**AVTOVAZ GROUP**

**INTERNATIONAL FINANCIAL REPORTING STANDARDS**
**CONSOLIDATED FINANCIAL STATEMENTS**
**AND AUDITORS' REPORT**

**31 December 2004**

# AVTOVAZ GROUP
## Consolidated Financial Statements and Auditors' Report
## 31 December 2004

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## AUDITORS' REPORT

To the Shareholders of JSC "AVTOVAZ"

1 We have audited the accompanying consolidated balance sheet of JSC "AVTOVAZ" and its subsidiaries (the "Group") as of 31 December 2004 and the related consolidated statements of income, of cash flows and of changes in equity for the year then ended. These financial statements (as set out on pages 1 to 29) are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

3 In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2004, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Moscow, Russian Federation
30 June 2005

# AVTOVAZ GROUP
## Consolidated Balance Sheet at 31 December 2004
**(In millions of Russian Roubles)**
**(Amounts translated into US dollars for convenience purposes, Note 2.2)**

| | RR million | | Supplementary information Unaudited US$ million |
|---|---|---|---|
| | **31 December 2004** | 31 December 2003 | 31 December 2004 |
| **ASSETS** | | | |
| Current assets: | | | |
| Cash and cash equivalents (Note 9) | **11,966** | 6,871 | 431 |
| Trade receivables (Notes 8 and 10) | **7,548** | 6,970 | 272 |
| Financial assets (Note 11) | **3,624** | 4,255 | 131 |
| Other assets (Note 12) | **10,134** | 7,079 | 365 |
| Inventories (Note 13) | **20,742** | 19,060 | 747 |
| Total current assets | **54,014** | 44,235 | 1,946 |
| Non-current assets: | | | |
| Property, plant and equipment (Note 14) | **103,158** | 101,454 | 3,718 |
| Financial assets (Note 16) | **2,251** | 675 | 81 |
| Investments in associates (Note 17) | **1,898** | 866 | 68 |
| Development costs (Note 15) | **2,818** | 1,699 | 102 |
| Other assets (Note 18) | **1,720** | 3,135 | 62 |
| **Total assets** | **165,859** | 152,064 | 5,977 |
| **LIABILITIES & EQUITY** | | | |
| Current liabilities: | | | |
| Trade payables current (Note 8 and 19) | **18,494** | 17,495 | 666 |
| Other payables and accrued expenses (Note 20) | **6,541** | 5,743 | 236 |
| Taxes other than income tax (Note 23) | **4,064** | 4,289 | 146 |
| Provisions (Note 21) | **1,208** | 1,732 | 44 |
| Debt (Note 22) | **16,249** | 11,852 | 586 |
| Advances from customers | **8,207** | 5,635 | 296 |
| Total current liabilities | **54,763** | 46,746 | 1,974 |
| Non-current liabilities: | | | |
| Debt (Note 22) | **12,298** | 10,587 | 443 |
| Taxes other than income tax (Note 23) | **4,299** | 4,405 | 155 |
| Deferred tax liability (Note 34) | **11,009** | 10,824 | 397 |
| **Total liabilities** | **82,369** | 72,562 | 2,969 |
| **Equity** | | | |
| Share capital (Note 24) | **28,890** | 28,890 | 1,041 |
| Currency translation adjustment | **1,338** | 1,289 | 48 |
| Retained earnings | **51,646** | 48,033 | 1,861 |
| Equity holders' of the Company | **81,874** | 78,212 | 2,950 |
| Minority interest | **1,616** | 1,290 | 58 |
| **Total equity** | **83,490** | 79,502 | 3,008 |
| **Total liabilities and equity** | **165,859** | 152,064 | 5,977 |

V. Vilchik
President – General Director
30 June 2005

N. Khatuntsov
Chief Accountant

The accompanying notes 1 to 39 are an integral part of the consolidated financial statements.

## AVTOVAZ GROUP
## Consolidated Statement of Income for the year ended 31 December 2004
**(In millions of Russian Roubles, except for earnings per share)**
**(Amounts translated into US dollars for convenience purposes, Note 2.2)**

| | RR million | | Supplementary information US$ million |
|---|---|---|---|
| | Year ended 31 December | | |
| | **2004** | 2003 | **Unaudited** 2004 |
| Sales (Note 25) | **160,536** | 130,772 | 5,572 |
| Cost of sales (Notes 26) | **(133,687)** | (110,120) | (4,640) |
| **Gross profit** | **26,849** | 20,652 | 932 |
| Distribution costs (Note 27 and 33) | **(6,339)** | (4,128) | (220) |
| Administrative expenses (Notes 28 and 33) | **(9,768)** | (8,676) | (339) |
| Other operating expenses (Note 29 and 33) | **(1,036)** | (2,146) | (36) |
| Research and development expenses (Notes 30 and 33) | **(703)** | (628) | (24) |
| Other gains (Note 31) | **493** | 867 | 17 |
| **Operating profit** | **9,496** | 5,941 | 330 |
| Finance costs (Note 32) | **(2,771)** | (3,708) | (96) |
| Income from associates (Note 17) | **701** | 333 | 24 |
| **Profit before taxation** | **7,426** | 2,566 | 258 |
| Income tax (expense)/credit (Note 34) | **(2,851)** | 385 | (99) |
| **Net profit** | **4,575** | 2,951 | 159 |
| **Attributable to:** | | | |
| Equity holders of the Company | **4,245** | 3,034 | 147 |
| Minority interest | **330** | (83) | 12 |
| | **4,575** | 2,951 | 159 |
| Weighted average number of shares outstanding during the period (000's) | **14,445** | 14,445 | 14,445 |
| **Earnings per share (basic/diluted) (in RR and US $) (Note 35)** | **294** | 210 | 10 |

## Consolidated Statement of Cash Flows for the year ended 31 December 2004

**(In millions of Russian Roubles)**
**(Amounts translated into US dollars for convenience purposes, Note 2.2)**

| | RR million | | Supplementary information (Note 2.2) US$ million |
|---|---|---|---|
| | Year ended 31 December | | |
| | **2004** | 2003 | **Unaudited** 2004 |
| **Cash flows from operating activities:** | | | |
| Profit before taxation | **7,426** | 2,566 | 258 |
| Adjustments for: | | | |
| Depreciation (Note 26) | **6,379** | 6,293 | 221 |
| Provision for impairment of receivables (Note 28) | **(272)** | 110 | (9) |
| Provisions (Note 29) | **(265)** | 121 | (9) |
| Interest expense (Note 32) | **3,451** | 3,416 | 120 |
| Gains on forgiveness of tax debt and restructuring of other debt (Note 32) | **-** | (325) | - |
| Loss on disposal of property, plant and equipment (Note 29) | **747** | 393 | 26 |
| Income from associates (Note 17) | **(701)** | (333) | (24) |
| Loss on impairment of property, plant and equipment (Note 14) | **415** | 117 | 14 |
| Reversal of impairment loss on property, plant and equipment (Note 14) | **(303)** | (501) | (11) |
| Impairment loss on non-current financial assets (Note 29) | **121** | 584 | 4 |
| Negative goodwill (Note 7) | **-** | (458) | - |
| Loss on disposal of subsidiaries (Note 29) | **(203)** | 256 | (7) |
| Unrealised foreign exchange effect on non-operating balances | **632** | 507 | 22 |
| **Operating cash flows before working capital changes** | **17,427** | 12,746 | 605 |
| Increase in gross trade receivables | **(473)** | (519) | (16) |
| Increase in current financial and other assets | **(2,425)** | (4,238) | (84) |
| Increase in inventories | **(1,868)** | (525) | (65) |
| Increase/(decrease) in trade payables and other payables and accrued expenses | **485** | (1,342) | 17 |
| (Decrease)/increase in taxes payable other than income tax | **(224)** | 2,051 | (8) |
| Increase in advances from customers | **2,571** | 4,575 | 89 |
| **Cash provided from operations** | **15,493** | 12,748 | 538 |
| Income tax paid | **(2,650)** | (1,671) | (92) |
| Interest paid | **(2,084)** | (3,660) | (72) |
| **Net cash provided from operating activities** | **10,759** | 7,417 | 374 |
| **Cash flows from investing activities:** | | | |
| Purchase of property, plant and equipment | **(8,963)** | (9,210) | (311) |
| Proceeds from the sale of property, plant and equipment | **38** | 225 | 1 |
| Proceeds from the sale of subsidiaries | **3** | 49 | - |
| Purchase of subsidiaries, associates and financial assets | **(33)** | (303) | (1) |
| Loans issued by bank | **(2,406)** | (423) | (84) |
| Loans repaid by bank | **865** | - | 30 |
| Business combination (Note 7) | **-** | (68) | - |
| **Net cash used in investing activities:** | **(10,496)** | (9,730) | (365) |
| **Cash flows from financing activities:** | | | |
| Proceeds from borrowings | **16,083** | 19,570 | 558 |
| Repayment of loans and long-term taxes payable | **(10,695)** | (12,905) | (371) |
| Dividends paid | **(538)** | (219) | (19) |
| **Net cash provided from financing activities** | **4,850** | 6,446 | 168 |
| Effect of exchange rate changes | **(18)** | (13) | (1) |
| Effect of translation | **-** | - | 22 |
| **Net increase in cash and cash equivalents** | **5,095** | 4,120 | 198 |
| **Cash and cash equivalents at the beginning of the period** | **6,871** | 2,751 | 233 |
| **Cash and cash equivalents at the end of the period (Note 9)** | **11,966** | 6,871 | 431 |

The accompanying notes 1 to 39 are an integral part of the consolidated financial statements.

