

**AK “ALROSA”**

**IFRS UNAUDITED INTERIM CONSOLIDATED**

**FINANCIAL STATEMENT**

**FOR THE PERIOD ENDED 30 SEPTEMBER 2005**



**AK “ALROSA”**

**IFRS unaudited interim consolidated financial statements for the period ended 30 September 2005**

*(in millions of Russian roubles, unless otherwise stated)*

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**INDEPENDENT ACCOUNTANTS' REPORT  
to the Shareholders and Board of Directors of AK "ALROSA "**

On the basis of information provided by management, we have compiled, in accordance with the International Financial Reporting Standards applicable to compilation engagements, the unaudited consolidated balance sheet of AK "ALROSA" ("the Company") and its subsidiaries ("the Group") as of 30 September 2005, unaudited consolidated statements of income, cash flows, and of changes in equity for the period ended 30 September 2005 and the related notes to the unaudited interim consolidated financial statements. Management of the Company is responsible for these unaudited interim consolidated financial statements. We have neither audited nor reviewed the accompanying unaudited interim consolidated financial statements and, accordingly, do not imply or express an opinion or any other form of assurance on them.

OOO "Financial and Accounting Consultants", PKF  
Moscow, Russia  
16 January 2006



AK "ALROSA"

IFRS unaudited interim consolidated financial statements for the period ended 30 September 2005

(in millions of Russian roubles, unless otherwise stated)

## Consolidated Balance Sheet

	Notes	30 September 2005 (unaudited)	31 December 2004
<b>Assets</b>			
<b>Non-current Assets</b>			
Restricted cash	4	264	252
Investments in associates	3	1,153	1,083
Available-for-sale investments	3	526	518
Long-term accounts receivable	7	5,112	3,973
Property, plant and equipment	5	122,243	113,898
<b>Total Non-current Assets</b>		<b>129,298</b>	<b>119,724</b>
<b>Current Assets</b>			
Restricted cash	4	118	184
Inventories	6	23,974	19,537
Trade and other receivables	7	14,958	8,755
Prepaid income tax		120	9
Available-for-sale investments		20	269
Cash and cash equivalents	4	12,725	1,877
<b>Total Current Assets</b>		<b>51,915</b>	<b>30,631</b>
<b>Total Assets</b>		<b>181,213</b>	<b>150,355</b>
<b>Shareholders' Equity</b>			
Share capital	8	11,491	11,491
Treasury shares	8	(870)	(151)
Retained earnings		68,533	60,731
		<b>79,154</b>	<b>72,071</b>
<b>Minority Interest</b>		<b>3,172</b>	<b>2,958</b>
<b>Total Equity</b>		<b>82,326</b>	<b>75,029</b>
<b>Grant</b>	9	<b>8,868</b>	<b>9,363</b>
<b>Liabilities</b>			
<b>Non-current Liabilities</b>			
Long-term debt	10	30,812	31,410
Provision for restoration liability	12	8,566	6,492
Provision for pension obligations	13	1,656	1,462
Other provisions	15	1,129	1,095
Deferred tax liabilities	16	3,846	3,866
<b>Total Non-current Liabilities</b>		<b>46,009</b>	<b>44,325</b>
<b>Current Liabilities</b>			
Short-term loans and current portion of long-term debt	11	25,650	10,032
Trade and other payables	14	12,729	8,568
Taxes payable	16	4,105	2,982
Dividends payable		1,526	56
<b>Total Current Liabilities</b>		<b>44,010</b>	<b>21,638</b>
<b>Total Liabilities</b>		<b>90,019</b>	<b>65,963</b>
<b>Total Equity, Grant, and Liabilities</b>		<b>181,213</b>	<b>150,355</b>

Signed by the following members of management:

Alexander O. Nichiporuk  
President, Chairman of the Board  
16 January 2006

Olga A. Lyashenko  
Chief accountant

The accompanying notes form an integral part of these unaudited interim consolidated financial statements



AK "ALROSA"

IFRS unaudited interim consolidated financial statements for the period ended 30 September 2005

(in millions of Russian roubles, unless otherwise stated)

## Consolidated Statement of Income

	Notes	Period ended 30 September 2005 (unaudited)	Period ended 30 September 2004 (unaudited)
Sales	17	69,931	56,387
Cost of sales	18	(34,816)	(25,274)
Royalty	9	(6,429)	(6,503)
<b>Gross profit</b>		<b>28,686</b>	<b>24,610</b>
General and administrative expenses	19	(2,407)	(2,236)
Selling and marketing expenses	20	(944)	(764)
Other income	21	1,547	1,484
Other expenses	22	(7,650)	(6,818)
Net finance costs	23	(4,393)	(3,244)
Share of profit of associates	3	558	403
<b>Profit before Income Tax</b>		<b>15,397</b>	<b>13,435</b>
Income tax	16	(4,824)	(4,703)
<b>Profit after Income Tax</b>		<b>10,573</b>	<b>8,732</b>
Attributable to equity holders of parent		9,602	8,114
Attributable to minority interest		971	618
		<b>10,573</b>	<b>8,732</b>

The accompanying notes form an integral part of these unaudited interim consolidated financial statements



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(in millions of Russian roubles, unless otherwise stated)

## Consolidated Statement of Cash Flows

	Notes	Period ended 30 September 2005 (unaudited)	Period ended 30 September 2004 (unaudited)
<b>Net cash Inflow from Operating Activities</b>	24	<b>11,477</b>	<b>7,451</b>
<b>Cash Flows from Investing Activities</b>			
Purchase of property, plant and equipment		(11,461)	(10,617)
Proceeds from sales of fixed assets		380	87
Acquisition of available-for-sale investments		(24)	(84)
Proceeds from sale of available-for-sale investments		59	35
Interest received		356	195
Dividends received from associated undertakings		174	-
<b>Net Cash Outflow from Investing Activities</b>		<b>(10,516)</b>	<b>(10,384)</b>
<b>Cash Flows from Financing Activities</b>			
Repayments of loans		(20,215)	(54,293)
Loans received		33,808	64,714
Interest paid		(2,711)	(2,663)
Payment (decrease) to restricted cash account		54	(112)
Purchase of treasury shares		(719)	-
Dividends paid		(330)	(534)
<b>Net Cash Inflow from Financial Activities</b>		<b>9,887</b>	<b>7,112</b>
<b>Net Increase in Cash and Cash Equivalents</b>		<b>10,848</b>	<b>4,179</b>
Cash and cash equivalents at the beginning of the period		1,877	3,347
<b>Cash and Cash Equivalents at the End of The Period</b>		<b>12,725</b>	<b>7,526</b>

Significant non-cash transactions are discussed in note 28.



AK "ALROSA"

IFRS unaudited interim consolidated financial statements for the period ended 30 September 2005

(in millions of Russian roubles, unless otherwise stated)

## Consolidated Statement of Changes in Equity

	Shareholder's equity			Total	Minority interest	Total equity
	Share capital	Treasury shares	Retained Earnings			
<b>Balance at 31 December 2003</b>	<b>11,491</b>	-	<b>49,813</b>	<b>61,304</b>	<b>3,035</b>	<b>64,339</b>
Dividends	-	-	(1,200)	(1,200)	-	(1,200)
Profit for the period ended 30 September 2004 (unaudited)	-	-	8,114	8,114	618	<b>8,732</b>
Changes in minority interest for the period ended 30 September 2004 (unaudited)	-	-	-	-	(525)	<b>(525)</b>
<b>Balance at 30 September 2004 (unaudited)</b>	<b>11,491</b>	-	<b>56,727</b>	<b>68,218</b>	<b>3,128</b>	<b>71,346</b>
<b>Balance at 31 December 2004</b>	<b>11,491</b>	(151)	<b>60,731</b>	<b>72,071</b>	<b>2,958</b>	<b>75,029</b>
Dividends	-	-	(1,800)	(1,800)	-	(1,800)
Treasury shares (note 8)	-	(719)	-	(719)	-	(719)
Profit for the period ended 30 September 2005 (unaudited)	-	-	9,602	9,602	971	<b>10,573</b>
Changes in minority interest for the period ended 30 September 2005 (unaudited)	-	-	-	-	(757)	<b>(757)</b>
<b>Balance at 30 September 2005 (unaudited)</b>	<b>11,491</b>	<b>(870)</b>	<b>68,533</b>	<b>79,154</b>	<b>3,172</b>	<b>82,326</b>

The accompanying notes form an integral part of these unaudited interim consolidated financial statements



## AK "ALROSA"

### Notes to the IFRS consolidated financial statements for the period ended 30 June 2005

(in millions of Russian roubles, unless otherwise stated)

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## 1. ACTIVITIES

The core activities of Closed Joint Stock Company AK "ALROSA" ("the Company") and its subsidiaries ("the Group") are the exploration and extraction of diamond reserves and the marketing and distribution of raw and cut diamonds. The Company was registered on 13 August 1992 as a closed joint stock company in the Republic of Sakha (Yakutia), which is located within the Russian Federation. The Company is subject to special legislation issued by the Russian Federation and the Republic of Sakha (Yakutia), which significantly influences the Company's core operating activities. This legislation includes, but is not limited to, the Law on State Secrets of the Russian Federation and requirements to obtain quotas for export of diamonds from the Government of the Russian Federation (note 17).

As at 30 September 2005 the Company's principal shareholders are the Russian Federation (37 percent of shares) and the Republic of Sakha (Yakutia) (32 percent of shares). The rest of shares are held by administrations of districts of the Republic of Sakha (Yakutia) (8 percent of shares) and individuals (23 percent of shares).

## 2. ACCOUNTING POLICIES

### (a) Basis of presentation

Group companies incorporated in Russia maintain their statutory accounting records and prepare statutory financial reports in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR") and their measurement currency is the Russian rouble ("RR"). Group companies incorporated in other countries maintain their statutory accounting records in accordance with relevant legislation and in the appropriate measurement currency. The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of available-for-sale investments and financial assets held-for-trading. The consolidated financial statements are based on the statutory accounting records, with adjustments and reclassifications for the purpose of fair presentation in accordance with International Financial Reporting Standards ("IFRS").

