Open Joint Stock Company
Magnitogorsk Iron & Steel Works
and subsidiaries

Consolidated Financial Statements

for the year ended 31 December 2003

Contents

KPMG Limited

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Independent Auditor's Report

To the shareholders and Board of Directors of
Open Joint Stock Company Magnitogorsk Iron & Steel Works

We have audited the accompanying consolidated balance sheet of Open Joint Stock Company Magnitogorsk Iron & Steel Works and its subsidiaries (the "Group") as at 31 December 2003 and the related statements of income, changes in equity and cash flows for the year then ended. The consolidated financial statements, as set out on pages 3 to 39, are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing as issued by the International Federation of Accountants. 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.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2003, and the results of its operations, changes in equity and cash flows for the year then ended in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG Limited

KPMG Limited
Moscow, Russian Federation
31 March 2004

Consolidated balance sheet

As at 31 December 2003

In millions of US dollars	Note	2003	2002
Assets			
Property, plant and equipment	12	2,071	2,125
Intangible assets	13	(5)	(2)
Investments in associates	14	11	6
Other investments	15	1	1
Other non-current assets	16	6	3
Total non-current assets		2,084	2,133
Inventories	17	308	231
Trade and other receivables	18	384	266
Other investments	15	50	6
Cash and cash equivalents	19	824	222
Total current assets		1,566	725
Total assets		3,650	2,858
Equity	20		
Share capital		363	363
Treasury shares		(19)	(22)
Additional paid in capital		39	16
Asset revaluation reserve		113	131
Retained earnings		1,962	1,319
Total equity		2,458	1,807
Minority interest		19	50
Liabilities			
Loans and borrowings	21	465	218
Employee benefits	23	22	22
Deferred tax liabilities	24	239	322
Other non-current liabilities		12	10
Total non-current liabilities		738	572
Bank overdrafts		47	6
Loans and borrowings	21	87	131
Trade and other payables	25	301	292
Total current liabilities		435	429
Total liabilities		1,173	1,001
Total equity, minority interest and liabilities		3,650	2,858

The consolidated balance sheet is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 7 to 39.

Consolidated income statement

For the year ended 31 December 2003

In millions of US dollars	**Note**	**2003**	**2002**
Revenues	5	3,047	2,065
Cost of sales		(1,883)	(1,527)
Gross profit		1,164	538
Distribution expenses		(112)	(92)
General and administrative expenses	6	(235)	(219)
Social costs	7	(37)	(35)
Impairment and reversal of property, plant and equipment, net	12	-	150
Revaluation of property plant and equipment	12	-	(88)
Income from associates		7	-
Other operating expenses, net	8	(8)	(9)
Profit from operations		779	245
Net financing costs	10	(18)	(43)
Profit before tax and minority interest		761	202
Income tax expense	11	(141)	(86)
Profit before minority interest		620	116
Minority interest		10	(1)
Net profit for the year		630	115

The consolidated income statement is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 7 to 39.

Consolidated statement of cash flows

For the year ended 31 December 2003

In millions of US dollars	**2003**	**2002**
Operating activities		
Profit before tax and minority interest	761	202
Adjustments for:		
Depreciation and amortisation	212	220
Bad debts and changes in accounts receivable and other provisions	(13)	9
Income from associates	(7)	-
Impairment and reversal of property, plant and equipment, net	-	(150)
Revaluation of property, plant and equipment	-	88
Loss on disposal of property, plant and equipment	24	15
Net loss on sale of other investments	-	2
Finance lease expense	3	-
Foreign exchange loss	17	9
Interest expense	52	38
Operating profit before changes in working capital	1,049	433
Increase in inventories	(77)	10
Increase in trade and other receivables	(144)	16
Increase in trade and other payables	28	(159)
Cash flows from operations before taxes and interest paid	856	300
Income taxes paid	(228)	(51)
Interest paid	(40)	(37)
Cash flows from operating activities	588	212
Investing activities		
Proceeds from disposal of property, plant and equipment	14	22
Acquisition of investments	-	52
Acquisition of property, plant and equipment	(202)	(204)
Acquisition of intangible assets	(17)	(8)
Acquisition of subsidiaries less cash acquired	(5)	(5)
Net cash flow from other investments	(39)	-
Cash flows to investing activities	(249)	(143)
Financing activities		
Proceeds from borrowings	628	440
Repayments of borrowings	(412)	(375)
Proceeds from the re-issuance of treasury shares	34	33
Acquisition of treasury shares	(8)	(16)
Payments made under finance lease	(15)	(10)
Dividends paid	(5)	(2)
Cash flows from financing activities	222	70
Net increase in cash and cash equivalents	561	139
Cash and cash equivalents at beginning of year	216	77
Cash and cash equivalents at end of year	777	216

The consolidated statement of cash flows is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 7 to 39.

Consolidated statement of changes in equity

For the year ended 31 December 2003

In millions of US dollars	Ordinary shares	Preference shares	Ordinary treasury shares	Preference treasury shares	Additional paid in capital	Asset revaluation reserve	Retained earnings	Total
Balance at 1 January 2002	20	6	(15)	(8)	-	-	1,543	1,546
Shares issued: 1,200 for 1 split	252	85	-	-	-	-	(337)	-
Acquisition of treasury shares	-	-	(10)	(6)	-	-	-	(16)
Property, plant and equipment revaluation, net of tax effect	-	-	-	-	-	792	-	792
Property, plant and equipment impairment decrease, net of tax effect	-	-	-	-	-	(647)	-	(647)
Revaluation reserve arising from step acquisition, net of tax effect	-	-	-	-	-	8	-	8
Minorities share of revaluation gain	-	-	-	-	-	(22)	-	(22)
Re-issuance of treasury shares	-	-	6	11	16	-	-	33
Dividends	-	-	-	-	-	-	(2)	(2)
Net profit for the year	-	-	-	-	-	-	115	115
Balance at 31 December 2002	272	91	(19)	(3)	16	131	1,319	1,807
Amortisation of asset revaluation reserve	-	-	-	-	-	(18)	18	-
Acquisition of treasury shares	-	-	(6)	(2)	-	-	-	(8)
Re-issuance of treasury shares	-	-	6	5	23	-	-	34
Dividends	-	-	-	-	-	-	(5)	(5)
Net profit for the year	-	-	-	-	-	-	630	630
Balance at 31 December 2003	272	91	(19)	-	39	113	1,962	2,458

The consolidated statement of changes in equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 7 to 39.

