 at 31 December 2006 (31 December 2005 – RR 31,319).

**Recoverable VAT**

Recoverable VAT of RR 2,983,179 at 31 December 2006 (RR 1,188,511 – 31 December 2005) relating to construction of property, plant and equipment under project "North" is classified as long-term as the Group management considers that this element of VAT will likely not be recovered within 12 months from the balance sheet date.

Short-term recoverable VAT of RR 1,381,389 at 31 December 2006 (RR 842,212 – 31 December 2005) includes VAT related to purchases and to materials and services used for construction of property, plant and equipment that in accordance with amendments to the Tax Code of the Russian Federation was reclaimed from budget through tax returns but was not physically settled as at the reporting date.



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**8. CASH AND CASH EQUIVALENTS**

	<b>31 December 2006</b>	<b>31 December 2005</b>
Cash in banks and in hand	1,701,597	3,314,530
Deposits	1,061,797	6,807
	<b>2,763,394</b>	<b>3,321,337</b>

Balance of cash and cash equivalents as at 31 December 2006 includes short-term bank deposits. Deposits were placed with Bank of International Trade (“Vneshtorgbank”) for less than 1 month and had weighted average interest rate of 2.9% - 3.8%.

RR 356,277 of cash are denominated in US dollars at 31 December 2006 (RR 280,335 – 31 December 2005).

**9. SHARE CAPITAL**

	<b>Nominal value, RR thousand</b>	<b>Amounts per Balance sheet</b>	
		<b>31 December 2006</b>	<b>31 December 2005</b>
Authorized, issued and fully paid ordinary shares of par value RR 1 each			
1,263,952,668 shares	1,263,953	1,471,642	1,471,642

**Distributable reserves**

Profit distribution and other appropriations are based on data from the statutory accounting reports of the Company prepared in accordance with Russian accounting rules (“RAR”), according to the Federal Law “On joint stock companies” pursuant to a decision taken by the General Shareholder’s meeting. Russian legislation identifies the basis of distribution as the net profit. For the years ended 31 December 2006 and 2005, the statutory net profits of the Company were RR 3,056,416 and RR 3,730,012, respectively. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretations and accordingly, management believes at present, it would not be appropriate to disclose an amount as “distributable reserves” in these consolidated financial statements.

**Dividends**

<b>Date of General Shareholder’s meeting</b>	<b>No. of shares</b>	<b>Amount per share in RR</b>	<b>Total amount in thousand RR</b>
20 July 2006	1,263,952,668	0.08	100,000
6 June 2007	1,263,952,668	0.08	100,000

**OJSC AK TRANSNEFTPRODUCT****Notes to the IFRS Consolidated Financial Statement – 31 December 2006**

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**10. BORROWINGS AND LOANS****Long-term borrowings and loans**

	<b>31 December 2006</b>	<b>31 December 2005</b>
Secured borrowings and loans	11,918,501	-
Unsecured borrowings and loans	-	1,012,924
Total borrowings and loans	11,918,501	1,012,924
Less: current portion of long-term borrowings and loans	(207,717)	(1,012,924)
	11,710,784	-
Due for repayment:		
One to two years from the balance sheet date	658,278	-
Two to five years from the balance sheet date	11,052,506	-
	11,710,784	-

**Short-term borrowings and loans**

	<b>31 December 2006</b>	<b>31 December 2005</b>
Secured borrowings and loans	-	1,057,690
Total borrowings and loans	-	1,057,690
Plus: current portion of long-term borrowings and loans	207,717	1,012,924
	207,717	2,070,614

**Secured borrowings and loans**

RR 11,918,501 of borrowings at 31 December 2006 (31 December 2005 – RR 1,057,690) are denominated in US dollars.

