Open Joint Stock Company
Magnitogorsk Iron & Steel Works
and subsidiaries

Consolidated Financial Statements

for the year ended 31 December 2001

Contents

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 subsidiaries (the “Group”) as at 31 December 2001 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 38, 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 2001, 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
8 July 2002

Consolidated balance sheet

As at 31 December 2001

In millions of US dollars	Note	2001	2000
Assets			
Property, plant and equipment	13	1,853	1,729
Intangible assets	14	22	10
Investments in associates	15	55	2
Other investments	16	2	5
Other non-current assets	17	12	7
Total non-current assets		1,944	1,753
Inventories	18	233	194
Trade and other receivables	19	267	184
Other investments	16	3	3
Cash and cash equivalents	20	77	74
Total current assets		580	455
Total assets		2,524	2,208
Equity	21		
Share capital		26	26
Treasury shares		(23)	(15)
Retained earnings		1,543	1,402
Total equity		1,546	1,413
Minority interest		7	9
Liabilities			
Loans and borrowings	23	81	21
Employee benefits	25	21	21
Deferred tax liabilities	26	239	346
Other non-current liabilities		26	-
Total non-current liabilities		367	388
Loans and borrowings	23	195	83
Trade and other payables	27	409	315
Total current liabilities		604	398
Total liabilities		971	786
Total equity, minority interest and liabilities		2,524	2,208

The consolidated financial statements were approved on 8 July 2002 and signed by:

A.A. Morozov
First Deputy of General Director

A.S. Batrutdinov
Deputy Chief Accountant

The consolidated balance sheet is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 7 to 38.

Consolidated income statement

For the year ended 31 December 2001 *In millions of US dollars, except earnings per share*	**Note**	**2001**	**2000**
Revenues	6	1,733	1,713
Cost of sales		(1,333)	(1,160)
Gross profit		400	553
Distribution expenses		(86)	(59)
Administrative expenses	7	(120)	(110)
Social costs	8	(48)	(56)
Taxes other than profit tax		(45)	(94)
Impairment of property, plant and equipment	13	34	(584)
Impairment of investments	15	(11)	-
Other operating expenses	9	(29)	(17)
Profit/(loss) from operations		95	(367)
Net financing costs	11	(12)	(28)
Profit/(loss) before tax and minority interest		83	(395)
Income tax benefit	12	58	61
Profit/(loss) before minority interest		141	(334)
Minority interest		3	(4)
Net profit/(loss) for the year		144	(338)
Basic and diluted earnings per share (USD)	22	35	(77)

The consolidated income statement is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 7 to 38.

Consolidated statement of cash flows

For the year ended 31 December 2001
In millions of US dollars

	2001	**2000**
Operating activities		
Profit/(loss) before tax	83	(395)
Adjustments for:		
Depreciation and amortisation	206	176
Impairment of property, plant and equipment	(34)	584
Impairment of investments	11	-
Loss on disposal of fixed assets	19	51
Gain on investments	(1)	(13)
Interest expense	19	21
Operating profit before changes in working capital	303	424
Increase in inventories	(35)	(48)
Increase in trade and other receivables	(74)	(41)
Increase in trade and other payables	145	17
Cash flows from operations before taxes and interest paid	339	352
Interest paid	(18)	(26)
Profits tax paid	(54)	(105)
Cash flows from operating activities	267	221
Investing activities		
Proceeds from sale of property, plant and equipment	3	-
Acquisition of property, plant and equipment	(287)	(236)
Acquisition of intangible assets	(14)	(5)
Acquisition of investments in associates	(64)	-
Acquisition of subsidiaries less cash acquired	(2)	-
Net cash flow from other investments	4	(6)
Cash flows to investing activities	(360)	(247)
Financing activities		
Proceeds from borrowings	310	156
Repayments of borrowings	(200)	(106)
Cash transactions with minorities	-	2
Acquisition of treasury shares	(8)	(4)
Payments made under finance lease	(4)	-
Dividends paid	(2)	(2)
Cash flows from financing activities	96	46
Net increase in cash and cash equivalents	3	20
Cash and cash equivalents at 1 January	74	54
Cash and cash equivalents at 31 December	77	74

The consolidated statement of cash flows is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 7 to 38.

Consolidated statement of changes in shareholders' equity

For the year ended 31 December 2001

In millions of US dollars	Share capital	Treasury shares	Retained earnings	Total
Balance at 1 January 2000	26	(11)	1,740	1,755
Acquisition of treasury shares	-	(4)	-	(4)
Net loss for the year	-	-	(338)	(338)
Balance at 31 December 2000	26	(15)	1,402	1,413
Balance at 1 January 2001	26	(15)	1,402	1,413
Acquisition of treasury shares	-	(8)	-	(8)
Dividends	-	-	(3)	(3)
Net profit for the year	-	-	144	144
Balance at 31 December 2001	26	(23)	1,543	1,546

The consolidated statement of changes in equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 7 to 38.

