# ZAO Raspadskaya

Consolidated Financial Statements

*Years ended December 31, 2005, 2004 and 2003*
*with Report of Independent Auditors*

# ZAO Raspadskaya

# Consolidated Financial Statements

# Years ended December 31, 2005, 2004 and 2003

## Contents

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# Report of Independent Auditors

The Shareholders and Board of Directors
ZAO Raspadskaya

We have audited the accompanying consolidated balance sheets of ZAO Raspadskaya (the "Company") as at December 31, 2005, 2004 and 2003 and the related consolidated statements of income, changes in equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing. 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.

We did not observe the counting of the physical inventories as of December 31, 2002 since that date was prior to the time we were initially engaged as auditors for the Company. We were unable to satisfy ourselves as to inventory quantities by other audit procedures. Inventory balance as of December 31, 2002 with carrying value of $5,244 thousand enters materially into the determination of net income and cash flows for the year ended December 31, 2003.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to physical inventory quantities as of December 31, 2002, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2005, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Ernst & Young

Without further qualifying our opinion, we draw attention to Note 1 to the consolidated financial statements, which discloses the fact that 2004 and 2003 consolidated financial statements have been revised to reflect the acquisitions of OOO Raspadsky Ugol, ZAO Raspadskaya Ugolnaya Company, ZAO OF Raspadskaya and ZAO Raspadskaya-Koksovaya representing business combinations involving entities under common control with the Company, which have been accounted for in the accompanying consolidated financial statements using the pooling of interests method to present the consolidated financial statements of the Company as if the acquisitions had occurred on the date these entities were originally established by the transferring entity.

Also, without further qualifying our opinion, we draw attention to Note 1 to the consolidated financial statements. A significant part of the Company's transactions were made with related parties.

Ernst & Young LLC

June 30, 2006

# ZAO Raspadskaya

## Consolidated Balance Sheets

*(In thousands of US dollars)*

| | Notes | December 31, 2005 | 2004 | 2003 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Non-current assets** | | | | |
| Property, plant and equipment | **6** | **$ 289,258** | $ 226,423 | $ 159,390 |
| Deferred income tax assets | **4** | **501** | – | – |
| Other non-current assets | | **2,081** | 672 | 901 |
| | | **291,840** | 227,095 | 160,291 |
| **Current assets** | | | | |
| Inventories | **7** | **18,552** | 12,681 | 10,477 |
| Trade and other receivables | **8** | **20,279** | 15,626 | 4,544 |
| Prepayments | | **3,653** | 4,693 | 3,068 |
| Receivables from related parties | **9** | **11,856** | 3,180 | 7,813 |
| Taxes recoverable | **10** | **47,278** | 32,645 | 13,702 |
| Short-term investments | | **105** | 7,440 | 1,073 |
| Cash and cash equivalents | | **26,946** | 48,100 | 15,151 |
| | | **128,669** | 124,365 | 55,828 |
| Non-current assets classified as held for sale | **5** | **–** | 2,387 | 5,042 |
| | | **128,669** | 126,752 | 60,870 |
| **TOTAL ASSETS** | | **$ 420,509** | $ 353,847 | $ 221,161 |
| **EQUITY AND LIABILITIES** | | | | |
| **Equity** | | | | |
| Parent shareholders' equity | | | | |
| Issued capital | **11** | **$ 259** | $ 256 | $ 240 |
| Treasury shares | **11** | **(6,627)** | (5,579) | – |
| Additional paid-in capital | **11** | **1,402** | 1,338 | 274 |
| Reserve capital | **11** | **7** | 7 | 7 |
| Accumulated losses | | **(13,518)** | (48,267) | (87,973) |
| Unrealised gain on investments available-for-sale | | **650** | – | – |
| Translation difference | | **8,535** | 6,978 | 10,190 |
| | | **(9,292)** | (45,267) | (77,262) |
| Minority interests | | **3,684** | 3,681 | 3,738 |
| | | **(5,608)** | (41,586) | (73,524) |
| **Non-current liabilities** | | | | |
| Long-term loans | **12** | **17,326** | 43,018 | 2,993 |
| Payables to related parties | **9** | **–** | 299,469 | 217,613 |
| Deferred income tax liabilities | **4** | **12,685** | 14,184 | 17,620 |
| Finance lease liabilities | **13** | **–** | – | 951 |
| Post-employment benefits | **14** | **8,219** | 2,931 | 2,470 |
| Other long-term liabilities | | **70** | 224 | 94 |
| | | **38,300** | 359,826 | 241,741 |
| **Current liabilities** | | | | |
| Trade and other payables | **15** | **11,794** | 10,237 | 28,673 |
| Short-term loans and current portion of long-term loans | **12** | **46,387** | 855 | 7,087 |
| Payables to related parties | **9** | **317,091** | 11,607 | 8,342 |
| Taxes payable | **16** | **12,545** | 12,539 | 3,426 |
| Current portion of finance lease liabilities | **13** | **–** | – | 4,121 |
| | | **387,817** | 35,238 | 51,649 |
| Liabilities directly associated with non-current assets classified as held for sale | **5** | **–** | 369 | 1,295 |
| | | **387,817** | 35,607 | 52,944 |
| **TOTAL EQUITY AND LIABILITIES** | | **$ 420,509** | $ 353,847 | $ 221,161 |

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

# ZAO Raspadskaya

## Consolidated Income Statements

*(In thousands of US dollars)*

| | Notes | Year ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|---|
| **Continuing operations** | | | | |
| **Revenue** | | | | |
| Sale of goods | | **$ 534,291** | $ 378,920 | $ 125,990 |
| Rendering of services | | **14,600** | 12,729 | 5,453 |
| | | **548,891** | 391,649 | 131,443 |
| Cost of revenue | 3 | **(315,422)** | (214,658) | (101,428) |
| **Gross profit** | | **233,469** | 176,991 | 30,015 |
| Selling and distribution costs | 3 | **(5,255)** | (5,476) | (6,315) |
| General and administrative expenses | 3 | **(25,587)** | (16,986) | (14,602) |
| Social and social infrastructure maintenance expenses | 3 | **(7,118)** | (3,956) | (1,963) |
| Gain/(loss) on disposal of property, plant and equipment | | **(1,188)** | 133 | (202) |
| Foreign exchange gains/(losses), net | | **113** | (92) | (348) |
| Other operating income/(expenses), net | | **(9,639)** | (811) | (2,090) |
| **Profit from operations** | | **184,795** | 149,803 | 4,495 |
| Dividend income | | **93** | – | – |
| Interest income | | **3,294** | 2,297 | 773 |
| Interest expense | | **(5,665)** | (4,715) | (1,167) |
| **Profit before income taxes** | | **182,517** | 147,385 | 4,101 |
| Income tax expense | 4 | **(49,909)** | (39,241) | (2,018) |
| **Profit after tax from continuing operations** | | **132,608** | 108,144 | 2,083 |
| **Discontinued operation** | | | | |
| Gain/(loss) after tax from discontinued operation | 5 | **–** | (1,886) | 237 |
| **Net profit** | | **$ 132,608** | $ 106,258 | $ 2,320 |
| Attributable to: | | | | |
| Equity holders of the parent entity | | **$ 132,148** | $ 105,644 | $ 2,058 |
| Minority interests | | **460** | 614 | 262 |
| | | **$ 132,608** | $ 106,258 | $ 2,320 |
| Earnings per share: | | | | |
| for profit attributable to equity holders of the parent entity, US dollars | 11 | **$ 293.35** | $ 231.61 | $ 4.48 |
| for profit from continuing operations attributable to equity holders of the parent entity, US dollars | 11 | **$ 293.35** | $ 235.74 | $ 3.96 |

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

# ZAO Raspadskaya

## Consolidated Cash Flow Statements

*(In thousands of US dollars)*

| | Year ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net profit | **$ 132,608** | $ 106,258 | $ 2,320 |
| Adjustments to reconcile net profit to net cash provided by operating activities: | | | |
| Depreciation and depletion *(Note 3)* | **30,785** | 37,802 | 43,056 |
| Deferred income tax benefit *(Note 4)* | **(1,575)** | (4,418) | (6,383) |
| (Gain)/loss on disposal of property, plant and equipment | **1,188** | (133) | 202 |
| Gain on sale of subsidiary | **–** | – | (120) |
| Foreign exchange (gains)/losses, net | **(113)** | 92 | 348 |
| (Gain)/loss from discontinued operation *(Note 5)* | **–** | 1,886 | (237) |
| Bad debt expense/(recovery) | **765** | (216) | 247 |
| Dividend income | **(93)** | – | – |
| Interest income | **(3,294)** | (2,297) | (773) |
| Interest expense | **5,665** | 4,715 | 1,167 |
| | **165,936** | 143,689 | 39,827 |
| Changes in operating assets and liabilities: | | | |
| Inventories | **(6,335)** | (1,254) | (4,126) |
| Trade and other receivables | **(3,451)** | (10,117) | 702 |
| Prepayments | **729** | (960) | (914) |
| Receivables from/payables to related parties | **15,334** | 17,197 | 1,688 |
| Taxes recoverable | **(16,084)** | (17,023) | (6,053) |
| Trade and other payables | **(2,045)** | (2,038) | 9,062 |
| Taxes payable | **499** | 9,240 | (723) |
| **Net cash flows from operating activities** | **$ 154,583** | $ 138,734 | $ 39,463 |