In October 2005, the Company obtained a short-term loan facility of USD 100 million from the Bank of International Trade (“Vneshtorgbank”). The loan was used for the financing of the Project “North”. The loan bore interest at 10%. The loan was secured by the right of Vneshtorgbank to withdraw cash from the Company’s accounts. In April 2006 the Company has fully repaid the outstanding balance of this short-term loan facility of USD 100 million and the respective interest accrued by the date. The loan agreement was terminated. The outstanding liability as at 31 December 2005 was RR 1,057,690.

In October 2005 the Company signed a long-term loan facility of USD 753 million from the Bank of International Trade, first tranche of which was taken in April 2006. USD 450 million had been drawn by 31 December 2006 and USD 620,641 thousand had been drawn by the date of preparation of these consolidated financial statements. The loan is used for the financing of the Project “North”. The loan is secured by the right of the bank to write off cash from the Company’s accounts. The loan bears interest at an annual rate of 10%, which is paid quarterly. The loan is repayable by April 2013 in 29 equal semi-annual instalments starting October 2008. The outstanding liability as at 31 December 2006 amounts to RR 11,918,501.

**OJSC AK TRANSNEFTPRODUCT****Notes to the IFRS Consolidated Financial Statement – 31 December 2006**

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**10. BORROWINGS AND LOANS (CONTINUED)****Unsecured borrowings and loans**

In May 2003, the Company issued RR 1 billion of bonds redeemable in May 2006 at par, which were listed on the Moscow Stock Exchange. The bonds incurred interest at an annual rate of 8.9%, which was paid twice a year. In May 2006 the Company paid off the bonds and the respective interest. The outstanding liability as at 31 December 2005 was RR 1,012,924.

**11. PAYABLES AND ADVANCES FROM CUSTOMERS**

	<b>31 December 2006</b>	<b>31 December 2005</b>
Advances from customers	1,238,285	1,261,780
Trade payables	1,944,775	722,754
Wages payable	77,239	231,257
Other payables	231,960	96,535
	<b>3,492,259</b>	<b>2,312,326</b>

**12. PROFIT TAX AND OTHER TAX LIABILITIES**

Taxes payable were as follows:

	<b>31 December 2006</b>	<b>31 December 2005</b>
VAT	46,832	144,956
Profit tax	16,972	3,945
Payroll taxes	16,125	34,524
Other taxes and charges payable	60,667	37,542
	<b>140,596</b>	<b>220,967</b>

Profit tax expense was as follows:

	<b>Year ended 31 December 2006</b>	<b>Year ended 31 December 2005</b>
Current profit tax expense	1,931,570	1,789,315
Deferred profit tax benefit – origination and reversal of temporary differences	(34,416)	(171,237)
	<b>1,897,154</b>	<b>1,618,078</b>

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

	<b>Year ended 31 December 2006</b>	<b>Year ended 31 December 2005</b>
Profit before profit tax	6,123,594	6,072,056
Theoretical profit tax at 24%	1,469,663	1,457,293
Increase/(reduction) due to:		
Profit tax concessions	(89)	(6,644)
Non-taxable income and other items	(114,760)	(21,883)
Staff costs, social and other expenses not deductible for tax purposes	393,659	131,644
Other reconciling items	148,681	57,668
Profit tax expense	<b>1,897,154</b>	<b>1,618,078</b>



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**12. PROFIT TAX AND OTHER TAX LIABILITIES (CONTINUED)**

Deferred tax liabilities and assets consist of the following:

	31 December 2005	Changes in equity	Change of temporary differences	1 January 2005
<b>Tax effects of taxable temporary differences:</b>				
Property, plant and equipment	2,683,395	-	(151,554)	2,834,949
Inventories and revenue recognition	11,145	-	(26,661)	37,806
Long-term investments	190,948	(17,790)	8,014	200,724
<b>Tax effects of deductible temporary differences:</b>				
Impairment of assets	(31,004)	-	3,924	(34,928)
Dismantlement provision	(95,381)	-	(8,981)	(86,400)
Other	(30,287)	-	4,021	(34,308)
<b>Net deferred tax liability</b>	<b>2,728,816</b>	<b>(17,790)</b>	<b>(171,237)</b>	<b>2,917,843</b>