Prior to 1 January 2003 the adjustments and reclassifications made to the statutory records for the purpose of IFRS presentation included the restatement of balances and transactions for the changes in the general purchasing power of the RR in accordance with IAS 29 "Financial Reporting in Hyperinflationary Economies" ("IAS 29"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation had ceased, effective from 1 January 2003 the Group no longer restates its financial statements in accordance with IAS 29. Accordingly, the amounts expressed in the measuring unit current at 31 December 2002 are treated as the basis for the carrying amounts in these financial statements.

The preparation of consolidated financial statements in conformity with IFRS requires management to make prudent estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements preparation and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to realization of inventories, investments, allowance for bad and doubtful accounts receivable, deferred taxation, reserve estimates used to calculate depreciation, pension and other post-retirement benefit costs and the evaluation of the provision for restoration liability. Actual results could differ from these estimates.

Certain amounts have been reclassified in the comparative financial information for the period ended 30 September 2004 to conform to the current period presentation. Other operating expenses for the period ended 30 September 2004 have been decreased by RR'mln 764 due to presentation of selling and marketing expenses as a separate line in the statement of income. This change has been made in order to present the information about the Group's activity in a format considered to be more useful to the users of the consolidated financial statements. Finance income and finance cost were presented gross in the statement of income, also net exchange gains for the period ended 30 September 2004 totalling RR'mln 53 were included into finance income. This reclassification better reflects the nature of these items.

The unaudited comparatives for the nine months period ended 30 September 2004 have been restated to correct for the Group's recognition of deferred tax assets and liabilities. The effect of this restatement resulted in a decrease of retained earnings in the amount of RR 1,474 million and an increase of deferred tax liability in the amount of RR 1,474 million as at 30 September 2004. Inventory balance was adjusted for extraction tax relating to unrealized diamonds of OAO "ALROSA-Nyurba", a subsidiary, in the amount of RR'mln 360. The effect of this restatement resulted in increase of net profit for the nine months period ended 30 September 2004 in the amount of RR'mln 360.



**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)*

The impact of the restatements on the unaudited comparatives for the nine months period ended 30 September 2004 is shown as follows:

	<b>Period ended 30 September 2004 (unaudited)</b>	<b>Adjustment</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Movement in inventories	2,539	360	2,899
Profit after income tax attributable to Minority interest	(569)	(49)	(618)
Deffered tax benefit (expense) for the 9 months 30 September 2004	736	(1,474)	(738)
Profit after income tax attributable to equity holders of parents for the nine months ended 30 June 2004	9,228	(1,114)	8,114
Deferred tax liability at 30 September 2004	1,729	1,474	3,203
Equity at 30 September 2004	69,332	(1,114)	68,218

During the period December 2003 to December 2004, the International Accounting Standards Board (“IASB”) revised 17 of its standards and issued five new standards. These standards are effective for accounting periods commencing on or after 1 January 2005, except for IFRS 6 “Exploration for and Evaluation of Mineral Resources” effective for periods commencing on or after 1 January 2006). By preparation of the present consolidated financial statements the Group applied requirements of the revised or new standards.

**(b) Principles of consolidation**

The Group comprises the Company and its subsidiaries. The effects of transactions between subsidiaries within the Group are eliminated and accounting policies of the subsidiaries and associates are conformed to those of the Company.

A subsidiary is an entity in which the Group has control through holding of more than half of the voting rights or otherwise has the power to exercise control over the operations.

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.

For subsidiaries that are not wholly owned, the minority interest at the balance sheet date represents the minority shareholders’ portion of the pre-acquisition carrying amounts of the identifiable assets and liabilities of the subsidiary at the acquisition date (for subsidiaries that are acquired after 31 March 2004 – portion of fair value of the identifiable assets and liabilities of the subsidiary at the acquisition date), and the minority shareholders’ portion of movements in equity since the date of the business combination. Minority interest is presented in equity separately from shareholders’ equity in the consolidated balance sheet.

Associates, over which the Group has a significant but not a controlling influence, are accounted for using the equity method. Significant influence is usually evidenced by the Group owning, directly or indirectly, between 20 percent and 50 percent of the voting share capital.

If the Group’s share of losses of an associate equals or exceeds its interest in the associate, the Group discontinues recognizing its share of further losses. The interest in an associate is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the Group’s net investment in the associate. After the Group’s interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

The Group share in the associate’s profit and losses resulting from transactions between the Group and the associate is eliminated.

**(c) Grant**

Production assets received from the Republic of Sakha (Yakutia) on 19 January 1993 under the terms of a mineral lease agreement (the “Lease Agreement”) to “transfer of rights to use and exploit land, diamond deposits, main production and non-production facilities”, are recorded in accordance with IAS 20, “Accounting for Government Grants and Disclosure of Government Assistance”, at historical cost adjusted for the effects of inflation, with a corresponding credit reflected as a

**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)*

Grant in the Group's balance sheet. The Grant is amortized in line with the reduction in the carrying value of the underlying assets, with the amortized portion recorded as an increase in income (see note 9).

Social assets received under the aforementioned Lease Agreement have not been included in the accompanying consolidated financial statements, since the majority of these assets have been or will be transferred free of charge to local administrations.

**(d) Property, plant and equipment**

Property, plant and equipment comprises costs incurred in developing areas of interest as well as the costs related to the construction and acquisition of mining assets. Expenditure related to geophysical analysis is expensed until it is determined to be probable that economically recoverable reserves exist.

At each reporting date, management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's net selling price and its value in use, the carrying amount is reduced to the recoverable amount and the difference is recognized as an expense (impairment loss) in the statement of income. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

***Depreciation and amortization***

Property, plant and equipment are depreciated upon commencement of commercial mining activities at a specific area of interest.

Depreciation and amortization of buildings, land and improvements and plant and equipment related to extraction of minerals is calculated on a units of production basis for each area of interest.

Depreciation of assets not directly associated with production is calculated on a straight-line basis over their estimated useful life.

Summary of useful lives and alternative basis for depreciation:

	<b>Assets related to extraction of minerals</b>	<b>Other assets</b>
Buildings	Units of production	8-50 years
Land and improvements	Units of production	7-50 years
Plant and equipment	4-13 years	4-13 years
Transport	5-13 years	5-13 years
Other	4-17 years	4-17 years

***Disposals and retirement***

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the balance sheet along with the corresponding accumulated depreciation (if any). Any gain or loss resulting from such retirement or disposal is included in the consolidated statement of income.

***Repair and maintenance costs***

Maintenance and repairs are expensed as incurred. Major renewals and improvements that result in the enhancement of the asset beyond its original capacity are capitalized.

***Local infrastructure assets***

Local infrastructure assets constructed or purchased by the Group subsequent to 1 January 1993 (the date of privatization) are included in the financial statements at historical cost adjusted for the effects of inflation and depreciated during their useful lives as set out above. These assets are integral part of the Group's production activities.

**(e) Provisions**

Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events, when it is



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probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

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

The provision for restoration liability is determined based on the terms of the Lease Agreement (see note 9). Under this agreement, in the year 2017 the Company is obliged to transfer property, plant and equipment subject to the Lease Agreement to the Republic of Sakha (Yakutia) or settle its liability by means of a cash payment. The initial provision for restoration liability together with any changes in estimation of the ultimate restoration liability is recorded on the balance sheet, with a corresponding amount recorded as part of property, plant and equipment in accordance with IAS 16 “*Property, Plant and Equipment*”. This amount is amortized over the term of the Lease Agreement.

Changes in the provision for restoration liability resulting from the passage of time are reflected in the consolidated statement of income each period under finance costs. Other changes in the provision, relating to a change in the discount rate applied, in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change. The effects of such changes are added to, or deducted from, the cost of the related asset.

#### (f) Inventories

Inventories of diamonds, extracted ore and concentrates, mining and construction stores and consumable supplies are valued at the lower of the weighted average cost or net realizable value.

Cost of extracted ore and concentrates is calculated using the quantities determined based on surveyors' measurements of the volumes of ore and concentrates remaining at the period end. Cost of inventories include those directly attributable to mining the diamonds, extracting the ore and producing concentrates, and those directly attributable to bringing mining and construction stores and consumable supplies to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

#### (g) Investments

The Group classifies its investments into the following categories:

- a financial assets at fair value through profit or loss, including held for trading
- held-to-maturity and
- available-for-sale.

Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as a financial assets at fair value through profit or loss including held for trading and included in current assets. Investments with a fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets. During the period, the Group did not hold any investments classified as trading or held-to-maturity. 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 expressed the 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 reviews such designation on a regular basis.

All purchases and sales of investments are recognized on the settlement date, which is the date that the investment is delivered to or by the Group. Cost of purchase includes transaction costs. Trading and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortized cost using the effective yield method. Realized and unrealized gains and losses on a trading investments are recognized in profit or loss. A gains or losses on an available-for-sale investments are recognized directly in equity, through the statement of changes in equity, except for impairment losses and foreign exchange gains and losses, until the investment is derecognized, at which time the cumulative gain or loss previously recognized in equity is recognized in profit or loss.

Since the majority of the Group's investments are not publicly traded and no reliable method of fair value estimation exists for those investments, these investments are excluded from fair value valuation.



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*(in millions of Russian roubles, unless otherwise stated)*

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Those financial assets that are excluded from fair valuation and that have a fixed maturity are measured at amortized cost using the effective interest rate method less impairment. Those that do not have a fixed maturity date are measured at cost less impairment.

