

SEVERSTAL-AUTO GROUP

INTERNATIONAL FINANCIAL REPORTING STANDARDS

**CONSOLIDATED FINANCIAL STATEMENTS
AND AUDITORS' REPORT**

31 December 2006

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Independent auditor's report

To the Shareholders and Board of Directors of the Open Joint-Stock Company "Severstal-auto"

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of open joint stock "Severstal-auto" (the "Company") and its subsidiaries (the 'Group') which comprise the consolidated balance sheet as of 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit

ZAO PricewaterhouseCoopers Audit
24 April 2007
Moscow, Russian Federation

Severstal-auto Group
Consolidated Balance Sheet at 31 December 2006
(in millions of Russian Roubles)
(Amounts translated into US Dollars for convenience purposes, Note 2)

	Note	RUB million		Supplementary information US\$ million (Note 2)	
		At 31 December 2006	At 31 December 2005	At 31 December 2006	At 31 December 2005
ASSETS					
Non-current assets:					
Property, plant and equipment	7	13,012	12,227	494	425
Development costs	8	803	739	31	26
Goodwill	9	1,484	1,484	56	52
Intangible assets	10	163	96	6	3
Financial assets	11	54	53	2	2
Other non-current assets	12	272	235	10	8
Total non-current assets		15,788	14,834	599	516
Current assets:					
Inventories	13	6,396	4,702	243	163
Accounts receivable and prepayments	14	4,662	3,431	177	119
Other current assets	15	19	6	1	-
Cash and cash equivalents	16	1,449	1,296	55	45
Total current assets		12,526	9,435	476	327
Total assets		28,314	24,269	1,075	843
LIABILITIES AND EQUITY					
Equity:					
Capital and reserves attributable to the Company's equity holders:					
	17				
Share capital		530	530	20	18
Share premium		6,019	6,019	229	209
Additional paid-in capital		1,438	1,438	55	50
Retained earnings		4,769	3,422	181	119
Total capital and reserves attributable to the Company's equity holders		12,756	11,409	485	396
Minority interest		4,008	3,371	152	117
Total equity		16,764	14,780	637	513
Non-current liabilities:					
Long-term borrowings	18	1,736	1,702	66	59
Long-term taxes payable	19	6	157	-	5
Post-retirement benefit obligation	20	57	34	2	1
Deferred income on government grant and other non-current liabilities	21	369	306	14	11
Deferred income tax liabilities	32	1,186	1,268	45	44
Total non-current liabilities		3,354	3,467	127	120
Current liabilities:					
Accounts payable		4,273	2,715	162	94
Advances received and other payables	22	1,327	951	50	33
Taxes payable	19	522	476	20	17
Warranty and other provisions	23	186	130	7	5
Short-term borrowings	24	1,888	1,750	72	61
Total current liabilities		8,196	6,022	311	210
Total liabilities		11,550	9,489	438	330
Total liabilities and equity		28,314	24,269	1,075	843

General Director
V.A. Shvetsov

24 April 2007

Chief Financial Officer
N.A. Sobolev

The accompanying notes are an integral part of the consolidated financial statements.

Severstal-auto Group
Consolidated Statement of Income for the year ended 31 December 2006
(in millions of Russian Roubles)

(Amounts translated into US Dollars for convenience purposes, Note 2)

	Note	RUB million		Supplementary information US\$ million (Note 2)	
		Year ended 31 December		Year ended 31 December	
		2006	2005	2006	2005
Sales	25	33,462	26,541	1,231	938
Cost of sales	26	(25,590)	(20,365)	(941)	(720)
Gross profit		7,872	6,176	290	218
Distribution costs	27	(1,312)	(913)	(48)	(32)
General and administrative expenses	28	(2,656)	(2,266)	(98)	(80)
Other operating expenses	29	(431)	(154)	(16)	(5)
Operating income		3,473	2,843	128	101
Interest expense		(336)	(351)	(12)	(12)
Foreign exchange gain - net	30	82	10	3	-
Gain on forgiveness of tax penalties		10	41	-	1
Net income before taxation		3,229	2,543	119	90
Income tax expense	32	(765)	(627)	(28)	(22)
Net income for the year		2,464	1,916	91	68
Attributable to:					
Equity holders of the Company		1,827	1,527	67	54
Minority interest		637	389	24	14
		2,464	1,916	91	68
Weighted average number of shares outstanding during the period (thousands)	33	34,270	31,290	34,270	31,290
Earnings per share (in RUB and US\$) – basic and fully diluted	33	53.31	48.80	2.0	1.7

The accompanying notes are an integral part of the consolidated financial statements.

Severstal-auto Group
Consolidated Statement of Cash Flows for the year ended 31 December 2006
(in millions of Russian Roubles)

(Amounts translated into US Dollars for convenience purposes, Note 2)

	Note	RUB million		Supplementary information US\$ million (Note 2)	
		Year ended 31 December		Year ended 31 December	
		2006	2005	2006	2005
Cash flows from operating activities					
Income before taxation		3,229	2,543	119	90
Adjustments for:					
Depreciation	31	921	783	34	28
Provision for impairment of receivables	14	5	(30)	-	(1)
Excess of acquired share of net assets over purchase consideration	9	-	(57)	-	(2)
Interest expense		336	351	12	12
Provisions movements		56	(2)	2	-
Loss on disposal of other non-current assets		32		1	
Post-employment benefit obligation	20	23	17	1	-
Fair value losses on financial assets at fair value through profit or loss		6	(3)	-	-
Forgiveness of tax debts		(10)	(41)	-	(1)
Government grant amortisation	29	(14)	(10)	(1)	-
Development expenses write-off	8	95	138	3	4
Loss/(Gain) on sale of property, plant and equipment	29	86	(4)	3	-
Operating cash flows before working capital changes		4,765	3,685	174	130
Increase in accounts receivable and prepayments		(1,237)	(746)	(45)	(26)
Increase in inventories		(1,694)	(983)	(62)	(35)
(Increase)/decrease in other current assets		(13)	52	-	2
Increase in accounts payable, advances received and other payables		1,802	1,035	66	37
Decrease in taxes payable, other than income tax		(299)	(51)	(11)	(2)
Cash provided from operations		3,324	2,992	122	106
Income tax paid		(709)	(576)	(26)	(20)
Interest paid		(188)	(350)	(7)	(12)
Net cash from operating activities		2,427	2,066	89	74
Cash flows from investing activities:					
Purchase of property, plant and equipment		(1,956)	(1,340)	(73)	(47)
Proceeds from the sale of property, plant and equipment		251	84	10	3
Development costs	8	(212)	(350)	(8)	(12)
Increase of stake in subsidiary	9	-	(160)	-	(6)
Acquisition of subsidiary, net of cash acquired	9	-	(1,323)	-	(47)
Purchase of other non-current assets		(174)	(47)	(6)	(2)
Interest received		-	21	-	1
Net cash used in investing activities:		(2,091)	(3,115)	(77)	(110)
Cash flows from financing activities:					
Proceeds from borrowings		13,189	12,564	485	444
Repayment of borrowings and long-term taxes payable		(13,099)	(12,424)	(482)	(440)
Proceeds from parent company share issue	17	-	1,816	-	64
Proceeds from government grant		77	15	3	-
Dividends paid		(350)	(549)	(13)	(20)
Dividends paid to minorities		-	(59)	-	(2)
Net cash (used in) / provided from financing activities		(183)	1,363	(7)	46
Net increase in cash and cash equivalents		153	314	5	10
Effect of exchange rate changes on cash & cash equivalents				5	
Cash and cash equivalents at the beginning of the period		1,296	982	45	35
Cash and cash equivalents at the end of the period	16	1,449	1,296	55	45

The accompanying notes are an integral part of the consolidated financial statements.

Severstal-auto Group
Consolidated Statement of Changes in Equity for the year ended 31 December 2006
(in millions of Russian Roubles)

(Amounts translated into US Dollars for convenience purposes, Note 2)

	Note	Share capital	Share premium	Additional paid-in-capital	Retained earnings	Attributable to equity shareholders of the Company	Minority interest	Total equity
Balance at 31 December 2004		474	4,259	1,438	2,210	8,381	3,154	11,535
Net income for the year		-	-	-	1,527	1,527	389	1,916
Additional share issue		56	1,760	-	-	1,816	-	1,816
Dividends	17	-	-	-	(327)	(327)	-	(327)
Share of net assets acquired from minority shareholders	9	-	-	-	12	12	(177)	(165)
Business combination	9	-	-	-	-	-	5	5
Balance at 31 December 2005		530	6,019	1,438	3,422	11,409	3,371	14,780
Net income for the year					1,827	1,827	637	2,464
Dividends	17				(480)	(480)		(480)
Balance at 31 December 2006		530	6,019	1,438	4,769	12,756	4,008	16,764
		Share capital	Share premium	Additional paid-in-capital	Retained earnings	Attributable to equity shareholders of the Company	Minority interest	Total equity
Supplementary information								
USS million								
(Note 2)								
Balance at 31 December 2005		18	209	50	119	396	117	513
Balance at 31 December 2006		20	229	55	181	485	152	637

The accompanying notes are an integral part of the consolidated financial statements.

1 The Severstal-auto Group and its operations

OAo "Severstal-auto" (the "Company") and its subsidiaries' (the "Group") principal activities are the manufacture and sale of vehicles, including automotive components, assembly kits, and engines. The Group's manufacturing facilities are primarily based in the City of Ulyanovsk, the Nizhny Novgorod Region, the City of Naberezhnye Chelny and Elabuga in the Russian Federation.

