

SEVERSTAL

Special purpose consolidated financial statements
for the year ended December 31, 2005

Severstal

Special purpose consolidated financial statements for the year ended December 31, 2005

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Independent Auditors' Report

The Board of Directors of OAO Severstal

We have audited the accompanying special purpose consolidated balance sheets of OAO Severstal (the "Company") and its subsidiaries (the "Group") as at 31 December 2005 and 2004, and the related special purpose consolidated statements of income, changes in equity and cash flows for the years then ended. These special purpose consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these special purpose consolidated financial statements based on our audit.

The special purpose consolidated financial statements have been prepared for the purpose of presenting the consolidated financial position, results of operations and cash flows of the Group as if acquisitions of subsidiaries from the common controlling shareholder in May and June 2006 had taken place as at the date when control was obtained by the common controlling shareholder. The basis of preparation is described in notes 1 and 2.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the special purpose consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2005 and 2004, and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG Limited.

KPMG Limited
29 August 2006

Severstal

Special purpose consolidated balance sheet December 31, 2005 (Amounts expressed in thousands of US dollars)

	Note	December 31,	
		2005	2004
Assets			
Current assets:			
Cash and cash equivalents	11	941,609	1,090,061
Short-term bank deposits	12	674,512	556,623
Short-term financial investments	13	262,440	191,540
Trade accounts receivable	14	497,275	479,781
Amounts receivable from related parties	15	176,807	297,089
Inventories	16	1,089,967	1,122,700
VAT receivable		390,121	201,632
Income tax receivable		17,064	46,322
Other current assets	17	157,571	162,793
Total current assets		4,207,366	4,148,541
Non-current assets:			
Amounts receivable from related parties	15	22,026	19,976
Long-term financial investments	18	653,150	96,594
Investment in associates	19	208,317	85,770
Property, plant and equipment	20	7,464,629	3,477,886
Intangible and other assets		37,250	8,267
Total non-current assets		8,385,372	3,688,493
Total assets		12,592,738	7,837,034
Liabilities and shareholders' equity			
Current liabilities:			
Trade accounts payable		369,765	359,848
Bank customer accounts	21	98,867	44,695
Amounts payable to related parties	22	264,943	198,998
Income taxes payable		45,284	42,705
Other taxes and social security payable		150,198	422,130
Short-term debt finance	23	344,170	273,995
Dividends payable		12,275	18,440
Other current liabilities	24	241,371	232,603
Total current liabilities		1,526,873	1,593,414
Non-current liabilities:			
Long-term debt finance	23	1,441,304	1,399,267
Deferred tax liabilities	10	1,111,597	339,616
Other non-current liabilities	25	411,474	260,762
Total non-current liabilities		2,964,375	1,999,645
Equity:			
Share capital	26	3,311,254	3,311,248
Additional capital		60,367	60,367
Revaluation reserve		3,093,608	631,996
Foreign exchange differences		24,877	191,770
Accumulated earnings/(deficit)		1,410,958	(73,656)
Total equity attributable to shareholders of parent		7,901,064	4,121,725
Minority interest		200,426	122,250
Total equity		8,101,490	4,243,975
Total equity and liabilities		12,592,738	7,837,034

These special purpose financial statements were approved by the Board of Directors on August 29, 2006. The accompanying notes form an integral part of these special purpose consolidated financial statements.

Severstal

Special purpose consolidated income statement Year ended December 31, 2005

(Amounts expressed in thousands of US dollars, except shares and earnings per share)

	Note	Year ended December 31,	
		2005	2004
Sales			
Sales - external		7,964,490	6,407,518
Sales - to related parties	15	659,835	602,614
	4	<u>8,624,325</u>	<u>7,010,132</u>
Cost of sales		(5,304,357)	(4,189,926)
Gross profit		<u>3,319,968</u>	<u>2,820,206</u>
Selling, general and administrative expenses		(379,914)	(343,544)
Distribution expenses		(590,568)	(442,748)
Indirect taxes and contributions		(71,826)	(56,781)
Share of associates' (losses)/profits		(4,266)	7,158
Net income from bank lending operations	6	9,982	4,263
Net income from securities operations	7	6,841	18,592
Net expenses from insurance operations		-	(18,237)
Loss on disposal of property, plant and equipment		(35,551)	(41,111)
Net other operating (expense)/income		(4,412)	8,069
Profit from operations		<u>2,250,254</u>	<u>1,955,867</u>
Reversal of impairment/(impairment) of property, plant and equipment	20	73,710	(16,097)
Penalties on tax liabilities under restructuring		(26,675)	(16,699)
Gain on restructuring of tax liabilities		200,853	6,793
Negative goodwill		7,630	61,274
Net other non-operating expenses	8	(52,647)	(44,798)
Profit before financing and taxation		<u>2,453,125</u>	<u>1,946,340</u>
Net financing expense	9	(170,594)	(106,106)
Profit before income tax		<u>2,282,531</u>	<u>1,840,234</u>
Income tax expense	10	(550,635)	(481,329)
Profit for the year		<u><u>1,731,896</u></u>	<u><u>1,358,905</u></u>
Attributable to:			
shareholders of OAO Severstal and acquired companies		1,672,297	1,344,321
minority interest		<u>59,599</u>	<u>14,584</u>
Weighted average number of shares outstanding during the year (millions of shares after split)		<u>908.7</u>	<u>872.6</u>
Basic and diluted earnings per share (US dollars)		<u>1.84</u>	<u>1.54</u>

The accompanying notes form an integral part of these special purpose consolidated financial statements.

Severstal

Special purpose consolidated statement of cash flows Year ended December 31, 2005 (Amounts expressed in thousands of US dollars)

	Year ended December 31,	
	2005	2004
Operating activities:		
Profit before financing and taxation	2,453,125	1,946,340
Adjustments to reconcile profit to cash generated from operations:		
Depreciation and amortization	416,275	391,882
(Reversal of impairment)/impairment of assets	(73,710)	16,097
Provisions against inventories and receivables	9,306	11,414
Negative goodwill	(7,630)	(61,274)
Loss on disposal of property, plant and equipment	35,551	41,111
Gain on restructuring of tax liabilities	(200,853)	(6,793)
Loss on disposal of subsidiaries/associates	9,759	10,118
Gain on remeasurement and disposal of financial investments	(3,315)	(18,067)
Dividends from associates less share of associates' income	17,312	4,362
Changes in operating assets and liabilities:		
Trade accounts receivable	(36,169)	(205,834)
Amounts receivable from related parties	56,141	12,527
VAT receivable	(199,104)	(98,733)
Inventories	(17,506)	(515,485)
Trade accounts payable	39,796	174,631
Amounts payable to related parties	71,734	106,684
Other non-current liabilities	31,484	58,765
Net other changes in operating assets and liabilities	114,580	(9,077)
Cash generated from operations	2,716,776	1,858,668
Interest paid (excluding banking operations)	(152,383)	(92,229)
Income tax paid	(538,121)	(541,864)
Net cash provided from operating activities	2,026,272	1,224,575
Investing activities:		
Additions to property, plant and equipment	(1,143,501)	(723,491)
Additions to intangible assets	(30,290)	(4,886)
Net additions to short-term bank deposits	(133,526)	(420,231)
Additions to financial investments and associates	(1,502,005)	(305,320)
Buy out of minority interests	(24,040)	(12,926)
Net cash outflow on acquisitions of subsidiaries	(4,880)	(254,927)
Net cash inflow/(outflow) on disposals of subsidiaries	13,701	(22,964)
Proceeds from disposal of property, plant and equipment	5,983	13,751
Proceeds from disposal of financial investments	749,380	323,651
Interest received (excluding banking operations)	46,549	40,965
Cash used for investing activities	(2,022,629)	(1,366,378)
Financing activities:		
Proceeds from debt finance	747,322	1,501,338
Repayment of debt finance	(604,947)	(463,736)
Parent company dividends paid	(277,605)	(337,255)
Minority capital contributions	22,765	4,024
Net other cash flows from financing activities	(7,742)	(682)
Cash (used for)/provided from financing activities	(120,207)	703,689
Effect of exchange rates on cash and cash equivalents	(31,888)	264
Net (decrease)/increase in cash and cash equivalents	(148,452)	562,150
Cash and cash equivalents at beginning of the period	1,090,061	527,911
Cash and cash equivalents at end of the period	941,609	1,090,061

The accompanying notes form an integral part of these special purpose consolidated financial statements.

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Special purpose consolidated statement of changes in equity

Year ended December 31, 2004

(Amounts expressed in thousands of US dollars)

	Attributable to the shareholders of OAO Severstal					Total	Minority interest	Total
	Share capital	Additional capital	Revaluation reserve	Foreign exchange differences	Accumulated earnings/ (deficit)			
Balances at December 31, 2003	3,311,229	44,443	728,467	-	(1,191,860)	2,892,279	129,164	3,021,443
Profit for the year	-	-	-	-	1,344,321	1,344,321	14,584	1,358,905
Realization of revaluation reserve:								
Disposals	-	-	(12,455)	-	12,455	-	-	-
Depreciation	-	-	(114,481)	-	114,481	-	-	-
Deferred tax on realization	-	-	30,465	-	(30,465)	-	-	-
Foreign exchange differences								
Origination	-	-	-	189,137	-	189,137	3,669	192,806
Business de-combinations	-	-	-	2,633	(2,633)	-	-	-
Total recognized income and expenses						1,533,458	18,253	1,551,711
Dividends	-	-	-	-	(316,214)	(316,214)	(58)	(316,272)
Effect of acquisitions and disposals	19	15,924	-	-	(3,741)	12,202	(25,109)	(12,907)
Balances at December 31, 2004	<u>3,311,248</u>	<u>60,367</u>	<u>631,996</u>	<u>191,770</u>	<u>(73,656)</u>	<u>4,121,725</u>	<u>122,250</u>	<u>4,243,975</u>

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Special purpose consolidated statement of changes in equity

Year ended December 31, 2005

(Amounts expressed in thousands of US dollars)

	Attributable to the shareholders of OAO Severstal					Minority interest	Total	
	Share capital	Additional capital	Revaluation reserve	Foreign exchange differences	Accumulated earnings/ (deficit)			Total
Balances at December 31, 2004	3,311,248	60,367	631,996	191,770	(73,656)	4,121,725	122,250	4,243,975
Profit for the year	-	-	-	-	1,672,297	1,672,297	59,599	1,731,896
Realization of revaluation reserve:								
Disposals	-	-	(13,383)	-	13,383	-	-	-
Business de-combinations	-	-	-	-	-	-	-	-
Depreciation	-	-	(105,030)	-	105,030	-	-	-
Deferred tax on realization	-	-	28,419	-	(28,419)	-	-	-
Revaluation of property, plant & equipment:								
Revaluation	-	-	3,358,502	(6,104)	(50,580)	3,301,818	50,580	3,352,398
Deferred tax	-	-	(806,896)	1,465	12,200	(793,231)	(12,200)	(805,431)
Foreign exchange differences								
Origination	-	-	-	(162,254)	-	(162,254)	(4,445)	(166,699)
Business de-combinations	-	-	-	-	-	-	-	-
Revaluation of available-for-sale investments	-	-	-	-	14,124	14,124	-	14,124
Total recognized income and expenses						4,032,754	93,534	4,126,288
Dividends	-	-	-	-	(271,996)	(271,996)	(3,181)	(275,177)
Effect of acquisitions and disposals	6	-	-	-	18,575	18,581	(12,177)	6,404
Balances at December 31, 2005	<u>3,311,254</u>	<u>60,367</u>	<u>3,093,608</u>	<u>24,877</u>	<u>1,410,958</u>	<u>7,901,064</u>	<u>200,426</u>	<u>8,101,490</u>

Included in Accumulated earnings/(deficit) at December 31, 2005 are US\$ 14,124 thousand of unrealized gains on available-for-sale investments (2004: US\$ nil, 2003: US\$ nil).

