# Joint Stock Bank “Moscow Bank for Reconstruction and Development” (Open Joint Stock Company)

**Independent Auditors’ Report**

**Consolidated Financial Statements**
Years Ended 31 December 2005 and 2004

# JOINT STOCK BANK "MOSCOW BANK FOR RECONSTRUCTION AND DEVELOPMENT" (OPEN JOINT STOCK COMPANY)

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## JOINT STOCK BANK "MOSCOW BANK FOR RECONSTRUCTION AND DEVELOPMENT" (OPEN JOINT STOCK COMPANY)

### STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004

The following statement, which should be read in conjunction with the independent auditors' responsibilities stated in the independent auditors' report set out on page 2, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of Joint Stock Bank "Moscow Bank for Reconstruction and Development" and its subsidiaries (the "Group").

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of the Group at 31 December 2005 and 2004, the results of its operations, cash flows and changes in equity for the years then ended, in accordance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- selecting suitable accounting principles and applying them consistently;
- making judgments and estimates that are reasonable and prudent;
- stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- maintaining statutory accounting records in compliance with legislation and accounting standards of the Russian Federation;
- taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- detecting and preventing fraud and other irregularities.

The consolidated financial statements for the years ended 31 December 2005 and 2004 were authorized for issue on 10 March 2006 by the Management Board of Joint Stock Bank "Moscow Bank for Reconstruction and Development".

**On behalf of the Management Board:**

| | |
|---|---|
| **S.Y. Zaitsev** | **T.V. Zapodovnikova** |
| **Acting Chairman of the Board** | **Chief Accountant** |
| 10 March 2006 | 10 March 2006 |
| Moscow | Moscow |

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## INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Joint Stock Bank "Moscow Bank for Reconstruction and Development":

We have audited the accompanying consolidated balance sheets of Joint Stock Bank "Moscow Bank for Reconstruction and Development" and its subsidiary (the "Group") as of 31 December 2005 and 2004 and the related consolidated income statements, consolidated statements of cash flows and changes in equity (the "consolidated financial statements") for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

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

Deloitte & Touche

10 March 2006
Moscow

## JOINT STOCK BANK “MOSCOW BANK FOR RECONSTRUCTION AND DEVELOPMENT” (OPEN JOINT STOCK COMPANY)

### CONSOLIDATED INCOME STATEMENTS
### FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004

| | Notes | For the year ended 31 December 2005 RUR’000 | For the year ended 31 December 2004 RUR’000 |
|---|---|---|---|
| Interest income | 4,22 | 2,642,769 | 1,649,005 |
| Interest expense | 4,22 | (1,495,835) | (863,304) |
| NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT LOSSES ON INTEREST-BEARING ASSETS | | 1,146,934 | 785,701 |
| Provision for impairment losses on interest-bearing assets | 5 | (356,485) | (225,435) |
| NET INTEREST INCOME | | 790,449 | 560,266 |
| Net gain on assets at fair value through profit or loss | | 38,909 | 59,009 |
| Net gain on foreign exchange operations | | 117,724 | 46,136 |
| Fee and commission income | 6,22 | 202,176 | 127,775 |
| Fee and commission expense | 6 | (20,117) | (22,571) |
| Other income | 22 | 19,001 | 11,675 |
| NET NON-INTEREST INCOME | | 357,693 | 222,024 |
| OPERATING INCOME | | 1,148,142 | 782,290 |
| OPERATING EXPENSE | 7,22 | (869,374) | (585,679) |
| OPERATING PROFIT | | 278,768 | 196,611 |
| Recovery of provision/(provision) on other transactions | 5 | 20,558 | (17,343) |
| PROFIT BEFORE INCOME TAX | | 299,326 | 179,268 |
| Income tax expense | 8 | (112,221) | (10,552) |
| NET PROFIT | | 187,105 | 168,716 |
| **Earnings per ordinary share** | | | |
| Basic and diluted earnings (RUR) | 9 | 211.9 | 209.3 |

**On behalf of the Management Board:**

**S.Y. Zaitsev**
**Acting Chairman of the Board**

**T.V. Zapodovnikova**
**Chief Accountant**

The notes on pages 8-42 form an integral part of these consolidated financial statements. The Independent Auditors’ Report is on page 2.

## JOINT STOCK BANK "MOSCOW BANK FOR RECONSTRUCTION AND DEVELOPMENT" (OPEN JOINT STOCK COMPANY)

### CONSOLIDATED BALANCE SHEETS
### AT 31 DECEMBER 2005 AND 2004

| | Notes | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|---|
| **ASSETS:** | | | |
| Cash and balances with the Central Bank of the Russian Federation | 10 | 2,741,832 | 2,342,092 |
| Assets at fair value through profit or loss | 11,22 | 3,612,060 | 968,388 |
| Loans and advances to banks | 12,22 | 2,343,582 | 4,805,498 |
| Loans to customers, less allowance for impairment losses | 13,22 | 22,624,199 | 12,075,361 |
| Fixed and intangible assets, less accumulated depreciation | 14 | 452,419 | 250,050 |
| Current income tax assets | 8 | 2,760 | 2,472 |
| Other assets | 15,22 | 228,298 | 47,045 |
| TOTAL ASSETS | | 32,005,150 | 20,490,906 |
| **LIABILITIES AND EQUITY** | | | |
| LIABILITIES: | | | |
| Loans and advances from banks | 16,22 | 3,460,477 | 1,296,006 |
| Customer accounts | 17,22 | 16,641,957 | 12,998,333 |
| Debt securities issued | 18 | 8,010,143 | 3,016,526 |
| Other provisions | 21,22 | 2,861 | 23,419 |
| Current income tax liability | 8 | - | 15,361 |
| Deferred income tax liability | 8 | 20,936 | 25,130 |
| Other liabilities | 19 | 19,592 | 9,881 |
| Total liabilities | | 28,155,966 | 17,384,656 |
| EQUITY: | | | |
| Share capital | 20 | 943,408 | 878,408 |
| Share premium | 20 | 3,575,304 | 3,042,304 |
| Accumulated deficit | | (669,528) | (814,462) |
| Total equity | | 3,849,184 | 3,106,250 |
| TOTAL LIABILITIES AND EQUITY | | 32,005,150 | 20,490,906 |

**On behalf of the Management Board:**

**S.Y. Zaitsev**
**Acting Chairman of the Board**

**T.V. Zapodovnikova**
**Chief Accountant**

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## JOINT STOCK BANK “MOSCOW BANK FOR RECONSTRUCTION AND DEVELOPMENT” (OPEN JOINT STOCK COMPANY)

### CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004

| | Notes | Share capital RUR’000 | Share premium RUR’000 | Accumulated deficit RUR’000 | Total equity RUR’000 |
|---|---|---|---|---|---|
| **31 December 2003** | | 878,408 | 3,042,304 | (945,917) | 2,974,795 |
| Dividends declared on: | | | | | |
| - ordinary shares | 20 | - | - | (36,000) | (36,000) |
| - preferred shares | 20 | - | - | (1,261) | (1,261) |
| Net profit for the year | | - | - | 168,716 | 168,716 |
| **31 December 2004** | | 878,408 | 3,042,304 | (814,462) | 3,106,250 |
| Paid in capital and share premium | | 65,000 | 533,000 | - | 598,000 |
| Dividends declared on: | | | | | |
| - ordinary shares | 20 | - | - | (40,920) | (40,920) |
| - preferred shares | 20 | - | - | (1,251) | (1,251) |
| Net profit for the year | | - | - | 187,105 | 187,105 |
| **31 December 2005** | | 943,408 | 3,575,304 | (669,528) | 3,849,184 |

**On behalf of the Management Board:**

**S.Y. Zaitsev**
**Acting Chairman of the Board**

**T.V. Zapodovnikova**
**Chief Accountant**

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## JOINT STOCK BANK "MOSCOW BANK FOR RECONSTRUCTION AND DEVELOPMENT" (OPEN JOINT STOCK COMPANY)

### CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004

| | Notes | Year ended 31 December 2005 RUR'000 | Year ended 31 December 2004 RUR'000 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Profit before income tax | | 299,326 | 179,268 |
| Adjustments for: | | | |
| Provision for impairment losses on interest-bearing assets | | 356,485 | 225,435 |
| (Recovery of provision)/provision on other transactions | | (20,558) | 17,343 |
| Depreciation/amortization charge on fixed and intangible assets | | 68,159 | 54,237 |
| Change in net interest accruals | | 121,501 | (66,534) |
| Net change in market value of derivatives | | - | (9,312) |
| Cash flows from operating activities before changes in operating assets and liabilities | | 824,913 | 400,437 |
| Changes in operating assets and liabilities | | | |
| (Increase)/decrease in operating assets: | | | |
| Obligatory reserves with the Central Bank of the Russian Federation | | (316,508) | 1,043,542 |
| Assets at fair value through profit or loss | | (2,408,422) | 826,653 |
| Loans and advances to banks | | 2,064,657 | 225,896 |
| Loans to customers | | (11,128,706) | (3,182,656) |
| Other assets | | (7,747) | (25,825) |
| Increase/(decrease) in operating liabilities: | | | |
| Loans and advances from banks | | 2,189,005 | (409,269) |
| Customer accounts | | 3,833,521 | 147,992 |
| Other liabilities | | 9,748 | 1,470 |
| Cash outflows from operating activities before income tax | | (4,939,539) | (971,760) |
| Income tax paid | | (132,064) | (28,293) |
| Net cash outflows from operating activities | | (5,071,603) | (1,000,053) |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Purchase of fixed and intangible assets | | (272,005) | (89,601) |
| Proceeds on sale of fixed and intangible assets | | 1,477 | 2,564 |
| Change in cash and cash equivalents due to disposal of investments in affiliates | | - | (30,047) |
| Investments in securities, net | | (173,499) | (348) |
| Net cash outflows from investing activities | | (444,027) | (117,432) |

# JOINT STOCK BANK “MOSCOW BANK FOR RECONSTRUCTION AND DEVELOPMENT” (OPEN JOINT STOCK COMPANY)

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004 (CONTINUED)

| | Notes | Year ended 31 December 2005 RUR’000 | Year ended 31 December 2004 RUR’000 |
|---|---|---|---|
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Issue of share capital | | 65,000 | - |
| Share premium received on issue of share capital | | 533,000 | - |
| Proceeds from debt securities issued, net | | 4,920,120 | 197,658 |
| Dividends paid | | (42,171) | (37,261) |
| Net cash inflows from financing activities | | 5,475,949 | 160,397 |
| Effect of foreign exchange rate changes on cash and cash equivalents | | (18,293) | (40,866) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | | (57,974) | (997,954) |
| CASH AND CASH EQUIVALENTS, beginning of year | 10 | 3,677,661 | 4,675,615 |
| CASH AND CASH EQUIVALENTS, end of year | 10 | 3,619,687 | 3,677,661 |

Interest paid and received by the Group during the year ended 31 December 2005 amounted to RUR 1,485,569 thousand and RUR 2,584,975 thousand, respectively.

