UTair Aviation Joint-Stock Company

Consolidated Financial Statements

For the year ended 31 December 2004
with Report of Independent Auditors

UTair Aviation Joint-Stock Company

Consolidated Financial Statements

For the Year Ended 31 December 2004

Contents

UTair Aviation Joint-Stock Company

Consolidated Balance Sheet at 31 December 2004

(in thousands of Russian Roubles)

	Notes	2004	2003
ASSETS			
Current assets:			
Cash and cash equivalents	**7**	**43,579**	39,796
Available for sale investments	**12**	**223,398**	16,574
Accounts receivable and prepayments	**8**	**1,674,902**	1,038,893
Current income tax receivable		**73,799**	129,435
Net investment in lease - short-term	**11**	**30,084**	3,251
Inventories	**9**	**374,304**	283,076
Total current assets		**2,420,066**	1,511,025
Non-current assets:			
Property, plant and equipment	**10**	**4,052,435**	3,258,775
Intangible assets		**14,006**	12,457
Net investment in lease - long-term	**11**	**37,595**	6,530
Investments in associates	**13**	**92,636**	83,043
Available for sale investments		**7,303**	7,856
Other non-current assets	**15**	**5,645**	6,220
Total non-current assets		**4,209,620**	3,374,881
Total assets		**6,629,686**	4,885,906
LIABILITIES & SHAREHOLDERS' EQUITY			
Current liabilities:			
Accounts payable and accrued expenses	**16**	**723,773**	621,182
Other taxes payable	**18**	**583,219**	465,134
Short-term borrowings	**17**	**1,849,605**	1,540,913
Advances from customers and deferred revenue	**19**	**200,444**	111,072
Total current liabilities		**3,357,041**	2,738,301
Non-current liabilities:			
Long-term borrowings	**17**	**1,400,989**	258,235
Long-term restructured taxes payable	**18**	**273,883**	547,774
Deferred tax liability	**26**	**303,195**	305,734
Other long-term liabilities		**32,700**	–
Total non-current liabilities		**2,010,767**	1,111,743
Total liabilities		**5,367,808**	3,850,044
Minority interest	**27**	**63,024**	48,856
Shareholders' equity:			
Share capital	**20**	**3,101,456**	3,101,456
Treasury shares	**20**	**(14,240)**	(18,511)
Surplus from reissuance of treasury shares		**13,010**	–
Assets revaluation reserve		**1,070,076**	1,189,728
Accumulated deficit		**(2,971,448)**	(3,285,667)
Total shareholders' equity		**1,198,854**	987,006
Total liabilities and shareholders' equity		**6,629,686**	4,885,906

The accompanying notes are an integral part of these financial statements.

UTair Aviation Joint-Stock Company

Consolidated Statement of Operations

For the Year Ended 31 December 2004

(in thousands of Russian Roubles)

	Notes	2004	2003
Revenues			
Flight revenue		**7,633,092**	5,713,440
Other revenue		**686,968**	498,607
Total operating revenues	**21**	**8,320,060**	6,212,047
Direct operating expenses	**22**	**(4,928,808)**	(3,653,805)
Personnel expenses	**23**	**(1,503,795)**	(1,454,712)
Depreciation and amortization		**(418,591)**	(312,612)
Repair expenses		**(621,674)**	(589,846)
Commissions		**(310,513)**	(194,117)
Allowance for doubtful debts	**8**	**(41,722)**	(79,521)
Other operating income / (expenses), net	**24**	**(408,224)**	(322,593)
Total operating expenses		**(8,233,327)**	(6,607,206)
Operating profit/(loss)		**86,733**	(395,159)
Interest income/ (expenses), net	**25**	**(363,918)**	(280,546)
Gain from acquisition of a subsidiary	**14**	**290,238**	
Gains on restructuring of tax debts and other borrowings	**18**	**201,912**	441
Share of result of associates, before tax	**13**	**14,938**	9,013
Net foreign exchange losses		**(15,470)**	(10,960)
Profit/(Loss) before income taxes and minority interest		**214,433**	(677,211)
Income tax	**26**	**12,567**	206,430
Net profit/(loss) before minority interest		**227,000**	(470,781)
Minority interest	**27**	**(7,515)**	(11,262)
Net profit/(loss)		**219,485**	(482,043)
Earnings/(loss) per share – basic and diluted (in Russian Roubles)	**28**	**0.39**	(0.86)

The accompanying notes are an integral part of these financial statements.

UTair Aviation Joint-Stock Company

Consolidated Statement of Cash Flows

For the Year Ended 31 December 2004

(in thousands of Russian Roubles)

	Notes	2004	2003
Cash flows from operating activities:			
Income/(Loss) before income tax and minority interest		**214,433**	(677,211)
Adjustments for:			
Interest expense	**25**	**343,724**	238,047
Depreciation and amortization		**418,591**	312,612
Amortization of discount attributable to restructured tax debts	**25**	**51,606**	39,028
Loss/(gain) on disposal of property, plant and equipment		**65,029**	(7,416)
Provision for impairment of receivables	**8**	**41,722**	79,521
Other provisions and allowances		**34,996**	60,328
Gains on restructuring of tax debts and other borrowings	**18**	**(201,912)**	(441)
Interest income	**25**	**(31,412)**	(5,709)
Gain from purchase of a subsidiary, before minority interest	**14**	**(296,892)**	–
Share of result of associates, before tax	**13**	**(14,938)**	(9,013)
Operating cash flows before working capital changes		**624,947**	29,746
Increase in accounts receivable and prepayments		**(567,176)**	(11,934)
(Increase)/decrease in inventories		**(46,237)**	6,765
Increase in accounts payable, advances and other payables		**37,768**	64,313
Increase in taxes payable		**111,470**	58,064
Cash generated from operations		**160,772**	146,954
Income taxes paid		**(17,011)**	(20,636)
Interest paid		**(340,890)**	(221,832)
Net cash flows used in operating activities		**(197,129)**	(95,514)
Cash flows from investing activities:			
Purchase of property, plant and equipment		**(765,714)**	(662,326)
Proceeds from the sale of property, plant and equipment and investments		**3,198**	37,101
Increase in net investments in lease		**(57,898)**	(9,781)
Acquisition of subsidiary, net of cash acquired	**14**	**(114,892)**	–
Short-term loans provided to third parties		**(23,925)**	(9,500)
Short-term loans repaid by third parties		**23,925**	9,500
Interest received		**6,773**	5,161
Net cash flows used in investing activities		**(928,533)**	(629,845)
Cash flows from financing activities:			
Purchase of treasury shares		**(370,948)**	–
Proceeds from reissuance of treasury shares		**388,229**	–
Proceeds from borrowings		**4,963,653**	4,857,942
Repayment of borrowings		**(3,738,441)**	(4,031,408)
Repayment of long-term taxes restructured		**(92,442)**	(89,373)
Dividends paid		**(24,329)**	(12,425)
Net cash flows from financing activities		**1,125,722**	724,735
Effect of exchange rate changes on cash and cash equivalents		**3,723**	2,062
Net decrease/(increase) in cash and cash equivalents		**3,783**	1,438
Cash and cash equivalents at the beginning of the year		**39,796**	38,358
Cash and cash equivalents at the end of the year	7	**43,579**	39,796

The accompanying notes are an integral part of these financial statements.