OAo "Severstal-auto" was incorporated as an open joint stock company in the Russian Federation in March 2002 by OAo "Severstal" (the predecessor) by contributing its controlling interests in OAo "UAZ" and OAo "ZMZ", which were acquired through purchases close to the end of 2000, in exchange for the Company's share capital.

The Company's parent is Newdeal Investments Limited which holds 58% (31 December 2005: 63%) of the Company's share capital. At the balance sheet date Aleksey Mordashov and Vadim Shvetsov controlled, respectively, 85% and 15% of the share capital of Newdeal Investments Limited, see Note 38.1.

During the year ended 31 December 2005 the Company acquired control over OAo "Small Car Plant" (OAo "ZMA") based in Naberezhnye Chelny, Republic of Tatarstan.

In 2006 the Group commenced production of FIAT and Ssang Young passenger cars and started sales of FIAT and Ssang Yong imported vehicles.

The registered office of the Company is Prospect Pobedy, 33, Cherepovets, Vologda Region, 162614, Russian Federation.

These consolidated financial statements were approved for issue by the General Director and Chief Financial Officer on 24 April 2007.

2 Basis of preparation and significant accounting policies

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention as modified by available-for-sale investments at fair value, financial assets at fair value through profit and loss. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated (refer to Note 4, Adoption of New or Revised Standards and Interpretations).

The Group companies maintain their accounting records in Russian Roubles ("RUB") and prepare their statutory financial statements in accordance with the Federal Law on Accounting of the Russian Federation. The financial statements are based on the statutory records, with adjustments and reclassifications recorded for the purpose of fair presentation in accordance with IFRS.

2.1. Presentation currency

All amounts in these financial statements are presented in millions of Russian Roubles ("RR millions"), unless otherwise stated.

2.2. Accounting for the effects of hyperinflation

The Russian Federation has previously experienced relatively high levels of inflation and was considered to be hyperinflationary as defined by IAS 29 "Financial Reporting in Hyperinflationary Economies" ("IAS 29"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. Hyperinflation in the Russian Federation ceased effective from 1 January 2003. Restatement procedures of IAS 29 are therefore only applied to assets acquired or revalued and liabilities incurred or assumed prior to that date. For these balances, the amounts expressed in the measuring unit current at 31 December 2002 are treated as the basis for the carrying amounts in these financial statements.

2 Basis of presentation and significant accounting policies (continued)

2.3. Supplementary information

U.S. Dollar ("US\$") amounts shown in the consolidated financial statements are translated from the RUB as a matter of arithmetic computation only, at the official rate of the Central Bank of the Russian Federation at 31 December 2006 of RUB 26.33 = US\$1 (at 31 December 2005 of RUB 28.78 = US\$1). The statement of income and cash flow statement have been translated at the average exchange rates during the years ended 31 December 2006 and 31 December 2005. The difference was recognised in equity. The US\$ amounts are presented solely for the convenience of the reader, and should not be construed as a representation that RUB amounts have been or could have been converted to the US\$ at this rate, nor that the US\$ amounts present fairly the financial position and results of operations and cash flows of the Group in accordance with IFRS.

Exchange restrictions and currency controls exist relating to converting the RUB into other currencies. The RUB is not freely convertible in most countries outside of the Russian Federation

2.4. Consolidated financial statements

Subsidiaries are those companies and other entities (including special purpose entities) in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain economic benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The date of exchange is the acquisition date where a business combination is achieved in a single transaction, and is the date of each share purchase where a business combination is achieved in stages by successive share purchases.

The excess of the cost of acquisition over the fair value of the net assets of the acquiree at each exchange transaction represents goodwill. The excess of the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired over cost ("negative goodwill") is recognised immediately in profit or loss.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any minority interest. The difference, if any, between the fair values of the net assets at the dates of exchange and at the date of acquisition is recorded directly in equity.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

Minority interest is that part of the net results and of the net assets of a subsidiary, including the fair value adjustments, which is attributable to interests which are not owned, directly or indirectly, by the Company. Minority interest forms a separate component of the Group's equity.

2.5. Purchases of minority interests

Difference, if any, between the carrying amount of a minority interest and the amount paid to acquire it is recorded as gain or loss directly in equity.

2 Basis of presentation and significant accounting policies (continued)

2.6. Purchases of subsidiaries from parties under common control

Purchases of subsidiaries from parties under common control are accounted for using the pooling of interest method. Under this method the financial statements of the combined entity are presented as if the businesses had been combined from the beginning of the earliest period presented. The assets and liabilities of the subsidiary transferred under common control are at the predecessor entity's carrying amounts. Related goodwill inherent in the predecessor entity's original acquisitions is also recorded in these financial statements. Any difference between the carrying amount of net assets, including the predecessor entity's goodwill, and the consideration paid is accounted for in these consolidated financial statements as an adjustment to equity.

2.7. Property, plant and equipment

Property, plant and equipment are stated at cost, restated to the equivalent purchasing power of the Russian Rouble at 31 December 2002 for assets acquired prior to 1 January 2003, less accumulated depreciation and provision for impairment, where required. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets.

Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing or renewing major parts or components of property, plant and equipment items are capitalised and the replaced part is retired.

At each reporting date the management assess whether there is any indication of impairment of property, plant and equipment. If any such indication exists, the management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the income statement. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss.

2.8. Depreciation

Land is not depreciated. Depreciation on other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	<u>Useful life in years</u>
Buildings	35 to 45
Plant and machinery	15 to 25
Other	5 to 12

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

2.9. Operating leases

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss on a straight-line basis over the period of the lease.

When assets are leased out under an operating lease, the lease payments receivable are recognised as rental income on a straight-line basis over the lease term.

2 Basis of presentation and significant accounting policies (continued)

2.10. Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the acquirer's share of the net identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of exchange. Goodwill on acquisitions of subsidiaries is presented separately in the consolidated balance sheet. Goodwill on acquisitions of associates is included in the investment in associates. Goodwill is carried at cost less accumulated impairment losses, if any.

The Group tests goodwill for impairment at least annually and whenever there are indications that goodwill may be impaired. Goodwill is allocated to the cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the business combination. Such units or group of units represent the lowest level at which the Group monitors goodwill and are not larger than a segment. Gains or losses on disposal of an operation within a cash generating unit to which goodwill has been allocated include the carrying amount of goodwill associated with the operation disposed of, generally measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit which is retained.

Goodwill is allocated to cash generating units for the purposes of impairment testing, namely the two major subsidiaries: OAO "UAZ" and OAO "ZMZ".

2.11. Other intangible assets

All of the Group's other intangible assets have definite useful lives and primarily include capitalised computer software, patents, trademarks, licences and clips.

Acquired computer software licenses, patents and trademarks are capitalised on the basis of the costs incurred to acquire and bring them to use.

Development costs that are directly associated with identifiable and unique software controlled by the Group are recorded as intangible assets if inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred. Intangible assets are amortised using the straight-line method over their useful lives:

	<u>Number of years</u>
Computer software licenses	3 to 5
Trademarks and licences	3 to 10

If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less costs to sell.

2 Basis of presentation and significant accounting policies (continued)

2.12. Classification of financial assets

The Group classifies its financial assets into the following measurement categories: trading, available-for-sale, held to maturity and loans and receivables.

Trading investments are securities or other financial assets, which are either acquired for generating a profit from short-term fluctuations in price or trader's margin, or are included in a portfolio in which a pattern of short-term trading exists. The Group classifies financial assets into trading investments if it has an intention to sell them within a short period after acquisition, i.e. within 1 to 3 months. Trading investments are not reclassified out of this category even when the Group's intentions subsequently change.

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Group intends to sell in the near term.

Held to maturity classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at each balance sheet date. All other financial assets are included in the available-for-sale category.

2.13. Initial recognition of financial instruments

Trading investments and derivatives are initially recorded at fair value. All other financial assets and liabilities are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Group commits to deliver a financial asset. All other purchases and sales are recognised on the settlement date with the change in value between the commitment date and settlement date not recognised for assets carried at cost or amortised cost; recognised in profit or loss for trading investments; and recognised in equity for assets classified as available for sale.

2.14. Derecognition of financial assets

The Group derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (ii) the Group has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Group has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

2 Basis of presentation and significant accounting policies (continued)

2.15. Available-for-sale investments

Available-for-sale investments are carried at fair value. Interest income on available for sale debt securities is calculated using the effective interest method and recognised in profit or loss. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Group's right to receive payment is established. All other elements of changes in the fair value are deferred in equity until the investment is derecognised or impaired at which time the cumulative gain or loss is removed from equity to profit or loss.

Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of available-for-sale investments. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss. Impairment losses on equity instruments are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through current period's profit or loss.

2.16. Income taxes

Income taxes have been provided for in the consolidated financial statements in accordance with Russian legislation enacted or substantively enacted by the balance sheet date. The income tax charge comprises current tax and deferred tax and is recognised in the consolidated income statement unless it relates to transactions that are recognised, in the same or a different period, directly in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxes, other than on income, are recorded within operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised. Deferred income tax is provided on post acquisition retained earnings of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

2.17. Inventories

Inventories are recorded at the lower of cost and net realisable value. Cost of inventory is determined on the weighted average basis. The cost of finished goods and work in progress comprises raw material, direct labour, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

2.18. Trade and other receivables

Trade and other receivables are carried at amortised cost using the effective interest method. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The amount of the provision is recognised in the income statement.