(In millions of Russian Roubles)

| In RR million | Share capital | Treasury shares (Notes 7.1 and 24) | Currency translation adjustment | Retained earnings | Attributable to equity holders of the Company | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|
| **Balances as of 31 December 2002 (as restated)** | **64,251** | **(35,361)** | **1,119** | **45,218** | **75,227** | **1,587** | **76,814** |
| Currency translation adjustment | - | - | 170 | - | **170** | **-** | **170** |
| Dividends | - | - | - | (219) | **(219)** | **-** | **(219)** |
| Purchase of additional shares in subsidiary | - | - | - | - | **-** | **(526)** | **(526)** |
| Purchase of subsidiaries | - | - | - | - | **-** | **312** | **312** |
| Profit for the year | - | - | - | 3,034 | **3,034** | **(83)** | **2,951** |
| **Balances as of 31 December 2003** | **64,251** | **(35,361)** | **1,289** | **48,033** | **78,212** | **1,290** | **79,502** |
| Currency translation adjustment | - | - | 49 | - | **49** | **-** | **49** |
| Dividends | - | - | - | (632) | **(632)** | **-** | **(632)** |
| Purchase of subsidiaries | - | - | - | - | **-** | **(17)** | **(17)** |
| Sale of subsidiaries | - | - | - | - | **-** | **13** | **13** |
| Profit for the year | - | - | - | 4,245 | **4,245** | **330** | **4,575** |
| **Balances as of 31 December 2004** | **64,251** | **(35,361)** | **1,338** | **51,646** | **81,874** | **1,616** | **83,490** |

| **Supplementary information (Note 2.2)** **(Unaudited)** In US$ million | Share capital | Treasury shares (Notes 7.1 and 24) | Currency translation adjustment | Retained earnings | Attributable to equity holders of the Company | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|
| **Balances as of 31 December 2004** | **2,315** | **(1,274)** | **48** | **1,861** | **2,950** | **58** | **3,008** |

The statutory accounting reports of JSC AVTOVAZ (the "Company") are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the net profit. For 2004, the current net statutory profit for the Company as reported in its statutory reporting forms was RR 5,600 (the year ended 31 December 2003: RR 4,655). However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and accordingly management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these consolidated financial statements.

## 1. JSC AVTOVAZ and subsidiaries

JSC AVTOVAZ and its subsidiaries' (the "Group") principal activities include the manufacture and sale of passenger automobiles. The Group's manufacturing facilities are primarily based in the Samara Oblast of Russia. The Group has a sales and service network spanning the Commonwealth of Independent States and some other countries. The parent company, JSC AVTOVAZ ("the Company" or JSC AVTOVAZ), was incorporated as an open joint stock company in the Russian Federation on 5 January 1993. At 31 December 2004 the Group employed 159,953 employees (31 December 2003: 161,228). JSC AVTOVAZ is registered at Yuzhnoye Shosse, 36, Togliatti, 445633, Russian Federation.

These consolidated financial statements have been approved for issue by the President-General Director on 30 June 2005.

## 2. Basis of presentation of the consolidated financial statements

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

JSC AVTOVAZ and its subsidiaries resident in the Russian Federation, which account for approximately 94% of assets and liabilities of the Group, maintain their accounting records in Russian Roubles ("RR") and prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation. These consolidated financial statements are based on the statutory records, with adjustments and reclassifications recorded for compliance with IFRS. Similarly, adjustments to conform with IFRS, where necessary, are recorded in the financial statements of companies not resident in the Russian Federation.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. Trade receivables, non-current receivables, other current assets, trade and other current payables are shown at fair value through profit or loss. The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 5.

### 2.1 Accounting for the effect of inflation

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 changes in the general purchasing power of the RR in accordance with IAS 29 ("Financial Reporting in Hyperinflationary Economies"). 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 has ceased, effective from 1 January 2003 the Group no longer applies the provisions of 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.

### 2.2 Supplementary information

U.S. dollar ("US$") amounts shown in the accompanying consolidated balance sheet are translated from RR as a matter of arithmetical computation only, at the official rate of the Central Bank of the Russian Federation at 31 December 2004 of RR 27.7487 = US$1 (31 December 2003: RR 29.4545 = US$1). The consolidated statement of income and the consolidated statement of cash flows have been translated at the average exchange rates during the year (2004: 28.81 = US$1). The difference was recognized in equity. The US$ amounts are presented solely for the convenience of the reader as supplementary information, and should not be construed as a representation that RR amounts have been, could have been, or would be converted to US$ at this rate, nor that the US$ amounts present fairly the financial position and results of operations and cash flows of the Group in accordance with IFRS.

## 3. Summary of significant accounting policies

### 3.1 Early adoption of standards

In 2003 the Group early adopted the IFRS below, which are relevant to its operations.

IAS 1 (revised 2003) "Presentation of Financial Statements"
IAS 2 (revised 2003) "Inventories"
IAS 8 (revised 2003) "Accounting Policies, Changes in Accounting Estimates and Errors"
IAS 10 (revised 2003) "Events after the Balance Sheet Date"
IAS 16 (revised 2003) "Property, Plant and Equipment"
IAS 17 (revised 2003) "Leases"
IAS 21 (revised 2003) "The Effects of Changes in Foreign Exchange Rates"
IAS 24 (revised 2003) "Related Party Disclosures"
IAS 27 (revised 2003) "Consolidated and Separate Financial Statements"
IAS 28 (revised 2003) "Investments in Associates"
IAS 31 (revised 2003) " Interests in Joint Ventures"
IAS 32 (revised 2003) "Financial Instruments: Disclosure and Presentation"
IAS 33 (revised 2003) "Earnings per Share"
IAS 39 (revised 2003) "Financial Instruments: Recognition and Measurement"
IFRS 2 (issued 2004) "Share-based Payments"
IFRS 3 (issued 2004) "Business Combinations"
IFRS 5 (issued 2004) "Non-current Assets Held for Sale and Discontinued Operations"
IAS 36 (revised 2004) "Impairment of Assets"
IAS 38 (revised 2004) "Intangible Assets".

### 3.2 New accounting standards and IFRIC interpretations

Certain new accounting standards and IFRIC interpretations have been published that are mandatory for accounting periods beginning on or after 1 January 2006. The Group's assessment of the impact of these new standards and interpretations is set out below.

*(a) IFRS 6, Exploration for and Evaluation of Mineral Resources*
The Group does not have any exploration and evaluation assets. This standard will not affect the Group's financial statements.

*(b) IFRIC 2, Members' Shares in Co-operative Entities and Similar Instruments*
This interpretation will not affect the Group's financial statements.

*(c) IFRIC 3, Emission Rights*
The Group does not participate in an emission rights scheme. This interpretation will not affect the Group's financial statements.

*(d) IFRIC 4, Determining whether an Asset Contains a Lease*
IFRIC 4 is applicable to annual periods beginning on or after 1 January 2006. The Group has not elected to adopt IFRIC 4 early. It will apply IFRIC 4 in its 2006 financial statements and the IFRIC 4 transition provisions. The Group will therefore apply IFRIC 4 on the basis of facts and circumstances that existed at 1 January 2005. Implementation of IFRIC 4 is not expected to change the accounting for any of the Group's current arrangements.

*(e) IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
The Group does not have interests in decommissioning, restoration and environmental rehabilitation funds. This interpretation will not affect the Group's financial statements.