Unquoted available-for-sale equity investments are reviewed for impairment losses at every balance sheet date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When a review for impairment is conducted, the recoverable amount is assessed by reference to the net present value of expected future cash inflows. The discount rate applied is based upon the Group's weighted average cost of capital with appropriate adjustment for the risks associated with the investment under assessment. When the level of information available to calculate the net present value of expected future cash inflows makes this exercise unworkable, management uses different valuation techniques (such as net assets test) to estimate whether there is objective evidence of impairment and to determine the likely amount of impairment, if any.

#### **(h) Components of cash and cash equivalents**

Cash and cash equivalents consist of cash on hand, balances with banks and instruments with maturity at the date of inception of less than three months, which are considered by the Group at the time of deposit to have minimal fair value and default risks.

#### **(i) Deferred income 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. 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 and associates, 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.

#### **(j) Foreign currencies**

Monetary assets and liabilities, which are held by the Group entities and denominated in foreign currencies at 30 September 2005, are translated into the RR at the exchange rate prevailing at that 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 recognised in the statement of income.

Exchange rate for US dollar effective at 30 September 2005 was RR 28.499 to US\$ 1 (31 December 2004: RR 27.75 to US\$ 1).

#### **(k) Revenue recognition**

Revenues are recognized when goods are shipped to the customer, as this is the date on which the risks and rewards of ownership are transferred to the customer. Sales are shown net of VAT and export duties, and after eliminating sales within the Group.

Revenue from rendering of transport services is recognized in financial statements in the period when the services are rendered.

Interest income is recognized on accrual basis that takes into account the effective yield on the asset.

Dividend income is recognized when the shareholder's right to receive payment is established.



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### Notes to the IFRS consolidated financial statements for the period ended 30 June 2005

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#### **(l) Measurement of trade and other receivables**

Trade and other receivables are initially recognised at the fair value of the consideration given, which normally is the original invoice amount including value added tax less provision made for impairment of these receivables. A provision for impairment of trade receivables is established when there is an objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected future cash flows, discounted at the market rate of interest for similar borrowers at the inception date.

#### **(m) Value added tax**

Value added taxes related to sales are payable to tax authorities upon collection of receivables from customers. Input VAT is generally reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) 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. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

#### **(n) Borrowings**

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

#### **(o) Pension and other post-retirement benefits**

In the normal course of business the Group contributes to the Russian Federation State pension plan on behalf of its employees. Mandatory contributions to the State pension plan, which is a defined contribution plan, are expensed when incurred and are included within wages, salaries and other staff costs in cost of sales.

The Group operates a defined benefit pension plan. Pension costs are recognized using the projected unit credit method. The cost of providing pensions is charged to the relevant category in the consolidated statement of income so as to spread the regular cost over the service lives of employees. The pension obligation is measured at the present value of the estimated future cash outflows using the interest rates on governmental securities, which have the terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognized over the average remaining service life of employees.

Pension Fund “Almaznaya Osen”, in which the Group holds a 97 percent voting interest, administers the Group’s defined benefit plan. The Group contributes funds to the Pension Fund “Almaznaya Osen”, which invests them in governmental securities and other financial instruments. These investments, which represent the majority of assets of Pension Fund “Almaznaya Osen”, are considered the pension fund plan assets, as these assets are available to be used only to pay or fund employee benefits, are not available to the Group’s own creditors (even in bankruptcy), and cannot be returned to the Group, unless either the remaining assets of the Pension Fund are sufficient to meet all the related employee benefit obligations of the pension plan, or the assets are returned to the Group to reimburse it for employee benefits already paid. The defined benefit liability is recognized net of the fair value of plan assets at the balance sheet date.

Prior to the period ended 30 September 2005 the assets of Pension Fund “Almaznaya Osen” primary consisted of cash, commercial papers and financial instruments of Russian issuers (including the Company and its subsidiaries) that are quoted in an active market. Non-convertible bonds and commercial papers of the Company and its subsidiaries did not meet the definition of plan assets and were eliminated in the consolidated balance sheet as intercompany balances.

#### **(p) Social costs**

Social costs relating to the maintenance of housing are determined in accordance with agreements with the local authorities and expensed or capitalized as appropriate.

Discretionary and voluntary payments made to support social programs and related operations are expensed as incurred.



**AK “ALROSA”**

**Notes to the IFRS consolidated financial statements for the period ended 30 June 2005**

*(in millions of Russian roubles, unless otherwise stated)*

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**(q) Non-cash transactions**

Non-cash transactions are measured at the fair value of the consideration received or receivable.

Non-cash transactions have been excluded from the operating, investing and financing activities components in the accompanying consolidated statement of cash flows.

**(r) Shareholders' equity**

*Share capital*

Share capital consists of ordinary shares, which are classified as equity.

*Treasury shares*

Where the Group companies purchase the Company's equity share capital, the consideration paid including any attributable transaction costs net of income taxes is deducted from total shareholders' equity as treasury shares until they are re-sold. Where such shares are subsequently sold, any consideration received is included into shareholders' equity. Treasury shares are recorded at weighted average cost. The gains (losses) arising from treasury share transactions are recognized as a movement in the consolidated statement of changes in shareholders' equity, net of associated costs including taxation.

*Dividends*

Dividends are recognized as a liability and deducted from shareholders' equity at the balance sheet date only if they are declared before or on the balance sheet date.

**(s) Segment reporting**

Business segments (primary segments) provide products or services that are subject to risks and returns that are different from those of other business segments. Geographical segments (secondary segments) provide products or services within a particular economic environment that is subject to risks and returns that are different from those of components operating in other economic environments.

**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)***3. GROUP STRUCTURE AND INVESTMENTS**

The Company’s significant consolidated subsidiaries and associates are as follows:

Name	Country of Incorporation	Percentage of voting interest held	
		30 September 2005 (unaudited)	31 December 2004
<b>Consolidated Subsidiaries</b>			
“ALROSA Finance” S.A.	Luxembourg	100	100
ZAO “Irelyakhneft”	Russia	100	100
OOO “GRK Aldanzoloto”	Russia	99	99
OAO “Severalmaz”	Russia	92	92
OAO “Viluygesstroy”	Russia	90	90
OOO “MAK-Bank”	Russia	88	88
OAO “ALROSA-Nyurba”	Russia	86	86
OAO “Viluyskaya GES-3”	Russia	79	76
OAO “ALROSA-Gas”	Russia	53	53
OAO “Almazy Anabara”	Russia	51	51
OAO “Investment Group ALROSA”	(1) Russia	50	50
<b>Associates</b>			
“Catoka Mining Company Ltd”	(2) Angola	33	33

(1) The Group owned a 50.01 percent of voting interest in OAO “Investment Group ALROSA” at 30 September 2005 and 31 December 2004.

(2) “Catoka Mining Company Ltd” is a diamond-mining venture located in Angola. The investment in this associate was accounted for by the Group using the equity method. Income of RR’mln 564 was included in the Group’s financial statements for the period ended 30 September 2005, with a corresponding income of RR’mln 403 included in the financial statements for the period ended 30 September 2004. The Group’s share of the net assets of “Catoka Mining Company Ltd” included in these financial statements is RR’mln 941 and RR’mln 904 as at 30 September 2005 and 31 December 2004, respectively. In year 2005 “Catoka Mining Company Ltd” declared dividends for the year ended 31 December 2004; the Group’s share of these dividends amounted to RR’mln 527.

**Non-current available-for-sale investments**

	Period ended 30 September 2005 (unaudited)	Period ended 30 September 2004 (unaudited)
Available-for-sale investments at the beginning of the period	518	1,187
Additions	37	87
Disposals	(56)	(42)
Change in provision for impairment of available-for-sale investments (see note 22)	27	(314)
Available-for-sale investments at the end of the period	526	918

All equity investments classified as available-for-sale at 30 September 2005 and 31 December 2004 are carried at cost less impairment, because they are not publicly traded and no reliable method for their fair valuation exists.

**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)***4. CASH AND CASH EQUIVALENTS AND RESTRICTED CASH****Cash and cash equivalents**

As at 30 September 2005 and 31 December 2004, the cash and cash equivalents balance represent:

<b>Sort of cash and cash equivalents</b>	<b>Interest rates</b>	<b>30 September 2005</b>		<b>Interest rates</b>	<b>31 December</b>
		<b>(unaudited)</b>			
Bank deposit	10.8%	285	7.9%	388	
Current accounts	0%	12,440	0%	1,489	
		<b>12,725</b>		<b>1,877</b>	

**Restricted cash**

Included within long-term restricted cash are balances of RR'mln 170 and RR'mln 174 as at 30 September 2005 and 31 December 2004, respectively, which represent deposit accounts held with J.P. Morgan Chase Bank. The Group is required to maintain a balance equal to the amount of its next scheduled principal and interest payment in accordance with loan agreements with these banks.

The remaining RR'mln 94 as at 30 September 2005 (31 December 2004: RR'mln 78) represents mandatory reserve deposits held with the Central Bank of the Russian Federation by OOO “MAK-Bank”, a consolidated subsidiary; these balances are not available for use in the Group’s day to day operations.

At 30 September 2005 short-term restricted cash represents cash of RR'mln 118 held with the OAO Investment Bank “KIT Finance” (previous name - OAO “Web-Invest Bank”). At 30 September 2004 short-term restricted cash represents cash of RR'mln 184 held with the OAO “Web-Invest Bank” and ZAO “Banque Societe Generale Vostok”. According to Russian exchange regulation, these authorized banks reserved 2 percent of loans proceeds received by the Group from foreign banks (at 31 December 2004: 3 percent). These balances are not available for use in the Group’s day-to-day operations for 365 days from the date of transfer of cash to the specified account.

At 30 September 2005 the weighted average interest rate on the restricted cash balances is approximately nil percent (31 December 2004: approximately nil percent).





