OAO Scientific Production Corporation "Irkut"

Consolidated Financial Statements

for the year ended 31 December 2003

Contents

KPMG Limited

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Independent Auditors' Report

To the Board of Directors of OAO Scientific Production Corporation "Irkut"

We have audited the accompanying preliminary consolidated balance sheet of OAO Scientific Production Corporation "Irkut" and its subsidiaries (the "Group") as of 31 December 2003 and the related preliminary consolidated statements of income, changes in equity and cash flows for the year then ended. These preliminary consolidated financial statements, as set out on pages 4 to 29, are the responsibility of the Group's management. They have been prepared as part of the Group's conversion to International Financial Reporting Standards (IFRSs). Our responsibility is to express an opinion on these financial statements based on our audit. The examination of certain underlying documentation on sales, cost of sales, inventories and fixed assets were performed by another auditor due to the circumstances described in 1 (b) to the consolidated financial statements. Our audit opinion, insofar as it relates to the examination of such documentation, is based on the work of this auditor.

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 accompanying preliminary consolidated financial statements of the Group as of and for the year ended 31 December 2003 have been prepared, in all material respects, in accordance with the basis set out in note 2 (a), which describes how IFRSs have been applied under IFRS 1 *First-time Adoption of IFRSs*, including the assumptions management has made about the standards and interpretations expected to be effective, and the policies expected to be adopted, when management prepares its first complete set of IFRS financial statements as of and for the year ended 31 December 2004.

Without qualifying our opinion, we draw attention to the fact that note 2 (a) explains why there is a possibility that the accompanying preliminary consolidated financial statements may require adjustment before constituting the comparative information in the Group's first IFRS consolidated financial statements. Moreover, we draw attention to the fact that, under IFRSs, only a complete set of consolidated financial statements comprising a balance sheet, income statement, statement of changes in equity and cash flow statement, together with comparative financial information and explanatory notes, can provide a fair presentation of the Group's financial position, results of operations and cash flows in accordance with IFRSs.

KPMG Limited
Moscow, Russian Federation
8 September 2004

	Note	2003 '000 USD
Revenues	5	522,025
Cost of sales		(315,093)
Gross profit		**206,932**
Research and development costs		(10,923)
Distribution expenses		(58,420)
Administrative expenses		(35,494)
Taxes, other than on profit		(9,117)
Other operating expenses	7	(17,719)
Profit from operations		**75,259**
Net financing costs	8	(74,141)
Loss from associates		(733)
Profit before tax		**385**
Income tax benefit	9	565
Profit for the year		**950**
Minority interest		865
Net profit for the year		**1,815**
Basic and diluted earnings per share (USD)		0.002

The consolidated financial statements were approved on 8 September 2004:

Senior Vice-President
Tsivilev S.V.

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 8 to 29.

	Note	2003 '000 USD	2002 '000 USD
ASSETS			
Non-current assets			
Property, plant and equipment	10	169,188	152,653
Intangible assets	11	38,304	22,363
Investments in associates		7,914	7,669
Other investments and non-current financial assets	12	19,579	22,293
		234,985	**204,978**
Current assets			
Investments	12	36,438	65,058
Inventories	13	200,210	206,875
Trade and other receivables	14	264,421	144,252
Cash and cash equivalents	15	13,146	22,217
		514,215	**438,402**
Total assets		**749,200**	**643,380**
EQUITY AND LIABILITIES			
Equity	16		
Share capital		84,183	84,183
Foreign currency translation reserve		574	-
Accumulated losses		(51,117)	(50,606)
		33,640	**33,577**
Minority interest		**25**	**890**
Non-current liabilities			
Loans and borrowings	17	245,447	104,393
Deferred tax liabilities	18	2,996	3,606
		248,443	**107,999**
Current liabilities			
Loans and borrowings	17	337,870	460,330
Trade and other payables	19	122,289	33,898
Provisions	20	6,933	6,686
		467,092	**500,914**
Total equity and liabilities		**749,200**	**643,380**

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 8 to 29.