2 Basis of presentation and significant accounting policies (continued)

2.19. Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method. Restricted balances are excluded from cash and cash equivalents for the purposes of the cash flow statement. Balances restricted from being exchanged or used to settle a liability for at least twelve months after the balance sheet date are included in other non-current assets.

2.20. Discontinued operations

A discontinued operation is a component of the Group that either has been disposed of, or that is classified as held for sale, and: (a) represents a separate major line of business or geographical area of operations; (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or (c) is a subsidiary acquired exclusively with a view to resale. Earnings and cash flows of discontinued operations, if any, are disclosed separately from continuing operations with comparatives being re-presented.

2.21. Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is presented in the notes as a share premium.

2.22. Treasury shares

Where any Group company purchases the Company's equity share capital, the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

2.23. Dividends

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

2.24. Value added tax

Output value added tax related to sales is payable to tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the balance sheet on a gross basis and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

2.25. Borrowings

Borrowings are carried at amortised cost using the effective interest method. Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

Accrued interest is recorded within the relevant borrowing.

Restructured taxes are recognised initially at their fair value (which is determined using the prevailing market rate of interest for a similar instrument). In subsequent periods, restructured taxes are stated at amortised cost.

2 Basis of presentation and significant accounting policies (continued)

2.26. Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred income and are credited to the income statement on a straight line basis over the expected lives of the related assets. Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

2.27. Trade and other payables

Trade payables are accrued when the counterparty performed its obligations under the contract and are carried at amortised cost using the effective interest method.

2.28. Provisions for liabilities and charges

Provisions for liabilities and charges are recognised when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The Group recognises the estimated liability to repair or replace products sold still under warranty at the balance sheet date. This provision is calculated based on past history of the level of repairs and replacements.

2.29. Financial guarantees

Financial guarantees are contracts that requires the Group to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the guarantee. At each balance sheet date, the guarantees are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the obligation at the balance sheet date.

2.30. Asset retirement obligations

Estimated costs of dismantling and removing an item of property, plant and equipment (asset retirement obligations) are added to the cost of an item of property plant and equipment when incurred either when an item is acquired or as the item is used during a particular period for purposes other than to produce inventories during that period. Changes in the measurement of an existing asset retirement obligation that result from changes in the estimated timing or amount of the outflows, or from changes in the discount rate alter the previously recognised revaluation surplus or deficit for asset carried at valuation or adjust the cost of the related asset in the current period for assets carried under the cost model.

2.31. Foreign currency translation

Functional currency of each of the Group's consolidated entities is the currency of the primary economic environment in which the entity operates. The Company's functional currency and the Group's presentation currency is the national currency of the Russian Federation, Russian Roubles ("RR").

Monetary assets and liabilities are translated into each entity's functional currency at the official exchange rate of the CBRF at the respective balance sheet dates. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into each entity's functional currency at year-end official exchange rates of the CBRF are recognised in profit or loss. Translation at year-end rates does not apply to non-monetary items, including equity investments. Effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

2 Basis of presentation and significant accounting policies (continued)

2.32. Revenue recognition

Revenues from sales of vehicles, engines and automotive components are recognised at the point of transfer of risks and rewards of ownership of the goods, normally when the goods are shipped. If the Group agrees to transport goods to a specified location, revenue is recognised when the goods are passed to the customer at the destination point.

Sales of services are recognised in the accounting period in which the services are rendered, by reference to stage of completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Sales are shown net of VAT and discounts.

Revenues are measured at the fair value of the consideration received or receivable. When the fair value of goods received in a barter transaction cannot be measured reliably, the revenue is measured at the fair value of the goods or service given up. Interest income is recognised on a time-proportion basis using the effective interest method.

2.33. Barter transactions and mutual cancellations

A portion of sales and purchases are settled by mutual cancellations, barter or non-cash settlements. These transactions are generally in the form of direct settlements by dissimilar goods and services from the final customer (barter), cancellation of mutual balances or through a chain of non-cash transactions involving several companies. Non-cash settlements include promissory notes or bills of exchange, which are negotiable debt instruments.

Sales and purchases that are expected to be settled by mutual settlements, barter or other non-cash settlements are recognised based on the management's estimate of the fair value to be received or given up in non-cash settlements. The fair value is determined with reference to observable market information.

Non-cash transactions have been excluded from the cash flow statement. Investing and financing activities and the total of operating activities represent actual cash flows (Note 14).

Bills of exchange are issued by the Group entities as payment instruments, which carry a fixed date of repayment. Bills of exchange issued by the Group are carried at amortised cost using the effective interest method.

The Group also accepts bills of exchange from its customers (both issued by customers and third parties) as a settlement of receivables. Bills of exchange issued by customers or issued by third parties are carried at amortised cost using the effective interest method. A provision for impairment of bills of exchange is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

2.34. Research and development costs

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and costs can be measured reliably. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs with a finite useful life that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit, on average over 10 years

2.35. Employee benefits

Wages, salaries, contributions to the Russian Federation state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and kindergarten services) are accrued in the year in which the associated services are rendered by the employees of the Group.

2 Basis of presentation and significant accounting policies (continued)

2.36. Pension costs

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

OA0 "ZMZ" and its subsidiaries operate voluntary pension schemes, which are defined benefit plans. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors, such as age, years of service and average compensation by employee's grade.

The liability recognised in the balance sheet in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the balance sheet date, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by management using the Projected Unit Credit Method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to income over the employees' expected average remaining working lives.

Past service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

2.37. Earnings per share

Earnings per share is determined by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of participating shares outstanding during the reporting year.

2.38. Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments with a majority of revenue earned from sales to external customers and whose revenue, result or assets are ten percent or more of all the segments are reported separately.

3 Critical accounting Estimates, and Judgements in applying accounting policies.

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Tax legislation.

Russian tax, currency and customs legislation is subject to varying interpretations. Refer to Note 35.

3 Critical accounting Estimates, and Judgements in applying accounting policies (continued)

Capitalisation of development costs

The Group capitalises development costs in accordance with the accounting policy stated in Note 2.34. Judgement is required to assess the probability that future economic benefits that are attributable to these assets will flow to the Group.

If management assumptions at 31 December 2006 in relation to the flow of future economic benefits are not fulfilled, writing off all development costs which do not meet recognition criteria would reduce the operating income by RUB 803 at 31 December 2006.

Estimated impairment of goodwill

The Group tests annually whether the goodwill has suffered any impairment in accordance with the accounting policy stated in Note 2.10. The recoverable amounts of cash generating units have been determined, based on value-in-use calculations. These calculations require the use of estimates.

If the operating margin had been 20% lower, or the estimated pre-tax discount rate applied to the individual segments' cash flows had been 20% higher than management has assumed in its impairment testing, the carrying value of the goodwill relating to either segment would have remained unchanged.

Remaining useful life of property, plant and equipment

Management assesses the remaining useful life of property, plant and equipment in accordance with the current technical conditions of assets and estimated period when these assets will bring economic benefit to the Group.

If the estimated remaining useful life of buildings had been 20% higher or lower than management estimates, then at 31 December 2006 the carrying value of buildings would have been RUB 187 higher or RUB 281 lower accordingly. If the estimated remaining useful life of plant and equipment had been 20% higher or lower than management estimates, then at 31 December 2006 the carrying value of plant and equipment would have been RUB 346 higher or RUB 519 lower accordingly.

Warranty provision

Judgement is required in determining a warranty provision. The Group recognises liabilities for warranty based on estimates of additional liabilities to repair or replace products sold which are still under warranty at the balance sheet date. This provision is calculated based on the past history of the level of repairs and replacements. If the revised warranty expense incurred during the twelve months of 2006 had been 50% higher than actual, the Group would need to reduce its income attributable to the equity holders of the Company by RUB 21.

Provision for impairment of accounts receivable

Judgement is required in determining a provision for impairment of accounts receivable. The Group recognises a provision for impairment based on estimates of the collectibility of receivables. As at 31 December 2006 the Group had balances outstanding for more than one year of RUB 42 (at 31 December 2005: RUB 53). Management is confident that these balances will be recoverable in full. However, to the extent that these estimates are not realised, the Group would have to recognise additional bad debt expense.

4 Adoption of new and revised standards and interpretations

Certain new IFRSs became effective for the Group from 1 January 2006. Listed below are those new or amended standards or interpretations which are or in the future could be relevant to the Group's operations and the nature of their impact on the Group's accounting policies. All changes in accounting policies were applied retrospectively with adjustments made to retained earnings at 1 January 2005, unless otherwise described below.

IFRIC 4 – Determining whether an Arrangement contains a Lease (effective from 1 January 2006). IFRIC 4 requires that determining whether an arrangement is, or contains, a lease be based on the substance of the arrangement. It requires an assessment of whether (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset.

4 Adoption of new and revised standards and interpretations (continued)

IAS 39 (Amendment) – The Fair Value of Option (effective from 1 January 2006). IAS 39 (as revised in 2003) permitted entities to designate irrevocably on initial recognition practically any financial instrument as one to be measured at fair value with gains and losses recognised in profit or loss ('fair value through profit or loss'). The amendment changes the definition of financial instruments 'at fair value through profit or loss' and restricts the ability to designate financial instruments as part of this category. The Group may now designate financial instruments as part of this category only if (a) such classification eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or (b) a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information on that basis is regularly provided to and reviewed by the Company's Board of Directors; or (c) a contract contains one or more embedded derivatives unless: (i) the embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract; or (ii) it is clear with little or no analysis when the embedded derivative is first considered that separation of the embedded derivative(s) is prohibited. The Group applies the amendment retrospectively in accordance with the transitional provisions of the Fair Value Option amendment to IAS 39.