**AK “ALROSA”**

**Notes to the IFRS consolidated financial statements for the period ended 30 June 2005**

*(in millions of Russian roubles, unless otherwise stated)*

**5. PROPERTY, PLANT AND EQUIPMENT**

	<b>Buildings</b>	<b>Land and Improvements</b>	<b>Plant and Equipment</b>	<b>Transport</b>	<b>Assets under Construction</b>	<b>Other</b>	<b>TOTAL</b>
<b>Cost at 31 December 2004</b>	<b>47,614</b>	<b>39,168</b>	<b>31,497</b>	<b>15,707</b>	<b>33,157</b>	<b>1,753</b>	<b>168,896</b>
Additions through acquisition of subsidiaries	-	-	1	1	34	36	72
Additions	207	460	1,408	786	10,297	370	13,528
Transfers	3,077	4,256	1,393	34	(8,837)	77	-
Disposals	(403)	(2,970)	(577)	(1,089)	(189)	(331)	(5,559)
Change in estimate of provision for restoration liability (see note 12)	1,246	453	85	14	-	1	1,799
Impairment of property, plant and equipment (see note 22)	124	-	-	-	(180)	-	(56)
<b>Cost at 30 September 2005 (unaudited)</b>	<b>51,865</b>	<b>41,367</b>	<b>33,807</b>	<b>15,453</b>	<b>34,282</b>	<b>1,906</b>	<b>178,680</b>
<b>Accumulated depreciation at 31 December 2004</b>	<b>(13,664)</b>	<b>(15,592)</b>	<b>(15,671)</b>	<b>(9,692)</b>	-	<b>(379)</b>	<b>(54,998)</b>
Charge for the period	(1,125)	(1,291)	(2,642)	(979)	-	(137)	(6,174)
Disposals	212	2,943	507	1,051	-	22	4,735
<b>Accumulated depreciation at 30 September 2005 (unaudited)</b>	<b>(14,577)</b>	<b>(13,940)</b>	<b>(17,806)</b>	<b>(9,620)</b>	-	<b>(494)</b>	<b>(56,437)</b>
<b>Net book value at 31 December 2004</b>	<b>33,950</b>	<b>23,576</b>	<b>15,826</b>	<b>6,015</b>	<b>33,157</b>	<b>1,374</b>	<b>113,898</b>
<b>Net book value at 30 September 2005 (unaudited)</b>	<b>37,288</b>	<b>27,427</b>	<b>16,001</b>	<b>5,833</b>	<b>34,282</b>	<b>1,412</b>	<b>122,243</b>

Refer to note 9 for property, plant and equipment included above which is subject to the Lease Agreement with the Republic of Sakha (Yakutia).

**6. INVENTORIES**

	<b>30 September 2005 (unaudited)</b>	<b>31 December 2004</b>
Diamonds	10,302	9,187
Ores and concentrates	2,284	2,146
Mining and construction materials	8,639	6,998
Consumable supplies	1,032	1,206
Diamonds for resale	1,717	-
	<b>23,974</b>	<b>19,537</b>

Diamonds for resale represent the diamonds acquired by the Group from “Sunland Mining Company Ltd.” for the purpose of the subsequent resale.



**AK “ALROSA”**

**Notes to the IFRS consolidated financial statements for the period ended 30 June 2005**

*(in millions of Russian roubles, unless otherwise stated)*

**7. TRADE AND OTHER RECEIVABLES**

	<b>30 September 2005</b>	<b>31 December 2004</b>
<b>Long-term accounts receivable</b>	<b>(unaudited)</b>	
Long-term VAT recoverable	2,725	1,967
Loans issued	1,454	948
Long-term advances to suppliers	515	515
Receivables from related parties (see note 27)	227	543
Long-term prepaid royalty	191	-
	<b>5,112</b>	<b>3,973</b>

	<b>30 September 2005</b>	<b>31 December 2004</b>
<b>Current accounts receivable</b>	<b>(unaudited)</b>	
Advances to suppliers	1,044	708
Prepayments for own bonds redemption	4,605	-
Receivables from related parties (see note 27)	2,205	906
Taxes recoverable	1,711	2,160
Notes receivable	1,196	2,297
Loans issued	1,923	1,026
Prepaid taxes, other than income tax	369	362
Trade receivables for supplied diamonds	23	22
Other receivables	1,882	1,274
	<b>14,958</b>	<b>8,755</b>

Taxes recoverable relate to input Value Added Tax (VAT) incurred with respect to purchases. The amount is available for offset against future output VAT following the settlement of outstanding balances payable in relation to the inventories and services purchased.

Long-term VAT recoverable, which relates to the materials and services used for construction of property, plant and equipment, becomes available for offset against future output VAT after the respective asset is put into use.

Prepayments for own bonds redemption represent cash, transferred to OAO Investment Bank “KIT Finance” for redemption of Eurobonds, issued by “ALROSA Finance S.A.” on 6 May 2008, and to OOO “Antanta Capital” for redemption of non-convertible bonds of the Company of the 19th series.

The impairment provision offset against individual receivable balances is as follows:

	<b>30 September 2005</b>	<b>Interest on impaired receivables</b>	<b>Reversal of expenses</b>	<b>31 December 2004</b>
<b>Long-term accounts receivable</b>	<b>(unaudited)</b>			
Receivables from related parties (see note 27)	58	2	-	56
	58	2	-	56
<b>Current accounts receivable</b>				
Prepaid taxes, other than income tax	13	(14)	(2)	29
Receivables from related parties (see note 27)	229	-	(54)	283
Notes receivable	226	-	(25)	251
Loans issued	176	-	-	176
Other receivables	1,814	(4)	62	1,756
	<b>2,458</b>	<b>(18)</b>	<b>(19)</b>	<b>2,495</b>

**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)*

<b>Long-term accounts receivable</b>	<b>30 September 2004 (unaudited)</b>	<b>Interest on impaired receivables</b>	<b>Bad debt expense</b>	<b>31 December 2003</b>
Long-term prepaid taxes, other than profit tax	125	(29)	83	71
	125	(29)	83	71
<b>Current accounts receivable</b>				
Receivables from related parties (see note 27)	292	-	(15)	307
Notes receivable	251	-	-	251
Loans issued	176	-	80	96
Prepaid taxes, other than income tax	57	(2)	13	46
Other receivables	1,575	(6)	100	1,481
	2,351	(8)	178	2,181

The average effective interest rates at the balance sheet dates were as follows:

<b>Long-term accounts receivable</b>	<b>30 September 2005 (unaudited)</b>	<b>31 December 2004</b>
Receivable from related parties	12%	12%
Loans issued	25%	25%
Long-term prepaid royalty	10%	10%

**8. SHAREHOLDERS' EQUITY*****Share capital***

Share capital authorized, issued and paid in totals RR'mln 11,491 at 30 September 2005 and 31 December 2004 and consists of 200,000 ordinary shares at RR 57,455 per share.

***Distributable profits***

The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net profit. For the period ended 30 September 2005 and 30 September 2004, the statutory profit of the Company as reported in the published statutory reporting forms was RR'mln 10,646 and RR'mln 9,459, respectively. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation, and accordingly, management believes that at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements.

***Treasury shares***

At 30 September 2005 OOO “Management Company Almaz”, OOO “MAK-Bank” and NPF “Almaznaya osen”, a subsidiaries of the Group, held ordinary shares of the Company. The Group management controls the voting right of these shares.

***Dividends***

On 19 June 2004, the Company's shareholders approved dividends for the year ended 31 December 2003 totalling RR'mln 1,200. Dividends per share amounted to RR 6,000.

On 25 June 2005, the Company's shareholders approved dividends for the year ended 31 December 2004 totalling RR'mln 1,800. Dividends per share amounted to RR 9,000.

**9. GRANT AND ASSETS SUBJECT TO MINERAL LEASE AGREEMENT**

On 19 January 1993, the Company entered into a Lease Agreement with the Republic of Sakha (Yakutia) for the “transfer of rights to use and exploit land, diamond deposits, main production and non-production facilities”. This agreement has a term of 25 years and provides the Company with the right to use certain production and non-production assets for exploring, mining and operating diamond deposits. The agreement requires the Company to return the assets in 2017 and reimburse the Government of Republic of Sakha (Yakutia) for depreciation of assets. The Government in turn is required to reimburse the Company for qualifying repair and maintenance costs. The precise mechanism for determining the value and nature of the assets to be returned to the Republic of Sakha (Yakutia) under the terms of the Lease Agreement is being negotiated between the parties.

Management have estimated the restoration liability based upon their interpretation of the Lease Agreement and, in accordance with IAS 37 “*Provisions, Contingent Liabilities and Contingent Assets*”, have calculated and recorded the net present value of the restoration liability (see notes 2 (e) and 12).

The agreement stipulates that its certain terms should be renegotiated every five years. The agreement also stipulates that the Company is subject to royalties and other taxes on the right to use the land and logging areas, disposal and burial of waste and contaminated materials and the use of mineral resources and water for industrial purposes. The main subject of the renegotiations relates to the amount and timing of royalty and other payments.

Royalty payments expensed during the period ended 30 September 2005 totalled RR’mln 6,429 (period ended 30 September 2004: RR’mln 6,503). Ecology fund payments expensed during the period ended 30 September 2005 totalled RR’mln 666 (period ended 30 September 2004: RR’mln 684).

Pursuant to an addendum to the Lease Agreement dated 22 December 2002, the Company and the Republic of Sakha (Yakutia) agreed that the royalty payments, including ecology fund payments and value added tax, due in 2003 are fixed at RR’mln 10,680.

Pursuant to an addendum to the Lease Agreement dated 17 September 2003, the Company and the Republic of Sakha (Yakutia) agreed that the royalty payments, including ecology fund payments and value added tax, due in 2004 are fixed at RR’mln 10,500.

Pursuant to an addendum to the Lease Agreement dated 17 December 2004, the Company and the Republic of Sakha (Yakutia) agreed that the royalty payments, including ecology fund payments and value added tax, due in 2005 are fixed at RR’mln 10,500.