Accounting policies and notes to the consolidated financial statements

1. Background

(a) Organisation and operations

The consolidated financial statements of the Open Joint Stock Company Magnitogorsk Iron & Steel Works comprise the parent company Open Joint Stock Company Magnitogorsk Iron & Steel Works ("MMK" or "the Parent Company") and its 66 subsidiaries ("the Group"). The Parent Company is an open joint stock (public) company as defined in the Civil Code of the Russian Federation. The head office of the Group is located at:

Ulitsa Kirova 93
455002 Magnitogorsk,
Russia

The Parent Company was established as a state owned enterprise in 1932. It was incorporated as an open joint stock company on 17 October 1992, as part of the Russian Federation's privatisation program. The principal activity of the Group is the production of ferrous metal products at the Parent Company's plant located in the city of Magnitogorsk in the Chelyabinsk region of the Russian Federation. The products are sold in the Russian Federation and abroad. The subsidiaries are mainly involved in the various sub-processes within the production cycle of the ferrous metal products or in the distribution of the products.

(b) Russian business environment

The Russian Federation has been experiencing political and economic change which has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks that typically do not exist in other markets. The accompanying consolidated financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

2. Basis of preparation

(a) Statement of compliance

The Group maintains its accounting records in accordance with the legislative requirements of the countries in which the individual entities are located (the Russian Federation, Switzerland and Luxembourg). The accompanying consolidated financial statements have been prepared from those accounting records and adjusted as necessary to comply with the requirements of International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

(b) Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: property, plant and equipment in use, derivative financial instruments, investments held for trading and investments available for sale.

(c) Measurement and presentation currency

The national currency of the Russian Federation is the Russian Rouble ("RUR"). The Parent Company's measurement currency is the United States Dollar ("USD") because it best reflects the economic substance of the underlying events and circumstances of the company.

Accounting policies and notes to the consolidated financial statements

2. Basis of preparation continued

USD is also the currency in which the consolidated financial statements are presented. All financial information presented in USD has been rounded to the nearest million.

The RUR is not a readily convertible currency outside the Russian Federation and, accordingly, any conversion of RUR to USD should not be construed as a representation that the RUR amounts have been, could be, or will be in the future, convertible into USD at the exchange rate disclosed, or at any other exchange rate.

(d) Going concern

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business. The recoverability of the Group's assets, as well as the future operations of the Group, may be significantly affected by the current and future economic environment (refer note 1(b)). The accompanying consolidated financial statements do not include any adjustments should the Group be unable to continue as a going concern.

(e) Use of estimates

Management of the Group has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with IFRS. Actual results could differ from those estimates.

3. Significant accounting policies

The following significant accounting policies have been applied by the Group in the preparation of the consolidated financial statements and, except as otherwise stated, are consistent with those applied in the prior year.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are those enterprises controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. The minority interest represents the minorities' proportion of the net identifiable assets of the subsidiaries.

(ii) Associates

Associates are those enterprises in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence effectively commences until the date that significant influence effectively ceases. When the Group's share of losses exceeds the carrying amount of the associate, the carrying amount is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associate.

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

(iii) Jointly controlled operations

Jointly controlled operations are those operations where the Group combines its operations, resources and expertise with other enterprises in order to manufacture, market or distribute goods under a joint contractual agreement, but which do not constitute a legal entity. The consolidated financial statements include those assets controlled by the Group, the liabilities and expenses that it incurs, and its share of the net income that it earns from the sale of goods or services by the jointly controlled operations, from the date that joint control effectively commences until the date that joint control effectively ceases.

(iv) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated to the extent of the Group's interest in the enterprise. Unrealised gains resulting from transactions with associates are eliminated against the investment in the associate. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

(b) Foreign currency

(i) Foreign currency transactions

Transactions in foreign currencies are translated into US dollars at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into US dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated to US dollars at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to USD at the foreign exchange rate ruling at the dates the fair values were determined.

(ii) Financial statements of foreign operations

The operations of the Group's foreign entities are integral to those of the Group. Accordingly, the assets and liabilities of these entities are translated into US dollars as set out in paragraph (i) above. There are no foreign operations that operate in hyperinflationary economies. Foreign exchange differences are recognised in the income statement.

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

(c) Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment in use are stated at fair value less accumulated depreciation (see below) and impairment losses (refer accounting policy (i)). Assets under construction are recorded at cost less impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. Furthermore, borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets are included in the cost.

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and equipment acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation (see below) and impairment losses (refer accounting policy (i)). Operating lease payments are accounted for as described in accounting policy (q).

(iii) Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalised with the carrying amount of the component being written off. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as incurred.

(iv) Revaluations

Revaluations are performed periodically, such that the carrying amount does not differ materially from fair value. Revaluations are carried out by an independent appraiser.

A revaluation increase is recognised in the statement of changes in equity under the heading of revaluation increase, unless it reverses a revaluation decrease previously recognised in the income statement for the same asset. A revaluation decrease is recognised in the income statement unless it reverses a revaluation increase previously recognised in the statement of changes in equity for the same asset.

(v) Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated.

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

The estimated useful lives are as follows:

■ Buildings	28-50 years
■ Machinery and equipment	10-30 years
■ Transportation equipment	5-21 years
■ Fixtures and fittings	3-11 years

(d) Intangible assets

(i) Goodwill

Goodwill arising on acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired. Goodwill is stated at cost less accumulated amortisation (see below) and impairment losses (refer accounting policy (i)). In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associate.

(ii) Negative goodwill

Negative goodwill arising on an acquisition represents the excess of the fair value of the net identifiable assets acquired over the cost of acquisition.

To the extent that negative goodwill relates to an expectation of future losses and expenses that are identified in the plan of acquisition and can be measured reliably, but which have not yet been recognised, it is recognised in the income statement when the future losses and expenses are recognised. Any remaining negative goodwill, but not exceeding the fair values of the non-monetary assets acquired, is recognised in the income statement over the weighted average useful life of those assets that are depreciable/amortisable. Negative goodwill in excess of the fair values of the non-monetary assets acquired is recognised immediately in the income statement.

In respect of associates, the carrying amount of negative goodwill is included in the carrying amount of the investment in the associate. The carrying amount of other negative goodwill is deducted from the carrying amount of intangible assets.

(iii) Patents and trademarks

Patents and trademarks are carried at historical cost less any accumulated amortisation and any accumulated impairment losses (refer accounting policy (i)).

(iv) Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense as incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses (refer accounting policy (i)).

