Open Joint Stock Company
Magnitogorsk Iron & Steel Works
and subsidiaries

Consolidated Financial Statements

for the year ended 31 December 2002

Contents

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 of 31 December 2002 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 45, 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 2002, 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
Moscow, Russian Federation
30 May 2003

Consolidated balance sheet

As at 31 December 2002

In millions of US dollars	Note	2002	2001
Assets			
Property, plant and equipment	13	2,125	1,853
Intangible assets	14	(2)	22
Investments in associates	15	1	55
Other investments	16	1	2
Other non-current assets	17	3	12
Total non-current assets		2,128	1,944
Inventories	18	231	233
Trade and other receivables	19	266	267
Other investments	16	11	3
Cash and cash equivalents	20	222	77
Total current assets		730	580
Total assets		2,858	2,524
Equity	21		
Share capital		363	26
Treasury shares		(22)	(23)
Additional paid in capital		16	-
Asset revaluation reserve		131	-
Retained earnings		1,319	1,543
Total equity		1,807	1,546
Minority interest		50	7
Liabilities			
Loans and borrowings	22	218	81
Employee benefits	24	22	21
Deferred tax liabilities	25	322	239
Other non-current liabilities		10	26
Total non-current liabilities		572	367
Bank overdrafts		6	-
Loans and borrowings	22	131	195
Trade and other payables	26	292	409
Total current liabilities		429	604
Total liabilities		1001	971
Total equity, minority interest and liabilities		2,858	2,524

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 3 to 45.

Consolidated income statement

For the year ended 31 December 2002 *In millions of US dollars, except earnings per share*	Note	2002	2001
Revenues	6	2,065	1,733
Cost of sales		(1,516)	(1,333)
Gross profit		549	400
Distribution expenses		(92)	(86)
General and administrative expenses	7	(230)	(165)
Social costs	8	(35)	(48)
Impairment and reversal of property, plant and equipment, net	13	150	34
Revaluation of property plant and equipment	13	(88)	-
Other operating expenses, net	9	(9)	(29)
Profit from operations		245	106
Impairment of investments in associates	15	-	(11)
Net financing costs	11	(43)	(12)
Profit before tax and minority interest		202	83
Income tax (expense)/benefit	12	(86)	58
Profit before minority interest		116	141
Minority interest		(1)	3
Net profit for the year		115	144

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 4 to 45.

Consolidated statement of cash flows

For the year ended 31 December 2002 *In millions of US dollars*	2002	2001
Operating activities		
Profit before tax and minority interest	202	83
Adjustments for:		
Depreciation and amortisation	220	206
Impairment and reversal of property, plant and equipment, net	(150)	(34)
Revaluation of property, plant and equipment	88	-
Impairment of investments in associates	-	11
Loss on disposal of property, plant and equipment	15	19
(Loss)/gain on other investments	2	(1)
Foreign exchange loss	9	-
Interest expense	38	19
Operating profit before changes in working capital	424	303
Decrease/(increase) in inventories	10	(35)
Decrease/(increase) in trade and other receivables	16	(74)
(Decrease)/increase in trade and other payables	(150)	145
Cash flows from operations before taxes and interest paid	300	339
Income taxes paid	(51)	(54)
Interest paid	(37)	(18)
Cash flows from operating activities	212	267
Investing activities		
Proceeds from disposal of property, plant and equipment	22	3
Proceeds from disposal of investments	52	-
Acquisition of property, plant and equipment	(204)	(287)
Acquisition of intangible assets	(8)	(14)
Acquisition of investments in associates	-	(64)
Acquisition of subsidiaries less cash acquired	(5)	(2)
Net cash flow from other investments	-	4
Cash flows to investing activities	(143)	(360)
Financing activities		
Proceeds from borrowings	440	310
Repayments of borrowings	(375)	(200)
Proceeds from the re-issuance of treasury shares	33	
Acquisition of treasury shares	(16)	(8)
Payments made under finance lease	(10)	(4)
Dividends paid	(2)	(2)
Cash flows from financing activities	70	96
Net increase in cash and cash equivalents	139	3
Cash and cash equivalents at beginning of year	77	74
Cash and cash equivalents at end of year	216	77

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 5 to 45.

Consolidated statement of changes in equity

For the year ended 31 December 2002

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 2001	20	6	(12)	(3)	-	-	1,402	1,413
Acquisition of treasury shares	-	-	(3)	(5)	-	-	-	(8)
Dividends	-	-	-	-	-	-	(3)	(3)
Net profit for the year	-	-	-	-	-	-	144	144
Balance at 31 December 2001	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
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

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 6 to 45.

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 73 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 which do not typically exist in other markets. The accompanying 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"), as promulgated by the International Accounting Standards Board ("IASB").

(b) Basis of consolidation

(i) Subsidiaries

Subsidiaries are those enterprises controlled by the parent company. Control exists when the parent company 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.

Accounting policies and notes to the consolidated financial statements

2. Basis of preparation continued

(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 accounted for on an equity accounting 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.

(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 and losses arising from transactions with associates are eliminated to the extent of the Group's interest in the enterprise. Unrealised gains and losses 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.

(c) Historical cost basis

The 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.

