

OPEN JOINT STOCK COMPANY “AEROFLOT – RUSSIAN AIRLINES”

Independent Auditors’ Report

Consolidated Financial Statements
For the Year Ended December 31, 2005

OJSC “AEROFLOT – RUSSIAN AIRLINES”

TABLE OF CONTENTS

	Page
STATEMENT OF MANAGEMENT’S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2005	1
INDEPENDENT AUDITORS’ REPORT	2
CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2005:	
Consolidated statement of income	3
Consolidated balance sheet	4
Consolidated statement of cash flows	5-6
Consolidated statement of changes in shareholders’ equity	7
Notes to the consolidated financial statements	8-38

OJSC “AEROFLOT – RUSSIAN AIRLINES”

STATEMENT OF MANAGEMENT’S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2005

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 Open Joint Stock Company “Aeroflot – Russian Airlines” and its subsidiaries (the “Group”).

Management is responsible for the preparation of the consolidated financial statements that present fairly the consolidated financial position of the Group as of December 31, 2005, and the consolidated results of its operations, cash flows and changes in shareholders’ equity for the year then ended, in compliance 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 local legislation and accounting standards in the respective jurisdictions in which the Group operates;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements for the year ended December 31, 2005 were approved on May 24, 2006 by:

V. M. Okulov
General Director

M. I. Poluboyarinov
Deputy General Director
Finance and Planning

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Open Joint Stock Company "Aeroflot – Russian Airlines":

We have audited the accompanying consolidated balance sheet of Open Joint Stock Company "Aeroflot – Russian Airlines" and its subsidiaries (the "Group") as of December 31, 2005 and the related consolidated statements of income, cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

May 24, 2006

OJSC “AEROFLOT – RUSSIAN AIRLINES”

CONSOLIDATED STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31, 2005

(Amounts in millions of US Dollars, except shares and earnings-per-share amounts)

	Notes	2005	2004
Traffic revenue	7	2,079.3	1,735.5
Other revenue	8	460.3	423.3
Revenue		2,539.6	2,158.8
Operating costs	9	(1,875.2)	(1,565.1)
Staff costs	10	(342.3)	(300.9)
Depreciation	20	(80.0)	(94.0)
Operating costs		(2,297.5)	(1,960.0)
Operating income		242.1	198.8
Interest expense	11	(25.3)	(12.0)
Interest income		6.9	3.2
Share of income in associated undertakings	18	5.7	3.5
Foreign exchange and translation (loss)/gain, net		(12.8)	13.5
Non-operating income, net	12	62.2	24.1
Income before taxation		278.8	231.1
Taxation	13	(89.0)	(59.0)
Net income		189.8	172.1
Attributable to:			
Equity holders of the parent		184.2	170.2
Minority interest		5.6	1.9
		189.8	172.1
Earnings per share, basic and diluted (US Dollars)		0.179	0.159
Weighted average number of shares outstanding (millions)	27	1,060	1,085

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May 24, 2006

The accompanying notes form an integral part of these consolidated financial statements.
The Independent Auditors' Report is presented on page 2.

OJSC "AEROFLOT – RUSSIAN AIRLINES"

CONSOLIDATED BALANCE SHEET AS OF DECEMBER 31, 2005 (Amounts in millions of US Dollars)

	Notes	2005	2004
ASSETS			
Current assets			
Cash and cash equivalents	14	101.1	65.2
Short-term aircraft lease deposits		4.3	6.4
Short-term investments	15	30.5	20.6
Accounts receivable and prepayments, net	16	568.1	448.3
Expendable spare parts and inventories	17	61.4	64.5
Assets of a disposal group classified as held for sale	34	83.2	-
		848.6	605.0
Non-current assets			
Equity accounted investments, net	18	14.0	10.2
Long-term investments, net	19	16.8	20.4
Aircraft lease deposits		4.4	-
Deferred tax assets	13	5.0	6.4
Other non-current assets		6.7	3.3
Property, plant and equipment	20	726.7	717.4
		773.6	757.7
TOTAL ASSETS		1,622.2	1,362.7
LIABILITIES AND EQUITY			
Current liabilities			
Accounts payable and accrued liabilities	21	325.8	302.0
Unearned transportation revenue		99.6	98.6
Short-term borrowings	24	100.9	78.4
Provisions	22	7.2	-
Current portion of finance lease payable	26	26.1	53.0
Liabilities associated with assets of a disposal group classified as held for sale	34	9.4	-
		569.0	532.0
Non-current liabilities			
Long-term borrowings	25	76.0	16.2
Finance lease payable	26	281.3	304.3
Provisions	22	81.4	67.3
Deferred tax liabilities	13	36.5	8.2
Other non-current liabilities	23	10.5	23.2
		485.7	419.2
Capital and reserves			
Share capital	27	51.6	51.6
Treasury stock	27	(32.9)	(35.4)
Revaluation reserve		8.8	12.0
Translation reserve		0.3	1.2
Retained earnings	28	530.8	373.5
Equity attributable to equity holders of the parent		558.6	402.9
Minority interest		8.9	8.6
		567.5	411.5
TOTAL LIABILITIES AND EQUITY		1,622.2	1,362.7

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May 24, 2006

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OJSC “AEROFLOT – RUSSIAN AIRLINES”

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2005 (Amounts in millions of US Dollars)

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Income before taxation	278.8	231.1
Adjustments to reconcile income before taxation to net cash provided by operating activities:		
Depreciation of property, plant and equipment (Note 20)	80.0	94.0
Gain on disposal of property, plant and equipment (Note 9)	(3.4)	(6.6)
Income on acquisition of subsidiary (Note 33)	-	(5.7)
Increase (decrease) in interest accrued	2.3	(3.1)
Share of income in associated undertakings (Note 18)	(5.7)	(3.5)
Loss on impairment of property, plant and equipment (Note 9)	5.5	12.7
Increase in tax and legal provisions (Note 9)	21.3	37.6
(Decrease) increase in accounts receivable and other assets impairments	(6.5)	9.1
Gain from restructuring and settlement of tax penalties (Note 12)	(8.6)	-
Other non-cash income, net	(3.8)	(2.5)
Operating profit before working capital changes	359.9	363.1
Increase in accounts receivable	(120.1)	(149.0)
Decrease (increase) in inventory	2.9	(19.3)
Increase in accounts payable and accrued liabilities	6.8	1.9
Increase in unearned transportation revenue	1.0	28.9
Decrease in other taxes payable	(13.1)	(1.5)
	237.4	224.1
Income tax paid	(25.5)	(64.5)
Net cash provided by operating activities	211.9	159.6
Cash flows from investing activities:		
Purchases of property, plant and equipment and intangible assets	(182.5)	(104.5)
Proceeds from sale of property, plant and equipment	1.1	10.0
(Investments in) refund of aircraft lease deposits	(4.9)	7.6
Purchases of investments	(36.2)	(18.6)
Proceeds from sale of investments	30.1	1.5
Acquisition of subsidiary	-	(3.2)
Refund of prepayments made for aircraft	-	28.0
Dividends received	1.8	3.6
Net cash used in investing activities	(190.6)	(75.6)
Cash flows from financing activities:		
Repayment of capital element of finance lease	(25.9)	(38.3)
Dividends paid	(31.5)	(16.2)
Purchases of treasury stock	(1.9)	(35.2)
Sale of treasury stock	3.5	-
Issue of shares to minority shareholders	-	1.3
Proceeds from borrowings, net	82.4	16.5
Restricted cash movements	(3.3)	0.2
Net cash provided by (used in) financing activities	23.3	(71.7)

OJSC "AEROFLOT – RUSSIAN AIRLINES"

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2005 (CONTINUED) (Amounts in millions of US Dollars)

	<u>2005</u>	<u>2004</u>
Net increase in cash and cash equivalents	44.6	12.3
Cash and cash equivalents at the beginning of the year (Note 14)	65.2	52.2
Effect of exchange rate change	(0.2)	0.7
Cash and cash equivalents at the end of the year (Note 14)	<u>109.6</u>	<u>65.2</u>
Supplemental cash flow information:		
Interest paid	(25.6)	(11.2)
Interest received	8.8	4.3
Non-cash investing and financing activities:		
Property, plant and equipment acquired under finance lease	2.8	204.0
Gain from early termination of finance lease	7.5	-

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OJSC “AEROFLOT – RUSSIAN AIRLINES”

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEAR ENDED DECEMBER 31, 2005 (Amounts in millions of US Dollars)

	Share capital	Treasury stock	Revaluation reserve	Translation reserve	Retained earnings	Attributable to equity holders of the parent	Minority interest	Total
As of December 31, 2003	51.6	(0.5)	-	0.3	229.8	281.2	5.7	286.9
Effect of adoption of new accounting standards (Note 4)	-	-	10.1	-	(10.1)	-	-	-
As restated	51.6	(0.5)	10.1	0.3	219.7	281.2	5.7	286.9
Net income	-	-	-	-	170.2	170.2	1.9	172.1
Purchase of treasury stock	-	(34.9)	-	-	-	(34.9)	-	(34.9)
Minority interest on acquisition of subsidiary	-	-	-	-	-	-	1.3	1.3
Gains on investments available-for-sale	-	-	1.9	-	-	1.9	-	1.9
Foreign currency translation for the year	-	-	-	0.9	-	0.9	0.4	1.3
Dividends (Note 28)	-	-	-	-	(16.4)	(16.4)	(0.7)	(17.1)
As of December 31, 2004	51.6	(35.4)	12.0	1.2	373.5	402.9	8.6	411.5
Net income	-	-	-	-	184.2	184.2	5.6	189.8
Sale of treasury stock	-	0.6	-	-	-	0.6	-	0.6
Purchase of treasury stock	-	(1.9)	-	-	-	(1.9)	-	(1.9)
Gain on disposal of treasury stock	-	2.9	-	-	-	2.9	-	2.9
Loss on investments available-for-sale	-	-	(3.2)	-	-	(3.2)	-	(3.2)
Foreign currency translation for the year	-	0.9	-	(0.9)	-	-	(0.6)	(0.6)
Dividends (Note 28)	-	-	-	-	(26.9)	(26.9)	(4.7)	(31.6)
As of December 31, 2005	51.6	(32.9)	8.8	0.3	530.8	558.6	8.9	567.5

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OJSC “AEROFLOT – RUSSIAN AIRLINES”

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2005 (Amounts in millions of US Dollars)

1. NATURE OF THE BUSINESS

OJSC “Aeroflot – Russian Airlines” (the “Company”) was formed as a joint stock company following a government decree in 1992. The 1992 decree conferred all the rights and obligations of “Aeroflot-Soviet Airlines” and its structural units, excluding its operations in Russia and Sheremetyevo Airport, upon the Company, including inter-governmental bilateral agreements and agreements signed with foreign airlines and enterprises in the field of civil aviation.