### 3.3 Group reporting

**Subsidiary undertakings**

Subsidiary undertakings are those entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealised gains on transactions between the Group's companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Minority interest at the balance sheet date includes the minority shareholders' portion of the fair values of the identifiable assets and liabilities of subsidiaries at the acquisition date, and the minority's portion of movements in those subsidiaries' equity since the date of acquisition. Minority interest is presented in the consolidated balance sheet within equity, separately from the equity attributable to equity holders of the Company. The Group no longer attributes minority interest relating to cross shareholdings (Note 7.1).

**3. Summary of significant accounting policies (continued)**

**3.3 Group reporting (continued)**

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group.

The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisitions date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of net assets of the subsidiary acquired, the difference is recognised directly in the consolidated statement of income.

**Associated undertakings**

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20 % and 50 % of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

Unrealised gains on transactions between the Group and its associated undertakings are eliminated to the extent of the Group's interest in the associated undertakings; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Equity accounting is discontinued when the carrying amount of the investment in an associated undertaking reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated undertaking.

**3.4 Investments**

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

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current if they are either held for trading or are expected to be realised within 12 months of the balance sheet date.

Realised and unrealised gains and losses arising from changes in the fair value of these financial assets are included in the consolidated statement of income in the period in which they arise.

**Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and with no intention of trading. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets.

**Available-for-sale financial assets**

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the assets. Investments are initially recognised at fair value plus transactions costs for all financial assets not carried at fair value through profit or loss. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method. Realised and unrealised gains and losses arising from changes in the fair value of the "Financial assets at fair value through profit or loss" category are included in the consolidated statement of income in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of non-monetary securities classified as available-for-sale are recognised in equity. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments are included in the consolidated statement of income as gains and losses from investment securities.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same and discounted cash flow analysis refined to reflect the issuer's specific circumstances.

(In millions of Russian Roubles)

**3. Summary of significant accounting policies (continued)**

**3.4 Investments (continued)**

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the consolidated statement of income. Impairment losses recognised in the consolidated statement of income on equity instruments are not reversed through the consolidated statement of income.

The Group holds no trading investments.

**3.5 Revenue recognition**

Revenues on sales of automobiles, spare parts and miscellaneous production are recognised when goods are dispatched to customers as this is normally the date that the risks and rewards of ownership are transferred to the customers.

Sales are shown net of value added tax (VAT) and discounts, and after eliminating sales within the Group.

**3.6 Trade receivables**

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the market rate of interest for similar borrowers, less provision for impairment and includes value added taxes. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers. The amount of the provision is recognised in the statement of income.

**3.7 Value added tax**

Value added taxes related to sales is payable to tax authorities upon collection of receivables from customers. Input VAT is 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 from the actual VAT payable/receivable. VAT deferred is classified as a current assets or liability. Where provision has been made against debtors deemed to be uncollectible bad debt expense 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.

**3.8 Inventories**

Inventories are recorded at the lower of cost and net realisable value. Cost of inventory is determined on the weighted average basis. The costs of finished goods and work in progress comprises material, direct labour and the appropriate indirect manufacturing costs (based on normal operating capacity). Obsolete and slow-moving inventories are written down, taking into account their expected use, to their future realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

**3.9 Cash and cash equivalents**

Cash comprises cash on hand, demand deposits and bank promissory notes. Cash equivalents comprise short-term investments which are readily converted to cash, are not subject to significant risk of changes in value and with original maturities of three months or less.

**3.10 Property, plant and equipment**

Property, plant and equipment are recorded at purchase or construction cost. Property, plant and equipment purchased before 31 December 2002 were recorded at purchase or construction cost restated to the equivalent purchasing power of the RR as at 31 December 2002. At each reporting date management assess whether there is any indication of impairment of property, plant and equipment. If any such indication exists, the 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 recognised as an expense (impairment loss) in the consolidated 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 assets recoverable amount.

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

| | Number of years |
|---|---|
| Buildings | 40 to 50 |
| Foundry equipment | 25 |
| Plant, machinery and equipment | 10 to 20 |
| Other | 5 to 10 |

**3. Summary of significant accounting policies (continued)**

**3.10 Property, plant and equipment (continued)**

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the statement of income during the financial period in which they are incurred. Major renewals and improvements are capitalised and the assets replaced are retired. Gains and losses arising from the retirement or disposal of property, plant and equipment are included in the consolidated statement of income as incurred.

Assets under construction owned by the Group are not depreciated.

**3.11 Intangible assets**

**Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

When the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised exceeds the cost of the business combination, the Group:

(a) reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and
(b) recognise immediately in profit or loss any excess remaining after that reassessment.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. Goodwill impairment is not reversed.

**Research and development costs**

Research expenditure is recognised as an expense as incurred. Costs incurred for development projects related to a new range of vehicles are recognised as intangible assets if, and only if, it is probable that the future economic benefits that are attributable to the asset will flow to the Group and the cost of the asset can be measured reliably. Development costs with a finite useful life that have been capitalised are amortised from the commencement of the commercial production of the new vehicles on a straight-line basis over the period of their expected benefits, not exceeding three years.

**3.12 Impairment of assets**

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

**3.13 Deferred income taxes**

Deferred tax assets and liabilities are calculated in respect of temporary differences using the balance sheet liability method for financial reporting and accounting for deferred income taxes. 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, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

**3. Summary of significant accounting policies (continued)**

**3.14 Borrowings and restructured taxes**

Borrowings are recognised initially at cost which is the fair value of the proceeds received, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of income over the period of the borrowings using the effective using the effective interest method. All borrowing costs are expensed in the period in which they are incurred. Interest expense, which is currently due, is recorded within other payables, whilst other interest that accrues is included within the restructured liabilities.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Restructured taxes are recognised initially at their fair value (which is determined using the prevailing market rate of interest for a similar instrument). In subsequent periods, restructured taxes are stated at amortised cost.

**3.15 Foreign currency transactions and translation**

Exchange restrictions and controls exist relating to converting the RR into other currencies. The RR is not a freely convertible in most countries outside of the Russian Federation.

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Russian Roubles, which is the Company's functional and presentation currency. U.S. dollar amounts have been provided as supplementary information only.

Monetary assets and liabilities, which are denominated in foreign currencies at 31 December 2004, are translated into the functional currency 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 consolidated statement of income.

**Functional and presentation currency**

Foreign subsidiary balance sheets and statements of income have been translated into RR at the exchange rate ruling at 31 December 2004 and average exchange rates for the year then ended, respectively. Differences arising from translation of foreign subsidiaries' balances are included in shareholders' equity as currency translation adjustments.

**3.16 Product warranty costs**

The Group recognises the estimated liability to repair or replace products sold still under warranty at the balance sheet date. This provision is calculated based on past history of the level of warranty repairs and replacements.

**3.17 Employee benefits**

**Social costs**

The Group incurs costs on social activities, principally within the City of Togliatti. These costs include the provision of health services and kindergartens. These amounts represent an implicit cost of employing principally production workers and, accordingly, have been charged to the Group's IFRS consolidated statement of income.

**Pension costs**

The Group's obligatory contributions to the Pension Fund of the Russian Federation are expensed as incurred.

**3.18 Interest expense and interest income**

Interest income and expenses are recognised on the accrual basis, as earned or incurred. Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cashflow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised either as cash is collected or on a cost-recovery basis as conditions warrant.

**3.19 Earnings/(loss) per share**

Preference shares are considered to be participating shares, as their dividend may not be less than that given with respect to ordinary shares. An earnings per share is determined by dividing the net income attributable to ordinary and preference shareholders by the weighted average number of participating shares outstanding during the reporting period. Losses are allocated to preference shares in this calculation.

**3.20 Use of promissory notes**

Promissory notes are debt securities. The Group makes extensive use of both third party promissory notes and Group originated promissory notes in its operations. Bank promissory notes received are included in the balance sheet within cash and cash equivalents. Promissory notes issued by the Group, are included within trade payables until they are settled for cash.

**3 Summary of significant accounting policies (continued)**

**3.21 Leases**

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the consolidated statement of income on a straight-line basis over the period of the lease.

**3.22 Shareholders' equity**

**Treasury shares**

Treasury shares are stated at nominal value, restated to the equivalent purchasing power of the RR as at 31 December 2002. Any difference between cost and nominal value on the purchase of treasury shares is recorded direct to retained earnings. Any gains or losses arising on the disposal of treasury shares are recorded direct to the consolidated statement of changes in equity.