(d) Measurement and presentation currency

The national currency of the Russian Federation is the Russian rouble ("RUR"). The measurement and presentation currency used in the preparation of these financial statements is the United States dollar ("USD"). Management has determined the US dollar to be the measurement currency as they consider that the US dollar reflects the economic substance of the underlying events and circumstances of the Group. In making this assessment, management has considered the following matters:

- A significant portion of the Group's revenues are earned from exports, which are invoiced and collected in US dollars;
- A significant portion of the Group's property, plant and equipment purchases are imported and are invoiced and settled in US dollars;
- A significant portion of the Group's expenses are denominated and settled in US dollars; and
- The Group retains a significant portion of its sales proceeds in US dollars.

Accounting policies and notes to the consolidated financial statements

2. Basis of preparation continued

All financial information presented in US dollars has been rounded to the nearest million.

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

(e) 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.

(f) 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 financial statements and, except as otherwise stated, are consistent with those applied in the prior year.

(a) 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.

(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

(b) 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 (h)). This policy was changed on 31 December 2002 (refer note 4). 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 (h)). Operating lease payments are accounted for as described in accounting policy (p).

(iii) Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalised. 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	28-41 years
■ Machinery and equipment	10-30 years
■ Transportation equipment	8-21 years
■ Fixtures and fittings	3-11 years

(c) 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 (refer below) and impairment losses (refer accounting policy (h)). 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 (h)).

(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 (h)).

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 (refer below) and impairment losses (refer accounting policy (h)). 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

(d) Investments

Investments held for trading are classified as current assets and are stated at fair value, with any resultant gain or loss being recognised in the income statement. Where the Group has the positive intent and ability to hold debt securities to maturity, they are stated at amortised cost less impairment losses (refer accounting policy (h)). Other investments held by the Group are classified as being 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 investments available-for-sale is their quoted bid price at the balance sheet date.

An investment is recognised by the Group when it becomes a party to the contractual provisions of the investment. An investment is derecognised when the Group loses control over its contractual rights.

(e) Trade and other receivables

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

(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.

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

(g) 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.

(h) Impairment

The carrying amounts of the Group's assets, other than inventories (refer accounting policy (f)) and deferred tax assets (refer accounting policy (q)), 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 whenever 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.

(i) Share capital

(i) Preference share capital

Preference share capital that is non-redeemable 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.

(j) 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.

(k) 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 expert 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.

(l) 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.

(m) 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.

(n) Trade and other payables

Trade and other payables are stated at their cost.

(o) 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.

Accounting policies and notes to the consolidated financial statements

3. Significant accounting policies continued

(iii) Government grants

Government grants are recognised in the balance sheet initially as deferred income when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as revenue in the income statement on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are recognised in the income statement as revenue on a systematic basis over the useful life of the asset.

(iv) 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 17% (2001: 13%) of revenues and 18% (2001: 14%) of purchases in 2002 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.

(p) 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.

(q) 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.

(r) Comparative amounts

Comparative amounts were reclassified to separately identify insurance costs and VAT payable in the notes to the consolidated financial statements.

Accounting policies and notes to the consolidated financial statements

4. Change in accounting policy

With effect from 31 December 2002 the Group prospectively adopted the alternative treatment allowed by IAS 16 *Property, Plant and Equipment* with respect to the measurement of property plant and equipment in use. The alternative treatment allows property, plant and equipment to be carried at a revalued amount subsequent to initial recognition, being its fair value at the date of revaluation less any subsequent accumulated depreciation and impairment losses. Previously the Group had carried its property, plant and equipment at cost less accumulated depreciation and impairment losses. Management believes that the adoption of the new accounting policy results in a more relevant and reliable presentation of the Group's financial position and performance.

5. 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 6. 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 6.

6. Revenues

In millions of US dollars	**2002**	**2001**
Rolled steel	1,174	973
Assorted rolled products	191	225
Tin plated steel	133	199
Slabs	112	89
Band	94	85
Tubes	19	28
Other	342	134
	2,065	1,733

Regions in which products are sold by traders

	2002	**2001**
Russia and the CIS	48%	55%
Asia	21%	20%
Middle East	9%	12%
Europe	19%	11%
Other	3%	2%
	100%	100%

Accounting policies and notes to the consolidated financial statements

7. General and administrative expenses

In millions of US dollars	**2002**	**2001**
Wages, salaries and related taxes	51	44
Insurance costs	40	27
Services consumed	23	11
Depreciation	15	19
Amortisation of intangibles	8	8
Pension costs, net	3	1
Bank charges	9	8
Taxes other than profit tax	65	45
Other administrative expenses	16	2
	230	165

Insurance costs

During 2002 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 (ARR) Inc. and other licensed appraisers.

Transactions with related parties

OAO SKM

OAO SKM ("SKM") is an insurance company that provides insurance related services to the Group. The Group has the ability to exercise significant influence over the financial and operating policy decisions of SKM through the directors' controlling financial interest in OAO Trust Capital-M, a company in which the Group has no ownership.

The Group insured a significant portion of it risks through SKM, including the property, plant and equipment of the Parent Company. SKM reinsured its property risks with internationally recognised insurance companies, and other risks with OAO National Insurance Group ("NIG"), a Russian legal entity.