	2003 ’000 USD
OPERATING ACTIVITIES	
Profit before tax	385
Adjustments for:	
Depreciation and amortisation	16,378
Unrealised foreign exchange differences	18,491
Impairment of loans and bad debts	2,305
Loss on disposal of property, plant and equipment	2,019
Loss from associates	733
Loss from investments	2,519
Interest expense	70,239
Interest income	(5,130)
Operating profit before changes in working capital and provisions	**107,939**
Decrease in inventories	6,665
Increase in trade and other receivables	(105,999)
Increase in trade and other payables	88,352
Increase in provisions	247
Cash flows from operations before income taxes and interest paid	**96,957**
Income taxes paid	(998)
Interest paid	(70,368)
Cash flows from operating activities	**25,838**
INVESTING ACTIVITIES	
Proceeds from disposal of property, plant and equipment	114
Acquisition of property, plant and equipment	(28,981)
Acquisition of intangible assets	(16,606)
Loans advanced to related parties	(14,167)
Acquisition of subsidiaries and associates	(5,804)
Net cash received from disposal of investments	17,660
Interest received	5,130
Cash flows from investing activities	**(42,654)**
FINANCING ACTIVITIES	
Proceeds from borrowings	367,946
Repayment of borrowings	(358,520)
Dividends paid	(2,287)
Cash flows from financing activities	**7,139**
Net decrease in cash and cash equivalents	**(9,677)**
Cash and cash equivalents at beginning of year	22,217
Effect of exchange rates fluctuations on cash and cash equivalents	606
Cash and cash equivalents at end of year (note 15)	**13,146**

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 8 to 29.

'000 USD	**Share capital**	**Foreign currency translation reserve**	**Accumulated losses**	**Total**
Balance at 1 January 2003	84,183	-	(50,606)	33,577
Net profit for the period	-	-	1,815	1,815
Foreign exchange differences	-	574	-	574
Total recognised gains and losses				2,389
Dividends to shareholders	-	-	(2,326)	(2,326)
Balance at 31 December 2003	**84,183**	**574**	**(51,117)**	**33,640**

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 8 to 29.

1 Background

(a) Organisation and operations

OAO Scientific Production Corporation "Irkut" ("the Company") was formed as an open joint stock company following the President Decree and State Privatization Programme of 1992. The principal activity of the Company is the construction of military and civil aircraft under contracts with Russian and foreign governments. The Company and its subsidiaries ("the Group") are also engaged in research and development works for military and civil aircraft. This research and development is carried out for the Group's own purposes.

In accordance with Russian legislation the supply of military equipment to foreign governments is the competence of the Russian government and, therefore, all contracts with foreign governments are concluded through the Russian state organization FGUP "Rosoboronexport" ("Rosoboronexport").

The Company's operations are subject to license for production and repair of aviation equipment awarded by FGUP "Rosaviacosmos". The current license is valid until April 2007.

The Parent Company's registered office is at 13 Novoalexeevskaya st., Moscow, 129626, Russia.

(b) State Secrets

The operations of the Group related to the construction and sale of military aircraft are subject to the Law of the Russian Federation on State Secrets signed by the President of the Russian Federation on July 21, 1993. This Law provides that the information on the foreign economic activities of the Russian Federation, disclosure of which can cause damage to the security of the country, is considered a state secret. Access to information classified as a state secret can be granted by the appropriate authorities only to organizations and individuals holding security licenses with the appropriate form of clearance. In addition, part of the property, plant and equipment of the Company makes up the mobilization capacity of the state and is also subject to the Law on State Secrets. The law also limits the authority of the Company to dispose of these assets.

(c) Russian business environment

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

2 Basis of preparation

(a) Statement of compliance

These preliminary consolidated financial statements have been prepared as part of the Group's preparation for the future adoption of International Financial Reporting Standards ("IFRS"), as promulgated by the International Accounting Standards Board ("IASB") and Interpretations issued by the International Financial Reporting Interpretations Committee of the IASB. When the Group prepares its first complete set of financial statements in accordance with IFRS as of and for the year ending 31 December 2004 they will be prepared in accordance with the Standards and Interpretations in effect as of that date and will include full comparative information. These preliminary consolidated financial statements have been prepared by management using its best knowledge of the expected Standards and Interpretations, facts and circumstances, and accounting policies that will be applied when the Group prepares its first complete set of IFRS financial statements. Accordingly, there is a possibility that these preliminary consolidated financial statements may require adjustment before constituting the comparative information in the Group's first complete set of IFRS financial statements.

The Group previously prepared consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("US GAAP") (refer note 26).

(b) Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that instruments held for trading and available-for-sale are stated at fair value.

(c) Measurement and presentation currency

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

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

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

(d) Going concern

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

The ultimate realisation of the Group's assets and its long-term liquidity will be impacted by its operating success. Management plans to obtain the economic benefits from the investments in the research and development of military and civil aircraft and expects a corresponding improvement of the Group's operating results. Management believes that the current order book calculated on the basis of existing contracts and framework agreements is sufficient to fund future operating and capital expenditures for a reasonable period of time.