	31 December 2006	Changes in equity	Change of temporary differences	1 January 2006
<b>Tax effects of taxable temporary differences:</b>				
Property, plant and equipment	2,673,111		10,284	2,683,395
Inventories and revenue recognition	12,270		(1,125)	11,145
Long-term investments	189,684	(2,863)	4,127	190,948
<b>Tax effects of deductible temporary differences:</b>				
Impairment of assets	(35,984)		4,980	(31,004)
Dismantlement provision	(105,913)		10,532	(95,381)
Other	(35,905)		5,618	(30,287)
<b>Net deferred tax liability</b>	<b>2,697,263</b>	<b>(2,863)</b>	<b>34,416</b>	<b>2,728,816</b>

Most companies of the Group were subject to tax rates of 24% on taxable profits for both 2006 and 2005. Deferred tax assets and liabilities are measured at the rate of 24% as at 31 December 2006 and 2005.

The Group has not recognized a deferred tax liability in respect of RR 8,105,979 of taxable temporary differences associated with its investments in subsidiaries as the Company is able to control the timing of their reversal and does not believe they will reverse in the foreseeable future.

**13. PROVISIONS FOR LIABILITIES AND CHARGES**

**Dismantlement provision**

	Year ended 31 December 2006	Year ended 31 December 2005
At 1 January	397,421	360,000
Effect of the passage of time (Note 18)	28,754	30,600
Effect of change in discount rate (Note 18)	15,131	6,821
<b>At 31 December</b>	<b>441,306</b>	<b>397,421</b>

A provision is established for the expected cost of dismantling specific underground storage reservoirs, pipelines and related infrastructure based on the estimated future cost of dismantling according to technical plans and discounted to net present value using a rate of 6.7% per year (2005 – 7.3% per year). Changes in the provision could result from the revision of estimates as to the expected cost of or date of carrying out the work, and the applicable discount rates. It is expected that the cash outflows related to this provision will occur between 2008 and 2014.



## OJSC AK TRANSNEFTPRODUCT

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#### 14. SALES

	Year ended 31 December 2006	Year ended 31 December 2005
Transportation services	13,412,851	12,492,773
Trading in oil products	439,079	398,409
Loading services	327,738	312,193
Storage services	389,741	274,961
Other revenue	593,818	432,854
	15,163,227	13,911,190

Other revenue includes mainly engineering and construction works, transportation of oil, agriculture and commission fees.

#### Tariff structure

The Group's revenue from oil products transportation services is derived from distance-related tariffs, which are denominated and payable in RR and revised periodically after approval by the Federal Tariffs Service for transportation of oil products to destinations in Russia, Belarus and Ukraine on the pipeline networks in those countries. The tariffs set by the Federal Tariffs Service represent the maximum amount that may be charged for each journey, and actual tariffs are frequently lower.

The actual tariffs are calculated based on total operating costs calculated in accordance with RAR (with certain exclusions) based on normal levels of activity and profit margin.

#### 15. COST OF SALES

	Year ended 31 December 2006	Year ended 31 December 2005
Staff costs:		
Wages and salaries	1,894,660	1,680,308
Unified Social Fund contributions	481,371	430,402
Depreciation	1,171,394	1,035,158
Fuel and electricity	1,077,038	945,042
Materials and supplies	724,504	525,065
Third party repair, maintenance and diagnostic	497,238	472,526
Trading in oil products	411,890	369,115
Social expenses	128,387	115,418
Telecommunication services	105,946	100,529
Taxes other than profit tax:		
Property tax	83,270	77,773
Land royalty	20,132	66,392
Other taxes and charges	95,211	70,831
Insurance services	68,375	80,841
Other	495,975	478,088
	7,255,391	6,447,488

Taxes included in cost of sales are calculated on amounts prepared in accordance with RAR. Property tax is assessed at a maximum of 2.2% for 2006 and 2005 on the average annual net book value of property, plant and equipment. Specific legislation provides for the exclusion of trunk pipelines from the taxable base.