The accompanying notes form an integral part of these special purpose consolidated financial statements.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

1. Operations

These special purpose consolidated financial statements of OAO Severstal comprise the parent company, OAO Severstal ('Severstal' or 'the Parent Company'), its subsidiaries, and those companies that were acquired from the common controlling shareholder in May and June 2006 (collectively 'the Group') as listed in note 27.

Severstal began operations on August 24, 1955 and completed the development of an integrated iron and steel mill in Cherepovets during February 1959 when the first steel was rolled. On September 24, 1993, as part of the Russian privatization program, Severstal was registered as a Joint Stock Company ('OAO') and privatized. Severstal's registered office is located at Ul Mira 30, Cherepovets, Russia. Severstal's shares are quoted on the Russian Trading System, and since June 2005, on the Moscow Interbank Currency Exchange ('MICEX'). Through participating in Severstal's privatization auctions and other purchases, Alexey Mordashov (the "Majority Shareholder") has purchased shares in Severstal such that as at the balance sheet date he controlled, directly or indirectly, 82.75% (2004: 82.75%) of Severstal's share capital.

The Group comprises the following segments:

- *Steel segment* – this segment operates full cycle integrated iron and steel mills in Russia and the USA and has supporting companies for the sale of products in the Russian and international markets. The maintenance companies, which also are part of this segment, were sold to related parties in December 2004, and the majority of them was purchased back in 2006.
- *Metalware segment* – this segment comprises three locations in Russia containing wire drawing equipment that takes long products (mainly wire) from the Steel segment and turns them into products with a higher value added for the Russian and international markets.
- *Mining segment* – this segment comprises two locations in Russia, where coking coal is produced, one location, where iron ore is produced, and one location, where pellets are produced. This segment also includes coal refining facilities and other auxiliary businesses.
- *Financing and insurance segment* – this segment operates a retail bank. A leasing company, which also had been part of this segment, was sold to related parties in December 2004. This segment also operated two general insurance companies; a specialist medical insurance company; and a life insurance company. A large part of the insurance business was sold to related parties in December 2004, and the remaining part in April 2005.

A segmental analysis of the consolidated balance sheet and income statement is given in note 29.

OAO Severstal and its subsidiaries have earlier issued consolidated financial statements for the year ended December 31, 2005, which were authorized for issue by the Board of Directors on April 24, 2006. In May and June 2006 OAO Severstal and its subsidiaries completed the acquisitions of controlling stakes in mining and repair assets previously controlled by Severstal's Majority Shareholder. These special purpose consolidated financial statements take account of such acquisitions as if they had occurred at the beginning of the earliest comparative period presented or, if later, at the date on which control was obtained by the common controlling shareholder. The acquisition transactions are described in the following paragraphs.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

On March 27, 2006, the Meeting of Shareholders of the Parent Company approved the additional share issue to acquire controlling stakes in coal and iron ore mining assets controlled by its Majority Shareholder and approved an independent appraiser.

On March 29, 2006, having received a fairness opinion on the proposed transaction from Citigroup, the Board of Directors approved the independent appraiser's valuations of the Parent Company shares being issued at RUR 320.74 per share (US\$ 11.24 at the exchange rate on the date of valuation - October 1, 2005) and of the mining assets being acquired at RUR 117,202 million (US\$ 4,107 million at the exchange date on the date of valuation - October 1, 2005).

On May 29, 2006, an extraordinary shareholder meeting approved the price and other terms of the share issue for acquiring the mining assets and on June 6, 2006, the transaction was completed.

Shareholders of the Parent Company, which were entitled to voting on March 27, 2006 but did not participate in it or voted against the deal, had the right to participate in the additional share issue by purchasing for cash the amount of shares that maintained their current shareholding interest at a price of RUR 320.74 per share. The market price of shares on March 27, 2006 was RUR 384 (US\$ 13.79) per share. The Parent Company issued 13,516,489 shares to the shareholders that used these pre-emptive purchase rights.

In May 2006, the Group completed the process of purchasing back controlling stakes in certain repair and construction companies, which were disposed by the Group on December 31, 2004 to related parties. Purchase prices totalled US\$ 60.8 million, which is not significantly different from the amounts received by the Group for disposal of these entities on December 31, 2004.

Intended business combination with Lucchini SpA subsequent to December 31, 2005

The Group's Majority Shareholder intends to sell to the Group the majority stake in Lucchini SpA, a European steel and metalware products producer. Lucchini SpA is not included in these special purpose consolidated financial statements.

Economic environment

A large part of the Group is based in the Russian Federation and is consequently exposed to the economic and political effects of the policies adopted by the Russian government. These conditions and future policy changes could affect the operations of the Group and the realization and settlement of its assets and liabilities.

International sales of rolled steel from the Group's Russian operations have been the subject of several anti-dumping investigations. The Group has taken steps to address the concerns of such investigations and participates actively in their resolution. A brief description of protective measures effective at Severstal's key export markets is given below:

- Exports from Russia to the USA are restricted by the minimum prices issued quarterly by the US Department of Commerce and quotas. Severstal is the first Russian company, for which since September 2005 minimum prices for certain types of steel plate were established based on producer's actual cost and finance data.
- The Canadian market of hot-rolled plate is restricted by minimum prices as well. Work directed to getting minimum prices based on Severstal's actual data was performed in 2005.
- The European Union ('EU') market is protected by quotas. During the last few years quotas have been raised about 2-2.5% each year after adjusting for the effects of EU

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

enlargements. Severstal traditionally gets approximately 35% of the total Russian quota and strives to utilize it fully because the EU market is a key market for Severstal.

- The Chinese market is open to the Russian exporters. No antidumping or safeguard measures are in force.

2. Presentation of the special purpose consolidated financial statements

Statement of compliance

These special purpose consolidated financial statements are prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board, and are prepared under the historic cost convention except that property, plant and equipment; investments designated at fair value through profit and loss; and investments available-for-sale are stated at fair value. The Group's statutory financial records are maintained in accordance with the legislative requirements of the countries in which the individual entities are located, which differ in certain respects from IFRS. The accounting policies applied in the preparation of these special purpose consolidated financial statements are set out in note 3.

Going concern basis

These special purpose consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business.

Use of estimates

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts reported therein. Due to the inherent uncertainty involved in making such estimates, actual results could differ from those estimates.

In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies are described in the following notes:

- Note 18 – Long-term financial investments
- Note 20 – Property, plant and equipment
- Note 25 – Other non-current liabilities

Functional and presentation currency

The national currency of the Russian Federation is the Russian rouble. After extensive reviews of Severstal's operations management determined that Severstal's functional currency changed from the United States dollar ('US dollar') to the Russian rouble ('RUR') at January 1, 2004. This change reflected mainly the consequences of the changes in the Russian economic environment, such as a decrease in inflation level, that led Severstal to move its selling and purchasing activities from mainly US dollar based transactions to mainly rouble based transactions.

Since the Group's consolidated financial statements prior to January 1, 2004 were presented in US dollars, management has elected to continue to use the US dollar as the Group's presentation currency to facilitate the comparability of the Group's results.

The rouble is not a fully convertible currency outside the Russian Federation and accordingly, any conversion of rouble amounts into US dollars should not be construed as a representation

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

that rouble amounts have been, could be, or will be in the future, convertible into US dollars at the exchange rates used, or at any other exchange rate.

Basis of consolidation

Subsidiaries are those enterprises controlled, directly or indirectly, by the Parent Company. The financial statements of subsidiaries are included in these special purpose consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. The minority interest represents the minorities' proportion of the net identifiable assets of the subsidiaries.

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

Intra-group balances and transactions, and any unrealized gains arising from intra-group transactions, are eliminated in preparing the special purpose consolidated financial statements.

Accounting for business combinations of entities under common control

IFRS provides no guidance on accounting for business combinations of entities under common control. Management adopted the accounting policy for such transactions based on the relevant guidance of accounting principles generally accepted in the United States ('US GAAP'). Management believes that this approach and the accounting policy disclosed below are in compliance with IFRS.

Acquisitions of controlling interests in companies that were previously under the control of the same controlling shareholder as the Group have been accounted for as if the acquisition had occurred at the beginning of the earliest comparative period presented or, if later, at the date on which control was obtained by the common controlling shareholder. The assets and liabilities acquired have been recognized at their book values. The components of equity of the acquired companies have been added to the same components within Group equity except that any share capital of the acquired companies has been recorded as part of additional paid in capital. Cash consideration for such acquisitions has been recognized as a liability to or a reduction of receivables from related parties from the date the acquired company is included in these special purpose consolidated financial statements until the cash consideration is paid. Parent Company shares issued in consideration for the acquired companies are recognized from the date the acquired companies are included in these special purpose financial statements.

Acquisitions by the Majority Shareholder of additional interests in the acquired companies, after control over those companies has been obtained by the Majority Shareholder, are treated as if those additional interests were acquired by the Group. No goodwill is recognized on these transactions. The difference between the share of net assets acquired and the cost of investment is recognized directly in equity.

As part of acquiring the mining assets, during 2006 the Group acquired fixed assets that were leased during 2004 and 2005 by the companies controlled by the Majority Shareholder to the acquired mining companies. These fixed assets are included in these special purpose

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

consolidated financial statements from the moment that they were acquired by the companies controlled by the Majority Shareholder. A liability to related parties for purchasing of these fixed assets is recorded in these special purpose consolidated financial statements from the moment the acquired fixed assets were included in the special purpose consolidated financial statements.

3. Summary of the principal accounting policies

The following significant accounting policies have been consistently applied in the preparation of the special purpose consolidated financial statements. These accounting policies are based on the accounting policies used by OAO Severstal for the preparation of consolidated financial statements of Severstal and its subsidiaries for the year ended December 31, 2005, which were authorized for issue by the Board of Directors on April 24, 2006.

a. Cash and cash equivalents

Cash equivalents are all highly liquid temporary cash investments with original maturity dates of three months or less.

b. Inventories

Inventories are stated at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of inventories is based on the weighted average principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads. Provisions are recorded against slow moving and obsolete inventories.

c. Trade and other receivables

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

d. Foreign currency

Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of each entity at the foreign exchange rate ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the functional currency of each entity at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated to the functional currency of the entity at the foreign exchange rate ruling at the date of the transaction. Components of equity are translated into US dollars using rates approximating historic exchange rates ruling on the dates of the transactions. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the Russian roubles at the foreign exchange rate ruling at the dates the fair values were determined. Foreign exchange gains and losses arising on translation are recognized as a part of net financing expense in the income statement.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

Presentation and consolidation

For presentation and consolidation purposes all assets and liabilities at the balance sheet date are translated into US dollars at the foreign exchange rate ruling on that date. Revenues and expenses are translated into US dollars using rates approximating the foreign exchange rates ruling on the dates of the transactions. Foreign exchange gains and losses arising on translation into the presentation currency are recognized directly in the statement of changes in equity.

e. Investments

Investments are recognized (derecognized) when the Group obtains (loses) control over the contractual rights inherent in that asset. Investments are accounted for as follows:

- Investments designated at fair value through profit and loss, including investments held for trading, are stated at fair value, with any resultant gain or loss recognized in the income statement.
- Investments held-to-maturity are stated initially at cost. Subsequent to initial recognition they are stated at amortized cost with any difference between cost and redemption value being recognized in the income statement over the period to maturity on an effective interest basis.
- Originated loans and receivables are stated initially at cost, subject to impairment test, which is done using discounted cash flow techniques. Subsequent to initial recognition they are stated at amortized cost with any difference between cost and redemption value being recognized in the income statement over the period to maturity on an effective interest basis.
- Other investments are classified as available-for-sale and are stated at fair value. A gain or loss on an available-for-sale financial asset is recognized directly in equity, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognized, at which time the cumulative gain or loss previously recognized in equity is recognized in profit or loss. Interest, which is calculated using the effective interest method, is recognized in profit or loss. Dividends on an available-for-sale equity instrument are recognized in profit or loss.

