AK “ALROSA”

IFRS CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2003

CONTENTS

ZAO PricewaterhouseCoopers Audit
Kosmodamianskaya Nab. 52, Bld. 5
115054 Moscow
Russia
Telephone +7 (095) 967 6000
Facsimile +7 (095) 967 6001

AUDITORS' REPORT
to the Shareholders and Supervisory Council of
Closed Joint Stock Company AK “ALROSA”

1. We have audited the accompanying consolidated balance sheet of Closed Joint Stock Company AK “ALROSA” (the “Company”) and its subsidiaries (the “Group”) as at 31 December 2003, and the related consolidated statements of income, of cash flows and of changes in shareholders' equity for the year then ended. These consolidated financial statements as set out on pages 4 to 32 are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

2. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 audit provides a reasonable basis for our opinion.

3. In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2003, and the results of its operations and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers.

Moscow, Russian Federation
23 July 2004

(in millions of Russian roubles, unless otherwise stated)

Consolidated Balance Sheet

	Notes	31 December 2003	31 December 2002
Assets			
Non-current Assets			
Restricted cash	4	340	194
Investments into associated undertakings	3	900	901
Available-for-sale investments	3	1,187	1,427
Long-term accounts receivable	7	2,339	1,682
Property, plant and equipment	5	104,443	96,440
Total Non-current Assets		**109,209**	**100,644**
Current Assets			
Restricted cash	4	-	214
Inventories	6	15,796	13,639
Trade and other receivables	7	7,235	8,524
Prepaid profit tax		277	210
Available-for-sale investments		505	383
Cash and cash equivalents	4	3,347	2,997
Total Current Assets		**27,160**	**25,967**
Total Assets		**136,369**	**126,611**
Shareholders' Equity			
Share capital	8	11,491	11,491
Retained earnings		49,813	44,157
Total Shareholders' Equity		**61,304**	**55,648**
Grant	9	**10,498**	**11,560**
Minority Interest		**3,035**	**2,974**
Liabilities			
Non-current Liabilities			
Long-term debt	10	24,684	15,903
Provision for restoration liability	12	5,394	2,743
Provision for pension obligations	13	1,963	1,268
Other provisions	15	1,215	-
Deferred tax liabilities	16	2,466	4,186
Total Non-current Liabilities		**35,722**	**24,100**
Current Liabilities			
Short-term loans and current portion of long-term debt	11	13,883	19,970
Trade and other payables	14	9,122	8,912
Taxes payable	16	2,758	3,321
Dividends payable		47	126
Total Current Liabilities		**25,810**	**32,329**
Total Liabilities		**61,532**	**56,429**
Total Shareholders' Equity, Grant, Minority Interest and Liabilities		**136,369**	**126,611**

Signed by the following members of management:

Alexander O. Nichiporuk
First vice-president

Valentina N. Kopytova
Deputy chief accountant

23 July 2004

(in millions of Russian roubles, unless otherwise stated)

Consolidated Statement of Income

	Notes	Year ended 31 December 2003	Year ended 31 December 2002
Sales	17	60,004	59,119
Cost of sales	18	(29,818)	(31,106)
Royalty	9	(9,096)	(8,166)
Gross profit		**21,090**	**19,847**
General and administrative expenses	19	(2,881)	(3,101)
Other operating income	20	2,238	1,953
Other operating expenses	21	(10,324)	(9,536)
Operating Profit		**10,123**	**9,163**
Finance cost, net	22	(4,073)	(5,457)
Income from associated undertakings	3	400	497
Monetary gain	2(a)	-	3,702
Exchange gains (losses), net		1,910	(813)
Profit before Profit Tax		**8,360**	**7,092**
Profit tax	16	(1,718)	(4,274)
Profit after Profit Tax		**6,642**	**2,818**
Minority interest		(286)	(327)
Net Profit for the Period		**6,356**	**2,491**

(in millions of Russian roubles, unless otherwise stated)

Consolidated Statement of Cash Flows

	Notes	Year ended 31 December 2003	Year ended 31 December 2002
Net cash Inflow from Operating Activities	23	**9,997**	**11,584**
Cash Flows from Investing Activities			
Purchase of property, plant and equipment		(11,919)	(16,726)
Proceeds from sales of fixed assets		815	49
Acquisition of available-for-sale investments		(191)	(392)
Proceeds from sale of available-for-sale investments		238	-
Interest received		348	147
Dividends received from associated undertakings		392	385
Net Cash Outflow from Investing Activities		**(10,317)**	**(16,537)**
Cash Flows from Financing Activities			
Repayments of loans		(56,373)	(49,558)
Loans received		61,853	61,685
Interest paid		(4,100)	(4,783)
Receipt from (payment to) restricted cash account		68	(14)
Dividends paid		(778)	(761)
Net Cash Inflow from Financial Activities		**670**	**6,569**
Effects of inflation on cash and cash equivalents		-	(340)
Net Increase in Cash and Cash Equivalents		**350**	**1,276**
Cash and cash equivalents at the beginning of the period		2,997	1,721
Cash and Cash Equivalents at the End of The Period		**3,347**	**2,997**

Significant non-cash transactions are discussed in note 27.

(in millions of Russian roubles, unless otherwise stated)

Consolidated Statement of Changes in Shareholders' Equity

	Share capital	Retained Earnings	Total
Balance at 31 December 2001	**11,491**	**42,304**	**53,795**
Dividends (note 8)	-	(638)	(638)
Net profit for the year ended 31 December 2002	-	2,491	2,491
Balance at 31 December 2002	**11,491**	**44,157**	**55,648**
Balance at 31 December 2002	11,491	44,157	55,648
Dividends (note 8)	-	(700)	(700)
Net profit for the year ended 31 December 2003	-	6,356	6,356
Balance at 31 December 2003	**11,491**	**49,813**	**61,304**

(in millions of Russian roubles, unless otherwise stated)

1. ACTIVITIES

The core activities of Closed Joint Stock Company AK "ALROSA" ("the Company") and its subsidiaries ("the Group") are the exploration and extraction of diamond reserves and the marketing and distribution of raw and cut diamonds. The Company was registered on 13 August 1992 as a closed joint stock company in the Republic of Sakha (Yakutia), which is located within the Russian Federation. The Group operates mining facilities in Mirny, Udachny, Aikhal, Nyurba and Anabar (located in Eastern Siberia) and had 46,998 employees as at 31 December 2003 (31 December 2002: 48,757 employees). The Company is subject to special legislation issued by the Russian Federation and the Republic of Sakha (Yakutia), which significantly influences the Company's core operating activities. This legislation includes, but is not limited to, the Law on State Secrets of the Russian Federation and requirements to obtain quotas for export of diamonds from the Government of the Russian Federation (note 17).

2. ACCOUNTING POLICIES

(a) Basis of presentation

Group companies incorporated in Russia maintain their statutory accounting records and prepare statutory financial reports in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR") and their measurement currency is the Russian rouble ("RR"). Group companies incorporated in other countries maintain their statutory accounting records in accordance with relevant legislation and in the appropriate measurement currency. The accompanying consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of available-for-sale investment securities and financial assets held-for-trading. The consolidated financial statements are based on the statutory accounting records, with adjustments and reclassifications for the purpose of presentation in accordance with International Financial Reporting Standards ("IFRS"), including International Accounting Standards and Interpretations issued by the International Accounting Standards Board.

Prior to 1 January 2003 the adjustments and reclassifications made to the statutory records for the purpose of IFRS presentation included the restatement of balances and transactions for the changes in the general purchasing power of the RR in accordance with IAS 29 *"Financial Reporting in Hyperinflationary Economies" ("IAS 29")*. IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation has ceased, effective from 1 January 2003 the Group no longer restates its financial statements in accordance with IAS 29. Accordingly, the amounts expressed in the measuring unit current at 31 December 2002 are treated as the basis for the carrying amounts in these financial statements.