In 2002 total insurance expense incurred by the Group with SKM amounted to USD 26 million (2001: USD 20 million), of which USD 10 million relates to co-insurance contracts primarily with NIG. Payments made by the Company to SKM totalled USD 39 million (2001: USD 20 million). As at the balance sheet date the Group had recorded USD 13 million of insurance prepayments to SKM (2001: Nil). SKM received a commission of approximately 13% for the provision of these insurance services.

Accounting policies and notes to the consolidated financial statements

8. Social costs

In millions of US dollars	2002	2001
Social asset construction costs	11	31
Operational and maintenance expenses	24	17
	35	48

9. Other operating expenses, net

In millions of US dollars	2002	2001
Net loss/(gain) on sale of investments	2	(1)
Bad debts and change in accounts receivable provision, change in other provisions	9	17
Loss on disposal of property, plant and equipment	15	19
Other operating gain, net	(17)	(6)
	9	29

10. Personnel expenses

In millions of US dollars	2002	2001
Wages, salaries and related taxes included in:		
cost of sales	194	163
distribution costs	4	4
administrative expenses	54	44
	252	211

The average number of employees during the year ended 31 December 2002 was 56,000 (2001: 60,000).

11. Net financing costs

In millions of US dollars	2002	2001
Interest expense	38	19
Interest income	(4)	(2)
Net foreign exchange loss/(gain)	9	(5)
	43	12

Accounting policies and notes to the consolidated financial statements

12. Income tax expense/(benefit)

In millions of US dollars	**2002**	**2001**
Current tax expense		
Current year expense	65	51
Overprovided in prior years	(1)	(4)
	64	47
Deferred tax expense/(benefit)		
Origination and reversal of temporary differences (refer note 25)	22	5
Change in tax rate	-	(110)
	22	(105)
	86	(58)

The Parent Company's applicable tax rate is the corporate income tax rate of 24% (2001: 35%) and 24% for measuring deferred taxes (2001: 24%).

Reconciliation of effective tax rate

In millions of US dollars		**2002**		**2001**
Profit before tax and minority interest		202		83
Income tax at applicable tax rate	24%	48	35%	29
Non-deductible expenses	36%	39	96%	80
Tax incentives not recognised in the income statement	-	-	(7%)	(6)
Tax exemption	-	-	(56%)	(47)
Overprovided in prior years	(1%)	(1)	(5%)	(4)
Impact of change in tax rate	-	-	(133%)	(110)
	59%	86	(70%)	(58)

Accounting policies and notes to the consolidated financial statements

13. 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 2002	6,896	4,774	463	60	205	12,398
Additions	9	30	14	6	145	204
Acquisition of subsidiaries	35	29	-	-	-	64
Transfers	77	182	2	1	(262)	-
Disposals	(288)	(76)	(13)	(3)	(1)	(381)
Balance at 31 December 2002	6,729	4,939	466	64	87	12,285
Depreciation						
Balance at 1 January 2002	(6,535)	(3,544)	(418)	(48)	-	(10,545)
Charge for the year	(23)	(181)	(6)	(2)	-	(212)
Disposals	272	58	12	2	-	344
Balance at 31 December 2002	(6,286)	(3,667)	(412)	(48)	-	(10,413)
Revaluation and impairment at 31 December 2002						
Reversal of impairment	114	243	5	7	-	369
Revaluation increase	169	829	42	2	-	1,042
Revaluation decrease	(50)	(35)	-	(3)	-	(88)
Impairment	(223)	(808)	(30)	(9)	-	(1,070)
Carrying amount						
Balance at 1 January 2002	361	1,230	45	12	205	1,853
Balance at 31 December 2002	453	1,501	71	13	87	2,125
Carrying amount had no revaluation taken place at 31 December 2002	453	1,478	59	12	87	2,089

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.

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

13. 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.

Recognition of revaluation and impairment

The allocation of the results of the revaluation and impairment testing were applied to property, plant and equipment on an item-by-item basis. As a result, the following amounts were recognised in the income statement and statement of changes in equity:

	2002	
	Income statement	**Statement of changes in equity**
Reversal of impairment loss recognised in prior years	369	-
Revaluation increase	-	1,042
Impairment loss	(219)	(851)
Revaluation decrease	(88)	-
Impact on property, plant and equipment	62	191
Effect of deferred tax	(15)	(46)
Net impact on the income statement/statement of changes in equity	47	145

Borrowing costs

14. Borrowing costs incurred during 2002 of USD 10 million were capitalised as part of the cost of qualifying assets (2001: USD 4 million).

Accounting policies and notes to the consolidated financial statements

Intangible assets

In millions of US dollars	Negative Goodwill	Goodwill	Other intangible assets	Total
Cost				
Balance at 1 January 2002	-	6	25	31
Additions	(9)	-	8	(1)
Disposals	-	-	(3)	(3)
Adjustment arising from business combination (refer note 29)	(9)	(6)	-	(15)
Balance at 31 December 2002	(18)	-	30	12
Depreciation/Amortisation				
Balance at 1 January 2002	-	-	(9)	(9)
Charge for the year	2	-	(10)	(8)
Disposals	-		3	3
Balance at 31 December 2002	2	-	(16)	(14)
Carrying amount				
At 1 January 2002	-	6	16	22
At 31 December 2002	(16)	-	14	(2)

Negative Goodwill

Negative goodwill relating to the acquisition of OAO Magnitogorsky Kalibrovochny Zavod ("MKZ") and OAO Magnitogorsky Metizno-Metallurgiechesky Zavod ("MMMZ") is being recognised in the income statement over a period of 6 and 7 years, respectively.