(e) Use of estimates

Management 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 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 in the preparation of the consolidated financial statements. These accounting policies have been consistently applied.

(a) Basis of consolidation

(i) Subsidiaries

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

(ii) Associates

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

(iii) Transactions eliminated on consolidation

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

(b) Foreign currencies

Transactions in foreign currencies are translated to the respective functional currency of each enterprise in the Group 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 to the functional currency 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 the functional currency at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the functional currency at the foreign exchange rate ruling at the dates the fair values were determined.

The assets and liabilities of foreign entities are translated into USD at the exchange rate at the end of the year. Revenues and expenses are translated into USD using rates approximating exchange rates at the dates of the transactions. The resulting exchange difference is recorded directly in equity in the foreign currency translation reserve.

(c) Classification of assets and liabilities

The operating cycle for aircraft construction contracts exceeds one year. Assets, which are reasonably expected to realise in cash or sold or consumed during the operating cycle of the business are shown under current assets. Liabilities whose liquidation is reasonably expected within the operating cycle of the business are also shown under current liabilities.

(d) Property, plant and equipment

(i) Owned assets

Property, plant and equipment is stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads.

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) Subsequent expenditure

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

(iii) 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.

The estimated useful lives are as follows:

- Buildings 40-50 years
- Plant and equipment 5-20 years

(e) Intangible Assets

(i) 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, other than development carried out as part of construction contracts (refer accounting policy (q)), 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. Amortisation is charged to the income statement over the estimated units to be produced. The carrying amount is reviewed for impairment annually when the asset is not yet in use and thereafter whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

(ii) Goodwill, other intangible assets

Intangible assets are recorded at cost less accumulated amortisation and/or impairment losses. Intangible assets that have limited useful lives are amortised on a straight-line basis over the estimated useful lives of the individual assets, which are in the range of 3-5 years.

Goodwill and intangible assets with indefinite useful lives are not amortised but are instead tested for impairment at least annually.

(f) Investments

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

Except as outlined below, investments are accounted for as follows:

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

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

(g) Inventories

Construction work in progress is stated at cost plus profit recognised to date less a provision for foreseeable losses and less progress billings. Cost includes all expenditure related directly to specific projects and an allocation of fixed and variable overheads incurred in the Group's contract activities based on normal operating capacity.

Other 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 based on the average cost principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

Inventories are presented in the balance sheet net of advance payments received.

(h) Trade and other receivables

Trade and other receivables are stated at cost less impairment losses.

(i) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. 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 for the purpose of the statement of cash flows.

(j) Impairment

The carrying amounts of the Group's assets, other than inventories and deferred tax assets, 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. An impairment loss is recognised when the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement.

(i) Calculation of recoverable amount

The recoverable amount of the Group's held-to-maturity investments 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 investment 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. 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 reversed only 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.

(k) Dividends

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

(l) Loans and borrowings

Loans and borrowings are recognised initially at cost. 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.

(m) Employee benefits

Employees receive pension benefits from the government of the Russian Federation and the Group makes contributions on their behalf in accordance with the appropriate laws and regulations which are expensed as incurred.

(n) 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.

(i) Warranties

A provision for estimated standard warranty costs is recognised in the period in which the related product sales occur. An accrual for warranty costs is recognised based on the Group's historical experience on previous deliveries of aircrafts. Estimates are adjusted as necessary based on subsequent experience.

(o) Trade and other payables

Trade and other payables are stated at cost.

(p) 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 expense 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; initial recognition of assets or liabilities that affect neither accounting nor taxable profit; and investments in subsidiaries where the Parent Company 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 asset 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.

(q) Revenues

The operations of the Group principally consist of building aircraft under fixed-price contracts. Revenues under such contracts are recognised on a percentage of completion basis, measured by the ratio of total direct materials, labour and design and development costs incurred to date relative to the total estimated respective costs on the contract. This method is used as the management of the Group considers this to be the best available measure of progress on the contracts. Marketing costs that are incurred for a specific contract may be included in contract costs, but only if these costs can be directly associated with a specific contract and if their recoverability from that contract is probable.

Provisions for estimated losses on uncompleted contracts, if any, are made in the period in which such losses are determined. Changes in job performance, contract conditions and estimated profitability, including those arising from contract penalty provisions, if any, and final contract settlements may result in revisions to costs and income and are recognised in the period in which the revisions are determined.

Revenues under contracts, other than those classified as long-term construction-type contracts, are generally recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer.