*Continued on the next page*

# ZAO Raspadskaya

## Consolidated Cash Flow Statements (continued)

*(In thousands of US dollars)*

| | Year ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| **Cash flows from investing activities** | | | |
| Purchases of property, plant and equipment | **$ (104,732)** | $ (91,631) | $ (26,936) |
| Proceeds from disposal of property, plant and equipment | **548** | 51 | 44 |
| Proceeds from sale of a subsidiary, net of cash disposed | **1,980** | – | – |
| Purchases of minority interests | **(259)** | (56) | – |
| Short-term deposits at banks, including interest, net | **11,100** | (6,993) | – |
| Other investing activities, net | **(829)** | 1,105 | (862) |
| **Net cash flows used in investing activities** | **(92,192)** | (97,524) | (27,754) |
| **Cash flows from financing activities** | | | |
| Purchase of treasury shares | **(1,048)** | (5,579) | – |
| Settlement of promissory notes payable | **–** | (19,758) | (9,216) |
| Dividends paid by the Group to its shareholders | **(97,156)** | – | – |
| Proceeds from loans provided by related parties | – | – | 7,033 |
| Proceeds from loans and borrowings | **52,529** | 48,247 | 10,753 |
| Repayment of loans and borrowings, including interest | **(36,459)** | (27,907) | (6,782) |
| Payments under finance lease, including interest | **–** | (5,579) | (5,976) |
| **Net cash flows used in financing activities** | **(82,134)** | (10,576) | (4,188) |
| Effect of foreign exchange rate changes on cash and cash equivalents | **(1,411)** | 2,315 | 559 |
| Net (decrease)/increase in cash and cash equivalents | **(21,154)** | 32,949 | 8,080 |
| Cash and cash equivalents at beginning of year | **48,100** | 15,151 | 7,071 |
| **Cash and cash equivalents at end of year** | **$ 26,946** | $ 48,100 | $ 15,151 |
| **Supplementary cash flow information:** | | | |
| Cash flows during the period: | | | |
| Interest paid | **$ 5,801** | $ 5,382 | $ 423 |
| Income taxes paid | **59,105** | 44,760 | 5,517 |

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

ZAO Raspadskaya

# Consolidated Statements of Changes in Equity

*(In thousands of US dollars)*

| | Issued capital | Treasury shares | Additional paid-in capital | Reserve capital | Accumulated losses | Unrealised gain on investments available-for-sale | Translation difference | Parent shareholders' equity | Minority interests | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| **At December 31, 2004** | $ 256 | $ (5,579) | $ 1,338 | $ 7 | $ (48,267) | $ – | $ 6,978 | $ (45,267) | $ 3,681 | $ (41,586) |
| Effect of exchange rate changes | – | – | – | – | – | – | **1,557** | **1,557** | **(134)** | **1,423** |
| Total income and expense for the period recognised directly in equity | – | – | – | – | – | – | **1,557** | **1,557** | **(134)** | **1,423** |
| Net profit | – | – | – | – | **132,148** | – | – | **132,148** | **460** | **132,608** |
| Total income and expense for the period | – | – | – | – | **132,148** | – | **1,557** | **133,705** | **326** | **134,031** |
| Issue of share capital, net of issuance costs *(Note 11)* | **3** | – | – | – | – | – | – | **3** | – | **3** |
| Purchase of treasury shares *(Note 11)* | – | **(1,048)** | – | – | – | – | – | **(1,048)** | – | **(1,048)** |
| Net gains on available-for-sale financial assets | – | – | – | – | – | **650** | – | **650** | – | **650** |
| Acquisition of minority interests in existing subsidiaries | – | – | **64** | – | – | – | – | **64** | **(323)** | **(259)** |
| Dividends declared by the Group to its shareholders *(Note 11)* | – | – | – | – | **(97,399)** | – | – | **(97,399)** | – | **(97,399)** |
| **At December 31, 2005** | **$ 259** | **$ (6,627)** | **$ 1,402** | **$ 7** | **$ (13,518)** | **$ 650** | **$ 8,535** | **$ (9,292)** | **$ 3,684** | **$ (5,608)** |

*Continued on the next page*

## Consolidated Statements of Changes in Equity (continued)

*(In thousands of US dollars)*

| | Issued capital | Treasury shares | Additional paid-in capital | Reserve capital | Accumulated profits/ (losses) | Unrealised gain on investments available-for-sale | Translation difference | Parent shareholders' equity | Minority interests | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| **At December 31, 2002** | $ 240 | $ – | $ 274 | $ 7 | $ 127,553 | $ – | $ – | $ 128,074 | $ 2,902 | $ 130,976 |
| Effect of exchange rate changes | – | – | – | – | – | – | 10,190 | 10,190 | 263 | 10,453 |
| Total income and expense for the period recognised directly in equity | – | – | – | – | – | – | 10,190 | 10,190 | 263 | 10,453 |
| Net profit | – | – | – | – | 2,058 | – | – | 2,058 | 262 | 2,320 |
| Total income and expense for the period | – | – | – | – | 2,058 | – | 10,190 | 12,248 | 525 | 12,773 |
| Group's reorganisation: acquisition of subsidiaries from entities under common control *(Note 1)* | – | – | – | – | (217,584) | – | – | (217,584) | – | (217,584) |
| Minority interest arising on acquisition of subsidiaries | – | – | – | – | – | – | – | – | 311 | 311 |
| **At December 31, 2003** | $ 240 | $ – | $ 274 | $ 7 | $ (87,973) | $ – | $ 10,190 | $ (77,262) | $ 3,738 | $ (73,524) |
| Effect of exchange rate changes | – | – | – | – | – | – | (3,212) | (3,212) | 213 | (2,999) |
| Total income and expense for the period recognised directly in equity | – | – | – | – | – | – | (3,212) | (3,212) | 213 | (2,999) |
| Net profit | – | – | – | – | 105,644 | – | – | 105,644 | 614 | 106,258 |
| Total income and expense for the period | – | – | – | – | 105,644 | – | (3,212) | 102,432 | 827 | 103,259 |
| Group's reorganisation: acquisition of subsidiaries from entities under common control *(Note 1)* | – | – | – | – | (65,938) | – | – | (65,938) | – | (65,938) |
| Increase in par value of shares *(Note 11)* | 16 | – | (16) | – | – | – | – | – | – | – |
| Purchase of treasury shares *(Note 11)* | – | (5,579) | – | – | – | – | – | (5,579) | – | (5,579) |
| Minority interest arising on acquisition of subsidiaries | – | – | – | – | – | – | – | – | 252 | 252 |
| Acquisition of minority interests in existing subsidiaries | – | – | 1,080 | – | – | – | – | 1,080 | (1,136) | (56) |
| **At December 31, 2004** | **$ 256** | **$ (5,579)** | **$ 1,338** | **$ 7** | **$ (48,267)** | **$ –** | **$ 6,978** | **$ (45,267)** | **$ 3,681** | **$ (41,586)** |

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

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 1. Corporate Information

The consolidated financial statements of ZAO Raspadskaya (ZAO Raspadskaya or the "Company") for the year ended December 31, 2005 were authorised for issue in accordance with a resolution of the Board of Directors on June 30, 2006.

The Company commenced operations in 1973. It was registered as a Russian closed joint stock company following its privatization in 1991. The registered office of the Company is 109, Mira street, Mezhdurechensk, the Kemerovo region, the Russian Federation. The Company's principal shareholder is Corber Enterprises Limited (Cyprus), a joint venture set up by Mastercroft Mining Limited, the ultimate subsidiary of Evraz Group S.A. (Luxembourg), and Adroliv Limited (Cyprus).

ZAO Raspadskaya and its subsidiaries (the "Group") derive approximately 90% of their revenues from sales of coal. Other revenue sources include transport-handling services and other non-production revenues. In the years ended December 31, 2005, 2004 and 2003, approximately 30%, 27% and 51%, respectively, of the Group's revenues were generated in transactions with related parties. In addition, a significant portion of the Group's purchases was made in transactions with related parties. For detailed information related to such activities refer to Note 9.