Accounting policies and notes to the consolidated financial statements

15. Investments in associates

The Group has the following significant investments in associates:

	Country of incorporation	Ownership 2002	Ownership 2001	Voting interest 2002	Voting interest 2001
OAO Ugolnaya Kompania Kuzbassugol	Russia	-	26%	-	26%
ZAO Uralkord	Russia	50%	50%	50%	50%

Disposal of investments in associates

OAO Ugolnaya Kompania Kuzbassugol

In June 2002, the Group sold its 26% investment in OAO Ugolnaya Kompania Kuzbassugol ("Kuzbassugol") for USD 52 million. The difference between the acquisition price and disposal price of USD 11 million was recognised as an impairment loss in 2001. Consequently, no gain or loss on disposal of the investment was recognised in 2002.

Transactions with associates

Kuzbassugol
A loan provided by the Group to Kuzbassugol of RUR 100 million (USD 3 million) in 2001 was repaid during 2002.

Subsequent events
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.

16. Other investments

In millions of US dollars	2002	2001
Non-current investments		
Equity securities available-for-sale	1	2
	1	2
Current investments		
Equity securities available-for-sale	9	2
Equity securities held for trading	2	1
	11	3

Accounting policies and notes to the consolidated financial statements

17. Other non-current assets

In millions of US dollars	2002	2001
Loans to employees	2	1
Restricted cash	1	11
	3	12

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.

Transactions with related parties
OOO Kluch
OOO Kluch ("Kluch") is a construction company that constructs apartment buildings in the city of Magnitogorsk. The Group has the ability to exercise significant influence over the financial and operating policy decisions of Kluch through the positions that certain directors of the Group have on the board of directors of Kluch. As at 31 December 2002, the Group had loaned in aggregate USD 2 million (2000: USD 1 million) to certain employees of the Group in order for them to acquire apartments being constructed by Kluch. As at the balance sheet date the Group had guaranteed USD 5 million (2001: 4 million) of loans advanced to Kluch by third parties.

18. Inventories

In millions of US dollars	2002	2001
Raw materials and consumables	155	171
Work in progress	59	48
Finished goods and goods for resale	33	23
	247	242
Provision for obsolescence	(16)	(9)
	231	233

Accounting policies and notes to the consolidated financial statements

19. Trade and other receivables

In millions of US dollars	**2002**	**2001**
Trade accounts receivable	96	127
VAT receivable	119	101
Prepayments and advances	48	31
Other receivables	19	25
	282	284
Provision for doubtful debts (trade)	(16)	(17)
	266	267

Transactions with related parties

OOO MMK Louch

OOO MMK Louch ("Louch") is an intermediary trader controlled by the directors of the Group through the directors' controlling financial interest in OAO Trust Capital-M. During 2002 the Group made sales of USD 16 million to Louch. As at the balance sheet date the Group had received advances from Louch of USD 1 million.

20. 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	**2002**	**2001**
Foreign currency bank accounts	19	20
RUR bank accounts	16	15
USD short-term bank deposits	96	14
RUR short-term bank deposits	14	-
USD denominated liquid bank promissory notes	69	23
Other RUR denominated cash equivalents	8	5
Cash and cash equivalents per the balance sheet	222	77
Bank overdrafts	(6)	-
Cash and cash equivalents per the statement of cash flows	216	77

Accounting policies and notes to the consolidated financial statements

20. Cash and cash equivalents continued

Deposits with related parties

OAO Credit Ural Bank

The Group has cash and cash equivalents of USD 23 million (2001: USD 46 million) on deposit with OAO Credit Ural Bank ("CUB") in which certain directors of the Group have, in aggregate, a controlling financial interest. In their capacity as owners of CUB, these directors act solely for the benefit of CUB, and not in the interest of the Group.

CUB provided loans (refer note 22), overdrafts, customer and supplier settlements and employee payroll services to the Parent Company and to the majority of its subsidiaries. It is the intention of the Group to enter into such transactions at market prices.

The Group also incurred bank charges from CUB totalling USD 9 million for the year ended 31 December 2002 (2001: USD 9 million).

21. Equity

Share capital

At the Parent Company's annual shareholders meeting on 17 May 2002, shareholders approved a decision to increase the value of authorized ordinary and preference shares from RUR 6.6 million (USD 12 million) and RUR 2.2 million (USD 3 million), to RUR 8 billion (USD 252 million) and RUR 2.6 billion (USD 85 million), respectively, and approved a one thousand two hundred to one split of the Company's ordinary and preference shares. On 22 July 2002 MMK registered the share split and subsequently the shareholders received one thousand two hundred shares for every one share they owned as at 6 August 2002. All references in the consolidated financial statements to ordinary and preference shares and per share amounts have been restated retroactively for the share split, unless otherwise noted.