Interest paid and received by the Group during the year ended 31 December 2004 amounted to RUR 917,682 thousand and RUR 1,636,849 thousand, respectively.

**On behalf of the Management Board:**

**S.Y. Zaitsev**
**Acting Chairman of the Board**

**T.V. Zapodovnikova**
**Chief Accountant**

The notes on pages 8-42 form an integral part of these consolidated financial statements. The Independent Auditors’ Report is on page 2.

## 1. ORGANISATION

Joint Stock Bank "Moscow Bank for Reconstruction and Development" (open joint stock company) ("MBRD") is a joint stock bank, which was incorporated in the Russian Federation (the "RF") in 1993. MBRD is regulated by the Central Bank of the Russian Federation (the "CBR") and conducts its business under license number 2268. MBRD's primary business consists of commercial banking activities, securities dealings and foreign currency transactions.

MBRD's principal business activities are within the Russian Federation. Registered headquarters of MBRD is located at: 5 bldg. 1, Yeropkinsky per., Moscow, 119034, RF.

MBRD has 5 branches in the territory of the RF.

Joint Stock Bank "Moscow Bank for Reconstruction and Development" is the Group's parent company (the "Group"). The Group included the financial statements of its subsidiary JSC Sistema K-Invest in the consolidated financial statements:

| **Name** | **Country of operation** | **Proportion of ownership interest and voting power of JSB MBRD** | | **Type of activity** |
|---|---|---|---|---|
| | | **2005** | **2004** | |
| JSC "Sistema K-Invest" | Russian Federation | 100% | 100% | Property lease out |

The Group renders services to a group of entities related by means of direct or indirect ownership by one parent company which is also an ultimate parent of the Group. At the close of business on 31 December 2005 and 2004 loans issued to such companies were 44.7% and 51.8% of the total loans to customers and loans and advances to banks (see Note 22). Deposits from such companies were 56.7% and 46.3% of the total amount of banks and advances from banks and customer accounts (see Note 22).

As of 31 December 2005, shareholders owned outstanding shares are as follows:

| **Shareholder** | **%** |
|---|---|
| JSFC "Sistema" | 60.66 |
| JSC "Promtorgcenter", controlled by Sistema | 16.10 |
| JSC "Moscow City Telephone Network", controlled by Sistema | 5.35 |
| LLC "Notris", controlled by Sistema | 4.97 |
| Other | 12.92 |
| **Total** | **100.00** |

As of 31 December 2005 Sistema directly or indirectly owed 99.2% of the share capital of MBRD. Mr. Evtoushenkov owns a controlling stake in JSFC "Sistema".

## 2. BASIS OF PRESENTATION

***Accounting basis*** – These consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (hereinafter referred to as "IFRS"). These consolidated financial statements are presented in thousands of Russian Roubles ("RUR") unless otherwise indicated. These consolidated financial statements are prepared under the historical cost convention modified for the measurement at fair value of certain financial instruments and according to International Accounting Standard 29 "Financial Reporting in Hyperinflationary Economies" ("IAS 29").

The Group maintains its accounting records in accordance with Russian law. These consolidated financial statements have been prepared from the Russian statutory accounting records and have been adjusted to conform to IFRS. Adjustments to these financial statements included reclassifications of certain assets and liabilities, income and expenses into the respective items of the balance sheet and income statement for reflecting the economic substance of the transactions.

Equity as of 31 December 2005 and 2004 and net profit for the years then ended are reconciled between Russian accounting standards and IFRS as follows:

| | 31 December 2005 | Year ended 31 December 2005 | 31 December 2004 | Year ended 31 December 2004 |
|---|---|---|---|---|
| | RUR'000 Equity | RUR'000 Profit | RUR'000 Equity | RUR'000 Profit |
| **Russian Accounting Standards** | **3,943,289** | **274,627** | **3,112,909** | **222,965** |
| Accrued interest, net | (257,351) | (152,342) | (107,825) | 20,309 |
| Provision for impairment | 92,760 | (31,083) | 124,011 | (44,383) |
| Deferred income tax | (20,936) | 4,194 | (25,130) | 55,480 |
| Fixed and intangible assets | 11,088 | 9,911 | 1,610 | (13,069) |
| Assets at fair value through profit or loss | 48,006 | 44,017 | 6,885 | (76,719) |
| Commission income and expense | 69,199 | 68,598 | - | - |
| Operating expenses | (23,890) | (20,845) | - | - |
| Other | (12,981) | (9,972) | (6,210) | 4,133 |
| **International Financial Reporting Standards** | **3,849,184** | **187,105** | **3,106,250** | **168,716** |

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses of the reporting period. Actual results could differ from those estimates. Estimates that are particularly susceptible to change relate to the provisions for impairment losses and the fair value of financial instruments.

***Key assumptions*** – Key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year include:

| | 31 December 2005 RUR'000 |
|---|---|
| Loans to customers, less allowance for impairment losses | 22,624,199 |

Loans to customers are measured at amortised cost/cost less allowance for impairment losses. The estimation of allowance for impairment losses involves an exercise of judgment. It is impracticable to assess the extent of the possible effects of key assumptions or other sources of uncertainty on these balances at the balance sheet date.

***Functional currency*** – The functional currency of these financial statements is the Russian Rouble.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Basis of consolidation*** – The consolidated financial statements incorporate the financial statements of MBRD and entity controlled by MBRD (its subsidiary) made up to 31 December each year. Control is achieved where MBRD has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognized as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to income statement in the period of acquisition. The minority interest is stated at the minority's proportion of the fair values of the assets and liabilities recognized. Subsequently, any losses applicable to the minority interest in excess of the minority interest are allocated against the interests of the parent.

Results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used in line with those used by MBRD.

All balances related to transactions between MBRD and consolidated entity and any income and expenses resulting from such transactions are eliminated on consolidation.

***Recognition and measurement of financial instruments*** – The Group recognizes financial assets and liabilities on its balance sheet when it becomes a party to the contractual provisions of the instrument. Regular way purchase and sale of the financial assets and liabilities are recognized using settlement date accounting. Regular way purchases of financial instruments that will be subsequently measured at fair value between trade date and settlement date are accounted for in the same way as for acquired instruments.

Financial assets and liabilities are initially recognized at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss transaction costs that are directly attributable to acquisition or issue of the financial asset or financial liability. The accounting policies for subsequent measurement of these items are disclosed in the respective accounting policies set out below.

***Cash and cash equivalents*** – Cash and cash equivalents include cash on hand, unrestricted balances on correspondent account with the CBR, advances to banks in countries included in the Organization for Economic Co-operation and Development ("OECD"), except for margin deposits for operations with plastic cards, which may be converted to cash within a short period of time and government debt securities in portfolio of assets at fair value through profit or loss. For purposes of determining cash flows, the minimum reserve deposit required by the CBR is not included as a cash equivalent due to restrictions on its availability.

***Assets at fair value through profit or loss*** – Assets at fair value through profit or loss represent assets acquired principally for the purpose of selling them in the near term, or it is a part of portfolio of identified financial instruments that are managed together and for which there is evidence of a recent and actual pattern of short-term profit-taking, or it is a trading derivative or an asset classified in this category on purchase. Assets at fair value through profit or loss are initially recorded and subsequently measured at fair value. The Group uses quoted market prices to determine fair value for the Group's assets at fair value through profit or loss. When reliable market prices are not available or if liquidating the Group's position would reasonably be expected to impact market prices, fair value is determined by reference to price quotations for similar instruments traded in different markets or management's estimates of the amounts that can be realized from an orderly disposition over a period of time, assuming current market conditions. Fair values of derivatives are obtained from the interest rates model. Fair value adjustment on assets at fair value through profit or loss is recognized in income statement for the period.

***Loans and advances to banks*** – In the normal course of business, the Group maintains advances or deposits for various periods of time with other banks. Loans and advances to banks with a fixed maturity term are subsequently re-measured at amortized cost using the effective interest rate method. Those that do not have fixed maturities are carried at amortized cost based on maturities estimated by the management.

***Originated loans*** – Loans originated by the Group are financial assets that are created by the Group by providing money directly to a borrower.

Loans granted by the Group with fixed maturities are initially recognized in accordance with the policy stated above. The difference between the nominal amount of consideration given and the amortized cost of loans issued at lower than market terms is recognized in the period the loan is issued as initial recognition adjustment discounting using market rates at inception and included in the income statement as losses on origination of assets. Subsequently, the carrying amount of such loans is adjusted for amortization of the losses on origination and the related income is recorded as interest income within the income statement using the effective interest method. Loans to customers that do not have fixed maturities are carried at cost. Loans to customers are carried net of any provision for impairment losses.

***Write off of loans and advances*** – Loans and advances are written off against provision for impairment losses in case of uncollectibility of loans and advances, including through repossession of collateral. Loans and advances are written off after management has exercised all possibilities available to collect amounts due to the Group and after the Group has sold all available collateral. The decision on writing off bad debt to impairment losses for all major, preferential, unsecured and insider loans should necessarily be confirmed with a procedural document of judicial bodies certifying that at the time of the decision the debt could not be repaid (partially repaid) with the debtor's funds.

***Non-accrual loans*** – Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is thereafter recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

***Provision for impairment losses*** – The Group establishes provision for impairment losses of financial assets when there is objective evidence that a financial asset or group of financial assets is impaired. The provision for impairment losses is measured as the difference between carrying amounts and the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted at the financial asset's original effective interest rate, for financial assets which are carried at amortised cost. If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusted provision account.
For financial assets carried at cost the provision for impairment losses is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

The determination of provision for impairment losses is based on an analysis of the risk assets and reflects the amount which, in the judgment of management, is adequate to provide for losses incurred. Provisions are made as a result of an individual appraisal of risk assets for financial assets that are individually significant, and an individual or collective assessment for financial assets that are not individually significant.

The change in provision for impairment losses is charged to income statement and the total of provision for impairment losses is deducted in arriving at assets as shown in balance sheet. Factors that the Group considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors' or issuers' liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.

It should be understood that estimates of losses involve an exercise of judgment. While it is possible that in particular periods the Group may sustain losses, which are substantial relative to provision for impairment losses, it is the judgment of management that provision for impairment losses is adequate to absorb losses incurred on the risk assets.

***Fixed and intangible assets*** – Fixed and intangible assets acquired after 1 January 2003 are carried at historical cost, less accumulated depreciation. Fixed assets and intangible assets acquired before 1 January 2003 are carried at historical cost restated for inflation, less accumulated depreciation. Depreciation on assets under construction and those not placed in service commences from the date the assets are ready for their intended use. Depreciation of leasehold improvements is calculated based on the period of lease.

Depreciation of fixed and intangible assets is designed to write off assets over their useful economic lives. It is calculated on a straight line basis at the following annual prescribed rates:

| | |
|---|---|
| Buildings and facilities | 2% |
| Furniture and equipment | 20-30% |
| Intangible assets | 10-20% |

The carrying amounts of fixed assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts. Where carrying values exceed this estimated recoverable amount, fixed assets are written down to their recoverable value. Impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss depreciation charges for fixed assets are adjusted in future periods to allocate the assets' revised carrying value, less residual value (if any), on a systematic basis over their remaining useful lives.