The principal activity of the Company is the provision of passenger and cargo air transportation services, both domestically and internationally, and other aviation services from its base at Moscow Sheremetyevo Airport. The Company and its subsidiaries (the “Group”) also conduct activities comprising airline catering, operation of a hotel, and provision of insurance services. Associated undertakings mainly comprise cargo-handling services, fuelling services and duty-free retail businesses.

As of December 31, 2005 and 2004, the Government of the Russian Federation owned 51% of the Company. The Company’s headquarters are located in Moscow at 37 Leningradsky Prospect.

The principal subsidiary undertakings are:

<u>Company name</u>	<u>Place of incorporation and operation</u>	<u>Activity</u>	<u>Percentage held as of December 31, 2005</u>	<u>Percentage held as of December 31, 2004</u>
CJSC “Sherotel”	Moscow region	Hotel	100.0%	100.0%
OJSC “Terminal”	Moscow region	Project Sheremetyevo-3	100.0%	100.0%
CJSC “Aeroflot Plus”	Moscow region	Airline	100.0%	100.0%
OJSC “Insurance company “Moscow”	Moscow	Insurance services	100.0%	98.7%
CJSC “Aeromar”	Moscow region	Catering	51.0%	51.0%
OJSC “Aeroflot-Don”	Rostov-on-Don	Airline	51.0%	51.0%
CJSC “Aeroflot-Nord”	Arkhangelsk	Airline	51.0%	51.0%

The significant entities in which the Group holds more than 20% but less than 50% of equity are:

<u>Company name</u>	<u>Place of incorporation and operation</u>	<u>Activity</u>	<u>Percentage held as of December 31, 2005</u>	<u>Percentage held as of December 31, 2004</u>
LLC “Airport Moscow”	Moscow region	Cargo handling	50.0%	50.0%
CJSC “Aerofirst”	Moscow region	Trading	33.3%	33.3%
CJSC “TZK Sheremetyevo”	Moscow region	Fuel trading company	31.0%	31.0%
CJSC “AeroMASH – AB”	Moscow region	Aviation security	45.0%	45.0%

All the companies listed above are incorporated in the Russian Federation.

The table below provides information on the Group's aircraft fleet as of December 31, 2005:

<u>Type of aircraft</u>	<u>Ownership</u>	<u>Aeroflot – Russian Airlines (number)</u>	<u>Aeroflot-Don (number)</u>	<u>Aeroflot-Nord (number)</u>	<u>Group total (number)</u>
Ilyushin Il-96-300	Owned	6	-	-	6
Ilyushin Il-62M	Owned	1	-	-	1
Ilyushin Il-86	Owned	9	-	-	9
Tupolev Tu-154	Owned	25	9	1	35
Tupolev Tu-134	Owned	12	2	8	22
Antonov An-24	Owned	-	-	3	3
Antonov An-26	Owned	-	-	1	1
Airbus A-319	Finance lease	4	-	-	4
Airbus A-320	Finance lease	1	-	-	1
Airbus A-321	Finance lease	3	-	-	3
Tupolev Tu-134	Operating lease	2	-	-	2
Tupolev Tu-154	Operating lease	2	-	3	5
Ilyushin Il-62M	Operating lease	1	-	-	1
Antonov An-24	Operating lease	-	-	1	1
Antonov An-26	Operating lease	-	-	1	1
Airbus A-319	Operating lease	4	-	-	4
Airbus A-320	Operating lease	6	-	-	6
Boeing 767-36 NER	Operating lease	9	-	-	9
McDonnell Douglas DC10-40F	Operating lease	4	-	-	4
		89	11	18	118

2. THE RUSSIAN ENVIRONMENT AND ECONOMIC CONDITIONS

Currency exchange and control – The Russian ruble is the national currency of the Russian Federation, however, foreign currencies, in particular the US dollar (“USD”), play a significant role in the underlying economics of many business transactions in Russia and it is a functional currency of the Company. Following the 1998 economic crisis, the Russian ruble's value fell significantly against the USD, falling from a pre-crisis rate of approximately 6 Russian rubles to 1 USD, to 27 Russian rubles to 1 USD by the end of 1999. During 2005 and 2004, the Russian ruble's value fluctuated between a low of 27.46 and a high of 29.45 to 1 USD. During 2005, the Russian ruble has depreciated against the US Dollar. As of May 24, 2006 the exchange rate is 26.99 Russian rubles to 1 USD.

The following table summarizes the exchange rate of the Russian ruble to 1 US Dollar:

	<u>Exchange rate</u>
31 December 2005	28.78
Average rate for 2005	28.29
31 December 2004	27.75
Average rate for 2004	28.81
31 December 2003	29.45

The Group's principal currency exchange risks relate to its ability to recover investments in non-monetary assets, specifically property, plant and equipment, as well as exposure to currency exchange losses on monetary assets and liabilities linked to currencies other than the functional currency of the Group's companies.

Currency regulations imposed by Russian law place certain limitations on the conversion of Russian rubles into foreign currencies and establish requirements for conversion of foreign currency sales to Russian rubles.

Inflation – The Russian economy has been characterized by relatively high rates of inflation. The following table summarizes the annual rate of inflation for the past three years:

For the years ended December 31,	Annual inflation
2005	10.9%
2004	11.7%
2003	12.0%

The Company's principal inflation rate risk relates to the Company's ability to raise tariffs for tickets sold in Russia in line with the growth in operating expenses expressed in Russian rubles caused by inflation.

3. PRESENTATION OF FINANCIAL STATEMENTS

Basis of presentation – The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (“IFRS”). The consolidated financial statements are presented in millions of US Dollars, except where it specifically noted otherwise.

All significant subsidiaries directly or indirectly controlled by the Company are included in the consolidated financial statements. A listing of the Group's principal subsidiary undertakings is set out in Note 1.

The Group maintains its accounting records in Russian rubles and in accordance with Russian accounting legislation and regulations. The accompanying consolidated financial statements are based on the underlying accounting records, appropriately adjusted and reclassified for fair presentation in accordance with the standards prescribed by the International Accounting Standards Board.

Functional and presentation currency – The functional and presentation currency of the Company is US Dollars. Transactions and balances not already measured in US Dollars have been remeasured to US Dollars in accordance with International Accounting Standard (“IAS”) 21 “The Effect of Changes in Foreign Exchange Rates”.

The Russian ruble is not a freely convertible currency outside the Russian Federation and accordingly any conversion of Russian ruble amounts to US Dollars should not be considered as a representation that Russian ruble amounts have been, could be or will be in the future, converted into US dollars at the exchange rate shown or at any other exchange rate.

The assets and liabilities, both monetary and non-monetary, of the subsidiaries of the Company with functional currencies other than US dollar have been translated at the closing rate at the date of each balance sheet presented; income and expense items for all periods presented have been translated at the exchange rates existing at the dates of the transactions or a rate that approximates the actual exchange rates. All exchange differences resulting from translation have been classified as equity and transferred to the Group's translation reserve.

4. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS AND OTHER CHANGES IN ACCOUNTING POLICIES

The following new or revised standards and interpretations issued by International Accounting Standards Board became effective for the Group's 2005 annual financial statements:

- IAS 1 (revised) "Presentation of Financial Statements"
- IAS 2 (revised) "Inventories"
- IAS 8 (revised) "Accounting Policies, Changes in Accounting Estimates and Errors"
- IAS 10 (revised) "Events after the Balance Sheet Date"
- IAS 16 (revised) "Property, Plant and Equipment"
- IAS 17 (revised) "Leases"
- IAS 21 (revised) "Effect of Changes in Foreign Exchange Rates"
- IAS 24 (revised) "Related Party Disclosures"
- IAS 27 (revised) "Consolidated and Separate Financial Statements"
- IAS 28 (revised) "Investments in Associates"
- IAS 31 (revised) "Interests in Joint Ventures"
- IAS 32 (revised) "Financial Instruments: Disclosure and presentation"
- IAS 33 (revised) "Earnings per Share"
- IAS 36 (revised) "Impairment of Assets"
- IAS 38 (revised) "Intangible Assets"
- IAS 39 (revised) "Financial Instruments: Recognition and Measurement"
- IAS 40 (revised) "Investment Property"
- IFRS 2 "Share-based Payments"
- IFRS 3 "Business Combinations"
- IFRS 4 "Insurance Contracts"
- IFRS 5 "Non-current Assets Held for Sale"
- IFRIC 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities"
- IFRIC 2 "Members' Shares in Co-operative Entities and Similar Instruments"

IAS 27 (revised) "Consolidated and Separate Financial Statements" – This requires minority interests in equity of subsidiaries to be presented on the balance sheet within equity, but separate from shareholders' equity; and profit for the year allocated between minority interest and equity holders of the parent company. Accordingly, the Group's prior year financial statements were restated to reflect the new presentation of minority interests. Before the adoption of IAS 27 (revised) minority interests were deducted in arriving at the Group's net income and presented as a separate line on the balance sheet between liabilities and shareholders' equity.

IAS 39 (revised) "Financial Instruments: Recognition and Measurement" – IAS 39 (revised) eliminated the option to recognize in income statement gains and losses from remeasurement to fair value of available-for-sale financial assets. Such gains and losses are now recognized in equity until the related asset is sold or otherwise disposed of. As a result of this change in accounting policy the net profit for the year ended December 31, 2005 has been increased by USD 3.2 million and the opening balance of retained earnings as of January 1, 2004 decreased by USD 10.1 million. The effect on basic and diluted earnings per share for the year ended December 31, 2005 is an increase of USD 0.003 per share. The effect on basic and diluted earnings per share for the year ended December 31, 2004 was insignificant.

Following the adoption of IAS 1 (revised) and public comments by the International Financial Reporting Interpretations Council ("IFRIC") the Group changed its classification of certain items of income and expense such as gains/losses from disposal and impairment of property, plant and equipment and other similar items. Such items are now included in arriving at the Group's operating result. Comparative information has been restated to comply with current year's presentation.

Except for the presentational changes described above, the adoption of the new or revised standards and interpretations has not resulted in significant changes to the Group's accounting policies. Certain additional disclosures were provided by the Group as required by the new standards.

At the date of authorization of these financial statements, the following new standards and interpretations were in issue but not yet effective:

IFRS 6 "Exploration for and Evaluation of Mineral Resources"

IFRS 7 "Financial Instruments: Disclosures"

IAS 39 Amendments: "The Fair Value Option", "Hedges of Forecast Intragroup Transactions", "Financial Guarantee Contracts"

IAS 19 (revised) "Employee Benefits"

IFRS 4 Amendment "Financial Guarantee Contracts"

IFRIC 4 "Determining whether an Arrangement contains a Lease"

IFRIC 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds"

IFRIC 6 "Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment"

IFRIC 7 "Applying the Restatement Approach under IAS 29"

IFRIC 8 "Scope of IFRS 2"

IFRIC 9 "Reassessment of Embedded Derivatives"

The Group's management anticipates that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group.