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

(v) Other intangible assets

Other intangible assets, which are acquired by the Group, are stated at cost less accumulated amortisation (see below) and impairment losses (refer accounting policy (i)). Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

(vi) Subsequent expenditure

Subsequent expenditure on intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

(vii) Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. Goodwill is amortised from the date of initial recognition and other intangible assets are amortised from the date they are available for use. The estimated useful lives are as follows:

- Goodwill 5-15 years
- Intangibles other than goodwill 3-10 years

(e) Investments

Investments are recognised (derecognised) when the Group obtains (loses) control over the contractual rights inherent in that asset.

- Except as outlined below, investments are accounted for as follows:
- Investments held for trading are stated at fair value, with any resultant gain or loss recognised in the income statement.
- Investments held-to-maturity are stated initially at cost. Subsequent to initial recognition they are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period to maturity on an effective interest basis.
- Other investments are classified as available-for-sale and are stated at fair value, with any resultant gain or loss being recognised in the income statement.

The fair value of investments held for trading and available-for-sale is their quoted bid price at the balance sheet date. Investments in equity securities that are not quoted on a stock exchange, and where fair value cannot be estimated on a reasonable basis by other means, are stated at cost less impairment losses.

(f) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of inventories is calculated on the weighted average basis and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition.

(g) Trade and other receivables

Trade and other receivables are stated at their cost less impairment losses (refer accounting policy (i)).

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

(h) Cash and cash equivalents

Cash and cash equivalents comprises cash balances, call deposits and liquid bank promissory notes. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents in the statement of cash flows.

(i) Impairment

The carrying amounts of the Group's assets, other than inventories (refer accounting policy (f)) and deferred tax assets (refer accounting policy (o)), are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amounts are estimated. For intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised when the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

An impairment loss in respect of a revalued asset is recognised in the statement of changes in equity to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. Otherwise, all impairment losses are recognised in the income statement.

(i) Calculation of recoverable amount

The recoverable amount of the Group's investments in debt securities and receivables is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset.

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

(ii) Reversals of impairment

An impairment loss in respect of a held-to-maturity security or receivable is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of goodwill is not reversed unless the loss was caused by a specific external event of an exceptional nature that is not expected to recur, and the increase in recoverable amount relates clearly to the reversal of the effect of that specific event.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

A reversal of an impairment loss in respect of a revalued asset is recognised in the income statement to the extent that an impairment loss on the same revalued asset was previously recognised as an expense in the income statement. Otherwise, a reversal of an impairment loss in respect of a revalued asset is recognised in the statement of changes in equity. Reversals of impairment losses in respect of other assets are recognised in the income statement.

(j) Share capital

(i) Preference share capital

Preference share capital that is non-redeemable, non-cumulative and for which dividends are payable at the discretion of the directors, is classified as equity.

(ii) Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity.

(iii) Dividends

Dividends are recognised as a liability in the period in which they are declared.

(k) Loans and borrowings

Loans and borrowings are recognised initially at cost, net of any transaction costs incurred. Subsequent to initial recognition, loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

When borrowings are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is recognised immediately in the income statement.

(l) Employee benefits

(i) Short-term employee benefits

The Group reimburses its employees for expenses incurred in case of injuries at work from Group funds and reimbursement from the Social Insurance Fund to which the Group pays a percentage of each employee’s wage as established by the Russian Tax Code. The Group also grants annual vacations to its employees with an average duration of 34 calendar days.

(ii) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

(iii) Defined benefit plans

The Group's net obligation in respect of defined benefit pension and healthcare plans is calculated separately for each defined benefit plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. These benefits are discounted to determine the present value, and the fair values of any plan assets are deducted. The discount rate is the yield at balance sheet date on government bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed annually by a suitably qualified actuary using the projected unit credit method. Any actuarial gain or loss arising from the calculation of the defined benefit obligation is fully recognised in the current year's income statement.

(m) Provisions

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(n) Trade and other payables

Trade and other payables are stated at their cost.

(o) Income tax

Income tax for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, and the initial recognition of assets or liabilities that affect neither accounting nor taxable profit and investments in subsidiaries, where the parent is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the unused tax losses and credits can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

(p) Revenues

(i) Goods sold and services rendered

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Revenue from services rendered is recognised in the income statement in proportion to the stage of completion of the transaction at the balance sheet date. The stage of completion is assessed by reference to surveys of work performed. No revenue is recognised if there are significant uncertainties with regard to recovery of the consideration due, associated costs or the possible return of goods.

(ii) Rental income

Rental income from property is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income to be received.

(iii) Non-cash transactions

The Group has a significant level of non-cash transactions as is common with many Russian companies. Non-cash transactions consist of mutual settlements arising from the exchange of goods and services, and transactions which are settled by means of promissory notes. Approximately 15% (2002: 17%) of revenues and 17% (2002: 18%) of purchases in 2003 were received and paid for in the form of non-cash transactions. Mutual settlement transactions are centrally managed by the Group. Prices are usually fixed in contracts with the mutual settlement transactions valued and recorded at market prices for the goods involved in the transaction. Non-cash sales and purchases are accounted for on an accruals basis in the same manner as traditional cash transactions.

(q) Expenses

(i) Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease payments made.

(ii) Social costs

Social asset construction costs

Capital expenditure of a social nature that benefits the community as a whole, but which is not expected to bring future economic benefits to the Group, is recognised in the income statement as incurred.

Operational and maintenance expenses

Expenditure related to the operation and maintenance of sports complexes, holiday and recreational facilities, medical centres, public housing, kindergartens and restaurants is recognised in the income statement as incurred.

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

(iii) Net financing costs

Net financing costs comprise interest on borrowings, interest income, dividend income and foreign exchange gains and losses.

Interest income is recognised in the income statement as it accrues, taking into account the effective yield on the asset and the liability. Dividend income is recognised in the income statement on the date that the dividend is declared.

Interest that is not directly attributable to the acquisition, construction or production of qualifying assets, as well as the interest expense component of finance lease payments, is recognised in the income statement using the effective interest method.

(r) Environmental expenditures

Capital expenditure in respect of ongoing environmental compliance measures is capitalised and recorded in the consolidated balance sheet. Environmental expenditure of a non-capital nature is recognised in the income statement as incurred.

(s) Comparative amounts

During the year the Company modified the classification of its expenses in the consolidated income statement. The Company determined a more appropriate basis for allocation of the Groups depreciation charge to administrative related assets, resulting in USD 11 million being reclassified from administration expenses to cost of sales.

4. Segment information

The Group predominantly produces iron and steel products, which are primarily sold to traders unrelated to the Group for sale on the world steel market. The revenues from the sale of these products constitute more than 95% of total revenues. An analysis of sales by product is included in note 5. Geographically, all significant assets, production and management/administrative facilities are located in Magnitogorsk. An analysis of the regions in which all traders sold the Group's products is included in note 5.