***Operating leases*** – Leases of assets under which the risks and rewards of ownership are effectively retained with the lessor are classified as operating leases. Lease payments effected by the Group under operating lease are recognized as expense on a straight-line basis over the lease term and included into operating expense.

***Taxation*** – Income tax expense represents the sum of current and deferred tax expense.

The current tax expense is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's current tax expense is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such tax assets and liabilities are recognized in the financial statements unless the temporary differences relate to goodwill or result from initial recognition (except for business combinations) of other assets and liabilities as part of a transaction which does not affect taxable or accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred income tax assets and liabilities are offset when:

- The Group has a legally enforceable right to set off the recognized amounts of current tax assets and current tax liabilities;
- The Group intends to settle on a net basis, or to realize the asset and settle the liability simultaneously;
- The deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority in each future tax period in which significant amounts of deferred tax liabilities and assets are expected to be settled or recovered.

RF also has various other taxes and levies, which are assessed on the Group's activities. These taxes and levies are included under "Taxes, other than income tax" in the operating expenses.

***Loans and advances from banks and customer accounts*** – Customer and bank deposits are initially recognized at fair value, which amounts to the issue proceeds less transaction costs incurred. Subsequently amounts due are stated at amortized cost and any difference between net proceeds and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method.

***Debt securities issued*** – Debt securities issued represent eurobonds, promissory notes and certificates of deposit issued by the Group. They are accounted for according to the same principles used for customer and bank deposits.

***Other provisions*** – Other provisions are recognized when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made.

***Share capital and share premium*** – Share capital and premium issued before 1 January 2003 is recognized at restated cost. Share capital and premium issued since 1 January 2003 is recognized at historic cost. Share premium represents the excess of contributions received over the nominal value of shares issued.

Dividends on ordinary shares are recognized in shareholders' equity as a reduction in the period in which they are declared. Dividends that are declared after the balance sheet date are treated as a subsequent event under IAS 10 "Events after the Balance Sheet Date" and disclosed accordingly.

***Retirement and other benefit obligations*** – In accordance with the requirements of the Russian legislation, the Group calculates the amounts of pension contributions based on employees' salaries and transfers them to the state pension fund. These payments are recorded as operating expense in income statement in the period the related salaries are earned. Upon retirement all retirement benefit payments are made by pension funds selected by employees. The Group does not have any pension arrangements separate from the State pension system of the RF. In addition, the Group has no post-retirement benefits or other significant compensated benefits requiring accrual.

***Financial guarantees and letters of credit*** – Financial guarantees and letters of credit issued by the Group represent its obligations to ensure payment of a determined amount of money to the beneficiary as a compensation for losses arising due to the payer's inability to effect timely payment in accordance with the initial or modified conditions of the debt instrument. Such financial guarantees and letters of credit are initially recognized at fair value. Subsequently they are measured at the higher of the created provision or fair value, less amortization of commission received on the relevant financial guarantee or letter of credit, where required.

***Recognition of income and expense*** – Interest income and expense are recognized on an accrual basis using effective interest rate method. Interest income also includes income earned on securities included in the portfolio of assets at fair value through profit or loss. Other income is credited to income statement when the related transactions are completed. Fee and commission income includes loan origination fees, loan commitment fees, loan servicing fees and fees on guarantees issued. Loan origination fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the loan. Where it is probable that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are deferred, together with the related direct costs, and recognized as an adjustment to the effective interest rate of the resulting loan. Where it is unlikely that a loan commitment will lead to a specific lending arrangement, the loan commitment fees are recognized in income statement over the remaining period of the loan commitment. Where a loan commitment expires without resulting in a loan, the loan commitment fee is recognized in income statement on expiry. Loan servicing fees are recognized as income as the services are provided.

***Foreign currency translation*** – Monetary assets and liabilities denominated in foreign currencies are translated into Russian Roubles at the appropriate spot rates of exchange ruling at the balance sheet date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of transaction. Profits and losses arising from the translations are included in net gain on foreign exchange transactions.

***Rates of exchange*** – The exchange rates at year-end used by the Group in the preparation of the financial statements are as follows:

| | **31 December 2005** | **31 December 2004** |
|---|---|---|
| RUR/USD | 28.7825 | 27.7487 |
| RUR/EUR | 34.1850 | 37.8104 |

***Fiduciary activities*** – The Group provides trustee services to its customers. Also the Group provides depositary services to its customers, that include transactions with securities on their depo accounts. Assets accepted and liabilities incurred under the fiduciary activities are not included in the Group's financial statements. The Group accepts the operational risk on these activities, but the Group's customers bear the credit and market risks associated with such operations.

***Restatements due to the changes in IFRS*** – Certain restatements have been made to the consolidated financial statements as of 31 December 2004 and for the year ended 31 December 2004 to comply with the changes in IAS 1 "Presentation of Financial Statements", IFRS 4 "Insurance Contracts", IAS 24 "Related party disclosures" (IAS 24) and IAS 39 "Financial Instruments: Recognition and Measurement" ("IAS 39") effective for the periods beginning on after 1 January 2005. Such restatements have been done retrospectively to the earliest financial statements period presented.

In accordance with the provisions of revised IAS 39 as of 31 December 2004 trading securities with carrying and fair value of RUR 959,076 thousand and derivative financial instruments reported within other assets at carrying value of a fair value of RUR 9,312 thousand were classified as assets at fair value through profit or loss.

***Reclassifications*** – The consolidated financial statements as at 31 December 2004 and for the year then ended were reclassified to comply with the financial statements presentation requirements as at 31 December 2005 and for the year then ended, including the disclosure in the cash flow statement of the effect of change in exchange rates on cash and cash equivalents.

***Effect of adoption of new standards issued, but not yet effective*** – The Group provided an assessment of the effect of changes on its financial position and results of operations reported under IFRS which would become effective for accounting periods beginning on or after 1 January 2006.

As of 1 January 2006 the International Accounting Standards Board amended the scope of IAS 39 to include financial guarantee contracts issued and remove them from IFRS 4. Under IAS 39 financial guarantee contracts issued are accounted and disclosed at the same way as under IFRS 4, therefore the effect of this change on the financial statements of the Group is not significant.

As of 1 January 2006 the option previously contained in IAS 39 to designate any financial asset or any liability to be measured at fair value through profit or loss has been eliminated. The Group reviewed its financial assets and financial liabilities at fair value through profit or loss as of 31 December 2005 and believes that the effect of the change is insignificant.

In accordance with IFRS 7 "Financial Instruments: Disclosures" ("IFRS 7") effective from 1 January 2007 the Group should present additional information regarding financial instruments. The Group assessed the influence of requirements under IFRS 7 and developed a plan for systems to provide appropriate level of disclosures.

## 4. NET INTEREST INCOME

| | Year ended 31 December 2005 RUR'000 | Year ended 31 December 2004 RUR'000 |
|---|---|---|
| **Interest income** | | |
| Interest on loans to customers | 2,065,057 | 1,315,981 |
| Interest on loans and advances to banks | 272,018 | 131,193 |
| Interest on other debt securities | 141,943 | 118,261 |
| Interest on discounted promissory notes | 134,021 | 33,714 |
| Interest on reverse repurchase transactions | 29,730 | 49,856 |
| Total interest income | 2,642,769 | 1,649,005 |
| **Interest expense** | | |
| Interest on customer accounts | 832,766 | 440,332 |
| Interest on debt securities issued | 574,293 | 230,045 |
| Interest on loans and advances from banks | 88,776 | 191,721 |
| Other interest expense | - | 1,206 |
| Total interest expense | 1,495,835 | 863,304 |
| Net interest income before provision for impairment losses on interest-bearing assets | 1,146,934 | 785,701 |

## 5. ALLOWANCE FOR IMPAIRMENT LOSSES

The movements in provision for impairment losses on interest-bearing assets were as follows:

| | Loans and advances to banks RUR'000 | Loans to customers RUR'000 | Total RUR'000 |
|---|---|---|---|
| 31 December 2003 | 48,516 | 576,434 | 624,950 |
| (Recovery of provision)/provision | (48,516) | 273,951 | 225,435 |
| 31 December 2004 | - | 850,385 | 850,385 |
| Provision | - | 356,485 | 356,485 |
| 31 December 2005 | - | 1,206,870 | 1,206,870 |

The movements in allowance on other transactions were as follows:

| | Guarantees and commitments RUR'000 |
|---|---|
| 31 December 2003 | 6,076 |
| Provision | 17,343 |
| 31 December 2004 | 23,419 |
| Recovery of provision | (20,558) |
| 31 December 2005 | 2,861 |

Allowances for impairment losses on assets are deducted from the related assets. Other provisions are recorded in liabilities.

## 6. FEE AND COMMISSION INCOME AND EXPENSE

| | Year ended 31 December 2005 RUR'000 | Year ended 31 December 2004 RUR'000 |
|---|---|---|
| **Fee and commission income from:** | | |
| Settlement operations | 111,749 | 52,651 |
| Cash operations | 57,938 | 42,292 |
| Documentary operations | 21,159 | 14,119 |
| Other | 11,330 | 18,713 |
| Total fee and commission income | 202,176 | 127,775 |
| **Fee and commission expense on:** | | |
| Settlement operations | 11,420 | 1,136 |
| Documentary operations | 6,233 | 8,301 |
| Cash operations | 2,077 | 11,325 |
| Other | 387 | 1,809 |
| Total fee and commission expense | 20,117 | 22,571 |

## 7. OPERATING EXPENSES

| | Year ended 31 December 2005 RUR'000 | Year ended 31 December 2004 RUR'000 |
|---|---|---|
| Staff cost | 372,569 | 243,136 |
| Operating lease | 89,665 | 68,837 |
| Depreciation/amortization of fixed and intangible assets | 68,159 | 54,237 |
| Employer social security contributions | 64,115 | 46,489 |
| Professional services | 45,725 | 48,692 |
| Taxes, other than income tax | 44,747 | 41,879 |
| Advertising expenses | 28,044 | 2,582 |
| Security | 27,769 | 21,801 |
| Deposit insurance system contributions | 17,402 | - |
| Maintenance of fixed assets (buildings, intangible assets etc.) | 17,134 | 12,039 |
| Telecommunication | 16,450 | 12,089 |
| Financing of social needs | 11,949 | 9,790 |
| Stationery and other office expenses | 11,238 | 11,278 |
| Business trip expenses | 5,488 | 3,021 |
| Hospitality expenses | 1,613 | 1,112 |
| Other expenses | 47,307 | 8,697 |
| Total operating expenses | 869,374 | 585,679 |

Advertising expenses for the year ended 31 December 2004 are shown net of reimbursement of expenses received from Mastercard of RUR 15,536 thousand.