**Dividends**

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

**3.23 Provisions**

Provisions are recognised when the Group has present legal or constructive obligations as a result of past events, it is probable that a significant outflow of resources will be required to settle the obligations, and a reliable estimate of the amount of the obligation can be made.

**3.24 Comparatives**

The Group has made some reclassifications of the comparatives in the accompanying consolidated financial statements for a fairer presentation, in particular:

- advances paid to suppliers of property, plant and equipment of RR 1,757 have been reclassified from Property, plant and equipment to Other non-current assets;
- non-current accounts receivable of RR 862 have been reclassified from current to non-current assets.

**4. Financial risk management**

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest risk and price risk), credit risk, liquidity risk and cash flow interest-rate risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

(a) Market risk

The Group's manufacturing operation is in the Russian Federation with limited imports of raw materials and components. The Group has limited international operations (see Note 25) and is exposed to foreign exchange risk arising from exposures primarily with respect to the U.S. dollar and the EURO. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations. Foreign exchange risk arises when future commercial transactions, recognised assets and liabilities are denominated in a currency that is not the entity's functional currency. Risk management is carried out by the Company's treasury department, which identifies, evaluates and manages foreign exchange risks in close co-operation with the Group's operating units by analysing the net position in each foreign currency. The Group is not exposed to equity securities price risk. The Group has not entered into any hedging arrangements in respect of its foreign currency exposure.

(b) Credit risk

The Group has no significant concentrations of credit risk. It has policies in place to ensure that wholesale sales of products are made to customers with an appropriate credit history. The Group has policies that limit the amount of credit exposure to any financial institution.

(c) Liquidity risk

The Group manages its liquidity risk by maintaining sufficient cash and marketable securities and available funding through an adequate amount of committed credit facilities.

(d) Cash flow and fair value interest rate risk

The Group's interest-rate risk arises from borrowings. The majority of interest rates on debt are fixed. Existing interest rates can be changed subject to agreement by the third parties. Assets are generally non-interest bearing; the Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group has not entered into any hedging arrangements in respect of its interest rate exposures.

## 5. Critical accounting estimates and judgements

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the current circumstances.

### 5.1 Operating environment of the Group

Whilst there have been improvements in the 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 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, the 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.

### 5.2 Taxes

The Group is subject to taxes. Significant judgement is required in determining the provision for taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcomes of these matters is different from the amounts that were initially recorded, such differences will impact the amount of income tax and deferred tax provision in the period in which such determination is made.
Were the actual final outcome (on the judgement areas) to differ by 10% from management's estimates, the Group would need to:

- increase in provision for taxes by RR 18, if unfavourable; or
- decrease in provision for taxes by RR 18, if favourable.

### 5.3 Remaining useful life of property, plant and equipment

Management assesses the remaining useful life of property, plant and equipment in accordance with the current technical conditions of assets and estimated period when these assets will bring economic benefit to the Group.
If the estimated remaining useful life of buildings had been 20% higher or lower than management estimates, then the carrying value of buildings would be RR 5,892 higher or RR 8,837 lower accordingly. If the estimated remaining useful life of plant and equipment had been 20% higher or lower than management estimates, then the carrying value of plant and equipment would be RR 11,930 higher or RR 17,896 lower accordingly.

### 5.4 Capitalisation of development costs

The Group capitalises development costs in accordance with the accounting policy stated in Note 3.11. Judgement is required to assess the probability that future economic benefits that are attributable to these assets will flow to the Group. If management assumptions at 31 December 2004 of the degree of certainty attached to the flow of future economic benefits are not fulfilled, all the development costs which do not meet recognition criteria would have to be written off reducing the equity at 31 December 2004 by up to RR 2,818.

### 5.5 Product warranty costs

The Group made a provision for warranties at the year end based on past experience of the level of repairs and returns. Were the actual outcome to exceed by 10% management's estimates, the Group would need to increase provision for warranties by RR 121.

### 5.6 Fair values

In assessing the fair value of non-traded financial instruments the Group uses a variety of methods including estimated discounted value of future cash flows, and makes assumptions that are based on market conditions existing at each balance sheet date.

At 31 December 2004 and 2003, the fair value of certain financial liabilities was 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, and is disclosed in the relevant notes to these consolidated financial statements.

## 6. Segment reporting

The Group operates as one business segment – automobiles manufacturing – as its operations are subject to similar risks and returns. No geographical segments are identified as reportable segments.

(In millions of Russian Roubles)

**7. Principal subsidiaries, business combinations**

The principal subsidiaries of the Group and the degree of control exercised by the Group are as follows:

| Entity | Country of Incorporation | Activity | **31 December 2004 % share** | 31 December 2003 % share |
|---|---|---|---|---|
| OAO DAAZ | Russia | Car components | **100** | 100 |
| OAO SAAZ | Russia | Car components | **100** | 100 |
| OAO AvtoVAZtrans | Russia | Transport | **100** | 100 |
| OAO TEVIS | Russia | Utilities | **100** | 100 |
| OAO SeAZ | Russia | Car assembly | **100** | 100 |
| OAO Elektroset | Russia | Power supply | **100** | 100 |
| OAO AvtoVAZstroi | Russia | Construction | **100** | 100 |
| Lada International Ltd. | Cyprus | Car distribution | **99.9** | 99.9 |
| ZAO CB Avtomobilny Bankirsky Dom | Russia | Bank services | **58.4** | 58.4 |
| OAO AVVA | Russia | Investments | **86** | 86 |
| Delta Motor Group Oy | Finland | Car distribution | **100** | 100 |
| ZAO CO AFC | Russia | Financial | **60** | 60 |
| ZAO IFC | Russia | Financial | **51** | 51 |
| OOO Eleks-Polyus | Russia | Car distribution | **51** | 51 |
| ZAO TH Ukravtovaz | Ukraine | Car distribution | **76** | 76 |
| OAO Piter-Lada | Russia | Car distribution | **52.4** | 52.4 |
| OAO «Avtocenter-Togliatti-VAZ» | Russia | Maintenance | **51** | 51 |
| 124 Technical Service Centres | Russia | Car service centres | **50.1-100** | 50.1-100 |

All of the above subsidiaries have been consolidated.

The principal associated companies and degree of ownership by the Group are as follows:

| Entity | Country of Incorporation | Activity | **31 December 2004 % share** | 31 December 2003 % share |
|---|---|---|---|---|
| ZAO GM-AVTOVAZ | Russia | Vehicle production | **41.6** | 47.6 |
| National Trade Bank | Russia | Bank services | **19.9** | 19.9 |
| ZAO VAZinterService | Russia | Car components | **32.4** | 64.8 |

On 12 March 2003 the Group purchased an additional number of ordinary shares of Delta Motor Group Oy. The share of the Group in this entity's capital increased to 100% from 69.83%. No goodwill arose on earlier purchases of ordinary shares of Delta Motor Group Oy. Delta Motor Group Oy contributed revenues of RR 11,732 and net profit of RR 73 to the Group for the year ended 31 December 2004 (RR 9,465 and RR 25, respectively, for the year ended 31 December 2003).

Details of net assets acquired and excess of the acquired share in the net fair value of identifiable assets and liabilities are as follows:

| | |
|---|---|
| Purchase consideration | |
| - Cash paid | 68 |
| Total purchase consideration | 68 |
| Fair value of net assets acquired | (526) |
| Negative goodwill | (458) |

The negative goodwill is attributable to the fact that the dissentient shareholder of Delta Motor Group Oy decided to cease its participation in the group and accepted the bargain price of RR 68.

(In millions of Russian Roubles)

## 7. Principal subsidiaries, business combinations (continued)

### 7.1 Cross shareholding:

At 31 December 2004 OAO AVVA, an 86% owned subsidiary of JSC AVTOVAZ, owned 38% of the ordinary shares of JSC AVTOVAZ. ZAO "Central Branch of Automobile Financial Corporation" (ZAO CB AFC), a 60% owned subsidiary, in turn owns 24% of the ordinary shares of JSC AVTOVAZ. Furthermore, ZAO IFC, a 51% owned subsidiary of JSC AVTOVAZ, owns 2% of the ordinary shares of JSC AVTOVAZ. As a result approximately 64% of the ordinary voting share capital of JSC AVTOVAZ is held by entities within the Group. The shares of JSC AVTOVAZ that are owned by subsidiaries are recognised as treasury shares in these consolidated financial statements. In accordance with Russian legislation JSC AVTOVAZ's shares owned by its subsidiaries have the right to vote at shareholders' meetings and participate in dividend distribution. Consequently, the ultimate controlling party of the Group is JSC AVTOVAZ (the parent company) itself.