As at the balance sheet date, the authorised and issued share capital comprised of 7,972,665,600 ordinary shares (2001: 7,972,665,600) and 2,657,556,000 non-redeemable non-cumulative preference shares (2001: 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.

Accounting policies and notes to the consolidated financial statements

21. Equity continued

Issued and net outstanding shares comprised the following:

	Issued	Treasury shares	Net outstanding
Number of ordinary shares in thousands			
Balance at 1 January 2001	6,644	(2,342)	4,302
Acquisition of treasury shares	-	(171)	(171)
Balance at 31 December 2001	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
Number of preference shares in thousands			
Balance at 1 January 2001	2,215	(725)	1,490
Acquisition of treasury shares	-	(161)	(161)
Balance at 31 December 2001	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

Treasury shares

At the balance sheet date the Group held 2,540,785 thousand (2001: 3,014,954 thousand) of its own ordinary shares and 390,856 thousand (2001: 1,062,998 thousand) of its own preference shares. The Group also controls the voting rights of a further 2,018,835 thousand (2001: 143,043 thousand) of its own ordinary shares and 1,648,648 thousand (2001: 423,973 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.

During the year the Group re-issued treasury shares in the form of 808,415 thousand ordinary shares and 1,268,744 thousand preference shares for aggregate amounts of USD 25 million and USD 8 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 264,744 thousand ordinary and 509,767 thousand preference treasury shares were re-issued for aggregate amounts of USD 8 million and USD 3 million, respectively. These shares 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.

Accounting policies and notes to the consolidated financial statements

21. Equity continued

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 324 million (2001: USD 242 million). The Russian statutory profit after tax for the year was USD 99 million (2001: USD 208 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	**2002**	**2001**
RUR 0.011 per qualifying ordinary share (2001: RUR 0.008)	3	2
RUR 0.033 per preference share (2001: RUR 0.008)	3	1
	6	3

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.

Accounting policies and notes to the consolidated financial statements

21. Equity continued

Transactions with related parties

Conares Trading AG

A principal shareholder of the Parent Company appointed a representative to the Board of Directors of MMK. The appointed director also has a controlling financial interest in Conares Trading AG ("Conares"), a major export customer of the Group. During 2002 the Group made sales of USD 106 million (2001: USD 118 million) to Conares, and as at the balance sheet date Conares owed the Group USD 3 million (2001: USD 5 million).

The Government

The Government of the Russian Federation owned 23.8% of the voting shares of the Group as at 31 December 2002 (2001: 23.8%). The Government plans to sell its financial interest in the Parent Company at a special-purpose auction scheduled for June 2003.

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

22. Loans and borrowings

In millions of US dollars		Effective interest rate	2002	Effective interest rate	2001
Non-current liabilities					
Secured loans	- RUR, fixed	18%	74	20%	51
	- USD, variable	7%	19	7%	15
	- EUR, variable	-	-	6%	2
Unsecured loans	- USD, fixed	-	-	11%	1
	- EUR, fixed	10%	2	-	-
Unsecured bond issues	- EUR, fixed	11%	112	-	-
Finance lease liabilities	- USD, fixed	17%	3	11%	9
	- RUR, fixed	26%	4	24%	3
	- USD, variable	10%	4	-	-
			218		81
Current liabilities					
Secured loans	- RUR, fixed	22%	2	21%	68
	- RUR, variable	20%	8	-	-
	- USD, variable	4%	28	6%	28
Unsecured loans	- RUR, fixed	19%	7	18%	2
	- RUR, variable	21%	2	-	-
	- USD, variable	6%	22	7%	7
	- USD, fixed	9%	5	5%	48
Unsecured Russian bond issues	- RUR, fixed	19%	10	18%	34
Current portion of secured loans	- RUR, fixed	17%	20	-	-
Current portion of secured loans	- USD, variable	7%	19	7%	3
Current portion of finance lease obligations	- USD, fixed	12%	3	11%	3
	- RUR, fixed	25%	3	24%	2
	- USD, variable	10%	2	-	-
			131		195
Unutilised available borrowing facilities	- USD, variable		3		31

Issue of Eurobonds

On 18 February 2002 the Group issued 100,000 notes with a face value of Euro ("EUR") 1,000 each. The notes constitute unsecured and unsubordinated obligations of MMK Finance S.A. and rank pari passu with all other unsecured and unsubordinated present and future obligations of MMK Finance S.A. The notes were issued with a yield of 10.1%, maturing in three years. The Parent Company provided an unconditional, unsecured, and unsubordinated guarantee for the note issue.

A covenant to the note issue, which is specified in the Guarantee agreement, restricts the Parent Company, as Guarantor, from issuing a security interest where the aggregate consolidated secured debt will exceed 10% of the Guarantor's consolidated total assets, unless the same or similar security interest is provided to the noteholders. Exemptions exist under the covenant depending on the purpose for which the security interest is provided.

Accounting policies and notes to the consolidated financial statements

22. Loans and borrowings continued

The purpose of the note issue was primarily to refinance certain short-term obligations which existed at 31 December 2001, and to finance the Group's approved capital investment program.