## 8. INCOME TAX

The Group provides for current taxes based on the statutory tax accounts maintained and prepared in accordance with the Russian statutory tax regulations which may differ from the IFRS. During the years ended 31 December 2005 and 2004, Russian Federation corporate tax rate (excluding certain specific categories) amounted to 24%.

The Group is subject to certain permanent tax differences due to non-tax deductibility of certain income and expenses under local tax regulations.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for the purposes of taxation. Temporary differences as of 31 December 2005 and 2004 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Temporary differences as of 31 December 2005 and 2004 comprise:

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| **Deferred assets:** | | |
| Loans and advances from banks | 71,032 | - |
| Other assets | 9,111 | 6,735 |
| Fixed and intangible assets | - | 9,217 |
| Assets at fair value through profit or loss | - | 5,685 |
| Total deferred assets | 80,143 | 21,637 |
| **Deferred liabilities:** | | |
| Fixed and intangible assets | (117,476) | - |
| Loans to banks and customers | (31,790) | (126,347) |
| Assets at fair value through profit or loss | (13,023) | - |
| Debt securities issued | (5,089) | - |
| Total deferred liabilities | (167,378) | (126,347) |
| Net deferred liabilities | (87,235) | (104,710) |
| Net deferred income tax liability | (20,936) | (25,130) |

Reconciliation of tax expense and accounting profit for the year ended 31 December 2005 and 2004 are explained as follows:

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| Profit before income tax | 299,326 | 179,268 |
| Theoretical tax at the statutory tax rate | 71,838 | 43,024 |
| Effect of income taxed at different tax rates | - | (2,052) |
| Tax effect of permanent differences | 40,383 | (30,420) |
| Income tax expense | 112,221 | 10,552 |
| Current income tax expense | 116,415 | 66,032 |
| Change in net deferred income tax liability | (4,194) | (55,480) |
| Income tax expense | 112,221 | 10,552 |

| Deferred income tax liabilities | 2005 RUR'000 | 2004 RUR'000 |
|---|---|---|
| 1 January | 25,130 | 80,610 |
| Change in deferred income tax liabilities | (4,194) | (55,480) |
| 31 December | 20,936 | 25,130 |

As of 31 December 2005 and 2004 income tax assets comprise current income tax assets amounting to RUR 2,760 thousand and RUR 2,472 thousand, respectively.

The income tax liabilities comprise:

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| Current income tax liability | - | 15,361 |
| Deferred income tax liability | 20,936 | 25,130 |
| Income tax liability | 20,936 | 40,491 |

## 9. EARNINGS PER SHARE

The Group's basic and diluted earnings per share are calculated as follows:

| | Year ended 31 December 2005 RUR'000 | Year ended 31 December 2004 RUR'000 |
|---|---|---|
| Net profit for the year | 187,105 | 168,716 |
| Less dividends on preferred shares | (1,251) | (1,261) |
| Net profit attributable to ordinary shareholders | 185,854 | 167,455 |
| Weighted average number of ordinary shares for the calculation of basic and diluted earnings per share | 877,143 | 800,000 |
| Earnings per share – basic and diluted (RUR) | 211.9 | 209.3 |

There were no dilutions during the reported periods that would have resulted from conversions, exercises, and other contingent issuances that individually would have decreased earnings per share reported by the Group.

## 10. CASH AND BALANCES WITH THE CENTRAL BANK OF THE RUSSIAN FEDERATION

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| Cash in vault | 688,741 | 371,630 |
| Balance with the Central Bank of the Russian Federation | 2,053,091 | 1,970,462 |
| Total cash and balances with the Central Bank of the Russian Federation | 2,741,832 | 2,342,092 |

The balances with the CBR as of 31 December 2005 and 2004 include RUR 619,424 thousand and RUR 302,916 thousand, respectively, that represent the minimum reserve deposit required by the CBR. The Group is required to maintain the reserve deposit with the CBR at all times.

The balances with the CBR as of 31 December 2005 include RUR 55,912 thousand that represents reserve deposit on customers operations with foreign currencies required by the CBR.

Cash and cash equivalents for the purposes of the statement of cash flows are comprised of the following:

| | **31 December 2005 RUR'000** | **31 December 2004 RUR'000** |
|---|---|---|
| Cash in vault | 688,741 | 371,630 |
| Balances with the Central Bank of the Russian Federation | 2,053,091 | 1,970,462 |
| Loans and advances to banks in OECD countries | 1,020,992 | 1,384,833 |
| Assets at fair value through profit or loss | 476,287 | 253,652 |
| | 4,239,111 | 3,980,577 |
| Less minimum reserve deposit with the CBR | (619,424) | (302,916) |
| Cash and cash equivalents | 3,619,687 | 3,677,661 |

## 11. ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | Interest to nominal % | 31 December 2005 RUR'000 | Interest to nominal % | 31 December 2004 RUR'000 |
|---|---|---|---|---|
| **Corporate and bank bonds** | | | | |
| Avtovaz bonds | 9-10% | 201,078 | 11% | 67,630 |
| Stroytransgaz bonds | 10% | 187,821 | | - |
| Emerging markets structured PR B.V. bonds | 9% | 144,282 | | - |
| KhKF Bank bonds | 8-9% | 109,844 | 11% | 51,625 |
| Uralvagon bonds | 9% | 102,229 | | - |
| Salavatsetklo bonds | 9% | 101,500 | | - |
| Sevkabelfinance bonds | 12% | 100,536 | | - |
| Magnezit bonds | 10% | 100,243 | | - |
| CB RF bonds | 9% | 99,120 | | - |
| Salut Energy bonds | 10% | 91,000 | | - |
| Marta Finance bonds | 15% | 87,097 | | - |
| ACBK-Invest bonds | 12% | 72,283 | | - |
| Efko bonds | 8% | 68,008 | 16% | 32,560 |
| NSMMZ bonds | 12% | 62,800 | | - |
| OMK bonds | 9% | 61,848 | | - |
| Russian Standard Bank bonds | 8% | 60,289 | | - |
| Spurt bonds | 9% | 60,012 | 11% | 60,810 |
| Yakovlevsky bonds | 12% | 51,052 | | - |
| RAF bonds | 7% | 40,477 | | - |
| Tatenergo bonds | 10% | 31,899 | | - |
| Irkut bonds | 9% | 30,718 | | - |
| TchTPZ bonds | 10% | 26,068 | | - |
| OMZ bonds | 14% | 18,092 | | - |
| Izhavto bonds | | - | 13% | 78,882 |
| Kamaz Finance bonds | | - | 12% | 18,451 |
| MGTS bonds | | - | 10% | 34,515 |
| Micron bonds | | - | 15% | 103,904 |
| YuTK bonds | | - | 9% | 62,159 |
| Vneshtorgbank bonds | | - | 15% | 38,414 |
| Zenit Bank bonds | | - | 9% | 5,099 |
| | | 1,908,296 | | 554,049 |
| **Corporate and bank promissory notes** | | | | |
| Promissory notes of Transcredit bank | | 271,203 | | - |
| Promissory notes of Salavatnefteogrsyntez | | 236,907 | | - |
| Promissory notes of NOMOS bank | | 202,151 | | - |
| Promissory notes of Stroytransgaz | | 106,534 | | - |
| Promissory notes of Impeksbank | | 80,495 | | - |
| Promissory notes of Souz bank | | 67,715 | | - |
| Promissory notes of Rossekhozbank | | 58,439 | | - |
| Promissory notes of Stroycredit bank | | 56,565 | | - |
| Promissory notes of UTK | | 54,143 | | - |
| Promissory notes of Mezhprombank | | 48,332 | | 9,350 |
| Promissory notes of Promsvyazbank | | 46,898 | | - |
| Kamaz-Finance promissory notes | | 39,343 | | 9,086 |
| Promissory notes of VBRR | | 28,489 | | - |
| Promissory notes of Center Telekom | | 26,479 | | - |
| Promissory notes of Sberbank RF | | 656 | | - |
| | | 1,324,349 | | 18,436 |

| | Interest to nominal % | 31 December 2005 RUR'000 | Interest to nominal % | 31 December 2004 RUR'000 |
|---|---|---|---|---|
| **Russian government debt securities** | | | | |
| OVGVZ bonds | 3% | 208,117 | 3% | 190,652 |
| Russian State Bonds (OFZ) | 6-8% | 169,050 | 8-10% | 63,000 |
| | | 377,167 | | 253,652 |
| **Shares** | | | | |
| Ordinary and preferred shares of MGTS | | 2,248 | | 13,124 |
| Ordinary shares of Lukoil | | - | | 24,450 |
| Ordinary shares of Surgutneftegaz | | - | | 17,146 |
| Ordinary shares of RAO UES | | - | | 11,655 |
| Ordinary shares of Rostelecom | | - | | 7,973 |
| Ordinary shares of MMC Norilsk Nickel | | - | | 2,310 |
| | | 2,248 | | 76,658 |
| **Municipal debt securities** | | | | |
| Bonds of the Moscow City Government | | - | 10% | 54,708 |
| | | - | | 54,708 |
| Other securities | | - | | 1,573 |
| Derivative financial instruments | | - | | 9,312 |
| **Total assets at fair value through profit or loss** | | **3,612,060** | | **968,388** |

Corporate and bank bonds are bonds issued by Russian enterprises and commercial banks. A coupon of 3%-11% and 8.7%-15.5% to the nominal value is payable under the bonds outstanding as of 31 December 2005 and 2004. Corporate and bank bonds have maturities between 1 and 5 years.

Corporate and bank promissory notes represent debt instruments issued by companies and commercial banks in the RF with a discount from the par value. Corporate and bank promissory notes mature within one year.

OVGVZ Bonds are US Dollar denominated government securities issued at discount to face value with maturity in 2011. Interest on these bonds is payable once a year at the annual rates of 3% of the par value.

Russian State Bonds (OFZ) are Russian Rouble denominated government securities issued at discount to face value and guaranteed by the Ministry of Finance of the Russian Federation with medium to long-term maturities. Interest on these bonds is payable four times a year at the annual rates of 6-10% of the par value.

Municipal bonds included in portfolio of assets at fair value through profit or loss as of 31 December 2004 represent bonds maturing in 2014. Coupon interest on these securities is paid at the annual rate of 10% to the par value.

As of 31 December 2005 and 2004 included in assets at fair value through profit or loss is accrued interest income on debt securities amounting to RUR 48,541 thousand and RUR 29,248 thousand, respectively.

As of 31 December 2005 and 2004 included in the portfolio of assets at fair value through profit or loss were OFZ bonds of RUR 60,917 thousand and RUR 63,000 thousand, respectively, which were provided as collateral for CBR loan facilities.

As of 31 December 2004 included in assets at fair value through profit or loss were securities sold under repurchase agreements with other banks at fair value of RUR 198,491 thousand. These agreements were settled by the Group in January 2005 (Note 16).

As of 31 December 2004 derivative financial instruments of RUR 9,312 thousand comprise fair value of a foreign currency forward contract with notional sell equivalent of RUR 1,946,294 and notional buy amount of RUR 1,936,982 thousand.