Recoverable value added tax related to royalty and ecology fund payments depends on the percentage of export diamond sales to the total diamond sales of the Company. The amount of such value added tax for the period ended 30 September 2005 was RR’mln 780 (for the period ended 30 September 2004 – RR’mln 688).

The carrying values of Company owned and granted assets subject to the Lease Agreement with the Republic of Sakha (Yakutia) and Grant are as follows:

<b>Assets subject to the agreement with the Republic of Sakha (Yakutia)</b>	<b>30 September 2005 (unaudited)</b>	<b>31 December 2004</b>
Net book value of granted assets received in 1993	8,868	9,363
Net book value of Company owned assets subsequently transferred to the lease	5,302	5,309
<b>Net book value at the end of the year</b>	<b>14,170</b>	<b>14,672</b>



**AK “ALROSA”**

**Notes to the IFRS consolidated financial statements for the period ended 30 June 2005**

*(in millions of Russian roubles, unless otherwise stated)*

**10. LONG-TERM DEBT**

	<b>30 September 2005</b> <b>(unaudited)</b>	<b>31 December 2004</b>
Banks:		
US\$ denominated floating rate	6,551	6,870
US\$ denominated fixed rate	6,926	5,746
RR denominated fixed rate	-	400
	<b>13,477</b>	<b>13,016</b>
Eurobonds	25,522	19,594
RR denominated non-convertible bonds	3,075	3,921
Commercial paper	403	175
Other US\$ denominated fixed rate loans	434	511
Other RR denominated fixed rate loans	437	467
	<b>43,348</b>	<b>37,684</b>
Less: current portion of long-term debt (see note 11)	<b>(12,536)</b>	<b>(6,274)</b>
	<b>30,812</b>	<b>31,410</b>

The long-term commercial paper is denominated in RR, has defined maturity dates ranging between one and ten years, and is carried at amortized cost.

The average effective interest rates at the balance sheet dates were as follows:

	<b>30 September 2005</b> <b>(unaudited)</b>	<b>31 December 2004</b>
Banks:		
US\$ denominated floating rate	7.1%	6.0%
US\$ denominated fixed rate	9.6%	9.6%
RR denominated fixed rate	0%	14.0%
Eurobonds	8.7%	8.9%
RR denominated non-convertible bonds	15.3%	13.8%
Commercial paper	51.6%	51.6%
Other US\$ denominated fixed rate	9.0%	11.0%
Other RR denominated fixed rate loans	11.1%	10.3%

At 30 June 2005 long-term loans had the following maturity profile:

	<b>Within</b> <b>1 year</b>	<b>1 to 2</b> <b>years</b>	<b>2 to 3</b> <b>years</b>	<b>3 to 4</b> <b>years</b>	<b>4 years and</b> <b>thereafter</b>	<b>Total</b>
Banks:						
US \$ denominated floating rate	4,169	1,940	342	100	-	6,551
US \$ denominated fixed rate	5,065	1,488	-	25	348	6,926
RR denominated fixed rate	-	-	-	-	-	-
Eurobonds	-	-	11,303	-	14,219	25,522
RR denominated non-convertible bonds	3,075	-	-	-	-	3,075
Commercial paper	-	196	101	39	67	403
Other US\$ denominated fixed rate loans	98	79	73	67	117	434
Other RR denominated fixed rate loans	129	167	-	1	140	437
	<b>12,536</b>	<b>3,870</b>	<b>11,819</b>	<b>232</b>	<b>14,891</b>	<b>43,348</b>



**AK “ALROSA”**

**Notes to the IFRS consolidated financial statements for the period ended 30 June 2005**

*(in millions of Russian roubles, unless otherwise stated)*

At 31 December 2004 long-term loans had the following maturity profile:

	<b>Within 1 year</b>	<b>1 to 2 years</b>	<b>2 to 3 years</b>	<b>3 to 4 years</b>	<b>4 years and there after</b>	<b>Total</b>
<b>Banks:</b>						
US \$ denominated floating rate	982	2,688	2,888	312	-	6,870
US \$ denominated fixed rate	702	4,141	638	-	265	5,746
RR denominated fixed rate	400	-	-	-	-	400
<b>Eurobonds</b>						
RR denominated non-convertible bonds	3,921	-	-	11,379	8,215	19,594
Commercial paper	-	8	75	40	52	175
Other US\$ denominated fixed rate loans	179	78	72	66	116	511
Other RR denominated fixed rate loans	90	217	20	-	140	467
	<b>6,274</b>	<b>7,132</b>	<b>3,693</b>	<b>11,797</b>	<b>8,788</b>	<b>37,684</b>

The Group has not entered into any derivative contracts in respect of its foreign currency obligations or interest rate exposure.

The carrying amounts and fair values of long-term debt are as follows:

	<b>30 September 2005 (unaudited)</b>		<b>31 December 2004</b>	
	<b>Carrying amounts</b>	<b>Fair values</b>	<b>Carrying amounts</b>	<b>Fair values</b>
<b>Banks</b>				
	13,477	13,390	13,016	13,054
<b>Eurobonds</b>				
Non-convertible bonds	25,522	29,142	19,594	20,623
Commercial paper	3,075	3,079	3,921	3,972
Other US\$ denominated fixed rate loans	403	1,152	175	841
Other RR denominated fixed rate loans	434	434	511	511
	437	460	467	493

The fair value of long-term debt is estimated by discounting the future contractual cash outflows at the market interest rate available to the Group at the balance sheet date.

As at 30 September 2005, long-term debt totalling RR'mln 299 (31 December 2004: RR'mln 42) included above was secured with the assets of the Group. As separate loan agreements do not specify individual pledged assets, the carrying amount of pledged assets is not disclosed.

**Eurobonds**

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Balance at the beginning of the period	19,594	14,463
Issuance	5,699	-
Amortization of discount	47	49
Repayment	(425)	-
Exchange gains	607	(116)
<b>Balance at the end of the period</b>	<b>25,522</b>	<b>14,397</b>

In May 2003 “ALROSA Finance S.A.”, a wholly owned subsidiary of the Group, issued Eurobonds in the amount of RR'mln 15,280 (nominal value - US\$'mln 500) due for repayment on 6 May 2008 with an interest rate of 8.125 percent per annum. In December 2004 part of these Eurobonds in the amount of RR'mln 2,315 (nominal value - US\$'mln 83) was early repaid and cancelled.

In November 2004 “ALROSA Finance S.A.” issued Eurobonds in the amount of RR'mln 8,491 (nominal value - US\$'mln 300) due for repayment on 17 November 2014 with an interest rate of 8.875 percent per annum.

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In January 2005 “ALROSA Finance S.A.” issued Eurobonds in the amount of RR’mln 5,699 (nominal value - US\$’mln 200) due for repayment on 17 November 2014 with an interest rate of 8.53 percent per annum.

**RR denominated non-convertible bonds**

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Balance at the beginning of the period	3,921	4,870
Issuance	-	104
Amortization of discount	29	29
Repayment	(875)	(926)
<b>Balance at the end of the period</b>	<b>3,075</b>	<b>4,077</b>

Non-convertible bonds of the Company of the 19th series totalling RR’mln 2,997 at 30 September 2005 (31 December 2004: RR’mln 2,968) have fixed coupon rates of 16 percent. Other non-convertible bonds have variable interest rate. The first coupon on these bonds is determined by the Supervisory Council of the Company and the following coupons are linked to certain indicators, such as the Central Bank of the Russian Federation refinancing rate or the yields on government bonds.

**11. SHORT-TERM LOANS AND CURRENT PORTION OF LONG-TERM DEBT**

	<b>30 September 2005 (unaudited)</b>	<b>31 December 2004</b>
Banks:		
US\$ denominated floating rate	285	277
US\$ denominated fixed rate	4,298	1,380
RR denominated fixed rate	1,039	217
	5,622	1,874
European commercial paper	4,851	-
Commercial paper	459	482
Other US\$ denominated fixed rate loans	578	161
Other RR denominated fixed rate loans	1,604	1,241
	13,114	3,758
Add: current portion of long-term debt (see note 10)	12,536	6,274
	<b>25,650</b>	<b>10,032</b>

The average effective interest rates at the balance sheet dates were as follows:

	<b>30 September 2005 (unaudited)</b>	<b>31 December 2004</b>
Banks:		
US\$ denominated floating rate	4.0%	4.0%
US\$ denominated fixed rate	9.0%	10.5%
RR denominated fixed rate	7.9%	13.3%
European commercial paper	5.9%	-
Commercial paper	14.7%	18.6%
Other US\$ denominated fixed rate loans	6.9%	6.0%
Other RR denominated fixed rate loans	1.8%	3.5%

As at 30 September 2005, short-term loans totalling RR’mln 114 (31 December 2004: RR’mln 139) included above were secured with the assets of the Group. As separate loan agreements do not specify individual pledged assets, the carrying amount of pledged assets is not disclosed.



## AK “ALROSA”

### Notes to the IFRS consolidated financial statements for the period ended 30 June 2005

(in millions of Russian roubles, unless otherwise stated)

#### Commercial paper

Commercial paper comprises unsecured notes, denominated in RR, issued by the Group to provide short- and medium-term working capital facilities. The short-term commercial paper is typically discounted non-interest bearing instrument, with defined maturity dates ranging from 1 month to 1 year and is carried at amortized cost.

#### European commercial paper

In April 2005 “ALROSA Finance S.A.” issued the 1st series of European commercial paper in the amount of RR’mln 849 (nominal value - US\$’mln 30) due for repayment on 28 July 2005 with effective interest rate of 5.41 percent per annum. Offering price was RR’mln 823.

In May 2005 “ALROSA Finance S.A.” issued the 2nd series of European commercial paper in the amount of RR’mln 2,086 (nominal value - US\$’mln 75) due for repayment on 14 November 2005 with effective interest rate of 6.02 percent per annum. Offering price was RR’mln 2,028.