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 and it's subsidiaries ("the Group") comprise the parent company Open Joint Stock Company Magnitogorsk Iron & Steel Works ("MMK" or "the Parent Company") and it's 85 subsidiaries. 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 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. The impact of such differences on the operations and the financial position of the Group may be significant.

2. Basis of preparation

(a) Statement of compliance

The Group maintains it's 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 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 it's 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.

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 does not have 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 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 it's 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 it's 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: derivative financial instruments, investments held for trading and investments available for sale. Recognised assets and liabilities that are hedged are stated at fair value in respect of the risk that is hedged.

(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 have 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 have 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 it's sales proceeds in US dollars.

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 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 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 have 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 consistently applied by the Group in the preparation of the financial statements and are consistent with those applied in the prior year except for adoption of IAS 39 *Financial Instruments: Recognition and Measurement* (refer note 4).

(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 which operate in hyperinflationary economies. Foreign exchange differences are recognised in the income statement.

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 are stated at cost less accumulated depreciation (see below) and impairment losses (refer accounting policy (h)). 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 it's 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, including major inspection and overhaul expenditure, 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) 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.

Management commissioned an independent appraisal of the property, plant and equipment of the Parent Company as at 31 December 2000. The estimated useful lives applied to depreciation were adjusted with effect from 1 January 2001 to reflect the useful lives determined by the independent appraiser and are as follows:

■ buildings	33-44 years
■ machinery and equipment	17-32 years
■ transport equipment	8-22 years
■ fixtures and fittings	8-14 years

Notes to the consolidated financial statements

3. Significant accounting policies continued

(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 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. As control over the assets is achieved through legal rights with a definite period, their useful lives do not exceed the period of the legal rights.

(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.

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	10-15 years
■ intangibles other than goodwill	3-10 years

(d) Investments

(i) Investments in associates

Associates are those enterprises in which the Group has significant influence but does not have control over the financial and operating policies. The 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.

(ii) Other 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.

Investments held for trading and available-for-sale investments are recognised/derecognised by the Group on the date it commits to purchase/sell the investments. Investments held-to-maturity are recognised/ derecognised on the day they are transferred to/by the Group.

(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.

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 it's cash-generating unit exceeds it's recoverable amount. Impairment losses are recognised in the income statement.

(i) Calculation of recoverable amount

The recoverable amount of the Group's investments in non-current 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. Short-term receivables are not discounted.

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.

Notes to the consolidated financial statements

3. Significant accounting policies continued

(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 is committed to reimburse employees for all expenses incurred in case of injuries at work. These amounts are expensed when they are paid. Furthermore, the Group pays into the Russian Federation State Pension Fund a percentage of each employee's wage based on a scale as specified in the Russian Tax Code. These amounts are expensed when they are incurred. The Group grants 24 to 33 days vacation per year to it's employees (weighted average 26 days).

(ii) Defined contribution plans

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

(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 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.

Notes to the consolidated financial statements

3. Significant accounting policies continued

(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

Capital expenditures for ongoing environmental compliance measures are recorded in the consolidated balance sheet, and related expenses are recognised as normal business operating expenses.

Where the Company is obligated to undertake certain environmental remediation-related activities, the fair value of this obligation is recorded as a liability in the period in which this legal obligation is incurred, and is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash outflows underlying this obligation. A corresponding amount is capitalised to the cost of the asset which will require environmental remediation, and is depreciated over the useful life of the asset.

(n) Trade and other payables

Trade and other payables are stated at their cost.

(o) Revenue

(i) Goods sold and services rendered

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

(ii) Rental income

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

(iii) 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.

Notes to the consolidated financial statements

3. Significant accounting policies continued

(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 13% (2000: 10%) of revenues and 14% (2000: 19%) of purchases in 2001 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 construction costs

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

Operation and maintenance expenses

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

(iii) Net financing costs

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

Interest 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.

All interest and other costs incurred in connection with borrowings, which are not directly attributable to the acquisition, construction or production of qualifying assets, are expensed as incurred as part of net financing costs. The interest expense component of finance lease payments is recognised in the income statement using the effective interest rate method.

Notes to the consolidated financial statements

3. Significant accounting policies continued

(q) Income tax

Income tax on the profit or loss 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 substantially 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, 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 substantially 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

Prior year amounts have been reclassified, where applicable, to conform with presentation for the current year.

4. Change in accounting policy

During the year the Company adopted IAS 39 *Financial Instruments: Recognition and Measurement*. This had no significant impact on these financial statements.

5. Segment information

The Group predominantly produces iron and steel products. The revenues from the sale of these products constitute more than 95% of the total revenues. An analysis of sales by product and location of customers is included in note 6. Geographically, all significant assets, production and management/administrative facilities are located in Magnitogorsk.