Accounting policies and notes to the consolidated financial statements

5. Revenues

In millions of US dollars	**2003**	**2002**
Rolled steel	1,850	1,174
Assorted rolled products	277	191
Tin plated steel	185	133
Slabs	71	112
Galvanized steel	264	82
Band	106	94
Metae	73	29
Wire, sling, bracing	50	20
Tubes	28	19
Other	143	211
	3,047	2,065

Regions in which products are sold by traders

	2003	**2002**
Russia and the CIS	55%	48%
Asia	20%	21%
Middle East	13%	9%
Europe	9%	19%
Other	3%	3%
	100%	100%

6. General and administrative expenses

In millions of US dollars	**2003**	**2002**
Wages, salaries and related taxes	79	51
Insurance costs	47	40
Services consumed	28	23
Depreciation	4	4
Amortisation of intangibles	6	8
Pension costs, net	2	3
Bank charges	12	9
Taxes other than profit tax	36	65
Other administrative expenses	21	16
	235	219

Insurance costs

During 2003 the Group insured its property, plant and equipment, constructions in progress and operational current assets. It also insured against certain other risks including risks related to industrial accidents and civil liability. The Group's property, plant and equipment is insured in accordance with its replacement cost as determined by American Appraisal (AAR) Inc. and other licensed appraisers.

Accounting policies and notes to the consolidated financial statements

7. Social costs

In millions of US dollars	2003	2002
Social asset construction costs	10	11
Operational and maintenance expenses	27	24
	37	35

8. Other operating expenses, net

In millions of US dollars	2003	2002
Net loss on sale of investments	-	2
Bad debts and changes in accounts receivable and other provisions	(13)	9
Loss on disposal of property, plant and equipment	24	15
Other operating gain, net	(3)	(17)
	8	9

9. Personnel expenses

In millions of US dollars	2003	2002
Wages, salaries and related taxes included in:		
Cost of sales	236	194
Distribution costs	5	4
Administrative expenses	74	54
	315	252

The average number of employees during the year ended 31 December 2003 was 62,000 (2002: 56,000).

10. Net financing costs

In millions of US dollars	2003	2002
Interest expense	52	38
Interest income	(17)	(4)
Net foreign exchange loss/(gain)	(17)	9
	18	43

Accounting policies and notes to the consolidated financial statements

11. Income tax expense

In millions of US dollars	**2003**	**2002**
Current tax expense		
Current year expense	224	64
	224	64
Deferred tax expense/(benefit)		
Origination and reversal of temporary differences (refer note 24)	(83)	22
	(83)	22
	141	86

The Parent Company's applicable tax rate is the corporate income tax rate of 24% (2002: 24%) and 24% for measuring deferred taxes (2002: 24%).

Reconciliation of effective tax rate

In millions of US dollars		**2003**		**2002**
Profit before tax and minority interest		761		202
Income tax at applicable tax rate	24%	182	24%	48
Non-deductible expenses/non-taxable income	(2%)	(16)	19%	39
Overprovided in prior years	(3%)	(25)	(1%)	(1)
	19%	141	43%	86

Accounting policies and notes to the consolidated financial statements

12. Property, plant and equipment

In millions of US dollars	Land and buildings	Machinery and equipment	Transportation equipment	Fixtures and fittings	Assets under construction	Total
Cost						
Balance at 1 January 2003	453	1,501	71	13	87	2,125
Additions	2	3	6	1	207	219
Transfers	31	87	1	16	(135)	-
Disposals	(13)	(32)	(16)	(3)	(7)	(71)
Balance at 31 December 2003	473	1,559	62	27	152	2,273
Depreciation						
Balance at 1 January 2003	-	-	-	-	-	-
Charge for the year	(36)	(159)	(8)	(3)	-	(206)
Disposals	1	2	1	-	-	4
Balance at 31 December 2003	(35)	(157)	(7)	(3)	-	(202)
Carrying amount						
Balance at 1 January 2003	453	1,501	71	13	87	2,125
Balance at 31 December 2003	438	1,402	55	24	152	2,071
Carrying amount had no revaluation taken place at 31 December 2002	453	1,478	59	12	87	2,089
Carrying amount had no revaluation taken place at 31 December 2003	440	1,402	47	23	152	2,064

Revaluation

In 2002 management commissioned American Appraisal (AAR) Inc. to independently appraise all classes of property, plant and equipment as at 31 December 2002, with the exception of assets under construction. The fair value of items of property, plant and equipment was determined based on their depreciated replacement cost.

The amount of accumulated depreciation at the date of the revaluation was eliminated against the gross carrying amount of the asset and the net amount was restated to the cost of the asset.

Impairment loss and reversal

Since the revaluation of property, plant and equipment was carried out using a basis other than market value, American Appraisal (AAR) Inc. subsequently determined the recoverable amount of the revalued property, plant and equipment. In addition to highlighting instances where the valuation based on depreciated replacement cost was higher than the asset's recoverable amount, and therefore an impairment loss was required, it also resulted in the partial reversal of the impairment loss recognised in the income statement in 2000.

Accounting policies and notes to the consolidated financial statements

12. Property, plant and equipment continued

For impairment purposes the recoverable amount was determined in aggregate for each cash-generating unit. In general each appraised company of the Group was treated as a single cash-generating unit. However, where subsidiaries were fully integral to the Parent Company they were included in the cash-generating unit of the Parent Company. This is consistent with the way in which the recoverable amount was determined when the impairment loss was recognised in 2000.

The recoverable amounts represent their value in use as determined by discounting the future cash flows of each unit generated from the continuing use of property, plant and equipment and from its ultimate disposal. A discount rate of 16% was applied in determining the recoverable amount of the Parent Company's property, plant and equipment. Various discount rates between 19% and 21% were applied in determining the recoverable amounts of property, plant and equipment of the Group's significant subsidiaries, depending on the characteristics of each subsidiary appraised. In 2000 a discount rate of 20% was applied in determining the recoverable amounts of property, plant and equipment of the Parent Company and its subsidiaries.

Borrowing costs
In 2003 there were no borrowing costs capitalised as part of the cost of qualifying assets (2002: USD 10 million).