Corresponding figures, for the year ended 31 December 2002 were restated for the changes in the general purchasing power of the RR at 31 December 2002. The restatement was calculated using the conversion factors derived from the Russian Federation Consumer Price Index, published by the Russian State Committee on Statistics, and from indices obtained from other sources for years prior to 1992. The indices used to restate corresponding figures, based on 1988 prices (1988 = 100), and the respective conversion factors for the five years ended 31 December 2002, are:

Year	Index	Conversion factor
31 December 1998	1,216,400	2.24
31 December 1999	1,661,481	1.64
31 December 2000	1,995,937	1.37
31 December 2001	2,371,572	1.15
31 December 2002	2,730,154	1.00

The significant guidelines followed in restating the corresponding figures were:

- all corresponding amounts, were stated in terms of the measuring unit current at 31 December 2002;
- monetary assets and liabilities held at 31 December 2002 were not restated because they were already expressed in terms of the monetary unit current at 31 December 2002;

- non-monetary assets and liabilities (those balance sheet items that were not expressed in terms of the monetary unit current at 31 December 2002) and components of shareholders’ equity were restated from their historical cost by applying the change in the general price index from the date the non-monetary item originated to 31 December 2002;
- all items in the consolidated statements of income and cash flows were restated by applying the change in the general price index from the dates when the items were initially transacted to 31 December 2002;
- gains or losses that arose as a result of holding monetary assets and liabilities for the reporting period ended 31 December 2002 were included in the consolidated statement of income as a monetary gain or loss.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as at the date of the consolidated financial statements, and the reported amount of revenues and operating costs during the reporting period. The most significant estimates relate to realization of inventories, investments, allowance for bad and doubtful accounts receivable, deferred taxation, reserve estimates used to calculate depreciation, pension and other post-retirement benefit costs and the evaluation of the provision for restoration liability. Actual results could differ from these estimates.

Certain amounts have been reclassified in the comparative financial information for the year ended 31 December 2002 to conform to the current period presentation. Cost of sales for the year ended 31 December 2002 have been increased by RR’mln 4,460 as a result of reclassification of the extraction tax from other operating expenses. This reclassification better reflects the nature of these costs. Other operating expenses for the year ended 31 December 2002 have also been decreased by RR’mln 8,166 due to presenting the royalty as a separate line in the statement of income. This change has been made in order to present the information about the Group’s activity in a format considered to be more useful to the users of the consolidated financial statements.

(b) Principles of consolidation

The Group comprises the Company and its subsidiaries. The effects of transactions between subsidiaries within the Group are eliminated and accounting policies of the subsidiaries and associated undertakings are conformed to those of the Company.

A subsidiary is an entity in which the Group has an interest of more than one half of the voting rights or otherwise has the power to exercise control over the operations.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases.

For subsidiaries that are not wholly owned, the minority interest at the balance sheet date represents the minority shareholders’ portion of the preacquisition carrying amounts of the identifiable assets and liabilities of the subsidiary at the acquisition date, and the minorities’ portion of movements in equity since the date of the combination. Minority interest is presented separately from liabilities and shareholders’ equity on the face of the consolidated balance sheet.

Associated undertakings over which the Group has a significant but not a controlling influence, are accounted for using the equity method. Significant influence is usually evidenced by the Group owning, directly or indirectly, between 20 percent and 50 percent of the voting share capital.

Equity accounting is discontinued when the carrying amount of the investment in an associated undertaking reaches zero, unless the group has incurred obligations or guaranteed obligations in respect of the associated undertaking.

(c) Grant

Production assets received from the Republic of Sakha (Yakutia) on 19 January 1993 under the terms of a mineral lease agreement (the "Lease Agreement") to "transfer of rights to use and exploit land, diamond deposits, main production and non-production facilities", are recorded in accordance with IAS 20, *"Accounting for Government Grants and Disclosure of Government Assistance"*, at historical cost adjusted for the effects of inflation, with a corresponding credit reflected as a Grant in the Group's balance sheet. The Grant is amortised in line with the reduction in the carrying value of the underlying assets, with the amortised portion recorded as an increase in income (see note 9).

Social assets received under the aforementioned Lease Agreement have not been included in the accompanying consolidated financial statements, since the majority of these assets have been or will be transferred free of charge to local administrations.

(d) Property, plant and equipment

Property, plant and equipment comprises costs incurred in developing areas of interest as well as the costs related to the construction and acquisition of mining assets. Expenditure related to geophysical analysis is expensed until it is determined to be probable that economically recoverable reserves exist.

At each reporting date, management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's net selling price and its value in use, the carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) in the statement of income. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

Depreciation and amortisation

Property, plant and equipment are depreciated upon commencement of commercial mining activities at a specific area of interest.

Depreciation and amortisation of buildings, land and improvements and plant and equipment related to extraction of minerals is calculated on a units of production basis for each area of interest over its expected useful life.

Depreciation of assets not directly associated with production is calculated on a straight line basis over its estimated useful life.

Summary of useful lives and alternative basis for depreciation:

	Assets related to extraction of minerals	Other assets
Buildings	Units of production	8-50 years
Land and improvements	Units of production	7-50 years
Plant and equipment	Units of production	4-13 years
Transport	5-13 years	5-13 years
Other	4-17 years	4-17 years

Disposals and retirement

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the balance sheet along with the corresponding accumulated depreciation (if any). Any gain or loss resulting from such retirement or disposal is included in the consolidated statement of income.

Repair and maintenance costs

Maintenance and repairs are expensed as incurred.

Local infrastructure assets

Local infrastructure assets constructed or purchased by the Group subsequent to 1 January 1993 (the date of privatisation) are included in the financial statements at historical cost adjusted for the effects of inflation and depreciated during their useful lives as set out above. These assets are integral part of the Group's production activities.

(e) Provisions

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

Provisions are reassessed at each reporting period, and are included in the consolidated financial statements at their expected net present values using discount rates appropriate to the Group in the economic environment in the Russian Federation at each balance sheet date.

The provision for restoration liability is determined based on the terms of the Lease Agreement (see note 9). Under this agreement, in the year 2017 the Company is obliged to transfer property, plant and equipment subject to the Lease Agreement to the Republic of Sakha (Yakutia) or settle its liability by means of a cash payment. The initial provision for restoration liability together with any changes in estimation of the ultimate restoration liability is recorded on the balance sheet, with a corresponding amount recorded as part of property, plant and equipment in accordance with IAS 16, *"Property, Plant and Equipment"* (revised 1998). This amount is amortized over the term of the Lease Agreement.

Changes in the provision for restoration liability resulting from the passage of time are reflected in the consolidated statement of income each period under finance costs. Other changes in the provision, relating to a change in the discount rate applied, in the expected pattern of settlement of the obligation or in the estimated amount of the obligation, are treated as a change in accounting estimate in the period of the change. The effects of such changes are added to, or deducted from, the cost of the related asset.

(f) Inventories

Inventories of diamonds, extracted ore and concentrates, mining and construction stores and consumable supplies are valued at the lower of the weighted average cost or net realisable value.

Cost of extracted ore and concentrates is calculated using the quantities determined based on surveyors' measurements of the volumes of ore and concentrates remaining at the period end. Cost of inventories include those directly attributable to mining the diamonds, extracting the ore and producing concentrates, and those directly attributable to bringing mining and construction stores and consumable supplies to their present location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

(g) Investments

In accordance with IAS 39 *"Financial Instruments: Recognition and Measurement"* investments are classified into the following categories: trading, held-to-maturity or available-for-sale. Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments and included in current assets. Investments with a fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets. During the period, the Group did not hold any investments classified as trading or held-to-maturity. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management determines the appropriate classification of its investments at the time of the purchase and evaluates such designation on a regular basis.

All purchases and sales of investments are recognised on the settlement date, which is the date that the investment is delivered to or by the Group. Cost of purchase includes transaction costs. Trading and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective yield method. Realised and unrealised gains and losses arising from changes in the fair value of trading investments and of available-for-sale investments are included in the statement of income in the period in which they arise.