The Group operates as a vertically integrated business and reports its activities as a single business segment.

On June 18, 2002, the Company's shareholders appointed ZAO Raspadskaya Ugolnaya Company as a management executive body of the Company. ZAO Raspadskaya Ugolnaya Company continued to operate in that capacity in 2005.

At December 31, 2005, 2004 and 2003, the Group employed approximately 6,000, 5,500 and 4,500 employees, respectively.

The subsidiaries included in the consolidated financial statements of ZAO Raspadskaya were as follows at December 31:

| | Effective ownership interest,% | | | | |
|---|---|---|---|---|---|
| **Subsidiary** | **2005** | **2004** | **2003** | **Business activity** | **Country of incorporation** |
| OOO Raspadsky Ugol | 100.00 | 100.00 | – | Coal trading | Russian Federation |
| ZAO Raspadskaya Ugolnaya Company | 100.00 | 100.00 | 100.00 | Management services | Russian Federation |
| ZAO OF Raspadskaya | 100.00 | 100.00 | 100.00 | Coal processing factory | Russian Federation |
| ZAO Raspadskaya-Koksovaya | 100.00 | 100.00 | 100.00 | Coal mine | Russian Federation |
| OOO Raspadskaya-Joy | 100.00 | 100.00 | 69.00 | Mining services | Russian Federation |
| OOO Puteets | 100.00 | 100.00 | – | Railway maintenance | Russian Federation |
| OAO Olzherasskoye shakhtoprokhodcheskoye upravlenie | 95.12 | 93.26 | 50.07 | Mining engineering and construction | Russian Federation |
| OAO Tomusinskoye pogruzochno-transportnoye upravlenie | 58.55 | 54.64 | 54.64 | Transportation | Russian Federation |
| OOO Montazhnik Raspadskoi | 51.00 | 51.00 | 51.00 | Mining equipment maintenance | Russian Federation |
| OOO Raspadskaya-Mintex | – | 100.00 | 100.00 | Trading | Russian Federation |
| ZAO Tomusinskoye lokomotivnoye depo | – | 100.00 | – | Transportation | Russian Federation |

## 1. Corporate Information (continued)

*Controlling Interests in Subsidiaries Transferred to the Group by a Shareholder*

Prior to the authorisation of these financial statements the Company finalised the reorganisation plan which resulted in the transfer of the entities under control of Corber Enterprises Limited to the Company. The Company acquired the controlling interests in OOO Raspadsky Ugol, ZAO Raspadskaya Ugolnaya Company, ZAO OF Raspadskaya, ZAO Raspadskaya-Koksovaya from Corber Enterprises Limited for a total cash consideration of 8,309,880,000 Russian roubles.

As this reorganisation represents acquisitions of entities under common control, these consolidated financial statements have been prepared using the pooling of interest method, and, as such, the financial statements, including corresponding figures, have been presented as if transfers of ownership interests in subsidiaries had occurred on the date they were originally established by the transferring party (the "Predecessor").

The assets and liabilities of the subsidiaries transferred under common control were recorded in these financial statements at the historical cost of the Predecessor. The difference between the total book value of net assets approximating zero at the date those subsidiaries were established and the purchase consideration was accounted for in these consolidated financial statements as an adjustment to the shareholders' equity in the amount of $65,938 in 2004 and $217,584 in 2003.

The balances of amounts due to related parties as of December 31, 2005, 2004 and 2003 include liabilities in the amount of $288,713, $299,469 and $217,613, respectively, payable to Corber Enterprises Limited for transfers of ownership interests in OOO Raspadsky Ugol, ZAO Raspadskaya Ugolnaya Company, ZAO OF Raspadskaya, ZAO Raspadskaya-Koksovaya (Note 9).

## 2. Significant Accounting Policies

### Basis of Preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The Group's subsidiaries maintain their records and prepare their financial statements in Russian roubles ("roubles"), in accordance with the Regulations on Accounting and Reporting in the Russian Federation. The accompanying financial statements differ from the financial statements issued for statutory purposes in Russia in that they reflect certain adjustments, which are appropriate to present the financial position, results of operations and cash flows of the Group in accordance with IFRS. The principal adjustments relate to (1) expense and revenue recognition, (2) valuation allowances for unrecoverable assets, (3) depreciation and valuation of property and equipment, (4) accounting for income taxes, and (5) use of fair values.

## 2. Significant Accounting Policies (continued)

**Basis of Preparation (continued)**

The consolidated financial statements have been prepared under the historical cost convention, other than in respect of property, plant and equipment at the date of transition to IFRS as described below. Other exceptions include available for sale investments and assets classified as held for sale measured at fair value and post-employment benefits measured at present value.

***First-time Adoption of International Financial Reporting Standards (IFRS 1)***

The Group applied IFRS 1 in the preparation of its first consolidated financial statements in accordance with IFRS for the year ended December 31, 2004. The Group's transition date to IFRS is January 1, 2003.

***First-time Adoption of International Financial Reporting Standards (IFRS 1) (continued)***

In accordance with IFRS 1, the Group elected to use the following exemptions:

- Property, plant and equipment are measured at their fair values in the IFRS opening balance sheet, which become their deemed cost going forward under the IFRS cost model.
- For business combinations that the Group recognised before December 31, 2002, the Group adjusted the carrying amounts of the subsidiaries' assets and liabilities to the amounts that IFRS would require in the separate subsidiaries' balance sheets. The deemed cost of goodwill/negative goodwill was determined as the difference at the date of transition to IFRS between: (i) the parent's interest in those adjusted carrying amounts; and (ii) the cost in the parent's separate financial statements of its investment in the subsidiary.

***Changes in Accounting Policies***

The accounting policies applied are consistent with those of the previous financial year except that the Group has adopted those new/revised standards mandatory for financial years beginning on or after January 1, 2005. The changes in accounting policies result from adoption of the following new or revised standards:

- IFRS 2 "Share-Based Payment";
- IFRS 3 "Business Combinations";
- IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations";
- IFRS 6 "Exploration for and Evaluation of Mineral Resources" (early adoption);
- IAS 1 (revised) "Presentation of Financial Statements";
- IAS 2 (revised) "Inventories";
- IAS 8 (revised) "Accounting Policies, Changes in Accounting Estimates and Errors";
- IAS 10 (revised) "Events After the Balance Sheet Date";
- IAS 16 (revised) "Property, Plant and Equipment";
- IAS 17 (revised) "Leases";

## 2. Significant Accounting Policies (continued)

### Basis of Preparation (continued)

***Changes in Accounting Policies (continued)***

- IAS 21 (revised) “The Effects of Changes in Foreign Exchange Rates”;
- IAS 24 (revised) “Related Party Disclosures”;
- IAS 28 (revised) “Investments in Associates”;
- IAS 32 (revised) “Financial Instruments: Disclosure and Presentation”;
- IAS 33 (revised) “Earnings per Share”;
- IAS 36 (revised) “Impairment of Assets”;
- IAS 38 (revised) “Intangible Assets”; and
- IAS 39 (revised) “Financial Instruments: Recognition and Measurement”.

The principal effects of these changes in policies are discussed below.

*IAS 16 (revised) “Property, Plant and Equipment”*

From January 1, 2005 the Group capitalises subsequent expenditures relating to replacement of components of property, plant and equipment. The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing parts when that cost is incurred and the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of IAS 16. In 2005, the Group capitalised subsequent expenditures net of replaced components for an approximate amount of $4,210. Net book value of the replaced components amounting to $112 was included in loss on disposal of property, plant and equipment in the accompanying consolidated income statement for the year ended December 31, 2005. It is impracticable to determine the effect of adoption of the revised standard on the corresponding figures.

The adoption of other standards listed above had no significant impact on the Group’s financial statements.

*IFRSs and IFRIC Interpretations not yet Effective*

The Group has not applied the following IFRSs and IFRIC Interpretations that have been issued but are not yet effective:

- IAS 19 (amended 2004) “Employee Benefits”;
- IAS 39 (amended 2005) “Financial Instruments: Recognition and Measurement”;
- IFRS 7 “Financial Instruments: Disclosures”;
- IFRIC 4 “Determining whether an Arrangement contains a Lease”.

The Group expects that the adoption of the pronouncements listed above will have no significant impact on the Group’s financial statements in the period of initial application.