UTair Aviation Joint-Stock Company

Consolidated Statement of Changes in Shareholders' Equity

For the Year Ended 31 December 2004

(in thousands of Russian Roubles)

	Notes	Share capital	Treasury shares	Surplus from reissuance of treasury shares	Revaluation reserve	Retained earnings	Total shareholders' equity
Balance at 31 December 2002	**20**	3,101,456	(18,511)	–	1,291,028	(2,887,608)	1,486,365
Amortization of revaluation reserve		–	–	–	(101,300)	101,300	–
Dividends		–	–	–	–	(17,316)	(17,316)
Net loss for the year		–	–	–	–	(482,043)	(482,043)
Balance at 31 December 2003	**20**	3,101,456	(18,511)	–	1,189,728	(3,285,667)	987,006
Amortization of revaluation reserve		**–**	**–**	**–**	**(119,652)**	**119,652**	**–**
Purchase of treasury shares		**–**	**(369,598)**	**–**	**–**	**–**	**(369,598)**
Sale of treasury shares		**–**	**373,869**	**13,010**	**–**	**–**	**386,879**
Dividends		**–**	**–**	**–**	**–**	**(24,918)**	**(24,918)**
Net profit for the year		**–**	**–**	**–**	**–**	**219,485**	**219,485**
Balance at 31 December 2004	**20**	**3,101,456**	**(14,240)**	**13,010**	**1,070,076**	**(2,971,448)**	**1,198,854**

The accompanying notes are an integral part of these financial statements.

(in thousands of Russian Roubles, unless otherwise stated)

1. The UTair Group and Its Operations

UTair Aviation Joint Stock Company ("the Company" or "UTair") and its subsidiaries (collectively "the Group") provide cargo and passenger services using helicopters and aircraft. The Group is the largest helicopter operator in Russia and provides cargo and passenger helicopter services on domestic market (mainly in oil and gas regions) and outside Russia. The Group operates five domestic airports located in Khanty-Mansijsk and Yamalo-Nenetzk region and aircraft-repair facilities where it provides airport and technical maintenance services for own air fleet as well as for other carriers. The UTair is involved in providing transport services for UN peacekeeper missions. UTair provides aircraft passenger services on domestic and international routes.

The parent company "UTair" was incorporated as an open joint stock company in the Russian Federation on 28 October 1992. The registered office of the Company is: Airport, Khanty-Mansijsk.

As of 31 December the Company's ordinary shares were owned by:

Name	**2004 % share**	**2003 % share**
OOO "La Manche" (Russia)	**19,99%**	–
OOO "Triseltco" (Russia)	**19,84%**	–
OOO "Polint" (Russia)	**18,80%**	–
OOO "Krajel" (Russia)	**17,00%**	–
Individuals	**16,86%**	17,23%
Other legal entities	**6,19%**	13,54%
Department of State Property of Khanty-Mansijsk Region (Russian State Agency)	–	26,99%
Administration of City of Surgut (Russian Municipal Agency)	–	18,80%
OOO "Zentroinvest" (Russia)	–	14,92%
OAO "Bank razvitia predprinimateljstva" (Russia)	–	5,83%
Treasury shares	**1,32%**	2,69%

1. The UTair Group and Its Operations (continued)

The Company has the following principal subsidiaries, which are included into the consolidated financial statements:

Entity	Activity	2004 % share	2003 % share
OOO "Zentr Realizazii Perevozok I Uslug" (Center for sale of transportation services)	General agent for air ticket sales	**100%**	100%
OOO "UTair Leasing"	Leasing company	**100%**	100%
NP "Zentr Professionalnoj Podgotovki" (Professional education center)	Education and certification services for cockpit personnel	**100%**	100%
ZAO "Tjumenjspezavia"	Air carrier	**100%**	100%
OOO "Tjumenjaviatechsnab"	Fixed assets and inventories supply	**100%**	100%
OOO "Zentr Aviazionnoj Bezopasnosti" (Center for air safety)	Organization of the Group's security	**100%**	100%
OOO "UTair Finance"	Finance services	**100%**	–
UTair South Africa (Pty) Ltd. (South African Republic)	Transportation services and technical support and maintenance of air fleet	**100%**	–
OAO "Komiinteravia"	Air carrier	**98.4%**	–
OOO "Irtyshaviatrans"	Air carrier	**73%**	73%
OOO "Zavod Nr. 26"	Repair and maintenance of air fleet	**55.8%**	55.8%
OOO "Zapadno-Sibirskoe Agentstvo Vozdushnyh Soobcheny" (West- Siberian Agency for ticket sales)	Sale of air tickets	**51%**	51%

All companies of the Group are incorporated under the Laws of the Russian Federation except the subsidiary in South Africa.

In 2004 the Group continued developing its network and acquired Komiinteravia airline, based in Syktyvkar, Russia (see Note 14). In the beginning of 2004 the Group registered a subsidiary in the South African Republic (UTair South Africa) in order to support services performed both for UNO and other clients in this region and provide base for own repair and maintenance facilities. At 31 December 2004 the Group employed approximately 6,484 employees (31 December 2003: 5,982). The Group's facilities are primarily based in Khanty-Mansijsk and Tymenj regions.

The consolidated financial statements of the Group for the year ended 31 December 2004 were authorized for issue on 30 June 2005 by the executive body of the Company.

2. Going Concern

The Group's negative cash flow from the operating activities for the year ended 31 December 2004 was 197,129. As of 31 December 2004, the Group's current liabilities were 3,357,041 and exceeded current assets by 936,975. The management believes that the current situation is related to the expansion of operations and the start of flights from new key airport (Vnukovo). In 2005 the Group is working on debt restructuring and lowering interest rate on borrowed funds and initiated cost cutting program. Based on these facts and taking into account the positive changes in the Group's profitability in 2004 (net income for the year ended 31 December 2004 was 219,485, and in particular operating profit was 86,733) and positive equity the management believes that the accompanying consolidated financial statements were appropriately prepared on the basis of accounting principles applicable to a going concern, which assumes that the Group will continue operations in the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. If going concern assumptions were not appropriate for these financial statements, adjustments would be necessary in the carrying value of assets and liabilities and in the reported revenues and expenses.

3. Basis of Presentation of the Financial Statements

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

Group companies 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 or of the country in which the particular subsidiary is resident. The financial statements are based on the statutory accounting records, with adjustments and reclassifications recorded for the purpose of fair presentation in accordance with IFRS. The principal adjustments relate to (1) expense and revenue recognition, (2) valuation allowances for unrecoverable assets, (3) depreciation and valuation of property and equipment, (4) accounting for income taxes, (5) measurement of financial instruments.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below.

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 the changes in the general purchasing power of the 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 only recognizes the cumulative impact of inflation indexing on non-monetary elements of the financial statements through 31 December 2002.

3. Basis of Presentation of the Financial Statements (continued)

Accounting for the Effect of Inflation (continued)

Non-monetary assets and liabilities acquired prior to 31 December 2002, and share capital transactions occurring before 31 December 2002, have been restated by applying the relevant conversion factors to the historical cost ("restated cost") through 31 December 2002, except for as measured at fair value. Gains or losses on subsequent disposal are recognised based on the restated cost of the non-monetary assets and liabilities.

Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates with regard to those financial statements relate to the useful lives of tangible and intangible assets, recoverability of amounts receivable, fair values of long-term liabilities and deferred taxation, as discussed in Notes 8, 10, 18 and 26.

4. Summary of Significant Accounting Policies

4.1 Principles of Consolidation

Subsidiaries

Subsidiaries, which are those entities in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over its operations, are consolidated. 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 group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Aircompany Komiinteravia has been included in the consolidated financial statements using the purchase method of accounting that measures the acquiree's assets and liabilities at their fair value at acquisition date. Accordingly, the consolidated financial statements include the results of Komiinteravia for the six month period from its acquisition on 1 July 2004.

UTair-Finance has been included in the consolidated financial statements from the date of inception (1 March 2004). Accordingly, the consolidated financial statements include the results of UTair-Finance for the ten month period.