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**16. GENERAL AND ADMINISTRATIVE EXPENSES**

	<b>Year ended 31 December 2006</b>	<b>Year ended 31 December 2005</b>
Staff costs:		
Salaries and bonuses of management personnel	821,614	699,005
Unified Social Fund contributions	131,804	113,013
Depreciation	62,469	85,989
Legal and consulting services	74,029	83,380
Telecommunication services	24,361	25,993
Other administrative costs	250,152	206,571
	<b>1,364,429</b>	<b>1,213,951</b>

**17. NET OTHER OPERATING EXPENSES**

	<b>Year ended 31 December 2006</b>	<b>Year ended 31 December 2005</b>
Impairment loss on financial assets	14,787	59,669
Loss on property, plant and equipment disposals	182,670	29,951
Gain on the commodity loan settlement	-	(122,870)
Change in provision for impairment of fixed assets	(64,439)	-
Other operating (income)/expenses	(79,932)	55,789
	<b>53,086</b>	<b>22,539</b>

**18. FINANCIAL INCOME/ FINANCIAL EXPENSE**

Financial income for the year 2006 and 2005 were as follows:

	<b>Year ended 31 December 2006</b>	<b>Year ended 31 December 2005</b>
Interest income on the commodity loan settlement	-	67,242
Interest income	33,867	33,963
	<b>33,867</b>	<b>101,205</b>

Financial expenses for the year 2006 and 2005 were as follows:

	<b>Year ended 31 December 2006</b>	<b>Year ended 31 December 2005</b>
Interest expense	608,210	246,350
Effects of changes in provisions (Note 13), due to:		
Effect of the passage of time	28,754	30,600
Effect of change in discount rate	15,131	6,821
	<b>652,095</b>	<b>283,771</b>

**19. FINANCIAL INSTRUMENTS AND COMMODITY PRICE RISKS****Credit risk**

The Group's policy is to place cash and cash equivalents with banks which are considered to have a minimum risk of default. Its trade accounts receivable are unsecured, and the largest single credit exposure related to advances paid for construction materials (based on combined figures of accounts receivable from and advances to the same group of



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#### 19. FINANCIAL INSTRUMENTS AND COMMODITY PRICE RISKS (CONTINUED)

entities) at 31 December 2006 was RR 245,003 (at 31 December 2005 - RR 394,124).

Financial assets with potential credit risk include mainly trade receivables. The Group has developed procedures for ensuring that goods and services are sold only to customers having an appropriate credit history. Most sales are on an advance payment basis. Accounts receivable net of provision for impairment represents the maximum credit exposure. The Group has no material concentration of credit risk. Although the collection of receivables may be affected by economic factors, management believes that there is no significant risk of loss in excess of the impairment provisions included in the consolidated financial statements.

#### Foreign exchange risk

The Group has foreign currency and contracts denominated in currencies other than the Russian rouble. The Group does not hedge its currency transactions risks. The Central Bank of the Russian Federation rates and cross-rates of exchange at 31 December 2006 were RR 26.33, 5.04 Ukrainian hryvna, and 2,142 Belarusian roubles to US\$1, respectively (at 31 December 2005 – RR 28.78, 5.07 Ukrainian hryvna, and 2,154 Belarusian roubles to US\$1, respectively). Assets and liabilities denominated in Ukrainian hryvna or Belarusian rouble giving rise to foreign currency exchange exposure are insignificant.