## 2. Significant Accounting Policies (continued)

### Estimation Uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

*Impairment of Property, Plant and Equipment*

The Group assesses at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the Group estimates the recoverable amount of the asset. This requires an estimation of the value in use of the cash-generating units (each individual subsidiary) to which the item is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. No impairment losses were recognised or reversed in the years ended December 31, 2005, 2004 and 2003.

*Useful Lives of Items of Property, Plant and Equipment*

The Group assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end and, if expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". In 2005, the change in estimates of useful lives of property, plant and equipment resulted in an additional depreciation expense of approximately $504.

*Site Restoration Provisions*

The Group reviews expected restoration costs of mining sites at each balance sheet date. As a result, the management concluded that as of December 31, 2005, 2004 and 2003 no liabilities existed in respect of restoration of mining sites other than contingent liabilities disclosed in Note 17.

*Fair Values of Assets and Liabilities Acquired in Business Combinations*

The Group is required to recognise separately, at the acquisition date, the identifiable assets, liabilities and contingent liabilities acquired or assumed in the business combination at their fair values, which involves estimates. Such estimates are based on valuation techniques which require considerable judgement in forecasting future cash flows and developing other assumptions.

## 2. Significant Accounting Policies (continued)

### Estimation Uncertainty (continued)

*Post-Employment Benefits*

The Group uses actuarial valuation method for measurement of the present value of post-employment benefit obligations and related current service cost. This involves the use of demographic assumptions about the future characteristics of current and former employees who are eligible for benefits (mortality, both during and after employment, rates of employee turnover, disability and early retirement, etc.) as well as financial assumptions (discount rate, future salary and benefit levels, expected rate of return on plan assets, etc.).

*Allowances*

The Group makes allowances for doubtful accounts receivable. Significant judgement is used to estimate doubtful accounts. In estimating doubtful accounts such factors are considered as current overall economic conditions, industry-specific economic conditions, historical and anticipated customer performance. Changes in the economy, industry, or specific customer conditions may require adjustments to the allowance for doubtful accounts recorded in the consolidated financial statements. As of December 31, 2005, 2004 and 2003, allowances for doubtful accounts have been made in the amount of $591, $156 and $247, respectively (Note 8).

*Deferred Income Tax Assets*

Deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. The estimation of that probability includes judgments based on the expected performance.

### Foreign Currency Transactions

The presentation currency of the Group is the US dollar because the presentation in US dollars is convenient for the major current and potential users of the consolidated financial statements.

The functional currency of the Group's subsidiaries located in the Russian Federation is the Russian rouble (the "rouble"). As at the reporting date, the assets and liabilities of the subsidiaries with the rouble, as functional currency, are translated into the presentation currency at the rate of exchange ruling at the balance sheet date, and their income statements are translated at the weighted average exchange rate for the year. The exchange differences arising on the translation are taken directly to a separate component of equity.

Transactions in foreign currencies in the Group and each subsidiary are initially recorded in the functional currency at the rate ruling at the date of transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the consolidated income statement.

**2. Significant Accounting Policies (continued)**

**Basis of Consolidation**

*Subsidiaries*

Subsidiaries, which are those entities in which the Company has an interest of more than 50% of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Company and are no longer consolidated from the date that control ceases. All intercompany 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.

*Acquisition of Subsidiaries*

The purchase method of accounting was used to account for the acquisition of subsidiaries except for acquisitions made prior to the date of transition to IFRS, which were accounted for in accordance with IFRS 1, as described above.

The excess of purchase consideration over the fair value of the Group's share of identifiable net assets is recorded as goodwill. If the cost of the acquisition is less than the fair value of the Group's share of identifiable net assets of the subsidiary acquired the difference is recognised directly in the income statement.

Minority interest is that portion of the profit or loss and net assets of subsidiaries attributable to equity interests that are not owned, directly or indirectly through subsidiaries, by the parent. 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 in the consolidated balance sheet within equity, separately from the parent's shareholders' equity.

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary. Any additional losses are allocated to the Group unless there is a binding obligation of the minority to fund the losses.

*Increases in Ownership Interests in Subsidiaries*

Increases in ownership interests in subsidiaries prior to January 1, 2004 were accounted for using the purchase method.

Effective January 1, 2004, the differences between the carrying values of net assets attributable to interests in subsidiaries acquired and the consideration given for such increases is either added to additional paid-in capital, if positive, or charged to accumulated profits, if negative, in the accompanying consolidated financial statements.

## 2. Significant Accounting Policies (continued)

### Property, Plant and Equipment

The Group's property, plant and equipment, except for the items acquired prior to January 1, 2003, are stated at purchase or construction cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any impairment in value. Such cost includes the cost of replacing part of plant and equipment when that cost is incurred and recognition criteria are met. As described under Basis of Preparation above, the items of property, plant and equipment acquired prior to January 1, 2003 were accounted for at deemed cost being their fair value at January 1, 2003.

At each balance sheet date management makes an assessment to determine whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is the higher of an asset's fair value less cost to sell and its value in use. The carrying amount is reduced to the recoverable amount, and the difference is recognised as an expense (impairment loss) in the income statement. An impairment loss recognised for an asset in previous years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

Land is not depreciated. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets. The useful lives of items of property, plant and equipment and methods of their depreciation are reviewed, and adjusted as appropriate, at each fiscal year-end. The table below presents the useful lives of items of property, plant and equipment.

| | Useful lives (years) | Weighted average useful life (years) |
|---|---|---|
| Buildings and constructions | 10-60 | 30 |
| Machinery and equipment | 2-25 | 6 |
| Transport and motor vehicles | 4-32 | 6 |

The Group determines the depreciation charge separately for each significant part of an item of property, plant and equipment.

The Group's property, plant and equipment include mining assets, which consist of mine development and construction costs. Mine development and construction costs represent expenditures incurred in developing access to mineral reserves and preparations for commercial production, including sinking shafts and underground drifts, roads, infrastructure, buildings, machinery and equipment.

Depletion of mining assets is calculated using the units-of-production method based upon proved developed mineral reserves.

Maintenance costs relating to items of property, plant and equipment are expensed as incurred. Major renewals and improvements are capitalised, and the replaced assets are derecognised.

The Group has the title to certain non-production and social assets, primarily buildings and facilities of social infrastructure, which are carried at their recoverable amount of zero. The costs to maintain such assets are expensed as incurred.

## 2. Significant Accounting Policies (continued)

### Leases

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised from the commencement of the lease term at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to interest expense.

The depreciation policy for depreciable leased assets is consistent with that for depreciable assets, which are owned. If there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is fully depreciated over the shorter of the lease term or its useful life.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

### Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary/associated undertaking at the date of acquisition. Goodwill on an acquisition of a subsidiary is included in intangible assets. Goodwill on an acquisition of an associate is included in investment in associate.

Goodwill relating to business combinations is not amortised but is reviewed for impairment annually or more frequently, if events or changes in circumstances indicate that the carrying amount may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

Where goodwill forms part of a cash-generating unit and part of the operations within that unit are disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation.

The excess of the fair value of the Group's share of the net assets acquired over the cost of acquisition is recognised in the income statement.

### Investments

The Group classified its investments into the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity and available-for-sale. When investments are recognised initially, they are measured at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its investments after initial recognition.

## 2. Significant Accounting Policies (continued)

**Investments (continued)**

Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as held for trading and included in the category "financial assets at fair value through profit or loss". Investments which are included in this category are subsequently carried at fair value; gains or losses on such investments are recognised in income.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Investments with fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity. Held-to-maturity investments are carried at amortised cost using the effective yield method.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis. After initial recognition available-for-sale investments are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement. Reversals of impairment losses in respect of equity instruments are not recognised in the income statement. Impairment losses in respect of debt instruments are reversed through profit or loss if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in the income statement.

For investments that are actively traded in organised financial markets, fair value is determined by reference to stock exchange quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same or discounted cash flow analysis.

All purchases and sales of financial assets under contracts to purchase or sell financial assets that require delivery of the asset within the time frame generally established by regulation or convention in the market place are recognised on the settlement date i.e. the date the asset is delivered by/to the counterparty.

## 2. Significant Accounting Policies (continued)

### Inventories

Inventories are recorded at the lower of cost and net realisable value. Cost of inventory is determined on the weighted average basis and includes expenditure incurred in acquiring inventories and bringing them to their existing location and condition. The cost of finished goods and work in progress includes an appropriate share of production overheads based on normal operating capacity, but excluding borrowing costs.

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and estimated costs necessary to make the sale.

### Accounts Receivable

Accounts receivable, which generally are short term, are recognised and carried at the original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

### Value Added Tax

The tax authorities permit the settlement of sales and purchases value added tax (“VAT”) on a net basis.