## 12. LOANS AND ADVANCES TO BANKS

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| Loans and advances to banks | 2,188,519 | 4,664,184 |
| Correspondent accounts with banks | 151,517 | 139,253 |
| Accrued interest income on loans and advances to banks | 3,546 | 2,061 |
| Total loans and advances to banks | 2,343,582 | 4,805,498 |

As of 31 December 2005 loans and advances to banks included RUR 30,991 thousand placed with one Russian and three foreign banks as a guarantee deposits on operations with plastic cards.

As of 31 December 2005 the Group placed USD deposit of equivalent of RUR 20,148 thousand with a Russian bank which was secured by deposit of RUR 20,000 thousand received from the same bank (Note 16).

As of 31 December 2005 and 2004 the maximum credit risk exposure of loans and advances to banks amounted to RUR 2,343,582 thousand and RUR 4,805,498 thousand, respectively.

As of 31 December 2005 and 2004 the Group had loans and advances to 2 and 3 banks totaling RUR 1,172,853 thousand and RUR 3,583,307 thousand, respectively, that individually exceeded 10% of the Group's equity.

## 13. LOANS TO CUSTOMERS

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| Originated loans | 23,623,783 | 12,906,061 |
| Securities purchased under agreement to resell | 150,585 | - |
| Accrued interest income on loans to customers | 56,701 | 19,685 |
| | 23,831,069 | 12,925,746 |
| Less allowance for impairment losses | (1,206,870) | (850,385) |
| Total loans to customers, net | 22,624,199 | 12,075,361 |

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| **Analysis by type of collateral:** | | |
| Loans secured by corporate guarantees | 11,245,857 | 6,954,040 |
| Loans collateralized by pledge of equipment | 5,011,008 | 80,834 |
| Loans collateralized by pledge of shares of other companies | 2,507,819 | 1,928,410 |
| Loans collateralized by pledge of real estate | 2,457,472 | - |
| Loans collateralized by pledge of inventory | 508,289 | 1,520,757 |
| Loans collateralized by the MBRD's promissory notes | 135,510 | - |
| Other | 150,585 | - |
| Unsecured loans | 1,814,529 | 2,441,705 |
| | 23,831,069 | 12,925,746 |
| Less allowance for impairment losses | (1,206,870) | (850,385) |
| Total loans to customers, net | 22,624,199 | 12,075,361 |

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| **Analysis by sector:** | | |
| Real estate management and development | 10,132,269 | 5,052,861 |
| Trading | 2,886,981 | 2,369,701 |
| Manufacturing | 2,854,644 | 2,232,019 |
| Finance lease | 1,919,150 | 114,162 |
| Individuals | 1,673,856 | 204,681 |
| Finance | 1,197,432 | 1,245,372 |
| Telecommunications | 974,838 | 896,830 |
| Transport | 935,227 | - |
| Tourist and hotel business | 585,365 | 297,789 |
| Other | 671,307 | 512,331 |
| | 23,831,069 | 12,925,746 |
| Less allowance for impairment losses | (1,206,870) | (850,385) |
| Total loans to customers, net | 22,624,199 | 12,075,361 |

Movements in allowances for impairment losses for the years ended 31 December 2005 and 2004 are disclosed in Note 5.

As of 31 December 2005 included in loans to customers are loans received under reverse repurchase agreement of RUR 150,585 thousand. Such agreements were secured by Promissory notes of Irkut with fair value of RUR 150,585 thousand.

As of 31 December 2005 and 2004 the Group had loans to 18 and 13 borrowers totaling RUR 10,218,293 thousand and RUR 6,798,835 thousand, respectively, whose individual exposure exceeded 10% of the Group's equity.

The Group's loans to customers in Moscow and the Moscow region represent 77% and 85% of the total loan portfolio as of 31 December 2005 and 2004, respectively. Thus, there is a significant geographical concentration of the loan portfolio.

As of 31 December 2005 and 2004 the maximum credit risk exposure of loans to customers amounted to RUR 23,831,069 thousand and RUR 12,925,746 thousand, respectively.

## 14. FIXED AND INTANGIBLE ASSETS

| | Buildings and facilities RUR'000 | Leasehold improvements RUR'000 | Furniture and equipment RUR'000 | Intangible assets RUR'000 | Total RUR'000 |
|---|---|---|---|---|---|
| **Cost/inflated cost** | | | | | |
| 31 December 2003 | 34,171 | 32,756 | 181,750 | 40,744 | 289,421 |
| Additions | - | 11,357 | 68,045 | 10,199 | 89,601 |
| Disposals | (2) | (556) | (9,839) | (364) | (10,761) |
| 31 December 2004 | 34,169 | 43,557 | 239,956 | 50,579 | 368,261 |
| Additions | 127,913 | 24,849 | 106,449 | 12,794 | 272,005 |
| Disposals | - | (536) | (15,378) | (1,103) | (17,017) |
| 31 December 2005 | 162,082 | 67,870 | 331,027 | 62,270 | 623,249 |
| **Accumulated depreciation** | | | | | |
| 31 December 2003 | 683 | 8,726 | 50,383 | 12,379 | 72,171 |
| Charge for the year | 698 | 11,633 | 34,310 | 7,596 | 54,237 |
| Disposal | - | (556) | (7,280) | (361) | (8,197) |
| 31 December 2004 | 1,381 | 19,803 | 77,413 | 19,614 | 118,211 |
| Charge for the year | 698 | 11,712 | 46,940 | 8,809 | 68,159 |
| Disposal | - | (508) | (14,096) | (936) | (15,540) |
| 31 December 2005 | 2,079 | 31,007 | 110,257 | 27,487 | 170,830 |
| **Net book value at** | | | | | |
| 31 December 2005 | 160,003 | 36,863 | 220,770 | 34,783 | 452,419 |
| 31 December 2004 | 32,788 | 23,754 | 162,543 | 30,965 | 250,050 |

## 15. OTHER ASSETS

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| Advances on purchase of subsidiaries | 173,499 | - |
| Prepaid expenses and receivables on other transactions | 31,853 | 39,641 |
| Taxes recoverable, other than income tax | 22,779 | - |
| Other | 167 | 7,404 |
| Total other assets | 228,298 | 47,045 |

As of 31 December 2005 advances on purchase of subsidiaries included 50% prepayments for shares of CJSC "Leasing company "Sistema-Finleasing" and CJSC "INVEST-SVYAZ-HOLDING". Ownership on the shares was transferred to the Group after 31 December 2005.

## 16. LOANS AND ADVANCES FROM BANKS

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| Loans from banks and other financial institutions | 3,401,088 | 1,006,681 |
| Correspondent accounts of banks | 58,440 | 128,302 |
| Securities sold under agreement to repurchase | - | 156,047 |
| Accrued interest expense on loans and advances from banks | 949 | 4,976 |
| Total loans and advances from banks | 3,460,477 | 1,296,006 |

As of 31 December 2004 included in loans from banks and financial institutions was RUR 584,900 thousand received from a Russian bank maturing in June 2006 and bearing interest at an annual rate of 11.5%.

As of 31 December 2004 agreements to repurchase were secured by:

| | Fair value of securities RUR'000 | Carrying value of liabilities, RUR'000 |
|---|---|---|
| Avtovaz bonds | 62,533 | 47,293 |
| YuTK bonds | 41,439 | 31,657 |
| Vneshtorgbank bonds | 33,895 | 27,481 |
| KhKF Bank bonds | 30,975 | 24,098 |
| MGTS bonds | 29,649 | 25,518 |
| | 198,491 | 156,047 |

## 17. CUSTOMER ACCOUNTS

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| Time deposits | 11,451,073 | 4,995,190 |
| Demand deposits | 5,119,954 | 7,946,605 |
| Accrued interest expense on customer accounts | 70,930 | 56,538 |
| Total customer accounts | 16,641,957 | 12,998,333 |

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| **Analysis by sector:** | | |
| Individuals | 5,255,503 | 2,074,131 |
| Finance | 4,122,539 | 2,332,956 |
| Telecommunications | 3,812,183 | 5,012,094 |
| Trading | 1,084,503 | 116,929 |
| Production | 829,420 | - |
| Construction | 494,469 | 130,261 |
| Culture and sports | 297,184 | 151,047 |
| Aircraft manufacturing | 51,186 | 2,449,111 |
| Food industry | 39,727 | 96,141 |
| Other | 655,243 | 635,663 |
| Total customer accounts | 16,641,957 | 12,998,333 |

As of 31 December 2005 and 2004 customer accounts of RUR 414,377 thousand and RUR 117,545 thousand, respectively, were held as security against letters of credit and guarantees issued by the Group.

As of 31 December 2005 included in customer accounts were RUR 2,160,971 thousand, RUR 1,771,947 thousand and RUR 479,047 thousand, payable to three Russian companies.

As of 31 December 2004 included in customer accounts were RUR 3,071,953 thousand and RUR 1,591,099 thousand payable to two Russian companies.

## 18. DEBT SECURITIES ISSUED

| | Redemption date (month, year) | Interest to nominal % | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|---|---|
| Eurobonds | Mar' 08 | 8.63% | 4,396,802 | - |
| Discount-bearing promissory notes | Jan' 06-May' 07 | 7.06%-11.49% | 2,960,253 | 1,185,649 |
| Interest-bearing promissory notes | Jan' 06-Feb' 10 | 0.10%-7.40% | 461,563 | 1,829,059 |
| Non-interest/discount-bearing promissory notes | Jan' 06 | - | 150,410 | 1,818 |
| Certificates of deposit | Sep' 06 | 9.00% | 41,115 | - |
| Total debt securities issued | | | 8,010,143 | 3,016,526 |

Non-interest/discount-bearing promissory notes are issued for settlement purposes, on demand, at nominal value.

## 19. OTHER LIABILITIES

| | 31 December 2005 RUR'000 | 31 December 2004 RUR'000 |
|---|---|---|
| Current settlements | 12,923 | 5,124 |
| Taxes payable, other than income tax | 1,630 | 2,925 |
| Other payables | 5,039 | 1,832 |
| Total other liabilities | 19,592 | 9,881 |

## 20. SHARE CAPITAL

As of 31 December 2005 and 2004 share capital authorized, issued and fully paid comprised of 930,000 and 800,000 ordinary shares with par value of RUR 500 each and 1,000 preferred shares with par value of RUR 500 each.

On 31 May 2005 annual shareholders' meeting approved payment of dividends on preferred and ordinary shares for the year 2004 of RUR 1,251.25 per share and RUR 51.15 per share, respectively. The dividends were paid before 31 December 2005.

On 31 May 2004 annual shareholders' meeting approved payment of dividends on preferred and ordinary shares for 2003 of RUR 1,299 per share and RUR 45 per share, respectively. The dividends were paid before 31 December 2004.

The Group's reserves distributable to shareholders are limited to the amount of its reserves (share capital, share premium and retained earnings) as disclosed in its statutory accounts. Non-distributable reserves are represented by a general reserve fund, which is created as required by the statutory regulations, in respect of general banking risks, including future losses and other unforeseen risks or contingencies. The reserve was created in accordance with the Charter.