The fair value of investments is their quoted bid price at the balance sheet date. If a quoted market price at the balance sheet date is not available, the fair value of the instrument is estimated using prices of transactions close to the balance sheet date or, if such prices are also not available, the discounted cash flow techniques. Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate at the balance sheet date. Investments in equity securities that are not quoted on a stock exchange, and where fair value cannot be reliably measured by discounted cash flow techniques and other means, are stated at cost less impairment losses.

Additions to financial investments and proceeds from disposals of financial investments are shown separately in the cash flow statement, except for cash inflows and outflows on loans to bank customers, which are shown on a net basis and included, depending on the sign of net change, either in additions to financial investments or in proceeds from disposals of financial investments.

f. Property, plant and equipment

Property, plant and equipment is periodically revalued to be stated at fair market value. In the case of assets constructed by the Group, related works and direct project overheads are

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

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included in cost. Repair and maintenance expenses are charged to the income statement as incurred. Gains or losses on disposals of property, plant and equipment are recognized in the income statement.

Depreciation is provided so as to write off property, plant and equipment over its expected useful life. Depreciation is calculated using the straight line basis, except for depreciation on vehicles and certain metal-rolling equipment, which is calculated on the basis of mileage and units of production, respectively. The estimated useful lives of assets are reviewed regularly and revised when necessary.

The principal periods over which assets are depreciated are as follows:

Buildings and constructions	20 – 50 years
Plant and machinery	10 – 20 years
Other productive assets	5 – 20 years
Community and infrastructure assets	5 – 50 years

With effect from December 31, 2005 management commissioned an independent appraiser to assess for the purpose of financial reporting the value of its productive property, plant and equipment at key entities of the Steel and Mining segments. As at the date of the valuation, accumulated depreciation was offset against cost, and cost was restated to fair market value. Depreciation charge for the subsequent periods is based on estimated remaining useful lives of assets.

A revaluation increase on an item of property, plant and equipment is recognized directly in equity, net of deferred tax, except to the extent that it reverses a previous revaluation decrease recognized in the income statement, in which case it is recognized in the income statement. A revaluation decrease on an item of property, plant and equipment is recognised in the income statement except to the extent that it reverses a previous revaluation increase recognized directly in equity, in which case it is recognized directly in equity.

As the revaluation reserve is realized through depreciation and disposal of the corresponding items of property, plant and equipment the relevant portion of the revaluation reserve, net of deferred tax, is transferred directly into retained earnings.

The previous independent valuation for all productive property, plant and equipment was performed as at January 1, 2001. Management used similar procedures to value the Group's community and infrastructure assets as at January 1, 2001.

g. Goodwill and negative goodwill

Goodwill

Goodwill arising on acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired. Goodwill is stated at cost less impairment losses. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associate.

Negative goodwill

Negative goodwill arising on an acquisition represents the excess of the fair value of the net identifiable assets acquired over the cost of acquisition. All negative goodwill is recognized in the income statement as it arises.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

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h. Asset impairment

The carrying amount of goodwill is tested for impairment annually. The carrying amounts of the Group's other assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognized whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses in respect of revalued property, plant and equipment are recognised in the same way as revaluations; other impairment losses are recognised in the income statement.

Calculation of recoverable amount

The recoverable amount of the Group's held-to-maturity investments and loans and receivables, is calculated as the present value of expected future cash flows, discounted at the effective interest rate inherent in the asset. For other assets the recoverable amount is the greater of the net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Reversals of impairment

An impairment loss in respect of a held-to-maturity investment, loan or receivable is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised. An impairment loss in respect of goodwill is not reversed. In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

i. Dividends payable

Dividends are recognized as a liability in the period in which they are authorized by the shareholders.

j. Indirect taxes and contributions

Indirect taxes and contributions are taxes and mandatory contributions paid to the government, or government controlled agencies, that are calculated on a variety of bases, but exclude taxes calculated on profits, value added taxes calculated on revenues and purchases and social security costs calculated on wages and salaries. Social security costs are included in cost of sales, distribution expenses and selling, general and administrative expenses in accordance with the nature of related wages and salaries expenses.

k. Income tax

Income tax on the profit for the year comprises current and deferred tax. Income tax is recognized in the income statement except to the extent that it relates to items recognized directly to equity, in which case it is recognized in equity.

Current tax expense is calculated by each entity on the pretax income determined in accordance with the tax law of a country, in which the entity is incorporated, using tax rates

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enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is calculated using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting and taxation purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date. Deferred tax assets are recognized only to the extent that it is probable that future taxable profits will be available against which these assets can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred tax is not recognized in respect of the following:

- investments in subsidiaries where the Group is able to control the timing of the reversal of the temporary differences and it is probable that the temporary difference will not reverse in the foreseeable future;
- if it arises from the initial recognition of an asset or liability that affect neither accounting nor taxable profit,
- initial recognition of goodwill.

l. Debt finance

Debt finance is stated at amortized cost, net of any transaction costs incurred, and includes accrued interest at the balance sheet date. The difference between cost and redemption value is recognized in the income statement over the period of the borrowings on an effective interest basis. Borrowing costs on loans specifically for the purchase or construction of property, plant and equipment are capitalized as part of the cost of the asset they are financing.

m. Income recognition

Sales

Revenue from the sale of goods is recognized in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Sales include all amounts billed to customers and are stated net of taxes.

Banking income

Interest income is recognized in the income statement as it accrues. Fees relating to the ongoing provision of services to customers are recognized as income in proportion to the service provided in the year.

n. Net financing expense

Net financing expense comprises interest on debt finance, amortization of transaction costs, amortization of discount on discounted assets and liabilities, interest income and foreign exchange gains and losses.

Interest is recognized in the income statement as it accrues, taking into account the effective yield on the asset or liability.

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All interest costs incurred in connection with borrowings, which are not directly attributable to the acquisition, construction or production of qualifying assets, are expensed as incurred as part of net financing expense.

o. Net income from securities operations

Net income from securities operations comprises dividends income, except for dividends from equity associates, realized and unrealized gains on financial assets at fair value through profit or loss, realized gains and impairment losses on available for sale and held to maturity investments.

p. Earnings per share

Earnings per share is calculated by dividing the net profit by the weighted average number of shares outstanding during the year, assuming the share split in 2004 had occurred at the start of the earliest comparative period and assuming that shares issued in consideration for the companies acquired from the Majority Shareholder were issued from the moment these companies are included in these special purpose consolidated financial statements.

q. Provisions

Retirement benefits

The Group pays retirement and post-employment medical benefits to former employees. The Group's net obligation in respect of defined retirement benefit plans is calculated separately for each defined benefit plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to its present value and the fair value of any plan assets is deducted. The discount rate used is the yield at the balance sheet date on government bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed annually by management using the projected unit credit method. Any actuarial gain or loss arising from the calculation of the retirement benefit obligation is fully recognized in the current year's income statement.

Decommissioning liability

The Group has environmental liabilities related to restoration of soil and other related works, which are due upon the closures of certain of its production sites. The Group generally estimates provisions related to environmental issues on a case-by-case basis, taking into account applicable legal requirements. A best estimate, based on available information, is calculated, provided that the available information indicates that the loss is probable. Decommissioning liabilities are estimated using existing technology, at current prices, and discounted using a real discount rate.

Other provisions

Other provisions are recognized in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

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r. Early adoption of IFRS

Management early adopted IFRS 3 '*Business Combinations*' from the first occasion on which the Group started to prepare general purpose consolidated financial statements. This standard was effective for business combinations for which agreement date is on or after March 31, 2004. If the Group had adopted this standard only from its effective date, then cumulative negative goodwill of US\$ 105.1 million and US\$ 43.8 million would have been capitalized at December 31, 2004 and 2003, respectively, instead of being recognized directly in the income statement, and in accordance with transitional provisions set out in this standard, the amount of US\$ 105.1 million would have been derecognized as an adjustment to the opening balance of retained earnings for the year ended December 31, 2005.

s. New Standards and Interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2005, and have not been applied in preparing these special purpose consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group's operations. The Group plans to adopt these pronouncements when they become effective.

- Amendment to IAS 19 Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures, which is effective for annual periods beginning on or after January 1, 2006. The amendment includes an option for actuarial gains and losses to be recognized in full as they arise, directly in the statement of changes in equity. Management has not used this option in preparation of these special purpose consolidated financial statements.
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts – Financial Guarantee Contracts, which is effective for annual periods beginning on or after 1 January 2006. The amendment requires guarantees that are not insurance contracts to be measured at fair value upon initial recognition. The adoption of this change in accounting policies will have no significant impact on the Group's financial position and results of operations.
- IFRS 7 Financial Instruments: Disclosures, which is effective for annual periods beginning on or after 1 January 2007. The Standard will require increased disclosure in respect of the Group's consolidated financial instruments.
- Amendment to IAS 1 *Presentation of Financial Statements – Capital Disclosures*, which is effective for annual periods beginning on or after 1 January 2007. The Standard will require increased disclosure in respect of the Parent Company's capital.

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(Tabular amounts expressed in thousands of US dollars)

4. Sales

Sales by product were as follows:

	Year ended December 31,	
	2005	2004
Hot rolled sheet	3,279,885	2,447,882
Cold rolled sheet	1,468,927	1,331,408
Galvanized sheet	1,041,711	797,078
Hot rolled sections	493,078	480,015
Semi finished products	348,330	323,502
Further processed products	277,905	262,102
Wire	253,894	249,402
Fastenings	69,544	59,662
Wire rope	72,969	62,807
Netting	29,011	28,752
Electric arc welding rods	19,977	16,114
Pellets and iron ore	400,194	133,316
Coke	142,819	201,901
Chemical by-products	67,570	69,975
Repair services	21,337	26,352
Manufactured equipment	23,381	23,308
Shipping and handling costs billed to customers	405,829	334,801
Other	207,964	161,755
	<u>8,624,325</u>	<u>7,010,132</u>

Sales by delivery destination were as follows:

	Year ended December 31,	
	2005	2004
Russian Federation	3,736,437	2,892,991
United States of America ('USA')	2,052,284	1,787,659
Europe	1,205,056	1,372,241
China and Central Asia	540,781	123,604
The Middle East	353,001	340,893
South-East Asia	325,394	102,784
Central America	172,689	161,204
Africa	148,570	116,856
South America	64,417	71,628
North America (excluding the USA)	25,696	40,272
	<u>8,624,325</u>	<u>7,010,132</u>

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(Tabular amounts expressed in thousands of US dollars)

5. Staff costs

Employment costs were as follows:

	Year ended December 31,	
	2005	2004
Wages and salaries	(780,866)	(670,099)
Social security costs	(167,091)	(164,217)
Retirement benefit costs (see note 25)	4,566	(547)
	(943,391)	(834,863)
Actuarial losses recognized (see note 25)	(59,635)	(80,293)
Staff costs	(1,003,026)	(915,156)

Key management received the following remuneration during the year, which is included in the above staff costs:

	Year ended December 31,	
	2005	2004
Wages and salaries	(3,040)	(3,168)
Social security costs	(108)	(113)
Other benefits	(114)	(251)
	(3,262)	(3,532)

6. Net income from bank lending operations

	Year ended December 31,	
	2005	2004
Interest income:		
Placements with other financial institutions	3,759	1,871
Loans to bank customers:		
- third parties	5,635	3,801
- related parties	1,304	2,597
Interest expense:		
Deposits from other financial institutions	-	(3)
Client accounts:		
- third parties	(593)	(3,899)
- related parties	(622)	(99)
Loan loss provisions	470	(319)
Leasing income	29	314
	9,982	4,263

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(Tabular amounts expressed in thousands of US dollars)

7. Net income from securities operations

	Year ended December 31,	
	2005	2004
Held-for-trading securities		
Profit on disposal	2,034	2,477
Restatement to fair value	198	-
Held to maturity securities and originated loans		
Restatement to fair value	(15,347)	11,836
Coupon income	9	-
Available-for-sale securities		
Profit on disposal	29,497	21,479
Restatement to fair value	(13,076)	(17,725)
Dividends received	3,526	525
	<u>6,841</u>	<u>18,592</u>

8. Net other non-operating expenses

	Year ended December 31,	
	2005	2004
Social expenditure	(28,387)	(16,207)
Charitable donations	(13,283)	(17,022)
Depreciation of community and infrastructure assets	(1,218)	(1,451)
Loss on disposal of subsidiaries and associates	(9,759)	(10,118)
	<u>(52,647)</u>	<u>(44,798)</u>

9. Net financing expense

	Year ended December 31,	
	2005	2004
Interest income:		
Third parties	45,005	29,428
Related parties	12,977	11,537
Interest expense:		
Third parties	(154,179)	(121,169)
Related parties	(2,668)	(4,914)
Amortization of transaction costs	(4,099)	(2,398)
Foreign exchange losses	(67,630)	(18,590)
	<u>(170,594)</u>	<u>(106,106)</u>

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

10. Taxation

The following is an analysis of the income tax expense:

	Year ended December 31,	
	2005	2004
Current tax charge	(567,527)	(521,704)
Corrections to prior year's current tax charge	(5,296)	4,304
Deferred tax benefit	22,188	36,071
	(550,635)	(481,329)

The following is a reconciliation of the reported net income tax expense and the amount calculated by applying the Russian statutory tax rate of 24.0% to reported profit before income tax.