Since the majority of the Group's investments are not publicly traded and no reliable method of fair value estimation exists for those investments, these investments are excluded from fair value valuation.

Those financial assets that are excluded from fair valuation and that have a fixed maturity are measured at amortised cost using the effective interest rate method less impairment. Those that do not have a fixed maturity date are measured at cost less impairment.

Unquoted available-for-sale equity investments are reviewed for impairment losses at every balance sheet date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When a review for impairment is conducted, the recoverable amount is assessed by reference to the net present value of expected future cash inflows. The discount rate applied is based upon the Group's weighted average cost of capital with appropriate adjustment for the risks associated with the investment under assessment. When the level of information available to calculate the net present value of expected future cash inflows makes this exercise unworkable, management uses different valuation techniques to estimate whether there is objective evidence of impairment and to determine the likely amount of impairment, if any.

(h) Components of cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks with a maturity at the date of inception of less than three months, which are considered by the Group at the time of deposit to have minimal fair value and default risks.

(i) Deferred taxes

Deferred tax is calculated at rates enacted or substantively enacted at the balance sheet date, using the liability method, for all temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. The principal temporary differences arise from application in previous periods of IAS 29, depreciation on property, plant and equipment and provisions and expenses, which are charged to the consolidated statement of income before they become deductible for tax purposes.

Deferred tax liabilities are recognised in respect of all taxable temporary differences relating to investments in subsidiaries, unless the Group is able to control the timing of the reversal of the temporary difference and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax assets attributable to temporary differences, unused tax losses and credits are recognised only to the extent that it is probable that future taxable profit will be available against which they can be utilised.

Deferred tax assets and liabilities are offset when the Group has a legally enforceable right to set off current tax assets against current liabilities, when deferred tax balances relate to the same regulatory body (i.e., federal or republic), and when they relate to the same jurisdiction and taxable entity.

(j) Foreign currencies

Transactions denominated in foreign currencies are recorded, on initial recognition, in the measurement currency, by applying the exchange rate between the measurement currency and the foreign currency at the date of the transaction. Outstanding foreign currency monetary items at the balance sheet date are reported at the closing rate. Non-monetary items which are carried in terms of historical cost denominated in a foreign currency are reported using the exchange rate at the date of the transaction, and non-monetary items which are carried at fair value denominated in a foreign currency are reported using the exchange rates that existed when the values were determined.

Exchange differences arising on the settlement of monetary items or reporting monetary items at rates different from those at which they were initially recorded are recognised in the statement of income in the period in which they arise.

(k) Revenue recognition

Revenues are recognised when goods are shipped to the customer, as this is the date on which the risks and rewards of ownership are transferred to the customer. Sales are shown net of VAT and export duties, and after eliminating sales within the Group.

Revenue from rendering of transport services is recognized in financial statements in the period when the services are rendered.

Interest income is recognized on a time proportion basis that takes into account the effective yield on the asset.

Dividend income is recognized when the shareholder's right to receive payment is established.

(l) Measurement of trade and other receivables

Trade and other receivables are carried at original invoice amount including value added tax less provision made for impairment of these receivables. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected future cash flows, discounted at the market rate of interest for similar borrowers.

(m) Value added taxes

In the consolidated balance sheet and the consolidated statement of cash flows, transactions and balances are presented inclusive of the associated Value Added Tax ("VAT") applicable under the legislation of the relevant jurisdiction in which the transaction occurred.

(n) Borrowings

Borrowings are recognised initially at cost, which is the fair value of the proceeds received (which is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price), net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognised as interest expense over the period of the borrowings.

Borrowing costs are expensed as incurred.

(o) Pension and other post-retirement benefits

The Group operates a defined benefit pension plan. Pension costs are recognised using the projected unit credit method. The cost of providing pensions is charged to cost of sales within the consolidated statement of income so as to spread the regular cost over the service lives of employees. The pension obligation is measured at the present value of the estimated future cash outflows using the interest rates on governmental securities, which have the terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognized over the average remaining service life of employees.

The Group owns and controls Pension fund "Almaznaya Osen", which administers the Group's defined benefit plan. The assets of Pension fund "Almaznaya Osen" primarily consist of commercial paper and non-convertible bonds of the Company and its subsidiaries and other accounts receivable due from the Company. The parent/subsidiary relationship between the Group and Pension fund "Almaznaya Osen" means that the assets held by Pension fund "Almaznaya Osen" do not meet the definition of plan assets and are eliminated in the consolidated balance sheet as intercompany balances.

In the normal course of business the Group contributes to the Russian Federation State pension plan on behalf of its employees. Mandatory contributions to the State pension plan, which is a defined contribution plan, are expensed when incurred and are included within wages, salaries and other staff costs in cost of sales.

(p) Social obligations

Social costs relating to the maintenance of housing are determined in accordance with agreements with the local authorities and expensed or capitalised as appropriate.

Discretionary and voluntary payments made to fund and support social programs and related operations are expensed as incurred.

(in millions of Russian roubles, unless otherwise stated)

(q) Non-cash transactions

Non-cash transactions are measured at the fair value of the consideration received or receivable. When it is not possible to measure reliably the fair value of the consideration received or receivable, non-cash transactions are measured at the fair value of the consideration given.

Non-cash transactions have been excluded from the operating, investing and financing activities components in the accompanying consolidated statement of cash flows.

(r) Share capital

Share capital consists of ordinary shares, which are classified as equity.

(s) Segment reporting

Business segments (primary segments) provide products or services that are subject to risks and returns that are different from those of other business segments. Geographical segments (secondary segments) provide products or services within a particular economic environment that is subject to risks and returns that are different from those of components operating in other economic environments.

3. GROUP STRUCTURE AND INVESTMENTS

The Company's significant consolidated subsidiaries and associated undertaking are as follows:

Name		Country of Incorporation	Percentage of voting interest held	
			31 December 2003	**31 December 2002**
Consolidated Subsidiaries				
"ALROSA Finance" S.A.	(1)	Luxembourg	100	-
ZAO "Irelyakhneft"		Russia	100	100
Pension fund "Almaznaya Osen"		Russia	97	97
OAO "Severalmaz"	(2)	Russia	92	72
OAO "Viluygesstroy"		Russia	90	90
OOO "MAK-Bank"		Russia	88	85
OAO "ALROSA-Nyurba"		Russia	87	87
OAO "Viluyskaya GES-3"	(3)	Russia	72	66
OAO "ALROSA-Gas"		Russia	53	53
OAO "Investment Group ALROSA"	(4)	Russia	50	50
Associated Undertaking				
"Catoka Mining Company Ltd"	(5)	Angola	33	33

(1) In April 2003 the Group established the special purpose entity "ALROSA Finance" S.A., which is registered in Luxembourg, for the purpose of making Eurobond offering.

(2) In June and November 2003 the Group increased its shareholding in OAO "Severalmaz" to 92 percent through additional cash contributions of RR'mln 410.

(3) In July and December 2003 the Group increased its shareholding in OAO "Viluyskaya GES-3" to 72 percent through additional cash contributions of RR'mln 844.

(4) The Group owned 50.01 percent of voting interest in OAO "Investment Group ALROSA" at 31 December 2003 and 2002.

(in millions of Russian roubles, unless otherwise stated)

(5) "Catoka Mining Company Ltd" is a diamond-mining venture located in Angola. The investment in this associated undertaking was accounted by the Group using the equity method. Income of RR'mln 400 was included in the Group's financial statements for the year ended 31 December 2003, with a corresponding income of RR'mln 497 included in the financial statements for the year ended 31 December 2002. In April 2003 "Catoka Mining Company Ltd" declared dividends for the year ended 31 December 2002; the Group's share of these dividends amounted to RR'mln 392. The Group's share of the net assets of "Catoka Mining Company Ltd" included in these financial statements is RR'mln 792 and RR'mln 784 as at 31 December 2003 and 31 December 2002, respectively.