UTair South Africa has been included in the consolidated financial statements from the date of inception (10 February 2004). Accordingly, the consolidated financial statements include the results of UTair South Africa for the ten month period.

4. Summary of Significant Accounting Policies (continued)

4.1 Principles of Consolidation (continued)

Acquisition of Subsidiaries

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of purchase consideration over the fair value of the Group’s share of identifiable net assets is recorded as goodwill. If the cost of the acquisition is less than the fair value of the Group’s share of identifiable net assets of the subsidiary acquired the difference is either recorded on the balance sheet as negative goodwill (for business combinations prior to 31 March 2004) or recognized directly in the statement of operations (for business combinations on or after 31 March 2004).

Minority interest is the interest in subsidiaries not held by the Group. Minority interest at the balance sheet date represents the minority shareholders' portion of the pre-acquisition carrying amounts and the minorities' portion of movements in equity since the date of the combination. Minority interest is presented separately from liabilities and shareholders’ equity.

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

4.2 Investments in Associates

Associates are entities in which the Group generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost including goodwill.

Subsequent changes in the carrying value reflect the post acquisition changes in the Group’s share of net assets of the associate. The Group’s share of its associates’ profits or losses is recognised in the statement of operations and its share of movements in reserves is recognised in equity. However, when the Group’s share of losses in an associate equals or exceeds its interest in the associate the Group does not recognise further losses, unless the Group is obligated to make further payments to, or on behalf of, the associate.

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.

4. Summary of Significant Accounting Policies (continued)

4.3 Investments

The Group classified its investments as available-for-sale. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

All purchases and sales of investments are recognised on the settlement date, which is the date that the investment is delivered to or by the Group. All investments are initially recognised at cost, being the fair value of the consideration given and including transaction costs. Available-for-sale investments are subsequently carried at fair value. Realised and unrealised gains and losses arising from changes in the fair value of available-for-sale investments are included in the statement of operations in the period in which they arise.

For investments that are actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on the balance sheet date. For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment.

4.4 Cash and Cash Equivalents

Cash comprises cash in hand and cash held on demand with banks.

4.5 Trade Receivables

Trade receivables are carried at original invoice amount less provision made for impairment of these receivables. 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 operations.

4. Summary of Significant Accounting Policies (continued)

4.6 Value Added Tax

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

Value Added Tax Payable

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

Value Added Tax Recoverable

VAT recoverable relates to purchases which have not been settled at the balance sheet date. VAT recoverable is reclaimable against sales VAT upon payment for the purchases.

4.7 Inventories

Inventories are recorded at the lower of cost and net realisable value. Cost of fuel is determined on the weighted average basis. Cost of other inventory is determined on the "first in – first out" (FIFO) basis. Net realisable value is the estimated selling price in the ordinary course of business, less selling expenses.

4.8 Property, Plant and Equipment

Aircraft, Helicopters, Engines and Buildings

Aircraft, helicopters, engines and buildings are measured at fair value less depreciation. Following initial recognition at cost, they are carried at a revalued amount which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and accumulated impairment losses. The Group involved independent appraisers to determine the fair value of aircraft, engines and buildings. The most recent valuation was performed at 1 January 2003.

Any revaluation surplus is credited to the asset revaluation reserve included in the equity section of the balance sheet. Any revaluation deficit directly offsetting a previous surplus in the same asset is directly offset against the surplus in the asset revaluation reserve.

An annual transfer from the asset revaluation reserve is transferred to retained earnings for the depreciation relating to the revaluation surplus. Additionally, accumulated depreciation as at revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

4. Summary of Significant Accounting Policies (continued)

4.8 Property, Plant and Equipment (continued)

Equipment and Assets under Construction

Other equipment is recorded at purchase or construction cost.

Impairment

At each reporting date the 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 statement of operations. 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

Depreciation for aircraft, helicopters and engines is computed using the straight-line method over the remaining useful lives defined in years by independent appraisers for each specific aircraft and engine. The remaining useful life varies from 1 to 30 years.

Depreciation for other property and equipment groups is computed using the straight-line method over the following estimated useful lives:

Buildings	20 to 50 years
Rotables	10 years
Equipment	8 years
Furniture	5 years
Vehicles	5 years
Office equipment	3 years

Accounting for Major Overhauls

Consistent with IAS 16 "Property, Plant and Equipment" the Group identifies as a separate component of its aircraft and engines an amount representing major overhaul and depreciates that component within the period to the next major overhaul to reflect the consumption of benefits, which are replaced or restored by the subsequent major overhaul. Amounts spent on major maintenance overhauls are subsequently capitalised as a separate component of an aircraft or an engine with a different useful life.

Repair and Maintenance

Repair and maintenance expenditure is expensed as incurred. Major renewals and improvements are capitalised and the assets replaced are retired. Gains and losses arising from the retirement of property, plant and equipment are included in the statement of operations as incurred.

4. Summary of Significant Accounting Policies (continued)

4.8 Property, Plant and Equipment (continued)

Borrowing Costs

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

4.9 Intangible Assets

Expenditures on acquired soft-ware licences are capitalised and amortised using the straight-line method over their useful lives, but not exceeding 20 years. Where an indication of impairment exists, the carrying amount of any intangible asset, is assessed and, when impaired, the asset is written down immediately to its recoverable amount.

4.10 Borrowings

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

4.11 Deferred Income Taxes

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from goodwill amortization or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

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.

4. Summary of Significant Accounting Policies (continued)

4.12 Foreign Currency Transactions

The functional and presentation currency of the Group is the national currency of the Russian Federation, Russian Ruble (RR). Transactions in foreign currencies are initially recorded in the functional currency at the rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the consolidated statement of operations. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of initial transaction.

4.13 Provisions

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

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

4.14 Revenue Recognition

Operating revenues comprise the invoiced value of airline and other services, net of any discounts and taxes.

Revenue from sales of tickets for regular flights is recognized in the period in which the service is provided. Unearned revenue represents tickets sold but not yet flown and is included in deferred income. It is released to the statement of operations as passengers fly. Unused tickets are recognized as revenue each year.

Sales of other services (cargo, charters, airport and technical support services) are recognised in the period the services are provided.

4.15 Employee Benefits

Pension Costs

In the normal course of business the Group contributes to the Russian Federation state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred.

Discretionary pensions and other post-employment benefits are included in labour costs in the statement of operations, however, separate disclosures are not provided as these costs are not material.

4. Summary of Significant Accounting Policies (continued)

4.15 Employee Benefits (continued)

Other Costs

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

4.16 Leases

One of the Group's subsidiaries is a leasing company entering the finance and operating lease agreements as a lessor. The leasing operations within the Group are eliminated during the consolidation.

Finance Lease

When assets are sold to the non-Group companies under a finance lease, the present value of the lease payments ("net investment in leases") is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return. The net investment in the lease and the related obligation to purchase the asset are recorded when the lease contract is signed. Any advance payments made by the lessee prior to commencement of the lease reduces the net investment in the lease.

Provisions against net investment in leases are based on the evaluation by management of the collectibility of the net investment in leases. Specific provisions are made against amounts whose recovery has been identified as doubtful. The aggregate provisions made as at the year-end are charged against statement of income for the year.

Settlements on equipment purchased for leasing purposes are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Operating Lease

Payments made under operating leases are charged against income in equal installments over the period of the lease.

4. Summary of Significant Accounting Policies (continued)

4.17 Equity

Treasury Shares

Where the Group or its subsidiaries purchases the Group's share capital, the consideration paid including any attributable transaction costs net of income taxes is deducted from total shareholders' equity as treasury shares until they are cancelled or reissued.

Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity separately. Treasury shares are stated at weighted average cost.

Dividends

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

4.18 Government Grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as other income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the statement of operations over the expected useful life of the relevant asset by equal annual installments.

5. Segment Information

The Group's primary reporting format is business segments and its secondary format is geographical segments. The operating businesses are organised and managed separately according to the nature of services provided, with each segment representing a strategic business unit that offers different services and serves different markets.

The Group is organised into two main business segments: transportation services performed by planes and transportation services performed by helicopters. The major part of services performed by planes is represented by regular flights. The major part of services performed by helicopters are charter flights. Other operations of the Group mainly comprise airport services, technical support and repairs of air fleet, neither of which are of a sufficient size to be reported separately.

The technical support and air fleet repairs are provided from other operations segment to the helicopters transportation segment. Transfer prices between business segments are set by mutual agreements of the parties involved in these transactions.

5. Segment Information (continued)

Unallocated costs represent corporate expenses. Segment assets consist primarily of property, plant and equipment and accounts receivable. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate borrowings. Capital expenditure comprises additions to property, plant and equipment. Impairment loss and provisions relate only to those charges made against allocated assets.

The following table presents revenue and profit and certain asset and liability information regarding the Group's business segments:

Year ended 31 December 2004	**Air planes**	**Helicopters**	**Other**	**Unallocated**	**Group**
External sales	**5,113,294**	**2,500,766**	**706,000**	**–**	**8,320,060**
Intersegment sales/costs	**–**	**(105,910)**	**–**	**105,910**	**–**
Segment result	**87,155**	**518,192**	**108,998**	**(627,612)**	**86,733**
Segment assets	**1,695,171**	**1,135,912**	**–**	**3,798,603**	**6,629,686**
Segment liabilities	**(146,900)**	**(19,132)**	**–**	**(5,201,776)**	**(5,367,808)**
Capital expenditure	**537,531**	**239,577**	**–**	**499,425**	**1,276,533**
Depreciation and amortization	**(151,397)**	**(130,575)**	**–**	**(136,619)**	**(418,591)**

Year ended 31 December 2003	**Air planes**	**Helicopters**	**Other**	**Unallocated**	**Group**
External sales	3,691,219	1,930,512	590,316	–	6,212,047
Intersegment sales/costs	–	(61,656)	–	61,656	–
Segment result	(167,193)	544,810	(65,383)	(707,393)	(395,159)
Segment assets	937,216	1,057,312	–	2,891,378	4,885,906
Segment liabilities	(56,143)	(111,616)	–	(3,682,285)	(3,850,044)
Capital expenditure	277,229	127,481	–	291,291	696,001
Depreciation and amortization	(87,349)	(108,980)	–	(116,283)	(312,612)

Secondary Reporting Format – Geographical Segments

The Group's business segments operate mainly within Russia. In addition, the Group provides helicopter transportation services outside Russia (primarily for UN). Sales are based on the geographical area in which the customer is located. There are no sales between the segments.

Year ended 31 December 2004	**Russia**	**Non-Russia**	**Group**
Segment sales	**6,731,315**	**1,588,745**	**8,320,060**
Segment costs	**(6,850,243)**	**(755,472)**	**(7,605,715)**
Unallocated operating expenses	**–**	**–**	**(627,612)**
Segment result	**(118,928)**	**833,273**	**86,733**
Segment assets	**6,225,106**	**404,580**	**6,629,686**
Capital expenditure	**1,238,182**	**38,351**	**1,276,533**

5. Segment Information (continued)

Secondary Reporting Format – Geographical Segments (continued)

Year ended 31 December 2003	**Russia**	**Non-Russia**	**Group**
Segment sales	5,369,603	842,444	6,212,047
Segment costs	(5,363,001)	(536,812)	(5,899,813)
Unallocated operating expenses	–	–	(707,393)
Segment result	6,602	305,632	(395,159)
Segment assets	4,571,283	314,623	4,885,906
Capital expenditure	694,368	1,633	696,001

6. Balances and Transactions with Related Parties

For the purpose of these financial statements the following related parties were identified in accordance with IAS 24 "Related Party Disclosures":

- enterprises that directly, or indirectly through one or more intermediaries control the Group;
- associates – enterprises in which the Group has significant influence and which is neither a subsidiary nor an interest in a joint venture;
- key management personnel;
- others.

The outstanding amounts due from related parties were as follows as of 31 December:

	2004	**2003**
Trade receivables (Note 8):		
Entities with joint control or significant influence over the Group	**5,596**	18,645
Associates	**10,227**	631
Others	**334**	415
	16,157	19,691
Prepayments (Note 8):		
Entities with joint control or significant influence over the Group	**353**	121
Associates	**224**	631
Others	**306**	207
	883	959
Loan receivable (Note 15):		
Key management personnel (interest-free, maturity date 31.12.2007)	**4,600**	6,220
Others (Note 8):		
Key management personnel	**605**	1,358
	22,245	28,228

6. Balances and Transactions with Related Parties (continued)

The balances are interest free and short-term, except for noted above. Most are related to Group's rendering transport services to the related parties. The balances are not guaranteed and not secured. The settlements are to be performed in cash. No doubtful debts due from related parties existed as of 31 December 2004 and 2003.

The Group also had cash of 368 and 1,938 held with entities with joint control or significant influence over the Group as of 31 December 2004 and 2003 respectively.

The outstanding amounts due to related parties were as follows as of 31 December:

	2004	2003
Trade payables (Note 16):		
Entities with joint control or significant influence over the Group	**–**	1,580
Associates	**32,203**	20,564
Others	**275**	311
	32,478	22,455
Advances received (Note 19):		
Entities with joint control or significant influence over the Group	**4,950**	1,164
Associates	**–**	101
Others	**30**	–
	4,980	1,265
Loans payable (Note 17):		
Entities with joint control or significant influence over the Group	**324,830**	433,904
Remuneration payable(Note 16):		
Key management personnel	**5,200**	6,342
	367,488	463,966

Trade payables are related to the purchase of airport services and duties and transportation services.

Loans payable are denominated in roubles, bear an interest of 15% per annum (174,830) and of 12% (150,000) as at 31 December 2004 and 15% per annum (433,904) as at 31 December 2003 and are payable according to the following schedule:

	2004	2003
2004	**–**	195,000
2005	**50,633**	238,904
2006	**217,043**	–
2007	**57,154**	–
	324,830	433,904

6. Balances and Transactions with Related Parties (continued)

316,657 and 343,742 of aircraft and engines were pledged as collateral to secure these loans as of 31 December 2004 and 2003, respectively.

The Group had the following transactions with related parties:

	2004	2003
Sales – transportation services:		
Entities with joint control or significant influence over the Group	**471,857**	598,335
Associates	**135,994**	16,805
Others	**2,707**	57
Total sales to related parties	**610,558**	615,197
Purchases – airport services and duties:		
Associates	**211,940**	195,904
Others	**11,752**	7,677
	223,692	203,581
Purchases – transportation services:		
Entities with joint control or significant influence over the Group	**3,974**	3,321
Purchases – insurance:		
Entities with joint control or significant influence over the Group	**28,469**	17,975
Interest expenses on loans payable:		
Entities with joint control or significant influence over the Group	**62,718**	70,765
Total purchases from related parties	**318,853**	295,642
Proceeds from borrowings:		
Entities with joint control or significant influence over the Group	**1,021,587**	1,786,779
Repayment of borrowings:		
Entities with joint control or significant influence over the Group	**(1,129,395)**	(1,788,593)
Net repayment of borrowings to related parties	**(107,808)**	(1,814)

Key management personnel comprised of fifteen members of Management Board and Board of Directors of the Group both as at 31 December 2004 and 2003, respectively. Total compensation to key management personnel included in general and administrative expenses in the statement of operations comprised 32,152 and 32,086 for the years ended 31 December 2004 and 2003, respectively. Compensation to key management personnel consists of contractual salary and performance bonus depending on operating results.