Notes to the consolidated financial statements

6. Revenues

In millions of US dollars	2001	2000
Rolled steel	973	926
Assorted rolled products	225	208
Tin plated steel	199	191
Slabs	89	65
Band	85	96
Tubes	28	43
Other	134	184
	1,733	1,713

Percentage of sales by location of customer

	2001	2000
Russia and the CIS	55%	46%
Asia	20%	22%
Middle East	12%	17%
Europe	11%	11%
Other	2%	4%
	100%	100%

7. Administrative expenses

In millions of US dollars	2001	2000
Wages, salaries and related taxes	44	29
Services consumed	38	45
Depreciation	19	17
Amortisation of intangibles	8	3
Pension costs, net	-	3
Other administrative expenses	11	13
	120	110

8. Social costs

In millions of US dollars	2001	2000
Social assets construction	31	31
Operation and maintenance expenses	17	25
	48	56

Notes to the consolidated financial statements

9. Other operating expenses

In millions of US dollars	**2001**	**2000**
Net gain on sale of investments	(1)	(13)
Bad debts and change in accounts receivable provision	17	6
Loss on disposal of property, plant and equipment	19	51
Other operating (gain)/loss, net	(6)	(27)
	29	17

10. Personnel expenses

In millions of US dollars		**2001**	**2000**
Wages, salaries and related taxes included in:			
cost of sales		163	131
distribution costs		4	3
administrative expenses		44	29
Contributions to defined contribution plan	25	1	1
Actuarial (gain)/loss	25	(1)	2
		211	166

The average number of employees during the year ended 31 December 2001 was 60,000 (2000: 56,000).

11. Net financing costs

In millions of US dollars	**2001**	**2000**
Interest expense	19	21
Interest income	(2)	(3)
Net foreign exchange (gain)/loss	(5)	10
	12	28

Notes to the consolidated financial statements

12. Income tax benefit

In millions of US dollars	**2001**	**2000**
Current tax expense		
Current year expense	51	101
Overprovided in prior years	(4)	-
	47	101
Deferred tax benefit		
Origination and reversal of temporary differences	5	(213)
Change in tax rate	(110)	51
	(105)	(162)
	(58)	(61)

The Parent Company's applicable tax rate is the corporate income tax rate of 35% (2000: 30%) and 24% for measuring deferred taxes (2000: 35%).

Reconciliation of effective tax rate

In millions of US dollars		**2001**		**2000**
Profit/(loss) before tax		83		(395)
Income tax using corporate tax rate	35%	29	30%	(119)
Non-deductible expenses	96%	80	(13%)	51
Tax incentives not recognised in the income statement	(7%)	(6)	1%	(3)
Overprovided in prior years	(5%)	(4)	-	-
Investment tax credits	(56%)	(47)	10%	(41)
Impact of change in tax rate	(133%)	(110)	(13%)	51
	(70%)	(58)	15%	(61)

Notes to the consolidated financial statements

13. Property, plant and equipment

In millions of US dollars	Land and Buildings	Machinery and equipment	Transpor-tation equipment	Fixtures and fittings	Assets under construction	Total
Cost						
Balance at 1 January 2001	6,865	4,687	460	53	146	12,211
Reversal of impairment	-	-	-	-	34	34
Additions	12	44	9	4	233	302
Acquisition of subsidiaries	2	7	1	-	3	13
Transfers	76	128	1	6	(211)	-
Disposals	(59)	(92)	(8)	(3)	-	(162)
Balance at 31 December 2001	6,896	4,774	463	60	205	12,398
Depreciation/Amortisation						
Balance at 1 January 2001	(6,559)	(3,453)	(420)	(50)		(10,482)
Acquisition of subsidiaries	(1)	(4)	-	-	-	(5)
Charge for the year	(21)	(170)	(6)	(1)	-	(198)
Disposals	46	83	8	3	-	140
Balance at 31 December 2001	(6,535)	(3,544)	(418)	(48)	-	(10,545)
Carrying amount						
At 1 January 2001	306	1,234	40	3	146	1,729
At 31 December 2001	361	1,230	45	12	205	1,853

Reversal of impairment
In 2000, management commissioned an independent appraisal of property, plant and equipment of the Parent Company as at 31 December 2000. Based on the appraiser's assessment, the carrying value of assets under construction were impaired by an amount of USD 101 million. In 2001, following a reassessment by management of the underlying assumptions relating to assets under construction, the Group reassessed the fair value estimate of these assets and USD 34 million of the initially recognised impairment was reversed. The estimate of the recoverable amount was based on the assets future value in use, determined using a discount rate of 20% (2000: 20%).

Borrowing costs
Borrowing costs of USD 4 million were capitalised as part of the cost of qualifying assets (2000: USD 1 million).