The Group has changed its accounting policy in respect of borrowing costs as described below.

Borrowing costs – Before 2005 the Group capitalized the borrowing costs that were directly attributable to the acquisition, construction or production of a qualifying asset, as part of the cost of that asset. During 2005 the Group changed its accounting policy in respect of the recognition of borrowing costs. From 2005 all borrowing costs are recognized as an expense in the period in which they are incurred. Management believes that this treatment will result in a less judgmental treatment and a more transparent presentation of the Group's finance costs. Had the Group continued to apply the previous accounting policy the borrowing costs of approximately USD 5.6 million would be capitalized as part of capital expenditure within property, plant and equipment and the basic and diluted earnings per share would increase by USD 0.005 per share. The impact on amounts reported in the prior years is not material.

5. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below.

Consolidation – The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) prepared through December 31 each year. Subsidiaries comprise entities in which the Company, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over their operations. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

Subsidiaries are consolidated from the date on which effective control is obtained by the Group and are no longer consolidated from the date of disposal or loss of control.

All intra-group transactions, balances and unrealized surpluses and deficits on transactions between Group companies are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets and liabilities recognized. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Business combinations – The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 are recognized at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 "Non-Current Assets Held for Sale and Discontinued Operations", which are recognized and measured at fair value less costs to sell.

The 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 their accounting policies into line with those used by other members of the Group.

Investments in associates – Associates in which the Group has significant influence but not a controlling interest are accounted for using the equity method of accounting. Significant influence is usually demonstrated by the Group's owning, directly or indirectly, between 20 percent and 50 percent of the voting share capital or by exerting significant influence through other means.

Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. The Group's share of the net income or losses of associates is included in the consolidated income statement. An assessment of investments in associates is performed when there is an indication that the asset has been impaired or that the impairment losses recognized in prior years no longer exist. Losses of an associate in excess of the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate) are not recognized.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate. A listing of the Group's principal associated undertakings is shown in Note 1.

Foreign currency translation – Transactions in currencies other than the functional currency are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in such currencies at the balance sheet date are translated into the functional currency at the year-end exchange rate. Exchange differences arising from such translation are included into the consolidated income statement.

Non-current assets and disposal groups held for sale – Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Any liabilities related to non-current assets to be sold are also presented on a separate line in liabilities on the balance sheet.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of the assets' previous carrying amount and fair value less costs to sell.

Revenues recognition – Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of sales related taxes.

Passenger revenue: Ticket sales are reported as traffic revenue when the transportation service has been provided. The value of tickets sold and still valid but not used by the balance sheet date is reported as unearned transportation revenue. This item is reduced either when the Group completes the transportation service or when the passenger requests a refund. Sales representing the value of tickets that have been issued, but which will never be used, are recognized as operating income at the date the tickets are issued based on analysis of historic patterns of actual sales data. Commissions which are payable to the sales agents are recognized as the commercial and marketing expenses at the same time as revenue from the air transportation to which they refer to.

Passenger revenue includes revenue from code-share agreements with certain other airlines. Under these agreements, the Group sells seats on these airlines' flights and those other airlines sell seats on the Group's flights. Revenue from the sale of code-share seats on other airlines are recorded net in Group's passenger revenue in the consolidated income statement. The revenue from other airlines' sale of code-share seats on our flights is recorded in passenger revenue in the Group's consolidated income statement.

Cargo revenue: Group's cargo transport services are recognized as revenue when the air transportation is provided. Cargo sales for which transportation service has not yet been provided are shown as unearned transportation revenue.

Catering revenue: Revenues are recognized when meal package are delivered to the aircraft, as this is the date when the risks and rewards of ownership are transferred to the customers.

Other revenue: Sales of hotel accommodation are recognized when the services are provided. Sales of goods and other services are recognized as revenue when the goods are delivered or the service carried out.

Segment reporting – For the purposes of segment disclosure the Group has identified the following segments:

(a) *Business segments*

The principal business segments are airline operations, airline catering, hotel operations and other. Business segment assets comprise all assets used directly in the business area's operations. Equity shares in affiliated companies, however, are presented separately. Business segment liabilities and provisions comprise all commitments that are directly attributable to the business segment's operations.

(b) *Geographic segments*

The operations of all segments are based in the Russian Federation. With respect to scheduled passenger and cargo activities, the following geographic analysis is provided:

- (i) *Geographic analysis of revenue from flights* – The analysis of revenue from scheduled flights is based upon the geographic location of the place of flight origin;
- (ii) *Geographic analysis of net assets* – The major revenue-earning assets of the Company are comprised of its aircraft fleet. Since the Company's aircraft fleet is employed flexibly across its worldwide route network, there is no suitable basis for allocating such assets and liabilities to geographic segments.

Property, plant and equipment – Property, plant and equipment are stated at cost, or appraised value, as described below. Depreciation is calculated in order to amortize the cost or appraised value (less estimated salvage value where applicable) over the remaining useful lives of the assets.

(a) *Fleet*

- (i) *Owned aircraft and engines* – Aircraft and engines owned by the Group as of December 31, 1995 were stated at depreciated replacement cost based upon external valuations denominated in US Dollars. Subsequent purchases are recorded at cost. Airclaims, an international firm of aircraft appraisers, conducted the valuation. The Group has chosen not to revalue these assets subsequent to 1995.
- (ii) *Finance leased aircraft and engines* – Where assets are financed through finance leases, under which substantially all the risks and rewards of ownership are transferred to the Group, the assets are treated as if they had been purchased outright. The Group recognizes finance leases as assets and liabilities in the balance sheet as amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. The corresponding obligation, reduced by the capital portion of lease payments made, is included in payables. Legal fees deferred over the lease term of finance leased asset. The interest element of lease payments made is included in interest expense in the income statement.
- (iii) *Capitalized maintenance costs* – The valuation of aircraft and engines as of December 31, 1995 reflected their maintenance condition, as measured on the basis of previous expenditure on major overhauls and estimated usage since the previous major overhaul. Expenditure of modernization and improvements projects that are significant in size (mainly aircraft modifications involving installation of replacement parts) subsequently are separately capitalized in the balance sheet. The carrying amount of those parts that are replaced is derecognized from the balance sheet and included in gain or loss on disposals of property, plan and equipment in the Group’s consolidated income statement. Capitalized costs of aircraft checks and major modernization and improvements projects are depreciated on a straight-line basis to the projected date of the next check or based on estimates of their useful lives. Ordinary repair and maintenance costs are expensed as incurred.
- (iv) *Depreciation* – The Group depreciates fleet assets owned or held under finance leases on a straight-line basis to the end of their estimated useful life. Salvage value for the foreign fleet is estimated as 5% of historic cost, while salvage value for Russian aircraft is zero. Engines are depreciated on a straight-line basis to the end of the useful life of the related type of aircraft. Operating lives for the Russian fleet range from 11 to 25 years; for the foreign fleet 16 to 20 years. These lives are reviewed periodically.
- (v) *Capitalized leasehold improvements* – capitalized costs that relate to the rented fleet are depreciated over the shorter of their useful life and the lease term.

(b) *Land and buildings, plant and equipment*

Property, plant and equipment are stated at historical US Dollar cost. Provision is made for the depreciation of property, plant and equipment based upon expected useful lives or, in the case of leasehold properties, over the duration of the leases using a straight-line basis. These useful lives range from 10 to 20 years. Land areas are not depreciated.

(c) *Capital expenditure*

Capital expenditures comprise costs directly related to the construction of property, plant and equipment including an appropriate allocation of directly attributable variable overheads that are incurred in construction as well as costs of purchase of other assets that require installation or preparation for their use. Depreciation of these assets, on the same basis as for other property assets, commences when the assets are put into operation. Capital expenditures are reviewed regularly to determine whether its carrying value is fairly stated and whether appropriate provision for impairment is made.

- (d) The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in the consolidated income statement

Impairment of non-current assets – At each balance sheet date, the Group reviews the carrying amounts of its non-current assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in the consolidated income statement.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (cash-generating unit) in prior years.

Lease deposits – Lease deposits represent amounts paid to the lessors of foreign aircraft, which are held as security deposits by lessors in accordance with the provisions of finance and operating lease agreements; these deposits are returned back to the Group at the end of the lease period. A part of these deposits is interest-free. Interest-free deposits have been recorded at amortized cost using an average market yield of 6.3% percent.

Operating leases – Payments under operating leases are charged to the consolidated income statement in equal annual installments over the period of the lease.

Financial instruments – Financial assets and financial liabilities carried on the balance sheet include cash and cash equivalents, marketable securities, investments, derivative financial instruments, trade and other accounts receivable, trade and other accounts payables, borrowings and notes payable. The accounting policies on recognition and measurement of these items are disclosed below in this Note.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, and gains and losses relating to a financial instrument classified as a liability are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity. Financial instruments are offset when the Group has a legally enforceable right to offset and intends to settle either on a net basis or to realize the asset and settle the liability simultaneously. The result from the realization of the financial instruments is determined based on the FIFO method.

- (a) *Credit risks*

The sale of passenger and freight transportation is largely processed through agencies that are normally linked to country-specific clearing systems for the settlement of passenger and freight sales. Clearing centers check individual agents operating outside of the Russian Federation. Individual agents operating within the Russian Federation are checked in-house.

Receivables and liabilities between major airlines, unless otherwise stipulated in the respective agreements, are settled on a bilateral basis or by settlement through a clearinghouse of the International Air Transport Association (IATA).

(b) *Fair value*

The fair value of financial instruments is determined by reference to various market information and other valuation methods as considered appropriate. At the balance-sheet date, the fair values of the financial instruments held by the Group did not materially differ from their recorded book values.

(c) *Foreign exchange risk*

The significant portion of the Group's sales and purchases are denominated in US Dollars and hence the foreign exchange risk to the Group is minimized. The majority of borrowings are denominated in US Dollars, thus further reducing foreign currency exposure in US Dollar terms. In 2005 the Group did not manage foreign exchange risk through the use of hedging instruments but rather aimed to broadly match its assets and liabilities in the different currencies to limit exposure. The Group constantly monitors changes in foreign exchange rates to minimize the level of foreign currency exposure and to identify need for hedging activities.

(d) *Interest rate risk*

The Group's main exposure to interest-rate risk is from its finance lease liabilities and short-term borrowings. In 2005 the Group did not use financial hedging instruments to hedge its exposure to the changes in interest rates, as they are not generally available on the Russian market. The Group constantly monitors changes in interest rates to minimize the level of its exposure and to identify need for hedging activities.