7. Cash and Cash Equivalents

Cash and cash equivalents were as follows as of 31 December:

	2004	2003
Denominated cash on hand and balances with banks	**43,211**	39,079
Foreign currency denominated balances with bank	**368**	717
	43,579	39,796

8. Accounts Receivable and Prepayments

	2004	2003
Trade receivables	**673,708**	518,010
Advances to suppliers	**493,223**	265,463
Other receivables – claims	**377,310**	358,867
VAT recoverable	**388,706**	211,086
Road users tax overpayment	**79,345**	–
Other taxes receivable	**45,516**	23,997
Prepaid expenses	**21,563**	19,854
Receivables from related parties (see Note 6)	**17,645**	22,008
Less: Provision for impairment of trade receivables	**(67,393)**	(70,154)
Provision for impairment of other receivables - claims	**(354,721)**	(310,238)
	1,674,902	1,038,893

Other receivables (claims) as at 31 December 2004 include 173,091 (2003: 149,934) of the compensation receivable from the Russian Ministry of Finance and local governmental bodies of some Russian regions for the free of charge transportation of privileged groups of passengers. In 2004 the Group filed a lawsuit against the Russian Ministry of Finance, which is now in progress. The outcome of this legal case is yet uncertain. The amount of claims outstanding as at 31 December 2004 includes also 160,304 (2003: 160,304) of receivables (principal debt, interest and penalties) from a supplier of aircraft resulted from the lawsuit filed by the Group against this supplier in 2002. The 100% provision for impairment of both claims receivable was created as at 31 December 2002.

The Group filed the amended road users tax return in 2004 declaring tax overpayments in 2001-2003 of 98,413.

252,030 and 205,302 of net trade receivables are denominated in foreign currency, mainly US Dollars, at 31 December 2004 and 2003, respectively.

8. Accounts Receivable and Prepayments (continued)

The following summarizes the changes in the provision for impairment of trade and other receivables for the years ended 31 December:

	2004	2003
Balance at the beginning of the year	**380,392**	300,871
Impairment charge for the year	**41,722**	79,521
Balance at the end of the year	**422,114**	380,392

9. Inventories

Inventories consist of the following as of 31 December:

	2004	2003
Fuel	**191,986**	102,456
Spare parts	**148,798**	142,465
Other inventories	**46,682**	47,999
On-board goods for resale	**10,180**	10,319
Provision for impairment for obsolescence	**(23,342)**	(20,163)
	374,304	283,076

At 31 December 2004 inventories of 339,655 (2003: 243,398) have been pledged as security for borrowings (Note 17).

10. Property, Plant and Equipment

Property, plant and equipment and related accumulated depreciation in 2003 consist of the following:

	Buildings	Aircraft and engines	Other	Assets under construction	Total
Cost					
Balance at 31 December 2002	1,154,062	1,527,054	755,019	102,305	3,538,440
Additions	86,143	484,436	114,551	10,871	696,001
Disposals	(98)	(13,140)	(62,885)	(46,856)	(122,979)
Balance at 31 December 2003	1,240,107	1,998,350	806,685	66,320	4,111,462
Accumulated Depreciation					
Balance at 31 December 2002	(3,742)	(19,086)	(570,424)	–	(593,252)
Depreciation charge	(49,199)	(213,737)	(48,112)	–	(311,048)
Disposals	–	1,586	50,027	–	51,613
Balance at 31 December 2003	(52,941)	(231,237)	(568,509)	–	(852,687)
Net Book Value					
Balance at 31 December 2002	1,150,320	1,507,968	184,595	102,305	2,945,188
Balance at 31 December 2003	1,187,166	1,767,113	238,176	66,320	3,258,775

10. Property, Plant and Equipment (continued)

Property, plant and equipment and related accumulated depreciation in 2004 consist of the following:

	Buildings	Aircraft and engines	Other	Assets under construction	Total
Cost					
Balance at 31 December 2003	**1,240,107**	**1,998,350**	**806,685**	**66,320**	**4,111,462**
Acquisition of a subsidiary	**6,568**	**463,307**	**12,611**	**–**	**482,486**
Additions	**63,638**	**415,799**	**86,814**	**227,796**	**794,047**
Disposals	**(18,966)**	**(48,713)**	**(49,403)**	**–**	**(117,082)**
Balance at 31 December 2004	**1,291,347**	**2,828,743**	**856,707**	**294,116**	**5,270,913**
Accumulated Depreciation					
Balance at 31 December 2003	**(52,941)**	**(231,237)**	**(568,509)**	**–**	**(852,687)**
Depreciation charge	**(49,168)**	**(306,302)**	**(59,064)**	**–**	**(414,534)**
Disposals	**2,525**	**10,269**	**35,949**	**–**	**48,743**
Balance at 31 December 2004	**(99,584)**	**(527,270)**	**(591,624)**	**–**	**(1,218,478)**
Net Book Value					
Balance at 31 December 2003	**1,187,166**	**1,767,113**	**238,176**	**66,320**	**3,258,775**
Balance at 31 December 2004	**1,191,763**	**2,301,473**	**265,083**	**294,116**	**4,052,435**

At 31 December 2004 and 31 December 2003 the gross carrying value of fully depreciated property, plant and equipment was 526,002 and 509,001, respectively.

Major overhauls capitalized comprised 125,732 and 122,624 in the years ended 31 December 2004 and 2003, respectively.

Bank borrowings are secured on properties to the value of 712,491 (2003: 575,363) (see Note 17).

The assets transferred to the Group upon privatisation do not include the land on which the Group's factories and buildings, comprising the Group's principal manufacturing facilities, are situated. The Group has the option to purchase this land upon application to the state registrator body or to continue occupying this land under a rental agreement. Russian legislation does not specify an expiry date to this option. At 31 December 2004 the Group has not filed any application to exercise the purchase option.

11. Net Investment in Leases

The net investment in leases resulting from the finance lease agreements entered by the Group as a lessor through its subsidiary, comprise the following:

	2004	2003
Gross investment in leases	**79,568**	13,221
Less: Unearned finance lease income	**(11,889)**	(3,440)
Net investment in leases	**67,679**	9,781

The interest rate incremental in the lease agreements varied between 17% and 27% p.a. depending on the total amount and duration of the contract as well as other terms. The amounts receivable under the lease agreements are secured by the assets leased out.

Gross investment in leases is payable in RR. The maturity structure of the net investment in lease is detailed as follows:

	2004	2003
Not later than 1 year	**30,084**	3,251
Later than 1 year and not later than 5 years	**37,595**	6,530
Total	**67,679**	9,781

Some of the leased out assets are pledged as collateral in accordance with the borrowing agreements with banks (Note 17). Related net investment in lease comprised 18,081 at 31 December 2004 (2003: 1,917). In addition, the accounts receivable in the amount of 1,835 were pledged as collateral in accordance with these agreements at 31 December 2004 (2003: 3,007).

12. Available-for-Sale Investments

Short-term available-for -sale investments are comprised of the following:

	2004	2003
Investment in trust	**117,471**	–
Promissory notes issued by financial institutions, interest-bearing	**58,061**	–
Promissory notes issued by non-financial institutions, non-interest bearing	**47,866**	16,574
	223,398	16,574

As of 31 December 2004, the amounts transferred to an investment company (trustee) were placed mainly in the interest-bearing long-term bonds issued by the Group (98,119, see Note 17), interest bearing publicly traded bonds issued by the governmental bodies (1,035) and interest bearing non-publicly traded bonds issued by the governmental bodies and third party companies (18,317). The trust agreement was terminated in the first quarter of 2005 when cash was repaid to the Group.