(r) Expenses

(i) Operating leases

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) Net financing costs

Net financing costs comprise interest expense on borrowings, the accretion of interest on provisions, interest income on funds invested, dividend income, foreign exchange gains and losses, and gains and losses on the revaluation and disposal of investments held for trading and available-for-sale.

All interest and other costs incurred in connection with borrowings are expensed as incurred as part of net financing costs.

Interest income is recognised as it accrues, taking into account the effective yield on the asset. For investments in associates, dividend income is included in the determination of the carrying amounts of the investments in associates. For investments in other companies, dividend income is recognised on the date that the dividend is declared.

(iii) Social expenditure

To the extent that the Group's contributions to social programs benefit the community at large and are not restricted to the Group's employees, they are recognised in the income statement as incurred.

4 Acquisition of subsidiaries

In November 2003, the Company acquired approximately 98% of the issued share capital of OAO "NII Izmerenia" for approximately USD 5,400 thousand. Assets of OAO "NII Izmerenia" principally consist of freehold of office space in Moscow to which the Group plans to move its headquarters.

5 Revenues

	2003 '000 USD
Revenue earned on military aircraft construction contracts	382,618
Revenue earned on civil aircraft construction contracts	22,912
Revenue on sales of aircraft components and related products	96,401
Other revenues	20,094
	522,025

6 Personnel expenses

	2003 '000 USD
Wages and salaries	46,036
Compulsory social security contributions	14,819
	60,855

The number of employees at 31 December 2003 was 16,346 (2002: 16,180).

7 Other operating expenses

	2003 '000 USD
Social costs	5,700
Repair and maintenance	5,557
Impairment of loans and bad debts	2,305
Loss on disposal of property, plant and equipment	2,019
Other operating income and expenses, net	2,138
	17,719

8 Net financing costs

	2003 '000 USD
Interest income	(5,130)
Interest expense	70,239
Foreign exchange loss	6,513
Loss from investments	2,519
	74,141

9 Income tax benefit

	2003 '000 USD
Current tax expense	
Current year	(45)
Deferred tax benefit	
Origination and reversal of temporary differences	(2,795)
Change in recognised deferred tax assets	3,405
	565

The Group's applicable tax rate is the corporate income tax rate of 24% (2002: 24%).

Reconciliation of effective tax rate:

	2003 '000 USD	%
Profit before tax	385	100%
Income tax at applicable tax rate	92	24%
Non-deductible/non-taxable items	2,748	714%
Change in recognised deferred tax assets	(3,405)	(884%)
	(565)	**(147%)**

10 Property, plant and equipment

'000 USD	Land and Buildings	Plant and equipment	Construction in progress	Total
Cost				
At 1 January 2003	142,650	206,514	41,749	390,913
Additions and transfers	12,758	40,184	(18,561)	34,381
Disposals	(18)	(6,127)	(79)	(6,224)
At 31 December 2003	**155,390**	**240,571**	**23,109**	**419,070**
Depreciation				
At 1 January 2003	(91,137)	(147,123)	-	(238,260)
Depreciation charge	(2,316)	(13,397)	-	(15,713)
Disposals	18	4,073	-	4,091
At 31 December 2003	**(93,435)**	**(156,447)**	**-**	**(249,882)**
Net book value				
At 1 January 2003	**51,513**	**59,391**	**41,749**	**152,653**
At 31 December 2003	**61,955**	**84,124**	**23,109**	**169,188**

(a) Security

Property, plant and equipment with a carrying amount of USD 35,200 thousand (2002: USD 12,466 thousand) is pledged as collateral for secured loans (see note 17).

(b) Other restrictions

The net book value of property, plant and equipment restricted for sale by the Russian government in accordance with the state military programme amounted to USD 41,427 thousand (2002: USD 41,178 thousand).

11 Intangible assets

'000 USD	Development costs	Other intangibles	Total
Cost			
At 1 January 2003	21,271	1,859	23,130
Additions	15,703	903	16,606
At 31 December 2003	**36,974**	**2,762**	**39,736**
Amortisation			
At 1 January 2003	-	(767)	(767)
Amortisation charge	(219)	(446)	(665)
At 31 December 2003	**(219)**	**(1,213)**	**(1,432)**
Net book value			
At 1 January 2003	**21,271**	**1,092**	**22,363**
At 31 December 2003	**36,755**	**1,549**	**38,304**

The Group contracted Beriev Aircraft Company, an associate of the Group, to perform development works related to Be-200 amphibian aircraft. In the year ended 31 December 2003 the expenses, incurred in relation to this project, capitalised as intangible assets, were USD 9,093 thousand.