IAS 39 (Amendment) - Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006). The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. The Group does not apply hedge accounting and therefore the amendment did not have an impact on these financial statements.

IAS 39 (Amendment) – Financial Guarantee Contracts (effective from 1 January 2006). As a result of this amendment, the Group measures issued financial guarantees initially at their fair value, which is normally evidenced by the amount of fees received. This amount is then amortised on a straight line basis over the life of the guarantee. At each balance sheet date, the guarantees are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the balance sheet date.

IAS 21 (Amendment) - Net Investment in a Foreign Operation (effective from 1 January 2006). This amendment requires foreign exchange gains and losses on monetary items that form part of net investment in a foreign operation (e.g. quasi-equity intercompany loans) to be reported in consolidated equity even if the loans are not in the functional currency of either the lender or the borrower. Previously, such exchange differences were required to be recognised in consolidated profit or loss. It also extended the definition of 'net investment in a foreign operation' to include loans between sister companies. This amendment did not have a significant impact on these financial statements.

IAS 19 (Amendment) - Employee Benefits (effective from 1 January 2006). The amendment introduced an additional option to recognise actuarial gains and losses arising in post-employment defined benefit plans in full directly in retained earnings in equity. It also requires new disclosures about defined benefit plans and clarifies accounting for a contractual agreement between a multi-employer plan and participating employers. This amendment did not have a significant impact on these financial statements.

IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006). Subject to certain exceptions, this interpretation prohibits offsetting a liability for decommissioning costs with an asset representing an interest in a decommissioning or similar fund and clarifies measurement of the reimbursement asset. This interpretation did not have a significant impact on these financial statements.

IFRIC 6, Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment (effective for periods beginning on or after 1 December 2006, that is from 1 January 2006). The Interpretation states that a liability shared among market participants in proportion to their respective market share, in particular the liability for the decommissioning of historical waste electrical and electronic equipment in the European Union, should not be recognised until the measurement period because participation in the market during the measurement period is the obligating event in accordance with IAS 37. This interpretation did not have a significant impact on these financial statements.

4 Adoption of new and revised standards and interpretations (continued)

IFRS 6, Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006). IFRS 6 allows an entity to continue using the accounting policies for exploration and evaluation assets applied immediately before adopting the IFRS, subject to certain impairment test requirements. This standard did not have a significant impact on these financial statements.

Effect of Adoption. The effect of adoption of the above new or revised standards and interpretations on the Group's financial position at 31 December 2006 and 31 December 2005 and on the results of its operations for the years then ended was not significant.

5 New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2007 or later periods and which the entity has not early adopted:

IFRS 7 Financial Instruments: Disclosures and a complementary Amendment to IAS 1 Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007). The IFRS introduces new disclosures to improve the information about financial instruments. The volume of disclosures will increase significantly with an emphasis on quantitative aspects of risk exposures and the methods of risk management. The quantitative disclosures will provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Qualitative and quantitative disclosures will cover exposure to credit risk, liquidity risk and market risk including sensitivity analysis to market risk. IFRS 7 replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and some of the requirements in IAS 32, Financial Instruments: Disclosure and Presentation. The Amendment to IAS 1 introduces disclosures about level of an entity's capital and how it manages capital. The Group is currently assessing what impact the new IFRS and the amendment to IAS 1 will have on disclosures in its financial statements.

IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009). The Standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information. Management is currently assessing what impact the Standard will have on segment disclosures in the Group's financial statements. Management does not expect IFRS 8 to affect the Group's financial statements.

IAS 23 (Revised) IAS 23 removes the option of immediately recognising as an expense borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is one that takes a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised Standard does not require the capitalisation of borrowing costs relating to assets measured at fair value, and inventories that are manufactured or produced in large quantities on a repetitive basis, even if they take a substantial period of time to get ready for use or sale. The revised Standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. Earlier application is permitted.

Other new standards or interpretations. The Group has not early adopted the following other new standards or interpretations:

- IFRIC 7, Applying the Restatement Approach under IAS 29 (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007).
- IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007).
- IFRIC 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006);

5 New Accounting Pronouncement (continued)

- IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006);
- IFRIC 11, IFRS 2—Group and Treasury Share Transactions (effective for annual periods beginning on or after 1 March 2007);
- IFRIC 12, Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008).

Unless otherwise described above, these new standards and interpretations are not expected to significantly affect the Group's financial statements.

6 Balances and transactions with related parties

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party, is under common control with, or exercises significant influence over the other party in making financial and operational decisions as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

6.1 Balances and transactions with related parties

Balances with related parties of the Group as at 31 December 2006 and 31 December 2005 consist of the following:

	Newdeal Investments Limited	Other Severstal group companies	Total
Nature of the relationship	Parent company	Significant influence of management	
Balances			
At 31 December 2006			
Accounts receivable and prepayments	-	25	25
Accounts payable	-	168	168
Borrowings received	-	-	-
At 31 December 2005			
Accounts receivable and prepayments	-	25	25
Accounts payable	-	177	177
Borrowings received	-	3	3

6 Balances and transactions with related parties (continued)

Transactions with related parties of the Group for the years ended 31 December 2006 and 31 December 2005 consist of the following:

Transactions	Newdeal Investments Limited	Other Severstal group companies	Total
Nature of relationship	Parent company	Significant influence of management	
Year ended 31 December 2006			
Purchases	-	983	983
Sales revenue	-	203	203
Borrowings issued	-	4,175	4,175
Borrowings repaid	-	-	-
Dividends paid	278	-	278
Year ended 31 December 2005			
Purchases	-	1,144	1,144
Sales revenue	-	252	252
Borrowings issued	-	52	52
Borrowings repaid	-	78	78
Dividends paid	549	-	549

6.2 Directors' compensation

Compensation paid to 9 key management and directors (year ended 31 December 2005: 9 people) for their services in full or part time executive management positions is made up of a contractual salary and a performance bonus depending on operating results.

Additional fees, compensation and allowances to directors for their services in that capacity, and also for attending board meetings and board committees' meetings were not paid.

Total key management and directors' compensation included in general and administrative expenses in the statement of income amounted to RUB 65 for the year ended 31 December 2006 (year ended 31 December 2005: RUB 63) representing short-term employee benefits only.

7 Property, plant and equipment

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

	<u>Land and Buildings</u>	<u>Plant and equipment</u>	<u>Other</u>	<u>Assets under construction</u>	<u>Total</u>
Cost					
Balance at 31 December 2004	4,792	5,558	811	896	12,057
Acquired through business combination (Note 9)	719	1,004	24	9	1,756
Additions	-	-	-	1,468	1,468
Disposals	(4)	(80)	(15)	(27)	(126)
Transfers	287	1,053	391	(1,731)	-
Balance at 31 December 2005	5,794	7,535	1,211	615	15,155
Additions	3	-	-	1,953	1,956
Disposals	(21)	(93)	(21)	(234)	(369)
Transfers	162	922	215	(1,299)	-
Balance at 31 December 2006	5,938	8,364	1,405	1,035	16,742
Accumulated Depreciation					
Balance at 31 December 2004	(738)	(1,232)	(233)	-	(2,203)
Depreciation expense for year 2005	(189)	(426)	(140)	-	(755)
Disposals	1	21	8	-	30
Balance at 31 December 2005	(926)	(1,637)	(365)	-	(2,928)
Depreciation expense for year 2006	(198)	(468)	(168)	-	(834)
Disposals	-	25	7	-	32
Balance at 31 December 2006	(1,124)	(2,080)	(526)	-	(3,730)
Net Book Value					
Balance at 31 December 2005	4,868	5,898	846	615	12,227
Balance at 31 December 2006	4,814	6,284	879	1,035	13,012

Bank borrowings are secured on properties as at 31 December 2006 to the value of RUB 1,202 (31 December 2005: RUB 1,257); see Note 24.

During 2006 the Group capitalized borrowing costs of RUB 69 (year ended 31 December 2005: RUB 82) in the cost of the qualifying assets (see Note 2.25), annual capitalization rate was 8% (year ended 31 December 2005: 11%).

The Group owns the land on which factories and buildings, comprising the principal manufacturing facilities of the Group, are situated. At 31 December 2006 cost of the land amounts to RUB 931 (31 December 2005: RUB 931).

8 Development costs

	2006	2005
Cost		
Balance at the beginning of the year	753	543
Additions	212	350
Disposals	-	(2)
Write-off	(95)	(138)
Balance at the end of the year	870	753
Accumulated amortisation and impairment		
Balance at the beginning of the year	(14)	-
Amortisation charge	(53)	(14)
Disposals	-	-
Balance at the end of the year	(67)	(14)
Net Book Value		
Balance at 31 December	803	739

The write-off consists of costs that will not result in future economic benefits to the Group.