Cash and cash equivalents – Cash and cash equivalents consist of cash on hand, balances with banks and short-term interest-bearing accounts which are used in the day-to-day financing of the Group's airline activities.

Investments – The Group's financial assets have been classified according to IAS 39 (amended 2004) "Financial Instruments: Recognition and Measurement" into the following categories: trading securities, held-to-maturity investments, loans and other receivables, and available-for-sale investments. Investments with fixed or determinable payments and fixed maturity, which the Group has the positive intent and ability to hold to maturity, other than loans and receivables, are classified as held-to-maturity investments. Derivative financial instruments and investments acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading. All other investments, other than loans and receivables, are classified as available-for-sale.

Investments are recognized and derecognized on a trade date basis where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, plus directly attributable transaction costs.

Held-to-maturity investments are financial assets excluding derivative contracts which mature on a specified date and which a company has the firm intent and ability to hold to maturity. They are valued at allocated acquisition cost and they are included in long-term assets.

Investments other than held-to-maturity debt securities are classified as either investments held for trading or as available-for-sale, and are measured at subsequent reporting dates at fair value. Investments in equity instruments of other companies that do not have a quoted market price are stated at cost less impairment loss, as it is not practicable to determine the fair value of such investments. Where securities are held for trading purposes, gains and losses arising from changes in fair value are included in profit or loss for the period. For available-for-sale investments, gains and losses arising from changes in fair value are recognized directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is included in the profit or loss for the period. Impairment losses recognized in profit or loss for equity investments classified as available-for-sale are not subsequently reversed through profit or loss. Impairment losses recognized in profit or loss for debt instruments classified as available-for-sale are subsequently reversed if

an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss.

Results of Group's operations can be significantly impacted by changes in the price of aircraft fuel. The Group periodically purchases derivatives such as jet fuel options in order to hedge its exposure from future price fluctuations in jet fuel. The Group does not use derivatives instruments for speculative purposes. Derivative instruments are accounted for as held for trading with related gains or losses from remeasurement to fair value included in the current period consolidated income statement as other non-operating gains or losses.

The Group assesses on each closing date whether there is any objective evidence that the value of a financial asset item or group of items has been impaired. If there is objective evidence that an impairment loss has arisen for loans and other receivables entered at allocated acquisition cost in the balance sheet or for held-to-maturity investments, the size of the loss is determined as the difference of the book value of the asset item and the present value of expected future cash flows of the said financial asset item discounted at the original effective interest rate. The loss is recognized in the consolidated income statement.

Treasury shares – The Company's shares, which are held in treasury stock or belong to the Company's subsidiaries, are reflected as a reduction of the Group's shareholders' equity. The disposal of such shares does not impact net income of the current year and is recognized as a change in shareholders' equity of the Group. Dividends distributions by the Company are recorded net of the dividends related to treasury shares.

Loans and receivables – Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured at initial recognition at fair value, and are subsequently measured at amortized cost using the effective interest rate method. Because the expected term of an account receivable is short, the value is typically stated at the nominal amount without discounting, which corresponds with fair value. Uncertain accounts receivable are assessed individually and any impairment losses are stated in non-operating expenses.

Accounts payables – Trade payables are initially measured at fair value, and are subsequently measured at amortized cost, because the expected term of accounts payable is short, the value is stated at the nominal amount without discounting, which corresponds with fair value.

Short-term borrowings – Short-term borrowings comprise the short-term portion of interest-bearing long-term borrowings, i.e. the portion of the loans that is amortized in the coming year, as well as other current interest-bearing liabilities with a term shorter than one year. These liabilities are measured at amortized cost and reported on the settlement date.

Long-term borrowings – Long-term borrowings, i.e., liabilities with a term longer than one year, consist of interest-bearing loans are initially measured at fair value, and are subsequently measured at amortized cost, using the effective interest rate method, as of the settlement date.

Expendable spare parts and inventories – Inventories, including aircraft expendables, are valued at cost as determined by the "first-in, first-out" method ("FIFO") or net realizable value, whichever is lower. Inventories are reported net of provisions for slow-moving or obsolete items.

Value added taxes – Value added taxes ("VAT") related to sales are payable to the tax authorities when tickets are sold. Input VAT is reclaimable against output VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. Output VAT payable and input VAT related to purchase transactions which have not been settled at the balance sheet date are recognized in the balance sheet on a gross basis. Where provision has been made against debtors deemed to be uncollectible, a bad debt expense is recorded for the gross amount of the debtor, including VAT.

Frequent flyer program – The Company records an estimated liability for the incremental cost associated with providing free transportation under the "Aeroflot Bonus" program (see also Note 21) when a free air ticket or upgrade of service class are earned.

Principal incremental costs include aircraft fuel costs and third-party passenger services (such as catering services and airport charges). The liability is included in accounts payable and accrued liabilities, and is adjusted periodically based on awards earned, awards redeemed and changes to the “Aeroflot Bonus” program. The costs are included in sales and marketing expenses in the consolidated income statement.

Borrowing costs – All borrowing costs are recognized as an expense in the period in which they are incurred.

Provisions – Provisions are recognized when, and only when, the Group has a present obligation (legal or constructive) as a result of a past event, and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. Where the effect of the time value of money is significant, the amount of a provision is the present value of the expenditures required to settle the obligation.

Income tax – The nominal income tax rate for industrial enterprises in Russia in 2005 and 2004 was 24%. The nominal tax rate is subject to regional reductions by up to 4%. The average nominal tax rate of the Group was lower than 24% as the tax rate applicable to different entities within the Group varied from 20% to 24%.

Deferred income taxes – Deferred tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12 “Income Taxes”. IAS 12 requires the use of the balance-sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its tax assets and liabilities on a net basis.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply during the period when the asset is to be realized or the liability settled, based on tax rates that have been enacted or substantively enacted as at the balance-sheet date. As of December 31, 2005 and 2004 deferred tax assets and liabilities have been measured based on tax rates applicable to the Group’s companies range from 20% to 24%. It is charged or credited to the consolidated income statement, except when it relates to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity.

Employee benefits – The Company makes certain payments to employees on retirement, or when they otherwise leave the employment of the Company. These obligations, which are unfunded, represent obligations under a defined benefit pension plan. For such plans, the pension accounting costs are assessed using the projected unit credit method. Under this method, the cost of providing pensions is charged to the income statement in order to spread the regular cost over the average service lives of employees. Actuarial gains and losses are recognized in the income statement immediately. The pension payments may be increased upon the retirement of an employee based on the decision of management. The pension liability for non-retired employees is calculated based on a minimum annual pension payment and do not include increases, if any, to be made by management in the future. Where such post-employment employee benefits fall due more than 12 months after the balance sheet date, they are discounted using a discount rate determined by reference to the average market yields at the balance sheet date.

The Company also participates in a defined contribution plan, under which the Company has committed to contribute a certain percentage (15% to 20% in 2005) of the contribution made by employees choosing to participate in the plan. Contributions made by the Company on defined contribution plans are charged to expenses when incurred. Contributions are additionally made to the Government’s Pension fund at the statutory rates in force during the year. Such contributions expensed as incurred.

Dividends – Dividends are recognized at the date they are declared by the shareholders at a general meeting.

Retained earnings legally distributable by the Company are based on the amounts available for distribution in accordance with applicable legislation and reflected in the statutory financial statements. These amounts may differ significantly from the amounts calculated on the basis of IFRS.

Earnings per share – Earnings per share are calculated by dividing the income for the period attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. The Group does not have any potentially dilutive equity instruments.

Contingencies – Contingent liabilities are not recognized in the financial statements unless they arise as a result of a business combination. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the financial statements but are disclosed when an inflow of economic benefits is probable.

6. SIGNIFICANT ESTIMATES

The 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, are discussed below.

Provisions – Provisions are made when any probable and quantifiable risk of loss attributable to disputes is judged to exist.

Depreciable lives of property, plant and equipment – In reporting intangible assets and tangible fixed assets, an assessment is made of the useful economic life and an assessment is made at least once a year to determine whether impairment exists.

Defined benefit pensions costs – Reporting of costs for defined benefit pensions are based on actuarial estimates derived from assumptions about the discount rate, expected return on managed assets, future pay increases and inflation.

Compliance with tax legislation – As discussed further in Note 35 compliance with tax legislation, particularly in the Russian Federation, is subject to significant degree of interpretation and can be routinely challenged by the tax authorities. The management records a provision in respect of its best estimate of likely additional tax payments and related penalties which may be payable if the Group's tax compliance is challenged by the relevant tax authorities.

7. TRAFFIC REVENUE

By sector	2005	2004
Scheduled flights:		
Passengers	1,815.9	1,523.2
Cargo	155.5	134.5
Charter flights:		
Passengers	15.3	14.9
Cargo	92.6	62.9
	<u>2,079.3</u>	<u>1,735.5</u>

8. OTHER REVENUE

	<u>2005</u>	<u>2004</u>
Airline revenue agreements	357.0	343.5
Ground handling and maintenance	22.7	18.1
Catering services	26.9	14.6
Hotel revenue	14.2	12.5
Refueling services	21.2	17.3
Other revenue	18.3	17.3
	<u>460.3</u>	<u>423.3</u>

Airline revenue agreements primarily represent revenue from pooling, code-sharing and bilateral air-service agreements.

9. OPERATING COSTS

	<u>2005</u>	<u>2004</u>
Aircraft fuel	741.2	496.1
Aircraft and traffic servicing	346.4	310.0
Maintenance	202.4	203.7
Sales and marketing	142.4	125.3
Operating lease expenses	128.5	127.6
Administration and general expenses	92.6	94.8
Passenger services	75.0	52.8
Communication expenses	41.8	34.2
Insurance expenses	22.3	27.0
Increase in provisions (Note 22)	21.3	37.6
Operating taxes	17.4	24.7
Increase of provision for impairment of fixed assets (Note 20)	5.5	12.7
Other expenses	41.8	47.5
Operating expenses, subtotal	<u>1,878.6</u>	<u>1,594.0</u>
Gain on disposal of property, plant and equipment, net	(3.4)	(6.6)
Taxes refunded under court decision (i)	-	(22.3)
Operating income, subtotal	<u>(3.4)</u>	<u>(28.9)</u>
Total operating costs, net	<u>1,875.2</u>	<u>1,565.1</u>

(i) Taxes refunded under a court decision in 2004 comprise a road users tax refund for the years 1998-2000.

10. STAFF COSTS

	<u>2005</u>	<u>2004</u>
Wages and salaries	291.8	251.8
Social security costs	14.1	13.0
Pension costs (i)	36.4	36.1
	<u>342.3</u>	<u>300.9</u>

The Company continued its participation in a non-government pension fund to provide additional pensions to certain of its employees upon their retirement. The pension fund requires contributions from both employees and the Company, and is a defined contribution pension plan for the employer.