Accounting policies and notes to the consolidated financial statements

13. Intangible assets

In millions of US dollars	Negative Goodwill	Goodwill	Other intangible assets	Total
Cost				
Balance at 1 January 2003	(18)	-	30	12
Additions	(15)	1	17	3
Disposals	-	-	-	-
Balance at 31 December 2003	(33)	1	47	15
Depreciation/Amortisation				
Balance at 1 January 2003	2	-	(16)	(14)
Charge for the year	4	-	(10)	(6)
Disposals	-	-	-	-
Balance at 31 December 2003	6	-	(26)	(20)
Carrying amount				
At 1 January 2003	(16)	-	14	(2)
At 31 December 2003	(27)	1	21	(5)

Negative Goodwill
The negative goodwill is being recognised in the income statement over periods of between 4 and 7 years.

14. Investments in associates

The Group has the following significant investments in associates:

	Country of incorporation	Ownership 2003	Ownership 2002	Voting interest 2003	Voting interest 2002
ZAO Uralkord	Russia	-	50%	-	50%
MMK Trans	Russia	49%	49%	50%	50%

Disposal of investments in associates
In April 2003 the Group's subsidiary, OAO Magnitogorsky Kalibrovochny Zavod, disposed of its equity interest in ZAO Uralkord for USD 5 million. There was no gain or loss on disposal of the equity interest.

Accounting policies and notes to the consolidated financial statements

15. Other investments

In millions of US dollars	2003	2002
Non-current investments		
Equity securities available-for-sale	1	1
	1	1
Current investments		
Traded equity securities	3	6
Traded debt securities	17	-
Promissory notes	30	-
	50	6

16. Other non-current assets

In millions of US dollars	2003	2002
Loans to employees	1	2
Non-current portion of loans given	3	-
Long-term debtors	1	-
Restricted cash	1	1
	6	3

Restricted cash
Restricted cash comprises amounts of cash held in certain bank accounts of the Group that have been pledged as collateral for letters of credit issued on the Group's behalf for the purpose of acquiring equipment.

17. Inventories

In millions of US dollars	2003	2002
Raw materials and consumables	205	155
Work in progress	78	59
Finished goods and goods for resale	41	33
	324	247
Provision for obsolescence	(16)	(16)
	308	231

Accounting policies and notes to the consolidated financial statements

18. Trade and other receivables

In millions of US dollars	2003	2002
Trade accounts receivable	202	96
VAT receivable	109	119
Prepayments and advances	53	48
Other receivables	38	19
	402	282
Provision for doubtful debts (trade)	(18)	(16)
	384	266

19. Cash and cash equivalents

Cash and cash equivalents comprise local and foreign currency bank balances, call deposits and liquid bank promissory notes.

In millions of US dollars	2003	2002
USD bank accounts	3	17
Euro bank accounts	13	2
RUR bank accounts	25	16
USD short-term bank deposits	135	96
RUR short-term bank deposits	-	14
USD denominated liquid bank promissory notes	102	69
Other RUR denominated cash equivalents	546	8
Cash and cash equivalents per the balance sheet	824	222
Bank overdrafts	(47)	(6)
Cash and cash equivalents per the statement of cash flows	777	216

Accounting policies and notes to the consolidated financial statements

20. Equity

Share capital

As at the balance sheet date, the authorised and issued share capital comprised of 7,972,665,600 ordinary shares (2002: 7,972,665,600) and 2,657,556,000 non-redeemable non-cumulative preference shares (2002: 2,657,556,000). All shares have a par value of RUR 1. There were no unpaid shares as at the balance sheet date. All shares rank equally with regard to the Group's residual assets.

Issued and net outstanding shares comprised the following:

	Issued	Treasury shares	Net outstanding
Number of ordinary shares in thousands			
Balance at 1 January 2002	6,644	(2,513)	4,131
Acquisition of treasury shares	-	(278)	(278)
Share issue: 1,200 for 1 split	7,966,022	(3,346,409)	4,619,613
Re-issuance of treasury shares	-	808,415	808,415
Balance at 31 December 2002	7,972,666	(2,540,785)	5,431,881
Acquisition of treasury shares	-	(167,546)	(167,546)
Re-issuance of treasury shares	-	671,951	671,951
Balance at 31 December 2003	7,972,666	(2,036,380)	5,936,286
Number of preference shares in thousands			
Balance at 1 January 2002	2,215	(886)	1,329
Acquisition of treasury shares	-	(497)	(497)
Share issue: 1,200 for 1 split	2,655,341	(1,658,217)	997,124
Re-issuance of treasury shares	-	1,268,744	1,268,744
Balance at 31 December 2002	2,657,556	(390,856)	2,266,700
Acquisition of treasury shares	-	(215,758)	(215,758)
Re-issuance of treasury shares	-	558,032	558,032
Balance at 31 December 2003	2,657,556	(48,582)	2,608,974

Treasury shares

At the balance sheet date the Group held 2,036,380 thousand (2002: 2,540,785 thousand) of its own ordinary shares and 48,582 thousand (2002: 390,856 thousand) of its own preference shares. The Group also controls the voting rights of a further 2,573,049 thousand (2002: 2,018,835 thousand) of its own ordinary shares and 1,930,682 thousand (2002: 1,648,648 thousand) of its own preference shares, which subsidiaries of the Group hold in a trustee capacity under trust management agreements. Dividends accrue to the beneficial owners of these shares. Transactions with the shares held under the trust management agreements can only be performed after receiving express written instructions from the Founder of the trust.

Accounting policies and notes to the consolidated financial statements

20. Equity continued

During the year the Group re-issued treasury shares in the form of 671,951 thousand ordinary shares and 558,032 thousand preference shares for aggregate amounts of USD 30 million and USD 4 million, respectively. As at the balance sheet date a subsidiary of the Group held these shares in a trustee capacity under the trust management arrangement as discussed above .

Subsequent to the balance sheet date, a further 38,346 thousand ordinary and 59,106 thousand preference treasury shares were re-issued for aggregate amounts of USD 4 million and USD 4 million, respectively. Of these ordinary and preference shares, 35,496 and 49,356 shares, respectively, are currently held in a trustee capacity by a subsidiary of the Group under a trust management arrangement with the same terms as discussed above.

Dividends

Holders of non-redeemable non-cumulative preference shares are entitled to receive a fixed dividend of 10% of profit after tax and other deductions calculated in accordance with Russian legislation. The amount of the preference dividend should not be less than the amount of ordinary dividend declared at the annual shareholders' meeting.

According to legislation in the Russian Federation, non-cumulative preference shareholders have the same voting rights as ordinary shareholders in the event of default on full payment of dividends to preference shareholders. This right commences from the shareholders' meeting following the annual meeting at which the decision was made to default on full payment of the preference dividend, and terminates from the moment the preference dividends are paid in full.

In accordance with the terms of the charter governing the preference shares, they may be converted into cumulative preference shares by a decision of those shareholders who hold a right to vote at a general meeting, at which time any unpaid or partially unpaid dividends relating to these shares would accrue and would be paid in the future.