Long-term debt repayment schedule

In millions of US dollars	Total	Current portion	2004	2005	2006
Secured bank loans					
- USD, variable	38	19	19	-	-
- RUR, fixed	94	20	31	30	13
Unsecured loans - EUR fixed	2	-	-	2	-
Unsecured bond issues - EUR, fixed	112	-	-	112	-
Finance lease liabilities					
- USD, fixed	6	3	1	1	1
- RUR, fixed	7	3	3	1	-
- USD, variable	6	2	2	1	1
	265	47	56	147	15

Finance lease liabilities
Finance lease liabilities are payable as follows:

	2002			2001		
In millions of US dollars	Payments	Interest	Principal	Payments	Interest	Principal
Less than one year	11	3	8	7	2	5
Between one and five years	13	2	11	11	3	8
More than five years	-	-	-	5	1	4
	24	5	19	23	6	17

As at the balance sheet date leased assets with a carrying amount of USD 14 million were included in property, plant and equipment (2001: USD 17 million).

Transactions with related parties
CUB
During 2002 the Group obtained additional loans and overdraft financing from CUB totalling USD 249 million (2001: USD 201 million) and made repayments to CUB totalling USD 241 million (2001: USD 179 million). As at the balance sheet date the Group had loans outstanding to CUB of USD 14 million (2001: USD 3 million), which includes an overdraft USD 2 million (2001: USD 1 million).

CUB also had outstanding loans as at the balance sheet date with related and third parties totalling USD 5 million and 2 million, respectively (2001: USD 5 million to related parties only), that were guaranteed by the Group (refer note 32).

Accounting policies and notes to the consolidated financial statements

22. Loans and borrowings continued

Total interest incurred by the Group on loans and overdraft financing amounted to USD 2 million (2001: USD 2 million).

OOO Leasing-M
OOO Leasing-M ("Leasing-M") provided leased equipment to the Group under an agreement which in substance is a finance lease. OAO Trust Capital-M retains a financial interest in Leasing-M which enables the Group to influence its financial and operating policy decisions.

The lease agreement is comprised of both Russian rouble and US dollar denominated components which have implicit interest rates of 26% and 10% per annum, respectively. As at the balance sheet date, the Group has outstanding finance lease obligations to Leasing-M of USD 9 million (2001: USD 8 million), and incurred interest of USD 1 million in 2002 (2001: USD 2 million). The Group has net amounts due to Leasing-M of USD 1 million, after the offset of advance payments made by the Group.

Subsequent events

On 17 March 2003 the Group received a USD 100 million medium term syndicated loan at a floating rate of Libor + 4.25% for a period of 3 years. A major customer (trader) of the Group, "MMK Metal Limited" provided a guarantee as security for this loan to the Group.

On 17 April 2003 the Group signed a USD 32 million loan agreement with a floating rate of Libor + 0.45% for a term of 7 years. The loan will be utilised by the Group to purchase equipment. The equipment will be pledged as security for the loan.

On 9 April 2003 the group issued 900,000 notes with a face value of RUR 1000 each. The notes were issued with a yield of 9.75% maturing 740 days after date of issue.

Accounting policies and notes to the consolidated financial statements

23. Pledges provided by the Group

The Group has pledged property, plant and equipment and inventory of USD 307 million (2001: USD 870 million) and USD 128 million (2001: USD 130 million), respectively. The Group has also pledged export contracts totalling USD 102 million (2001: USD 102 million), and 75% (2001: 75%) of the ordinary shares of a subsidiary, which had net assets of USD 13 million (2001: USD 12 million) at the balance sheet date.

The Group is subject to the following pledges as at 31 December 2002:

In millions of US dollars	Note	2002	2001
Short-term			
Pledges provided for the debt of related parties	26	-	61
Pledges provided for the debt of the Group	22	66	599
Pledges provided for the debt of third parties		-	9
Long-term			
Pledges provided for the debt of the Group	22	484	438
		550	1,107

24. 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 63) per employee. In 2002 contributions made by the Group to the fund were USD 3 million (2001: USD 1 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 2002 total payments made to the state pension fund totalled USD 28 million (2001: 27 million). These amounts are expensed when incurred and are recorded in taxes related to personnel expenses (refer note 10).

Accounting policies and notes to the consolidated financial statements

24. 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 7.58) per retiree (2001: RUR 200, USD 6.64), 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	**2002**	**2001**
Liability for defined benefit obligations	22	21

Movements in the liability recognised in the balance sheet:

In millions of US dollars	**2002**	**2001**
Liability at 1 January 2002	21	21
Payments made during the year	(2)	(2)
Expenses recognised in the income statement	3	2
Liability at 31 December 2002	22	21

Expenses recognised in the income statement:

In millions of US dollars	**2002**	**2001**
Interest costs	4	4
Current service costs	-	-
Actuarial gain	-	(1)
Foreign exchange gain	(1)	(1)
	3	2

Current service costs and actuarial gains and losses are recognised in administrative expenses in the income statement (refer note 7).