## 21. FINANCIAL COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Group is a party to financial instruments with off-balance sheet risk in order to meet the needs of its customers. These instruments, involving varying degrees of credit risk, are not reflected in the balance sheet.

The Group created provision on letters of credit and guarantees issued amounted to RUR 2,861 thousand and RUR 23,419 thousand as of 31 December 2005 and 2004, respectively.

The risk-weighted amount is obtained by applying credit conversion factor and counterparty risk weightings according to the principles employed by the Basle Committee on Banking Supervision.

As at 31 December 2005 and 2004, the nominal, or contract amounts and the risk weighted credit equivalents of instruments with off-balance sheet risks were:

| | 31 December 2005 | | 31 December 2004 | |
|---|---|---|---|---|
| | **Nominal amount RUR'000** | **Risk-weighted amount RUR'000** | **Nominal amount RUR'000** | **Risk-weighted amount RUR'000** |
| **Contingent liabilities and credit commitments** | | | | |
| Guarantees and other similar commitments | 1,202,946 | 788,569 | 200,223 | 195,755 |
| Letters of credit and other transactions related to contingent liabilities | 28,554 | 14,277 | 113,077 | - |
| Commitments on loans and unused credit lines | 3,509,948 | 701,806 | 3,376,237 | 226,673 |
| **Total financial commitments and contingencies** | **4,741,448** | **1,504,652** | **3,689,537** | **422,428** |

As of 31 December 2005 and 2004 RUR 414,377 thousand and RUR 4,468 thousand of guarantees issued were covered by customers' funds, respectively.

As of 31 December 2004 RUR 113,077 thousand of letters of credit was covered by customers' funds, respectively.

***Capital commitments*** – The Group had no material commitments for capital expenditure outstanding as at 31 December 2005.

***Operating leases*** – The Group's future minimum rental payments under non-cancellable operating leases of buildings, equipment and cars in effect at 31 December 2005 and 2004 are presented in the table below.

| | **31 December 2005 RUR'000** | **31 December 2004 RUR'000** |
|---|---|---|
| Not later than one year | 95,767 | 44,801 |
| Later than one year and not later than five years | 107,255 | 38,507 |
| Later than five years | 137,061 | 138,442 |
| Total operating lease | **340,083** | **221,750** |

***Fiduciary activities*** – In the normal course of its business the Group enters into agreements with limited right on decision making with clients for their assets management in accordance with specific criteria established by clients. The Group may be liable for losses due to its gross negligence or wilful misconduct until such funds or securities are not returned to the client. The maximum potential financial risk of the Group at any given moment is equal to the volume of the clients' funds plus/minus any unrealized income/loss on the client's position. In the judgment of management, as of 31 December 2005 the maximum potential financial risk on securities accepted by the Group on behalf of its clients does not exceed RUR 715,350 thousand.

The Group also provides depositary services to its customers. As of 31 December 2005 and 2004 the Group had customer securities totaling 18,984,563 items and 4,823,261 items, respectively, in its nominal holder accounts.

***Legal proceedings*** – From time to time and in the normal course of business, claims against the Group are received from customers and counterparties. Management is of the opinion that no material unaccrued losses will be incurred and accordingly no provision has been made in these financial statements.

***Taxes*** – Due to the presence in Russian commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgment of business activities, if a particular treatment based on Management's judgment of the Group's business activities was to be challenged by the tax authorities, the Group may by assessed additional taxes, penalties and interest. Such uncertainty may relate to valuation of financial instruments, loss and impairment provisions and market level for deals' pricing. The Group believes that it has already made all tax payments, and therefore no allowance has been made in the financial statements. Tax years remain open to review by the tax authorities for three years.

***Pensions and retirement plans*** – Employees receive pension benefits from the RF in accordance with the laws and regulations of the country. As of 31 December 2005 and 2004 the Group was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

***Operating environment*** – The Group's principal business activities are within the RF. Laws and regulations affecting business environment in the RF are subject to rapid changes and the Group's assets and operations could be at risk due to negative changes in the political and business environment.

## 22. RELATED PARTY TRANSACTIONS

Related parties or transactions with related parties, as defined by IAS 24, represent:

(a) Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the Group (this includes holding companies, subsidiaries and fellow subsidiaries);
(b) Associates – enterprises in which the Group has significant influence and which are neither a subsidiary nor a joint venture of the investor;
(c) Individuals owning, directly or indirectly, an interest in the voting power of the Group that gives them significant influence over the Group;
(d) Key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the Group, including directors and officers of the Group (also non-executive directors and close members of the families of such individuals);
(e) Enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the Group and enterprises that have a member of key management in common with the Group;
(f) Parties with joint control over the Group;
(g) Joint ventures in which the Group is a venture; and
(h) Post-employment benefit plans for the benefit of employees of the Group, or of any entity that is a related party to the Group.

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form. The Group had the following credit transactions with related parties outstanding as of 31 December 2005 and 2004:

| | 31 December 2005 RUR'000 | | 31 December 2004 RUR'000 | |
|---|---|---|---|---|
| | **Related party transactions** | **Total category as per financial statements** | **Related party transactions** | **Total category as per financial statements** |
| **Assets and fair value through profit or loss** | **2,248** | **3,612,060** | **160,855** | **968,388** |
| - entities with joint control or significant influence over the Group | 2,248 | | 160,855 | |
| **Loans and advances to banks** | **512,812** | **2,343,582** | **1,934,327** | **4,805,498** |
| - entities with joint control or significant influence over the Group | 512,812 | | 1,934,327 | |
| **Loans to customers gross of allowance for impairment losses** | **11,196,493** | **23,831,069** | **7,243,145** | **12,925,746** |
| - key management personnel of the Group or its parent company | 7,092 | | 7,087 | |
| - entities with joint control or significant influence over the Group | 11,189,401 | | 7,236,058 | |
| **Allowance for impairment losses on loans to customers** | **(567,021)** | **(1,206,870)** | **(467,183)** | **(850,385)** |
| - key management personnel of the Group or its parent company | (359) | | (457) | |
| - entities with joint control or significant influence over the Group | (566,662) | | 466,726 | |

| | 31 December 2005 RUR'000 | | 31 December 2004 RUR'000 | |
|---|---|---|---|---|
| | **Related party transactions** | **Total category as per financial statements** | **Related party transactions** | **Total category as per financial statements** |
| **Other assets** | **173,499** | **228,298** | **-** | **47,045** |
| - shareholders | 173,499 | | - | |
| **Loans and advance from banks** | **431,787** | **3,460,477** | **174,195** | **1,296,006** |
| - entities with joint control or significant influence over the Group | 431,787 | | 174,195 | |
| **Customer accounts** | **10,966,514** | **16,641,957** | **6,438,825** | **12,998,333** |
| - key management personnel of the Group or its parent company | 2,049,617 | | 538,342 | |
| - entities with joint control or significant influence over the Group | 8,196,073 | | 5,469,748 | |
| - shareholders | 720,824 | | 430,735 | |
| **Unused credit commitments** | **677,382** | **3,509,948** | **939,782** | **3,376,237** |
| - entities with joint control or significant influence over the Group | 677,382 | | 939,782 | |
| **Guarantees issued and similar commitments** | **500,001** | **1,202,946** | **148,614** | **200,223** |
| - entities with joint control or significant influence over the Group | 500,001 | | 148,614 | |
| **Provision on guarantees issued** | **(1,161)** | **(2,861)** | **(15,888)** | **(23,419)** |
| - entities with joint control or significant influence over the Group | (1,161) | | (15,888) | |
| **Fiduciary activities – trust operations** | **715,350** | **715,350** | **-** | **-** |
| - shareholders | 715,350 | | - | |

Included in the income statement for the years ended 31 December 2005 and 2004 are the following amounts which arose due to transactions with related parties:

| | Year ended 31 December 2005 | | Year ended 31 December 2004 | |
|---|---|---|---|---|
| | Related party transactions RUR'000 | Total category as per financial statements RUR'000 | Related party transactions RUR'000 | Total category as per financial statements RUR'000 |
| **Interest income** | **122,655** | **2,642,769** | **728,713** | **1,649,005** |
| - key management personnel of the Group or its parent company | 734 | | 23 | |
| - entities with joint control or significant influence over the Group | 121,921 | | 728,690 | |
| **Interest expense** | **(685,904)** | **(1,495,835)** | **(511,385)** | **(863,304)** |
| - shareholders | (147,258) | | | |
| - key management personnel of the Group or its parent company | (162,288) | | (50,999) | |
| - entities with joint control or significant influence over the Group | (376,358) | | (460,386) | |
| **Fees and commissions income** | **53,266** | **202,176** | **40,140** | **127,775** |
| - entities with joint control or significant influence over the Group | 53,266 | | 40,140 | |
| **Other income** | **3,401** | **19,001** | **-** | **11,675** |
| - entities with joint control or significant influence over the Group | 3,401 | | - | |
| **Operating expense (net of staff cost)** | **(58,747)** | **(432,690)** | **(62,275)** | **(296,054)** |
| - entities with joint control or significant influence over the Group | (58,747) | | (62,275) | |

| | 31 December 2005 RUR '000 | | 31 December 2004 RUR '000 | |
|---|---|---|---|---|
| | Related party transactions | Total category as per financial statements caption | Related party transactions | Total category as per financial statements caption |
| **Key management personnel compensation** | **52,709** | **436,684** | **22,453** | **289,625** |

## 23. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments is made in accordance with the requirements of IAS 32 and IAS 39. Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. As no readily available published price quotations in an active market exists for a large part of the Group's financial instruments, judgment is necessary in arriving at fair value using a valuation technique, based on current economic conditions and specific risks attributable to the instrument. The estimates presented herein are not necessarily indicative of the amounts the Group could realize in a market exchange from the sale of its full holdings of a particular instrument.

The fair value of financial assets and liabilities compared with the corresponding carrying amount in the balance sheet of the Group is presented below:

| | 31 December 2005 | | 31 December 2004 | |
|---|---|---|---|---|
| | **Current value RUR '000** | **Fair value RUR '000** | **Current value RUR '000** | **Fair value RUR '000** |
| Cash and balances with the Central Bank of the Russian Federation | 2,741,832 | 2,741,832 | 2,342,092 | 2,342,092 |
| Assets at fair value through profit or loss | 3,612,060 | 3,612,060 | 968,388 | 968,388 |
| Loans and advances to banks | 2,343,582 | 2,343,582 | 4,805,498 | 4,805,498 |
| Loans and advances from banks | 3,460,477 | 3,460,477 | 1,296,006 | 1,296,006 |
| Customer accounts | 16,641,957 | 16,641,957 | 12,998,333 | 12,998,333 |
| Debt securities issued | 8,010,143 | 8,079,107 | 3,016,526 | 3,016,526 |

The fair value of loans to customers with the carrying value of RUR 22,624,199 thousand and RUR 12,075,361 thousand as of 31 December 2005 and 2004 can not be measured reliably as it is not practicable to obtain market information or apply any other valuation techniques on such instruments.