12. Available-for-Sale Investments (continued)

Long-term available-for-sale investments of the Group consist of investments in ordinary shares of unlisted Russian companies, have no fixed maturity date or coupon rate.

13. Investments in Associates

The Group has the following investments in associates:

Entity	Activity	2004 % share	2003 % share
OAO "Airport Surgut", Russia	Airport facilities and services in Surgut	**26%**	26%
ZAO "Kondaavia", Russia	Operating the airport facilities and airport services	**45.5%**	45.5%

The development of the investments in associates is as follows:

	2004	2003
Balance at 1 January	**83,043**	77,369
Share of income/(loss) before tax	**14,938**	9,013
Share of tax charge	**(5,345)**	(3,339)
Share of income/(loss) after tax	**9,593**	5,674
Balance at 31 December	**92,636**	83,043

14. Acquisition of Komiinteravia

In July 2004, the Group acquired 98,42% of the voting shares of Aircompany Komiinteravia, an open joint stock company based in Syktyvkar (Russia) specialising in regular passengers air transportation within Russia. Consideration was settled in cash.

The fair value of the identifiable assets and liabilities of Komiinteravia as at the date of acquisition are:

	Recognized on acquisition
Property, plant and equipment	482,486
Inventories	41,812
Trade and other receivables, prepaid expenses	151,879
Cash and cash equivalents	10
Trade payables	(54,287)
Accruals and other payables	(127,430)
Deferred tax liability	(82,675)
Minority interest	(6,653)
Fair value of net assets	**405,140**
Consideration paid:	114,902
Gain from acquisition	290,238
The cash outflow on acquisition is as follows:	
Net cash acquired with the subsidiary	10
Cash paid	(114,902)
Net cash outflow	**(114,892)**

14. Acquisition of Komiinteravia (continued)

The excess of the Group's interest in the net fair value of the subsidiary's identifiable net assets over costs is recognized immediately in the income statement. The gain recognized results from a bargain purchase. From the date of acquisition, Komiinteravia contributed 21,899 loss to the net result of the Group.

15. Other Non-Current Assets

	2004	2003
Receivables from related parties (Note 6)	**4,600**	6,220
Others	**1,045**	–
	5,645	6,220

16. Accounts Payable and Accrued Expenses

	2004	2003
Trade payables	**469,911**	403,028
Accrued payroll	**86,826**	71,976
Accrued liabilities and other creditors	**83,837**	81,117
Frequent Flyer Program accrual	**8,440**	4,179
Payables to related parties (Note 6)	**37,678**	28,797
Unused vacation accrual	**31,600**	27,194
Dividends payable	**5,481**	4,891
	723,773	621,182

5,958 and 1,228 of trade payables are denominated in foreign currency, mainly US Dollar, at 31 December 2004 and 2003, respectively.

17. Borrowings

	2004	2003
Current borrowings:		
Sberbank, Surgut branch (a)	**1,143,381**	751,440
Khanty-Mansijsky Bank (b)	–	202,776
Subirjgasbank (c)	–	50,000
Related parties (Note 6)	–	32,477
Others	**5,370**	322
Current portion of long-term borrowings:		
- related parties (Note 6)	**54,903**	143,192
- non-related parties	–	230,000
Promissory notes issued, short-term (d)	**645,951**	130,706
Total current borrowings	**1,849,605**	1,540,913
Long-term borrowings:		
Related parties (Note 6)	**324,830**	401,427
Sberbank, Surgut branch (e)	–	230,000
Khanty-Mansijsky Bank (f)	**65,000**	–
Less: Current portion of long-term borrowings:		
- related parties (Note 6)	**(54,903)**	(143,192)
- non-related parties	–	(230,000)
	334,927	258,235
Promissory notes issued, long-term (d)	**66,062**	–
Bonds (g)	**1,000,000**	–
Total long-term borrowings	**1,400,989**	258,235

The weighted average interest rate for the bank loans outstanding as at December 31, 2004 amounts to 10,4% (December 31, 2003 – 15,1%.)

(a) During 2004 the Group entered into a number of short-term loan agreements with Sberbank of Russia (Surgut branch) as follows:

- loan agreement to borrow 86,382. Loan bears matures on 12 January 2005. The loan is secured by cash inflows from Group sales in the monthly amount of 22,988;
- loan agreement to borrow 290,000. Loan bears matures on 12 January 2005. The loan is secured by collateral of property, plant and equipment;
- loan agreement to borrow 360,000. Loan matures on 13 December 2005. The loan is secured by collateral of property, plant and equipment and inventories and by cash inflows from Group sales in the monthly amount of 59,399;
- loan agreement to borrow 407,000. Loan matures on 16 December 2005. The loan is secured by collateral of property, plant and equipment and inventories and by cash inflows from Group sales in the monthly amount of 67,154.

17. Borrowings (continued)

In 2003 the Group entered in a number of short-term loan agreements with SberBank (Surgut Branch) to borrow in total 751,440. Loans were secured by collateral of property, plant and equipment and inventories.

(b) In 2003 the Group entered into the loan agreement with Khanty-Mansijsky Bank to borrow 202,776. The loan was secured by collateral of property, plant and equipment. The loan was payable on demand and it was repaid in 2004.

(c) In 2003 the Group entered into a short-term loan agreement with Sibirjgasbank to borrow 50,000. Loan was unsecured and payable on demand. The loan was repaid in 2004.

(d) Both in 2003 and 2004 the Group placed its short-term interest-bearing RR denominated promissory notes through an investment company in the amount of 645,951 (2003: 130,706). In 2004 the Group placed its interest-bearing denominated long-term promissory notes in the total amount of 66,062. The long-term notes are repayable as follows:

2006: 35,961
2007: 25,240
2008: 4,861

(e) In 2003 the Group entered into the RR denominated long-term loan agreement with SberBank (Surgut branch) to borrow 230,000. The loan matures on 6 April 2005. The loan was secured by collateral of property, plant and equipment. The loan was fully repaid in 2004.

(f) In 2004 the Group entered into the long-term loan agreement with Khanty-Mansijsky Bank to borrow 65,000. The loan matures on 21 December 2007. The loan is secured by collateral of property, plant and equipment.

(g) In 2004 the Group's subsidiary, UTair-finance, placed interest-bearing non-convertible bearer bonds (1,000,000 bonds 1,000 RR par value). The bonds were issued at 100% face value. The obligatory redemption date is 24 November 2006, no premature payments are allowed. The bonds have four semi-annual coupon periods; the interest rate is defined for each coupon period separately. The bonds issue is secured by the guarantee of the parent Company, UTair aviation Company, in the amount of 1,300,000.

18. Taxes Payable

Taxes payable are comprised of the following:

	2004	2003
State Pension Fund additional charges (overdue)	**144,910**	105,842
VAT deferred	**320,585**	172,585
Unified social tax	**7,619**	3,591
Value-added tax payable	**2,566**	94,367
Property tax	**2,268**	8,020
Other taxes	–	6,599
Current portion of taxes restructured to long-term	**105,271**	74,130
	583,219	465,134

In 2002-2004 the Group made an additional 14% accrual (calculated on the basis of salaries of cockpit personnel) based on demand from the State Pension Fund of Russia. This liability was paid in April 2005. No fines and penalties for the late payment were imposed by State Pension Fund of Russia.