*VAT Payable*

VAT is payable to tax authorities upon collection of receivables from customers. VAT on purchases, which have been settled at the balance sheet date, is deducted from the amount payable. In addition, VAT related to sales which have not been settled at the balance sheet date (VAT deferred) is also included in VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

*VAT Recoverable*

VAT recoverable relates to purchases which have not been settled at the balance sheet date and property, plant and equipment not put into operation. VAT recoverable is reclaimable against VAT related to sales upon payment for the purchases and putting property, plant and equipment into operation.

### Cash and Cash Equivalents

Cash and cash equivalents, mainly denominated in roubles, comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

## 2. Significant Accounting Policies (continued)

### Shareholders' Equity

*Share Capital*

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction in equity from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recognised as additional paid-in capital.

*Dividends*

Dividends are recognised as a liability and deducted from equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are authorised for issue.

### Borrowings

Borrowings are initially recognised at the fair value of consideration received, net of directly attributable transaction costs. In subsequent periods, borrowings are measured at amortised cost using the effective interest rate method; any difference between the amount initially recognised and the redemption amount is recognised as interest expense over the period of the borrowings. Borrowing costs are expensed as incurred.

### Accounts Payable

Accounts payable are carried at cost, which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the Group.

### Government Grants

Government grants are recognised at their fair value, where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

Grants related to assets are presented in the balance sheet by deducting the grant in arriving at the carrying amount of the asset and are recognised as a deduction from depreciation expense over the life of the asset.

### Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

## 2. Significant Accounting Policies (continued)

**Provisions (continued)**

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as an interest expense.

**Employee Benefits**

*Social and Pension Contributions*

Defined contributions are made by the Group to the Russian Federation state pension, social insurance, medical insurance and unemployment funds at the statutory rates in force (approximately 24%), based on gross salary payments. The Group has no legal or constructive obligation to pay further contributions in respect of those benefits. Its only obligation is to pay contributions as they fall due. These contributions are expensed as incurred.

*Post-Employment Benefits*

The Group provides additional pensions and other post-employment benefits to its employees in accordance with collective bargaining agreements. The entitlement to these benefits is conditional on the employee remaining in service up to retirement age, the completion of a minimum service period and the amount of the benefits stipulated in the collective bargaining agreements.

The liability recognised in the balance sheet in respect of post-employment benefits is the present value of the defined benefit obligation at the balance sheet date less the fair value of the plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually using the projected unit credit method. The present value of the benefits is determined by discounting the estimated future cash outflows using interest rates of high-quality government bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related obligations.

Actuarial gains and losses are recognised as income or expense when the cumulative unrecognised actuarial gains or losses for each individual plan exceed 10% of the higher of defined benefit obligation and the fair value of plan assets. The excess of cumulative actuarial gains or losses over the 10% of the higher of defined benefit obligation and the fair value of plan assets are recognised over the expected average remaining working lives of the employees participating in the plan.

## 2. Significant Accounting Policies (continued)

### Employee Benefits (continued)

*Other Costs*

The Group incurs employee costs related to the provision of benefits such as health services, kindergartens and other services. These amounts principally represent an implicit cost of employment and, accordingly, have been charged to cost of sales.

### Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

When goods are sold or services are rendered in exchange for dissimilar goods or services, the revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

The following specific recognition criteria must also be met before revenue is recognised:

*Sale of Goods*

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably.

*Rendering of Services*

Revenue is recognised when services are rendered.

*Interest*

Interest is recognised using the effective interest method.

*Dividends*

Revenue is recognised when the shareholders' right to receive the payment is established.

### Deferred Income Tax

Deferred tax assets and liabilities are calculated in respect of temporary differences using the 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, except where the deferred income tax arises from goodwill amortisation or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 2. Significant Accounting Policies (continued)

### Deferred Income Tax (continued)

A deferred 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 utilised. 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, associates and joint ventures, 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.

## 3. Expenses

The following expenses were included in cost of revenues, selling and distribution costs, general and administrative expenses, and social and social infrastructure maintenance expenses for the years ended December 31:

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Cost of inventories recognised as expense | **$ 205,484** | $ 115,102 | $ 11,849 |
| Staff cost, including social security taxes | **65,766** | 38,582 | 29,647 |
| Depreciation, depletion and amortisation | **$ 30,785** | $ 37,802 | $ 43,056 |

## 4. Income Taxes

Major components of income tax expense were as follows for the years ended December 31:

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| *Current income tax* | **$ (51,484)** | $ (43,659) | $ (8,401) |
| *Deferred income tax* | | | |
| Relating to origination and reversal of temporary differences | **1,575** | 4,418 | 6,383 |
| Income tax expense reported in the consolidated income statement | **$ (49,909)** | $ (39,241) | $ (2,018) |

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 4. Income Taxes (continued)

The Russian Federation was the only tax jurisdiction in which the Group's income was subject to taxation. Reconciliation between the income tax expenses applicable to profit before income tax at the statutory tax rate to income tax expense at the Group's effective income tax rate is as follows for the years ended December 31:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Profit before income tax | **$ 182,517** | $ 147,385 | $ 4,101 |
| At Russian statutory income tax rate of 24% | **(43,804)** | (35,372) | (984) |
| Effect of non-deductible expenses and other non-temporary differences | **(6,105)** | (3,869) | (1,034) |
| Income tax expense reported in the consolidated income statement | **$ (49,909)** | $ (39,241) | $ (2,018) |

Deferred income tax assets and liabilities and their movements for the years ended December 31 were as follows:

| | 2005 | Change recognised in income statement | Translation difference | 2004 | Change recognised in income statement | Change due to business combination | Translation difference | 2003 |
|---|---|---|---|---|---|---|---|---|
| Deferred income tax liabilities: | | | | | | | | |
| Property, plant and equipment | **$ 13,832** | **$ (1,752)** | **$ (549)** | $ 16,133 | $ (5,661) | $ 34 | $ 1,129 | $ 20,631 |
| Inventories | **2** | **(168)** | **(5)** | 175 | 73 | – | 8 | 94 |
| | **13,834** | **(1,920)** | **(554)** | 16,308 | (5,588) | 34 | 1,137 | 20,725 |
| Deferred income tax assets: | | | | | | | | |
| Exploration expenses capitalised for tax purposes | **935** | **(507)** | **(24)** | 1,466 | 120 | – | 78 | 1,268 |
| Accrued liabilities | **220** | **(382)** | **(14)** | 616 | (1,197) | – | 105 | 1,708 |
| Other | **495** | **544** | **(91)** | 42 | (93) | – | 6 | 129 |
| | **1,650** | **(345)** | **(129)** | 2,124 | (1,170) | – | 189 | 3,105 |
| Total deferred income tax asset/(liability) | **$ (12,184)** | **$ 1,575** | **$ 425** | $ (14,184) | $ 4,418 | $ (34) | $ (948) | $ (17,620) |
| **Represented by the following:** | | | | | | | | |
| Net deferred income tax asset | **$ 501** | **$ 510** | **$ (9)** | $ – | $ – | $ – | $ – | $ – |
| Net deferred income tax liability | **12,685** | **(1,065)** | **(434)** | 14,184 | (4,418) | 34 | 948 | 17,620 |

Deferred income taxes have not been provided for undistributed earnings of the Group's subsidiaries amounting to $33,786 as of December 31, 2005, as management does not intend to dividend these earnings in the foreseeable future. The current tax rate for dividends income in Russia is 9%. The undistributed earnings are considered as permanently reinvested.

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 5. Discontinued Operation

On January 13, 2005, the Board of directors of the Group decided to dispose of OOO Raspadskaya-Mintex. The main business of OOO Raspadskaya-Mintex was resale of steel and coal products.

The disposal was completed on July 17, 2005. 100% of ownership interest in Raspadskaya-Mintex was sold for cash consideration of 56,000,000 roubles ($1,956, at the exchange rate as of the date of the transaction). The transaction was performed without any gains or losses. As at December 31, 2004 and 2003, OOO Raspadskaya-Mintex was classified as a disposal group held for sale. The results of OOO Raspadskaya-Mintex were as follows for the years ended December 31:

| | **2004** | **2003** |
|---|---|---|
| Revenues | $ 15,056 | $ 17,238 |
| Cost of revenues | (15,287) | (16,913) |
| Gross margin | (231) | 325 |
| Other operating expenses | (1,652) | – |
| Loss before tax from discontinued operation | (1,883) | 325 |
| Income tax expense | (3) | (88) |
| Net loss attributable to discontinued operation | $ (1,886) | $ 237 |

The result of operations and cash flows in 2005 was immaterial.