### 7.2 Minority interest:

The minority interest in equity presented in the consolidated balance sheet does not include the holdings of OAO AVVA, ZAO CB AFC and ZAO IFC in JSC AVTOVAZ's share capital. The effective interest in JSC AVTOVAZ's ordinary capital, held by minority shareholders of these entities, amounts to 16% and their effective interest in JSC AVTOVAZ's share capital amounts to 14%.

## 8. Balances and transactions with related parties

### 8.1 Balances with related parties:

| **Consolidated balance sheet caption** | Relationship | **31 December 2004** | 31 December 2003 |
|---|---|---|---|
| Trade receivables - gross | Associates | **997** | 1,611 |
| Provision for impairment of receivables | Associates | **(4)** | (7) |
| Trade payables current | Associates | **596** | 686 |
| Cash held in bank | Associates | **593** | 125 |
| Short-term bank promissory notes | Associates | **727** | 78 |
| Other accounts payable | Deposits by Key Management in the subsidiary bank | **290** | 185 |
| Current financial assets | Loans to Key Management in the subsidiary bank | **-** | 15 |
| Minority interest | Minority interest in the subsidiary bank attributable to Key Management | **25%** | 25% |

### 8.2 Transactions with related parties:

| **Consolidated statement of income caption** | Relationship | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|---|
| Sales | Associates | **8,035** | 5,944 |
| Finance costs | Interest payable on deposits by associate bank | **10** | - |
| Finance costs | Interest payable to Key Management on deposits in the subsidiary bank | **20** | 5 |
| Other gains | Interest receivable on loans to Key Management by the subsidiary bank | **-** | 2 |

Sales include sales of car kits to ZAO GM-AVTOVAZ and other sales. During the year ended 31 December 2004, the Group made purchases, mainly of car components, from associates of RR 8,121 (2003: 5,609) inclusive of VAT of 18% (2003: 20%). During the year ended 31 December 2004 dividends of RR 4 (2003: nil) were paid by the subsidiary bank to Key Management, who collectively held 25% shares in this bank at 31 December 2004 (2003: 25%).

(In millions of Russian Roubles)

**8. Balances and transactions with related parties (continued)**

**8.3 Directors' and Key Management's compensation:**

Compensation of the Board of Directors and the Management Board is disclosed in Note 38.

**9. Cash and cash equivalents**

Cash and cash equivalents comprise the following:

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| RR denominated cash on hand and balances with banks | **3,395** | 2,990 |
| Foreign currency denominated balances with banks | **1,975** | 990 |
| RR denominated short-term bank promissory notes and deposits | **5,936** | 2,670 |
| Euro denominated letters of credit | **660** | 221 |
| | **11,966** | 6,871 |

Foreign currency denominated balances with banks consist of the following:

| Currency | **31 December 2004** | 31 December 2003 |
|---|---|---|
| Euro | **1,386** | 372 |
| US$ | **561** | 608 |
| Other currencies | **28** | 10 |
| Total currency denominated balances with banks | **1,975** | 990 |

Cash deposits of RR 408 held by the Group at 31 December 2004 bear interest of 6% per annum (2003: RR 99 bear interest of 1.5% per annum). Cash and cash equivalents of RR 11,558 (2003: RR 6,772) held by the Group are not interest bearing.

**10. Trade receivables**

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| Trade receivables – gross | | |
| Rouble denominated | **6,268** | 4,848 |
| Foreign currency denominated | **1,621** | 2,487 |
| | **7,889** | 7,335 |
| Less Provision for impairment of receivables | | |
| Rouble denominated | **(297)** | (285) |
| Foreign currency denominated | **(44)** | (80) |
| | **(341)** | (365) |
| Trade receivables – net | | |
| Rouble denominated | **5,971** | 4,563 |
| Foreign currency denominated | **1,577** | 2,407 |
| | **7,548** | 6,970 |

Net trade receivables denominated in foreign currencies consist of the following:

| Currency | **31 December 2004** | 31 December 2003 |
|---|---|---|
| Euro | **1,141** | 968 |
| US$ | **233** | 1,201 |
| Other currencies | **203** | 238 |
| Total net trade receivables denominated in foreign currencies | **1,577** | 2,407 |

As at 31 December 2004 the fair value of trade receivables was RR 1,577 (31 December 2003: RR 2,407).

(In millions of Russian Roubles)

## 11. Financial assets – current

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| RR loans and receivables, net of provision | **2,633** | 2,101 |
| Promissory notes of third parties | **586** | 1,727 |
| Bank promissory notes (with original maturities of more than 3 months) | **308** | 76 |
| Balances with Central Bank of Russian Federation | **97** | 351 |
| | **3,264** | 4,255 |

Financial assets include RR 1,414 (31 December 2003: RR 1,847) of commercial loans given by ZAO CB Avtomobilny Bankirsky Dom to its customers for a period less than 12 months after the balance sheet date.

As at 31 December 2004 the fair value of these assets was RR 3,264 (31 December 2003: RR 4,255).

## 12. Other assets – current

Other current assets consist of the following:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Value-added tax | **5,406** | 4,268 |
| Prepaid expenses, advances and other receivables | **3,511** | 1,671 |
| Advances to sub-contractors by the subsidiary-real estate developer | **1,217** | 1,140 |
| | **10,134** | 7,079 |

## 13. Inventories

Inventories consist of the following:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| Raw materials | **9,366** | 9,600 |
| Work in progress | **4,337** | 3,518 |
| Finished products | **7,039** | 5,942 |
| | **20,742** | 19,060 |

Inventories are recorded net of obsolescence provision of RR 385 at 31 December 2004 (31 December 2003: RR 551). A decrease in the provision is predominantly due to a disposal of inventory previously provided for.

The cost of inventories recognised as expense and included in cost of sales amounted to RR 101,972 (2003: RR 82,679).

(In millions of Russian Roubles)

## 14. Property, plant and equipment

Property, plant and equipment and related accumulated depreciation and impairment consist of the following:

| | Buildings | Plant and equipment | Other | Assets under construction | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance at 31 December 2002 | 74,543 | 109,875 | 11,454 | 15,035 | 210,907 |
| Additions | - | - | - | 11,000 | 11,000 |
| Disposals | (584) | (1,726) | (556) | (296) | (3,162) |
| Transfers | 1,029 | 7,860 | 387 | (9,276) | - |
| **Balance at 31 December 2003** | **74,988** | **116,009** | **11,285** | **16,463** | **218,745** |
| Additions | - | - | - | 10,584 | 10,584 |
| Disposals | (1,089) | (3,657) | (471) | (629) | (5,846) |
| Transfers | 3,354 | 6,354 | 1,476 | (11,184) | - |
| **Balance at 31 December 2004** | **77,253** | **118,706** | **12,290** | **15,234** | **223,483** |
| **Accumulated depreciation and impairment** | | | | | |
| Balance at 31 December 2002 | (32,254) | (66,236) | (9,846) | (4,551) | (112,887) |
| Depreciation charge | (1,736) | (4,334) | (223) | - | (6,293) |
| Disposals | 136 | 1,015 | 354 | - | 1,505 |
| Impairment loss recognized | - | - | (117) | - | (117) |
| Reversal of impairment loss | - | - | - | 501 | 501 |
| **Balance at 31 December 2003** | **(33,854)** | **(69,555)** | **(9,832)** | **(4,050)** | **(117,291)** |
| Depreciation charge | (1,755) | (4,374) | (250) | - | (6,379) |
| Disposals | 256 | 2,374 | 375 | 452 | 3,457 |
| Impairment loss recognized | - | (3) | (412) | - | (415) |
| Reversal of impairment loss | - | - | - | 303 | 303 |
| **Balance at 31 December 2004** | **(35,353)** | **(71,558)** | **(10,119)** | **(3,295)** | **(120,325)** |
| **Net Book Value** | | | | | |
| Balance at 31 December 2002 | 42,289 | 43,639 | 1,608 | 10,484 | 98,020 |
| **Balance at 31 December 2003** | **41,134** | **46,454** | **1,453** | **12,413** | **101,454** |
| **Balance at 31 December 2004** | **41,900** | **47,148** | **2,171** | **11,939** | **103,158** |

Assets Under Construction ("AUC") include the cost of property, plant and equipment which have yet to be put into production. The balance of accumulated depreciation of AUC represents an impairment provision against construction projects started but not expected to be completed as well as a provision against the construction of properties to be used by the local community.