	31 December 2006	31 December 2005
Development of diesel engine funded by government grant	224	154
Expenditures related to establishing production of diesel engine	146	165
Development of new off-road vehicle (UAZ Patriot)	135	115
Improvement of vehicles and engines to satisfy Euro-2 requirements	60	66
Improvement of four-cylinder petrol engine	58	102
Development of SYMC production process	52	14
Improvement of some vehicle component parts	29	33
Development of new light commercial vehicle (UAZ-2360)	23	19
Improvement of diesel engine funded by internal financing	22	32
Development of Fiat production process	20	-
ISUZU light trucks	2	-
Other	32	39
	803	739

9 Acquisitions and goodwill

Goodwill arose first on the original purchase of controlling stake in OAO "UAZ" and OAO "ZMZ" and then on the increase of holding stake in OAO "UAZ" in 2003 and OAO "ZMZ" in 2004. The positive goodwill is attributable to the profitability of the acquired businesses and the significant synergies expected to arise after the Group's acquisition of OAO "UAZ" and OAO "ZMZ".

	31 December 2006	31 December 2005
Vehicle segment	1,207	1,207
Engine segment	277	277
	1,484	1,484

9 Acquisitions and goodwill (Continued)

Impairment tests for goodwill

The Group tested its goodwill for impairment at 31 December 2006. Goodwill is allocated to the Group's cash generating units (CGUs) according to business segments namely the two major subsidiaries: OAO "UAZ" (vehicle segment) and OAO "ZMZ" (engine segment).

The recoverable amount of a CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Management has based the CGU's cash flow projections on three key assumptions related to the operating margin, growth rate and discount rate specific to each CGU. Management determined budgeted operating margin based on past performance for the last two years and its expectations for market development. For the vehicle segment these include continued strong demand for quality vehicles in the niche markets in which the segment operates, and the segment's sales price advantage over its foreign competition in those markets. For the engine segment these include the consolidation of its position as the dominant supplier of car engines to the Russian market, and its capability to upgrade its products in line with expected increases in regulations over emission levels. Cash flows beyond the five-year period are extrapolated using estimated growth rates of 7.7% for the vehicle segment and 8.7% (31 December 2005: 7.7% and 8.7% respectively) for the engine segment; these growth rates do not exceed the long-term average growth rate for the automotive business in which the CGUs operate. The discount rates used of 19% for vehicle segment and 18.9% (31 December 2005: 19% and 18% respectively) for engine segment are pre-tax and reflect specific risks relating to the relevant segments. Management believes that any reasonably possible change in the key assumptions described above would not cause the carrying amount of goodwill related to vehicle and engine segments to exceed their recoverable amounts.

Acquisition of OAO "ZMA"

In addition to acquisitions described above, by 3 June 2005 the Company completed the acquisition of a new subsidiary OAO "ZMA" based in Naberezhnye Chelny, Republic of Tatarstan. In 2004 its output was 46 thousand vehicles. As a result, the Company acquired 99.66% of OAO "ZMA" shares for RUB 1,403, which also gave rise to negative goodwill of RUB 52 which was immediately written-off to profit and loss account.

The acquired business contributed revenues of RUB 1,459 and net loss of RUB 115 to the Group for the period from 3 June 2005 to 31 December 2005.

Details of net assets acquired and goodwill are as follows:

Purchase consideration:	
Cash paid	1,398
Direct costs relating to the acquisition	5
Total purchase consideration	<u>1,403</u>
Share of net asset acquired (99.66%)	<u>(1,455)</u>
Excess of acquired share in the net identifiable assets over purchase consideration (Note 29)	<u>(52)</u>

9 Acquisitions and goodwill (Continued)

The assets and liabilities arising from the acquisition are as follows:

	Note	<u>Fair value</u>
Cash and cash equivalents		80
Property, plant and equipment	7	1,756
Trademarks and licences	10	40
Other non-current assets		41
Inventories		272
Accounts receivable		510
Trade and other accounts payable		(435)
Short-term borrowings		(504)
Taxes payable		(32)
Warranty and other provisions	23	(33)
Long-term borrowings		(70)
Government grant		(12)
Long term tax liabilities		(16)
Net deferred tax liabilities	32	(137)
Net identifiable assets		<u>1,460</u>
Minority interests (0.34%)		(5)
Net identifiable assets acquired		<u>1,455</u>

Management considers impractical to disclose the carrying amounts of the net assets of OAO "ZMA" immediately before the combination, nor the acquiree's revenue and net profit for the period as though the acquisition was effected at the beginning of the reporting period due to the fact that the entity did not maintain IFRS compliant financial statements prior to the acquisition by the Company.

Increase in holding stake of OAO "ZMZ"

The holding stake in OAO "ZMZ" was further increased by step acquisition from 72% up to 75% of total share capital in 2005.

	<u>2005</u>
Step increase in % of ownership	2.92%
Purchase consideration	160
Share of net assets acquired from minority shareholders	(165)
Excess of acquired share in the net identifiable assets over purchase consideration (Note 29)	<u>(5)</u>

The Company was able to increase the ownership in this subsidiary by acquiring shares from minority shareholders who, having lost significant influence, sold their shares at favourable prices to the Company.

10 Intangible assets

Intangible assets comprise of the following:

	<u>Trade marks</u>	<u>Licences</u>	<u>Total</u>
Cost			
Balance at 31 December 2004	-	71	71
Acquired through business combination (Note 9)	40	-	40
Additions	-	37	37
Disposals	-	-	-
Balance at 31 December 2005	<u>40</u>	<u>108</u>	<u>148</u>
Additions	-	133	133
Disposals	(40)	-	(40)
Balance at 31 December 2006	<u>-</u>	<u>241</u>	<u>241</u>
Accumulated Amortisation			
Balance at 31 December 2004	-	(24)	(24)
Amortisation expense	(8)	(20)	(28)
Disposals	-	-	-
Balance at 31 December 2005	<u>(8)</u>	<u>(44)</u>	<u>(52)</u>
Amortisation expense	-	(34)	(34)
Disposals	8	-	8
Balance at 31 December 2006	<u>-</u>	<u>(78)</u>	<u>(78)</u>
Net Book Value			
Balance at 31 December 2005	<u>32</u>	<u>64</u>	<u>96</u>
Balance at 31 December 2006	<u>-</u>	<u>163</u>	<u>163</u>

11 Financial assets

Non-current financial assets are financial assets available for sale, which comprise principally non-marketable equity securities which are not publicly traded or listed on the Russian stock exchange and, due to the nature of the local financial markets it is not possible to obtain current market value for these investments. For these investments, fair value is estimated by reference to the discounted operating cash flows of the investee. The carrying value of these assets is approximately equal to their fair value.

12 Other non-current assets

Other non-current assets consist of the following:

	<u>31 December 2006</u>	<u>31 December 2005</u>
Advances for equipment	192	135
Advances for construction in progress	54	41
Other	26	59
	<u>272</u>	<u>235</u>

13 Inventories

	31 December 2006	31 December 2005
Raw materials	4,083	2,972
Less: provision	(56)	(49)
	<u>4,027</u>	<u>2,923</u>
Work in progress	694	640
Less: provision	-	-
	<u>694</u>	<u>640</u>
Finished products	1,677	1,139
Less: provision	(2)	-
	<u>1,675</u>	<u>1,139</u>
Total	<u>6,396</u>	<u>4,702</u>

Inventories of RUB 776 (31 December 2005: RUB 833) have been pledged as security for borrowings, see Note 24.

14 Accounts receivable and prepayments

	31 December 2006	31 December 2005
Trade receivables	2,789	2,511
Less: provision for impairment	(48)	(48)
	<u>2,741</u>	<u>2,463</u>
Other receivables	808	335
Less: provision for impairment	(8)	(7)
	<u>800</u>	<u>328</u>
Advances to suppliers	831	395
Less: provision for impairment	(16)	(12)
	<u>815</u>	<u>383</u>
VAT recoverable, net	276	246
Prepayments	30	11
Total	<u>4,662</u>	<u>3,431</u>

Included within net VAT recoverable is RUB 1 of deferred VAT payable (31 December 2005: RUB 515).

Foreign currency denominated net trade receivables:

Currency	31 December 2006	31 December 2005
Euro	1,026	39
US\$	22	377
Total	<u>1,048</u>	<u>416</u>

The carrying value of accounts receivable and prepayments as at 31 December 2006 and 31 December 2005 is approximately equal to their fair value.

Non-cash settlements

In the year ended 31 December 2006 RUB 326 (approximately 1% of total sales) of the Group's settlements of accounts receivable were settled by means of mutual settlements and RUB 36 by means of third-party bills of exchange. In the year ended 31 December 2005 RUB 798 (approximately 3% of total sales) of the Group's settlements of accounts receivable were settled by means of mutual settlements and RUB 290 (approximately 1% of total sales) by means of third-party bills of exchange.

15 Other current assets

Other current assets are represented mainly by bills of exchange of third parties with a turnover period of less than a year and are classified as short-term investments. They have been purchased for further settlements for supply of components.

16 Cash and cash equivalents

	31 December 2006	31 December 2005
Cash on hand and balances with banks	919	567
Letters of credit	416	88
Cash deposits	69	570
Short-term bank promissory notes	45	71
Total	1,449	1,296

Cash deposits of RUB 69 held by the Group at 31 December 2006 bear interest of 4.5% per annum (31 December 2005: RUB 570 bear interest of 6% per annum). Cash and cash equivalents of RUB 251 bear interest of 2%-3%, RUB 398 bear interest of 5% (31 December 2005: RUB 321 bear interest of 5% per annum), RUB 731 held by the Group are not interest bearing (31 December 2005: RUB 405). Letters of credit were established for suppliers of equipment.