	Year ended December 31,	
	2005	2004
Profit before income tax	2,282,531	1,840,234
Tax charge at the statutory rate	(547,807)	(441,656)
Non-tax deductible expenses, net	(17,359)	(28,727)
Profits taxed at different rates	19,827	(15,250)
Corrections to prior year's current tax charge	(5,296)	4,304
	(550,635)	(481,329)

The composition of, and movements in, the net deferred tax liability based on the temporary differences arising between the fiscal and reporting balance sheets of the consolidated companies, is given below:

	December 31,	
	2005	2004
Deferred tax assets/(liabilities):		
Property, plant and equipment	(1,116,457)	(372,507)
Provisions	31,988	42,796
Other	(27,128)	(9,905)
	(1,111,597)	(339,616)

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

The movement in the net deferred tax liability is as follows:

	Year ended December 31,	
	2005	2004
Opening balance	(339,616)	(326,363)
Recognized in income statement	22,188	36,071
Recognized in shareholders' equity	(805,431)	-
Business combinations	(76)	(37,343)
Business de-combinations	913	7,499
Foreign exchange difference	10,425	(19,480)
Closing balance	<u>(1,111,597)</u>	<u>(339,616)</u>

Temporary differences, related to investments in subsidiaries where the Group is able to control the timing of the reversal and it is probable that the temporary difference will not reverse in the foreseeable future, amounted to US\$ 565.4 million at December 31, 2005 (2004: US\$ 431.4 million).

11. Cash and cash equivalents

	December 31,	
	2005	2004
Petty cash	378	184
Cash at bank	350,999	514,801
Escrow accounts	18,911	34,492
Short term deposits with maturity less than 3 months:		
Related party banks	-	128,859
Other banks	428,074	204,032
Cash balances of consolidated bank:		
Cash	823	1,741
Nostro accounts at the Central Bank of Russia	39,781	48,904
Nostro accounts at other banks	16,997	27,210
Placements with international banks	85,646	96,686
Placements with Russian banks	-	33,152
	<u>941,609</u>	<u>1,090,061</u>

As described in note 27 to these special purpose consolidated financial statements, the Group has a subsidiary OAO Metallurgical commercial bank ("Metcombank"). Nostro accounts of Metcombank at Central Bank of Russia and at other banks and interbank loans given by Metcombank with original maturity of three months or less are included in cash and equivalents.

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(Tabular amounts expressed in thousands of US dollars)

12. Short-term bank deposits

Short-term bank deposits comprise of deposits with original maturity of more than three months but remaining period to maturity of less than one year. The majority of such deposits has the original maturity of less than 6 months, and such deposits are used by the Group to earn investment income, while preserving a high liquidity position. Substantially all such deposits can be withdrawn, in case of necessity, prior to the maturity date with no loss in principal but reduced interest income.

	December 31,	
	2005	2004
Deposits at Russian banks	674,512	473,611
Deposits at related banks	-	83,012
	<u>674,512</u>	<u>556,623</u>

13. Short-term financial investments

	December 31,	
	2005	2004
Held-for-trading securities:		
Promissory notes from related parties	4,772	10,524
Promissory notes and bonds of third parties	72,429	49,744
Russian Government bonds	-	579
Quoted equity shares	1,079	826
Originated loans:		
Loans to related parties	83,700	56,027
Loans to third parties	16,430	13,425
Loans to bank customers:		
Related parties	15,739	31,009
Third parties	71,232	32,835
Loan loss provisions	(3,008)	(3,606)
Available-for-sale securities	67	177
	<u>262,440</u>	<u>191,540</u>

Loans given to related parties were provided at interest rates ranging from nil to 14% per annum, and were given to finance working capital and investments.

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(Tabular amounts expressed in thousands of US dollars)

14. Trade accounts receivable

	December 31,	
	2005	2004
Customers	528,594	515,493
Allowance for doubtful accounts	(31,319)	(35,712)
	497,275	479,781

15. Amounts receivable from related parties

	December 31,	
	2005	2004
Advances paid	18,140	28,998
Trade accounts receivable	175,351	142,766
Other receivables	5,342	145,301
	198,833	317,065
Maturity analysis:		
within one year	176,807	297,089
after more than one year	22,026	19,976
	198,833	317,065

Sales and income received from related parties were as follows:

	Year ended December 31,	
	2005	2004
Associates:		
Sales	1,467	12,320
Other related parties:		
Sales	658,368	590,294
Banking income	1,304	2,597
Interest income	10,678	11,316
Insurance premiums	-	3,568
	671,817	620,095

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(Tabular amounts expressed in thousands of US dollars)

16. Inventories

	December 31,	
	2005	2004
Raw materials and supplies	603,034	516,970
Work-in-progress	131,001	131,591
Finished goods	355,932	474,139
	<u>1,089,967</u>	<u>1,122,700</u>

Of the above amounts US\$ 40.2 million (2004: US\$ 52.2 million) are stated at net realizable value, these amounts exclude inventories fully provided against.

Inventory write-downs were US\$ 10.9 million for the year ended December 31, 2005 (2004: US\$ 17.3 million).

17. Other current assets

	December 31,	
	2005	2004
Advances paid	107,369	103,101
Prepayments	26,119	26,585
Other taxes and social security prepaid	6,692	12,303
Reserves at Central Bank of Russia	4,938	4,695
Other assets	12,453	16,109
	<u>157,571</u>	<u>162,793</u>

18. Long-term financial investments

	December 31,	
	2005	2004
Originated loans:		
Loans to related parties	450,889	59,199
Loans to third parties	2,567	5,827
Available-for-sale securities:		
Shares in Lucchini SpA	187,386	-
Other investments in shares	10,320	31,552
Held to maturity securities	1,988	16
	<u>653,150</u>	<u>96,594</u>

On April 26, 2005 Severstal and its related parties (financed by Severstal) subscribed for new ordinary shares issued by Lucchini SpA (Italy) such that in exchange for €430.0 million, Severstal and its related parties obtained 61.9% voting control of Lucchini SpA. Related parties, financed by Severstal, acquired from third parties additional 7.9% of the outstanding

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share capital of Lucchini SpA for €61.0 million in May-June 2005, and a further 0.95% of the outstanding share capital of Lucchini SpA for €7.5 million in November 2005.

Long-term financial assets as of December 31, 2005 include the following balances related to these transactions: US\$ 187.4 million of carrying value of 19.99% shares of Lucchini SpA and US\$ 407.9 million of Euro-denominated loans to related parties.

Management used the share price of the November transaction to determine the fair value of 19.99% stake in Lucchini SpA at December 31, 2005, resulting in a US\$ 13.8 million gain being recognized directly in the statement of changes in equity.

19. Investment in associates

The Group's investment in associated companies is described in the tables below. Group structure and certain additional information on investments in associated companies, including ownership percentages, is given in note 27.

	December 31,	
	2005	2004
Double Eagle Steel Coating Company	26,409	29,296
Spartan Steel Coating LLC	56,374	52,915
FDS Coke Holdings LLC	-	2,893
Severstal US Holdings LLC	59,415	-
Mountain State Carbon LLC	60,205	-
TA Cord	2,108	-
Air Liquide Severstal	3,214	-
Others	592	666
	<u>208,317</u>	<u>85,770</u>

The following is summarized financial information, in aggregate, in respect of associates:

	2005	2004
Assets	476,742	174,499
Liabilities	54,569	13,628
Equity	422,173	160,871
Revenues	153,654	100,255
Net income	(3,645)	12,025

Double Eagle Steel Coating Company, Spartan Steel Coating LLC and FDS Coke Holdings LLC were associates of the bankrupt Rouge Steel Company, and were acquired on January 30, 2004, when the Group through its subsidiary Severstal North America Inc, acquired the assets and business of Rouge Steel Company. FDS Coke Holdings LLC was fully impaired in 2005, as a result of management impairment review.

Severstal US Holdings LLC, was created by Severstal and its related parties as a holding company for the SeverCorr project – construction of a mini mill in the United States of America. SeverCorr's mini mill is expected to produce approximately 1.5 million tons of high-quality flat-rolled steel on an annual basis. Total financing requirements of this project are approximately US\$ 880.0 million, and the project will be financed by Severstal, its related

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parties, third party equity participants and bank financing. Severstal have contributed to the project US\$ 48.0 million in September 2005 and US\$ 16.8 million in October 2005. Related parties of Severstal have contributed to the project US\$ 32.1 million in September 2005 and US\$ 13.4 million in October 2005. Subsequent to December 31, 2005, Severstal contributed a further US\$ 57.7 million to the project and provided a US dollar denominated loan to Severcorr LLC in the amount of US\$ 60.0 million. The loan is repayable in 2014 and bears interest at 15% per annum. Subsequent to December 31, 2005, Severstal's related parties contributed US\$ 40.0 million. Having completed those contributions, Severstal and its related parties have fully fulfilled their financing obligations for this project.

The Group, through its subsidiary Severstal North America Inc, has contributed US\$ 50.0 million in September 2005 and US\$ 10.0 million in November 2005 to the Mountain State Carbon LLC, a joint venture with Wheeling-Pittsburgh Steel Corporation ("Wheeling-Pittsburgh"). Wheeling-Pittsburgh has contributed to the joint venture all of its coking assets in Follansbee, USA, valued at US\$ 86.9 million, and US\$ 3.1 million in cash. Subsequent to December 31, 2005, the Group has contributed US\$ 60.0 million to the Mountain State Carbon LLC. This cash and US\$ 30.0 million of additional contributions from Wheeling-Pittsburgh over the next three years will be used to rehabilitate all of the coke batteries of the joint venture and provide the Group's US integrated steel operations a reliable and competitive supply of metallurgical coke. Each partner has a 50% share in Mountain State Carbon LLC from April 2006.

On August 31, 2005, the Group and Air Liquide established a company Air Liquide Severstal for construction of an air liquefaction plant in Cherepovets. The Group is to contribute €7.5 million for 25% ownership plus one share, Air Liquide is to contribute €22.5 million for 75% ownership minus one share. The remaining project financing requirements of €70.0 million will be met through bank loans.