Notes to the consolidated financial statements

14. Intangible assets

In millions of US dollars	Goodwill	Other intangible assets	Total
Cost			
Balance at 1 January 2001	-	14	14
Additions	-	14	14
Additions through business combinations	6	-	6
Disposals	-	(3)	(3)
Balance at 31 December 2001	6	25	31
Depreciation/Amortisation			
Balance at 1 January 2001	-	(4)	(4)
Charge for the year	-	(8)	(8)
Disposals	-	3	3
Balance at 31 December 2001	-	(9)	(9)
Carrying amount			
At 1 January 2001	-	10	10
At 31 December 2001	6	16	22

15. Investments in associates

The Group has the following significant investments in associates:

	Country of incorporation	Ownership 2001	Ownership 2000	Voting interest 2001	Voting interest 2000
OAO Ugolnaya Kompania Kuzbassugol	Russia	26%	-	26%	-
OAO Magnitogorsky Metizno-Metallurgiechesky Zavod	Russia	30%	25%	37%	33%

In addition, another 13 investments in associates, which are not material to the Group, either individually or in aggregate, have been aggregated and accounted for on an equity accounting basis in these consolidated financial statements.

Acquisition of associates

OAO Ugolnaya Kompania Kuzbassugol

In October 2001, the Group acquired 26% of the shares in OAO Ugolnaya Kompania Kuzbassugol ("Kuzbassugol") from the State for USD 63 million. The company mines coking coal which is necessary for the production of ferrous steel. In the two months to 31 December 2001, the loss attributable to the Group under the equity method was not significant.

In June 2002, the Group sold their 26% investment in Kuzbassugol for USD 52 million. The difference between the acquisition price and disposal price of USD 11 million has been recognised as an impairment of investments in 2001.

Notes to the consolidated financial statements

15. Investments in associates continued

OAO Magnitogorsky Metizno-Metallurgiechesky Zavod
In July 2001, the Group acquired an additional 5% of the shares in OAO Magnitogorsky Metizno-Metallurgiechesky Zavod ("MMMZ") for USD 146 thousand.

In February, April and May 2002, the Group acquired a further 5.3%, 15.4% and 15.3% of the shares in MMMZ (in total 38.1% voting interest) for USD 700 thousand, USD 1.7 million and USD 1.2 million, respectively, which resulted in the Group having a controlling financial interest in the company.

Transactions with associates
Kuzbassugol
During 2001, the Group did not enter into any sale or purchase agreements directly with Kuzbassugol. Purchases of coal were made indirectly through a related intermediary supplier, ZAO Vostokprominvest (refer note 27). The Group provided a loan to Kuzbassugol of RUR 100 million (USD 3.3 million) which was still outstanding at the balance date.

MMMZ
In 2001, the Group sold steel rods and other products to MMMZ totalling USD 14 million (2000: USD 9.9 million), and purchased steel products from MMMZ totalling USD 1.8 million (2000: USD 3.2 million). As at the balance sheet date, the Group has accounts receivable from MMMZ of USD 1.4 million (2000: USD 148 thousand) and accounts payable to MMMZ of USD 126 thousand (2000: USD 66 thousand).

16. Other investments

In millions of US dollars	**2001**	**2000**
Non-current investments		
Investments in joint ventures	-	2
Equity securities available-for-sale	2	3
	2	5
Current investments		
Equity securities available-for-sale	2	2
Equity securities held for trading	1	1
	3	3

Notes to the consolidated financial statements

17. Other non-current assets

In millions of US dollars	2001	2000
Loans to employees	1	-
Other originated loans	-	4
Restricted cash	11	3
	12	7

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

18. Inventories

In millions of US dollars	2001	2000
Raw materials and consumables	171	142
Work in progress	48	43
Finished goods and goods for resale	23	30
	242	215
Provision for obsolescence	(9)	(21)
	233	194

19. Trade and other receivables

In millions of US dollars	2001	2000
Trade account receivable	127	99
VAT receivable	84	32
Prepayments	31	35
Receivables from employees	1	8
Other receivables	41	19
	284	193
Provision for doubtful debts (trade)	(17)	(9)
	267	184

Notes to the consolidated financial statements

20. Cash and cash equivalents

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

In millions of US dollars	**2001**	**2000**
Foreign currency bank accounts	20	11
RUR bank accounts	15	8
USD bank deposits	14	42
USD denominated bank promissory notes	23	12
Other RUR denominated cash equivalents	5	1
	77	74

Deposits with related parties
The Group has cash and cash equivalents of USD 46.2 million (2000: USD 34.7 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 23), overdrafts, customer and supplier settlements and employee payroll services to the Parent Company and to the majority of it's subsidiaries. It is the intention of the Group to enter into these transactions at market prices for these services.

The Group also incurred bank charges from CUB totalling USD 9.4 million for the year ended 31 December 2001 (2000: USD 9.5 million).