Dividends payable are limited to the maximum retained earnings of the Group as determined in accordance with the legislation of the Russian Federation. At the balance sheet date, reserves available for distribution in accordance with Russian legislation amounted to USD 1,028 million (2002: USD 324 million).

At the balance sheet date the following dividends have been recommended by the directors, but have not been approved and are therefore not provided for:

In millions of US dollars	**2003**	**2002**
RUR 0.026 per qualifying ordinary share (2002: RUR 0.011)	7	3
RUR 0.081 per preference share (2002: RUR 0.033)	7	3
	14	6

Accounting policies and notes to the consolidated financial statements

20. Equity continued

Voting rights of shareholders
The holders of fully paid ordinary shares are entitled to one vote per share at the annual and general shareholder meetings of the Group. Shareholders that own fully paid preference shares shall ordinarily participate in the general meeting of shareholders with the right to vote only on issues of reorganisation or liquidation of the Company, and issues concerning amendments to the Parent Company's charter that would restrict their rights.

The Government
The Government of the Russian Federation owned 23.8% of the voting shares of the Parent Company as at 31 December 2003 (2002: 23.8%). The Government has expressed an intention to sell this financial interest.

The Government also owns, controls, or has influence over the operations of many other significant companies and enterprises in the Russian Federation and has a significant influence on the National economy. The Group's activities are significantly linked to companies owned or controlled by the Government. The Group has a significant influence in the local community and with local and regional Government authorities.

Management consider such trading relationships to be usual in conducting business in the Russian Federation and believe that these relationships will continue for the foreseeable future.

Accounting policies and notes to the consolidated financial statements

21. Loans and borrowings

In millions of US dollars		Effective interest rate	2003	Effective interest rate	2002
Non-current liabilities					
Secured loans	- RUR, fixed	-	-	18%	74
	- USD, variable	-	-	7%	19
	- RUR, variable	16%	1	-	-
Unsecured loans	- USD, variable	2%	11	-	-
	- EUR, fixed	-	-	10%	2
Unsecured bond issues	- EUR, fixed	11%	124	11%	112
	- USD, fixed	9%	295	-	-
	- RUR, fixed	10%	27	-	-
Finance lease liabilities:	- USD, fixed	-	-	17%	3
	- RUR, fixed	20%	7	26%	4
	- USD, variable	-	-	10%	4
			465		218
Current liabilities					
Secured loans	- RUR, fixed	15%	1	22%	2
	- RUR, variable	-	-	20%	8
	- USD, variable	-	-	4%	28
Unsecured loans	- RUR, fixed	-	-	19%	7
	- RUR, variable	-	-	21%	2
	- USD, variable	4%	40	6%	22
	- USD, fixed	4%	20	9%	5
Unsecured Russian bond issues	- RUR, fixed	-	-	19%	10
Current portion of unsecured bond issues	- EUR, fixed	11%	11	-	-
	- USD, fixed	9%	4	-	-
Current portion of secured loans	- RUR, fixed	-	-	17%	20
	- RUR, variable	16%	2	-	-
	- USD, variable	-	-	7%	19
Current portion of unsecured loans	- USD, variable	2%	2	-	-
Current portion of finance lease obligations	- USD, fixed	-	-	12%	3
	- RUR, fixed	21%	7	25%	3
	- USD, variable	-	-	10%	2
			87		131
Unutilised available borrowing facilities	- USD, variable		77		3

Accounting policies and notes to the consolidated financial statements

21. Loans and borrowings continued

Long-term debt repayment schedule

In millions of US dollars	Total	Current portion	2005	2006	2007	2008
Secured bank loans – RUR, variable	3	2	1	-	-	-
Unsecured loans - USD, variable	13	2	3	5	3	-
Unsecured bond issues - EUR, fixed	124	-	124	-	-	-
- USD, fixed	295	-	-	-	-	295
- RUR, fixed	27	-	27	-	-	-
Finance lease liabilities - RUR, fixed	14	7	5	2	-	-
	476	11	160	7	3	295

Finance lease liabilities
Finance lease liabilities are payable as follows:

	2003			2002		
In millions of US dollars	Payments	Interest	Principal	Payments	Interest	Principal
Less than one year	9	2	7	11	3	8
Between one and five years	8	1	7	13	2	11
More than five years	-	-	-	-	-	-
	17	3	14	24	5	19

As at the balance sheet date leased assets with a carrying amount of USD 22 million were included in property, plant and equipment (2002: USD 14 million).

Accounting policies and notes to the consolidated financial statements

22. Pledges provided by the Group

The Group has pledged property, plant and equipment of USD 158 million (2002: USD 307 million of property, plant and equipment and USD 128 million of inventory).

The Group is subject to the following pledges as at 31 December 2003:

In millions of US dollars	**2003**	**2002**
Short-term		
Pledges provided for the debt of the Group	-	66
Long-term		
Pledges provided for the debt of related parties	1	-
Pledges provided for the debt of the Group	157	484
	158	550

23. Employee benefits

Defined contribution obligations

Sotsialnaya Zashchita Starosti

The Group makes monthly employee contributions to a non-government pension fund "Sotsialnaya Zashchita Starosti" where an employee has an individual accumulation agreement with the fund.

The Group has the ability to exercise significant influence over the financial and operating policy decisions of the fund through positions that certain directors of the Group have on the board of directors of the fund.

The monthly contribution rate is equal to the employee's contribution, unless the employee is a male aged between 55 and 60, or a female aged between 50 and 55, in which case the contribution will be 1.5 times the employee's contribution. The monthly employee contribution by the Group may not exceed RUR 2,000 (USD 68) per employee. In 2003 contributions made by the Group to the fund were USD 1.5 million (2002: USD 3 million).

Russian Federation State Pension Fund

The Group pays into the Russian Federation State Pension Fund a percentage of each employee's wage based on a scale as established by the Russian Tax Code. In 2003 total payments made to the state pension fund totalled USD 37 million (2002: USD 28 million). These amounts are expensed when incurred and are recorded in taxes related to personnel expenses (refer note 9).

Accounting policies and notes to the consolidated financial statements

23. Employee benefits continued

Defined benefit obligations

The Group also has a defined benefit plan in favour of employees who retired prior to 1 April 2000. Pensions from this defined benefit plan are administered by the independent charity fund "BOF Metallurg".

The Group makes monthly payments to the fund of RUR 241 (USD 7.85) per retiree (2002: RUR 241, USD 7.58), which are then distributed by the fund to retirees. The fund does not hold any assets set aside for the benefit of retirees under this plan.