Non-current available-for-sale investments

	Year ended 31 December 2003	Year ended 31 December 2002
Available-for-sale investments at the beginning of the year	1,427	2,399
Additions	69	300
Disposals	(339)	(729)
Change in provision for impairment of available-for-sale investments (note 22)	30	(543)
Available-for-sale investments at the end of the year	1,187	1,427

4. CASH AND CASH EQUIVALENTS AND RESTRICTED CASH

Cash and cash equivalents

As at 31 December 2003, the cash and cash equivalents balance mainly represents current accounts of the Group on which the weighted average interest rate is 2 percent (31 December 2002: nil percent).

Restricted cash

Included within the non-current portion of restricted cash are balances of RR'mln 205 and RR'mln 82 as at 31 December 2003 and 31 December 2002, respectively, which represent deposit accounts held with J.P. Morgan Chase Bank and Vneshtorgbank. The remaining RR'mln 135 as at 31 December 2003 (31 December 2002: RR'mln 112) represents mandatory reserve deposits held with the Central Bank of the Russian Federation by MAK-Bank, a consolidated subsidiary; these balances are not available for use in the Group's day to day operations.

The current portion of restricted cash represented a deposit account held with the Bank of New York. The Group was required to maintain a balance equal to the amount of its next scheduled principal and interest payment in accordance with a loan agreement with that bank. The loan was fully repaid by the Group in October 2003, and the deposit account was closed.

At 31 December 2003 the weighted average interest rate on the restricted cash balance is approximately nil percent (31 December 2002: approximately nil percent).

(in millions of Russian roubles, unless otherwise stated)

5. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Land and Improvements	Plant and Equipment	Transport	Assets under Construction	Other	TOTAL
Cost at 31 December 2002	**37,957**	**31,293**	**24,108**	**14,712**	**34,038**	**661**	**142,769**
Additions through acquisition of subsidiaries	45	1	39	2	3	4	94
Additions	273	194	1,872	1,401	11,419	490	15,649
Transfers	6,528	3,999	3,288	292	(14,183)	76	-
Disposals	(1,446)	(463)	(1,052)	(989)	(1,744)	(390)	(6,084)
Change in estimate of provision for restoration liability (see note 12)	1,570	570	107	17	-	2	2,266
Cost at 31 December 2003	**44,927**	**35,594**	**28,362**	**15,435**	**29,533**	**843**	**154,694**
Accumulated depreciation at 31 December 2002	**(12,813)**	**(13,121)**	**(12,026)**	**(8,175)**	-	**(194)**	**(46,329)**
Charge for the period	(1,149)	(1,265)	(2,571)	(1,417)	-	(118)	(6,520)
Disposals	777	240	789	762	-	30	2,598
Accumulated depreciation at 31 December 2003	**(13,185)**	**(14,146)**	**(13,808)**	**(8,830)**	-	**(282)**	**(50,251)**
Net book value at 31 December 2002	**25,144**	**18,172**	**12,082**	**6,537**	**34,038**	**467**	**96,440**
Net book value at 31 December 2003	**31,742**	**21,448**	**14,554**	**6,605**	**29,533**	**561**	**104,443**

Refer to note 9 for property, plant and equipment included above which is subject to the Lease Agreement with the Republic of Sakha (Yakutia).

6. INVENTORIES

	31 December 2003	31 December 2002
Diamonds	5,245	2,554
Ores and concentrates	2,133	2,032
Mining and construction materials	7,255	7,989
Consumable supplies	1,163	1,064
	15,796	13,639

7. TRADE AND OTHER RECEIVABLES

Long-term accounts receivable	**31 December 2003**	**31 December 2002**
Long-term VAT recoverable	1,214	295
Receivables from related parties (see note 26)	670	721
Loans issued	189	125
Long-term prepaid royalty	144	174
Other long-term receivables	122	367
	2,339	1,682

Current accounts receivable	**31 December 2003**	**31 December 2002**
Taxes recoverable	1,859	1,901
Prepaid taxes, other than profit tax	1,055	1,454
Advances to suppliers	894	915
Receivables from related parties (see note 26)	524	891
Trade receivables for supplied diamonds	488	490
Loans issued	352	353
Notes receivable	108	468
Prepayment for commercial paper redemption	-	273
Other receivables	1,955	1,779
	7,235	8,524

(in millions of Russian roubles, unless otherwise stated)

Taxes recoverable relate to input Value Added Tax (VAT) incurred with respect to purchases. The amount is available for offset against future output VAT following the settlement of outstanding balances payable in relation to the inventories and services purchased.

Long-term VAT recoverable, which relates to the materials and services used for construction of property, plant and equipment, becomes available for offset against future output VAT after the respective asset is put into use.

The prepayment for commercial paper redemption relates to receivables from a broker, which the Group intended to realise by receiving from the broker the Group’s commercial paper purchased by broker from third parties.

The impairment provision offset against individual receivable balances is as follows:

Long-term accounts receivable	**31 December 2003**	**Interest on impaired receivables**	**Bad debt written-off**	**Bad debt expense**	**31 December 2002**
Long-term VAT recoverable	-	(278)	-	-	278
Receivable from related parties (see note 26)	-	-	(160)	-	160
Long-term prepaid royalty	71	(31)	-	14	88
	71	(309)	(160)	14	526
Current accounts receivable					
Prepaid taxes, other than profit tax	46	(16)	-	(17)	79
Receivables from related parties (see note 26)	307	-	-	(42)	349
Loans issued	96	-	-	-	96
Notes receivable	251	(12)	-	47	216
Other receivables	1,481	(10)	(23)	691	823
	2,181	(38)	(23)	679	1,563

The average effective interest rates at the balance sheet dates were as follows:

Long-term accounts receivable	**31 December 2003**	**31 December 2002**
Receivable from related parties	30%	30%
Loans issued	17%	19%
Long-term prepaid royalty	10%	18%
Other long-term receivables	-	16%

8. SHARE CAPITAL

	31 December 2003		**31 December 2002**	
	Shares	**Amount**	**Shares**	**Amount**
Authorised, issued and fully paid ordinary share capital at RR 57,455 per share	200,000	11,491	200,000	11,491

Distributable profits

The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current year net profit. For the year ended 31 December 2003 and 31 December 2002, the statutory profit for the Company as reported in the published statutory reporting forms was RR'mln 9,663 and RR'mln 6,474, respectively. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation, and accordingly, management believes that at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements.

(in millions of Russian roubles, unless otherwise stated)

Dividends

On 29 June 2002, the Company's shareholders approved dividends for the year ended 31 December 2001 totalling RR'mln 638 (RR'mln 600 in nominal terms). Dividends per share amounted to RR 3,190 (RR 3,000 in nominal terms).

On 21 June 2003, the Company's shareholders approved dividends for the year ended 31 December 2002 totalling RR'mln 700. Dividends per share amounted to RR 3,500.

9. GRANT AND ASSETS SUBJECT TO MINERAL LEASE AGREEMENT

On 19 January 1993, the Company entered into a Lease Agreement with the Republic of Sakha (Yakutia) for the "transfer of rights to use and exploit land, diamond deposits, main production and non-production facilities". This agreement has a term of 25 years and provides the Company with the right to use certain production and non-production assets for exploring, mining and operating diamond deposits. The agreement requires the Company to return the assets in 2017 and reimburse the Government of Republic of Sakha (Yakutia) for depreciation of assets. The Government in turn is required to reimburse the Company for qualifying repair and maintenance costs. The precise mechanism for determining the value and nature of the assets to be returned to the Republic of Sakha (Yakutia) under the terms of the mineral Lease Agreement is currently being negotiated between the parties.

Management have estimated the restoration liability based upon their interpretation of the Lease Agreement and, in accordance with IAS 37 *"Provisions, Contingent Liabilities and Contingent Assets"*, have calculated and recorded the net present value of the restoration liability (see notes 2 (e) and 12).