21. Equity

Share capital
The authorised and issued share capital comprises 6,643,888 ordinary shares (2000: 6,643,888) and 2,214,630 non-redeemable non-cumulative preference shares (2000: 2,214,630). All shares have a par value of RUR 1. There were no unpaid shares as at the balance date. All shares rank equally with regard to the Group's residual assets.

The issued share capital comprises of the following shares:

	Number of shares		**US dollar amount**	
	2001	**2000**	**2001**	**2000**
Ordinary shares, RUR 1 each	6,643,888	6,643,888	19,656,000	19,656,000
Preference shares, RUR 1 each	2,214,630	2,214,630	6,552,000	6,552,000
	8,858,518	8,858,518	26,208,000	26,208,000

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 preferred dividend must 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.

By decision of the shareholders at a general meeting, preference shares may be converted into cumulative preference shares, on which unpaid or partially unpaid dividends shall accrue and be paid in the future.

Dividends payable are restricted to the maximum retained earnings of the Group which are determined according to legislation in the Russian Federation. At the balance sheet date, reserves available for distribution in accordance with Russian legislation amounted to USD 242 million (2000: USD 61 million). The Russian statutory profit after tax for the year was USD 208 million (2000: USD 245 million).

The following ordinary and preference dividends were approved at the annual shareholders meeting.

In millions of US dollars	**2001**	**2000**
RUR 10.16 per qualifying ordinary share (2000: RUR 9.94)	2	2
RUR 10.16 per preference share (2000: RUR 9.94)	1	1
	3	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 which would restrict their rights.

Treasury shares

At the balance sheet date the Group held 2,512,462 (2000: 2,341,705) of it's own ordinary shares and 885,832 (2000: 724,844) of it's own preference shares. The Group also controls through trust arrangements the voting rights of a further 1,194,011 (2000: 1,330,488) of it's own ordinary shares and 353,311 (2000: 677,309) of it's own preference shares, which were held in trust by a subsidiary of the Group. Dividends accrue to the beneficial owners of the shares. The trust agreements can be cancelled by the beneficial owners of the shares by the giving of one year's notice to the trustee.

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 2001, the Group made sales of USD 117.9 million (2000:USD 118.9 million) to Conares, and as at balance sheet date Conares owed to the Group USD 5 million (2000: USD 4 million).

The Government

The Government of the Russian Federation owned 23.8% of the voting shares of the Group as at 31 December 2001 (2000: 23.8%). 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.

Subsequent event

At the Parent Company's annual shareholders meeting on 17 May 2002, shareholders voted in favour of increasing the charter capital to RUR 10.7 billion (USD 340 million) through the utilisation of unappropriated profits.

22. Earnings per share

The calculation of basic and diluted earnings per share as at 31 December 2001 was based on the net profit attributable to ordinary shareholders of USD 143 million (2000: loss of USD 339 million) and a weighted average number of ordinary shares outstanding during the year then ended of 4,138 thousand (2000: 4,409 thousand), calculated as follows:

Net profit attributable to ordinary shareholders

In millions of US dollars	**2001**	**2000**
Net profit/(loss) for the year	144	(338)
Dividends on non-redeemable non-cumulative preference shares	(1)	(1)
Net profit/(loss) attributable to ordinary shareholders	143	(339)

Notes to the consolidated financial statements

22. Earnings per share continued

Weighted average number of ordinary shares

In thousands of shares	**2001**	**2000**
Issued ordinary shares at 1 January	6,644	6,644
Effect of own shares held	(2,506)	(2,235)
Weighted average number of ordinary shares at 31 December	4,138	4,409

23. Loans and borrowings

In millions of US dollars	**Effective interest rate**	**2001**	**Effective interest rate**	**2000**
Current liabilities				
Secured loans: - RUR, fixed	21%	68	19%	8
- USD, variable	6%	28		-
- USD, fixed	-	-	10%	5
Unsecured loans: - RUR, fixed	18%	2	15%	1
- RUR, variable	-	-	31%	2
- USD, variable	7%	7		-
- USD, fixed	5%	48	6%	62
Unsecured Russian bond issues - RUR, fixed	18%	34	18%	5
Current portion of secured loans: - USD, variable	7%	3		-
Current portion of finance lease obligations: - USD, fixed	11%	3		-
- RUR, fixed	24%	2		-
		195		83
Non-current liabilities				
Secured loans: - RUR, fixed	20%	51		-
- USD, variable	7%	15		-
- EUR, variable	6%	2		-
Unsecured loans - USD, fixed	11%	1	5%	21
Finance lease liabilities: - USD, fixed	11%	9		-
- RUR, fixed	24%	3		-
		81		21
Unused available borrowing facilities - USD, variable		31		7

Notes to the consolidated financial statements

23. Loans and borrowings continued

Subsequent event

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.