In June 2005 “ALROSA Finance S.A.” issued the 3d series of European commercial paper in the amount of RR’mln 984 (nominal value - US\$’mln 35) due for repayment on 11 October 2005 with effective interest rate of 5.65 percent per annum. Offering price was RR’mln 974.

In June 2005 “ALROSA Finance S.A.” issued the 4th series of European commercial paper in the amount of RR’mln 1,810 (nominal value - US\$’mln 65) due for repayment on 9 December 2005 with effective interest rate of 5.92 percent per annum. Offering price was RR’mln 1,791.

#### 12. PROVISION FOR RESTORATION LIABILITY

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
At the beginning of the period	6,492	5,394
Change in estimate of provision for restoration liability	1,799	1,086
Increase in the discounted amount during the period	275	305
<b>At the end of the period</b>	<b>8,566</b>	<b>6,785</b>

The provision for restoration liability represents the net present value of the estimated future obligation, upon termination of the Lease Agreement, to return certain property, plant and equipment received from the Republic of Sakha (Yakutia) under the terms of the Lease Agreement (see notes 2(e) and 9). The discount rate used to calculate the net present value of the restoration liability at 30 September 2005 was 4.44 percent (30 September 2004: 6.5 percent), which is pre-tax real rate and is considered appropriate to the Group in the economic environment in the Russian Federation at the balance sheet date.

Under the Lease Agreement the Company is obliged to reimburse to the Republic of Sakha (Yakutia) the amount of accumulated depreciation on property, plant and equipment subject to this agreement (leased property, plant and equipment) and the Republic of Sakha (Yakutia) is obliged to reimburse to the Company the amount of qualified repair and maintenance expense incurred by the Company in relation to the leased property, plant and equipment. The Company and the Republic of Sakha (Yakutia) determined the amount to be reimbursed by the Company on a net basis as the difference between the amount of depreciation on leased assets and the amount of repair and maintenance expense in relation to the leased property, plant and equipment. Reimbursement is effected by means of the transfer of title of certain of the Company’s own items of property, plant and equipment to the Republic of Sakha (Yakutia) and these assets are, subsequent to their transfer, treated as leased property, plant and equipment (see note 9).

Prior to 1 January 2003 Republic of Sakha (Yakutia) was obliged to reimburse to the Company the actual amount of qualified repair and maintenance expense incurred by the Company in relation to the leased property, plant and equipment. Pursuant to an addendum to the Lease Agreement dated 17 September 2003, starting from 1 January 2003 the Republic of Sakha (Yakutia) is obliged to reimburse qualified repair and maintenance expense incurred by the Company, subject to such expense being limited to 30 percent of the depreciation on leased property, plant and equipment.

During the periods ended 30 September 2005 and 30 September 2004 change in amount of capital repairs and change of the



**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)*

discount rates resulted in decrease of change in estimate of provision for restoration liability by RR'mln 1,799 and RR'mln 1,086 respectively. These amounts were added to the cost of the related assets (see note 5).

**13. PROVISION FOR PENSION OBLIGATIONS**

The amounts recognized in the consolidated balance sheet are as follows:

	<b>30 September 2005</b>	<b>31 December 2004</b>
	<b>(unaudited)</b>	
Present value of obligations	8,236	7,513
Fair value of plan assets	(2,333)	(1,544)
Unrecognized actuarial losses	(4,247)	(4,507)
<b>Net liability</b>	<b>1,656</b>	<b>1,462</b>

Due to changes in pension legislation Pension Fund “Almaznaya Osen” reinvested the major part of its funds into financial instruments issued by third parties. These financial instruments are considered the Pension Fund plan assets.

The amounts recognized in the consolidated statement of income are as follows:

	<b>Period ended</b>	<b>Period ended</b>
	<b>30 September 2005</b>	<b>30 September 2004</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
Current service cost	202	180
Interest cost	855	576
Net actuarial losses	217	216
<b>Net expense recognized in the statement of income</b>	<b>1,274</b>	<b>972</b>

Total expenses associated with pension obligations are included within wages, salaries and other staff costs within cost of sales in the consolidated statement of income.

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

	<b>Period ended</b>	<b>Period ended</b>
	<b>30 September 2005</b>	<b>30 September 2004</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
Net liability at the beginning of the year	1,462	1,963
Net expense recognized in the statement of income during the year	1,274	972
Contributions made	(785)	(1,301)
Benefits paid	(295)	(240)
<b>Net liability at the end of the period</b>	<b>1,656</b>	<b>1,394</b>

Principal actuarial assumptions used:

	<b>30 September 2005</b>	<b>31 December 2004</b>
	<b>(unaudited)</b>	
Discount rate (nominal)	9%	9%
Future pension increases (nominal)	9%	9%
Employees average remaining working life (years)	13	13

**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)***14. TRADE AND OTHER PAYABLES**

	<b>30 September 2005</b> <b>(unaudited)</b>	<b>31 December 2004</b>
Accrual for employee flights and holidays	2,906	3,133
Trade payables	2,010	2,435
Wages and salaries	1,337	1,411
Payables to related parties	223	40
Interest payable	1,249	511
Current accounts of third parties in OOO “MAK-Bank”	437	455
Advances from customers	3,470	210
Other payables and accruals	1,097	373
	<b>12,729</b>	<b>8,568</b>

In accordance with Russian legislation, the Group entities are required to pay for the holiday entitlement and the cost of travel for employees and their family members to an agreed-upon destination and back, or a pre-determined allowance.

Advances from customers include amount of RR'mln 3,277 received “Investment Group ALROSA” as a result of prepayment for selling of assets of owned gold-mining companies (see note 30).

**15. OTHER PROVISIONS**

	<b>30 September 2005</b> <b>(unaudited)</b>	<b>31 December 2004</b>
Provision for guarantee given	894	866
Provision for legal claim	235	229
	<b>1,129</b>	<b>1,095</b>

***Provision for guarantee given***

	<b>Period ended</b> <b>30 September 2005</b> <b>(unaudited)</b>	<b>Period ended</b> <b>30 September 2004</b> <b>(unaudited)</b>
At the beginning of the period	866	972
Interest accrued	68	71
Interest paid	(65)	(124)
Exchange gain	25	(7)
At the end of the period	<b>894</b>	<b>912</b>

In April 2003 the Company guaranteed a US\$ denominated fixed rate loan issued by OAO “Investment Bank Trust” to ZAO “Nazymkaya Oil and Gas Research Expedition”, which is due for repayment in 2006. The Company management expects the Group to incur an outflow of economic resources in connection with this guarantee and therefore the Group has recognized a provision for the principal amount of the loan and accrued interest in the financial statements at 30 September 2005 and 31 December 2004. In the period ended 30 September 2005 ZAO “Nazymkaya Oil and Gas Research Expedition” failed to pay the interest installments to the bank. The Company as guarantor paid the interest installments to the bank totalling RR'mln 65.

***Provision for legal claim***

Bateman Projects Limited, a South African company, and its Dutch subsidiary, Bateman International B.V. (collectively “Bateman”), a third party construction firms, which were involved in the development of the Nyurba processing plant, filed an arbitration claim against the Company claiming damages for alleged loss of profit under the contracts concluded between the Company and Bateman and damages allegedly resulting from use of Bateman's intellectual property rights. As the Company management expects the Group to incur an outflow of economic resources in connection with this US\$ denominated legal claim, the Group has recognized a provision in the financial statements at 30 September 2005 and 31 December 2004. The Company management does not expect any additional material outflows of economic resources in relation to this claim.

**AK "ALROSA"****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)***16. INCOME AND OTHER TAX ASSETS AND LIABILITIES**

Taxes payable comprise the following:

	<b>30 September 2005</b>	<b>31 December 2004</b>
	<b>(unaudited)</b>	
Unified social tax	789	831
Value added tax	372	566
Extraction tax	689	472
Property tax	451	277
Personal income tax (employees)	280	218
Tax penalties	347	160
Income tax	1,056	341
Other taxes and accruals	121	117
	<b>4,105</b>	<b>2,982</b>

Taxes other than income tax and extraction tax included into other operating expenses comprise the following:

	<b>Period ended</b>	<b>Period ended</b>
	<b>30 September 2005</b>	<b>30 September 2004</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
Property tax	951	752
Ecology fund	666	684
Tax penalties	38	37
Other taxes and accruals	359	369
	<b>2,014</b>	<b>1,842</b>

In accordance with Resolution № 1364 of the Government of the Russian Federation dated 9 December 1999, in addition to the taxes noted above the Group is obliged to pay 6.5 percent on the value of diamonds sold for export in the form of an export duty (see note 17).

According to legislation which became substantively enacted in the year ended 31 December 2001, income tax payable by companies in the Russian Federation with effect from 1 January 2002 ranges from 20 percent to 24 percent, depending on the decision each year of regional and local tax authorities, which can agree jointly on a supplementary amount of up to 4 percent above that set by the federal tax authorities. The rate used to compute the deferred income tax assets and liabilities of the Group at 30 September 2005 and 31 December 2004 was 24 percent, which reflects the fact that, based on their decisions in respect of tax rates, substantially all regional and local tax authorities in the regions in which the Group operates assessed the maximum supplementary amount in respect of the period ended 30 September 2005 and period ended 31 December 2004.

Income tax expense comprises the following:

	<b>Period ended</b>	<b>Period ended</b>
	<b>30 September 2005</b>	<b>30 September 2004</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
Current tax expense	4,844	3,965
Deferred tax expense (benefit)	(20)	738
	<b>4,824</b>	<b>4,703</b>

**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)*

Net profit before taxation for financial reporting purposes is reconciled to tax expense as follows:

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Profit before income tax and minority interest	15,397	13,435
Theoretical tax charge at statutory rate of 24 percent thereon	3,695	3,224
Income not assessable for income tax purposes	(427)	(299)
Expenses and losses not deductible for income tax purposes	1,556	1,778
	<b>4,824</b>	<b>4,703</b>

Differences between IFRS and Russian statutory tax accounting give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for income tax purposes. The tax effect of the movement on these temporary differences is recorded at the rate of 24 percent (2004: 24 percent).