The agreement stipulates that its certain terms should be renegotiated every five years. The agreement also stipulates that the Company is subject to royalties and other taxes on the right to use the land and logging areas, disposal and burial of waste and contaminated materials and the use of mineral resources and water for industrial purposes. The main subject of the renegotiations relates to the amount and timing of royalty and other payments.

Royalty payments expensed during the year ended 31 December 2003 totalled RR'mln 9,096 (year ended 31 December 2002: RR'mln 8,166). Ecology fund payments expensed during the year ended 31 December 2003 totalled RR'mln 856 (year ended 31 December 2002: RR'mln 734).

Pursuant to an addendum to the Lease Agreement dated 22 December 2002, the Company and the Republic of Sakha (Yakutia) agreed that the royalty payments including ecology fund payments and value added tax due in 2003 are fixed at RR'mln 10,680.

Pursuant to an addendum to the Lease Agreement dated 17 September 2003, the Company and the Republic of Sakha (Yakutia) agreed that the royalty payments including ecology fund payments and value added tax due in 2004 are fixed at RR'mln 10,500.

Recoverable value added tax related to royalty and ecology fund payments for the year ended 31 December 2003 totalling RR'mln 728 depends on the percentage of paid domestic diamond sales to the total diamond sales of the Company.

The carrying values of Company owned and granted assets subject to the Lease Agreement with the Republic of Sakha (Yakutia) and Grant are as follows:

Assets subject to the agreement with the Republic of Sakha (Yakutia)	**31 December 2003**	**31 December 2002**
Net book value of granted assets received in 1993	10,498	11,560
Net book value of Company owned assets subsequently transferred to the lease	4,939	5,142
Net book value at the end of the year	15,437	16,702

(in millions of Russian roubles, unless otherwise stated)

10. LONG-TERM DEBT

	31 December 2003	31 December 2002
Banks:		
US$ denominated floating rate	2,843	3,496
US$ denominated fixed rate	4,665	7,726
RR denominated fixed rate	4,963	3,633
	12,471	14,855
Eurobonds	14,463	-
RR denominated non-convertible bonds	4,870	6,720
Commercial paper	235	602
Other RR denominated fixed rate loans	375	341
	32,414	22,518
Less: current portion of long-term debt (see note 11)	(7,730)	(6,615)
	24,684	15,903

In May 2003 “Alrosa Finance S.A.”, a wholly owned subsidiary of the Group, issued Eurobonds in the amount of US$’mln 500 due for repayment on 6 May 2008 with an interest rate of 8.125 percent per annum.

The long-term commercial paper has defined maturity dates ranging between one and ten years, and is carried at amortised cost.

The average effective interest rates at the balance sheet dates were as follows:

	31 December 2003	31 December 2002
Banks:		
US$ denominated floating rate	5.1%	6.8%
US$ denominated fixed rate	10.1%	10.8%
RR denominated fixed rate	16.8%	18.1%
Eurobonds	8.7%	-
RR denominated non-convertible bonds	14.0%	19.3%
Commercial paper	35.3%	30.2%
Other RR denominated fixed rate loans	11.4%	14.8%

Exchange rate for US dollar (US$) effective at 31 December 2003 was RR 29.45 to US$ 1 (31 December 2002: RR 31.78 to US$ 1).

At 31 December 2003 long-term loans have the following maturity profile:

	Within 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 years and thereafter	Total
Banks:						
US dollar denominated floating rate	971	835	261	479	297	2,843
US dollar denominated fixed rate	3,275	1,372	18	-	-	4,665
RR denominated fixed rate	2,433	2,000	-	-	530	4,963
Eurobonds	-	-	-	-	14,463	14,463
RR denominated non-convertible bonds	1,051	3,819	-	-	-	4,870
Commercial paper	-	106	30	38	61	235
Other RR denominated fixed rate loans	-	163	52	20	140	375
	7,730	8,295	361	537	15,491	32,414

The Group has not entered into any derivative contracts in respect of its foreign currency obligations or interest rate exposure.

(in millions of Russian roubles, unless otherwise stated)

The carrying amounts and fair values of long-term debt are as follows:

	31 December 2003		31 December 2002	
	Carrying amounts	**Fair values**	**Carrying amounts**	**Fair values**
Banks	12,471	12,855	14,855	14,920
Eurobonds	14,463	14,759	-	-
Non-convertible bonds	4,870	4,917	6,720	6,274
Commercial paper	235	545	602	722
Other	375	390	341	263

The fair value of long-term debt is estimated by discounting the future contractual cash outflows at the market interest rate available to the Group at the balance sheet date.

As at 31 December 2003, long-term debt totalling RR'mln 1,283 (31 December 2002: RR'mln 7,196) included above was secured with the assets of the Group. As separate loan agreements do not specify individual pledged assets, the carrying amount of pledged assets is not disclosed.

RR denominated non-convertible bonds

Balance at 31 December 2002	6,720
Issuance (par value RR 1 thousand totalling RR'mln 30)	30
Amortisation of discount	39
Repayment (par value RR 1 thousand totalling RR'mln 1,919)	(1,919)
Balance at 31 December 2003	4,870

Non-convertible bonds of the Company of the 19th series totalling RR'mln 2,929 at 31 December 2003 (31 December 2002: RR'mln 2,862) and non-convertible bonds of OAO "Vilyuiskaya GES-3" totalling RR'mln 1 at 31 December 2003 (31 December 2002: RR'mln 500) have fixed coupon rates of 16 percent and 19 percent, respectively. Other non-convertible bonds cannot be classified with certainty as fixed or floating rate. The first coupon on these bonds is determined by the Supervisory Council of the Company and the following coupons are linked to certain indicators, such as the Central Bank of the Russian Federation refinancing rate or the yields on government bonds.

11. SHORT-TERM LOANS AND CURRENT PORTION OF LONG-TERM DEBT

	31 December 2003	**31 December 2002**
Banks:		
US$ denominated floating rate	148	782
US$ denominated fixed rate	4,227	8,181
RR denominated fixed rate	207	978
	4,582	9,941
Commercial paper	450	1,513
Other US$ denominated fixed rate loans	171	974
Other RR denominated fixed rate loans	950	927
	6,153	13,355
Add: current portion of long-term debt (note 10)	7,730	6,615
	13,883	19,970

(in millions of Russian roubles, unless otherwise stated)

The average effective interest rates at the balance sheet dates were as follows:

	31 December 2003	**31 December 2002**
Banks:		
US$ denominated floating rate	6.2%	6.4%
US$ denominated fixed rate	9.5%	11.5%
RR denominated fixed rate	8.8%	19.4%
Commercial paper	22.5%	29.3%
Other US$ denominated fixed rate loans	6.5%	10.3%
Other RR denominated fixed rate loans	2.9%	8.9%

As at 31 December 2003, short-term loans totaling RR'mln 6,825 (31 December 2002: RR'mln 11,180) included above are secured with the assets of the Group. As separate loan agreements do not specify individual pledged assets, the carrying amount of pledged assets is not disclosed.

Commercial paper

Commercial paper comprises unsecured notes, denominated in RR, issued by the Group to provide short- and medium-term working capital facilities. The short-term commercial paper is typically non-interest bearing, with defined maturity dates ranging from 1 month to 1 year and is carried at amortized cost.

12. PROVISION FOR RESTORATION LIABILITY

	Year ended 31 December 2003	**Year ended 31 December 2002**
At the beginning of the year	2,743	3,047
Change in estimate of provision for restoration liability	2,266	(599)
Increase in the discounted amount during the year	385	295
At the end of the year	5,394	2,743

The provision for restoration liability represents the net present value of the estimated future obligation, upon termination of the lease, to return certain property, plant and equipment received from the Republic of Sakha (Yakutia) under the terms of the Lease Agreement (see notes 2(e) and 9). The discount rate used to calculate the net present value of the restoration liability was 8.2 percent (31 December 2002: 10.5 percent), which was considered appropriate to the Group in the economic environment in the Russian Federation at the balance sheet date.