12 Other investments and non-current financial assets

	2003 '000 USD	2002 '000 USD
Non-current		
Available-for-sale investments, stated at cost	18,253	20,753
Other non-current financial assets	1,326	1,540
	19,579	**22,293**
Current		
Available-for-sale debt securities, stated at fair value	36,116	64,193
Trading investments	322	865
	36,438	**65,058**

Available-for-sale investments stated at cost include equity securities of ZAO "Company "FTK" ("FTK"), a former subsidiary of the Group and a related party. A stock issuance in 2002, which the Company did not take part in, diluted its interest in FTK's from 56% to 9%. The investment was recorded at cost of USD 8,885 thousand.

At 31 December 2003, all available-for-sale debt securities are Russian rouble denominated, bear interest at 12-14% and mature during 2004.

The Group pledged available-for-sale debt securities with a carrying value of USD 26,700 thousand, as collateral for the debt of companies controlled by the Company's majority shareholders. The Group's estimated maximum exposure to credit losses in the event of non-performance by the other parties to these pledges is represented by the carrying value of pledged assets. Management believes that the likelihood of material losses being incurred under these agreements is remote.

13 Inventories

	2003 '000 USD	2002 '000 USD
Advance payments to suppliers	52,916	133,493
Raw materials and other supplies	31,768	31,201
Aircraft components	28,132	39,268
Amounts due from customers for contract work	232,621	198,940
Other work in progress	8,273	10,351
	353,710	413,253
Advance payments received	(153,500)	(206,378)
	200,210	**206,875**

Inventories with a carrying value of USD 60,967 thousand are pledged as collateral for loans at 31 December 2003 (2002: USD 90,155 thousand) (see note 17).

14 Trade and other receivables

	2003 '000 USD	2002 '000 USD
Accounts receivable – trade	116,816	40,731
Allowance for doubtful accounts	(995)	(925)
	115,821	39,806
VAT recoverable	95,520	93,675
Due from tax authorities (refer note 23 (b))	22,756	-
Loans given (refer note 24)	21,902	6,380
Prepaid taxes	2,993	37
Other receivables	5,429	4,354
	264,421	**144,252**

15 Cash and cash equivalents

	2003 '000 USD	2002 '000 USD
Bank balances, Russian roubles	3,851	14,986
Bank balances, US Dollars	9,295	7,231
	13,146	**22,217**

16 Equity

(a) Share capital

At the Company's stockholders meeting on 2 December 2003, stockholders approved a resolution to increase the number of shares by 87,894,653. At 31 December 2003 authorised capital stock consisted of 878,946,528 ordinary shares; issued and fully paid capital stock consisted of 791,051,875 ordinary shares. All ordinary shares have a nominal value of Russian roubles 3 each.

(b) Dividends and dividend limitations

Profits available for distribution to common stockholders in respect of any reporting period are determined by reference to the statutory financial statements of the Company prepared in accordance with the laws of the Russian Federation and denominated in Russian roubles. At 31 December 2003 amounts available for distribution amounted to USD 14,111 thousand (2002: USD 12,387 thousand).

At the annual stockholders' meeting on 26 June 2004, dividends were declared for 2003 in the amount of Russian roubles 0.04 per common share, which at the date of the decision was equivalent to USD 0.0014, or USD 1,128 thousand in total.

17 Loans and borrowings

This note provides information about the contractual terms of the Group's loans and borrowings.

	2003 '000 USD	2002 '000 USD
Non-current		
Secured bank loans	194,200	104,393
Unsecured bond issue	51,247	-
	245,447	**104,393**
Current		
Secured bank loans	4,773	39,456
Unsecured bank loans	60,014	66,274
Current portion of non-current secured bank loans	164,264	257,980
Current portion of non-current unsecured bank loans	101,314	1,406
Unsecured bond issue	7,125	68,168
Promissory notes	-	26,383
Other loans	380	663
	337,870	**460,330**

(a) Security

The loans are secured over property, plant and equipment with a carrying amount of USD 35,200 thousand (2002: USD 12,466 thousand) (refer note 10), inventory of USD 60,967 thousand (2002: USD 90,155 thousand) (refer note 13) and the right to receive future revenues under the agreement with a foreign government.

(b) Terms and debt repayment schedule

'000 USD	**Total**	**Under 1 year**	**1-5 years**
Secured bank loans:			
RUR – fixed at 9-15%	267,198	107,194	160,004
USD – fixed at 8-13%	37,808	17,777	20,031
USD – variable at 6-8%	58,231	9,820	48,411
Unsecured bank loans:			
USD – fixed at 10%-11%	161,328	70,046	91,282
Unsecured bond issues:			
RUR – fixed at 18%	51,247	-	51,247
RUR – variable at 12%	7,125	7,125	-
Other loans	380	380	-
	583,317	**212,342**	**370,975**

For more information about the Group's exposure to interest rate and foreign currency risk, see note 21.