The major classes of assets and liabilities of OOO Raspadskaya-Mintex measured at the lower of carrying amount and fair value less cost to sell at December 31, 2004 and 2003 were as follows:

| | **December 31,** | |
|---|---|---|
| | **2004** | **2003** |
| Assets | | |
| Property, plant and equipment | $ 76 | $ 5 |
| Input VAT | 215 | 332 |
| Accounts receivable | 890 | 4,287 |
| Goods | 1,150 | 412 |
| Cash | 56 | 6 |
| Non-current assets classified as held for sale | 2,387 | 5,042 |
| Liabilities | | |
| Accounts payable | (369) | (1,295) |
| Liabilities directly associated with non-current assets classified as held for sale | (369) | (1,295) |
| Net non-current assets classified as held for sale | $ 2,018 | $ 3,747 |

The net cash flows incurred by OOO Raspadskaya-Mintex consisted of net operating cash inflows of $2 in the year ended December 31, 2004 and net operating cash outflow of $1 in the year ended December 31, 2003.

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 6. Property, Plant and Equipment

Property, plant and equipment consisted of the following as of December 31:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Cost: | | | |
| Land | **$ 41** | $ – | $ – |
| Buildings and constructions | **57,591** | 13,753 | 12,527 |
| Machinery and equipment | **158,885** | 104,506 | 78,337 |
| Transport and motor vehicles | **5,827** | 4,620 | 3,317 |
| Mining assets | **119,718** | 110,951 | 98,051 |
| Other assets | **2,003** | 498 | 306 |
| Assets under construction | **58,596** | 80,307 | 15,577 |
| | **402,661** | 314,635 | 208,115 |
| Accumulated depreciation: | | | |
| Buildings and constructions | **(1,379)** | (1,066) | (502) |
| Machinery and equipment | **(67,096)** | (53,447) | (30,395) |
| Transport and motor vehicles | **(1,590)** | (791) | (382) |
| Mining assets | **(40,059)** | (29,974) | (14,428) |
| Other assets | **(399)** | (98) | (35) |
| | **(110,523)** | (85,376) | (45,742) |
| Government grants: | | | |
| Machinery and equipment, net | **(2,880)** | (2,836) | (2,983) |
| | **$ 289,258** | $ 226,423 | $ 159,390 |

As of December 31, 2005, 2004 and 2003, mining assets include coal extraction rights in the amount of $2,398, $2,407 and $2,198, respectively, representing a license for Raspadskaya-2 plot. In addition, the Company owns a license for Raspadskaya plot, which cost amounts to $1.

Assets under construction include prepayments to contractors and suppliers of property, plant and equipment in the amount of $5,986, $6,173 and $348 as of December 31, 2005, 2004 and 2003, respectively.

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 6. Property, Plant and Equipment (continued)

The movement in property, plant and equipment for the year ended December 31, 2005 was as follows:

| | **Land** | **Buildings and constructions** | **Machinery and equipment** | **Transport and motor vehicles** | **Mining assets** | **Other assets** | **Assets under construction** | **Total** |
|---|---|---|---|---|---|---|---|---|
| At December 31, 2004, cost, net of accumulated depreciation and government grants | **$ –** | **$ 12,687** | **$ 48,223** | **$ 3,829** | **$ 80,977** | **$ 400** | **$ 80,307** | **$ 226,423** |
| Additions | **–** | **–** | **–** | **–** | **12,975** | **–** | **91,928** | **104,903** |
| Assets put into operation | **41** | **46,750** | **61,078** | **1,679** | **–** | **1,496** | **(111,044)** | **–** |
| Disposals | **–** | **(1,180)** | **(220)** | **(447)** | **–** | **(49)** | **(41)** | **(1,937)** |
| Depreciation and depletion charge | **–** | **(817)** | **(17,941)** | **(677)** | **(11,358)** | **(207)** | **–** | **(31,000)** |
| Amortisation of government grants | **–** | **–** | **215** | **–** | **–** | **–** | **–** | **215** |
| Translation difference | **–** | **(1,228)** | **(2,446)** | **(147)** | **(2,935)** | **(36)** | **(2,554)** | **(9,346)** |
| At December 31, 2005, cost, net of accumulated depreciation and government grants | **$ 41** | **$ 56,212** | **$ 88,909** | **$ 4,237** | **$ 79,659** | **$ 1,604** | **$ 58,596** | **$ 289,258** |

The movement in property, plant and equipment for the year ended December 31, 2004 was as follows:

| | **Land** | **Buildings and constructions** | **Machinery and equipment** | **Transport and motor vehicles** | **Mining assets** | **Other assets** | **Assets under construction** | **Total** |
|---|---|---|---|---|---|---|---|---|
| At December 31, 2003, cost, net of accumulated depreciation and government grants | $ – | $ 12,025 | $ 44,959 | $ 2,935 | $ 83,623 | $ 271 | $ 15,557 | $ 159,390 |
| Additions | – | – | – | – | 1,810 | – | 91,582 | 93,392 |
| Assets put into operation | | 718 | 22,892 | 1,175 | 6,038 | 229 | (31,052) | – |
| Assets acquired in business combination | – | 78 | 471 | 212 | – | 48 | 31 | 840 |
| Disposals | – | (329) | (264) | (209) | – | (103) | (15) | (920) |
| Depreciation and depletion charge | – | (535) | (23,681) | (414) | (14,116) | (63) | – | (38,809) |
| Amortisation of government grants | – | – | 1,007 | – | – | – | – | 1,007 |
| Translation difference | – | 730 | 2,839 | 130 | 3,622 | 18 | 4,184 | 11,523 |
| At December 31, 2004, cost, net of accumulated depreciation and government grants | $ – | $ 12,687 | $ 48,223 | $ 3,829 | $ 80,977 | $ 400 | $ 80,307 | $ 226,423 |

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 6. Property, Plant and Equipment (continued)

The movement in property, plant and equipment for the year ended December 31, 2004 was as follows:

| | Land | Buildings and constructions | Machinery and equipment | Transport and motor vehicles | Mining assets | Other assets | Assets under construction | Total |
|---|---|---|---|---|---|---|---|---|
| At December 31, 2002, cost, net of accumulated depreciation and government grants | $ – | $ 11,504 | $ 55,994 | $ 2,765 | $ 78,695 | $ 146 | $ 13,775 | $ 162,879 |
| Additions | – | – | 6,417 | – | 2,302 | – | 19,581 | 28,300 |
| Assets put into operation | | 926 | 6,211 | 389 | 11,878 | 133 | (19,537) | – |
| Assets acquired in business combination | – | 117 | 886 | 39 | – | 16 | – | 1,058 |
| Disposals | – | (920) | (134) | (10) | – | (7) | (922) | (1,993) |
| Depreciation and depletion charge | – | (491) | (29,108) | (361) | (13,849) | (34) | – | (43,843) |
| Amortisation of government grants | – | – | 787 | – | – | – | – | 787 |
| Translation difference | – | 889 | 3,906 | 113 | 4,597 | 17 | 2,680 | 12,202 |
| At December 31, 2003, cost, net of accumulated depreciation and government grants | $ – | $ 12,025 | $ 44,959 | $ 2,935 | $ 83,623 | $ 271 | $ 15,577 | $ 159,390 |

As of December 31, 2005, 2004 and 2003, certain items of production equipment with an approximate carrying value of $58,335, $35,874 and $6,884, respectively, were pledged to banks as collateral against loans to the Group (Notes 12).

Government grants represent special purpose financing granted to the Group for the amount of actual expenditures on the acquisition of certain assets qualifying for ecological purposes.