Long-term taxes payable comprise various taxes payable as well as fines and penalties 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 Government Resolution Nr 1002 dated 3 September 1999 and Nr 699 dated 1 October 2001, as described below. The carrying value of this debt and its maturity profile is as follows:

	2004			2003		
	Federal and regional taxes	**Other state funds**	**Total**	**Federal and regional taxes**	**Other state funds**	**Total**
Current	**93,164**	**12,106**	**105,270**	62,042	12,088	74,130
1 to 2 years	**1,920**	**257,498**	**259,418**	110,853	11,533	122,386
2 to 3 years	**1,843**	–	**1,843**	26,150	290,194	316,344
3 to 4 years	**4,050**	–	**4,050**	34,493	–	34,493
4 to 5 years	**3,900**	–	**3,900**	35,364	–	35,364
Thereafter	**4,672**	–	**4,672**	39,187	–	39,187
Total restructured	**109,549**	**269,604**	**379,153**	308,089	313,815	621,904
Less: current portion of taxes payable	**(93,164)**	**(12,106)**	**(105,270)**	(62,042)	(12,088)	(74,130)
Long-term portion of restructured taxes	**16,385**	**257,498**	**273,883**	246,047	301,727	547,774

Long-term taxes payable have been recorded at fair value at the date of restructuring and are subsequently recorded at amortised cost. Fair value has been determined as the net present value of the future cash flows using a discount rate of 5.5%. The nominal amount of restructured tax liabilities as at 31 December 2004 is 406,991 (2003: 704,560).

18. Taxes Payable (continued)

The accumulated deficit as at 1 January 2003 includes 183,588 of the net gain on restructuring of tax debts. The net gain on restructuring of tax debt arose in the years of restructuring (2000-2002) from the application of Resolution Nr 1002 dated 3 September 1999 and Nr 699 dated 1 October 2001 and certain restructuring agreements which restructured current tax debts by deferring payment of liabilities to the federal and regional tax authorities and the pension and road funds to between 1 and 10 years free of interest or bearing an interest rate of 1/10 of rate established by the Central Bank of Russia. This restructuring constituted a substantial modification in terms of the difference between the recorded value of the tax liabilities prior to restructuring and the present value of the future cash flows of the restructured liabilities. The difference between the original amount and net present value of the restructured liabilities, using a discount rate of 5.5%, was accounted for as an extinguishment of debt. The increase of the carrying amount of tax debt in subsequent years as a result of unwinding of the discount is recognised in the statement of operations as interest expense.

At the same time in accordance with the above mentioned Resolutions in 2004 201,912 (2003: 441) of previously restructured fines and penalties were forgiven by the tax authorities reducing the Group's liabilities following the Group's compliance with the restructuring payment terms and early redemption of some restructured amounts.

19. Advances from Customers and Deferred Revenue

Advances from customers are comprised of the following:

	2004	2003
Advances from customers	**48,564**	53,664
Advances from related parties (Note 6)	**4,980**	1,265
Deferred revenue (air traffic liability)	**146,900**	56,143
	200,444	111,072

Advances from customers include the amounts received for transportation services to be performed, mainly from oil and gas companies. The air traffic liability represents the estimated value of sold but unused tickets as well as interline amounts due other carriers.

20. Shareholders' Equity

Total number of outstanding shares comprises:

	Number of outstanding ordinary shares (thousands)	Number of treasury shares (thousands)	Share capital	Treasury shares at costs	Premiums or discounts on transactions with treasury shares
At 31 December 2002	561,679	15,529	3,101,456	18,511	2,982
Sale of treasury shares	–	–	–	–	–
At 31 December 2003	561,679	15,529	3,101,456	18,511	2,982
Purchase of treasury shares	(179,823)	179,823	–	369,598	189,775
Sale of treasury shares	187,791	(187,791)	–	(373,869)	(187,078)
At 31 December 2004	**569,647**	**7,561**	**3,101,456**	**14,240**	**5,679**

The authorised number of ordinary shares is 577,208,000 (2003: 577,208,000), with a nominal value per share of 1 Russian Rouble. All authorised shares have been issued and fully paid.

Treasury shares represent ordinary shares held by the Company or by other Group subsidiaries.

A dividend was declared in 2004 in respect of 2003 to holders of ordinary shares of 0,043 Russian Rouble per ordinary share (2003: 0,03 Russian Rouble per ordinary share) in the total amount of 24,919 (2003: 17,316).

In accordance with Russian legislation, dividends may only be declared to the shareholders of the Group from accumulated undistributed and unreserved earnings as shown in the Company's Russian statutory financial statements. The OAO UTair Aviation Joint Stock Company had approximately 400,451 and 327,319 of undistributed and unreserved earnings as at 31 December 2004 and 2003, respectively. In addition, the Group's share in the undistributed and unreserved earnings of the OAO UTair Aviation Joint Stock Company's subsidiaries was approximately 232,103 and 95,133 as at 31 December 2004 and 2003, respectively.

21. Revenues

Revenues comprise:

	2004	2003
Aircraft transportation services, regular	**4,169,749**	3,042,696
Helicopters transportation services, abroad	**1,588,745**	842,444
Aircraft transportation services, charter	**943,545**	648,523
Helicopters transportation services, inland	**912,021**	1,088,068
Airport services	**210,700**	197,100
Technical support and maintenance services	**170,407**	121,547
Other revenues	**324,893**	271,669
	8,320,060	6,212,047

22. Direct Operating Expenses

Direct operating expenses included the following:

	2004	2003
Fuel	**1,848,074**	1,359,051
Airport services	**959,030**	802,905
Rent of air fleet and equipment	**438,204**	474,109
Passenger servicing	**271,905**	250,816
Air navigation and meteo	**209,178**	135,095
UNO missions support	**186,057**	70,539
Spare parts and other materials	**123,163**	121,286
Other direct operating expenses	**893,197**	440,004
	4,928,808	3,653,805

23. Personnel Expenses

Personnel expenses included the following:

	2004	2003
Remuneration	**1,155,574**	1,114,045
Social insurance charges	**337,012**	324,775
Other social payments	**6,803**	5,900
Accruals for vacation and bonuses	**4,406**	9,992
	1,503,795	1,454,712

24. Other Operating Income and Expenses

Other operating income/ (expenses) included the following:

	2004	2003
Tax claims of offset (see Note 8)	**98,413**	–
Government grants	**46,091**	91,709
Penalties receivable	**13,542**	12,816
Derecognition of accounts payable	**4,739**	42,991
Insurance coverage	**631**	3,039
Travel expenses	**(209,152)**	(140,491)
Insurance expenses	**(59,291)**	(44,239)
Consultating expenses	**(52,629)**	(34,312)
Utilities	**(52,373)**	(41,727)
Advertising	**(47,169)**	(28,222)
(Loss)/gain from disposal of fixed assets	**(65,029)**	7,416
Communication expenses	**(37,744)**	(33,460)
Bank charges	**(35,835)**	(33,087)
Provisions for Frequent Flyer Passengers program	**(4,261)**	(2,567)
Taxes	**(31,906)**	(59,274)
Training expenses	**(7,582)**	(8,225)
Release/ (addition) to provision for slow-moving inventory	**3,179**	(12,313)
Other operating income/(expenses)	**28,152**	(42,647)
	(408,224)	(322,593)

24. Other Operating Income and Expenses (continued)

Grants from local government are provided to UTair for the execution of regular flights to the distant regions in Russia's Western Siberia. The grants are provided both in form of cash remuneration for cover of losses from performing such flights and in form of reduced airport duties etc.