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(Tabular amounts expressed in thousands of US dollars)

20. Property, plant and equipment

The movements in property, plant and equipment are as follows:

	<u>Buildings and constructions</u>	<u>Plant and machinery</u>	<u>Other productive assets</u>	<u>Total productive assets</u>	<u>Community and infrastructure assets</u>	<u>Construction -in-progress</u>	<u>Total assets</u>
Valuation or cost:							
December 31, 2004	1,039,354	2,723,492	184,784	3,947,630	40,743	752,565	4,740,938
Reclassifications	(6,288)	6,858	265	835	(835)	-	-
Additions:							
External	-	-	-	-	-	1,152,553	1,152,553
Interest capitalised	-	-	-	-	-	13,128	13,128
Business combinations	3,983	-	53	4,036	-	-	4,036
Disposals:							
External	(4,225)	(63,350)	(8,902)	(76,477)	(1,243)	(10,074)	(87,794)
Business de-combinations	(5,542)	(5,720)	(24)	(11,286)	-	(258)	(11,544)
Transfer to inventories	-	-	-	-	-	(12,060)	(12,060)
Transfers	104,139	533,292	55,820	693,251	22,622	(715,873)	-
Foreign exchange difference	(38,669)	(104,476)	(7,713)	(150,858)	(1,742)	(29,819)	(182,419)
	<u>1,092,752</u>	<u>3,090,096</u>	<u>224,283</u>	<u>4,407,131</u>	<u>59,545</u>	<u>1,150,162</u>	<u>5,616,838</u>
Adjustment to fair market value	627,210	1,537,135	62,729	2,227,074	(36,783)	(95,699)	2,094,592
December 31, 2005	<u>1,719,962</u>	<u>4,627,231</u>	<u>287,012</u>	<u>6,634,205</u>	<u>22,762</u>	<u>1,054,463</u>	<u>7,711,430</u>
Depreciation and impairment:							
December 31, 2004	179,029	886,151	62,391	1,127,571	21,592	113,889	1,263,052
Reclassifications	(3,188)	5,316	(834)	1,294	(1,294)	-	-
Depreciation expense	63,547	319,389	31,749	414,685	1,303	-	415,988
Business combinations	-	-	-	-	-	-	-
Disposals - external:							
External	(1,561)	(35,047)	(5,502)	(42,110)	(1,188)	(2,962)	(46,260)
Business de-combinations	(625)	(2,011)	(10)	(2,646)	-	-	(2,646)
Transfers	400	6,080	656	7,136	17,071	(24,207)	-
Impairment of assets:							
included in income statement	-	761	-	761	4,932	11,138	16,831
included in equity	-	-	-	-	-	-	-
Foreign exchange difference	(7,467)	(36,659)	(2,744)	(46,870)	(1,134)	(3,813)	(51,817)
	<u>230,135</u>	<u>1,143,980</u>	<u>85,706</u>	<u>1,459,821</u>	<u>41,282</u>	<u>94,045</u>	<u>1,595,148</u>
Adjustment to fair market value	(187,327)	(987,433)	(45,011)	(1,219,771)	(36,700)	(91,876)	(1,348,347)
December 31, 2005	<u>42,808</u>	<u>156,547</u>	<u>40,695</u>	<u>240,050</u>	<u>4,582</u>	<u>2,169</u>	<u>246,801</u>

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005 (Tabular amounts expressed in thousands of US dollars)

	<u>Buildings and constructions</u>	<u>Plant and machinery</u>	<u>Other productive assets</u>	<u>Total productive assets</u>	<u>Community and infrastructure assets</u>	<u>Construction -in-progress</u>	<u>Total assets</u>
Valuation or cost:							
December 31, 2003	928,990	2,349,448	149,515	3,427,953	32,416	346,888	3,807,257
Reclassifications	20,016	(19,644)	(959)	(587)	587	-	-
Additions:							
External	-	-	-	-	-	723,491	723,491
Interest capitalised	-	-	-	-	-	4,639	4,639
Business combinations	29,142	66,768	1,230	97,140	-	380	97,520
Disposals:							
External	(6,912)	(68,210)	(13,604)	(88,726)	(1,845)	(14,446)	(105,017)
Business de-combinations	(13,860)	(3,732)	(11,542)	(29,134)	-	(1,341)	(30,475)
Transfer to inventories	-	-	-	-	-	(6,324)	(6,324)
Transfers	23,161	248,890	49,769	321,820	7,403	(329,223)	-
Foreign exchange difference	58,817	149,972	10,375	219,164	2,182	28,501	249,847
December 31, 2004	<u>1,039,354</u>	<u>2,723,492</u>	<u>184,784</u>	<u>3,947,630</u>	<u>40,743</u>	<u>752,565</u>	<u>4,740,938</u>
Depreciation and impairment:							
December 31, 2003	98,917	585,923	40,648	725,488	14,492	113,880	853,860
Reclassifications	13,169	(12,510)	(841)	(182)	182	-	-
Depreciation expense	62,019	301,421	26,700	390,140	1,465	-	391,605
Business combinations	-	737	-	737	-	-	737
Disposals - external:							
External	(1,793)	(34,825)	(5,358)	(41,976)	(637)	(13,101)	(55,714)
Business de-combinations	(2,327)	(759)	(3,591)	(6,677)	(1)	(23)	(6,701)
Transfers	724	2,421	552	3,697	3,920	(7,617)	-
Impairment of assets:							
included in income statement	-	-	1,067	1,067	1,093	13,937	16,097
included in equity	-	-	-	-	-	-	-
Foreign exchange difference	8,320	43,743	3,214	55,277	1,078	6,813	63,168
December 31, 2004	<u>179,029</u>	<u>886,151</u>	<u>62,391</u>	<u>1,127,571</u>	<u>21,592</u>	<u>113,889</u>	<u>1,263,052</u>
Net book values:							
December 31, 2004	<u>860,325</u>	<u>1,837,341</u>	<u>122,393</u>	<u>2,820,059</u>	<u>19,151</u>	<u>638,676</u>	<u>3,477,886</u>
December 31, 2005	<u>1,677,154</u>	<u>4,470,684</u>	<u>246,317</u>	<u>6,394,155</u>	<u>18,180</u>	<u>1,052,294</u>	<u>7,464,629</u>
Net book values based on cost, less depreciation and impairment:							
December 31, 2004	<u>844,526</u>	<u>936,156</u>	<u>122,393</u>	<u>1,903,075</u>	<u>19,153</u>	<u>641,037</u>	<u>2,563,265</u>
December 31, 2005	<u>962,186</u>	<u>1,213,005</u>	<u>105,798</u>	<u>2,280,989</u>	<u>16,999</u>	<u>1,056,119</u>	<u>3,354,107</u>

Other productive assets include transmission equipment, transportation equipment and tools.

Impairment of assets, which was recognized during 2005 before the revaluation, primarily relates to social objects purchased or constructed by the Group. The amounts of costs incurred in purchase or construction of social objects, which are not expected to be profit-generating, are normally impaired as incurred.

As described in Note 3f, the Group uses the revaluation model of accounting for property, plant and equipment. Management commissioned independent appraisers to evaluate the fair value of productive property, plant and equipment as of December 31, 2005 of the key entities of the Steel

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

segment – the Parent Company and Severstal North America LLC, and of the coal producing assets. Management considers that the carrying value of property, plant and equipment of other business segments approximate their fair values as of the balance sheet date. The impact of the independent appraisers' valuation report on the property, plant and equipment is shown in the lines "Adjustment to fair market value" in the tables above and is further described in the tables below.

The majority of the Group's property, plant and equipment is specialized in nature and can not be sold on the open market other than as part of a continuing business. In the absence of the active market for similar items, the fair value of property, plant and equipment was primarily determined using depreciated replacement cost. This method considers the cost to reproduce or replace the property, plant and equipment, adjusted for physical, functional or economical depreciation, and obsolescence.

The depreciated replacement cost was estimated based on internal sources and analysis of the Russian and international markets for similar property, plant and equipment. Various market data were collected from published information, catalogues, statistical data and industry experts and suppliers of property, plant and equipment were contacted both in the Russian Federation and abroad.

In addition to the determination of the depreciated replacement cost, cash flow testing was conducted in order to assess the recoverability of values, based on the depreciated replacement cost. The results of cash flow testing confirmed that the estimated future cash flows from each cash generating unit are higher than the depreciated replacement cost, which therefore represents the fair value of property, plant and equipment.

The fair value of property, plant and equipment was determined on an item-by-item basis. Where the carrying value of an individual item prior to the revaluation exceeded the current fair value, a revaluation decrease was recognized. Revaluation decreases were mainly driven by decreases in purchase prices of certain types of production equipment and by reduction of the estimated remaining useful lives for certain items of property, plant and equipment. To the extent that such revaluation decrease related to a previously recognized revaluation increase, it was recognized directly in equity, and the remaining amount was recognized as an impairment loss in the income statement.

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The following amounts were recognized in the income statement and statement of changes in equity as a result of the revaluation:

	<u>Buildings and constructions</u>	<u>Plant and machinery</u>	<u>Other productive assets</u>	<u>Total productive assets</u>	<u>Community and infrastructure assets</u>	<u>Construction -in-progress</u>	<u>Total assets</u>
Adjustment to fair market value during 2005:							
Cost	627,210	1,537,135	62,729	2,227,074	(36,783)	(95,699)	2,094,592
Accumulated depreciation	187,327	987,433	45,011	1,219,771	36,700	91,876	1,348,347
	<u>814,537</u>	<u>2,524,568</u>	<u>107,740</u>	<u>3,446,845</u>	<u>(83)</u>	<u>(3,823)</u>	<u>3,442,939</u>
Adjustment to fair market value:							
Revaluation included in equity:							
revaluation increase	679,346	2,584,082	109,964	3,373,392	-	-	3,373,392
revaluation decrease	-	(20,993)	(1)	(20,994)	-	-	(20,994)
	<u>679,346</u>	<u>2,563,089</u>	<u>109,963</u>	<u>3,352,398</u>	<u>-</u>	<u>-</u>	<u>3,352,398</u>
Revaluation included in income statement:							
reversal of previous impairment	143,843	11,428	278	155,549	-	-	155,549
impairment	(8,652)	(49,949)	(2,501)	(61,102)	(83)	(3,823)	(65,008)
	<u>135,191</u>	<u>(38,521)</u>	<u>(2,223)</u>	<u>94,447</u>	<u>(83)</u>	<u>(3,823)</u>	<u>90,541</u>
	<u>814,537</u>	<u>2,524,568</u>	<u>107,740</u>	<u>3,446,845</u>	<u>(83)</u>	<u>(3,823)</u>	<u>3,442,939</u>

The gain of US\$ 73.7 million recognized in the income statement for the year ended December 31, 2005 under the caption 'Reversal of impairment/(impairment) of property, plant and equipment, net' is composed of net gain on revaluation of property, plant and equipment in the amount US\$ 90.5 million and of impairment loss on property, plant and equipment in the amount of US\$ 16.2 million.

21. Bank customer accounts

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Customer accounts:		
Demand deposits	26,997	42,825
Term deposits	68,365	1,865
Deposits from other financial institutions	3,505	5
	<u>98,867</u>	<u>44,695</u>

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

22. Amounts payable to related parties

	December 31,	
	2005	2004
Trade accounts payable	116,328	90,945
Advances received	1,995	15,712
Other accounts payable	112,894	50,763
Bank demand deposits	16,302	11,827
Bank term deposits	17,424	29,751
	<u>264,943</u>	<u>198,998</u>

Purchases from related parties were as follows:

	Year ended December 31,	
	2005	2004
Purchases from associates:		
Non-capital expenditures	85,420	68,114
Purchases from other related parties:		
Non-capital expenditures	578,613	372,198
Capital expenditures	57,413	33,779
Bank expenses	-	99
Insurance claims paid	-	2,307

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(Tabular amounts expressed in thousands of US dollars)

23. Debt finance

	December 31,	
	2005	2004
International banks	1,390,051	1,279,424
Russian banks	223,371	220,372
Bonds issued in Russia	104,230	108,113
Factoring of receivables	16,801	22,924
Promissory notes issued	1,388	5,006
Other financing	37,840	30,089
Accrued interest	28,051	22,200
Unamortized balance of transaction costs	(16,258)	(14,866)
	1,785,474	1,673,262
Total debt is denominated in the following currencies:		
US dollars	1,287,620	1,228,578
Roubles	333,743	360,353
Euro	164,111	84,331
	1,785,474	1,673,262
Total debt is contractually repayable after the balance sheet date as follows:		
Less than one year	344,170	273,995
Between one and five years	1,006,306	972,095
After more than five years	434,998	427,172
	1,785,474	1,673,262

Debt finance raised from banks and unused long term credit lines are secured by charges over:

- US\$ 96.1 million (2004: US\$ 178.5 million) net book value of plant and equipment;
- US\$ 1,296.2 million (2004: US\$ 508.2 million) of current assets; and,
- US\$ 97.1 million (2004: US\$ 39.5 million) of financial assets.