In millions of US dollars	**2003**	**2002**
Liability for defined benefit obligations	22	22

Movements in the liability recognised in the balance sheet:

In millions of US dollars	**2003**	**2002**
Liability at 1 January	22	21
Payments made during the year	(2)	(2)
Expenses recognised in the income statement	2	3
Liability at 31 December	22	22

Expenses recognised in the income statement:

In millions of US dollars	**2003**	**2002**
Interest costs	4	4
Current service costs	-	-
Actuarial gain	4	-
Foreign exchange gain	(6)	(1)
	2	3

Current service costs and actuarial gains and losses are recognised in administrative expenses in the income statement (refer note 6).

The principal actuarial assumptions used to calculate the retirement benefit liabilities at the balance sheet date were are follows:

	2003	**2002**
Discount rate at 31 December	15.4%	18.6%
Future retirement benefit increases	13.1%	16.3%

Accounting policies and notes to the consolidated financial statements

24. Deferred tax liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
In millions of US dollars	**2003**	**2002**	**2003**	**2002**	**2003**	**2002**
Property, plant and equipment	-	10	(254)	(329)	(254)	(319)
Investments	4	1	(6)	(5)	(2)	(4)
Inventories	-	2	(3)	(5)	(3)	(3)
Trade and other accounts receivable	1	4	-	(3)	1	1
Trade and other accounts payable	117	7	-	(4)	117	3
Loans and borrowings	-	1	(98)	(1)	(98)	-
Tax assets/(liabilities)	122	25	(361)	(347)	(239)	(322)
Set-off of tax	(122)	(25)	122	25	-	-
Net tax liabilities	-	-	(239)	(322)	(239)	(322)

As at 31 December 2003 a deferred tax liability of USD 22 million (2002: USD 28 million) relating to investment in subsidiaries had not been recognised because the Group controls whether the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

Movement in temporary differences during the year

In millions of US dollars	**Balance 01 Jan 03**	**Recognised in income**	**Balance 31 Dec 03**
Property, plant and equipment	(319)	65	(254)
Investments	(4)	2	(2)
Inventories	(3)	-	(3)
Trade and other accounts receivables	1	-	1
Trade and other accounts payables	3	114	117
Loans and borrowings	-	(98)	(98)
	(322)	83	(239)

Accounting policies and notes to the consolidated financial statements

25. Trade and other payables

In millions of US dollars	**2003**	**2002**
Trade accounts payable	126	127
Amounts payable to related parties	1	6
Advances from customers	69	53
VAT payable	23	16
Other taxes payable	29	48
Provision for litigation	5	8
Payables to employees	9	9
Other current and accrued liabilities	39	25
	301	292

Provision for litigation

In 2003 the Group released a provision of USD 6.5 million previously recognized for litigation initiated by Polska Kasa bank against the Parent Company under a guarantee it had provided to Tokobank. On 29 May 2002 the International Commercial Court of the Russian Federation reduced the amount of the claim from USD 17.3 million and ruled that the Parent Company should pay an amount of USD 6.5 million to Polska Kasa bank. On 15 August 2003 the Federal Arbitrage Court overturned all previous decisions of the International Commercial Court removing the Parent Company from its obligation to pay this amount.

Accounting policies and notes to the consolidated financial statements

26. Subsidiary companies

The following is a list of significant subsidiaries:

	Country of incorporation	Effective ownership 2003	Voting Interest 2003	Effective ownership 2002	Voting Interest 2002
MMK Finance SA	Luxembourg	97%	97%	97%	97%
MMK Steel Trade AG	Switzerland	100%	100%	100%	100%
MMK Trading AG	Switzerland	100%	100%	100%	100%
ZAO A Kapital	Russia	100%	100%	100%	100%
OOO Avtotransportnoye Upravleniye	Russia	100%	100%	100%	100%
ZAO Agropromishleny Complex	Russia	73%	100%	100%	100%
OOO Emal	Russia	100%	100%	100%	100%
ZAO Energeticheski complex	Russia	100%	100%	100%	100%
ZAO Elektroremont	Russia	100%	100%	100%	100%
ZAO Energetichesky fond	Russia	100%	100%	100%	100%
ZAO Fabrika khlebno-konditerskih izdeliy	Russia	73%	100%	100%	100%
ZAO Glubokaya Pererabotka	Russia	99%	99%	51%	51%
ZAO IK RFC	Russia	100%	100%	100%	100%
OOO Interlux	Russia	100%	100%	51%	51%
ZAO Komplex Glubokoy Pererabotki	Russia	96%	96%	51%	51%
ZAO Magma	Russia	100%	100%	100%	100%
OAO Magnitogorsky Kalibrovochny Zavod	Russia	83%	83%	83%	83%
OAO Magnitogorsky Metizno-Metallurgiechesky Zavod	Russia	88%	91%	73%	91%
OAO MCOZ	Russia	78%	78%	56%	56%
ZAO Meharnoremont	Russia	66%	66%	51%	51%
ZAO Mehanoremontny Komplex	Russia	100%	100%	100%	100%
OOO Mekom	Russia	100%	100%	100%	100%
ZAO Metalloshlak	Russia	100%	100%	100%	100%
ZAO Metalurgspetstroyremont	Russia	100%	100%	100%	100%
ZAO Metiz-Kapital	Russia	100%	100%	62%	62%
OOO Minimax	Russia	60%	60%	60%	60%
ZAO Ogneupor	Russia	78%	100%	56%	100%
OOO Press-5P	Russia	85%	89%	45%	89%
ZAO Promgrazhdanstroy	Russia	95%	95%	95%	95%
ZAO Radio Magnit	Russia	100%	100%	100%	100%
OOO Region	Russia	100%	100%	100%	100%
ZAO RMK	Russia	100%	100%	100%	100%
ZAO Staleprokatny Zavod	Russia	100%	100%	100%	100%
ZAO Stroitelny Fond	Russia	99%	99%	100%	100%
ZAO Stroitelny Komplex	Russia	100%	100%	100%	100%
OOO TEK MMK	Russia	98%	98%	98%	98%
ZAO Torgovlya and PPP	Russia	73%	73%	79%	73%
OOO Vekselny tsentr MMK	Russia	100%	100%	100%	100%

Accounting policies and notes to the consolidated financial statements

27. Financial instruments

Exposure to credit, interest rate and currency risk arises in the normal course of the Group's business. The Group does not use derivative financial instruments to reduce exposure to fluctuations in foreign exchange rates and interest rates.