At 31 December 2006 and 2005 the outstanding balances denominated in Ukrainian hryvna and Belarusian roubles were as follows:

	31 December 2006	31 December 2005
Trade and other receivables	2,501	29,297
Cash and cash equivalents	119,053	24,829
Trade and other payables	141,995	162,896
Profit tax and other tax liabilities	14,873	12,781

The Group has also loans and cash denominated in US dollars (see Notes 8 and 10).

#### Cash flow and fair value interest rate risk

The Group's income and operating cash flows are exposed to changes in market interest rates. The Group is exposed to fair value interest rate risk through market value fluctuations of interest-bearing short-term and long-term borrowings all of which in 2006 are at fixed interest rates. During the year 2005 the Group was exposed to interest rate risk through its floating rate interest-bearing liabilities (Note 10), which were fully repaid as at 31 December 2005. The Group has no significant interest-bearing assets.

#### Commodity price risk

The Group's main activity requires it to maintain and replace the existing pipeline network, and to construct new pipelines which need to be filled with oil products as linefill, which necessitates the purchase of a significant amount of steel pipe each year for new and replacement pipelines, and of oil products as linefill. The Group has no long-term contracts with manufacturers of pipe or producers of oil products, and does not use derivative contracts to manage its exposure to fluctuations in the price of steel or oil products.

#### Fair value

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price.

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to



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#### **19. FINANCIAL INSTRUMENTS AND COMMODITY PRICE RISKS (CONTINUED)**

interpret market data to determine the estimated fair value. The Russian Federation continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. Market quotations may be outdated or reflect distress sale transactions and therefore not represent fair values of financial instruments. Management has used all available market information in estimating the fair value of financial instruments.

The fair value of financial assets and liabilities did not differ materially from their carrying value at 31 December 2006 and 2005.

#### **20. CONTINGENT LIABILITIES AND OTHER RISKS**

##### **Operating environment**

Whilst there have been improvements in economic trends in the country, the Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

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

##### **Legal proceedings**

During the year, the Group was involved in a number of court proceedings arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or claims outstanding at 31 December 2006, which could have a material adverse effect on the results of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated financial statements.

The governments of Ukraine and the Russian Federation have an arrangement regarding the legal status and ownership of the Group's subsidiary, DP Prikarpatzapadtrans, that ownership of the assets will remain with the Group. There may be further discussions between the governments in respect of the arrangements for future tariffs, which could have an impact on the future revenues of the Group, and consequently on the recoverable amount of the assets from which those revenues are generated. Until these matters are finally decided, management does not consider it appropriate to make any provision, since the nature and effect of those decisions, including any financial effect on the Group, cannot be reliably estimated at the date of issuing these consolidated financial statements.

The Company is currently involved in a number of cases related to the revised legal practice of 0% rate VAT application by transporters of export goods. Before 2006, when transporting oil products for export the Company accrued input VAT and paid it to the budget at the rate above zero which was in compliance with the legal practice applied at that time. In December 2005 the Resolution of the Presidium of Supreme Arbitration Court of Russia envisaged mandatory application of 0% rate VAT for export transportations, including transactions carried out before December 2005. In this connection, from 2006 the Company started to apply the 0% rate VAT to export oil product transportations.

In this regard, the Company signed contracts with most of its customers who used its oil product transportation services in 2004 – 2005, which provided the mechanism of paying back VAT amounts paid in access after the Company receives these amounts from the budget.

In 2006-2007 the Company applied for the recovery of VAT that was earlier accrued and paid at the rate of 18%. The tax authorities passed the decision to refuse the VAT recovery. The Company applied to the Moscow Arbitration



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## **20. CONTINGENT LIABILITIES AND OTHER RISKS (CONTINUED)**

Court with an action for annulment of the tax authorities' decision. On 19 June 2007 the Moscow Arbitration Court pronounced judgment for the plaintiff under which the stated VAT should be recovered from the budget. The Company management assess favorable outcome of the above litigations as high. Therefore, VAT payable to customers under corresponding contracts with them shall be reimbursed by the Company after respective VAT amounts are received from the budget which should not entail any negative consequences for the Company. The total amount of the above VAT is RR 1,215,614.