## 7. Inventories

Inventories, at cost, consisted of the following as of December 31:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Raw materials and spare parts | **$ 11,960** | $ 11,509 | $ 9,621 |
| Finished goods | **6,592** | 1,172 | 856 |
| | **$ 18,552** | $ 12,681 | $ 10,477 |

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 8. Trade and Other Receivables

Trade and other receivables, mainly denominated in roubles, consisted of the following as of December 31:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Trade accounts receivable | **$ 18,814** | $ 11,197 | $ 3,785 |
| Other receivables | **2,056** | 4,585 | 1,006 |
| | **20,870** | 15,782 | 4,791 |
| Allowance for doubtful accounts | **(591)** | (156) | (247) |
| | **$ 20,279** | $ 15,626 | $ 4,544 |

## 9. Related Party Disclosures

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

Amounts owed by/to related parties were as follows as of December 31:

| | Amounts owed by related parties | | | Amounts owed to related parties | | |
|---|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| OOO Trade House Evrazresource | **$ 2,674** | $ 2,629 | $ – | **$ –** | $ – | $ – |
| ZAO Razrez Raspadsky | **7,181** | 8 | 849 | **21,016** | 7,204 | – |
| ZAO Raspadskaya Financial Industrial Company | **671** | 12 | 1,306 | **7,114** | 3,294 | 737 |
| OAO MUK-96 | **16** | – | – | **10** | – | 540 |
| OOO Rilcom | – | 72 | 5,472 | – | 1,062 | 4 |
| Other entities | **1,314** | 459 | 186 | **238** | 47 | 28 |
| Loan from ZAO Raspadskaya Financial Industrial Company | – | – | – | – | – | 7,033 |
| Liabilities to Corber for transfers of ownership interests in subsidiaries (Note 1) | – | – | – | **288,713** | 299,469 | 217,613 |
| | **$ 11,856** | $ 3,180 | $ 7,813 | **$ 317,091** | $ 311,076 | $ 225,955 |

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 9. Related Party Disclosures (continued)

In the years ended December 31, 2005, 2004 and 2003, the Group's transactions with related parties were as follows:

| | **Sales to related parties** | | | **Purchases from related parties** | | |
|---|---|---|---|---|---|---|
| | **2005** | **2004** | **2003** | **2005** | **2004** | **2003** |
| OOO Trade House Evrazresource | **$ 146,879** | $ 79,504 | $ – | **$ –** | $ – | $ – |
| ZAO Razrez Raspadsky | **8,495** | 3,585 | 1,528 | **112,224** | 49,270 | 1,839 |
| ZAO Raspadskaya Financial Industrial Company | **4,144** | 21,808 | 64,970 | **64,492** | 30,490 | 1,051 |
| OAO Mezhdurechensk Coal Company-96 | **3,536** | 1,010 | 124 | **108** | 322 | 3,518 |
| OOO Rilcom | **12** | 13 | – | **457** | 10,216 | 4,592 |
| Other entities | **21** | 748 | 2 | **2,418** | 381 | 158 |
| | **$ 163,087** | $106,668 | $ 66,624 | **$ 179,699** | $ 90,679 | $ 11,158 |

OOO Trade House Evrazresource is an entity under common control with the Company's shareholder. In 2005 and 2004, the Group sold to the entity approximately 26% and 35% of sales volumes of coal concentrate, respectively. In addition, in 2005, the Group sold coal to OOO Trade House Evrazresource, representing 27% of total sales volume of coal. The transactions were made on terms equivalent to those that prevail in arm's length transactions.

ZAO Razrez Raspadsky is an entity under control of the Company's shareholder. The Group purchased mining and coal processing services from ZAO Razrez Raspadsky. In 2005 and 2004, the cost of mining services rendered by ZAO Razrez Raspadsky amounted to $69,978 and $29,864, respectively. The services included open-cut mining of coal of 2,211,000 tons in 2005 and 1,505,000 tons in 2004 on the Raspadskaya deposits. Fees for coal processing services amounted to $41,511 and $19,406 in 2005 and 2004, respectively.

ZAO Raspadskaya Financial Industrial Company ("RFPK") is an entity under control of the Company's shareholder. In 2005 and 2004, RFPK sold coal concentrate to the Group and operated as the Group's sales agent. All purchases of coal concentrate in 2005 and 2004 were made from RFPK. In 2003, the Group sold coal and coal concentrate to RFPK.

On July 01, 2003, ZAO Raspadskaya Financial Industrial Company granted a credit line to the Group for 423,000,000 roubles ($13,923 at the exchange rate as of the date of the transaction). Borrowings under the credit line bore interest of 16.00% per annum and matured in 2007. The credit line was fully repaid in June 2004.

OAO Mezhdurechensk Coal Company-96 ("MUK-96") is an entity under control of the Company's shareholder. MUK-96 purchases coal and coal concentrate from ZAO Raspadskaya.

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 9. Related Party Disclosures (continued)

OOO Rilcom is an entity under control of the Company's shareholder. Rilcom leased production assets to the Group. All lease obligations were repaid by December 31, 2004.

Other transactions with related parties are disclosed in Note 17 to the consolidated financial statements.

*Compensation to Key Management Personnel*

Key management personnel totalled 2 persons as at December 31, 2005, 2004 and 2003. Total compensation to key management personnel were included in general and administrative expenses in the accompanying income statement and consisted of the following:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Salary | **$ 1,113** | $ 1,019 | $ 148 |
| Performance bonuses | **–** | 480 | – |
| Social security taxes | **35** | 34 | 10 |
| | **$ 1,148** | $ 1,533 | $ 158 |

## 10. Taxes Recoverable

Taxes recoverable were denominated in roubles and consisted of the following as of December 31:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Input VAT | **$ 37,391** | $ 27,575 | $ 13,421 |
| Other taxes | **9,887** | 5,070 | 281 |
| | **$ 47,278** | $ 32,645 | $ 13,702 |

Input VAT, representing amounts payable or paid to suppliers, is recoverable from the tax authorities via offset against VAT payable to the tax authorities on the Group's revenue or direct cash receipts from the tax authorities. Management periodically reviews the recoverability of the balance of input value added tax and believes it is fully recoverable within one year.

## 11. Equity

At December 31, 2003, the Company's authorised and issued share capital comprised 459,720 fully paid shares with par value of 3 roubles each. In April 2004, par value of shares was increased to 4 roubles per share by appropriation of earnings. In 2005, the Company increased its share capital by $3 by issuance of 20,280 ordinary shares with par value of 4 roubles each.

As of December 31, 2005, 2004 and 2003, the Company's authorised and issued share capital comprised 480,000, 459,720 and 459,720 fully paid shares, respectively, with par value of 4, 4 and 3 roubles each, respectively.

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 11. Equity (continued)

In 2004, the Group acquired 19,319 of its own shares which constitute 4.20% of the Company's share capital. The Company paid 160,058,000 roubles ($5,579 at the exchange rates as of the dates of transactions) for the shares.

In 2005, the Group acquired 5,962 of its own shares which constitute 1.07% of the Company's share capital. The Company paid 24,410,000 roubles ($1,048 at the exchange rates as of the dates of transactions) for the shares.

*Reserve Capital*

According to the Russian Law, the Group creates a reserve capital in the amount of 5% of share capital per the Russian statutory accounts by annual appropriations which should be at least 5% of the annual net profit per statutory financial statements. The reserve capital can be used only for covering losses as well as for redemption of the Company's bonds and purchase of own shares if there are no other sources of financing.

*Earnings per Share*

Earnings per share are calculated by dividing the net income attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period.

The following reflects the income and share data used in earnings per share computations:

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Profit from continuing operations attributable to equity holders of the parent entity | **$ 132,148** | $ 107,530 | $ 1,821 |
| (Loss)/profit from discontinued operations attributable to equity holders of the parent entity | **–** | (1,886) | 237 |
| Net profit attributable to equity holders of the parent entity | **$ 132,148** | $ 105,644 | $ 2,058 |
| Weighted average number of ordinary shares for earnings per share | **450,477** | 456,130 | 459,720 |

The Group's annual earnings per share were as follows:

| | **2005** | **2004** | **2003** |
|---|---|---|---|
| *Earnings per share attributable to equity holders of the parent entity, (US dollars)* | | | |
| Profit from continuing operations | 293.35 | 235.74 | 3.96 |
| (Loss)/profit from discontinued operations | – | (4.13) | 0.52 |
| Profit | **$ 293.35** | **$ 231.61** | **$ 4.48** |

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 11. Equity (continued)

*Earnings per Share (continued)*

The Company has no potentially dilutive ordinary shares; therefore, the diluted earnings per share equals basic earnings per share.

*Dividends*

On September 30, 2005, shareholders of the Company approved distribution of dividends in respect of the results of 2005 in the amount of 949,920,000 roubles ($33,332 at the exchange rate as of the date of the transaction), which represents 1,979 roubles of dividends per share (63.06 US dollars at the exchange rate as of the date of the transaction).

In addition, in 2005, certain subsidiaries of the Group, accounted for under the pooling of interests method, declared dividends in the amount of $64,067 payable to the Company's parent.

## 12. Loans and Borrowings

Short-term and long-term loans and borrowings were as follows as of December 31:

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Russian banks | **$ 61,416** | $ 40,622 | $ 6,111 |
| Ministry of Finance of the Russian Federation | **2,138** | 3,251 | 3,848 |
| Interest payable | **159** | – | 121 |
| | **$ 63,713** | $ 43,873 | $ 10,080 |

As of December 31, 2005, 2004 and 2003, total interest bearing loans and borrowings consisted of short-term loans and borrowings in the amount of $17,292, $0 and $6,111, respectively, and long-term loans and borrowings in the amount of $46,262, $43,873 and $3,848, respectively, including the current portion of long-term liabilities of $28,936, $855 and $855, respectively.