Credit risk

Financial instruments that potentially subject the Group to significant credit risk consist primarily of cash and cash equivalents, accounts receivable and bank deposits. The Group has bank accounts held in Credit Ural Bank, a related party of the Group. The Group also holds deposits in leading Russian banks, and uses promissory notes acquired from Credit Ural Bank as cash equivalents. Credit risk evaluations are performed for all banks in which the Group holds deposits, and all customers requiring credit over a certain amount. The Group does not require collateral in respect of financial assets. The maximum exposure to credit risk is represented by the carrying amount of each financial asset.

Interest rate risk

The Group incurs interest rate risk primarily on loans and borrowings. The interest rate and terms of repayment of loans are disclosed in note 21. The Group borrows on both a fixed and variable interest rate basis. All variable interest rate loans and borrowings are re-priced on a monthly basis.

Foreign currency risk

The Group incurs foreign currency risk on transactions and borrowings that are denominated in a currency other than the US dollar. The currencies giving rise to this risk are primarily the Russian rouble and the Euro.

Management considers the Group's major foreign currency risk to be the devaluation of the rouble or the appreciation of the Euro against its measurement currency. Management mitigates against the Russian rouble foreign currency risk by ensuring a Russian rouble denominated net monetary liability position is maintained. This is achieved through ensuring that a significant portion of the Group's sales are exported obtaining US dollar receipts, holding these receipts in liquid US dollar cash equivalents, and incurring a significant portion of the Group's costs in Russian roubles. Management does not use foreign currency forward contracts or any other form of foreign currency derivatives to hedge against its foreign currency risk.

Fair value

The Group's financial instruments include cash and cash equivalents, receivables, payables, short-term and long-term investments, and short-term and long-term debt. The carrying amounts of cash and cash equivalents, short-term investments, short-term debt, receivables and payables approximate their fair value due to the short-term nature of these instruments. Long-term investments consist primarily of equity securities for which the fair value could not be determined as the securities are not publicly traded. A portion of the Group's long-term debt includes variable rate debt, the carrying amount of which approximates its fair value As at 31 December 2003, the carrying value of fixed rate long term debt (including finance lease liabilities) was USD 453 million (2002: USD 195 million). The fair value of fixed rate long-term debt, based on the estimated market values for debt instruments with similar characteristics was USD 453 million (2002: USD 200 million).

Accounting policies and notes to the consolidated financial statements

28. Related parties

The Group had the following related party transactions during the year with:

Enterprises in which the Directors had a financial interest

Transaction	2003	2002
Loans and overdrafts obtained	214	249
Loans and overdrafts repaid	217	241
Bank charges	11	9
Purchase of scrap	167	86
Domestic sales	25	16
Purchase of promissory notes	24	-
Lease payments	9	6
Insurance payments	41	39

Enterprises controlled by a representative of a principal shareholder and Director of the Group

Transaction	2003	2002
Export sales	154	106
Purchase of coal and ore concentrate	164	73

Associates

Transaction	2003	2002
Sale of steel	54	43
Purchase of freight services	17	8

As at the balance sheet date the Group had the following related party balances outstanding with:

Enterprises in which the Directors had a financial interest

Balance type	2003	2002
Cash and cash equivalents	40	23
Loans and overdraft facilities	11	14
Promissory notes receivable	24	-
Loans and borrowings	25	-
Trade payables	4	5
Insurance prepayment	-	13
Advances received	2	1
Lease payments outstanding	9	1

Accounting policies and notes to the consolidated financial statements

Enterprises controlled by a representative of a principal shareholder and Director of the Group

Balance type	**2003**	**2002**
Trade receivables	2	3
Trade payables	6	1

Associates

Balance type	**2003**	**2002**
Trade payables	5	3

29. Commitments

(i) Capital commitments

The Group is committed to capital expenditure of approximately USD 280 million (2002: USD 11 million).

(ii) Social commitments

The Group makes contributions to mandatory and voluntary social programs (refer note 7). The Group's social assets, as well as local social programs, benefit the community at large and are not normally restricted to the Group's employees. The Group has transferred certain social operations and assets to local authorities, and expects to continue to transfer any remaining responsibility for social programs to the community in the near future.

30. Contingencies

(i) Financial Guarantees

The Group has provided financial guarantees for loans advanced to certain related and third party suppliers of the Group. Amounts related to the Group's financial guarantees are as follows.

In millions of US dollars	**2003**	**2002**
Non-current		
Related party supplier	10	1
Current		
Related party supplier s	-	6
Third party suppliers	1	2
	11	9

Accounting policies and notes to the consolidated financial statements

30. Contingencies continued

The Group's estimated maximum exposure to credit losses in the event of non-performance by the other parties to these financial guarantees is represented by the contractual amounts disclosed above. Assets of the Group were also pledged against loans advanced to related parties (refer note 22). Management believe that the likelihood of material payments being required under these agreements is remote. As at 31 December 2003 the Group did not have any contractual commitments to extend financial guarantees, credit or other assistance.

(ii) Litigation

As at the balance sheet date the Group did not have any material unresolved claims against it.

(iii) Taxation contingencies

The taxation system in the Russian Federation is relatively new and is characterised by numerous taxes and frequently changing legislation, which is often unclear, contradictory and subject to interpretation. Often differing interpretations exist among the numerous taxation authorities and jurisdictions. Taxes are subject to review and investigation by a number of authorities, who are enabled by law to impose severe fines, penalties and interest charges.

These facts may create tax risks in the Russian Federation substantially more significant than in other countries. Management believes that it has provided adequately for all tax liabilities based on its interpretation of the tax legislation. However, the relevant authorities may have differing interpretations and the effects could be significant.

(iv) Environmental liabilities

The Group is obligated to undertake certain environmental remediation-activities to ensure site restoration of a large iron ore quarry in the Magnitogorsk region. In accordance with the permission granted by the Magnitogorsk Regional Ecological Committee, the Group utilises production waste to fill the iron ore quarry where this waste does not exceed a prescribed toxicity level. Amounts of waste that exceed this toxicity level are treated by licensed specialists. The future costs associated with the restoration of the iron ore quarry are not expected to be material. These costs, and other environmental compliance costs associated with air and water pollution are included in the normal operating expenses of the Group as they are incurred.

Environmental regulations are currently under consideration in the Russian Federation and the Group is continuously evaluating its obligations relating to new and changing legislation. The likelihood and amount of liabilities relating to environmental obligations under proposed or any future legislation cannot be reasonably estimated at present and could become material.

Under existing legislation, management believe that there are no material unrecorded liabilities or contingencies, which could have a significant adverse effect on the operating results or financial position of the Group.

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