Foreign currency denominated cash balances consist of the following:

Currency	31 December 2006	31 December 2005
Euro	63	29
US\$	45	71
Japanese yen	320	-
Total	428	100

The carrying value of cash and cash equivalents as at 31 December 2006 and 31 December 2005 is approximately equal their fair value.

17 Shareholders' equity

The value of share capital issued and fully paid up consists of the following shares:

	Number of outstanding ordinary shares (thousands)	Share capital, RUB	Share premium, RUB	Additional paid-in capital, RUB
At 31 December 2005	34 270	530	6 019	1 438
At 31 December 2006	34 270	530	6 019	1 438

The total authorised number of ordinary shares is 82,074 thousand (31 December 2005: 82,074 thousand). Nominal value of all shares is 12.5 roubles per share. Statutory share capital of the Company totalled RUB 428 (31 December 2005: RUB 428).

The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the net profit. For year ended 31 December 2006, the net statutory profit for the Company as reported in the published annual statutory reporting forms was RUB 3,661 and the closing balance of the accumulated profit including the current reporting period net statutory profit totalled to RUB 7,556. Management believes that the accumulated profit including the current year net statutory profit is distributable.

In June 2005, the General Shareholders' Meeting decided to pay dividends of RUB 327 for 2004, or 11 roubles per ordinary share, in addition to the already accrued interim dividends for the nine months ended 30 September 2004.

In June 2006, the General Shareholders' Meeting decided to pay dividends of RUB 480 for 2005, or 14 roubles per ordinary share.

17 Shareholders' equity (continued)

On 13 January 2005 the Federal Commission of Securities Market registered the prospectus for the issue of 4,470 thousand ordinary shares of the Company at a nominal value of 12.5 roubles per share (which is approximately 15% of the Company's share capital).

In April 2005, the Company started an initial public offering of its shares in the Russian stock market. As part of this offering, Newdeal Investments Ltd. Provided 8,940 thousand ordinary registered shares (amounting to approximately 30% of the Company's share capital) for the initial public offering at a price of US\$ 15.10 per share. The principal shareholder invested into the Company approximately 50% of the net proceeds from the sale of its shares by purchasing newly-issued shares of the Company. The placement of all the newly-issued shares was completed in July 2005.

On 30 August 2005 the Federal Service for Financial Markets approved the results of the issue of 4,470 thousand ordinary shares. As at 31 December 2005 the Company has received RUB 1,816 from the share issue net of transaction costs of RUB 31. Newdeal Investments' equity stake in the Company's post-offering share capital was equal to 63%. In February 2006 5% of it was sold on the market, reducing Newdeal Investments' share to 58%.

18 Long-term borrowings

In January 2004 the Company issued rouble-denominated non-convertible bonds for RUB 1,500 payable in six years time with a coupon payable every six months of 11.25% per annum, see Note 38.3. Transaction costs incurred on the bond placement of RUB 16 were deducted from proceeds received. The funds received were lent on to subsidiaries at similar terms.

During the year ended 31 December 2004 the Group received a Euro denominated loan from Sberbank amounting to RUB 297 with an effective floating interest rate of Euro LIBOR + 4.35% for purchase of equipment for a painting workshop. As of 31 December 2006 the outstanding long-term part of this loan amounted to RUB 121. (31 December 2005: RUB 179). The loan is repayable in nine equal semi-annual instalments starting from July 2005. In 2006 the Group received a Euro denominated loan from Kommerzbank of RUB 123 with an effective floating interest rate of Euro EURIBOR + 0.85%. As of 31 December 2006 the outstanding long-term part of this loan amounted to RUB 98, which will be paid proportionally before 2011.

Long-term debt is repayable as follows:

	31 December 2006	31 December 2005
1 to 2 years	97	89
2 to 3 years	97	61
3 to 4 years	1,521	60
4 to 5 years	21	1,492
Total	1,736	1,702

As at 31 December 2006 and 31 December 2005 the carrying value of these liabilities approximates their fair value.

19 Taxes payable

Current taxes payable

	31 December 2006	31 December 2005
Current portion of taxes restructured to long-term	187	178
Value-added tax	94	97
Payments to the Pension Fund and other social taxes	70	54
Personal income tax	38	40
Income tax	56	52
Property tax	19	12
Tax penalties and interest	7	9
Other taxes	51	34
Total	522	476

The Group had no tax liabilities past due at 31 December 2006 and 31 December 2005.

Long-term taxes payable

Long-term taxes payable comprise various taxes payable other than income tax to the Russian Government which were previously past due and which have been restructured to be repaid over a period of up to 10 years following the application of various Government Resolutions including No. 410 dated 23 May 2001 "On making changes and amendments to the Russian Government Resolution No. 1002 dated 3 September 1999 "Terms of the restructuring of payables to the Federal Budget", as described below. The carrying value of this debt and its maturity profile is as follows:

	31 December 2006	31 December 2005
Current	187	178
1 to 2 years	4	151
2 to 3 years	2	4
3 to 4 years	-	2
Total restructured	193	335
Less: current portion of taxes payable	(187)	(178)
Long-term portion of restructured taxes	6	157

In the event that the Group companies fail to make current tax payments and payments of restructured tax liabilities by the end of each quarter, the Ministry of Taxes and Duties may, within one month, recommend to the Government to cancel the restructuring agreement and call-in the entire liability.

OAO "UAZ", OAO "ZMZ" and OAO "ZMA" are in compliance with the terms of the restructuring of the federal, regional and local tax debts at 31 December 2006. Management is confident that these companies will continue to abide by the terms of the restructuring.

As at 31 December 2006 fair value of these liabilities was estimated to be RUB 6 (31 December 2005: RUB 172) using a current market interest rate of 11.25% (31 December 2005: 11.25%).

20 Post-retirement benefits

OAO "ZMZ" and its subsidiaries provide post employment benefits in the form of a lump sum payment on retirement and quarterly cash payments to their retirees via the non-state pension fund "Stalfond". The benefit amount is determined by key management. The entitlement to benefits (cash payments) ceases when the retirees die. To date it has been an unfunded plan, with no assets specifically allocated to cover the scheme liabilities. The scheme's retirement age is the State retirement age (55 for females and 60 for males). The last actuarial valuation was performed by management in December 2006.

20 Post-retirement benefits (continued)

The amounts recognised in the balance sheet are determined as follows:

	31 December 2006	31 December 2005
Present value of unfunded obligations	194	189
Unrecognized net actuarial loss	(43)	(42)
Unrecognised past service cost	(94)	(113)
Liability in the balance sheet	57	34

The amounts recognised in the statement of income are as follows:

	31 December 2006	31 December 2005
Recognised actuarial gain	-	-
Current service cost	11	12
Amortisation of past service cost	14	8
Interest cost	7	13
Total included in labour expenses (Note 31)	32	33

Deferred past service cost will be amortised over the employees' average remaining working life of 12 years.

Movements in the net liability recognised in the balance sheet are as follows:

	31 December 2006	31 December 2005
At the beginning of the period	34	18
Total expense as above	32	33
Contributions paid	(8)	(17)
Losses on curtailments	(19)	-
Net liability at the end of the period	39	34

The principal actuarial assumptions used were as follows:

	31 December 2006	31 December 2005
Withdrawal rate	3%	3%
Interest rate	7%	9%
Salary growth	8%	8%

21 Deferred income on government grant and other non-current liabilities

In May 2003 the Group won a government grant for a total of RUB 500 for the development of a new diesel engine during the years 2003 - 2007. As at 31 December 2006 the Group had received RUB 391 of this grant. RUB 162 was used for the purchase of new equipment required for research and development works and RUB 229 was spent on the development of the diesel engine and capitalised as development costs in the balance sheet as at 31 December 2006. As at 31 December 2006 the Group recognised RUB 22 of government grant in consolidated statement of income. Initially, to fulfil the terms of the grant the Group should sell during the period from 2005 to 2007 developed new diesel engines in the amount of RUB 4,000. If the sales target is not met, the Group would have to pay a fine to the government equal to 20% of the difference between the volume designated and sales made. During the reporting year the Group continued depreciation of the non-current assets acquired and amortization of deferred income.

As at the end of the year 2006 management finalized renegotiating the conditions attached to the grant with the government. Revised terms require the Group to sell diesel engines in the amount of RUB 2,000 over the period 2006 - 2009. The overall financing of the project was reduced to RUB 391, which were utilized by the end of 2006. Management believes that the Group will be able to comply with the new terms of the grant and will not need to pay a fine. As at 31 December 2006 the Group received the full amount of government grant and report of utilization was accepted by government.

22 Advances received and other payables

	31 December 2006	31 December 2005
Advances from customers	588	229
Salaries payable	207	231
Bonus accrual	185	105
Dividends payable	159	29
Vacation accrual	128	152
Payable for bills	-	74
Other	60	131
Total	1,327	951

Non-cash settlements

In the year ended 31 December 2006 RUB 7 of the Group's settlements of accounts payable and accrued charges were settled by means of third-party bills of exchange and RUB 326 (approximately 1% of total purchases) by means of mutual settlements with suppliers. In the year ended 31 December 2005 RUB 329 (approximately 2% of total purchases) of the Group's settlements of accounts payable and accrued charges were settled by means of third-party bills of exchange and RUB 799 (approximately 4% of total purchases) by means of mutual settlements.