A decrease of the impairment provision against AUC relates to buildings previously taken out of use which are now being converted to production. A respective gain of RR 303 was recorded in the consolidated statement of income for the year ended 31 December 2004 (2003: RR 501). An increase of the impairment provision of RR 415 in the year ended 31 December 2004 predominantly related to the assets of the Company's subsidiaries and additions of properties used by the local community (see below).

The assets transferred to the Company upon privatisation do not include the land on which the Company's factory and buildings, comprising the Group's principal manufacturing facilities, are situated. Until 11 December 2001 the land on which the Group's manufacturing facilities are situated was provided to JSC AVTOVAZ by local authorities for unlimited use. As a result of changes in existing legislation, on 11 December 2001 rental agreements were made with local authorities in relation to this land for the period of 49 years. Lease payments for land related to Group's production facilities can be changed subject to agreement by the parties. The future aggregate minimum lease payments under non-cancellable operating leases of land are disclosed in note 37.1.

**(In millions of Russian Roubles)**

**14. Property, plant and equipment (continued)**

Included in Property, plant and equipment and AUC are properties used by the local community (such as rest houses, kindergartens, sports and medical facilities) at a gross carrying value of RR 3,840 and RR 4,106 as of 31 December 2004 and 31 December 2003, respectively. These properties are fully provided for.

At 31 December 2004 and 31 December 2003, the gross carrying value of fully depreciated property, plant and equipment was RR 45,601 and RR 47,856, respectively.

**15. Development costs**

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Opening net book amount | **1,699** | 714 |
| Additions | **1,119** | 985 |
| Closing net book amount | **2,818** | 1,699 |
| | **31 December 2004** | 31 December 2003 |
| Cost | **2,818** | 1,699 |
| Accumulated amortisation and impairment | **-** | - |
| Net book amount | **2,818** | 1,699 |

Development costs relating to a new range of vehicles amounting to RR 1,119 (2003: RR 985) were capitalised in 2004.

**16. Financial assets – non-current**

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| Loans and receivables of ZAO CB Avtomobilny Bankirsky Dom | **2,056** | 473 |
| Other financial assets | **195** | 202 |
| | **2,251** | 675 |

Loans and receivables of ZAO CB Avtomobilny Bankirsky Dom at 31 December 2004 bear average interest of 19% p.a. (2003: 17%).

**17. Investments in associates**

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| **Beginning of the year** | **866** | 754 |
| Additions | **350** | - |
| Share of income | **701** | 333 |
| Disposals | **(19)** | (221) |
| **End of the year** | **1,898** | 866 |

The Group's ownership in ZAO GM-AVTOVAZ decreased from 47.6% to 41.6% during 2004, because of additional share issue by ZAO GM-AVTOVAZ in favour of General Motors, which contributed RR 1,076 in cash.

ZAO GM-AVTOVAZ is an associate which began production in September 2002. The shareholders are JSC AVTOVAZ (41.6%), General Motors (41.6%) and EBRD (16.8%). During 2004 the associate produced 58 thousand vehicles (2003: 25 thousand vehicles) and generated revenues of RR 13,463 and a net profit of RR 1,378 of which the Group's share was RR 635.

Investments in associates comprise of the following:

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| ZAO GM-AVTOVAZ | **1,365** | 730 |
| Other | **533** | 136 |
| **Total** | **1,898** | 866 |

(In millions of Russian Roubles)

### 17. Investments in associates (continued)

The following aggregated amounts represent the assets and liabilities, and sales and financial results of associates, which have been consolidated using the equity method:

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| **Assets:** | | |
| Non-current assets | **8,265** | 6,536 |
| Current assets | **15,887** | 5,746 |
| **Liabilities:** | | |
| Long-term liabilities | **1,186** | 358 |
| Short-term liabilities | **12,036** | 5,249 |
| Net assets | **10,930** | 6,675 |
| Income | **24,679** | 7,152 |
| Expenses | **(23,729)** | (6,465) |
| Profit after income tax | **950** | 687 |

There are no contingent liabilities relating to the Group's interests in the associates, and no contingent liabilities of the associates themselves.

### 18. Other assets – non-current

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| Advances for property, plant and equipment | **698** | 1,757 |
| Non-current receivables | **451** | 737 |
| Software | **131** | 119 |
| Other | **440** | 522 |
| | **1,720** | 3,135 |

### 19. Trade payables current

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| Trade payables | **17,898** | 16,809 |
| Payables to associated undertakings | **596** | 686 |
| | **18,494** | 17,495 |

Trade payables include RR 700 (31 December 2003: RR 611) of customers' current and settlement accounts and short-term deposits in ZAO CB Avtomobilny Bankirsky Dom.

### 20. Other payables and accrued expenses

Other payables and accrued expenses include the following:

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| Salaries payable and vacation accrual | **2,779** | 1,875 |
| Advances received by the subsidiary real estate developer | **1,131** | 945 |
| Insurance provisions | **449** | 71 |
| Accrued interest | **269** | 300 |
| Payable to customs authorities | **194** | 332 |
| Dividends payable | **107** | 40 |
| Settlements of claims | **35** | 414 |
| Income tax liability | **33** | 18 |
| Other | **1,544** | 1,748 |
| | **6,541** | 5,743 |

(In millions of Russian Roubles)

## 21. Provisions

During 2004 the following movements of provisions took place:

| | 2004 | 2003 |
|---|---|---|
| Balance at 31 December | **1,732** | 1,549 |
| Utilised | **(1,418)** | (1,278) |
| Released | **(234)** | - |
| Additional provisions | **1,128** | 1,461 |
| **Balance at 31 December** | **1,208** | 1,732 |

All provisions are made up for not more than 1 year.

The Group undertakes to repair vehicles or replace certain components that fail to perform satisfactorily during two years after sale or until a mileage of 35,000 kilometres is reached. A provision of RR 1,208 (31 December 2003: RR 1,498) is made at the year end based on past experience of the level of repair and returns.

## 22. Debt

Short-term debt by currency of loan consists of the following:

| Currency | Effective interest rate | 31 December 2004 | 31 December 2003 |
|---|---|---|---|
| RR | 14% | **11,672** | 11,805 |
| US$ | 12% | **4,169** | 29 |
| Euro | 11% | **297** | 18 |
| CHF | 8% | **111** | - |
| Total loans from financial institutions | | **16,249** | 11,852 |

Long-term debt by currency of loan consists of the following:

| Currency | Effective interest rate | 31 December 2004 | 31 December 2003 |
|---|---|---|---|
| US$ | 7% | **6,721** | 7,069 |
| RR | 13% | **4,841** | 2,986 |
| CHF | 7% | **443** | 487 |
| Euro | 6% | **293** | 45 |
| Total loans from financial institutions | | **12,298** | 10,587 |

Short-term and long-term debt comprises loans at fixed interest rates.

Long-term debt is repayable as follows:

| | 31 December 2004 | 31 December 2003 |
|---|---|---|
| 1 to 2 years | **7,729** | 2,748 |
| 2 to 3 years | **756** | 7,227 |
| 3 to 4 years | **3,184** | 158 |
| 4 to 5 years | **216** | 58 |
| Over 5 years | **413** | 396 |
| | **12,298** | 10,587 |

As at 31 December 2004, the fair value of these liabilities was estimated to be RR 12,698 using current market interest rates ranging between 10% and 12%. As at 31 December 2003, the fair value of these liabilities was estimated to be RR 10,982 using current market interest rates ranging between 17% and 18%.

During 2004 the Company issued RR 3,000 Rouble denominated documentary coupon bearer bonds maturing in 2008. These bonds carry 9 half yearly coupons. The rate of the first coupon, which was determined at the auction, was 11.78% per annum, the second coupon's rate is 11.28%, the rate of the third coupon is 10.78%. The rates of other coupons are determined by the issuer.

(In millions of Russian Roubles)

**22. Debt (continued)**

During 2003 management restructured and subsequently extinguished liabilities denominated in US$ and in Euro amounting to RR 5,852 (including liabilities to the Ministry of Finance restructured as of 31 December 2002) to Vnesheconombank and the Ministry of Finance of the Russian Federation.

As at 31 December 2004 and 31 December 2003 loans for RR 13,233 and RR 7,832, respectively, are guaranteed by collateral of inventories and equipment.

Included in long-term debt are rouble denominated interest-free bearer promissory notes maturing between 2017 and 2030. Their carrying value at 31 December 2004 is RR 251 (31 December 2003: RR 203), and gross nominal value is RR 9,129 (2003: RR 9,129).