18 Deferred tax assets and liabilities

(a) Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following items:

'000 USD	Assets		Liabilities		Net	
	2003	2002	2003	2002	2003	2002
Property, plant and equipment	1,683	-	(375)	(1,548)	1,308	(1,548)
Intangible assets	7,985	1,403	-	-	7,985	1,403
Investments	562	792	(3,706)	(3,993)	(3,144)	(3,201)
Inventories	3,009	1,333	(16,617)	(467)	(13,608)	866
Trade and other receivables	1,034	-	(90)	(1,626)	944	(1,626)
Loans and borrowings	-	-	(438)	(178)	(438)	(178)
Trade and other payables	1,425	911	-	-	1,425	911
Provisions	1,634	-	-	(233)	1,634	(233)
Tax loss carry-forwards	898	-	-	-	898	-
Net tax assets/(liabilities)	**18,230**	**4,439**	**(21,226)**	**(8,045)**	**(2,996)**	**(3,606)**

(b) Unrecognised deferred tax assets

At 31 December 2003, deferred tax asset in the amount of USD 3,574 thousand (2002: USD 6,979 thousand) has not been recognised in respect of tax losses carry-forward, because it is not probable that future taxable profit will be available against which the Group can utilise the benefits therefrom.

(c) Movement in temporary differences during the year

'000 USD	1 January 2003	Recognised in income	31 December 2003
Property, plant and equipment	(1,548)	2,856	1,308
Intangible assets	1,403	6,582	7,985
Investments	(3,201)	57	(3,144)
Inventories	866	(14,474)	(13,608)
Trade and other receivables	(1,626)	2,570	944
Loans and borrowings	(178)	(260)	(438)
Trade and other payables	911	514	1,425
Provisions	(233)	1,867	1,634
Tax loss carry-forwards	-	898	898
	(3,606)	**610**	**(2,996)**

19 Trade and other payables

	2003 '000 USD	2002 '000 USD
Accounts payable – trade	104,022	18,312
Income and other taxes payable	6,866	8,533
Accrued expenses	5,311	1,500
Advances from customers	1,004	851
Other payables	5,086	4,702
	122,289	**33,898**

20 Provisions

	Warranties '000 USD
Balance at 1 January 2003	6,686
Provisions made during the year	4,685
Provisions used during the year	(2,214)
Provisions reversed during the year	(2,224)
Balance at 31 December 2003	**6,933**

The Group provides product warranties in conjunction with certain product sales. Generally, aircraft sales are accompanied by a twelve to eighteen month warranty period that covers systems, accessories, equipment, parts and software manufactured by the Group to certain contractual specifications. Warranty coverage includes non-conformance to specifications and defects in material and workmanship.

The warranty liability recorded at each balance sheet date reflects the estimated number of months of warranty coverage outstanding for products produced times the expected monthly warranty payments, as well as additional amounts, if necessary, for certain major warranty issues that exceed a normal claims level.

21 Financial instruments

Exposure to credit, interest rate and currency risk arises in the normal course of the Group's business.

(a) Credit risk

Credit evaluations are performed on all customers, other than related parties, requiring credit over a certain amount.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

At the balance sheet date there was a significant concentration of credit risk in respect of amounts receivable from Rosoboronexport (refer also note 1 (a)). The total amount receivable from Rosoboronexport less advance payments received was USD 188,677 thousand (2002: USD 24,648 thousand).

(b) Interest rate risk

Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of issuing new debt management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

(c) Foreign currency risk

The Group incurs foreign currency risk on sales, purchases and borrowings that are denominated in a currency other than USD. The currency giving rise to this risk is primarily RUR. Management does not hedge the Group's exposure to foreign currency risk.

(d) Fair values

Due to the lack of liquidity and published "indicator interest rates" in the Russian market, and the fact that many of the Group's transactions are with related parties and are of a specialised nature, it has not been practicable to determine the fair values of investments in, receivables from and payables to related parties.

In other cases fair value has been determined either by reference to the market value at the balance sheet date or by discounting the relevant cash flows using market interest rates for similar instruments. As a result of this exercise management believes that the fair value of its financial assets and liabilities approximates their carrying amounts except in the following instance:

'000 USD	**Carrying amount 2003**	**Fair value 2003**
Unsecured bond issues (note 17)	58,372	61,909

22 Commitments

(a) Capital commitments

At 31 December 2003 the Group is committed to capital expenditure of approximately USD 14,475 thousand (2002: USD 3,052 thousand).