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

	2002	**2001**
Discount rate at 31 December	18.6%	22.2%
Future retirement benefit increases	16.3%	19.8%

Accounting policies and notes to the consolidated financial statements

25. 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	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**
Property, plant and equipment	10	3	(329)	(254)	(319)	(251)
Investments	1	-	(5)	(3)	(4)	(3)
Inventories	2	34	(5)	(2)	(3)	32
Trade and other accounts receivable	4	5	(3)	(27)	1	(22)
Trade and other accounts payable	7	5	(4)	-	3	5
Loans and borrowings	1	-	(1)	-	-	-
Tax assets/(liabilities)	25	47	(347)	(286)	(322)	(239)
Set-off of tax	(25)	(47)	25	47	-	-
Net tax liabilities	-	-	(322)	(239)	(322)	(239)

As at 31 December 2002 a deferred tax liability of USD 28 million (2000: USD 3 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 02**	**Recognised in income**	**Recognised in equity**	**Acquisition of subsidiary**	**Balance 31 Dec 02**
Property, plant and equipment	(251)	7	(48)	(13)	(319)
Investments	(3)	(1)	-	-	(4)
Inventories	32	(35)	-	-	(3)
Trade and other receivables	(22)	23	-	-	1
Trade and other payables	5	(2)	-	-	3
	(239)	(22)	(48)	(13)	(322)

Accounting policies and notes to the consolidated financial statements

26. Trade and other payables

In millions of US dollars	**2002**	**2001**
Trade accounts payable	127	182
Amounts payable to related parties	6	45
Advances from customers	53	32
VAT payable	16	19-
Other taxes payable	48	36
Provision for litigation	8	17
Payables to employees	9	9
Other current and accrued liabilities	25	69
	292	409

Provision for litigation
In 2002 the Group released USD 10.8 million of a USD 17.3 million provision previously recognised for litigation initiated by Polska Kasa bank against the Parent Company under a guarantee it had provided to Tokobank that went into bankruptcy in 1999. On 29 May 2002 the International Commercial Court of the Russian Federation reduced the amount of the claim and ruled that the Parent Company must pay an amount of USD 6.5 million to Polska Kasa bank. The Parent Company is continuing to defend itself through legal proceedings against this decision.

Transactions with related parties
ZAO Vostokprominvest
ZAO Vostokprominvest ("Vostokprominvest") is an intermediary trader controlled by directors of the Group through their controlling financial interest in OAO Trust Capital-M.

In 2002 the Group purchased coal, iron ore and other raw materials from ZAO Vostokprominvest totalling USD 18 million (2001: USD 89 million) at a margin of approximately 9%. Total accounts payable due to Vostokprominvest as at 31 December 2002 were USD 437 thousand (2001: USD 37 million).

In 2001 the Group provided a guarantee and pledged assets with a book value of USD 53 million for loans and a bank credit facility obtained by Vostokprominvest. These guarantee and pledge agreements expired during 2002.

In May 2002 the Group ceased to use this intermediary trader for the supply of raw materials.

ZAO Profit
ZAO Profit is an intermediary trader that supplies scrap to the Group. The Group has the ability to exercise significant influence over the financial and operating policy decisions of ZAO Profit ("Profit") through immediate family relationships which exist between senior directors of MMK and Profit.

In 2002 the Group purchased scrap metal totalling USD 86.4 million (2001: USD 63 million) from Profit, representing approximately 92% of the Group's scrap metal purchases. Total accounts payable as at 31 December 2002 amounted to USD 4.6 million (2001: USD 7.9 million). In addition, the Group sold USD 6.3 million (2001: USD 6.8 million) of metal products to Profit, of which an amount of USD 232 thousand was outstanding at the balance sheet date.

Accounting policies and notes to the consolidated financial statements

26. Trade and other payables continued

In 2001 the Group pledged scrap metal with a book value of USD 8 million as security for a loan obtained by Profit. The pledge agreement expired during 2002.

In 2002 the Group guaranteed a USD 16.2 million credit facility obtained by Profit. As at the balance sheet date Profit had drawn down an amount of USD 2 million against this facility.

Accounting policies and notes to the consolidated financial statements

27. Subsidiary companies

The following is a list of significant subsidiaries:

	Country of incorporation	Effective ownership 2002	Voting Interest 2002	Effective ownership 2001	Voting Interest 2001
MMK Finance SA	Luxembourg	97%	97%	97%	97%
MMK Steel Trade AG	Switzerland	100%	100%	100%	100%
MMK Trading AG	Switzerland	100%	100%	-	-
ZAO A Kapital	Russia	100%	100%	100%	100%
OOO Avtotransportnoye Upravleniye	Russia	100%	100%	100%	100%
ZAO Agropromishleny Complex	Russia	100%	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	100%	100%	100%	100%
ZAO Glubokaya Pererabotka	Russia	51%	51%	51%	51%
ZAO IK RFC	Russia	100%	100%	100%	100%
OOO Interlux	Russia	51%	51%	51%	51%
ZAO Komplex Glubokoy Pererabotki	Russia	51%	51%	96%	96%
ZAO Magma	Russia	100%	100%	100%	100%
OAO Magnitogorsky Kalibrovochny Zavod	Russia	83%	83%	65%	65%
OAO Magnitogorsky Metizno-Metallurgiechesky Zavod	Russia	73%	91%	30%	37%
OAO MCOZ	Russia	56%	56%	56%	56%
ZAO Meharnoremont	Russia	51%	51%	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	62%	62%	-	-
OOO Minimax	Russia	60%	60%	60%	60%
OOO MMK-Trans	Russia	49%	50%	49%	50%
ZAO Ogneupor	Russia	56%	100%	56%	100%
OOO Press-5P	Russia	45%	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 SK Remsroy	Russia	100%	100%	100%	100%
ZAO Staleprokatny Zavod	Russia	100%	100%	100%	100%
ZAO Stroitelny Fond	Russia	100%	100%	99%	99%
ZAO Stroitelny Komplex	Russia	100%	100%	100%	100%
OOO TEK MMK	Russia	98%	98%	98%	98%
ZAO Torgovlya and PPP	Russia	79%	73%	79%	73%
OOO Vekselny tsentr MMK	Russia	100%	100%	100%	100%