## 24. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Group to maintain minimum amounts and ratios (as set forth in the table below) of total and tier 1 capital to risk weighted assets.

The ratio was calculated in accordance with rules established by the Basel Agreement by applying the following risk estimates:

| Estimate | Description of position |
|---|---|
| 0% | Cash and balances with the Central Bank of the Russian Federation |
| 0% | Government debt securities denominated in Russian Rubles |
| 0% | Customs guarantees (for excise custom house) |
| 20% | Loans and advances to banks for less than one year |
| 50% | Commitments on unused loans with the initial maturity of up to 1 year |
| 100% | Loans and advances to customers |
| 100% | Guarantees |
| 50% | Import uncovered letters of credit |
| 50% | Credit lines with more than 1 year maturity |
| 4% | Forward contracts |
| 100% | Other assets |

As at 31 December 2005 and 2004 the Group's total capital amount for Capital Adequacy purposes and tier 1 capital amount was RUR 3,849,184 thousand and RUR 3,106,250 thousand with ratios of 13.9% and 21.5%, respectively.

## 25. DISPOSAL OF A SUBSIDIARY

On 30 July 2004, the Group sold shares of JSC "UK "Sistema Investments" and transferred control over this company to a related party, having received a compensation of RUR 20,195 thousand and recognized a gain on disposal of RUR 195 thousand in the income statement as part of other income.

## 26. SUBSEQUENT EVENTS

In March 2006 the Group raised a subordinated debt of USD 60 million with annual interest payable semi-annualy at a rate of 8.875% per annum and maturity in 2016.

In 2006 the Group acquired a control over two subsidiaries engaged in finance lease of equipment.

## 27. RISK MANAGEMENT POLICY

Management of risk is fundamental to the banking business and is an essential element of the Group's operations. The main risks inherent to the Group's operations are those related to credit exposures, liquidity and market movements in interest rates and foreign exchange rates. A description of the Group's risk management policies in relation to those risks is as follows.

The Group manages the following main types of risks:

**Liquidity risk**

Liquidity risk refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.

Cash flow forecasts are the primary tool that the Group uses to monitor liquidity. Cash flow forecasts contain a detailed breakdown by maturity and value of all assets and liabilities based on agreements and commitments entered into by the Group. In order to manage liquidity, Group regularly requests from its major corporate customers a schedule of upcoming changes in their deposit and loan balances. On the retail banking side, the Group carries out a scenario analysis and stress testing to forecast how likely customers request to withdraw funds.

The Group aims to match the terms of loans and deposits whenever possible. Gap analysis is used to monitor liquidity positions on a weekly basis. A maximum gap is set and monitored for a liquidity deficit. Stress testing is also carried out on a monthly basis using statistical analysis on the stability of deposits. For liquidity management purposes, the Group calculates expected liquidity surpluses/shortfalls over various time periods on the basis of cash flow forecasts under an "average expected scenario" assuming there are no significant losses or withdrawals of client deposits over the relevant period and under a "worst-case scenario" assuming losses are incurred as a result of market or credit risk or significant withdrawals of deposits. The "worst-case scenario" is essentially a stress-testing technique which is based on an analysis of the impact of a combination of negative factors.

An analysis of the liquidity and balance sheet interest rate risks as of 31 December 2005 based on contractual maturity is presented below.

| | On demand and up to 1 month | 1 month to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years | Maturity undefined | Total RUR'000 |
|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | |
| **Interest-bearing assets:** | | | | | | | |
| Assets at fair value through profit or loss | 3,609,812 | - | - | - | - | - | 3,609,812 |
| Loans and advances to banks | 1,629,375 | 272,734 | 289,956 | - | - | - | 2,192,065 |
| Loans to customers, less provision for impairment losses | 5,646,562 | 3,040,662 | 6,465,811 | 7,451,165 | 19,999 | - | 22,624,199 |
| **Total interest-bearing assets** | **10,885,749** | **3,313,396** | **6,755,767** | **7,451,165** | **19,999** | **-** | **28,426,076** |
| Cash and balances with the Central Bank of the Russian Federation | 2,122,408 | - | - | - | - | 619,424 | 2,741,832 |
| Assets at fair value through profit or loss | 2,248 | - | - | - | - | - | 2,248 |
| Loans and advances to banks | 151,517 | - | - | - | - | - | 151,517 |
| Fixed and intangible assets, net | - | - | - | - | - | 452,419 | 452,419 |
| Other assets and current income tax assets | 231,058 | - | - | - | - | - | 231,058 |
| **TOTAL ASSETS** | **13,392,980** | **3,313,396** | **6,755,767** | **7,451,165** | **19,999** | **1,071,843** | **32,005,150** |
| **LIABILITIES** | | | | | | | |
| **Interest-bearing liabilities:** | | | | | | | |
| Loans and advances from banks | 286,145 | - | 421,780 | 584,900 | - | - | 1,292,825 |
| Customer accounts | 2,997,191 | 4,318,634 | 3,825,899 | 380,279 | - | - | 11,522,003 |
| Debt securities issued | 551,033 | 817,066 | 1,645,603 | 4,846,031 | - | - | 7,859,733 |
| **Total interest-bearing liabilities** | **3,834,369** | **5,135,700** | **5,893,282** | **5,811,210** | **-** | **-** | **20,674,561** |
| Loans and advances from banks | 58,440 | 2,109,212 | - | - | - | - | 2,167,652 |
| Customer accounts | 5,119,954 | - | - | - | - | - | 5,119,954 |
| Debt securities issued | 150,410 | - | - | - | - | - | 150,410 |
| Other provisions | - | - | - | - | - | 2,861 | 2,861 |
| Current and deferred income tax liabilities | - | 20,936 | - | - | - | - | 20,936 |
| Other liabilities | 17,962 | 1,630 | - | - | - | - | 19,592 |
| **TOTAL LIABILITIES** | **9,181,135** | **7,267,478** | **5,893,282** | **5,811,210** | **-** | **2,861** | **28,155,966** |
| Liquidity gap | 4,211,845 | (3,954,082) | 862,485 | 1,639,955 | 19,999 | | |
| Interest sensitivity gap | 7,051,380 | (1,822,304) | 862,485 | 1,639,955 | 19,999 | | |
| Cumulative interest sensitivity gap | 7,051,380 | 5,229,076 | 6,091,561 | 7,731,516 | 7,751,515 | | |
| Cumulative interest sensitivity gap as a percentage of total assets | 20.03% | 16.34% | 19.03% | 24.16% | 24.22%% | | |

An analysis of the liquidity and balance sheet interest rate risks as of 31 December 2004 based on contractual maturity is presented below.

| | On demand and up to 1 month | 1 month to 3 months | 3 months to 1 year | 1 year to 5 years | Over 5 years | Maturity undefined | Total RUR'000 |
|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | |
| **Interest-bearing assets:** | | | | | | | |
| Assets at fair value through profit or loss | 882,418 | - | - | - | - | - | 882,418 |
| Loans and advances to banks | 4,315,828 | 477,132 | - | - | - | - | 4,792,960 |
| Loans to customers, less provision for impairment losses | 2,373,842 | 1,507,428 | 5,550,349 | 2,643,713 | - | - | 12,075,332 |
| **Total interest-bearing assets** | **7,572,088** | **1,984,560** | **5,550,349** | **2,643,713** | **-** | **-** | **17,750,710** |
| Cash and balances with the Central Bank of the Russian Federation | 2,039,176 | - | - | - | - | 302,916 | 2,342,092 |
| Assets at fair value through profit or loss | 76,658 | 9,312 | - | - | - | - | 85,970 |
| Loans and advances to banks | 12,538 | - | - | - | - | - | 12,538 |
| Loans to customers, less provision for impairment losses | - | - | 29 | - | - | - | 29 |
| Fixed and intangible assets, net | - | - | - | - | - | 250,050 | 250,050 |
| Other assets and current income tax assets | 46,439 | - | 2,472 | 606 | - | - | 49,517 |
| **TOTAL ASSETS** | **9,746,899** | **1,993,872** | **5,552,850** | **2,644,319** | **-** | **552,966** | **20,490,906** |
| **LIABILITIES** | | | | | | | |
| **Interest-bearing liabilities:** | | | | | | | |
| Loans and advances from banks | 286,145 | - | 421,780 | 584,900 | - | - | 1,292,825 |
| Customer accounts | 3,639,326 | 2,133,188 | 2,415,675 | 29,807 | - | - | 8,217,996 |
| Debt securities issued | 551,034 | 817,066 | 1,645,603 | 1,005 | - | - | 3,014,708 |
| **Total interest-bearing liabilities** | **4,476,505** | **2,950,254** | **4,483,058** | **615,712** | **-** | **-** | **12,525,529** |
| Loans and advances from banks | 3,181 | - | - | - | - | - | 3,181 |
| Customer accounts | 4,780,337 | - | - | - | - | - | 4,780,337 |
| Debt securities issued | - | 689 | 1,045 | 84 | - | - | 1,818 |
| Other liabilities, other provisions and current and deferred income tax liabilities | 33,300 | 40,491 | - | - | - | - | 73,791 |
| **TOTAL LIABILITIES** | **9,293,323** | **2,991,434** | **4,484,103** | **615,796** | **-** | **-** | **17,384,656** |
| Liquidity gap | 453,576 | (997,562) | 1,068,747 | 2,028,523 | - | | |
| Interest sensitivity gap | 3,095,583 | (965,694) | 1,067,291 | 2,028,001 | - | | |
| Cumulative interest sensitivity gap | 3,095,583 | 2,129,889 | 3,197,180 | 5,225,181 | 5,225,181 | | |
| Cumulative interest sensitivity gap as a percentage of total assets | 15.11% | 10.39% | 15.60% | 25.50% | 25.50% | | |

Substantially all of the Group's interest-bearing assets and interest-bearing liabilities are at fixed rates of interest.

Asset and liability maturity periods and the ability to replace interest liabilities at an acceptable cost when they mature are crucial in determining the Group's liquidity and its susceptibility to fluctuation of interest rates and exchange rates.

The maturity of time deposits of individuals is based on contractual terms. However, time deposits can be withdrawn by individuals on demand.

***Interest rate risk*** – Interest rate risk arises from the possibility that changes in interest rates will affect the value of the financial instruments.

The Group has exposure to interest rate risk both thought its bonds portfolio and interest-bearing assets and liabilities that are held to maturity. The interest rate gaps are divided by maturity, and are monitored by Group's financial committee on a weekly basis. The Group also carries out a scenario analysis.