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

Long term debt repayment schedule

In millions of US dollars	**Total**	**Current portion**	**2003**	**2004**	**2005**	**2006**	**2007 thereafter**
Secured bank loans							
- USD, variable	18	3	8	7	-	-	-
- RUR, fixed	51	-	16	16	17	2	-
- EUR, variable	2	-	-	2	-	-	-
Unsecured loans - USD fixed	1	-	1	-	-	-	-
Finance lease liabilities							
- USD, fixed	13	3	2	2	1	1	4
- RUR, fixed	4	2	1	1	-	-	-
	89	8	28	28	18	3	4

Finance lease liabilities

Finance lease liabilities are payable as follows:

	2001			**2000**		
In millions of US dollars	**Payments**	**Interest**	**Principal**	**Payments**	**Interest**	**Principal**
Less than one year	7	2	5	-	-	-
Between one and five years	11	3	8	-	-	-
More than five years	5	1	4	-	-	-
	23	6	17	-	-	-

As at the balance sheet date leased assets with a carrying amount of USD 17 million were included in property, plant and equipment (2000: Nil).

Notes to the consolidated financial statements

23. Loans and borrowings continued

Transactions with related parties
CUB
During 2001, CUB (refer note 20) provided a loan to the Group of USD 2.9 million which remained outstanding at the balance sheet date. CUB also provided loans totalling USD 4.9 million to third parties which were guaranteed by the Group (refer note 32).

OOO Leasing-M
OOO Leasing-M ("Leasing-M") provided leased equipment to the Group under an agreement which in substance is a finance lease. OOO Trust Capital-M (refer note 27) retains a financial interest in Leasing-M which enables the Group to influence it's 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 23.8% and 12.5% per annum, respectively. As at the balance sheet date, the Group has outstanding finance lease obligations to Leasing-M of USD 7.8 million (2000: Nil), and incurred interest of USD 1.5 million in 2001 (2000: Nil).

24. Pledges provided by the Group

The Group has pledged fixed assets and inventory of USD 870 million and USD 130 million, respectively. The Group has also pledged export contracts totalling USD 102 million, and 75% of the ordinary shares of a subsidiary which had net assets of USD 8 million at the balance sheet date.

The Group is subject to the following pledges as at 31 December 2001.

In millions of US dollars	**Note**	**2001**	**2000**
Short-term			
Pledges provided for the debt of related parties	27	61	-
Pledges provided for the debt of the Group	23	599	31
Pledges provided for the debt of third parties		9	-
Long term			
Pledges provided for the debt of the Group	23	438	-
		1,107	31

25. Employee benefits

Liability for defined benefit obligations
The Group voluntarily makes charitable contributions to a defined contribution plan. The contributions are made to the independent, non-government pension fund "Sotsialnaya Zashchita Starosti", which provides pension benefits to former employees upon retirement. Contributions of RUR 50 (USD 1.66) per retiree are made every month (2000: 100 RUR, USD 3.55). Payments made to this defined contribution plan during the year amounted to USD 0.5 million (2000: USD 1 million).

Notes to the consolidated financial statements

25. Employee benefits continued

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 payments to the fund of RUR 200 (USD 6.64) per retiree every month (2000: RUR 150, USD 5.33), 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	**2001**	**2000**
Liability for defined benefit obligations	21	21

Movements in the net liability recognised in the balance sheet:

In millions of US dollars	**2001**	**2000**
Net liability at 1 January 2001	21	18
Payments made during the year	(2)	(1)
Expenses recognised in the income statement	2	4
Net liability at 31 December 2001	21	21

Expenses recognised in the income statement:

In millions of US dollars	**2001**	**2000**
Interest costs	4	3
Current service costs	-	-
Actuarial (gain)/loss	(1)	2
Foreign exchange gain	(1)	(1)
	2	4

Current service costs and actuarial gains and losses are recognised in administrative expenses in the income statement.

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

	2001	**2000**
Discount rate at 31 December	22.2%	23.8%
Future retirement benefit increases (based on RUR amounts)	19.8%	21.4%

Notes to the consolidated financial statements

26. 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	**2001**	**2000**	**2001**	**2000**	**2001**	**2000**
Property, plant and equipment	3	-	(254)	(379)	(251)	(379)
Investments	-	-	(3)	(5)	(3)	(5)
Inventories	34	46	(2)	-	32	46
Trade and other accounts receivable	5	-	(27)	(23)	(22)	(23)
Trade and other accounts payable	5	15	-	-	5	15
Tax assets/(liabilities)	47	61	(286)	(407)	(239)	(346)
Set-off of tax	(47)	(61)	47	61	-	-
Net tax liabilities	-	-	(239)	(346)	(239)	(346)