	<b>30 September 2005 (unaudited)</b>	<b>Tax effect of movement in temporary differences</b>	<b>31 December 2004</b>
<b>Deferred tax liabilities</b>			
Property, plant and equipment	3,683	(206)	3,889
Inventories	2,575	338	2,237
Long-term investments	237	52	185
<b>Deferred tax assets</b>			
Accrual for employee benefits	(943)	57	(1,000)
Exploration costs written off	(453)	(188)	(265)
Impairment of accounts receivable	(8)	72	(80)
Provision for pension obligations	(296)	(50)	(246)
Write-down of inventories	(612)	(103)	(509)
Other deductible temporary differences	(337)	8	(345)
Net deferred tax liability	<b>3,846</b>	<b>(20)</b>	<b>3,866</b>

	<b>30 September 2004 (unaudited)</b>	<b>Tax effect of movement in temporary differences</b>	<b>31 December 2003</b>
<b>Deferred tax liabilities</b>			
Property, plant and equipment	3,618	(88)	3,706
Inventories	2,028	1,044	984
Long-term investments	228	109	119
<b>Deferred tax assets</b>			
Accrual for employee benefits	(943)	44	(987)
Exploration costs written off	(292)	(118)	(174)
Impairment of accounts receivable	(295)	(8)	(287)
Provision for pension obligations	(223)	(68)	(155)
Write-down of inventories	(559)	(179)	(380)
Other deductible temporary differences	(359)	2	(361)
Net deferred tax liability	<b>3,203</b>	<b>738</b>	<b>2,465</b>

**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)***17. SALES**

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Revenue from diamond sales:		
Export (predominantly one customer)	38,665	23,991
Domestic	24,355	26,906
	<b>63,020</b>	<b>50,897</b>
Other revenue:		
Transport	2,021	1,484
Gold	808	690
Social infrastructure	314	465
Trading	799	658
Construction	648	454
Other	2,321	1,739
	<b>69,931</b>	<b>56,387</b>

Export duties totalling RR'mln 1,952 for the period ended 30 September 2005 (period ended 30 September 2004: RR'mln 1,474) were netted against revenues from export of diamonds.

During the periods ended 30 September 2005 and 30 September 2004 sales to De Beers occurred on the basis of separate agreements for each individual shipment of diamonds. Contingencies related to the trade agreement with De Beers, covering the period from 1 January 2002 to 31 December 2006 are disclosed in note 26 (h).

Pursuant to existing federal legislation, the Government of the Russian Federation issued, on an annual basis, an export quota for rough diamonds. The quota stipulated the maximum amount of diamonds that might be exported in a given year. The physical volume in carats provided in any quota constituted a State secret.

In November 2002, the President of the Russian Federation signed a decree liberalizing the Russian diamond market. The decree authorized the Government of the Russian Federation to grant multi-year quotas, not to exceed five years. In February 2003 the Company was granted a five-year quota to export up to US\$'mln 1,450 of diamonds each year, based on current market prices.

**18. COST OF SALES**

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Wages, salaries and other staff costs	10,650	8,742
Depreciation	5,509	4,586
Fuel and energy	4,728	4,407
Cost of diamonds for resale (see note 6)	4,734	3,975
Extraction tax	3,942	-
Materials	3,785	3,665
Services	1,179	1,629
Transport	936	717
Write down of inventory	281	158
Other	325	294
Movement in inventories	(1,253)	(2,899)
	<b>34,816</b>	<b>25,274</b>

Depreciation totalling RR'mln 665 (period ended 30 September 2004: RR'mln 810) and staff costs totalling RR'mln 1,492 (period ended 30 September 2004: RR'mln 1,282) were incurred by the Group's construction divisions and were capitalized in the year.

Cost of diamonds for resale represents cost of diamonds acquired by the Group from “Sunland Mining Company Ltd.” and produced for the purpose of the subsequent resale.

**AK "ALROSA"**

Notes to the IFRS consolidated financial statements for the period ended 30 June 2005

*(in millions of Russian roubles, unless otherwise stated)***19. GENERAL AND ADMINISTRATIVE EXPENSES**

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Administrative expenses	2,426	1,975
Bad debt expense	(19)	261
	<b>2,407</b>	<b>2,236</b>

Wages, salaries and other staff costs totalling RR'mln 637 (period ended 30 September 2004: RR'mln 561) were included into administrative expenses.

**20. SELLING AND MARKETING EXPENSES**

Wages, salaries and other staff costs totalling RR'mln 480 (period ended 30 September 2004: RR'mln 432) are included into selling and marketing expenses.

**21. OTHER OPERATING INCOME**

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Amortization of Grant (see note 9)	495	820
Other	1,052	664
	<b>1,547</b>	<b>1,484</b>

**22. OTHER OPERATING EXPENSES**

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Social costs	2,423	1,732
Taxes other than income tax and extraction tax (see note 16)	2,014	1,842
Exploration expenses	1,528	1,365
Loss on disposal of property, plant and equipment	444	500
Provisions for guarantee given and legal claim (see note 15)	68	71
Impairment of property, plant and equipment	56	248
Provision for (reversal of provision for) impairment of available-for-sale investments	(27)	314
Other	1,144	746
	<b>7,650</b>	<b>6,818</b>

**Social costs consist of:**

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Maintenance of local infrastructure	1,236	903
Charity	306	272
Hospital expenses	199	128
Education	150	137
Arrangement of semicentenary of diamond-mining industry	174	-
Other	358	292
	<b>2,423</b>	<b>1,732</b>

**AK “ALROSA”**

Notes to the IFRS consolidated financial statements for the period ended 30 June 2005

*(in millions of Russian roubles, unless otherwise stated)***23. NET FINANCE COSTS**

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Interest income	(356)	(195)
Exchange expenses (gains), net	930	(53)
	574	(248)
Interest expense:		
Eurobonds	1,672	941
Bank loans	1,213	1,582
Non-convertible bonds	415	507
Commercial paper	96	89
European commercial paper	112	-
Other	37	68
Provision for restoration liability (see note 12)	274	305
	<b>4,393</b>	<b>3,244</b>

**24. CASH GENERATED FROM OPERATIONS**

Reconciliation of profit before tax to cash generated from operations:

	<b>Period ended 30 September 2005 (unaudited)</b>	<b>Period ended 30 September 2004 (unaudited)</b>
Profit before income tax	15,397	13,435
Adjustments for:		
Income from associates, net	(558)	(403)
Interest income (note 23)	(356)	(195)
Interest expense (note 23)	3,819	3,492
Provision for (reversal of provision for) impairment of available-for-sale investments (note 22)	(27)	314
Impairment of property, plant and equipment (note 22)	56	248
Provisions for guarantee given and legal claim (note 22)	68	71
Loss on disposal of property, plant and equipment (note 22)	444	500
Amortization of Grant (note 21)	(495)	(820)
Depreciation (note 18)	5,509	4,586
Adjustments for non-cash investing activity (note 28)	(2,228)	(1,032)
Adjustments for non-cash financing activity (note 28)	238	191
Foreign exchange effect on non-operating items	1,096	64
Net operating cash flow before changes in working capital	22,963	20,451
Net increase in inventories	(4,438)	(3,845)
Net increase in trade and other receivables, excluding dividends receivable	(6,990)	(4,647)
Net increase (decrease) in provisions, trade and other payables, excluding interest payable	3,774	(1,602)
Net increase in taxes payable other than income tax	408	175
<b>Cash generated from operations</b>	<b>15,717</b>	<b>10,532</b>
Income tax paid	(4,240)	(3,081)
<b>Net cash flows from operating activities</b>	<b>11,477</b>	<b>7,451</b>



## 25. FINANCIAL RISKS MANAGEMENT

### (a) Credit risk

Financial assets, which potentially subject Group entities to credit risk, consist principally of trade and other receivables. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of impairment provision, represents the maximum amount exposed to credit risk. The Group has no other significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision already recorded.

Cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

### (b) Foreign exchange risk

The Group exports production to European and other countries and attracts a substantial amount of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated liabilities (see notes 10 and 11) give rise to foreign exchange exposure.

At 30 September 2005 the Group does not have arrangements to mitigate the foreign exchange risks of the Group's operations

### (c) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest bearing long-term borrowings. The majorities of interest rates on long-term borrowings are fixed, and are disclosed in note 10. The Group's principal interest bearing assets are current accounts opened with a number of banks (see note 4), loans issued and notes receivable.

At 30 September 2005 the Group does not have arrangements to mitigate the interest rate risk.

### (d) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, and ensuring the availability of additional funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in its funding requirements by keeping committed credit lines available.

### (e) Fair value estimation

The fair value of publicly traded investment at fair value through profit or loss including held for trading and available-for-sale securities is based on quoted market prices at the balance sheet date.

The estimated fair value of financial assets carried at amortised cost is determined by discounting estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates available to the Group for similar financial instruments. Fair value of these financial assets did not materially differ from their carrying amount at 30 September 2005 and 31 December 2004. At 30 September 2005 and 31 December 2004 the fair value of financial liabilities which is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments with the same remaining maturity, did not materially differ from the carrying amount of these financial liabilities (note 10).

The carrying amounts of financial assets and liabilities with maturity of less than one year are assumed to approximate their fair values.





## 26. CONTINGENCIES, COMMITMENTS AND OTHER RISKS

### (a) Operating environment

Whilst there have been improvements in economic trends in the country, the Russian Federation continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, 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.

### (b) Taxes

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 may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review. Under certain circumstances reviews may cover longer periods.