Accounting policies and notes to the consolidated financial statements

27. Subsidiary companies continued

In April 2002 the Group established a new subsidiary, MMK Trading AG, to be primarily engaged in the trade of steel products manufactured by the Parent Company.

28. Acquisition of subsidiaries

OAO Magnitogorsky Metizno-Metallurgiechesky Zavod
In May 2002 the Group acquired a further 43% effective ownership in MMMZ for USD 3.4 million, increasing the Group's total effective ownership to 73%. The net loss attributable to this subsidiary for the 7 months ended 31 December 2002 was USD 1 million.

OAO Magnitogorsky Kalibrovochny Zavod
In April 2002 the Group acquired a further 18% effective ownership in MKZ for USD 104 thousand, increasing the Group's total effective ownership to 83%. The net loss attributable to this subsidiary for the 8 months ended 31 December 2002 was USD 1 million.

Effect of acquisitions
The acquisition of subsidiaries had the following effect on the Group's assets and liabilities on acquisition date:

In millions of US dollars	**Effect of acquisition 2002**	**Effect of acquisition 2001**
Property, plant and equipment	64	7
Inventories	8	4
Trade and other receivables	6	2
Investments	4	1
Interest-bearing loans and borrowings	(6)	(3)
Deferred tax asset/(liabilities)	(13)	2
Trade and other payables	(9)	(13)
Long-term tax payables	-	(4)
Minority interest	(15)	-
Net identifiable assets and liabilities	39	(4)
Goodwill/(negative goodwill) on acquisition	(24)	6
Revaluation reserve arising from step acquisition	(10)	-
Consideration paid, satisfied in cash	5	2
Cash acquired	-	-
Net cash outflow	5	2

Accounting policies and notes to the consolidated financial statements

28. Acquisition of subsidiaries continued

Changes in value of identifiable assets and liabilities

Subsequent to the acquisition of MKZ in 2001, additional information became available to better determine the amounts assigned to the identifiable assets and liabilities of the subsidiary when the acquisition was initially recognised.

The identifiable assets and liabilities were increased to reflect the results of an independent appraisal of property, plant and equipment performed in 2002, the reinstatement of an equity investment in Uralcord that the Group entered into a binding agreement to sell, and relief obtained from the restructuring of tax liabilities with the Russian tax authorities. The adjustment has been included in the effect of acquisitions in 2002. The majority of the adjustment relates to the change in the value of property, plant and equipment, and a corresponding adjustment has been made to the amount of goodwill initially recognised on acquisition (refer note 14).

The adjustment had no impact on the amount of amortization recognised in 2001 as control of the subsidiary was acquired at the end of 2001.

29. 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 (refer note 20). 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 22. 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.

Accounting policies and notes to the consolidated financial statements

29. Financial instruments continued

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 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 2002, the carrying amount of fixed rate long-term debt (including finance lease liabilities) was USD 195 million (2001: USD 64 million). The fair value of fixed rate long-term debt, based on the estimated market values for debt instruments with similar characteristics, was USD 200 million (2001: USD 65 million).

Accounting policies and notes to the consolidated financial statements

30. Related party transactions

Related party disclosures are included in notes 7, 15, 17, 19, 20, 21, 22, 23, 24, 26 and 32.

31. Commitments

(i) Capital commitments

The Group is committed to capital expenditure of approximately USD 11 million (2001: USD 77 million).

(ii) Social commitments

The Group makes contributions to mandatory and voluntary social programs (refer note 8). 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.

32. 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	Note	2002	2001
Non-current			
Related party supplier - Kluch	17	1	5
Related party supplier - Vostokprominvest	27	-	10
Current			
Related party supplier - Profit	27	2	-
Related party supplier - Vostokprominvest	27	-	21
Related party supplier - Kluch	17	4	-
Third party suppliers	-	2	
		9	36

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 23). Management believes that the likelihood of material payments being required under these agreements is remote. As at 31 December 2002 the Group did not have any contractual commitments to extend financial guarantees, credit or other assistance.

Accounting policies and notes to the consolidated financial statements

32. Contingencies continued

(ii) Litigation

Unresolved claims and litigation against the Group as at 31 December 2002 amounted to USD 8 million (2001: USD 4 million). These include a large number of small claims and litigation relating to sales made to domestic customers and purchases of goods and services from suppliers. Based on experience in resolving such matters, management believes that these will be resolved without material loss to the Group and, accordingly, no provision has been made for these unresolved claims and litigations.

(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 Russia substantially more significant than in other countries. Management believes that it has adequately provided 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 which 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 believes 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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