As at 31 December 2001 a deferred tax liability of USD 3.4 million (2000: USD 3.2 million) relating to an investment in a 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 01	Recognised in income	Acquisition of subsidiary	Balance 31 Dec 01
Property, plant and equipment	(379)	126	2	(251)
Investments	(5)	2	-	(3)
Inventories	46	(14)	-	32
Trade and other accounts receivable	(23)	1	-	(22)
Trade and other accounts payable	15	(10)	-	5
	(346)	105	2	(239)

27. Trade and other payables

In millions of US dollars	**2001**	**2000**
Trade accounts payable	182	171
Amounts payable to related parties	45	2
Advances from customers	32	37
Taxes payable	43	48
Accrued liabilities	17	21
Other current liabilities	90	36
	409	315

Notes to the consolidated financial statements

27. Trade and other payables continued

Transactions with related parties

ZAO Vostokprominvest

During 2001, the Group entered into an arrangement with ZAO Vostokprominvest ("Vostokprominvest"), an intermediary trader of the Group, to supply significant quantities of coking coal in order to build up the Group's Winter reserves. Vostokprominvest is controlled by certain directors of the Group through their controlling financial interest in OOO Trust Capital-M.

In 2001, the Group purchased coal, iron ore and other raw materials from Vostokprominvest totalling USD 88.7 million (2000: USD 25 million) at an overall margin of approximately 12%. The abovementioned arrangement resulted in the Group accumulating significant accounts payable to Vostokprominvest. Total accounts payable due to Vostokprominvest as at 31 December 2001 were USD 37.2 million (2000: USD 2 million). Vostokprominvest raised two bank loans totalling USD 16.3 million, and a credit facility with another bank with a limit of USD 14 million in order to finance this arrangement. The Group guaranteed the loans and the bank credit facility, and pledged assets with a book value of USD 53 million as security for the two bank loans (refer note 24).

Subsequent to the balance sheet date, the Group utilised USD 15 million of the proceeds received from the euro note issue (refer note 23) to repay a portion of the accounts payable due to Vostokprominvest.

ZAO Profit

During 2001, the Group entered into an arrangement with ZAO Profit ("Profit"), a supplier of scrap metal, to provide extended credit to the Group in order to improve the Group's short term cash position and facilitate the financing of capital expenditure and investments. Some members of the Group General Director's immediate family have a significant financial interest in Profit.

The arrangement resulted in the Group accumulating significant accounts payable to Profit. Total accounts payable as at 31 December 2001 amounted to USD 7.9 million (2000: USD 258 thousand).

In 2001, the Group purchased scrap metal totalling USD 63 million (2000: USD 50 million) from Profit, representing approximately 85% of the Group's scrap metal purchases. In the second half of the year, the price paid for scrap metal to this company progressively increased in comparison to the price paid to other suppliers. Profit obtained a loan of RUR 100 million (USD 3.3 million) to finance this arrangement and the Group pledged scrap metal with a book value of USD 8 million as security for this loan (refer note 24). A portion of the abovementioned price increase relates to the interest cost which Profit bears on the loan.

Subsequent to the balance sheet date, the Group utilised USD 6.1 million of the proceeds received from the abovementioned euro note issue (refer note 23) to repay a significant portion of the amount payable to Profit.

Notes to the consolidated financial statements

28. 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, and accounts receivable. Cash equivalents consist of USD denominated bank promissory notes acquired from Credit Ural Bank, a related party of the Group. Significant cash deposits are also held in this bank (refer note 20). Credit 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 23. The Group borrows on both a fixed and variable interest rate basis. All variable interest rate loans and borrowings are re-priced on a monthly basis.

Foreign currency risk

The Group incurs foreign currency risk on transactions that are denominated in a currency other than the US dollar. The currency giving rise to this risk is primarily the Russian rouble. Management consider the Group's major foreign currency risk as being the devaluation of the Russian rouble against it's measurement currency. Management mitigate this risk by ensuring a Russian rouble denominated net monetary liability position is maintained.

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 fair value. As at 31 December 2001, the carrying value of fixed rate long-term debt (including finance lease liabilities) was USD 64 million (2000: USD 21 million). The fair value of fixed rate long-term debt, based on the estimated market values for debt instruments with similar characteristics was USD 65 million (2000: USD 21 million).