Furthermore, the Company makes payments, upon retirement, to employees participating in the plan with one or more years' service. These obligations, which are unfunded, represent obligations under a defined benefit pension plan.

Pension costs include compulsory payments to the Pension fund of the Russian Federation ("RF"), contributions to a non-government pension fund and an increase in the net present value of the future benefits the Company expects to pay to its employees upon their retirement under a defined benefit pension plan, as follows:

	<u>2005</u>	<u>2004</u>
Payments to the Pension Fund of the RF	34.4	33.3
Defined benefit pension plan	1.7	2.5
Defined contribution pension plan	0.3	0.3
	<u>36.4</u>	<u>36.1</u>

11. INTEREST EXPENSE

	<u>2005</u>	<u>2004</u>
Finance leases	13.8	6.7
Short-term and long-term borrowings	11.5	5.3
	<u>25.3</u>	<u>12.0</u>

12. NON-OPERATING INCOME, NET

	<u>2005</u>	<u>2004</u>
Recovery of VAT paid in prior years (i)	29.0	-
Fines and penalties received from suppliers	11.9	6.0
Gain on derivatives (ii)	11.1	-
Restructuring and settlement of tax penalties (iii)	8.6	-
Insurance compensation	3.4	4.2
Gain (loss) from disposal of investments, net	3.7	(1.6)
Discounts received	(0.2)	4.8
Negative goodwill on acquisition (Note 33)	-	5.7
Reversal of payables no longer due	-	2.8
Increase of provision for long-term investments (iv)	-	(5.6)
Other (loss) income, net	(5.3)	7.8
	<u>62.2</u>	<u>24.1</u>

- (i) In 2005 the Company recorded a gain from recovery of VAT paid in prior years in the amount of USD 29.0 million relating to change in accounting for VAT on export cargo transportation services provided in 2003, 2004 and in the first half of 2005 based on adjusted tax returns for the respective previous periods filed with the tax authorities.
- (ii) In 2005 the Company purchased two jet fuel options to hedge its exposure to changes of aircraft fuel prices. The gain from exercise of these options accounted to USD 11.1 million during the year. The Company did not own any derivatives as of December 31, 2005.
- (iii) Restructuring and settlement of tax penalties amounting to USD 8.6 million represents a waiver received in respect of tax penalties relating to payments of income tax which were accrued for the period from 1997 to 2001.
- (iv) In 2004 the Company accrued 100% impairment reserve for a carrying value of investments in associates LLC "Aeroimp" and CJSC "TZK" due to discontinuation of their operations.

13. TAXATION

	<u>2005</u>	<u>2004</u>
Current income tax charge	(58.4)	(71.5)
Deferred income tax (expense) benefit	<u>(30.6)</u>	<u>12.5</u>
	<u>(89.0)</u>	<u>(59.0)</u>

Income before taxation for financial reporting purposes is reconciled to taxation as follows:

	<u>2005</u>	<u>2004</u>
Income before taxation	<u>278.8</u>	<u>231.1</u>
Theoretical tax at statutory rate (24%)	(66.9)	(55.5)
Tax effect of items which are not deductible or assessable for taxation purposes:		
Effect of lower tax rates applied	8.9	8.7
Non-deductible expenses	(29.5)	(17.8)
Non-taxable income	8.3	4.6
Deferred tax charged to equity	(0.9)	0.6
Other permanent differences	1.1	(2.0)
Prior period current tax adjustments	(10.0)	-
Effect of change in calculation of prior year deferred tax	-	2.4
Taxation	<u>(89.0)</u>	<u>(59.0)</u>

Differences between IFRS and Russian statutory taxation regulations give rise to certain temporary differences between the carrying values of certain assets and liabilities for financial reporting purposes and their values for profits tax purposes. The tax effect of the movement on these temporary differences is recorded at the tax rates applicable to the Group's companies and range from 20% to 24% for the years ended December 31, 2005 and 2004.

	<u>2005</u>	<u>Movement for year</u>	<u>2004</u>	<u>Movement for year</u>	<u>Effect of acquisition (Note 33)</u>	<u>2003</u>
Tax effects of temporary differences:						
Property, plant and equipment	1.9	(1.2)	3.1	1.0	-	2.1
Borrowings	3.1	-	3.1	(1.6)	-	4.7
Accounts payable	-	(0.2)	0.2	0.2	-	-
Deferred tax assets, net	<u>5.0</u>		<u>6.4</u>			<u>6.8</u>
Property, plant and equipment	(36.1)	(9.8)	(26.3)	3.7	(2.3)	(27.7)
Long-term investments	(13.6)	0.3	(13.9)	-	-	(13.9)
Accounts receivable	(0.9)	1.9	(2.8)	(0.3)	-	(2.5)
Accounts payable	14.1	(0.7)	14.8	5.6	-	9.2
Deferred revenue	-	(20.0)	20.0	3.3	-	16.7
Deferred tax liabilities, net	<u>(36.5)</u>		<u>(8.2)</u>			<u>(18.2)</u>
		<u>(29.7)</u>		<u>11.9</u>	<u>(2.3)</u>	

14. CASH AND CASH EQUIVALENTS

	<u>2005</u>	<u>2004</u>
Ruble denominated bank accounts	34.3	31.0
Bank accounts denominated in USD	17.4	9.2
Bank accounts denominated in Euros	3.4	5.4
Bank accounts denominated in other currencies	5.7	7.9
Bank deposits	43.8	10.1
Cash in transit and other	5.0	1.6
	<u>109.6</u>	<u>65.2</u>
Cash and cash equivalents classified within assets of disposal group	(8.5)	-
	<u>101.1</u>	<u>65.2</u>

Bank deposits are comprised primarily of term deposits with original maturities less than 90 days. As of December 31, 2005 short-term bank deposit balances denominated in US Dollars bore interest between 4.25 and 6.5 percent per annum. RUR balances have been invested at interest rates between 4.5 and 8.0 percent per annum. In 2004 the Company placed cash in a short-term bank deposit at the interest rate of 7.25 percent per annum.

15. SHORT-TERM INVESTMENTS

	<u>2005</u>	<u>2004</u>
Available-for-sale investments		
Corporate and government bonds	2.2	4.0
Corporate shares	3.2	0.3
	<u>5.4</u>	<u>4.3</u>
Other short-term investments		
Promissory notes from third parties	3.3	3.8
Bank deposits with original maturities exceeding 90 days	21.7	12.4
Other short-term investments	0.1	0.1
	<u>25.1</u>	<u>16.3</u>
	<u>30.5</u>	<u>20.6</u>

Corporate and government bonds represent bonds denominated in Russian rubles issued by the Government of the Russian Federation and major Russian companies with maturity dates from 2006 to 2014 and yield to maturity of 5.82–9.05 percent as of December 31, 2005.

Corporate shares are liquid publicly traded shares of Russian companies.

In the consolidated financial statements of the Group investments in bonds and shares are reflected at period-end market value based on last traded prices obtained from the Moscow Interbank Currency Exchange (“MICEX”).

The effective interest rate on bank deposits with original maturities exceeding 90 days as of December 31, 2005 and 2004 was 6.5 percent per annum for US dollars denominated deposits. Deposits denominated in Russian roubles have been invested at average interest rates of 7.5 and 6.5 percent per annum as of December 31, 2005 and 2004, respectively.

16. ACCOUNTS RECEIVABLE AND PREPAYMENTS, NET

	<u>2005</u>	<u>2004</u>
Trade receivables	232.7	203.7
Prepayments and accrued income	49.0	60.2
Other receivables	14.5	9.3
Provision for bad and doubtful accounts	<u>(18.3)</u>	<u>(32.7)</u>
	278.5	240.5
Income tax prepaid	4.8	6.6
VAT and other taxes recoverable, other than income tax	<u>285.4</u>	<u>201.2</u>
	<u>568.1</u>	<u>448.3</u>

17. EXPENDABLE SPARE PARTS AND INVENTORIES

	<u>2005</u>	<u>2004</u>
Expendable spare parts	25.6	27.3
Fuel	18.0	20.3
Other inventory	<u>17.8</u>	<u>16.9</u>
	<u>61.4</u>	<u>64.5</u>

18. EQUITY ACCOUNTED INVESTMENTS, NET

	<u>2005</u>		<u>2004</u>	
	<u>Voting power</u>	<u>Carrying value</u>	<u>Voting power</u>	<u>Carrying value</u>
CJSC "Aerofirst"	33.3%	4.4	33.3%	5.4
CJSC "TZK Sheremetyevo"	31%	3.5	31%	1.3
CJSC "AeroMASH – AB"	45%	1.1	45%	-
CJSC "TZK"	31%	0.1	31%	1.3
LLC "Aeroimp"	25%	3.5	25%	5.3
LLC "Airport Moscow"	50%	2.9	50%	1.2
OJSC Severleasing	25.5%	0.9	25.5%	0.9
Other	Various	1.2	Various	1.4
Less accumulated impairment		<u>(3.6)</u>		<u>(6.6)</u>
		<u>14.0</u>		<u>10.2</u>

	<u>2005</u>	<u>2004</u>
Cost of investment in associates, net of accumulated impairment	9.6	9.6
Share of post-acquisition profit, net of dividend received	<u>4.4</u>	<u>0.6</u>
	<u>14.0</u>	<u>10.2</u>

Summarized financial information in respect of the Group's affiliates accounted by using equity method based on their respective financial statements prepared for the years ended December 31, 2005 and 2004 is set out below:

	<u>2005</u>	<u>2004</u>
Total assets	100.6	94.9
Total liabilities	<u>(52.2)</u>	<u>(52.0)</u>
Net assets	<u>48.4</u>	<u>42.9</u>

	<u>2005</u>	<u>2004</u>
Group's share of associates' net assets	17.6	16.8
Impairment provision	<u>(3.6)</u>	<u>(6.6)</u>
	<u>14.0</u>	<u>10.2</u>
Revenue	578.8	322.0
Income for the year	<u>11.7</u>	<u>13.4</u>
Group's share of associates' income for the year	<u>5.7</u>	<u>3.5</u>

19. LONG-TERM INVESTMENTS, NET

	<u>2005</u>	<u>2004</u>
Available-for-sale investments		
SITA Investment Certificates	0.8	1.0
Corporate shares (France Telecom)	12.8	17.1
Mutual investment funds	<u>1.9</u>	<u>0.9</u>
	15.5	19.0
Other long-term investments		
Loans and promissory notes from related parties	0.4	-
Loans and promissory notes from third parties	0.6	0.4
Other	<u>0.3</u>	<u>1.0</u>
	1.3	1.4
	<u>16.8</u>	<u>20.4</u>