(b) Supply commitments

Commitments with third parties for the supply of aircraft components and services after 31 December 2003 under long-term supply agreements are estimated at USD 219,349 thousand at current market prices (2002: USD 180,529 thousand).

23 Contingencies

(a) Insurance

The insurance industry in the Russian Federation is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have full coverage for its plant facilities, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Group's operations and financial position.

(b) Litigation

The Group is involved in a number of disputes with tax authorities. Based on results of the recent tax audits tax authorities claimed additional tax payments and deducted the amount from the Company's bank account. Subsequent to the balance sheet date, the District East-Siberian Arbitration dismissed the tax claim and made the judgment to return the amount in full to the Company's bank account. As of 31 December 2003 the amount due from the tax authorities, included in the line "Trade and other receivables" of the consolidated balance sheet, was USD 22,756 thousand.

(c) Taxation contingencies

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

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

(d) Financial guarantees

The Group has provided financial guarantees for loans advanced to certain related and third party suppliers of the Group for the total amount of USD 5,100 thousand and USD 11,689 thousand, respectively. The Group's estimated maximum exposure to credit losses in the event of non-performance by the other parties to the financial guarantees is represented by the contractual amounts disclosed above. Management believes that the likelihood of material payments being required under these agreements is remote. As of 31 December 2003 the Group did not have any contractual commitments to extend financial guarantees, credit or other assistance.

(e) Environmental contingencies

Governmental authorities are continually considering environmental regulations and their enforcement and the Group periodically evaluates its obligations related thereto. As obligations are determined, they are recognised immediately. The outcome of environmental liabilities under proposed or any future legislation, or as a result of stricter enforcement of existing legislation, cannot reasonably be estimated. Under current levels of enforcement of existing legislation, management believes there are no liabilities, which will have a materially adverse effect on the financial position or the operating results of the Group.

24 Related party transactions

Related parties comprise the shareholders of the Parent Company and all other companies in which those shareholders, either individually or together, have a controlling interest. Transactions with related parties are disclosed in notes 11, 12 and 23 (d). In addition, the Group had the following transactions with related parties.

(a) Balance sheet

	2003 '000 USD	2002 '000 USD
Advance payments to suppliers	2,037	64,032
Accounts receivable – trade	660	-
Loans given	19,899	5,732
Accounts payable – trade	(10,016)	-
Other payables	(1,003)	(272)

(b) Income statement

In 1997 the Group contracted OAO "OKB Sukhogo", a related party of the Group, to develop the design of the Su-30MKI aircraft for supply under a contract with a foreign government. Expenses incurred by the Group on this contract for the year ended 31 December 2003, included in the line "Cost of sales" of the consolidated income statement, amounted to USD 60,886 thousand.

(c) Pricing policies

Prices for related party transactions are determined on a transaction-by-transaction basis, not necessarily at arm's length.

25 Significant subsidiaries and associates

	Country of incorporation	Ownership/voting 2003	2002
Subsidiaries			
ZAO “Beta Air”	Russia	66%	66%
ZAO “Russian Avionics”	Russia	51%	51%
ZAO “Irkut AviaSTEP”	Russia	100%	100%
ZAO “ITELA”	Russia	51%	51%
ZAO “Techserviceavia”	Russia	51%	51%
OAO “NII Izmerenia”	Russia	98%	-
Associates			
OAO “TANTK Imeni Berieva” (“Beriev Aircraft Company”)	Russia	44%	43%

In addition, the Group has other subsidiaries and associates, which are not material to the Group, either individually or in aggregate.

26 Transition to IFRS

The latest period when the Group prepared consolidated financial statements in accordance with US GAAP was the year ended 31 December 2003. This note describes how the transition from US GAAP to IFRS affected the Group’s financial position, results of operations and cash flows.