Effective April 2006, the Group applies a zero rate of VAT on export revenue.

### **Taxation**

Tax, currency and customs legislation in the countries in which the Group operates is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes in the Russian federation for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2006 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. Accordingly, at 31 December 2006 no provision for potential tax liabilities had been recorded (2005: no provision).

### **Commitments**

In the normal course of business, the Group prepares a plan for the construction, reconstruction and development of the pipeline network on an annual basis, and revises it periodically during the year. At 31 December 2006, current plans and commitments provided for RR 2,705,366 to be spent during 2007, and long-term constructional commitments relating to the construction of assets under Project "North" amounted RR 11,090,744.

### **Environmental reclamation, restoration and protection costs**

The Group is subject to various environmental laws regarding the handling, storage and disposal of certain products. Existing legislation does not require the removal of the pipeline and associated infrastructure at the end of its useful economic life. The enforcement of environmental regulations in Russian Federation is evolving, and the enforcement posture of government authorities is continually being reconsidered. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

## **21. RELATED PARTY BALANCES AND TRANSACTIONS AND COMPENSATION OF KEY MANAGEMENT PERSONNEL**

The only shareholder of the Company is the Federal Agency for Administration of Federal Property of Russia. Related parties therefore include all branches of the government of the Russian Federation, and entities, which they own or control. The Russian Federation has an arrangement with the Group under which reserves of oil products are stored in the Group's network, in return for which the Group benefits through improved operational flexibility.



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**21. RELATED PARTY BALANCES AND TRANSACTIONS AND COMPENSATION OF KEY MANAGEMENT PERSONNEL (CONTINUED)**

At 31 December 2006 and 2005 the outstanding balances with related parties were as follows:

	<b>31 December 2006</b>	<b>31 December 2005</b>
Financial assets at fair value through profit or loss	173,797	150,218
Trade and other receivables	22,976	19,484
Cash and cash equivalents	466,931	518,878
Payables and advances from customers	570,271	173,752
Long-term borrowings and loans	11,918,501	-
Short-term borrowings and loans	-	1,057,690

The income and expenses items with related parties for the year 2006 and 2005 were as follows:

	<b>Year ended 31 December 2006</b>	<b>Year ended 31 December 2005</b>
Sales:		
Transportation services	3,049,443	942,978
Other revenue	14,471	20,936
Cost of sales:		
Electricity	410,786	499,265
Other expenses	123,182	59,963
Interest income	3,936	3,678
Interest expense	575,961	66,474

Tax balances are disclosed in the balance sheet and notes 7 and 12. Tax transactions are detailed in the income statement and note 15.

**Compensation to key management personnel**

The Group paid to the members of the Management Committee (comprising 9 people) of the Company remuneration made up of a salary and a performance bonus depending on results for the year according to financial statements prepared in accordance with RAR. Compensation to the members of the Management Committee of the Company is determined by the terms of employment contracts. The amounts of such compensation are included in general and administrative expenses and comprised RR 119,058 for the year ended 31 December 2006 (RR 92,616 - year ended 31 December 2005).



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**22. EVENTS AFTER THE BALANCE SHEET DATE**

**Dividends declared**

On 6 June 2007 the Annual General Shareholder's meeting approved dividends in the amount of RR 100,000.

**Change in ownership**

In April 2007, the President of the Russian Federation signed a decree authorising OAO AK Transneft to acquire 100% of the ordinary shares of the Company by September 2007. As of the date of issuing these consolidated financial statements the transaction has not occurred and the accompanying financial statements do not reflect any impact from the transaction.

**Loans and borrowings**

From 1 January 2007 to 9 July 2007 the Group has drawn a further USD 170,641 thousand of its long-term loan facility of USD 753 million from Bank of International Trade ("Vneshtorgbank").