**23. Taxes other than income tax**

**Current taxes payable other than income tax**

Current taxes payable comprise the following:

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| Current portion of taxes restructured to long-term | **847** | 1,021 |
| Property, pensions and other taxes | **710** | 986 |
| Penalties and interest on property, pensions and other taxes | **617** | 655 |
| Value-added tax | **1,537** | 1,226 |
| Social taxes | **353** | 401 |
| | **4,064** | 4,289 |

The principal tax liabilities past due accrue interest each day at one three hundredth of the current refinancing rate of the Central Bank of Russia which, at 31 December 2004 was equal to an effective rate of 17% (31 December 2003: 18%). The principal tax liabilities (interest, penalties) past due at 31 December 2004 and 31 December 2003 were approximately RR 40 and RR 40, respectively.

**Non-current taxes payable**

Non-current taxes payable comprise various taxes payable to the Russian Government which were previously past due and which have been restructured to be repaid over a period of up to 10 years following the application of the Russian Government Resolutions No. 1002 dated 3 September 1999 “Terms of the restructuring of payables to the Federal Budget” and No. 927 dated 29 December 2001 “On changes of terms of JSC AVTOVAZ’s tax liabilities and accrued fines and interest payable to the Federal Budget”, as discussed further.

The carrying value of this debt and its maturity profile is as follows:

| | **31 December 2004** | 31 December 2003 |
|---|---|---|
| Current | **847** | 1,021 |
| 1 to 2 years | **1,479** | 708 |
| 2 to 3 years | **316** | 1,320 |
| 3 to 4 years | **247** | 272 |
| 4 to 5 years | **209** | 215 |
| Thereafter | **2,048** | 1,890 |
| Total restructured | **5,146** | 5,426 |
| Less: portion of current taxes payable | **(847)** | (1,021) |
| Long-term portion of restructured taxes | **4,299** | 4,405 |

The above liability is carried at amortised cost, calculated by applying the interest rates at inception ranging between 21% and 30%.

As at 31 December 2004, fair value of these liabilities was estimated to be RR 5,843 using current market interest rates ranging between 10% and 12%. As at 31 December 2003, fair value of these liabilities was estimated to be RR 5,670 using current market interest rates ranging between 17% and 18%.

In the event of the Company’s failure to make current tax payments and payments of restructured tax liabilities by the end of each quarter, the Ministry of Taxes and Duties may, within one month, recommend to the Government to cancel the restructuring agreement and call the entire liability.

The Company is in compliance with the terms of restructuring the federal, regional and local tax debts at 31 December 2004.

(In millions of Russian Roubles)

## 24. Share capital

The carrying value of share capital and the legal share capital value subscribed, issued and fully paid up, consists of the following classes of shares:

| | **31 December 2004** | | | 31 December 2003 | | |
|---|---|---|---|---|---|---|
| | **No. of shares** | **Legal statutory value** | **Carrying amount** | No. of shares | Legal statutory value | Carrying amount |
| Class A preference | 4,930,340 | 2,465 | 9,861 | 4,930,340 | 2,465 | 9,861 |
| Ordinary | 27,194,624 | 13,597 | 54,390 | 27,194,624 | 13,597 | 54,390 |
| Total share capital | 32,124,964 | 16,062 | 64,251 | 32,124,964 | 16,062 | 64,251 |
| Less: treasury share capital | | | | | | |
| Class A preference | (312,697) | (156) | (625) | (312,697) | (156) | (625) |
| Ordinary | (17,367,655) | (8,684) | (34,736) | (17,367,655) | (8,684) | (34,736) |
| Total treasury share capital | (17,680,352) | (8,840) | (35,361) | (17,680,352) | (8,840) | (35,361) |
| **Total outstanding share capital** | **14,444,612** | **7,222** | **28,890** | 14,444,612 | 7,222 | 28,890 |

Ordinary shares give the holders the right to vote on all matters within the remit of the General Shareholders' Meeting.

Class A preference shares give the holders the right to participate in general shareholders' meetings without voting rights except in instances where decisions are made in relation to re-organisation and liquidation of the Company, and where changes and amendments to the Company's charter which restrict the rights of preference shareholders are proposed. Preference shares obtain the right to vote on all matters within the remit of the General Shareholders' Meeting if at the previous Annual Shareholders' Meeting it was decided not to pay a dividend on preference shares even though the Company had statutory net profit for the year.

Preference shareholders are equally entitled to dividends along with holders of ordinary shares on the basis of a resolution of the General Shareholders' Meeting. A resolution regarding the payment and the amount of dividends is taken by the General Shareholders' Meeting upon recommendations of the Board of Directors in view of financial results for the year.

If the dividend paid on one ordinary share in the current year exceeds the dividend that is payable on one preference share, then the dividend paid on one preference share should be increased to the dividend paid on one ordinary share. As such, the preference holders share in earnings along with ordinary holders and thus the preference shares are considered participating shares for the purpose of the calculation of earnings per share.

In 2004, a dividend was declared and paid in respect of 2003 to holders of preference shares of RR 95 per preference share (2003: RR 17) and to holders of ordinary shares of RR 6 per ordinary share (2003: RR 5).

## 25. Sales

Net sales revenue comprises:

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Finished vehicles and assembly kits of own production | **122,367** | 101,665 |
| Automotive components of own production | **8,927** | 4,550 |
| Dealership sales of other producers' vehicles | **15,339** | 12,275 |
| Other sales | **13,903** | 12,282 |
| | **160,536** | 130,772 |

(In millions of Russian Roubles)

### 25. Sales (continued)

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Domestic sales | **135,318** | 110,689 |
| Sales outside of Russia | **25,218** | 20,083 |
| | **160,536** | 130,772 |

Demand for finished vehicles is not significantly influenced by seasons of the year. However, there is a slight increase in demand for vehicles prior to the summer months and a decrease in demand prior to the end of calendar year. The seasonality in the demand for vehicles does not significantly influence production, inventory levels are adjusted for these movements in demand. Seasonality does not impact the revenue or cost recognition policies of the Group. Substantially all assets of the Group are located in Russia.

### 26. Cost of sales

Cost of sales comprises:

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Materials and components used | **103,888** | 81,185 |
| Labour costs | **17,257** | 13,837 |
| Production overheads | **7,194** | 6,963 |
| Depreciation | **6,379** | 6,293 |
| Social expenditure | **773** | 732 |
| Reversal of provision for impairment of property, plant and equipment (Note 14) | **(303)** | (501) |
| Loss on impairment of property, plant and equipment (Note 14) | **415** | 117 |
| Changes in inventories of finished goods and work in progress | **(1,916)** | 1,494 |
| | **133,687** | 110,120 |

### 27. Distribution costs

Distribution costs comprise:

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Transportation | **3,707** | 2,482 |
| Advertising | **1,089** | 554 |
| Labour costs | **553** | 321 |
| Materials | **339** | 409 |
| Other | **651** | 362 |
| | **6,339** | 4,128 |

### 28. Administrative expenses

Administrative expenses comprise:

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Labour costs | **4,171** | 3,376 |
| Other local and regional taxes | **2,232** | 1,645 |
| Transportation | **622** | 569 |
| Materials | **485** | 597 |
| Bank services | **324** | 244 |
| Repair expenses | **211** | 176 |
| Consultants' fees | **164** | 205 |
| Provision for impairment of receivables | **(272)** | 110 |
| Other | **1,831** | 1,754 |
| | **9,768** | 8,676 |

(In millions of Russian Roubles)

## 29. Other operating expenses

Other operating expenses comprise:

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Loss on disposal of property, plant and equipment | **747** | 393 |
| Charitable donations | **157** | 68 |
| Impairment loss on financial assets | **121** | 584 |
| Provisions and settlements of claims and similar charges | **(265)** | 121 |
| (Gain)/Loss on disposal of subsidiaries | **(203)** | 256 |
| Other | **479** | 724 |
| | **1,036** | 2,146 |

## 30. Research and development expenses

Research and development expenses comprise:

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Labour costs | **311** | 290 |
| Materials | **180** | 171 |
| Other | **212** | 167 |
| | **703** | 628 |

## 31. Other gains

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Interest income - ZAO CB Avtomobilny Bankirsky Dom | **493** | 409 |
| Negative goodwill (Note 7) | **-** | 458 |
| | **493** | 867 |

## 32. Finance costs

Finance costs charged to the consolidated statement of income comprise:

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Interest expense | **(3,451)** | (3,416) |
| Foreign exchange gain/(loss) | **680** | (617) |
| Gains on forgiveness of tax interest | **-** | 325 |
| | **(2,771)** | (3,708) |

During 2003 a number of Group's subsidiaries in Russia were granted forgiveness of interest on taxes due in accordance with the Tax Code.