Reconciliation of shareholders’ equity

	2003 ’000 USD	2002 ’000 USD
Total shareholders’ equity under US GAAP	10,585	27,921
IFRS adjustments:		
Capitalisation of development costs, net of tax (a)	27,935	16,166
Deferred tax for temporary differences related to remeasurement of assets and liabilities (b)	(2,989)	(8,619)
Impairment of goodwill (c)	(1,891)	(1,891)
Total shareholders’ equity under IFRS	**33,640**	**33,577**

Reconciliation of net income/(loss)

	2003 ’000 USD
Net loss for the period under US GAAP	(14,413)
IFRS adjustments:	
Capitalisation of development costs, net of tax (a)	11,769
Deferred tax for temporary differences related to remeasurement of assets and liabilities (b)	4,459
Net profit for the period under IFRS	**1,815**

Reconciliation of cash flows

Acquisition of development costs of USD 15,703 thousand (refer below) was classified as operating cash flow under US GAAP and is reclassified to investing cash flow in IFRS. There are no other material differences between the cash flow statement presented under IFRS and the cash flow statement presented under US GAAP.

(a) Capitalisation of development costs

Under US GAAP, SFAS No. 2 *Accounting for Research and Development Costs* requires all research and development costs to be expensed as incurred. A first-time adopter of IFRS is required to recognise in its opening IFRS balance sheet all internally generated intangible assets that qualify for recognition under IAS 38 *Intangible Assets*, including those resulting from development activity.

Management reviewed current and previous research and development programs regarding potential expenses in the development phase of such programs that meet the recognition criteria. Based on management analysis, the development costs, which should be capitalised, amounted to USD 21,271 thousand for periods prior to 1 January 2003, and USD 15,703 thousand for the year ended 31 December 2003.

(b) Deferred tax for temporary differences related to remeasurement of assets and liabilities

SFAS No. 109 *Accounting for Income Taxes* prohibits recognition of a deferred tax liability or asset for differences related to assets and liabilities that, under SFAS No. 52 *Foreign Currency Translation*, are remeasured from the local currency into the functional currency using historical exchange rates and that result from (1) changes in exchange rates or (2) indexing for tax purposes. Unlike US GAAP, IAS 12 *Income Taxes* requires recognition of a deferred tax liability or assets for these temporary differences. The Group recognised deferred tax liability for the taxable difference related to remeasurement of non-monetary assets from RUR to USD in its opening IFRS balance sheet.

In addition, Beriev Aircraft Company, the Group's associate accounted for using equity method, recognised the deferred tax liability related to the temporary differences that has arisen from the change in functional currency from USD to RUR when Russian economy ceased to be considered highly inflationary, as an adjustment to the cumulative translation adjustments component of shareholders' equity in its US GAAP financial statements for the year ended 31 December 2003 in accordance with EITF 92-8 *Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary*. The related Group's share of the adjustment was also recorded in equity in the Group's US GAAP consolidated financial statements. Under IFRS the deferred tax liability was reflected in the opening Beriev Aircraft Company's balance sheet.

(c) Impairment of goodwill

IAS 36 (revised 2004) *Impairment of Assets* requires goodwill to be tested for impairment annually by comparing its carrying amount with its recoverable amount. The estimate of recoverable amount of goodwill recognised on the acquisition of ZAO “Russian Avionics” was assessed based on value in use of the cash-generating unit to which the goodwill had been allocated, as of 1 January 2003, determined using a pre-tax discount rate of 18%. The analysis demonstrated the excess of the carrying amount of the cash-generating unit over its recoverable amount. Consequently, the impairment loss was recognised at the date of transition to IFRS. The impairment loss reduced the carrying amount of goodwill to zero. The carrying amounts of other assets of the unit were not reduced because their recoverable amounts were higher than their carrying amounts.

Under US GAAP, SFAS No. 142 *Goodwill and Other Intangible Assets* requires an initial assessment of impairment of goodwill to be based on comparison of fair value of a reporting unit with its carrying amount, including goodwill. Under US GAAP, the carrying amount of the reporting unit was lower than its fair value; the primary reason was that the development costs were not capitalised as an asset (refer (a) above). Therefore, an impairment loss did not exist for US GAAP reporting purposes.

27 Events subsequent to the balance sheet date

In March 2004, the Company has issued 87,894,653 ordinary shares for the consideration of USD 51,770 thousand. The shares were distributed among various investors during the initial public offering of the Company’s shares.

In April 2004, the Company acquired 1,271,304 ordinary shares and 70,090 preference shares (or 75.46% of total issued share capital) of OAO “OKB Imeni A.S. Yakovleva” for USD 58,927 thousand. The primary strategic objective of the acquisition is to obtain the intellectual property rights to the Yak-130 aircraft, which won the tender to be the combat-training aircraft for the Russian air force.

In June 2004, the Company acquired 18,042 ordinary shares (or 8% of total issued share capital) of Taganrog Aviation Plant OAO “Taganrog Aviation” for USD 1,300 thousand. The objective of the acquisition is future expansion of the Group’s production facilities.

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