Under the Lease Agreement the Company is obliged to reimburse to the Republic of Sakha (Yakutia) the amount of accumulated depreciation on property, plant and equipment subject to this agreement (leased property, plant and equipment) and the Republic of Sakha (Yakutia) is obliged to reimburse to the Company the amount of qualified repair and maintenance expense incurred by the Company in relation to the leased property, plant and equipment. The Company and the Republic of Sakha (Yakutia) determined the amount to be reimbursed by the Company on a net basis as the difference between the amount of depreciation on leased assets and the amount of repair and maintenance expense in relation to the leased property, plant and equipment. Reimbursement is effected by means of the transfer of title of certain of the Company’s own items of property, plant and equipment to the Republic of Sakha (Yakutia) and these assets are, subsequent to their transfer, treated as leased property, plant and equipment (see note 9).

Prior to 1 January 2003 Republic of Sakha (Yakutia) was obliged to reimburse to the Company the actual amount of qualified repair and maintenance expense incurred by the Company in relation to the leased property, plant and equipment. Pursuant to an addendum to the Lease Agreement dated 17 September 2003, starting from 1 January 2003 the Republic of Sakha (Yakutia) is obliged to reimburse qualified repair and maintenance expense incurred by the Company, subject to such expense being limited to 30 percent of the depreciation on leased property, plant and equipment. This new limitation, in combination with the decrease in the discount rate, resulted in a change in the estimate of the amount of provision for restoration liability totalling RR’mln 2,266, which was added to the cost of the related asset (see note 5).

(in millions of Russian roubles, unless otherwise stated)

13. PROVISION FOR PENSION OBLIGATIONS

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

	31 December 2003	31 December 2002
Present value of obligations (unfunded)	5,387	4,391
Unrecognised actuarial losses	(3,424)	(3,123)
Net liability	1,963	1,268

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

	Year ended 31 December 2003	Year ended 31 December 2002
Current service cost	110	53
Interest cost	641	526
Net actuarial losses	244	337
Net expense recognised in the statement of income	995	916

Total expenses associated with pension obligations are included within wages, salaries and other staff costs within cost of sales in the consolidated statement of income.

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

	Year ended 31 December 2003	Year ended 31 December 2002
Net liability at the beginning of the year	1,268	554
Net expense recognised in the statement of income during the reporting period	995	916
Benefits paid	(300)	(202)
Net liability at the end of the year	1,963	1,268

Principal actuarial assumptions used:

	31 December 2003	31 December 2002
Discount rate (nominal)	9%	11%
Future pension increases (nominal)	9%	9%
Employees average remaining working life (years)	11	11

14. TRADE AND OTHER PAYABLES

	31 December 2003	31 December 2002
Accrual for employee flights and holidays	3,053	2,495
Trade	2,757	3,885
Advances from customers	1,251	231
Wages and salaries	1,051	1,037
Interest payable	397	526
Payables to related parties	85	88
Other payables and accruals	528	650
	9,122	8,912

In accordance with Russian legislation, the Group entities are required to pay for the holiday entitlement and the cost of travel for employees and their family members to an agreed-upon destination and back, or a pre-determined allowance.

(in millions of Russian roubles, unless otherwise stated)

15. OTHER PROVISIONS

	31 December 2003	31 December 2002
Provision for guarantee given	972	-
Provision for legal claim	243	-
	1,215	-

In April 2003 the Company guaranteed a US dollar denominated fixed rate loan issued by OAO "Investment Bank Trust" to ZAO "Nazymskaya Oil and Gas Research Expedition" totalling RR'mln 916 which is due for repayment in 2006. The Company management expects the Group to incur an outflow of economic resources in connection with this guarantee and therefore the Group has recognised a provision for the principal amount of the loan and accrued interest totalling RR'mln 972 in the financial statements at 31 December 2003. In June 2004, ZAO "Nazymskaya Oil and Gas Research Expedition" failed to pay the first interest installment to the bank. The Company as guarantor paid the interest installment to the bank.

Bateman Projects Limited, a South African company, and its Dutch subsidiary, Bateman International B.V. (collectively "Bateman"), outside construction firms, which were involved in the development of the Nyurba processing plant, filed an arbitration claim against the Company claiming damages for alleged loss of profit under the contracts concluded between the Company and Bateman and damages allegedly resulting from use of Bateman's intellectual property rights. As the Company management expects the Group to incur an outflow of economic resources in connection with this legal claim, the Group has recognised a provision totalling RR'mln 243 in the financial statements at 31 December 2003. The Company management does not expect any additional material outflows of economic resources in relation to this claim.

16. PROFIT AND OTHER TAX ASSETS AND LIABILITIES

Taxes payable comprise the following:

	31 December 2003	31 December 2002
Pension tax	869	893
Extraction tax	506	108
Property tax	385	310
Value added tax	243	162
Income tax (employees)	242	175
Profit tax	202	298
Tax penalties	154	867
Royalty payable to Republic of Sakha (Yakutia)	118	335
Road users tax	-	93
Other taxes and accruals	39	80
Taxes payable	2,758	3,321

Taxes other than profit tax and extraction tax included into other operating expenses comprise the following:

	Year ended 31 December 2003	Year ended 31 December 2002
Property tax	1,125	946
Ecology fund	856	734
Road users tax	-	613
Tax penalties	128	1,128
Other taxes and accruals	131	196
Taxes other than profit tax and extraction tax	2,240	3,617

Road users tax has been abolished in accordance with legislation effective since 1 January 2003.

As a result of a tax dispute, at 31 December 2002, the Group recorded a liability for tax penalties totalling RR'mln 1,195, relating to 1999, 2000 and 2001.

(in millions of Russian roubles, unless otherwise stated)

In accordance with Resolution № 1364 of the Government of the Russian Federation dated 9 December 1999, in addition to the taxes noted above the Company is obliged to pay 6.5 percent on the value of diamonds sold for export in the form of an export duty (see note 17).

According to legislation which became substantively enacted in the year ended 31 December 2001, profit tax payable by companies in the Russian Federation with effect from 1 January 2002 ranges from 20 percent to 24 percent, depending on the decision each year of regional and local tax authorities, which can agree jointly on a supplementary amount of up to 4 percent above that set by the federal tax authorities. The rate used to compute the deferred profit tax assets and liabilities of the Group at 31 December 2003 and 31 December 2002 was 24 percent, which reflects the fact that, based on their decisions in respect of tax rates, substantially all regional and local tax authorities in the regions in which the Group operates assessed the maximum supplementary amount in respect of the year ended 31 December 2003 and year ended 31 December 2002.

Profit tax expense comprises the following:

	Year ended 31 December 2003	**Year ended 31 December 2002**
Current tax expense	3,438	2,650
Deferred tax (benefit) expense	(1,720)	1,624
Profit tax	1,718	4,274

Net profit before taxation for financial reporting purposes is reconciled to tax expense as follows:

	Year ended 31 December 2003	**Year ended 31 December 2002**
Profit before profit tax and minority interest	8,360	7,092
Theoretical tax charge at statutory rate of 24 percent (year ended 31 December 2002: 24 percent) thereon	2,006	1,702
Income not assessable for profit tax purposes	(1,007)	(297)
Expenses and losses not deductible for profit tax purposes	719	1,146
Tax penalties	-	287
Non-temporary elements of monetary gain	-	1,773
Inflation effect on deferred tax balance at the beginning of the year	-	(337)
Profit tax	1,718	4,274

The non-temporary impact of monetary gains and losses reflects the effect on the theoretical tax charge of inflation with respect to non-monetary items of a non-temporary nature (primarily equity and net deferred tax liability).

Differences between IFRS and Russian statutory tax accounting give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profits tax purposes. The tax effect of the movement on these temporary differences is recorded at the rate of 24 percent (2002: 24 percent).