23 Warranty and other provisions

During 2006 and 2005 the following movements of the warranty provision took place:

	Warranty	Tax claims	Total
Balance at 31 December 2004	92	7	99
Acquired through business combination (Note 9)	22	11	33
Additional provision	125	-	125
Utilised in the year of 2005	(114)	(2)	(116)
Reversal of provision	-	(11)	(11)
Balance at 31 December 2005	125	5	130
Additional provision	117	65	182
Utilised in the year of 2006	(121)	(5)	(126)
Balance at 31 December 2006	121	65	186

The Group gives one-year warranty on ZMZ and UAZ products (for UAZ Patriot – 2 years) as well as 3-year warranty on sportage utility vehicles and 2-year warranty on passenger cars produced at ZMA, and undertakes to repair or replace items that fail to perform satisfactorily. A provision of RUB 121 (31 December 2005: RUB 125) was recognised at 31 December 2006 for expected warranty claims based on past experience of the level of repairs and replacements. An additional provision has been recognized for Rexton vehicles based on expected costs not covered by the supplier.

24 Short-term borrowings

As at 31 December 2006 and 31 December 2005 short-term borrowings consist of bank loans amounting to RUB 1,888 and RUB 1,750 respectively. That amount included short-term part of long-term loans of RUB 783 (31 December 2005: RUB 174); and interest accrued on loans amounting to RUB 87 (31 December 2005: RUB 19).

As at 31 December 2006 short-term debt comprises a total of rouble and foreign currency denominated loans at effective fixed interest rates of 1-7% of RUB 1,109, 7-11.25% of RUB 779. As at 31 December 2005 short-term debt comprises a total of rouble-denominated loans at effective fixed interest rates 3-5% of RUB 53, 11% of RUB 179 and 6-9% of RUB 1,518.

As at 31 December 2006 and 31 December 2005 loans for RUB 2,690 and RUB 1,897 respectively, inclusive of long-term borrowing from Sberbank (Note 18), are guaranteed by collateral of inventories and equipment; see Notes 7 and 13.

25 Sales

	Year ended 31 December 2006	Year ended 31 December 2005
Vehicles	19,102	13,397
Engines	8,488	7,879
Automotive components	4,047	3,944
Assembly kits	30	125
Other sales	1,795	1,196
Total	33,462	26,541

26 Cost of sales

	Year ended 31 December 2006	Year ended 31 December 2005
Materials and components used	20,429	16,073
Labour costs	3,669	3,122
Other production costs	1,290	1,068
Depreciation	792	673
Change in finished goods and work in progress	(590)	(571)
Total	25,590	20,365

27 Distribution costs

	Year ended 31 December 2006	Year ended 31 December 2005
Transportation	675	506
Advertising	346	162
Materials	142	148
Labour costs	67	51
Check and inspection performed by dealers	7	21
Other	75	25
Total	1,312	913

28 General and administrative expenses

	Year ended 31 December 2006	Year ended 31 December 2005
Labour costs	1,573	1,288
Services provided by third parties	316	330
Taxes other than income	233	171
Depreciation	129	110
Fire brigade and security costs	80	32
Materials	67	59
Insurance	59	34
Transportation	37	51
Repairs and maintenance	19	35
Training costs	9	25
Provision for impairment of receivables	5	(30)
Other	129	161
Total	2,656	2,266

29 Other operating expenses - net

	Year ended 31 December 2006	Year ended 31 December 2005
Research and development expenses	132	168
Loss/(gain) on disposals of property, plant and equipment	86	(4)
Social expenses	68	80
Provisions and settlements of claims and similar charges	65	(13)
Charity	48	54
Write-off/(reversal) of accounts payable	1	(7)
Fair value loss/(gain) on financial assets at fair value through profit or loss	-	(3)
Excess of acquired shares over purchase consideration	-	(57)
Amortisation of deferred income	(14)	(10)
Gain on disposal of materials	(43)	(22)
Other	88	(32)
Total	431	

30 Foreign exchange gain – net

	Year ended 31 December 2006	Year ended 31 December 2005
Foreign exchange gain	215	85
Foreign exchange loss	(133)	(75)
Total	82	10

31 Expenses by nature

Labour expenses were included in different captions of the consolidated statement of income were as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Cost of sales	3,669	3,122
Administrative expenses	1,573	1,288
Distribution costs	67	51
Total	5,309	4,461

Labour expenses comprise wages, salaries, bonuses, payroll taxes, vacation, salary and postretirement benefit accruals.

31 Expenses by nature (continued)

Depreciation and amortisation included in different captions of the consolidated statement of income was as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Cost of sales	792	673
Administrative expenses	129	110
Total	921	783

Materials included in different captions of the consolidated statement of income were as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Cost of sales	20,429	16,073
Distribution costs	142	148
Administrative expenses	67	59
Total	20,638	16,280

32 Income tax expense

	Year ended 31 December 2006	Year ended 31 December 2005
Income tax expense – current	847	658
Deferred tax credit – origination and reversal of temporary differences	(82)	(31)
Income tax expense	765	627

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated companies as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Income before taxation	3,229	2,543
Theoretical tax charge at the statutory rate of 24%	775	610
Tax effect of items which are not deductible or assessable for taxation purposes:		
Forgiveness of tax penalties	(2)	(10)
Charity	11	15
Tax penalties and interest	-	18
Excess of acquired share over purchase consideration	-	(14)
Other	(19)	8
Income tax expense	765	627

The weighted average applicable tax rate was 24% (2005: 25%).

In general, during the year ended 31 December 2006 the Group was subject to tax rates of 24% on taxable profits. Deferred tax assets/liabilities are measured at the rate of 24% as at 31 December 2006 and 31 December 2005.

32 Income tax expense (continued)

	31 December 2004	Acquired through business combination	Movement in the year 2005	31 December 2005	Movement in the year 2006	31 December 2006
Tax effects of deductible temporary differences:						
Accounts receivable	25	12	(16)	21	1	22
Inventories	-	-	-	-	8	8
Financial assets	1	45	(46)	-	3	3
Pension fund liabilities	4	-	4	8	(8)	-
Accounts payable and provisions	67	5	25	97	9	106
Long-term debt	-	-	-	-	9	9
Other non-current assets	-	(8)	47	39	(36)	3
	97	54	14	165	(14)	151
Tax effects of taxable temporary differences:						
Property, plant and equipment	(1,244)	(193)	13	(1,424)	87	(1,337)
Inventories	(15)	2	4	(9)	9	-
	(1,259)	(191)	17	(1,433)	96	(1,337)
Total net deferred tax liabilities	(1,162)	(137)	31	(1,268)	82	(1,186)

In the context of the Group's current structure, tax losses and current tax assets of the different companies may not be set off against current tax liabilities and taxable profits of other companies and, accordingly, taxes may accrue even where there is a net consolidated tax loss. The deferred tax assets will be realised in different periods than the deferred tax liabilities will be settled. Management believes that there will be sufficient taxable profits available at the time the temporary differences reverse to utilise the deferred tax assets.

Deferred income tax liabilities of RUB 685 (31 December 2005: RUB 494) have not been recognised for the withholding tax and other taxes that would be payable on the unremitted earnings of subsidiaries. Such amounts are permanently reinvested. Unremitted earnings totalled RUB 7,608 at 31 December 2006 (31 December 2005: RUB 5,495).

33 Earnings per share

Earnings per share is calculated by dividing the income attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the period.

	Year ended 31 December 2006	Year ended 31 December 2005
Weighted average number of ordinary shares in issue (thousands)	34,270	31,290
Income attributable to equity holders of the Company	1,827	1,527
Basic/diluted earnings per share (in roubles per share)	53.31	48.80

34 Segment information

Primary reporting format – business segments

At 31 December 2006 the Group is organised as two main business segments:

- (1) manufacture and sale of vehicles and
- (2) manufacture and sale of engines.

Other Group operations are not sufficiently significant to record as separate reportable segments.

The segment results for the year ended 31 December 2005 and balances at 31 December 2006 are as follows:

	Vehicles segment	Engines segment	Unallocated	Group
Sales	21,687	12,691	-	34,378
Inter-segmental sales	(32)	(884)	-	(916)
Net sales	21,655	11,807	-	33,462
Segment results / operating income	1,224	2,249	-	3,473
Interest expense	(181)	34	(189)	(336)
Net foreign exchange gain	80	2	-	82
Gain on forgiveness of tax penalties	-	10	-	10
Segment results	1,123	2,295	(189)	3,229
Income tax expense				(765)
Income for the year				2,464
Segment assets	18,026	8,387	1,901	28,314
Segment liabilities	7,547	2,147	1,855	11,549
Capital expenditures	2,007	335		2,342
Depreciation	604	317		921
Non-cash gains other than depreciation	(79)	5		(74)

The segment results for the year ended and balances at 31 December 2005 are as follows:

	Vehicles segment	Engines segment	Unallocated	Group
Sales	15,812	11,327	-	27,139
Inter-segmental sales	(24)	(574)	-	(598)
Net sales	15,788	10,753	-	26,541
Segment results / operating income	856	1,987	-	2,843
Interest expense	(323)	(18)	(10)	(351)
Net foreign exchange gain	-	-	10	10
Gain on forgiveness of tax penalties	-	41	-	41
Segment results	533	2,010	-	2,543
Income tax expense				(627)
Income for the year				1,916
Segment assets	13,848	8,364	2,057	24,269
Segment liabilities	5,891	2,019	1,579	9,489
Capital expenditures	889	848	-	1,737
Depreciation	550	233	-	783
Non-cash gains/(losses) other than depreciation	126	(143)		(17)

Inter-segment transfers or transactions are entered into under the normal commercial terms and conditions that would also be available to unrelated third parties.