At 30 September 2005 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.

In consequence of tax inspection taxation authorities laid claim for incomplete and out-of-time tax payment in 2002 in the amount of RR 1,123 mln. Management assesses the probability of settlement of this obligation as low so it is not recognized in the financial statements for the period ended 30 September 2005.

Where management believes it is probable that the financial position cannot be sustained, an appropriate amount has been accrued for in these financial statements.

### (c) Legal proceedings

The Group is a party to certain legal proceedings arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material adverse effect on the results of operations or financial position of the Group as at 30 September 2005, other than amounts that have been accrued in the consolidated financial statements.

### (d) Insurance

The Group is assessing its policies for insuring assets and operations. At present, apart from the full insurance of movements of diamond inventory from the production location to the customers, very few assets and operations of the Group are insured and, in the instances where assets are insured, the amounts generally are not sufficient to cover all costs associated with replacing the assets.

### (e) Capital commitments

At 30 September 2005, the Group has contractual commitments for capital expenditures of approximately RR'mln 3,595 (31 December 2004: RR'mln 4,078).

### (f) Restoration, rehabilitation and environmental costs

Under its license agreements, the Group is not responsible for any significant restoration, rehabilitation and environmental expenditures that may be incurred subsequent to the cessation of production at each mine, apart from the obligation to return assets received under the Lease agreement (see note 9). However, the Group is obliged to restore riverbeds and the surrounding areas. These expenses are not expected to be material to the Group and are expensed in the period incurred.

**AK “ALROSA”****Notes to the IFRS consolidated financial statements for the period ended 30 June 2005***(in millions of Russian roubles, unless otherwise stated)***(g) Guarantees**

As at 30 September 2005, the Group has guaranteed a US\$ denominated loan issued by National Bank of Republic of Belarus to AKB “Rosbank”, totalling RR'mln 712. Management of the Company does not expect the Group to incur any outflow of economic resources or economic benefits in connection with this guarantee.

**(h) Trade agreement with De Beers**

On 17 December 2001, a trade agreement between the Company and De Beers was signed, covering the period from 1 January 2002 to 31 December 2006. Pursuant to this agreement, the Company agreed to sell and De Beers agreed to buy up to US\$m 800 in value of the Company's annual diamond production at the current market prices. To be legally enforceable, this agreement requires the regulatory permission of the European Commission. Currently, the Company is in the process of negotiating the resolution of certain objections raised by the European Commission. Management of the Company believes that the result of these negotiations would not adversely affect the Group.

In addition, the European Commission could seek to impose fines of up to 10 percent of the Company's European sales in respect of the Company's previous trade agreements with De Beers, which were not notified to the European Commission. Management of the Company does not anticipate that any material liabilities will arise from this contingent liability.

**(i) Bankruptcy of subsidiaries**

In June 2005 the monitoring procedures were applied concerning the subsidiaries OAO “Viluygestroy” and OAO “ALROSA-Lesprom”. The situation remained the same at the date of signing of the financial statement.

**27. RELATED PARTY TRANSACTIONS**

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 as defined by IAS 24 “*Related Party Disclosures*”. 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.

One of the Company's principal shareholders is the Republic of Sakha (Yakutia). IAS 24 (revised) does not exclude government controlled entities from the definition of related parties. Information related to the relationship between the Group and the Republic of Sakha (Yakutia) is disclosed in notes 9 and 12.

Short-term key management personnel benefits incurred during period ended 30 September 2005 totalling RR'mln 139 (period ended 30 September 2004: RR'mln 114).

Additionally, in the period ended 30 September 2005 the Group entered into various transactions principally with the following related parties:

Name of the related party	Nature of relationships	Percentage of ownership interest held		Types of transactions
		30 September 2005	31 December 2004	
(unaudited)				
OAO “Yuzhno-Verkhoyanskaya Gornaya Company”	Associate	50	50	Financing, sales of inventory and other sales
ZAO “PIC Orel Almaz”	Associate	34	34	Sales of diamonds
Catoca Mining Company Ltd. (see note 3)	Associate	33	33	Receipt of dividends
OAO “Tuymaada Diamond”	Associate	13	13	Sales of diamonds

As at 30 September 2005 and at 31 December 2004 percentage of ownership interest of the Group in associates is equal to

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percentage of voting interest.

Significant related party transactions are summarized as follows:

<b>Long-term accounts receivable</b>	<b>30 September 2005</b>	<b>31 December 2004</b>
	<b>(unaudited)</b>	
OA0 “Yuzhno-Verkhoyanskaya Gornaya Company”, loans issued	-	283
Ministry of Finance of the Republic of Sakha (Yakutia)	285	316
Less: provision for bad debt	(58)	(56)
	<u>227</u>	<u>543</u>

The accounts receivable of the Ministry of Finance of the Republic of Sakha (Yakutia) represents a long-term part of prepaid royalty of the Group accordingly to the Lease Agreement dated 19 January 1993.

<b>Current accounts receivable</b>	<b>30 September 2005</b>	<b>31 December 2004</b>
	<b>(unaudited)</b>	
Ministry of Finance of the Republic of Sakha (Yakutia)	664	324
Catoka Mining Company Ltd. (see note 3), dividends receivable	527	193
LUO-Sociedade Mineira do Camachia-Camagico S.A.R.L.	45	-
OA0 “Yuzhno-Verkhoyanskaya Gornaya Company”, notes receivable	696	-
OA0 “Yuzhno-Verkhoyanskaya Gornaya Company”, loans issued	36	206
OA0 “Yuzhno-Verkhoyanskaya Gornaya Company”, other receivables	115	97
OOO “EPL Diamond”	116	-
ZAO “PIC Orel Almaz”, receivables for supplied diamonds	167	165
OA0 “Tuymaada Diamond”, receivables for supplied diamonds	-	145
Other	88	59
Less: provision for bad debt	(229)	(283)
	<u>2,205</u>	<u>906</u>

The accounts receivable of the Ministry of Finance of the Republic of Sakha (Yakutia) represents a short-term part of prepaid royalty of the Group accordingly to the Lease Agreement dated 19 January 1993.

According to assignment agreement the Company entered into in August 2005 repayment of receivables liability of OA0 “Tuymaada Diamond” transferred to OOO “EPL Diamond”. In the opinion of management OOO “EPL Diamond” is related party.

In September 2005 the bankruptcy proceedings were applied concerning the associate ZAO “PIC Orel Almaz”.

<b>Accounts payable</b>	<b>30 September 2005</b>	<b>31 December 2004</b>
	<b>(unaudited)</b>	
Ministry of Finance of the Republic of Sakha (Yakutia)	144	-
LUO-Sociedade Mineira do Camachia-Camagico S.A.R.L.	-	36
Catoka Mining Company Ltd	28	-
Escom-ALROSA Ltd	50	-
Other	1	4
	<u>223</u>	<u>40</u>

The accounts payable of the Group to the Ministry of Finance of the Republic of Sakha (Yakutia) represents royalty payables of the Group accordingly to the Lease Agreement dated 19 January 1993.

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*(in millions of Russian roubles, unless otherwise stated)***28. SIGNIFICANT NON-CASH TRANSACTIONS**

	Period ended 30 September 2005 (unaudited)	Period ended 30 September 2004 (unaudited)
<b>Non-cash investing activities:</b>		
Inventory used in construction	(1,492)	(973)
Other	(736)	(59)
	<b>(2,228)</b>	<b>(1,032)</b>
<b>Non-cash financing activities:</b>		
Commercial paper issuance	401	233
Commercial paper and loans redemption	(163)	(42)
	<b>238</b>	<b>191</b>

**29. SEGMENT INFORMATION**

The Group has one reportable business segment, which is the production and sale of diamonds. The Group evaluates performance and makes investment and strategic decisions based upon review of profitability for the Group as a whole. The performance measurement systems employed by the Group to review overall profitability are based on the results of the Group determined using Russian statutory accounting books and records. Russian statutory accounting differs in many significant respects from IFRS.

An analysis of revenue by type is disclosed in note 17. Revenue from sales by geographical location of the customer, and assets and capital expenditures by geographical location of the asset are as follows:

	Sales		Total assets		Capital Expenditures	
	Period ended 30 September 2005 (unaudited)	Period ended 30 September 2004 (unaudited)	30 September 2005 (unaudited)	31 December 2004	Period ended 30 September 2005 (unaudited)	Period ended 30 September 2004 (unaudited)
Russian Federation	31,266	32,396	176,586	148,405	13,036	13,277
Western Europe	19,301	13,730	2,029	-	37	-
Other countries	19,364	10,261	1,325	858	455	-
	<b>69,931</b>	<b>56,387</b>	<b>179,940</b>	<b>149,263</b>	<b>13,528</b>	<b>13,277</b>
Associates	-	-	1,153	1,083	-	-
Unallocated assets	-	-	120	9	-	-
<b>Total</b>	<b>69,931</b>	<b>56,387</b>	<b>181,213</b>	<b>150,355</b>	<b>13,528</b>	<b>13,277</b>

Sales to De Beers are included in the Western Europe geographical segment.

The Group has one individual customer, De Beers, that accounted for 22 percent of its sales during the period ended 30 September 2005 (period ended 30 September 2004: 25 percent).

**30. POST BALANCE SHEET EVENTS**

In September 2005 OAO “Investment Group ALROSA” sold own gold assets to ZAO “Polyus”: 99,2 percent of ownership interest in OOO “GRK Aldanzoloto”, 50 percent of the share capital of OAO “Yuzhno-Verkhoyanskaya Gornaya Company” and 100 percent of the share capital of OAO “Yakutskaya Gornaya Company” to the amount of US\$ mln 285. Acquired companies represent the surface users at Kuranakhksoe, Kyuchus and Nezhdaninskoe deposits in the Republic of Sakha (Yakutia). However real control over these companies was obtained in 4<sup>th</sup> quarter 2005.