At the balance sheet date the Group had US\$ 319.9 million (2004: US\$ 289.2 million) of unused long term credit lines available to it.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

24. Other current liabilities

	December 31,	
	2005	2004
Advances received	130,305	115,293
Amounts payable to employees	75,731	74,625
Accrued expenses	19,183	13,830
Lease liabilities	180	2,075
Other liabilities	15,972	26,780
	241,371	232,603

25. Other non-current liabilities

	December 31,	
	2005	2004
Retirement benefit liability	203,458	158,022
Decommissioning liability	102,885	86,137
Restructured tax liabilities	97,368	-
Insurance related reserves	-	623
Lease liabilities	32	2,803
Other	7,731	13,177
	411,474	260,762

Retirement benefit liability

The following assumptions have been used to calculate the retirement benefit liability:

	December 31,				
	2005		2004		2003
	USA	Russia	USA	Russia	Russia
Discount rate	5.50%	6.85%	5.75%	8.50%	8.27%
Future rate of benefit increase	n/a	6.20%	n/a	6.20%	0.00%
Future rate of medical cost increases	0.00%	n/a	11.00%	n/a	n/a

Under the terms of a collective bargaining agreement, the Group's US subsidiary is obliged to compensate for medical cost increases only during 2005. Any further increases in healthcare costs are to be borne by the plan beneficiaries.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

The components in the retirement benefit liabilities were as follows:

	December 31,	
	2005	2004
Retirees	156,345	120,513
Other participants:		
Vested	13,560	8,943
Non-vested	82,724	78,868
	252,629	208,324
Present value of the defined benefit obligation	252,629	208,324
Fair value of the plan assets	(49,171)	(50,302)
	203,458	158,022

The movements in the retirement benefit liabilities were as follows:

	Year ended December 31,	
	2005	2004
Net liability at beginning of year	158,022	51,298
Business combinations	-	31,347
Business de-combinations		
Contributions made during the year	(17,843)	(19,496)
Amounts recognized in the income statement:		
Return on plan assets	(9,084)	(3,143)
Interest cost	13,551	8,324
Service cost	4,518	3,690
Actuarial losses	59,635	80,293
Foreign exchange (gain)/loss	(5,341)	5,709
	203,458	158,022

The retirement benefit expenses that are recognized in the income statement are contained in the caption: 'Selling, general and administrative expenses', except for the interest cost, which is recognized in the caption 'Net financing expense'.

Decommissioning liability

The Group has environmental liabilities related to restoration of soil and other related works, which are due upon the closures of its coal mines. These liabilities have been estimated using existing technology, at current prices, and discounted using a real discount rate of 2%. A substantial part of the decommissioning costs is expected to be incurred between 2020 and 2040.

There are no significant environmental liabilities related to steel production facilities, metalware facilities, iron ore concentrate and pellets production sites.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

Restructured tax liabilities

OA0 Vorkutaugol and OA0 Mine Vorgashorskaya had significant amounts of taxes in arrears, when they were acquired by the Group's Majority Shareholder in June 2003.

In November 2005, these subsidiaries signed restructuring agreements with the tax authorities, which were their largest creditors. In accordance with these agreements, the principal amounts of taxes, and fines thereon and 15% of tax interest are payable by instalments over four years. If those payments are made on schedule, the remaining 85% of tax interest liability at the date of restructuring will be forgiven. The Group's management is confident that all payments will be in accordance with the agreed schedules, and accordingly US\$ 186.8 million of tax interest liabilities, which will be forgiven, have been derecognized as liabilities and recognized in the income statement under the caption "Gain on restructuring of tax liabilities". The remaining restructured tax obligations were discounted using the interest rate of 9.86%, and US\$ 14.1 million of the difference between the nominal and discounted amounts is also recognized as the "Gain on restructuring of tax liabilities" in the income statement. Current portion of restructured tax liabilities is included in the caption 'Other taxes and social security payable'. The total amount of the restructured taxes is presented in the table below:

Payable within one year	26,059
Payable after one year	97,368
	<hr/>
	123,427
	<hr/>

26. Share capital

The Parent Company's authorized capital, according to its Charter Document, at December 31, 2003, 2004 and 2005 comprised 551,854,800 ordinary shares with a nominal value of RUR 0.01 each, and this authorized share capital was issued and fully paid at these dates. The nominal amount of initial share capital was converted into US dollars using exchange rates during the Soviet period, when the Government contributed the original capital funds to the enterprise. These capital funds were converted into ordinary shares on September 24, 1993 and sold by the Government at privatization auctions. The Parent Company did not issue shares until June 2006. However, as described in notes 1 and 2, Parent Company shares issued in 2006 in consideration for the acquired companies are recognized from the moment the acquired companies are included in these special purpose financial statements. The Parent Company shares issued in respect of the interests that the Majority Shareholder had in the acquired mining companies at December 31, 2003, are recognized in the special purpose share capital at that date. Additional share issues are recognized in 2004 and 2005, in respect of ownership interests that the Majority Shareholder acquired in those companies during 2004 and 2005.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

Consequently, the total value of share capital presented in these special purpose consolidated financial statements comprises:

	<u>Number of shares, mln</u>	<u>US\$'000</u>
Nominal share capital at current exchange rate	551.9	199
Historic difference	-	3,310,930
	<u>551.9</u>	<u>3,311,129</u>
Total historic value of share capital		
Shares issued for acquisition of mining companies at December 31, 2003	<u>293.1</u>	<u>100</u>
Adjusted share capital at December 31, 2003	845.0	3,311,229
Shares issued for acquisition of mining companies during 2004	<u>55.2</u>	<u>19</u>
Adjusted share capital at December 31, 2004	900.2	3,311,248
Shares issued for acquisition of mining companies during 2005	<u>17.0</u>	<u>6</u>
Adjusted share capital at December 31, 2005	<u>917.2</u>	<u>3,311,254</u>

Numbers of shares in the table above is given, after adjusting for 1 to 25 share split, effective December 30, 2004.

All shares carry equal voting and distribution rights.

Dividends

The maximum dividend payable is restricted to the total accumulated retained earnings of the parent company determined according to Russian law. As at the balance sheet date, reserves available for distribution were US\$ 3,308.6 million (2004: US\$ 2,471.7 million).

On June 10, 2005, the Meeting of Shareholders approved the final dividend of RUR 3.00 (US\$ 0.11) per share in respect of 2004, and an interim dividend of RUR 4.00 (US\$ 0.14) per share in respect of the first quarter of 2005.

On September 22, 2005, the Meeting of Shareholders approved an interim dividend of RUR 3.90 (US\$ 0.14) per share in respect of the first half of 2005.

On December 6, 2005, the Meeting of Shareholders approved an interim dividend of RUR 3.00 (US\$ 0.10) per share in respect of the first nine months of 2005.

Share issue subsequent to December 31, 2005

As described in note 1, subsequent to December 31, 2005, the Group has completed the issuance of additional shares by the Parent Company to acquire controlling stakes in mining assets previously controlled by its Majority Shareholder. In addition, 13,516,489 shares were issued to the shareholders that used their pre-emptive rights related to this share issue. Total cash proceeds from shares issued under pre-emptive rights were US\$ 162,179 thousand.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005 (Tabular amounts expressed in thousands of US dollars)

27. Subsidiary and associated companies

The following is a list of the Group's significant subsidiaries, including those acquired from the Majority Shareholder in 2006, and associates and the effective ownership holdings therein.

Company	December 31,		Location	Activity
	2005	2004		
Steel segment - Russia:				
<u>Subsidiaries:</u>				
ZAO Severgal	75.0%	75.0%	Russia	Hot dip galvanizing
ZAO Izhorsky Tube Factory	100.0%	100.0%	Russia	Wide pipes
OOO SSM-Tyazhmash*	100.0%	100.0%	Russia	Repairs & construction
OAO Domnaremont*	56.4%	56.4%	Russia	Repairs & construction
ZAO Firma Stoik*	100.0%	100.0%	Russia	Repairs & construction
OAO Metallurgremont*	79.3%	79.3%	Russia	Repairs & construction
OOO Energoremont*	100.0%	100.0%	Russia	Repairs & construction
OOO Electroremont*	100.0%	100.0%	Russia	Repairs & construction
OOO Uralmash MO*	100.0%	100.0%	Russia	Engineering & design
OOO AviaCompany Severstal	100.0%	100.0%	Russia	Air transport
Severstal Export GmbH	100.0%	100.0%	Switzerland**	Steel sales
AS Severstallat	50.5%	50.5%	Latvia**	Steel sales
Latvijas Metals	50.5%	nil%	Latvia**	Steel sales
Armaturu Servisa Centrs SIA	25.0%	25.0%	Latvia**	Steel service center
<u>Associates:</u>				
Severstal US Holdings LLC ***	60.0%	nil%	USA**	Mini-mill
Steel segment - USA:				
<u>Subsidiaries:</u>				
Severstal North America Inc	93.0%	100.0%	USA	Iron & steel mill
<u>Associates:</u>				
Double Eagle Steel Coating company	46.5%	50.0%	USA	Electro-galvanizing
Spartan Steel Coating LLC	44.6%	48.0%	USA	Hot dip galvanizing
Delaco Processing LLC	45.6%	49.0%	USA	Steel slitting
FDS Coke Holdings LLC	41.9%	45.0%	USA	Coking coal
Mountain State Carbon LLC	31.0%	nil%	USA	Coking coal
Metalware segment:				
<u>Subsidiaries:</u>				
ZAO Severstal-Metiz	100.0%	nil%	Russia	Management company
OAO Cherepovets Steel Rolling Mill	88.8%	83.1%	Russia	Steel machining
OAO Orlovsky Steel Rolling Mill	87.2%	85.0%	Russia	Steel machining
OOO Volgometiz	100.0%	100.0%	Russia	Steel machining
OOO Policher	80.0%	74.8%	Russia	Polymer coatings
<u>Associates:</u>				
OOO ChSPZ MKR	44.4%	41.5%	Russia	Mattress springs

(continued on the next page)

(*) – subsidiaries acquired during 2006

(**) – 'Steel segment – Russia' contains Russian production entities, foreign trading companies, which are selling products primarily produced in Russia, and other foreign companies, which either provide services to Russian production entities or are managed from Russia.