34 Segment information (continued)

Secondary reporting format – geographical segments

The Group's sales are mainly within Russia and in CIS countries.

Geographical reportable segments by location of customers are as follows:

Sales	Year ended 31 December 2006	Year ended 31 December 2005
Domestic	30,119	23,108
Export to CIS	2,796	2,934
Export to other countries	547	499
Total	33,462	26,541

All assets of the Group are located in the Russian Federation.

35 Contingencies, commitments and operating risks

35.1. Contractual commitments and guarantees

As at 31 December 2006 the Group had contractual commitments of RUB 950 for the purchase of property, plant and equipment from third parties (31 December 2005: RUB 265).

35.2. Taxation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Before the acquisition by the Group OAO "ZMA" was the subject of a tax audit. As a result of this audit tax authorities raised a claim against this entity for additional taxes, penalties and late payment interest totalling RUB 22. This assessment relates primarily to income tax. Management is defending its position through the courts. At the date of issuing these financial statements management was successful in defending a part of the claim in amount of RUB 17. Outstanding amount of RUB 5 of this court case has not been resolved. Management believes that the Group's position can be sustained in the future. Therefore, no provision for this litigation or tax assessment has been recorded in these consolidated financial statements.

Russian transfer pricing legislation introduced 1 January 1999 provides the possibility for tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all controllable transactions, provided that the transaction price differs from the market price by more than 20%.

Controllable transactions include transactions with interdependent parties, as determined under the Russian Tax Code, and all cross-border transactions (irrespective whether performed between related or unrelated parties), transactions where the price applied by a taxpayer differs by more than 20% from the price applied in similar transactions by the same taxpayer within a short period of time, and barter transactions. There is no formal guidance as to how these rules should be applied in practice. The arbitration court practice in this respect is contradictory.

Tax liabilities arising from intercompany transactions are determined using actual transaction prices. It is possible with the evolution of the interpretation of the transfer pricing rules in the Russian Federation and the changes in the approach of the Russian tax authorities, that such transfer prices could potentially be challenged in the future. Given the brief nature of the current Russian transfer pricing rules, the impact of any such challenge cannot be reliably estimated; however, it may be significant.

35 Contingencies, Commitments and Operating Risks (Continued)

The Group's Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained. Accordingly, at 31 December 2006 no provision for potential tax liabilities had been recorded (2005: no provision).

35.3 Dependency on a limited number of suppliers and customers

The Group is dependent on a relatively limited number of suppliers for several raw materials and components used in the manufacturing of its products. Consequently, there is a risk that the Group may not be able to negotiate favourable terms, ensure adequate quality of its raw material and components and the performance of its business segments could be affected.

The engine business segment sells 54% (2005: 57%) of its production to one customer – OAO "GAZ". Consequently, the segment performance, results of the operation and prospects of the engine business are highly dependent on the continued relationship with this customer. In 2005 the Group signed a 3 year contract with OAO "GAZ" for delivery of engine supplies.

35.4 Insurance policies

The Group holds insurance policies in relation to its operating assets and vehicles and all events subject to mandatory insurance. The Group does not have business interruption insurance. The Group is subject to political, legislative, tax and regulatory developments and risks, which are not covered by insurance.

35.5 Environmental matters

The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognised immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

35.6 Legal proceedings

During the year ended 31 December 2006 the Group was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated financial statements.

35.7 Operating environment of the Group

Whilst there have been improvements in the economic trends in the country, the Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

36 Principal subsidiaries

The principal subsidiaries consolidated within the Group and the degree of control exercised by OAO "Severstal-auto" are as follows:

Entity	Country of incorporation	Activity	31 December 2006		31 December 2005	
			% of total share capital	% of ordinary shares	% of total share capital	% of ordinary shares
OAO "Ulyanovsky Avtomobilny Zavod"	Russia	Manufacture and sale of passenger automobiles, light trucks and minibuses	66	68	66	68
OAO "Zavolzhskiy Motor Works"	Russia	Manufacture and sale of engines for passenger automobiles, trucks and buses	75	88	75	88
OAO "Small Car Plant"	Russia	Manufacture and sale of passenger automobiles	100	100	100	100
OOO "Severstalavto-Elabuga"	Russia	Manufacture and sale of passenger automobiles	100	-	-	-
OOO «Severstalavto»	Russia	Auto trading	100	-	-	-
OOO "UAZ-Metallurgia"	Russia	Manufacture and sale of metal products	66	-	66	-
OOO "UAZ-Autotrans"	Russia	Transport services	66	-	66	-
OOO "UAZ-Tekhinstrument"	Russia	Manufacture and sale of tooling equipment	66	-	66	-
OOO "ZMZ-Podshipniki Skolzheniya"	Russia	Manufacture and sale of bearings	100	-	100	-
OOO "RosALit"	Russia	Manufacture and sale of metals products	75	-	75	-
OOO "Zavod "Metalloform"	Russia	Manufacture and sale of metals products	75	-	75	-
OOO "Specinstrument"	Russia	Manufacture and sale of tooling equipment	75	-	75	-
OOO "ZMZ-Transservice"	Russia	Transport services	75	-	75	-
OOO "Remservis"	Russia	Repair services	75	-	75	-
ZAO "Kapital"	Russia	Rent services	72	-	72	-

OOO "ZMZ - Transservice", OOO "RosALit", OOO "Zavod "Metalloform", OOO "Specinstrument" are 100% owned by the Company's subsidiary OAO "ZMZ". OOO "UAZ – Autotrans", OOO "UAZ-Tekhinstrument" and OOO "UAZ-Metallurgia" are 100% owned by the Company's subsidiary OAO "UAZ". Share in OOO "ZMZ – Podshipniki Skolzheniya", OOO "ZMZ - Transservice", OOO "UAZ-Metallurgia", OOO "UAZ-Autotrans", OOO "UAZ-Tekhinstrument", OOO "RosALit", OOO "Zavod "Metalloform", OOO "Specinstrument", OOO "Severstalauto-Elabuga", OOO "Severstalauto" represent stockholders' stakes, not number of shares held.

37 Financial risks

37.1. Credit risk

Financial assets, which potentially subject Group entities to credit risk, consist principally of trade receivables. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. The Group has no other significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision already recorded. Cash is placed in financial institutions, which are considered at the time of deposit to have minimal risk of default.

37.2. Foreign exchange risk

The Group's manufacturing operation is in the Russian Federation with limited imports of raw materials and components. Revenue from export of the Group's automotive production is 10% (for year ended 31 December 2005: 13%) of total revenue, most of these sales are denominated in hard currency. Net foreign currency receivables amount to RUB 1,048 (31 December 2005: RUB 416). Hence, the Group is exposed to the related foreign exchange risk primarily with respect to U.S. Dollar. However, management believes that foreign exchange risk is not significant.

37 Financial risks (continued)

37.3. Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest bearing borrowings. The Group has cash deposits bearing the interest rate of 4.5% (see Note 16). The Group has mostly fixed rate interest bearing borrowings, however the Group has a long term loan with floating interest rate of Euro LIBOR (see Note 18 and Note 24).

37.4. Fair values

In assessing the fair value of non-traded financial instruments the Group uses a variety of methods including estimated discounted value of future cash flows, and makes assumptions that are based on market conditions existing at each balance sheet date.

At 31 December 2006 and 31 December 2005 the fair value of financial liabilities, which are estimated by discounting the future contractual cash flows at the current market interest rate for similar financial instruments with the same remaining maturity were disclosed in relevant notes to these consolidated financial statements.

At 31 December 2006 and 31 December 2005 the carrying value of financial assets and cash deposits approximates their fair value.

38 Post balance sheet events

38.1. Change in ownership and shareholders structure

Vadim Shvetsov, General Director of OAO Severstal-Auto, has become the main owner of the company, having increased his participation in the registered capital by acquiring the share that used to belong to Alexey Mordashov, General Director of OAO Severstal.

Earlier Alexey Mordashov and Vadim Shvetsov controlled 49.3% and 8.7% of OAO Severstal-Auto shares respectively through New Deal Investments company. After completing the acquisition of New Deal Investments, which took place in the beginning of the year 2007, Vadim Shvetsov became the sole owner of 58% of Severstal-Auto shares.

38.2. Establishment of new Joint-venture with Isuzu Motors

Isuzu Motors Limited and Severstal-auto announce the signature of Protocol that calls for the study of establishing a joint venture (JV) to produce a wide range of Isuzu Brand trucks in Russia. The new JV is to be located within the production facilities of Severstal-auto in the Volga region. Production capacity of the new JV will reach 25 000 units per year. Isuzu Motors and Severstal-auto agreed to finalize all pending issues with the overall goal to sign joint venture contracts in the first half of 2007.

38.3. Change of interest rate of bonds issued

In January 2007 the Group changed the bond interest rate from 11,25% to 8%. As a result the holders of a part of the bonds in the amount of RUB 762 requested early redemption of the bonds and RUB 75 were subsequently placed at the secondary market.

38.4. Establishment of new companies

In February and March of 2007 the Group incorporated 3 subsidiaries: "TD Severstal-auto", OOO "Severstalinvest", where the Group controls 100% of voting rights. The "Trade House Severstal-auto" and OOO "Severstalinvest" subsidiaries are intended for developing the Group's own dealership network. OOO "Turin-Auto" will distribute FIAT branded vehicles.