In 2005, average annual interest rates were 10.9% for short-term loans denominated in roubles and 11.7%, 9.0% for long-term loans denominated in roubles and US dollars, respectively.

In 2004, average annual interest rates were 11.7%, 9.0% for long-term loans denominated in roubles and US dollars, respectively.

In 2003, average annual interest rates were 10.0% for short-term loans denominated in roubles and 9.0% for long-term loans denominated in US dollars.

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 12. Loans and Borrowings (continued)

The liabilities are denominated in the following currencies:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Roubles | **$ 61,510** | $ 40,622 | $ 6,121 |
| US dollars | **2,203** | 3,251 | 3,959 |
| | **$ 63,713** | $ 43,873 | $ 10,080 |

The liabilities are contractually repayable after the balance sheet date as follows:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Less than one year | **$ 46,387** | $ 855 | $ 7,087 |
| Between one year and two years | **16,898** | 29,984 | 855 |
| Between two years and five years | **428** | 13,034 | 2,138 |
| | **$ 63,713** | $ 43,873 | $ 10,080 |

At December 31, 2005, the Group had equipment with a carrying value of $58,335 pledged as collateral under the loan agreements.

## 13. Finance Lease Obligations

In 2001-2003, the Group entered into lease agreements under which it had an option to acquire the leased assets at the end of lease term ranging from 1.5 to 2 years. The estimated average remaining useful life of leased assets varied from 1.5 to 5 years.

The leases were accounted for as finance leases in the consolidated financial statements. As at December 31, 2003, carrying value of the leased assets was $6,836. The leased assets were machinery and equipment items included in property, plant and equipment in the accompanying consolidated balance sheets (Note 6).

Future minimum lease payments were as follows at December 31, 2003:

| | Principal | Interest | Total |
|---|---|---|---|
| 2004 | $ 4,121 | $ 386 | $ 4,507 |
| 2005 | 951 | 26 | 977 |
| | 5,072 | 412 | 5,484 |
| Less: current portion | (4,121) | (386) | (4,507) |
| | **$ 951** | **$ 26** | **$ 977** |

In 2004, the Group early repaid its obligations and purchased the leased items.

In the year ended December 31, 2003, the average interest rate under the finance lease liabilities was 13%.

The finance lease liabilities were denominated in roubles and euros at December 31, 2003.

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 14. Post-Employment Benefits

In accordance with collective bargaining agreements, the Group provides to its employees lump-sum amounts payable at the retirement date. In addition, the Group pays benevolent contributions to *Pensioner of Raspadskaya*, a non-profit organisation, which provides regular lifetime pension payments to the Group's employees.

The post-employment benefits, provided by the Group, depend on years of service, level of compensation, and amount of pension payment under the collective bargaining agreements.

In 2004 and 2003, the Group did not consider its contributions to *Pensioner of Raspadskaya* as a constructive obligation and, consequently, the Group did not accrue liabilities in its financial statements. In 2005, the management determined that the Group's relationships with *Pensioner of Raspadskaya* represent a constructive obligation. The change in estimate resulted in a recognition of past service cost of $5,361 in the year ended December 31, 2005.

The components of net benefit expense recognised in the consolidated income statement for the years ended December 31, 2005, 2004 and 2003 and amounts recognised in the consolidated balance sheet as of December 31, 2005, 2004 and 2003 for the post-employment benefits are as follows:

*Net Benefit Expense (recognised in cost of sales and general and administrative expenses)*

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Current service cost | **$ 335** | $ 203 | $ 161 |
| Interest cost on benefit obligation | **289** | 245 | 176 |
| Net actuarial loss recognised in the year | **33** | 56 | 39 |
| Past service cost | **5,361** | – | – |
| Net benefit expense | **$ 6,018** | $ 504 | $ 376 |

*Benefit Liability*

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| Benefit liability | **$ 8,219** | $ 2,931 | $ 2,470 |
| Unrecognised net actuarial losses | **405** | 757 | 529 |
| Benefit obligation | **$ 8,624** | $ 3,688 | $ 2,999 |

*Movements in Benefit Liability*

| | **2005** | 2004 | 2003 |
|---|---|---|---|
| At January 1 | **$ 2,931** | $ 2,470 | $ 2,135 |
| Benefit expense | **6,018** | 504 | 376 |
| Contribution | **(529)** | (195) | (231) |
| Translation difference | **(201)** | 152 | 190 |
| At December 31 | **$ 8,219** | $ 2,931 | $ 2,470 |

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 14. Post-Employment Benefits (continued)

The principal assumptions used in determining pension obligations for the Group's plan are shown below:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Discount rate | **8.0%** | 8.0% | 8.0% |
| Future benefits increases | **6.5%** | 6.5% | 6.5% |

## 15. Trade and Other Payables

Trade and other payables were mainly denominated in roubles and consisted of the following as of December 31:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Trade accounts payable | **$ 7,658** | $ 4,513 | $ 4,139 |
| Accrued payroll | **2,688** | 4,578 | 3,762 |
| Promissory notes | **–** | – | 19,329 |
| Other payables | **1,448** | 1,146 | 1,443 |
| | **$ 11,794** | $ 10,237 | $ 28,673 |

## 16. Taxes Payable

Taxes payable were denominated in roubles and consisted of the following as of December 31:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| VAT payable | **$ 8,324** | $ 9,903 | $ 1,047 |
| Income tax | **1,125** | 231 | 258 |
| Other taxes | **3,096** | 2,405 | 2,121 |
| | **$ 12,545** | $ 12,539 | $ 3,426 |

## 17. Commitments and Contingencies

*Operating Environment of the Group*

The Russian economy while deemed to be of market status continues to display certain characteristics consistent with that of a market in transition. These characteristics include, but are not limited to, relatively high inflation and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The stability of the Russian economy will be significantly impacted by the government's policies and actions with regards to supervisory, legal, and economic reforms.

## 17. Commitments and Contingencies (continued)

*Taxation*

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

Management believes that it has paid or accrued all taxes that are applicable. Where uncertainty exists, the Group has accrued tax liabilities based on management's best estimate of the probable outflow of resources embodying economic benefits, which will be required to settle these liabilities.

*Social Commitments*

The Group is involved in a number of social programmes aimed to support education, health care and social infrastructure development in towns where the Group's assets are located. In 2006, the Group plans to spend $7,000 under these programmes.

*Site Restoration Costs*

Under the Russian legislation, mining companies have obligations to restore mining sites. The owner of the licence bears this obligation. The Group owns a licence to develop a plot of land adjacent to the main exploration area by open-pit mining method. In 2004, the Group engaged ZAO Razrez Raspadsky to develop the plot. According to the agreement between the parties, ZAO Razrez Raspadsky performs all works and is liable for restoration of the site.

The plot is expected to be fully developed and closed in 2010. Estimated costs of restoration payable in 2010 will not exceed $4,800. If ZAO Razrez Raspadsky fails to meet its engagements, the Group will incur restoration costs.

Management believes that ZAO Razrez Raspadsky will perform necessary restoration works at its own expense in full compliance with the agreement and, as a result, the Company did not accrue a provision for site restoration costs in the accompanying consolidated financial statements.

*Guarantees of Debts of Related Parties*

On September 22, 2003, the Group guaranteed obligations of ZAO Razrez Raspadsky under the loan agreement with ZAO Gazprombank. The guarantee is limited to $19,000 and matures on September 1, 2010.

## 17. Commitments and Contingencies (continued)

*Credit Risk*

Financial instruments that potentially expose the Group to concentrations of credit risk consist primarily of cash, short-term deposits in banks and trade accounts receivable.

The Group maintains its available cash in Russian banks. Management periodically reviews the creditworthiness of the banks in which it deposits cash. The Group constantly monitors the status of accounts receivable collection and the creditworthiness of the customers.

*Fair Value of Financial Instruments*

The carrying amounts of financial instruments, consisting of cash, short-term investments, short-term accounts receivable and payable, short-term and long-term loans receivable and payable and promissory notes approximate their fair value.

## 18. Subsequent Events

On March 21, 2006, following the shareholders' resolution, the Company was reorganised into open joint stock company OAO Raspadskaya.

On April 28, 2006, OOO Raspadsky Ugol declared final dividends in the amount of $26,440 payable to the Company's parent.

On June 8, 2006, the shareholders approved the issue of 310,560,000 common shares with par value of 0.004 roubles per share each in exchange for the acquisition of 100% shares in OAO Mezhdurechenk Coal Company-96. The share issue was registered on June 30, 2006.