(in millions of Russian roubles, unless otherwise stated)

	31 December 2003	Tax effect of movement in temporary differences	31 December 2002
Deferred tax liabilities			
Property, plant and equipment	3,706	(1,081)	4,787
Inventories	984	163	821
Long-term investments	119	(142)	261
Deferred tax assets			
Accrual for employee benefits	(987)	(140)	(847)
Exploration costs written off	(174)	54	(228)
Impairment of accounts receivable	(520)	(138)	(382)
Provision for pension obligations	(155)	(46)	(109)
Write-down of inventories	(380)	(292)	(88)
Other deductible temporary differences	(127)	(98)	(29)
Net deferred tax liability	2,466	(1,720)	4,186

17. SALES

	Year ended 31 December 2003	Year ended 31 December 2002
Revenue from diamond sales:		
Export (predominantly one customer)	27,196	26,684
Domestic	27,595	27,184
	54,791	53,868
Other revenue:		
Transport	1,584	1,409
Trading	1,379	1,094
Social infrastructure	714	710
Construction	539	1,144
Other	997	894
	60,004	59,119

Export duties totalling RR'mln 1,641 for the year ended 31 December 2003 (year ended 31 December 2002: RR'mln 1,522) were netted against revenues from export of diamonds.

	Year ended 31 December 2003 US$'mln	Year ended 31 December 2002 US$'mln
Hard currency revenue from export diamond sales including export duties (predominantly one customer)	927	845
US dollar denominated domestic diamond sales settled in RR	916	823
	1,843	1,668

During the year ended 31 December 2003 and 31 December 2002 sales to De Beers occurred on the basis of separate agreements for each individual shipment of diamonds. Contingencies related to the trade agreement with De Beers, covering the period from 1 January 2002 to 31 December 2006 are disclosed in note 25 (i).

Pursuant to existing federal legislation, the Government of the Russian Federation issued, on an annual basis, an export quota for rough diamonds. The quota stipulated the maximum amount of diamonds that might be exported in a given year. The physical volume in carats provided in any quota constituted a State secret.

In November 2002, the President of the Russian Federation signed a decree liberalizing the Russian diamond market. The decree authorised the Government of the Russian Federation to grant multi-year quotas, not to exceed five years, and in February 2003 the Company was granted a five-year quota to export up to US$'mln 1,050 of diamonds each year, based on current market prices. The physical volume in carats provided in any quota constitutes a State secret.

(in millions of Russian roubles, unless otherwise stated)

18. COST OF SALES

	Year ended 31 December 2003	Year ended 31 December 2002
Wages, salaries and other staff costs	10,809	10,869
Depreciation	5,487	4,642
Materials	4,861	4,655
Fuel and energy	4,626	4,262
Extraction tax	3,878	4,460
Services	1,207	795
Transport	1,066	1,027
Other	441	505
Write down of inventory	235	141
Movement in inventories	(2,792)	(250)
	29,818	31,106

Depreciation totalling RR'mln 1,033 (year ended 31 December 2002: RR'mln 796) and staff costs totalling RR'mln 1,911 (year ended 31 December 2002: RR'mln 1,804) were incurred by the Group's construction division and were capitalized in the year.

19. GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended 31 December 2003	Year ended 31 December 2002
Administrative expenses	2,188	1,730
Bad debt expense	693	1,371
	2,881	3,101

Wages, salaries and other staff costs totalling RR’mln 781 (2002: RR’mln 477) are included into administrative expenses.

20. OTHER OPERATING INCOME

	Year ended 31 December 2003	Year ended 31 December 2002
Amortization of Grant (see note 9)	1,062	1,238
Other	1,176	715
	2,238	1,953

21. OTHER OPERATING EXPENSES

	Year ended 31 December 2003	Year ended 31 December 2002
Social costs	2,695	1,758
Taxes other than profit tax and extraction tax (see note 16)	2,240	3,617
Exploration expenses	1,308	1,105
Selling and marketing expenses	1,199	1,207
Loss on disposal of property, plant and equipment	1,044	744
Provision for guarantee given (see note 15)	972	-
Provision for legal claim (see note 15)	243	-
(Reversal of impairment) impairment of fixed assets	(74)	627
Other	697	478
	10,324	9,536

Wages, salaries and other staff costs totalling RR’mln 521 (2002: RR’mln 414) are included into selling and marketing expenses.

(in millions of Russian roubles, unless otherwise stated)

Social costs

	Year ended 31 December 2003	Year ended 31 December 2002
Maintenance of local infrastructure	1,194	967
Charity	871	279
Education	200	121
Hospital expenses	138	108
Other	292	283
	2,695	1,758

22. FINANCE COSTS, NET

	Year ended 31 December 2003	Year ended 31 December 2002
Interest expense:		
Bank loans	2,244	2,329
Commercial papers	258	1,249
Non-convertible bonds	912	875
Eurobonds	835	-
Provision for restoration liability (see note 12)	385	295
Other	94	500
	4,728	5,248
Interest income	(625)	(334)
(Reversal of provision for) provision for impairment of available-for-sale investments, net	(30)	543
	4,073	5,457

23. CASH GENERATED FROM OPERATIONS

Reconciliation of profit before tax to cash generated from operations:

	Year ended 31 December 2003	Year ended 31 December 2002
Profit before profit tax	8,360	7,092
Adjustments for:		
Income from associated undertakings (note 3)	(400)	(497)
Interest income (note 22)	(625)	(334)
Interest expense (note 22)	4,728	5,248
(Reversal of provision for) provision for impairment of available-for-sale investments, net (note 22)	(30)	543
(Reversal of impairment) impairment of fixed assets (note 21)	(74)	627
Provision for legal claim (note 21)	243	-
Provision for guarantee given (note 21)	972	-
Loss on disposal of property, plant and equipment (note 21)	1,044	744
Amortisation of Grant (note 20)	(1,062)	(1,238)
Depreciation (note 18)	5,487	4,642
Adjustments for non-cash investing activity (note 27)	(1,738)	(2,301)
Adjustments for non-cash financing activity (note 27)	(296)	(228)
Unrealized foreign exchange effect on non-operating items	(2,053)	825
Monetary effect on non-operating balances	-	(3,606)
Net operating cash flow before changes in working capital	14,556	11,517
Net increase in inventories	(2,157)	(57)
Net decrease in trade and other receivables, excluding dividends receivable	632	1,127
Net increase in provisions, trade and other payables, excluding interest payable	1,034	2,590
Net decrease in taxes payable other than profit tax	(467)	(1,757)
Cash generated from operations	**13,598**	**13,420**
Profit tax paid	(3,601)	(1,836)
Net cash flows from operating activities	**9,997**	**11,584**

24. FINANCIAL RISKS MANAGEMENT

(a) Credit risk

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

Cash is placed in financial institutions, which are considered at the time of the deposit to have minimal risk of default.

(b) Foreign exchange risk

The Group exports production to European and other countries and attracts a substantial amount of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated liabilities (see notes 10 and 11) give rise to foreign exchange exposure.

The Group does not have formal arrangements to mitigate the foreign exchange risks of the Group's operations.

(c) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest bearing long-term borrowings. The majority of interest rates on long-term borrowings are fixed, and are disclosed in note 10. The Group has no significant interest bearing assets.

(d) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, and ensuring the availability of additional funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in its funding requirements by keeping committed credit lines available.

(e) Fair value estimation

The fair value of publicly traded trading and available-for-sale securities is based on quoted market prices at the balance sheet date.

The estimated fair value of financial assets carried at amortised cost is determined by discounting estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates available to the Group for similar financial instruments. Fair value of these financial assets did not materially differ from their carrying amount at 31 December 2003 and 31 December 2002. At 31 December 2003 and 31 December 2002, the fair value of financial liabilities which is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments with the same remaining maturity, did not materially differ from the carrying amount of these financial liabilities (note 10).