(In millions of Russian Roubles)

## 33. Expenditure by nature

| | **Year ended 31 December 2004** | Year ended 31 December 2003 |
|---|---|---|
| Materials and components used | **104,712** | 82,191 |
| Labour costs | **21,981** | 17,534 |
| Production overheads | **7,194** | 6,963 |
| Depreciation | **6,379** | 6,293 |
| Social expenditure | **773** | 732 |
| Reversal of provision for impairment of property, plant and equipment (Note 14) | **(303)** | (501) |
| Loss on impairment of property, plant and equipment (Note 14) | **415** | 117 |
| Changes in inventories of finished goods and work in progress | **(1,916)** | 1,494 |
| Transportation | **4,329** | 3,051 |
| Advertising | **1,089** | 554 |
| Other local and regional taxes | **2,232** | 1,645 |
| Bank services | **324** | 244 |
| Repair expenses | **211** | 176 |
| Consultants' fees | **164** | 205 |
| Provision for impairment of receivables | **(272)** | 110 |
| Write-off or loss on disposal of property, plant and equipment | **747** | 393 |
| Loss on disposal of subsidiaries | **(203)** | 256 |
| Charitable donations | **157** | 68 |
| Impairment loss on financial assets | **121** | 584 |
| Provisions and settlements of claims and similar charges | **(265)** | 121 |
| Research and development | **703** | 628 |
| Other | **2,961** | 2,840 |
| | **151,533** | 125,698 |

## 34. Income tax (expense)/credit

| | **2004** | 2003 |
|---|---|---|
| Income tax expense – current | **(2,666)** | (2,007) |
| Gain on derecognition of income tax liability | **-** | 2,454 |
| Movement in deferred tax account | **(185)** | (62) |
| | **(2,851)** | 385 |

Following the favourable resolution of the legal proceedings in relation to the tax authorities' claims, the Group revised its estimates for the income tax liability of RR 2,454 and recorded a respective gain in the statement of income for the year ended 31 December 2003.

The tax charge of the Group is reconciled as follows:

| | **2004** | 2003 |
|---|---|---|
| **IFRS profit before taxation in the Group's consolidated financial statements** | **7,426** | 2,566 |
| **Theoretical tax charge at statutory rate of 24% (2003: 24%)** | **(1,782)** | (616) |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| Tax penalties and interest | **(44)** | (394) |
| Non-deductible expenses, net | **(1,025)** | (1,059) |
| Gain on de-recognition of income tax liability | **-** | 2,454 |
| **Income tax (expense)/credit** | **(2,851)** | 385 |

During 2004 the Group was subject to tax rates of approximately 24% on taxable profits. Deferred tax assets/liabilities are measured at the rate of 24% as at 31 December 2004 (24% as at 31 December 2003).

(In millions of Russian Roubles)

**34. Income tax (expense)/credit (continued)**
**Deferred tax liabilities**

| | 31 December 2002 | Movement in the year | 31 December 2003 | Movement in the year | 31 December 2004 |
|---|---|---|---|---|---|
| Tax effects of temporary differences: | | | | | |
| Provisions on trade receivables | 167 | (70) | 97 | 8 | **105** |
| General and overhead expenses allocation on inventories | 59 | (117) | (58) | 35 | **(23)** |
| Tax losses carried forward | - | 82 | 82 | 38 | **120** |
| Effect of inflation and different depreciation rates on and impairment of property, plant and equipment | (10,868) | (179) | (11,047) | (126) | **(11,173)** |
| Provision for impairment of property, plant and equipment | 1,169 | 249 | 1,418 | (232) | **1,186** |
| Impairment loss on investments | 98 | 162 | 260 | (300) | **(40)** |
| Accounts payable and provisions | 686 | (110) | 576 | 100 | **676** |
| Discounting of long-term debt | (2,316) | 167 | (2,149) | 8 | **(2,141)** |
| Other temporary differences | 243 | (246) | (3) | 284 | **281** |
| Deferred tax liability | (10,762) | (62) | (10,824) | (185) | **(11,009)** |

As at 31 December 2004 the Group has no subsidiaries, which have deferred tax assets.

At 31 December 2004 the Company has available Russian tax losses amounting to RR 498. These may offset future taxable profits until year 2014. The maximum offset in each year is limited to 30% of the total taxable profit of the year. A respective deferred tax asset of RR 120 is recorded at 31 December 2004.

**35. Earnings per share**
Earnings per share is calculated by dividing the net income attributable to participating shareholders by the weighted average number of ordinary and preference shares in issue during the period, excluding the average number of ordinary shares purchased by the Company and held as treasury shares (see Note 24).

| | **2004** | 2003 |
|---|---|---|
| Weighted average number of preference shares outstanding (thousands) | **4,930** | 4,930 |
| Weighted average number of ordinary shares outstanding (thousands) | **27,195** | 27,195 |
| Adjusted for weighted average number of treasury shares (thousands) | **(17,680)** | (17,680) |
| Weighted average number of ordinary and preference shares outstanding (thousands) | **14,445** | 14,445 |
| **Net income** | **4,245** | 3,034 |
| **Earnings per share, (basic/diluted) (in RR)** | **294** | 210 |

There are no dilution factors therefore basic earnings per share is equal to diluted earnings per share.

**36. Barter transactions**
Included in sales are non-cash transactions amounting to RR 686 (for the year ended 31 December 2003: RR 1,326). The transactions represent mainly sale of products in exchange for equipment.

**37. Contingencies, commitments and guarantees**
**37.1 Contractual commitments and guarantees**
As at 31 December 2004 the Group had contractual commitments for the purchase of property, plant and equipment from third parties for RR 214 (31 December 2003: RR 959).

Other than these commitments, there are no other commitments and guarantees in favour of third parties or related companies that were not disclosed in these consolidated financial statements.

In 2004, the Company signed a five-year contract with a distributor for exclusive supplies of spare parts for the Company's vehicles. If the Company dissolves the contract unilaterally or through its fault, the Company will be obliged to pay the distributor a fine in the amount of five-year spare parts supplies, which is estimated by management at RR 14 billion.

(In millions of Russian Roubles)

**37. Contingencies, commitments and guarantees (continued)**
**37.1 Contractual commitments and guarantees (continued)**
The future aggregate minimum lease payments under non-cancellable operating leases of land, estimated based on the rental rates in force in 2004, are as follows:

| | **2004** | 2003 |
|---|---|---|
| Not later than 1 year | **195** | 259 |
| Later than 1 year and not later than 5 years | **638** | 709 |
| Later than 5 years | **574** | 811 |
| | **1,407** | 1,779 |

The amount of lease payments recognized as an expense for the year ended 31 December 2004 was RR 223 (2003: 258).

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

As at 31 December 2004 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. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these consolidated financial statements.

**37.3 Environmental matters**
The enforcement of environmental regulation in Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised immediately. Expenditures which extend the life of the related property or mitigate or prevent future environmental contamination are capitalised. Potential liabilities which might arise as a result of changes in existing regulations, civil litigation or changes in legislation or regulation cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believe that there are no significant liabilities for environmental damage.

**37.4 Legal proceedings**
During 2004, the Group was involved in a number of court proceedings (both as a plaintiff and a defendant) 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 result of operations or financial position of the Group.

**38. Compensation of the Key Management - Board of Directors and the Management Board**
Total compensation of the members of the executive bodies, the Board of Directors and the Management Board, included in labour costs within administrative expenses in the consolidated statement of income (Note 28) amounted to RR 82 for 2004 (2003: RR 35), consisting of salaries and bonuses.

**39. Post balance sheet events**
The Annual Shareholders' Meeting in May 2005 voted for the payment of dividends of RR 23 per ordinary share and RR 23 per preference share in respect of 2004 financial results. Total dividends approved are RR 739.

In accordance with the Russian Government Resolution dated 28 April 2005 certain tax fines, penalties and interest previously accrued by the Company, have been provisionally forgiven. This forgiveness is contingent upon the Company's compliance with a revised repayment schedule for the outstanding principal. The precise amount to be forgiven, the precise repayment schedule and the timing of determining both have yet to be agreed with the tax authorities.

On 28 June 2005, the Company completed the issue of RR 5,000 Rouble denominated documentary coupon bearer bonds. The bonds are issued at par value and mature in 5 years. The rate for the first two coupons, which was determined at the auction, was 9.7% per annum. The coupon rates of the third to tenth coupons are to be set by the issuer.