(***) – 19.9% of ordinary shares

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

Company	December 31,		Location	Activity
	2005	2004		
Mining segment:				
<i>Subsidiaries:</i>				
OAo Karelsky Okatysh*	90.8%	84.2%	Russia	Iron ore pellets
OAo Olkon*	91.6%	90.9%	Russia	Iron ore concentrate
OAo Vorkutaugol*	88.1%	85.5%	Russia	Coking coal concentrate
OAo Mine Vorgashorskaya*	70.2%	65.8%	Russia	Coking coal concentrate
OAo Mine Pervomaiskaya*	99.1%	99.1%	Russia	Coking coal concentrate
OAo Mine Berezovskaya*	96.0%	92.6%	Russia	Coking coal concentrate
OAo SShEMK*	75.6%	60.0%	Russia	Engineering
OAo Severokuzbasskoe PTU*	87.3%	87.3%	Russia	Transportation
OAo Anzhero-Sudzhenskoe PTU*	94.4%	94.4%	Russia	Transportation
OAo Pechorugol*	99.3%	99.3%	Russia	Holding company
OOO Olkon-Invest*	100.0%	100.0%	Russia	Holding company
OOO Terra*	100.0%	100.0%	Russia	Holding company
OOO Holding Gornaya Company*	100.0%	100.0%	Russia	Holding company
ZAO Impulse-Consult*	100.0%	100.0%	Russia	Holding company
OOO Investment Company Kuzbassugol*	100.0%	100.0%	Russia	Holding company
Financing and insurance segment:				
<i>Subsidiaries:</i>				
OAo Metallurgical Commercial Bank	72.6%	71.4%	Russia	Banking
(*) – subsidiaries acquired during 2006				

In addition, at the balance sheet date, a further 26 (2004: 59) subsidiaries and associates, which are not material to the Group, either individually or in aggregate, have been included in these special purpose consolidated financial statements.

Information on carrying amounts, acquisitions and disposals of associated companies is disclosed in Note 19 of these special purpose consolidated financial statements.

Acquisitions of subsidiaries and additional interests in subsidiaries during 2005

During the first six months of 2005, the Group bought 84.8% of new share issue by OAo Cherepovets Steel Rolling Mill (“ChSPZ”) for US\$ 32.4 million and minority shareholders purchased 15.2% of this share issue for US\$ 5.8 million. Subsequently the Group acquired an additional 4.99% in ChSPZ for US\$ 5.4 million from third parties. Net assets of ChSPZ at the time of acquisition were US\$ 162.0 million, resulting in recognition of US\$ 2.7 million of negative goodwill.

ZAO Severstal-Metiz was a holding company that managed the activities of the Metalware segment, provided all administrative services to the companies of the Metalware segment and was the sole sales and procurement organization for the Metalware segment. In January 2005, Severstal acquired 100.0% of the outstanding share capital of ZAO Severstal-Metiz, from a company under common shareholder control, for US\$ 0.8 million.

During 2005 Severstal transferred to ZAO Severstal-Metiz its ownership interests in the metalware companies ChSPZ and OAo Orlovsky Steel Rolling Mill (“OSPaz”). Effective January 1, 2006, ChSPZ and OSPaz legal entities were merged into ZAO Severstal-Metiz. In December 2005, Volgometiz transferred all its principal assets and liabilities to ZAO

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

Severstal-Metiz. As a result of these transactions, from January 1, 2006 ZAO Severstal-Metiz is the principal operating company of metalware segment.

During 2005, AS Severstallat, a 50.5% subsidiary of the Group, acquired 100% of Latvijas Metals for US\$ 5.5 million. Latvijas Metals is the metals trader in Baltic states, and the acquisition was undertaken to strengthen the Group's position in this market. A summary of acquired assets and liabilities is presented below:

Cash and cash equivalents	657
Trade accounts receivable	1,311
Inventories	4,906
Other current assets	792
Property, plant and equipment	4,036
Trade accounts payable	(199)
Other taxes and social security payable	(144)
Other current liabilities	(151)
Debt finance	(841)
Net identifiable assets and liabilities acquired	<u>10,367</u>
Consideration paid	<u>(5,537)</u>
Negative goodwill	<u><u>4,830</u></u>

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

28. Subsequent events

Acquisitions of mining and repairs and construction companies from the Majority Shareholder are discussed in note 1 to these special purpose consolidated financial statements. Share issue to shareholders that used their pre-emptive rights is discussed in note 26. Contributions by the Group to its equity associates that were made subsequent to December 31, 2005, are described in note 19. In addition, the following material subsequent events have taken place:

Acquisitions of subsidiaries from third parties subsequent to December 31, 2005

In February 2006, the Group acquired 60% ownership (57.9% effective ownership interest) in joint stock company Dneprometiz for US\$ 33 million. Severstal also obtained an option to buy an additional 27% stake of the share capital after one year for a consideration in the range from US\$ 14.0 to US\$ 20.0 million. Dneprometiz produces wire and certain other metalware products at its production facilities located in Ukraine.

In April 2006, the Group acquired 100% of Carrington Wire Ltd., a UK wire and other metalware products producer, for US\$ 30.5 million.

These acquisitions were conducted to strengthen the Group's position in the metalware market.

A summary of acquired assets and liabilities is presented below:

Cash and cash equivalents	5,875
Trade accounts receivable	26,463
Inventories	18,841
Other current assets	7,025
Property, plant and equipment	79,331
Trade accounts payable	(33,557)
Other taxes and social security payable	(70)
Deferred tax liabilities	(6,528)
Retirement benefit liability	(10,762)
Debt finance	(8,623)
Other liabilities	(5,773)
Net identifiable assets and liabilities acquired	<u>72,222</u>
Minority interest	<u>(12,980)</u>
Severstal's share of net identifiable assets and liabilities acquired	<u>59,242</u>
Consideration paid	63,500
Goodwill	<u><u>4,258</u></u>

These fair values were determined provisionally, and are subject to changes after completion of the independent appraisers' valuation report and of internal management review.

Dividends subsequent to December 31, 2005

On June 9, 2006, the Meeting of Shareholders approved the final dividend for 2005 of RUR 4 (US\$ 0.15) per share.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005 (Tabular amounts expressed in thousands of US dollars)

29. Segment information

Segmental balance sheets as at December 31, 2005:

	Steel segment		Metalware segment	Mining segment	Financing segment	Inter segment balances	Conso- lidated
	Russia	USA					
Assets							
Current assets:							
Cash and cash equivalents	783,700	-	3,921	67,010	143,246	(56,268)	941,609
Short-term bank deposits	718,705	-	18,274	1,071	-	(63,538)	674,512
Short-term financial investments	265,028	-	15,619	25,352	143,999	(187,558)	262,440
Trade accounts receivable	273,827	166,541	27,652	29,255	-	-	497,275
Amounts receivable from related parties	87,229	970	9,411	129,151	-	(49,954)	176,807
Inventories	577,439	401,146	59,457	103,861	-	(51,936)	1,089,967
VAT receivable	316,651	-	33,797	39,673	-	-	390,121
Income tax receivable	755	-	914	15,395	-	-	17,064
Other current assets	98,247	22,964	8,041	23,133	5,186	-	157,571
Total current assets	3,121,581	591,621	177,086	433,901	292,431	(409,254)	4,207,366
Non-current assets:							
Amounts receivable from related parties	-	-	-	22,026	-	-	22,026
Long-term financial investments	982,945	-	7,601	3,824	-	(341,220)	653,150
Investment in associates	63,209	142,988	2,120	-	-	-	208,317
Property, plant and equipment	5,806,681	83,863	111,734	1,461,960	391	-	7,464,629
Intangible and other assets	5,723	-	1,418	30,059	50	-	37,250
Total non-current assets	6,858,558	226,851	122,873	1,517,869	441	(341,220)	8,385,372
Total assets	9,980,139	818,472	299,959	1,951,770	292,872	(750,474)	12,592,738
Liabilities and shareholders' equity							
Current liabilities:							
Trade accounts payable	197,444	129,040	7,354	34,934	-	993	369,765
Bank customer accounts	-	-	-	-	218,673	(119,806)	98,867
Amounts payable to related parties	116,977	14,149	10,610	138,438	33,725	(48,956)	264,943
Income taxes payable	30,059	14,183	104	938	-	-	45,284
Other taxes and social security payable	22,820	1,681	16,063	109,634	-	-	150,198
Short-term debt finance	253,337	143,818	20,560	81,982	-	(155,527)	344,170
Dividends payable	12,275	-	-	-	-	-	12,275
Other current liabilities	162,824	22,169	10,587	45,691	100	-	241,371
Total current liabilities	795,736	325,040	65,278	411,617	252,498	(323,296)	1,526,873
Non-current liabilities:							
Long-term debt finance	1,413,690	-	4,483	60,442	-	(37,311)	1,441,304
Deferred tax liabilities	904,144	62,508	8,462	150,333	466	(14,316)	1,111,597
Other non-current liabilities	79,110	45,340	21,354	265,670	-	-	411,474
Total non-current liabilities	2,396,944	107,848	34,299	476,445	466	(51,627)	2,964,375
Equity	6,787,459	385,584	200,382	1,063,708	39,908	(375,551)	8,101,490
Total equity and liabilities	9,980,139	818,472	299,959	1,951,770	292,872	(750,474)	12,592,738

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005 (Tabular amounts expressed in thousands of US dollars)

Segmental balance sheets as at December 31, 2004:

	Steel segment		Metalware segment	Mining segment	Financing & insurance segment	Inter segment balances	Conso- lidated
	Russia	USA					
Assets							
Current assets:							
Cash and cash equivalents	1,032,796	4,412	3,858	4,985	212,326	(168,316)	1,090,061
Short-term bank deposits	555,359	-	-	1,264	-	-	556,623
Short-term financial investments	109,381	85	102	21,692	120,373	(60,093)	191,540
Trade accounts receivable	336,691	101,815	28,746	12,529	-	-	479,781
Amounts receivable from related parties	261,412	1,053	8,423	40,128	-	(13,927)	297,089
Inventories	616,145	385,220	69,929	75,257	-	(23,851)	1,122,700
VAT receivable	155,177	-	26,249	20,206	-	-	201,632
Income tax receivable	42,712	6	3,264	340	-	-	46,322
Other current assets	109,108	18,883	8,405	21,447	4,950	-	162,793
Total current assets	3,218,781	511,474	148,976	197,848	337,649	(266,187)	4,148,541
Non-current assets:							
Amounts receivable from related parties	-	-	-	19,976	-	-	19,976
Long-term financial investments	463,156	-	1,156	6,072	827	(374,617)	96,594
Investment in associates	408	85,104	7,618	-	-	(7,360)	85,770
Property, plant and equipment	2,303,502	69,587	132,663	971,610	524	-	3,477,886
Intangible assets	5,721	-	1,418	1,028	100	-	8,267
Total non-current assets	2,772,787	154,691	142,855	998,686	1,451	(381,977)	3,688,493
Total assets	5,991,568	666,165	291,831	1,196,534	339,100	(648,164)	7,837,034
Liabilities and shareholders' equity							
Current liabilities:							
Trade accounts payable	209,432	107,620	8,428	34,357	-	11	359,848
Bank customer accounts	-	-	-	-	44,695	-	44,695
Amounts payable to related parties	115,107	2,427	14,916	40,789	255,550	(229,791)	198,998
Income taxes payable	21,290	9,403	3	12,009	-	-	42,705
Other taxes and social security payable	21,001	2,396	14,463	384,262	8	-	422,130
Short-term debt finance	211,322	18,568	27,115	29,602	-	(12,612)	273,995
Dividends payable	18,440	-	-	-	-	-	18,440
Other current liabilities	148,337	22,449	11,623	50,014	180	-	232,603
Total current liabilities	744,929	162,863	76,548	551,033	300,433	(242,392)	1,593,414
Non-current liabilities:							
Long-term debt finance	1,318,812	-	6,512	74,137	-	(194)	1,399,267
Deferred tax liabilities	216,558	52,351	12,482	65,719	(108)	(7,386)	339,616
Other non-current liabilities	52,946	39,513	16,839	150,841	623	-	260,762
Total non-current liabilities	1,588,316	91,864	35,833	290,697	515	(7,580)	1,999,645
Equity	3,658,323	411,438	179,450	354,804	38,152	(398,192)	4,243,975
Total equity and liabilities	5,991,568	666,165	291,831	1,196,534	339,100	(648,164)	7,837,034

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005 (Tabular amounts expressed in thousands of US dollars)

Segmental income statements for the year ended December 31, 2005:

	Steel segment		Metalware segment	Mining segment	Financing segment	Inter segment balances	Conso- lidated
	Russia	USA					
Sales							
Sales - external	5,170,145	1,822,573	562,630	409,142	-	-	7,964,490
Sales - to related parties	775,721	-	56,200	962,516	-	(1,134,602)	659,835
	<u>5,945,866</u>	<u>1,822,573</u>	<u>618,830</u>	<u>1,371,658</u>	<u>-</u>	<u>(1,134,602)</u>	<u>8,624,325</u>
Cost of sales	(3,395,194)	(1,716,332)	(556,963)	(742,385)	-	1,106,517	(5,304,357)
Gross profit	<u>2,550,672</u>	<u>106,241</u>	<u>61,867</u>	<u>629,273</u>	<u>-</u>	<u>(28,085)</u>	<u>3,319,968</u>
Selling, general and administrative expenses	(223,342)	(29,539)	(36,882)	(88,248)	(1,903)	-	(379,914)
Distribution expenses	(509,944)	-	(27,848)	(52,776)	-	-	(590,568)
Indirect taxes and contributions	(26,367)	-	(3,444)	(41,886)	(129)	-	(71,826)
Share of associates' (losses)/profits	(4,968)	2,749	(2,047)	-	-	-	(4,266)
Net income from bank lending operations	(812)	-	-	-	6,250	4,544	9,982
Net income/(expenses) from securities operations	(3,078)	505	470	3,728	3,461	1,755	6,841
Net expenses from insurance operations	-	-	-	-	-	-	-
Loss/(gain) on disposal of property, plant and equipment	(29,612)	(184)	(1,885)	(3,880)	10	-	(35,551)
Net other operating (expenses)/income	(3,309)	1,981	(273)	(4,342)	1,531	-	(4,412)
Profit from operations	<u>1,749,240</u>	<u>81,753</u>	<u>(10,042)</u>	<u>441,869</u>	<u>9,220</u>	<u>(21,786)</u>	<u>2,250,254</u>
Reversal of impairment/(impairment) of property, plant and equipment, net	85,249	-	(914)	(10,625)	-	-	73,710
Penalties on tax liabilities under restructuring	-	-	-	(26,675)	-	-	(26,675)
Gain on restructuring of tax liabilities	-	-	-	200,853	-	-	200,853
Negative goodwill	4,830	-	-	-	-	2,800	7,630
Net other non-operating expenses	(30,337)	-	(4,142)	(8,379)	-	(9,789)	(52,647)
Profit before financing and taxation	<u>1,808,982</u>	<u>81,753</u>	<u>(15,098)</u>	<u>597,043</u>	<u>9,220</u>	<u>(28,775)</u>	<u>2,453,125</u>
Net financing (expense)/income	(129,047)	(12,524)	197	(23,657)	-	(5,563)	(170,594)
Profit before income tax	<u>1,679,935</u>	<u>69,229</u>	<u>(14,901)</u>	<u>573,386</u>	<u>9,220</u>	<u>(34,338)</u>	<u>2,282,531</u>
Income tax expense	(408,072)	(27,088)	(2,819)	(118,040)	(2,378)	7,762	(550,635)
Profit for the year	<u>1,271,863</u>	<u>42,141</u>	<u>(17,720)</u>	<u>455,346</u>	<u>6,842</u>	<u>(26,576)</u>	<u>1,731,896</u>
Additional information:							
depreciation expense	233,280	7,159	19,550	155,853	146	-	415,988
revaluation of assets recognized in equity:							
revaluation increase	2,980,525	8,559	-	384,308	-	-	3,373,392
revaluation decrease	(20,994)	-	-	-	-	-	(20,994)

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

Segmental income statements for the year ended December 31, 2004:

	Steel segment		Metalware segment	Mining segment	Financing & insurance segment	Inter segment balances	Conso- lidated
	Russia	USA					
Sales							
Sales - external	4,428,230	1,332,733	521,731	124,824	-	-	6,407,518
Sales - to related parties	674,532	10,563	45,484	720,916	-	(848,881)	602,614
	<u>5,102,762</u>	<u>1,343,296</u>	<u>567,215</u>	<u>845,740</u>	<u>-</u>	<u>(848,881)</u>	<u>7,010,132</u>
Cost of sales	(2,675,127)	(1,201,880)	(487,544)	(658,629)	-	833,254	(4,189,926)
Gross profit	<u>2,427,635</u>	<u>141,416</u>	<u>79,671</u>	<u>187,111</u>	<u>-</u>	<u>(15,627)</u>	<u>2,820,206</u>
Selling, general and administration expenses	(203,355)	(17,748)	(32,881)	(103,447)	(7,687)	21,574	(343,544)
Distribution expenses	(418,658)	-	(18,876)	(7,937)	-	2,723	(442,748)
Indirect taxes and contributions	(22,264)	(19)	(2,759)	(31,515)	(224)	-	(56,781)
Share of associates' (losses)/profits	288	6,907	1,245	-	282	(1,564)	7,158
Net income from bank lending operations	-	-	-	-	4,465	(202)	4,263
Net income/(expenses) from securities operations	4,629	-	-	(9,013)	63	22,913	18,592
Net expenses from insurance operations	-	-	-	-	6,217	(24,454)	(18,237)
(Loss)/gain on disposal of property, plant and equipment	(25,971)	-	153	(15,009)	(284)	-	(41,111)
Net other operating (expenses)/income	(1,384)	646	(380)	7,095	2,260	(168)	8,069
Profit from operations	<u>1,760,920</u>	<u>131,202</u>	<u>26,173</u>	<u>27,285</u>	<u>5,092</u>	<u>5,195</u>	<u>1,955,867</u>
Impairment of property, plant and equipment	(15,764)	-	(302)	(31)	-	-	(16,097)
Penalties on tax liabilities under restructuring	-	-	-	(16,699)	-	-	(16,699)
Gain on restructuring of tax liabilities	-	-	-	6,793	-	-	6,793
Negative goodwill	-	57,143	3,934	-	-	197	61,274
Net other non-operating income/(expenses)	2,387	-	(2,667)	(10,760)	(32,941)	(817)	(44,798)
Profit before financing and taxation	<u>1,747,543</u>	<u>188,345</u>	<u>27,138</u>	<u>6,588</u>	<u>(27,849)</u>	<u>4,575</u>	<u>1,946,340</u>
Net financing (expense)/income	(52,123)	(8,441)	(5,488)	(16,043)	5,961	(29,972)	(106,106)
Profit before income tax	<u>1,695,420</u>	<u>179,904</u>	<u>21,650</u>	<u>(9,455)</u>	<u>(21,888)</u>	<u>(25,397)</u>	<u>1,840,234</u>
Income tax expense	(428,637)	(43,966)	(9,728)	(1,408)	(2,876)	5,286	(481,329)
Profit for the year	<u>1,266,783</u>	<u>135,938</u>	<u>11,922</u>	<u>(10,863)</u>	<u>(24,764)</u>	<u>(20,111)</u>	<u>1,358,905</u>
Additional information: depreciation expense	225,024	6,093	16,401	141,836	2,251	-	391,605

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

30. Commitments and contingencies

a. For litigation, tax and other liabilities

At the balance sheet date, the Group was subject to various claims from customers and suppliers and the tax authorities. Based on experience in resolving such matters, management believes that it has adequately provided for any liabilities in the accompanying financial statements.

The taxation system and regulatory environment of the Russian Federation are relatively new and characterized by numerous taxes and frequently changing legislation, which is often unclear, contradictory and subject to varying interpretations between the differing regulatory authorities and jurisdictions, who are empowered to impose significant fines, penalties and interest charges. Events during 2004 and 2005 suggest that the regulatory authorities within the Russian Federation are adopting a more assertive stance regarding the interpretation and enforcement of legislation. This situation creates substantial tax and regulatory risks, however, management has adopted a conservative approach to interpreting legislation and believes that it has complied with all relevant legislation and adequately provides for tax and other regulatory liabilities.

b. Long term purchase and sales contracts

In the normal course of business group companies enter into long term purchase contracts for raw materials, and long term sales contracts. These contracts allow for periodic adjustments in prices dependent on prevailing market conditions.

c. Capital commitments

At the balance sheet date the Group had contractual capital commitments of US\$ 358.8 million (2004: US\$ 267.7 million).

d. Insurance

The Group has insured its property and equipment to compensate for expenses arising from accidents. In addition, the Group has insurance for business interruption on a basis of reimbursement of fixed costs, subject to certain franchise. The Group has also insured third party liability in respect of property or environmental damage.

e. Guarantees

At the balance sheet date the Group had given US\$ 23.8 million (2004: US\$ 5.3 million) of guarantees, the majority of which were given for bank borrowings by related parties.

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Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

31. Financial instruments

Exposure to credit, liquidity, interest rate and currency risk arises in the normal course of the Group's business. The steel, metalware, mining and insurance segments of the Group have not used derivative financial instruments to reduce exposure to fluctuations in foreign exchange rates and interest rates. As at December 31, 2005 and 2004, the financing segment had no outstanding foreign exchange contracts.

Management believes that the fair value of its financial assets and liabilities approximates their carrying amounts except for the following long-term fixed rate borrowings:

	December 31, 2005		
	<u>Market value</u>	<u>Book value</u>	<u>Difference</u>
Citibank - Eurobonds 2009	336,830	325,000	11,830
Citibank - Eurobonds 2014	407,438	375,000	32,438
	<u>744,268</u>	<u>700,000</u>	<u>44,268</u>
	December 31, 2004		
	<u>Market value</u>	<u>Book value</u>	<u>Difference</u>
Citibank - Eurobonds 2009	334,750	325,000	9,750
Citibank - Eurobonds 2014	404,063	375,000	29,063
	<u>738,813</u>	<u>700,000</u>	<u>38,813</u>

The above amounts exclude accrued interest.

Credit risk

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet and guarantees (see note 30e). The Group has developed policies and procedures for the management of credit exposures, including the establishment of credit committees that actively monitors credit risk. At the balance sheet date there was a significant concentration of credit risk in respect of trade accounts receivable from related parties and originated loans to related parties.

Liquidity risk

The Group maintains liquidity management with the objective of ensuring that funds will be available at all times to honour all cash flow obligations as they become due.

Foreign exchange rate risk

The Group incurs currency risk when an entity enters into transactions and balances not denominated its functional currency. The Group has assets and liabilities denominated in several foreign currencies. Foreign currency risk arises when the actual or forecasted assets in a foreign currency are either greater or less than the liabilities in that currency.

Interest rate risk

Interest rates on Group's debt finance are either fixed or variable, at a fixed spread over LIBOR or Euribor for the duration of each contract. Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of

Severstal

Notes to the Special purpose consolidated financial statements for the year ended December 31, 2005

(Tabular amounts expressed in thousands of US dollars)

determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

The following table indicates weighted average effective interest rates of income-earning financial assets and interest-bearing financial liabilities at the balance sheet date:

	<u>Rouble</u>	<u>US dollar</u>	<u>Euro</u>
As at December 31, 2005:			
Interest bearing assets			
Short term bank deposits	5.92%	5.18%	-
Placements at financial institutions	6.17%	2.40%	2.25%
Loans to bank customers	8.79%	11.20%	-
Held-for-trading securities	6.25%	-	-
Originated loans	9.86%	7.91%	3.42%
Interest bearing liabilities			
Bank customer accounts	4.26%	1.85%	1.28%
Bank loan finance	9.89%	7.98%	3.46%
Bonds issued in Russia	8.10%	-	-
	<u>Rouble</u>	<u>US dollar</u>	<u>Euro</u>
As at December 31, 2004:			
Interest bearing assets			
Short term bank deposits	6.75%	3.40%	4.50%
Placements at financial institutions	0.18%	2.21%	1.63%
Loans to bank customers	9.20%	11.76%	12.65%
Held-for-trading securities	8.17%	-	-
Originated loans	8.17%	-	-
Interest bearing liabilities			
Bank customer accounts	2.91%	0.63%	0.51%
Promissory notes issued	8.17%	-	-
Bank loan finance	9.88%	7.91%	5.70%
Bonds issued in Russia	9.75%	-	-