The carrying amounts of financial assets and liabilities with maturity of less than one year are assumed to approximate their fair values.

25. CONTINGENCIES, COMMITMENTS AND OTHER RISKS

(a) Operating environment

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

Whilst there have been improvements in the economic trends, the future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory, and political developments.

(b) Taxes

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in its interpretation of the legislation and assessments. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2003 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these financial statements.

In December 2002, based on results of a tax audit, the tax authorities filed certain claims against the Company for tax penalties totalling RR'mln 657. The Company disputed the total amount of the tax authorities' claims, as management believes the Company is in compliance with the tax legislation. In March 2004 the case was heard in the Arbitration Court of the Republic of Sakha (Yakutia). The court decided in favour of the Company. In June 2004 the appeals instance of the Arbitration Court of the Republic of Sakha (Yakutia) upheld the decision. The tax authorities are preparing to dispute this decision in a higher court. The Company didn’t recognize these tax penalties as liability in its financial statements because management believes that the likelihood of this contingency is remote. The status of these tax claims has not changed as of the date of these financial statements.

(c) Legal proceedings

The Group is a party to certain legal proceedings arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding which could have a material adverse effect on the results of operations or financial position of the Group as at 31 December 2003, other than amounts that have been accrued in the consolidated financial statements.

(d) Insurance

The Group is assessing its policies for insuring assets and operations. At present, apart from the full insurance of movements of diamond inventory from the production location to the customers, very few assets and operations of the Group are insured and, in the instances where assets are insured, the amounts generally are not sufficient to cover all costs associated with replacing the assets.

(e) Social obligations

The Group makes contributions to mandatory and voluntary local social programs. The Group's local infrastructure assets as well as local social programs benefit the local communities at large and are not normally restricted to the Group's employees. The Group is negotiating the transfer of certain social assets to the local authorities; however, the Group expects to continue funding these social programs for the foreseeable future.

(in millions of Russian roubles, unless otherwise stated)

(f) Capital commitments

At 31 December 2003, the Group has contractual commitments for capital expenditures of approximately RR'mln 1,364 (31 December 2002: RR'mln 2,823).

(g) Restoration, rehabilitation and environmental costs

Under its license agreements, the Group is not responsible for any significant restoration, rehabilitation and environmental expenditures that may be incurred subsequent to the cessation of production at each mine, apart from the obligation to return assets received under the Lease agreement (see note 9). However, the Group is obliged to restore riverbeds and the surrounding areas. These expenses are not expected to be material to the Group and are expensed in the period incurred.

(h) Guarantees

As at 31 December 2003, the Group has guaranteed US dollar denominated loan issued by National Bank of Republic of Belarus to AKB "Rosbank" totalling RR'mln 736. The Company management does not expect the Group to incur any outflow of economic resources or economic benefits in connection with this guarantee.

(i) Trade agreement with De Beers

On 17 December 2001, a trade agreement between the Company and De Beers was signed, covering the period from 1 January 2002 to 31 December 2006. Pursuant to this agreement, the Company agreed to sell and De Beers agreed to buy up to US$'mln 800 in value of the Company's annual diamond production at the current market prices. To be legally enforceable, this agreement requires the regulatory permission of the European Commission. Currently, the Company is in the process of negotiating the resolution of certain objections raised by the European Commission. Management of the Company believes that the likelihood of negative result of these negotiations is remote.

In addition, the European Commission could seek to impose fines of up to 10 percent of the Company's sales in respect of the Company's previous trade agreements with De Beers, which were not notified to the European Commission. Management of the Company believes that the risk of the European Commission ruling against the Company is remote.

26. RELATED PARTY TRANSACTIONS

The Company's principal shareholders are the Russian Federation and the Republic of Sakha (Yakutia).

IAS 24, *"Related Party Disclosures"*, specifically excludes government departments and agencies in the course of their normal dealings with enterprise and government controlled entities from the definition of related parties, and therefore transactions under those exemptions between, and balances due to or from entities, under government or other state control and government departments and agencies in the course of their normal dealings and the Group's companies are not detailed in this note.

Information related to the Lease Agreement with the Republic of Sakha (Yakutia) is disclosed in notes 9 and 12.

Remuneration to the members of Supervisory Council and Management Board of the Company incurred during year ended 31 December 2003 totalled RR'mln 134 (year ended 31 December 2002: RR'mln 69).

Significant related party transactions are summarised as follows:

Long-term accounts receivable	**31 December 2003**	**31 December 2002**
OAO "Sobinbank" and its affiliates, receivable secured by the loan payable	670	848
ZAO PIC "Orel Almaz", an associated undertaking	-	33
Less: provision for bad debt	-	(160)
	670	721

(in millions of Russian roubles, unless otherwise stated)

Current accounts receivable	**31 December 2003**	**31 December 2002**
OAO “Yuzhno-Verkhoyanskaya Gornaya Company”, an associated undertaking	391	-
OAO "Tuymaada Diamond"	174	260
ZAO PIC "Orel Almaz", an associated undertaking	167	105
OAO "Sobinbank" and its affiliates, receivable secured by the loan payable	-	679
Other	99	196
Less: provision for bad debt	(307)	(349)
	524	891

Loans provided by related parties:

Name of bank	**Interest rate**	**31 December 2003**	**31 December 2002**
OAO “Sobinbank” (US dollar denominated)	12 percent	-	636
OAO “Sobinbank” (RR denominated)	20-25 percent	675	1,341
		675	1,977

The Group owns a 15 percent interest in OAO “Sobinbank” and 13 percent interest in OAO “Tuymaada – Diamond” at 31 December 2003 and 2002. The Group’s management are members of the Board of Directors of these companies.

27. SIGNIFICANT NON-CASH TRANSACTIONS

	Year ended 31 December 2003	**Year ended 31 December 2002**
Non-cash investing activities:		
Inventory used in construction	(1,470)	(1,349)
Purchase of property, plant and equipment	(337)	(491)
Other	69	(461)
	(1,738)	(2,301)
Non-cash financing activities:		
Commercial paper issuance	662	4,042
Commercial paper and loans redemption	(958)	(4,270)
	(296)	(228)

28. SEGMENT INFORMATION

The Group has one reportable business segment, which is the production and sale of diamonds. The Group evaluates performance and makes investment and strategic decisions based upon review of profitability for the Group as a whole. The performance measurement systems employed by the Group to review overall profitability are based on the results of the Group determined using Russian statutory accounting books and records. Russian statutory accounting differs in many significant respects from IFRS.

(in millions of Russian roubles, unless otherwise stated)

An analysis of revenue by type is disclosed in note 17. Revenue from sales by geographical location of the customer, and assets and capital expenditures by geographical location of the asset are as follows:

	Sales		Total assets		Capital Expenditures	
	Year ended 31 December 2003	**Year ended 31 December 2002**	**31 December 2003**	**31 December 2002**	**Year ended 31 December 2003**	**Year ended 31 December 2002**
Russian Federation	32,808	32,435	135,009	125,227	15,593	20,116
Western Europe	19,564	21,374	-	-	-	-
Other countries	7,632	5,310	183	273	56	-
Associated undertakings	-	-	900	901	-	-
Unallocated assets	-	-	277	210	-	-
Total	**60,004**	**59,119**	**136,369**	**126,611**	**15,649**	**20,116**

Sales to De Beers are included in the Western Europe geographical segment.

The Group has one individual customer, De Beers, that accounted for 30 percent of its sales during the year ended 31 December 2003 (year ended 31 December 2002: 36 percent).

29. POST BALANCE SHEET EVENTS

Borrowing

In March-April 2004 OAO "Severalmaz", a subsidiary of the Group, placed credit link notes in the amount of US$'mln 150 due for repayment in March-April 2006 with an yield rate of 8.875 percent per annum.

Dividends

On 19 June 2004, the Company's shareholders approved dividends for the year ended 31 December 2003 totalling RR'mln 1,200. Dividends per share amounted to RR 6,000.