20. PROPERTY, PLANT AND EQUIPMENT

	<u>Owned aircraft and engines</u>	<u>Leased aircraft and engines</u>	<u>Land and buildings</u>	<u>Plant, equipment and other</u>	<u>Capital expenditure (i), (vi)</u>	<u>Total</u>
Cost						
December 31, 2003	465.9	487.7	168.3	179.8	36.4	1,338.1
Foreign currency translation	1.3	0.1	0.6	0.8	-	2.8
Acquisition of net assets of OJSC "Arkhangelskie Avialinii"	8.9	2.6	2.6	1.5	-	15.6
Additions	32.4	204.0	7.5	7.5	31.4	282.8
Capitalized costs	18.0	2.3	-	-	5.6	25.9
Transfers	-	-	0.4	11.8	(12.2)	-
Disposals	<u>(43.9)</u>	<u>(249.9)</u>	<u>(0.2)</u>	<u>(12.2)</u>	<u>(6.9)</u>	<u>(313.1)</u>
December 31, 2004	482.6	446.8	179.2	189.2	54.3	1,352.1
Foreign currency translation	(0.8)	(0.1)	(0.4)	(0.5)	(1.4)	(3.2)
Additions (ii)	29.3	1.5	3.3	16.9	112.3	163.3
Capitalized costs (iv)	24.0	16.8	-	-	-	40.8
Transfers (iv)	10.5	5.2	-	3.6	(19.3)	-
Disposals (iii)	(53.6)	(80.7)	(0.3)	(13.9)	(11.0)	(159.5)
Reclassified as held for sale (i)	-	-	-	-	(67.6)	(67.6)
December 31, 2005	<u>492.0</u>	<u>389.5</u>	<u>181.8</u>	<u>195.3</u>	<u>67.3</u>	<u>1,325.9</u>

	Owned aircraft and engines	Leased aircraft and engines	Land and buildings	Plant, equipment and other	Capital expenditure (i), (vi)	Total
Accumulated Depreciation and Impairment						
December 31, 2003	(352.6)	(228.1)	(52.2)	(122.4)	-	(755.3)
Foreign currency translation	(0.6)	-	(0.2)	(0.5)	-	(1.3)
Impairment for the year (v)	(1.1)	-	-	(11.6)	-	(12.7)
Charge for the year	(43.7)	(26.7)	(8.2)	(15.4)	-	(94.0)
Disposals	34.9	184.3	0.1	9.3	-	228.6
December 31, 2004	(363.1)	(70.5)	(60.5)	(140.6)	-	(634.7)
Foreign currency translation	0.2	-	0.1	0.4	-	0.7
Impairment for the year (v)	(4.9)	-	-	0.5	(1.1)	(5.5)
Charge for the year	(35.7)	(22.2)	(9.1)	(13.0)	-	(80.0)
Disposals (iii)	49.3	60.3	0.1	10.6	-	120.3
December 31, 2005	(354.2)	(32.4)	(69.4)	(142.1)	(1.1)	(599.2)
Net Book Value						
December 31, 2004	119.5	376.3	118.7	48.6	54.3	717.4
December 31, 2005	137.8	357.1	112.4	53.2	66.2	726.7

As of December 31, 2005 and 2004, fixed assets, principally Russian aircraft and engines, with a net book value of USD 8.3 million and USD 24.2 million, respectively, were pledged as collateral under loan agreements (Notes 24 and 25).

- (i) Assets under construction include capital expenditures made by the Company on the construction of the new Sheremetyevo-3 terminal. Capital expenditures as of December 31, 2005 and 2004 amount to USD 67.6 million and USD 17.9 million, respectively, and mainly relate to pre-constructions studies and construction-site preparation work. Following the decision to dispose of 70% in the equity of OJSC Terminal during 2005 the assets and liabilities of this subsidiary and other assets related to the construction of the new terminal were reclassified as held for sale in accordance with IFRS 5 “Non-current Assets Held for Sale and Discontinued Operations”.
- (ii) In 2005 the Group put into operation three Tupolev Tu-154 aircraft. Two of the above mentioned aircraft were acquired in 2004 and as of December 31, 2004 have been included in capital expenditures in the amount of USD 7.5 million.
- (iii) In 2005 the Company returned to a lessor one Airbus A-310 aircraft, which was subject to finance leases. Gain from early termination of finance lease contract was recorded in the consolidated income statement in amount of USD 7.5 million. In the second half of 2005 the Company’s subsidiary, OJSC “Aeroflot-Don, sold two Antonov An-12 aircraft.
- (iv) Of the total costs of USD 24.0 million capitalized during 2005 in respect of owned aircraft and engines USD 20.7 million related to regular checks and modernization of engines and USD 3.3 million related to the aircraft overhauls. Transfers from capital expenditure account primarily relate to replacements of rotables. Additions to leased aircraft and engines represent leasehold improvements relating to Boeing 767-300 aircraft held under operating leases. In 2005 the Company has continued the program of modernization of the interiors of these aircraft and finished the modernization of seven aircraft. Total capitalized expenses incurred as a result of this modernization as of December 31, 2005 amounted to USD 24.3 million, including USD 7.5 million capitalized in 2004 and partly shown as transfer from capital expenditure.

- (v) As of December 31, 2004 the Group reviewed the carrying amounts of its fixed assets to determine whether there is any indication that those assets had suffered an impairment loss. As a result the Group recognized an impairment loss of USD 12.7 million in 2004. Also additional amount of impairment loss of USD 5.5 million was recognized in 2005.
- (vi) In 2005 the Company made prepayment for delivery of seven Airbus A-321 aircraft, which will be acquired by the Company on finance leases terms in the amount of USD 34.9 million recorded in capital expenditures as of December 31, 2005. Delivery of first of the aircraft is expected in the fourth quarter of 2006.

21. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	<u>2005</u>	<u>2004</u>
Trade payables and accruals	179.1	168.8
Income tax payable	42.0	19.0
Wages and social contributions payable	40.4	44.7
Other payables	16.6	21.0
Advances received	11.3	6.4
Taxes payable (other than income tax)	9.6	12.9
Merchandise credits (ii)	8.5	2.3
Frequent flyer program liability (i)	7.8	7.7
Accrued expenses	5.8	14.8
Dividends payable	2.7	2.8
Notes payable	2.0	1.6
	<u>325.8</u>	<u>302.0</u>

- (i) The Group introduced the “Aeroflot Bonus” frequent flyer program in 1999. As of December 31, 2005 and 2004 approximately 442 thousand and 326 thousand passengers, respectively, participated in the program. Frequent flyer program liability as of December 31, 2005 and 2004 represents incremental costs, which are included in sales and marketing expenses, associated with providing free transportation under “Aeroflot Bonus” program.

22. PROVISIONS

	<u>2005</u>	<u>2004</u>
Beginning of the year	67.3	29.5
Additional provision in the year	42.9	45.2
Utilization of provision	-	(0.7)
Release of provision	(21.6)	(6.7)
End of the year	<u>88.6</u>	<u>67.3</u>
Analyzed as:		
Current liabilities	7.2	-
Non-current liabilities	81.4	67.3
	<u>88.6</u>	<u>67.3</u>

The Group is a defendant in various legal actions. Provisions represent management’s best estimate of the Group’s probable losses relating to various actual and potential legal claims.

The Company is a defendant in a claim by the owner of a cargo plane which crashed in Italy in October 1996, whilst on charter to the Group. The basis of the claim concerns liability for the loss of the aircraft and the responsibilities of the parties at the time of the crash. According to a report prepared by Airclaims, compensation relating to crashed aircraft ranges from USD 11.8 million to USD 15.3 million. Management had made their best assessment of the likely outcome associated

with this issue and recorded a provision amounting to USD 12.0 million as of December 31, 2003. In April 2005 the Arbitration court has decided in favor of the claimant regarding compensation and awarded damages amounting to USD 35.0 million, accordingly the reserve was increased to USD 35.0 million. The provision amounting USD 35.0 million has been included in consolidated financial statements as of December 31, 2005 and 2004. Currently, there is uncertainty regarding final resolution. At the present time execution of the court decision is suspended and the Company has filed an appeal. Final adjustments (if any) to this uncertainty will be made in the financial statements when the outcome of the issue is known.

In 2001 Federal Unitary Entity, Goscorporation OVD claimed the agreement with Federal Aviation Service on application of a 50 percent discount in 1997-1998 to be void, as this contradicted Russian legislation and invoiced the Company for approximately USD 7.2 million for underpaid amounts relating to 1997-1998 and interest accrued as of December 31, 2004. This amount is included in provisions as of December 31, 2005 and 2004 in full and is presented as a current liability as of December 31, 2005.

23. OTHER NON-CURRENT LIABILITIES

	<u>2005</u>	<u>2004</u>
Defined benefit pension obligation – non-current portion	10.5	12.7
Other non-current liabilities	-	10.5
	<u>10.5</u>	<u>23.2</u>

24. SHORT-TERM BORROWINGS

	<u>2005</u>	<u>2004</u>
Loans and credit lines in USD		
West LB AG (Germany) (i)	60.2	10.0
Sberbank of the Russian Federation (ii)	-	27.0
Amsterdam Trading Bank – current portion (Note 25)	0.4	0.9
Loans in Russian rubles		
Vneshtorgbank (iii)	-	31.9
Transkreditbank (iii)	39.4	5.4
Other short-term bank loans	0.9	3.2
	<u>100.9</u>	<u>78.4</u>

- (i) The balance as of December 31, 2005 represented short-term portion of a credit line amounting to USD 60.2 million and bears interest of LIBOR + 2.3 percent per annum. The effective average interest rate for 2005 was 5.7 percent per annum.
- (ii) The credit line granted by the Sberbank of the Russian Federation amounting to USD 27 million. The credit was obtained to finance its current activities and bears interest of LIBOR + 3.5 percent per annum. Fixed assets with a net book value of USD 9.6 million are pledged as a collateral under this loan agreement. The effective average interest rate for 2005 was 6.0 percent per annum. During 2005 the loan was repaid in full.
- (iii) The amounts represent the net balance due under a series of short-term security sale and repurchase agreements bearing interest rates of between 7 and 9 percent.