25. Financial Income/ (Expenses), net

Financial income/ (expenses) comprise of:

	2004	2003
Gain from operations with 3rd parties promissory notes	**24,639**	5,161
Interest receivable on loans issued to 3rd parties	**6,773**	548
Interest payable on bank loans (Note 17)	**(146,570)**	(113,480)
Interest/discounts payable on own promissory notes issued (Note 17)	**(117,189)**	(53,802)
Amortization of discount of restructured tax debts (Note 18)	**(51,606)**	(39,028)
Interest payable to related parties (Note 6)	**(62,718)**	(70,765)
Interest payable on bonds issued (Note 17)	**(12,822)**	–
Interest on restructuring payable to tax authorities (Note 18)	**(4,425)**	(9,180)
	(363,918)	(280,546)

26. Income Tax

	2004	2003
Income tax expense/(credit) – current	**72,647**	(79,634)
Deferred tax expense/(income) – origination and reversal of temporary differences	**(85,214)**	(126,796)
Income tax	**(12,567)**	(206,430)

Reconciliation between the income tax expense reported in the accompanying financial statements and income before taxes multiplied by the statutory tax rate of 24% is as follows:

	2004	2003
Profit/(Loss) before taxation	**214,433**	(677,211)
Theoretical tax charge/(benefit) at statutory rate of 24%	**51,464**	(162,531)
Tax effect of items which are not deductible or assessable for taxation purposes:		
Profit tax corrections for prior periods	–	(102,595)
Forgiveness of fines and penalties	**(45,727)**	(106)
Non-taxable income from acquisition of a subsidiary	**(70,357)**	–
Non-deductible expenses	**12,691**	13,354
Non-recognized deferred tax asset movement	**39,362**	45,448
Consolidated tax benefit	**(12,567)**	(206,430)

26. Income Tax (continued)

	31 December 2004	31 December 2003
Tax effects of deductible temporary differences:		
Property, plant and equipment	**313,174**	129,151
Provision for impairment of receivables	**99,906**	91,294
Timely recognition of expenses attributable to prepayments	**33,072**	60,985
Inventory in use write off and provision for obsolescence	**40,200**	27,510
Timely recognition of expenses attributable to accounts payable	**21,205**	18,619
Other provisions	**9,610**	7,530
Others	**8,295**	2,760
	525,462	337,849
Tax effects of taxable temporary differences:		
Property, plant and equipment	**(496,933)**	(427,156)
Discounting of restructured taxes payable	**(21,106)**	(18,926)
Others	**(10,925)**	(19,845)
	(528,964)	(465,927)
Net tax effect of temporary differences	**(3,502)**	(128,078)
Deferred tax liability resulting from purchase of a subsidiary	**(82,675)**	–
Less non-recognised deferred tax asset	**(217,018)**	(177,656)
Total net deferred tax liability	**(303,195)**	(305,734)

In the context of the Group's current structure, tax losses and current tax assets of the different companies may not be set off against current tax liabilities and taxable profits of other companies and, accordingly, taxes may accrue even where there is a net consolidated tax loss. Therefore, deferred tax asset of one company of the Group is not offset against deferred tax liability of another company. As at 31 December 2004, deferred tax asset in the amount of 211,570 (2003: 177,656) has not been recorded as it is not probable that sufficient taxable profit will be available to offset the deductible temporary differences to which the asset relates to.

The Group filed the amended profit tax return in 2003 declaring tax overpayments in 2001-2002 in the amount of 102,595. The part of these overpayments was offset against current profit tax liability as at 31 December 2004. The outstanding amount (79,345) as at 31 December 2004 will be offset against the future tax payables (profit tax or other taxes).

27. Minority Interest

	2004	2003
Balance at 1 January	**48,856**	37,594
Share of net income of subsidiaries	**7,515**	11,262
Acquisition of the subsidiary	**6,653**	–
Balance at 31 December	**63,024**	48,856

28. Earnings/(Loss) per Share

Earnings per share is calculated by dividing the net income attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period, excluding the average number of ordinary shares purchased by the Group and held as treasury shares (see Note 20).

The Group has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal basic earnings per share.

	2004	2003
Weighted average number of ordinary shares outstanding (thousands)	**577,208**	577,208
Adjusted for weighted average number of treasury shares (thousands)	**(11,045)**	(15,530)
Weighted average number of ordinary shares outstanding (thousands)	**566,163**	561,678
Net income/(loss)	**219,485**	(482,043)
Basic and diluted earnings per share	**0.39**	(0.86)

29. Adjustments to Opening Retained Earnings Related to the Transition to IFRS

2003 was the period when IFRSs were applied for the first time as the primary accounting basis. The major adjustments resulting from the transition to IFRSs posted as adjustments to the opening balance of retained earnings of 2003 were as follows:

Unadjusted retained earnings as of 1 January 2003	697,036
Effect of hyperinflationary accounting under IAS 29	(2,495,109)
Provisions and write-offs	(515,130)
Timely recognition of expenses and accrued liabilities	(481,482)
Not recognized deferred tax asset	(132,208)
Equity accounting for associates	73,186
Other	(33,901)
IFRS retained earnings as of 1 January 2003	**(2,887,608)**

30. Contingencies, Commitments and Operating Risks

Operating Environment of the Group

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

Taxation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavorable outcome. 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 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 uncertainty exists, the Company has accrued tax liabilities based on management's best estimate.

Management's estimate of the amount of potential liabilities that can be subject to different interpretations of the tax laws and regulations and are not accrued in the accompanying financial statements could be up to approximately 100,782. Management believes that it is not probable that the ultimate outcome of such matters would result in a liability.

Insurance Policies

The Group holds insurance policies in relation to its air fleet, cockpit personnel and in respect of public liability resulting from its transportation activities.

Legal Proceedings

During the year, 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 effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated financial statements.

31. Financial Risks

Credit Risk

Financial assets, which potentially subject Group entities to credit risk, consist principally of trade receivables. The Group has policies in place to ensure that sales of services are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. The Group's credit risk is substantially concentrated in amounts receivable from UNO: 252,030 or 42% of trade accounts receivable as at 31 December 2004 (2003: 205,302 or 46%). Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision already recorded.

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

Foreign Exchange Risk

The Group exports services (mainly under the agreement with UNO) and purchases goods and services abroad and is thus exposed to foreign exchange risk. Foreign currency denominated assets (see Note 7) and liabilities (see Note 16) give rise to foreign exchange exposure.

The Group does not have formal arrangements to mitigate foreign exchange risks of the Group's operations. However, management believes that the Group is secured from foreign exchange risks as foreign currency denominated sales are used to cover repayment of foreign currency denominated liabilities.

Fuel Price Risk

The results of the Group's operations may be significantly affected by the fluctuation of fuel prices which is a major expense of the Group. Due to the lack of an acceptable hedging market for fuel prices in Russia, the Group does not have financial instruments to hedge the fuel price risk.

Interest Rate Risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest-bearing long-term borrowings. The majority of interest rates on long-term borrowings are fixed, these are disclosed in Note 17. The Group has no significant interest-bearing assets.

32. Post Balance Sheet Events

A dividend was declared in 2005 in respect of 2004 to holders of ordinary shares of 0,056 Russian Roubles per share in the total amount of 32,324.

In May 2005 the Group paid the interest of 13% p.a. for the first coupon period on their non-convertible bearer bonds in the amount of 64,820.

32. Post Balance Sheet Events (continued)

In 2005 the Group has regained from the tax authorities 26,485 of road users' tax overpaid and the total amount of profit tax overpaid.

In April 2005 the Group filed the lawsuit against the State Pension Fund of Russia attempting to claim back additional 14% payment (see Note 18) made in April 2005 in amount of 145,000. The outcome of this lawsuit is not yet certain.