Notes to the consolidated financial statements

29. Subsidiary companies

The following is a list of significant subsidiaries:

	Country of incorporation	Ownership 2001	Ownership 2000
MMK Steel Trade AG	Switzerland	100%	100%
MMK Finance S.A.	Luxembourg	100%	-
ZAO Avtotransportnoye Upravleniye	Russia	100%	100%
ZAO Magma	Russia	100%	100%
ZAO Metalloshlak	Russia	100%	100%
ZAO RMK	Russia	100%	100%
ZAO Emal	Russia	100%	100%
ZAO Ogneupor	Russia	100%	100%
ZAO Elektroremont	Russia	100%	100%
ZAO Agropromyshlenny Komplex	Russia	100%	100%
ZAO Metalurgspetstroyremont	Russia	100%	100%
ZAO IK RFC	Russia	100%	100%
OOO Region	Russia	100%	100%
ZAO Stalprokatny Zavod	Russia	100%	100%
OOO Mekom	Russia	100%	100%
ZAO A Kapital	Russia	100%	100%
ZAO Mehanoremontny Komplex	Russia	100%	100%
ZAO Stroitelny Komplex	Russia	100%	100%
ZAO Meharnoremont	Russia	100%	100%
ZAO Torgovlya and PPP	Russia	100%	100%
ZAO Stroitelny Fond	Russia	100%	99%
OOO Profil GP	Russia	100%	-
OOO Press-5P	Russia	89%	51%
ZAO Promzhilstroy MMK	Russia	75%	77%
OAO Magnitogorsky Kalibrovochny Zavod	Russia	65%	-
OOO Minimax	Russia	60%	60%
OAO MCOZ	Russia	56%	56%
ZAO Komplex Glubokoy Pererabotki	Russia	51%	96%
OOO Interlux Ltd.	Russia	51%	51%
ZAO Uralskaya Trubosvarochnaya Kompaniya	Russia	51%	51%
ZAO Glubokaya Pererabotka	Russia	51%	51%
OOO MMK-Trans	Russia	50%	50%

In addition, another 53 subsidiaries, which are not material to the Group, either individually or in aggregate, have been included in these consolidated financial statements.

Acquisition of subsidiary
On 28 December 2001, the Group acquired 64.7% of the shares in OAO Magnitogorsky Kalibrovochny Zavod for USD 946 thousand. The acquisition was accounted for using the purchase method of consolidation. The fair value of the company's net assets on acquisition was a negative amount of USD 4.1 million. The goodwill of USD 5.1 million recognised on acquisition will be amortised over 15 years.

Notes to the consolidated financial statements

30. Related party transactions

Sales & purchases to/from related parties

In millions of US dollars	**Note**	**Sales 2001**	**Sales 2000**	**Purchases 2001**	**Purchases 2000**
MMMZ	15	14	10	2	3
Conares	21	118	119	-	-
Vostokprominvest	27	-	-	89	25
Profit	27	-	-	63	50

Amounts due to/from related parties

In millions of US dollars	**Note**	**Receivable 2001**	**Receivable 2000**	**Payable 2001**	**Payable 2000**
Kuzbassugol	15	3	-	-	-
MMMZ	15	1	-	-	-
CUB - cash	20	46	35	-	-
Conares	21	5	4	-	-
CUB - loans	23	-	-	3	-
Leasing-M	23	-	-	8	-
Vostokprominvest	27	-	-	37	2
Profit	27	-	-	8	-

Financial guarantees provided to related parties

Details of financial guarantees and assets pledged against loans provided to related parties are disclosed in notes 24 and 32.

31. Commitments

(i) Capital commitments

The Group is committed to capital expenditure of approximately USD 77 million (2000: USD 152 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, however, management expects that the Group will continue to fund these social programs for the foreseeable future. These costs are recorded in the year they are incurred.

Notes to the consolidated financial statements

32. Contingencies

(i) Financial Guarantees

The Group has provided financial guarantees for loans obtained by 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	2001	2000
Non-current			
Related party supplier – Vostokprominvest		10	-
Current			
Related party supplier – Vostokprominvest	24	21	-
Third party suppliers		5	-
		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 represented above. Assets of the Group were also pledged against loans obtained by related parties (refer note 24). Management believes that the likelihood of material payments being required under these agreements is remote. As at 31 December 2001 the Group did not have any contractual commitments to extend financial guarantees, credit or other assistance.

Short term financial guarantees and pledge agreements provided for related party debt of USD 20.6 million have been cancelled due to the repayment of this debt subsequent to the balance sheet date. The amount of debt related to the long term financial guarantee has also been repaid subsequent to the balance sheet date. However, the financial guarantee agreement continues to be effective for a year after the date of the loan repayment.

(ii) 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 Company does not have full coverage for it's plant facilities, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Company property or relating to Company operations. Until the Company obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Company's operations and financial position.

(iii) Litigation

Unresolved claims and litigation against the Group as at 31 December 2001 amounted to USD 4 million (2000: USD 15 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 significant loss to the Group and, accordingly, no provision has been made for these unresolved claims and litigations.

Notes to the consolidated financial statements

32. Contingencies continued

(iv) 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 it's interpretation of the tax legislation. However, the relevant authorities may have differing interpretations and the effects could be significant.

(v) 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 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 not significant and are treated by licensed specialists. The future costs associated with the restoration of the iron ore quarry are not expected to be significant. 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 it's 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 significant 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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