25. LONG-TERM BORROWINGS

	<u>2005</u>	<u>2004</u>
Loans in USD		
West LB Vostok (i)	30.0	-
West LB AG (Germany) (ii)	30.0	-
Amsterdam trading Bank (iii)	8.0	8.0
Amsterdam trading Bank (iv)	2.6	3.0
Accor	2.5	2.4
Other long-term bank loans	2.9	2.8
	<u>76.0</u>	<u>16.2</u>

- (i) The balance as of December 31, 2005 consists of a credit line amounting to USD 30.0 million and bears interest of LIBOR + 1.9 percent per annum. The effective average interest rate for 2005 was 6.05 percent per annum. The loan is due to be repaid by April 2007.
- (ii) The balance as of December 31, 2005 represented long-term portion of a credit line amounting to USD 30.0 million and bears interest of LIBOR + 2.3 percent per annum. The effective average interest rate for 2005 was 5.7 percent per annum. The loan was due to be repaid by December 2007. As described in Note 36 to these financial statements this loan was fully repaid by the Company in May 2006.
- (iii) The loan amounting to USD 8 million bears interest of 8.5 percent per annum and is payable by December 1, 2009. The loan was obtained by the Company to finance the purchase of property, plant and equipment with a net book value of USD 5.2 million which were pledged as collateral under this agreement. The effective average interest rate for 2005 was 8.5 percent per annum.
- (iv) Long-term portion of the loan amounting to USD 2.5 million is payable by June 8, 2009 and bears interest of 8.0 percent per annum. The loan was obtained by the Company to finance the purchase of fixed assets. Fixed assets with a net book value of USD 3.1 million are pledged as collateral under this agreement. The effective average interest rate for 2005 was 8.0 percent per annum.

The borrowings are repayable as follows:

	<u>2005</u>	<u>2004</u>
On demand or within one year	100.9	78.4
In the second year	60.0	-
In the third year	-	-
In the fourth year	10.6	11.1
In the fifth year	-	-
After five years	5.4	5.1
Total	176.9	94.6
Less: amounts due to settlement within 12 months	<u>(100.9)</u>	<u>(78.4)</u>
Amounts due for settlement after 12 months	<u>76.0</u>	<u>16.2</u>

26. FINANCE LEASES PAYABLE

The Group leases aircraft under finance lease agreements. Leased assets are listed in Note 1 above.

	<u>2005</u>	<u>2004</u>
Total outstanding payments	350.1	407.8
Finance charge	(42.7)	(50.5)
Principal outstanding	307.4	357.3
Representing:		
Short-term lease payable	<u>26.1</u>	<u>53.0</u>
Long-term lease payable	<u>281.3</u>	<u>304.3</u>

	<u>2005</u>	<u>2004</u>
Due for repayment (principal and finance charge):		
2005	-	60.5
2006	33.6	31.3
2007	31.3	30.9
2008	31.6	31.5
2009	32.2	32.2
2010	32.9	32.9
After 2010	188.5	188.5
	<u>350.1</u>	<u>407.8</u>

Interest unpaid as of December 31, 2005 and 2004 was approximately USD 1.1 million and USD 1.3 million, respectively, and has been included in accrued expenses. In 2005 and 2004 the effective interest rate on these leases approximated 4.1 and 2.7 percent per annum, respectively.

In 2004 the Company obtained one Airbus A-320 aircraft and three Airbus A-321 aircraft under finance leases, that are reflected in short-term and long-term lease liabilities in the amounts of USD 12.3 million and USD 175.8 million, respectively.

In 2005 the Company returned to a lessor one Airbus A-310 which resulted in termination of a related finance lease agreement. At the date of termination the net book value of this aircraft was USD 19.4 million. The short-term finance lease liability decreased by USD 26.8 million, thus producing a gain of USD 7.5 million included in gain on disposal of property, plant and equipment.

The Company's aircraft leases are subject to both positive and negative covenants. In accordance with those covenants, the Company maintains insurance coverage for its leased aircraft.

27. SHARE CAPITAL

	<u>Number of shares authorised and issued</u>	<u>Number of shares in treasury stock</u>	<u>Number of shares outstanding</u>
Ordinary shares of one Russian ruble each:			
As of December 31, 2004	1,110,616,299	(51,321,913)	1,059,294,386
As of December 31, 2005	1,110,616,299	(50,198,379)	1,060,417,920

Ordinary shareholders are allowed one vote per share.

In 2003 one of the subsidiaries of the Group acquired 10,000 of the Company's shares, which were resold in 2004. During 2004 the Group increased the number of the Company's shares held by the Group by 51,311,913, including 36,913 its own shares acquired by the Company itself. During 2005 the number of treasury shares held by the Group decreased by 1,123,534.

The Company's shares are listed on the Russian Trade System ("RTS") and MICEX and as of May 24, 2006 were traded at RUR 45.26 per share.

The Company launched a Level 1 Global Depositary Receipts (GDR) program in December 2000. The Company signed a depositary agreement with Deutsche Bank Group, allowing the Company's shareholders to swap their shares for GDR's, which trade over-the-counter on US and European markets. The swap ratio was established at 100 shares per GDR. Per depositary agreement the total volume of GDR of the Company cannot exceed 20 percent of the Company's share capital. In 2001, the Company's GDR's were listed on the NEWEX (New Europe Exchange) stock exchange in Vienna and after closing

of this exchange the GDR's were transferred to the third segment of the stock exchange in Frankfurt. The Company's GDR's were traded at USD 140 as of May 24, 2006.

28. RETAINED EARNINGS

The statutory accounting reports of the Group companies are the basis for profit distribution and other appropriations. For the years ended December 31, 2005 and 2004, the statutory profits of the Company, as reported in the published annual statutory financial statements, were 6,032 million Russian rubles and 6,330 million Russian rubles, respectively.

For the years ended December 31, 2005 and 2004 the shareholders of the Company approved dividends totaling 777.4 million and 485.3 million Russian rubles, respectively (USD 28.0 million and USD 16.4 million at 2005 and 2004 year-end exchange rates, respectively).

In respect of 2005, the Board of Directors recommended to approve dividends of RUR 0.82 per share (approximately 3 cents per share) which will be paid to shareholders between June 19 and August 16, 2006. This dividend is subject to approval by shareholders at the annual shareholders' meeting and has not been recognized as a liability in these financial statements.

29. SEGMENT INFORMATION

The Group is organized into three main segments:

- Airline – domestic and international passenger and cargo air transport and other airline services;
- Catering – the preparation of food and beverages for air travel;
- Hotels – the operation of hotels.

All operations are based in the Russian Federation; therefore no geographical segment information is disclosed.

Details of the geographical breakdown of revenues from scheduled passenger and cargo airline activities are as follows:

By region	2005	2004
a) Scheduled passenger revenue		
International flights from Moscow to:		
Europe	376.8	335.0
Asia	171.5	135.6
North America	68.8	67.8
Other	13.6	49.3
International flights to Moscow from:		
Europe	383.3	342.4
Asia	182.4	142.2
North America	66.0	65.3
Other	12.7	49.5
Other international flights	45.2	4.0
Domestic flights	495.6	332.1
	1,815.9	1,523.2

	<u>2005</u>	<u>2004</u>
b) Scheduled cargo revenue		
International flights from Moscow to:		
Europe	10.0	8.5
Asia	5.3	3.0
North America	4.7	4.7
Other	0.1	2.2
International flights to Moscow from:		
Europe	27.7	29.6
Asia	54.4	38.2
North America	6.8	6.1
Other	0.2	6.2
Other international flights	13.1	18.7
Domestic flights	33.2	17.3
	<u>155.5</u>	<u>134.5</u>

Reporting format – business segments

Year ended December 31, 2005	<u>Airline</u>	<u>Catering</u>	<u>Hotels</u>	<u>Other</u>	<u>Eliminations</u>	<u>Total Group</u>
External sales	2,497.5	26.9	14.2	1.0	-	2,539.6
Inter-segment sales	8.5	27.8	5.1	1.1	(42.5)	-
Total revenue	<u>2,506.0</u>	<u>54.7</u>	<u>19.3</u>	<u>2.1</u>	<u>(42.5)</u>	<u>2,539.6</u>
Operating profit	220.6	8.7	10.3	2.5	-	242.1
Interest expense	(22.9)	(0.1)	(3.1)	(2.3)	3.1	(25.3)
Interest income	9.0	-	0.1	0.9	(3.1)	6.9
Share of income in associates	5.7	-	-	-	-	5.7
Foreign exchange and translation (loss) income, net	(12.6)	0.5	(0.8)	0.1	-	(12.8)
Non-operating income (loss), net	69.8	(3.0)	0.1	(4.7)	-	62.2
Income before taxation	<u>269.6</u>	<u>6.1</u>	<u>6.6</u>	<u>(3.5)</u>	<u>-</u>	<u>278.8</u>
Taxation	(85.0)	(2.7)	(1.1)	(0.2)	-	(89.0)
Net income	<u>184.6</u>	<u>3.4</u>	<u>5.5</u>	<u>(3.7)</u>	<u>-</u>	<u>189.8</u>
Segment assets	1,664.2	19.4	29.7	117.5	(213.0)	1,617.8
Associates	4.4	-	-	-	-	4.4
Consolidated total assets						<u><u>1,622.2</u></u>
Segment liabilities	990.5	17.7	79.3	141.4	(174.2)	1,054.7
Capital expenditure	144.2	1.0	0.9	58.0	-	204.1
Depreciation	75.6	1.0	3.4	-	-	80.0

Year ended December 31, 2004	Airline	Catering	Hotels	Other	Eliminations	Total Group
External sales	2,131.6	14.6	12.5	0.1	-	2,158.8
Inter-segment sales	2.3	37.1	5.1	-	(44.5)	-
Total revenue	2,133.9	51.7	17.6	0.1	(44.5)	2,158.8
Operating profit	192.8	1.7	5.7	(1.4)	-	198.8
Interest expense	(9.3)	(0.1)	(1.9)	(2.4)	1.7	(12.0)
Interest income	3.9	-	-	1.0	(1.7)	3.2
Share of income in associates	3.5	-	-	-	-	3.5
Foreign exchange and translation income (loss), net	15.1	(0.2)	(1.3)	(0.1)	-	13.5
Non-operating income (loss), net	19.9	(1.8)	0.6	5.4	-	24.1
Income before taxation	225.9	(0.4)	3.1	2.5	-	231.1
Taxation	(56.7)	(1.4)	(0.8)	(0.1)	-	(59.0)
Net income	169.2	(1.8)	2.3	2.4	-	172.1
Segment assets	1,411.1	22.0	32.9	24.7	(128.6)	1,362.1
Associates	0.6	-	-	-	-	0.6
Consolidated total assets						1,362.7
Segment liabilities	889.2	18.7	82.8	52.0	(91.5)	951.2
Capital expenditure	323.0	0.5	0.6	0.2	-	324.3
Depreciation	89.6	1.3	3.1	-	-	94.0

30. RELATED PARTY TRANSACTIONS

The ultimate controlling party of the Company is the government of the Russian Federation and all companies controlled by the government Russian Federation are treated as related parties of the Group for the purpose of these consolidated financial statements.