The following table presents an analysis of interest rate risk and thus the potential of the Group for gain or loss. Effective average interest rates are presented by categories of financial assets and liabilities to determine interest rate exposure and effectiveness of the interest rate policy used by the Group, as of 31 December 2005 and 2004:

| | **31 December 2005** | | | **31 December 2004** | | |
|---|---|---|---|---|---|---|
| | **RUR** | **USD** | **Other currency** | **RUR** | **USD** | **Other currency** |
| **ASSETS** | | | | | | |
| Assets at fair value through profit or loss | 8.4% | 7.2% | - | 10.20% | 5.80% | - |
| Loans and advances to banks | 7.7% | 3.2% | 2.3% | 5.60% | - | - |
| Correspondent accounts with banks | 2.8% | 1.0% | 2.0% | 0.80% | 2.50% | 2.30% |
| Loans to customers: | | | | | | |
| - corporate customers | 11.7% | 11.4% | 9.9% | 11.90% | 11.60% | 15.60% |
| - individuals | 23.0% | 11.3% | 9.0% | 18.60% | 12.50% | 14.00% |
| **LIABILITIES** | | | | | | |
| Loans and advances from banks | 6.5% | 8.0% | 5.6% | 11.50% | 4.10% | 2.00% |
| Customer accounts – demand deposits: | | | | | | |
| - corporate customers | 1.58% | 1.81% | 0.22% | 2.90% | - | 7.30% |
| - individuals | 1.00% | 0.35% | 0.49% | 1.20% | 0.20% | - |
| Customer accounts – time deposits: | | | | | | |
| - corporate customers | 6.95% | 6.62% | - | 7.70% | 0.20% | - |
| - individuals | 9.56% | 8.37% | 5.87% | 11.80% | 8.00% | - |
| Debt securities issued | 8.24% | 4.73% | 6.75% | 8.90% | 7.20% | 4.50% |

The majority of the Group's loan contracts and other financial assets and liabilities that bear interest contain clauses enabling the interest rate to be changed at the option of the lender. The Group management monitors its interest rate margin and consequently does not consider itself exposed to significant interest rate risk or consequential cash flow risk.

***Currency risk*** – Currency risk is defined as the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group is exposed to effects of fluctuation in the prevailing foreign currency exchange rates on its financial position and cash flows.

Foreign exchange risk is managed via derivative instruments (foreign currency forward contracts) with domestic and foreign banks.

The Group's exposure to foreign currency exchange rate risk as of 31 December 2005 is presented below:

| | **RUR** | **USD** USD 1 = RUR 28.7825 | **Other currency** | **Total** **RUR'000** |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and balances with the Central Bank of the Russian Federation | 2,613,533 | 81,571 | 46,728 | 2,741,832 |
| Assets at fair value through profit or loss | 3,259,661 | 352,399 | - | 3,612,060 |
| Loans and advances to banks | 254,692 | 1,244,657 | 844,233 | 2,343,582 |
| Loans to customers, less provision for impairment losses | 12,542,008 | 9,846,186 | 236,005 | 22,624,199 |
| Fixed and intangible assets, net | 452,419 | - | - | 452,419 |
| Other assets and current income tax assets | 230,266 | 563 | 229 | 231,058 |
| **TOTAL ASSETS** | **19,352,579** | **11,525,376** | **1,127,195** | **32,005,150** |
| **LIABILITIES** | | | | |
| Loans and advances from banks | 1,797,070 | 818,267 | 845,140 | 3,460,477 |
| Customer accounts | 9,820,668 | 6,570,624 | 250,665 | 16,641,957 |
| Debt securities issued | 3,094,928 | 4,878,933 | 36,282 | 8,010,143 |
| Other provisions | 2,861 | - | - | 2,861 |
| Current and deferred income tax liabilities | 20,936 | - | - | 20,936 |
| Other liabilities | 17,524 | 1,934 | 134 | 19,592 |
| **TOTAL LIABILITIES** | **14,753,987** | **12,269,758** | **1,132,221** | **28,155,966** |
| **OPEN BALANCE SHEET POSITION** | **4,598,592** | **(744,382)** | **(5,026)** | |

The Group's exposure to foreign currency exchange rate risk as of 31 December 2004 is presented below:

| | RUR | USD<br>USD 1 =<br>RUR 27.7487 | Other currency | Total<br><br>RUR'000 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and balances with the Central Bank of the Russian Federation | 2,254,049 | 72,245 | 15,798 | 2,342,092 |
| Assets at fair value through profit or loss | 780,718 | 187,670 | - | 968,388 |
| Loans and advances to banks | 1,413,321 | 3,141,457 | 250,720 | 4,805,498 |
| Loans to customers, less provision for impairment losses | 6,885,485 | 5,181,021 | 8,855 | 12,075,361 |
| Fixed and intangible assets, net | 250,050 | - | - | 250,050 |
| Other assets and current income tax assets | 49,403 | 2 | 112 | 49,517 |
| **TOTAL ASSETS** | **11,633,026** | **8,582,395** | **275,485** | **20,490,906** |
| **LIABILITIES** | | | | |
| Loans and advances from banks | 743,384 | 552,611 | 11 | 1,296,006 |
| Customer accounts | 6,930,436 | 5,865,826 | 202,071 | 12,998,333 |
| Debt securities issued | 2,185,323 | 744,881 | 86,322 | 3,016,526 |
| Other liabilities, other provisions and current and deferred income tax liabilities | 73,013 | 708 | 70 | 73,791 |
| **TOTAL LIABILITIES** | **9,932,156** | **7,164,026** | **288,474** | **17,384,656** |
| **OPEN BALANCE SHEET POSITION** | **1,700,870** | **1,418,369** | **(12,989)** | |

The following table presents further analysis of currency risk by types of derivative contracts as of 31 December 2004:

| **Derivative financial instruments** | RUR | USD<br>USD 1 =<br>RUR 27.7487 | Other currency | Total<br><br>RUR'000 |
|---|---|---|---|---|
| Payables under foreign exchange forward deals | - | (1,936,982) | - | (1,936,982) |
| Receivables on foreign exchange forward contracts | 1,946,294 | - | - | 1,946,294 |
| **NET DERIVATIVE FINANCIAL INSTRUMENTS POSITION** | **1,946,294** | **(1,936,982)** | **-** | **9,312** |
| **TOTAL OPEN POSITION** | **3,647,164** | **(518,613)** | **(12,989)** | |

**Credit risk**

The Group is exposed to credit risk which is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

The Group lends to corporate and retail customers. Rouble denominated loans to Russian customers represent a significant portion of Group's loan portfolio. Loans advanced are typically short-term and secured by collateral. The Group has established procedures for approving and monitoring loan quality and for extensions and refinancing of existing loans. These procedures are set out in the credit policy approved by the Group's Management Board and apply to all loans, including those to related parties.

Credit Committee performs primary Group's lending and approval process, makes all decisions with respect to any loan made by the Group's headquarters and branches to corporate clients and individuals. The final decisions with respect to transactions exceeding 25% of the Group's total assets and transactions with related parties are made by the Group's Board of Directors. Some transactions between the Group and related parties require the approval of directors or shareholders with no interest in the transaction.

The Group evaluates borrowers on the basis of their credit history, quality of the collateral offered and financial condition. In addition, it may take into account certain business relationships when determining the interest rate of loans to certain related parties.

The Group carries out regular monitoring of its loan portfolio. As well as ensuring that the borrower fulfils its obligations under each loan, the Group regularly reviews all of the available information on the borrower's activities. In particular, the Group obtains and analyses financial reports on a quarterly basis, regularly monitors the value of the underlying collateral for each loan. In relation to its loan portfolio, the Group also monitors the level of non-performing loans and the concentration of loan portfolio per borrower, group of borrowers or industry.

In 2004, the Group established a department that performs valuation and monitoring of collateral. When evaluating collateral, the Group discounts the market value of the assets to reflect the costs of sale.

**Market risk**

The Group's Financial Committee approves stop-loss limits, both on securities and foreign currency trading portfolios, securities position limits, foreign currency position limits. The largest limit, set for the RUR/USD exposure is in line with the CBR requirements on foreign currency exposure. Stop-loss limits are reviewed on a monthly basis, and positions are monitored and revalued daily. They are monitored in terms of mark-to-market exposure and for compliance with limits. A Value at Risk calculation is also used. In addition, the Group carries out stress testing procedures.

**Geographical concentration**

Country risk (risk of global changes in the bank services market and markets of the Group's principal debtors, changes in investment attractiveness of securities) are managed through on-going monitoring.

Geographical concentration analysis of assets and liabilities as of 31 December 2005 is presented below:

| | The Russian Federation | OECD | Other countries | Total |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and balances with the Central Bank of the Russian Federation | 2,741,832 | - | - | 2,741,832 |
| Assets at fair value through profit or loss | 3,612,060 | - | - | 3,612,060 |
| Loans and advances to banks | 807,538 | 1,020,992 | 515,052 | 2,343,582 |
| Loans to customers, less provision for impairment losses | 22,604,646 | 19,553 | - | 22,624,199 |
| Fixed and intangible assets, net | 452,419 | - | - | 452,419 |
| Other assets and current income tax assets | 230,792 | 266 | - | 231,058 |
| **TOTAL ASSETS** | **30,449,287** | **1,040,811** | **515,052** | **32,005,150** |
| **LIABILITIES** | | | | |
| Loans and advances from banks | 2,292,873 | 735,817 | 431,787 | 3,460,477 |
| Customers accounts | 16,198,944 | - | 443,013 | 16,641,957 |
| Debt securities issued | 3,613,341 | 4,396,802 | - | 8,010,143 |
| Other provisions | 2,861 | - | - | 2,861 |
| Current and deferred income tax liabilities | 20,936 | - | - | 20,936 |
| Other liabilities | 19,352 | 240 | - | 19,592 |
| **TOTAL LIABILITIES** | **22,148,307** | **5,132,859** | **874,800** | **28,155,966** |
| **NET POSITION** | **8,300,980** | **(4,092,048)** | **(359,748)** | |

Geographical concentration analysis of the assets and liabilities as of 31 December 2004 is presented below:

| | The Russian Federation | OECD | Other countries | Total |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and balances with the Central Bank of the Russian Federation | 2,342,092 | - | - | 2,342,092 |
| Assets at fair value through profit or loss | 959,076 | - | - | 959,076 |
| Loans and advances to banks | 1,465,282 | 1,384,833 | 1,955,383 | 4,805,498 |
| Loans to customers, less provision for impairment losses | 12,073,164 | - | 2,197 | 12,075,361 |
| Fixed and intangible assets, net | 250,050 | - | - | 250,050 |
| Other assets and current income tax assets | 49,460 | 57 | 9,312 | 58,829 |
| **TOTAL ASSETS** | **17,139,124** | **1,384,890** | **1,966,892** | **20,490,906** |
| **LIABILITIES** | | | | |
| Loans and advances from banks and customer accounts | 12,957,715 | - | 1,336,624 | 14,294,339 |
| Debt securities issued | 3,016,526 | - | - | 3,016,526 |
| Other liabilities, other provisions and current and deferred income tax liabilities | 73,791 | - | - | 73,791 |
| **TOTAL LIABILITIES** | **16,048,032** | **-** | **1,336,624** | **17,384,656** |
| **NET POSITION** | **1,091,092** | **1,384,890** | **630,268** | |