The financial statements of the Group include the following balances and transaction with related parties:

	2005	2004
Cash balances	28.0	0.7
Amounts receivable	28.4	34.2
Amounts payable and other liabilities	63.9	65.4
Sales	77.7	53.2
Purchases	550.3	262.4
Dividend income received	0.6	0.5

The summary of balances and charges relating to the taxes due to the government of the Russian Federation for the years ended December 31, 2005 and 2004 is presented below:

	2005	2004
Account receivable from tax authorities	188.1	188.0
Account payable to tax authorities	51.6	31.9
Income and other tax expenses	396.9	313.5

The amounts outstanding to and from related parties are unsecured and will be settled in cash. No guarantees have been given or received. No expense has been recognized in the period for bad or doubtful debts in respect of the amounts owed by related parties.

The remuneration of directors and other members of key management during the year was as follows:

	<u>2005</u>	<u>2004</u>
Salary and other short-term benefits	<u>0.7</u>	<u>0.5</u>

31. COMMITMENTS UNDER OPERATING LEASES

Future minimum lease payments under non-cancelable aircraft and other operating leases are as follows:

	<u>2005</u>	<u>2004</u>
2005	-	98.5
2006	114.1	78.9
2007	125.5	42.4
2008	106.9	39.3
2009	101.8	37.7
2010	94.3	32.4
after 2010	287.1	90.9
Total minimum payments	<u>829.7</u>	<u>420.1</u>

The table above includes five Airbus A-320 and two Boeing-767 aircraft the lease agreements for which were entered into in 2005 but which will be delivered to the Company during 2006-2007.

The amounts above represent base rent. Maintenance fees to be paid to the lessor based on actual flight hours are not included in the table.

In accordance with the operating lease agreements for the Airbus A-319 and A-320 aircraft, lease payments are not fixed and should be revised by the lessor periodically. As of December 31, 2005 and 2004 lease commitments were calculated using base rent which was effective in 2005 and 2004, respectively.

For details of the fleet subject to operating leases refer to Note 1.

In 2005 the Company renegotiated the base rent payable on certain aircraft operating leases as well as adjusting the delivery schedule for aircraft under fleet restructuring program. This resulted in changes to future minimum lease payments under non-cancelable operating leases as of December 31, 2005 as compared to those as of December 31, 2004.

32. CAPITAL COMMITMENTS

The Group's capital commitments related to acquisition of property, plant and equipment as of December 31, 2005 amounted to approximately USD 1,410 million. These commitments relate to purchases of thirty Russian Regional Jet aircraft, seven new A321-200 aircraft, contracts for modernization of interiors of leased Boeing 767-300 aircraft as well as contracts related to construction of Sheremetyevo-3 terminal. The assets and liabilities of OJSC Terminal, the legal party to construction contracts relating to Sheremetyevo-3 terminal, are classified as disposal group in these consolidated financial statements due to planned disposal of 70% interest in this entity (see Note 34).

33. ACQUISITION OF OJSC “ARKHANGELSKIE AVIALINII”

In October 2004 a 51% owned subsidiary of the Group, CJSC “Aeroflot-Nord”, acquired net assets of OJSC “Arkhangelskie Avialinii” for a total cash consideration of approximately USD 2.7 million.

Fair value of the identified assets and liabilities of OJSC “Arkhangelskie Avialinii” at the date of acquisition and the resulting negative difference on acquisition has been determined as follows:

Investments	0.9
Trade receivables	3.9
Other receivables	0.1
Inventories	0.8
Property, plant and equipment	15.6
Total assets	21.3
Trade payables	5.5
Other payables and accruals	2.7
Loans payable	2.5
Deferred tax liability	2.2
Total liabilities	12.9
Net assets acquired	8.4
Negative difference on acquisition	(5.7)
Satisfied by cash paid	2.7

This acquisition was accounted using the purchase method in accordance with IFRS 3 “Business Combinations”. Fair value of the acquired property, plant and equipment was determined based on results of an independent valuation by professional appraisers. It has not been practicable to determine the carrying amounts of the acquired assets and liabilities in accordance with IFRS immediately before the acquisition as the selling entity did not prepare financial statements that comply with IFRS. The excess of the net fair value of assets acquired over the consideration paid is recognized in the income statement in other non-operating income. The acquired business contributed USD 11.4 million to the Group’s revenue and USD 2.5 million to the Group’s consolidated income during the three month period ended December 31, 2004. It has not been practicable to determine the effect of this acquisition on the consolidated revenue and net profit for the whole year as if the acquisition date had been the beginning of 2004 due to the differences in accounting policies used in respect of the acquired business before and after the acquisition.

34. DISPOSAL OF GROUP CLASSIFIED AS HELD FOR SALE

On 30 December 2005, the Company entered into a preliminary agreement to sell 70% of its shares in OJSC Terminal as follows: 25% plus one share to International Airport Sheremetyevo; 25% plus one share to Vneshtorgbank; and 20% minus two shares to Vneshekonombank. The government of the Russian Federation is a controlling shareholder in all of the entities that are parties to this agreement. The assets and liabilities of OJSC Terminal and other capitalized costs relating to the construction of the Sheremetyevo-3 terminal, which are expected to be sold within twelve months, have been classified as a disposal group held for sale and are presented separately in the balance sheet. These assets and liabilities are included in the Group’s other activities for segment reporting purposes (see Note 29).

The proceeds of disposal are expected to exceed the net carrying amount of the relevant assets and liabilities and, accordingly, no impairment loss has been recognized on the classification of these operations as held for sale.

The major classes of assets and liabilities comprising the disposal group classified as held for sale as of December 31, 2005 are as follows:

Cash and cash equivalents	8.5
VAT and other taxes recoverable	6.2
Prepayments	0.6
Inventories	0.3
Property, plant and equipment	67.6
Assets of a disposal group classified as held for sale	83.2
Trade payables and accruals	(7.4)
Other non-current liabilities	(2.0)
Liabilities associated with assets of a disposal group classified as held for sale	(9.4)
Net assets of disposal group	73.8

35. CONTINGENT LIABILITIES

Political environment – The government of the Russian Federation continues to reform the business and commercial infrastructure in its transition to a market economy. As a result laws and regulations affecting businesses continue to change rapidly. These changes are characterized by poor drafting, different interpretations and arbitrary application by the authorities.

Taxation – Russian tax legislation is subject to varying interpretations and constant changes. Furthermore, the interpretation of the tax legislation by the tax authorities, as applied to the transactions and activity of the Group, may not coincide with that of management. As a result, the tax authorities could challenge transactions and the Group could be assessed additional taxes, penalties and interest, which could be significant. Periods remain open to review by the tax authorities for three years. The Group's management believes that it has adequately provided for tax liabilities in the consolidated financial statements, however the risk remains that the relevant authorities could take up differing positions with regard to interpretative issues, and the effect could be significant.

Currency control – The Group operates in approximately 50 countries, as well as in Russia, through its representative offices. Given the Group's significant foreign currency revenues and obligations, it is exposed to the risk of non-compliance with Russian currency control legislation. Management believes that the Group generally complies with currency control regulations and that no contingent provisions are necessary in the consolidated financial statements.

Legal claims

- (i) Former members of the Group's management and two Swiss non-bank financial companies that provided treasury and financial services to the Group, are currently under investigation by the Swiss and Russian authorities for potential misconduct related to funds managed under treasury and financial services agreements, which were entered into by the former management of the Group.

The Group is not named in the investigation. In management's opinion, the Group does not have any potential exposure related to the treasury and financial services agreements, or any of the allegations currently subject to investigation. The accompanying consolidated financial statements do not include provision for any amounts that might result from the investigations. Such amounts, if any, will be reported when they become known and estimable.

36. SUBSEQUENT EVENTS

SkyTeam – Aeroflot as of April 14, 2006 officially became the tenth member in the SkyTeam alliance. SkyTeam is the global airline alliance partnering Aeromexico, Air France, Alitalia, Continental Airlines, CSA – Czech Airlines, Delta Airlines, KLM – Royal Dutch Airlines, Korean Air, Northwest Airlines. Aeroflot became the first Russian carrier to become part of a global airline alliance. As part of its membership, Aeroflot passengers will be able to accrue and redeem frequent flyer miles interchangeably on any of the nine other SkyTeam member airlines. In turn, SkyTeam passengers on flights operated by Aeroflot can earn miles in their preferred frequent flyer program.

Electronic ticketing – As part of its agreement with SkyTeam alliance Aeroflot will be required to introduce e-ticketing on all of its flights. Introduction of e-ticketing would allow the Company to achieve savings, while also increasing convenience for its customers. Under the current Russian legislation, tickets for passenger air carriage can only be issued in documentary form. The Ministry of transportation of the Russian Federation signed an Order on May 6, 2006 which would allow the usage and regulate electronic ticketing in the civil aviation. To become effective this document is yet to be officially registered by the Ministry of Justice of the Russian Federation.

Terminal – In April 2006 Aeroflot's shareholders approved the offer to sell 70% of the ordinary shares in equity of OJSC Terminal to parties related by common ownership as follows: to International Airport Sheremetyevo 9,490,001 shares at the price of 108 rubles per share (25% plus one share), to Vneshtorgbank 9,490,001 shares at the price of 108 rubles per share (25% plus one share), and to Vneshekonombank 7,591,998 shares at the price of 102 rubles per share (20% minus two share). The Company expects to realize a significant gain on disposal of these shares. The sale is expected to be finalized by July 1, 2006.

Russian Regional Jet (“RRJ”) – Aeroflot's shareholders have also approved the purchase of 30 RRJ planes from CJSC Sukhoi Civil Aircraft, a subsidiary of the Sukhoi state holding and a related party. The total value of the related contract is included in the amount of capital commitments in Note 32. Deliveries are scheduled to begin in November 2008.

Airbus A231-200 – During 2005 the Company agreed to acquire seven new A321-200 aircraft from Airbus S.A.S. subject to the Board approval. In March 2006 the Company's Board of Directors approved the amended total purchase price. The total value of the related capital commitments, net of advance payments made, is included in Note 32. Deliveries are scheduled to begin in the last quarter of 2006 and be completed by the end of 2007. As of December 31, 2005 the Group made an advance payment of approximately USD 34.9 million presented within capital expenditures in the Group's consolidated financial statements. During the first quarter of 2006 the Group obtained a loan of USD 50.1 million from Natexis Transport Finance and Calyon to finance the advance payments under Airbus contract. The loan bears interest rate equal to LIBOR plus 1.75% and is to be repaid as the planes are delivered.

New shares – The Board of Directors of the Company proposed a decision to authorize an issue of 250 million of additional ordinary shares of the Company. This decision will require approval by the shareholders at the annual general shareholders' meeting to be held in June 2006.

Repayment of loan – On May 24, 2006 the Company repaid the full outstanding amount of the syndicated loan from WestLB AG and other international lending institutions including its long term portion. As of December 31, 2005 the Company had a liability of USD 30.0 million and USD 60.2 million recorded as a long term and short-term borrowings, respectively.