



Consolidated Financial Statements
JOINT STOCK COMPANY “CONCERN GALNAFTOGAZ”
Year ended 31 December 2003
With Report of Independent Auditors

These consolidated financial statements contain 28 pages

**Joint Stock Company “Concern Galnaftogaz”
Consolidated Financial Statements
Year ended 31 December 2003**

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Report of Independent Auditors

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Report of Independent Auditors

To the Board of Directors and Shareholders of
Joint Stock Company “Concern Galnaftogaz”:

We have audited the accompanying consolidated balance sheet of Joint Stock Company “Concern Galnaftogaz” (hereinafter referred to as the “Company”) and its subsidiaries as of 31 December 2003, and the related consolidated statements of income, changes in shareholders’ equity and cash flows for the year then ended. These consolidated financial statements on pages 2 to 28 are the responsibility of the management of the Company. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing issued by the International Federation of Accountants. 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.

As disclosed in Note 4, the year ended 31 December 2003 is the first year when International Financial Reporting Standards have been applied by the Company and its subsidiaries and therefore the accompanying consolidated financial statements do not present comparative consolidated balance sheet as of 31 December 2002 and the related consolidated statements of income, cash flows and changes in shareholders’ equity for the year then ended as required by International Accounting Standard No. 1, *Presentation of Financial Statements*.

In our opinion, except for the omission of comparative information as described in the preceding paragraph, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Joint Stock Company “Concern Galnaftogaz” and its subsidiaries as of 31 December 2003 and the results of their operations and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

12 April 2004

Joint Stock Company “Concern Galnaftogaz”
Consolidated income statement
For the year ended 31 December 2003
(In thousands of Ukrainian hryvnias, unless otherwise noted)

	Note	2003
Revenues	5	942,375
Cost of sales	6	910,415
Gross profit		<u>31,960</u>
General and administrative expenses	7	22,449
Other operating expenses	8	2,832
Profit from operations		<u>6,679</u>
Income from associates		989
Net financing income	9	4,955
Profit before income tax and minority interest		<u>12,623</u>
Income tax expense	10	1,536
Profit before minority interest		<u>11,087</u>
Minority interest		(1)
Net profit		<u><u>11,086</u></u>

These consolidated financial statements are authorised for issue on 12 April 2004 and signed on behalf of the Board of Directors of JSC “Concern Galnaftogaz” by:

General director
Y.L. Kuchabskiy

Financial Director
N.I. Kupybida

The consolidated income statement is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 6 to 28.

Joint Stock Company “Concern Galnaftogaz”**Consolidated balance sheet**

As of 31 December 2003

(In thousands of Ukrainian hryvnias, unless otherwise noted)

	Note	2003
ASSETS		
Non-current assets		
Property, plant and equipment	11	
Intangible assets	12	
Investments	13	
Deferred tax assets	14	
Other non-current assets		
Current assets		
Inventories	15	
Prepaid income tax		
Trade and other receivables	16	
Prepayments and other current assets	17	
Cash and cash equivalents	18	
Total assets		
LIABILITIES AND SHAREHOLDERS' EQUITY		
Shareholders' equity		
Share capital	19	
Additional paid-in capital		
Land revaluation reserve		
Retained earnings		
Total shareholders' equity		
Minority interest		
Non-current liabilities		
Loans and borrowings	20	
Deferred tax liabilities	14	
Current liabilities		
Loans and borrowings	20	
Income tax payable		
Trade and other payables	21	
Other current liabilities	22	
Total liabilities and shareholders' equity		

The consolidated balance sheet is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 6 to 28.

Joint Stock Company “Concern Galnaftogaz”
Consolidated cash flows statement
For the year ended 31 December 2003
(In thousands of Ukrainian hryvnias, unless otherwise noted)

2003

Cash flows from operating activities

Profit before income tax and minority interest

Adjustments for:

Depreciation and amortisation

Loss on disposal of property, plant and equipment

Impairment provision

Income from associates

Bonds amortization

Interest expense, net

Foreign currency exchange loss

Operating profit before changes in working capital

Increase in inventories

Increase in trade and other receivables

Increase in prepayments and other current assets

Increase in trade and other payables

Increase in other current liabilities

Cash flows generated from operations

Income taxes paid

Net cash from operating activities

Cash flows from investing activities

Acquisition of subsidiary, net of cash acquired (Note 24)

Purchases of property, plant and equipment

Purchases of intangible assets

Proceeds from sale of equipment

Proceeds from sale of investments

Purchase of investments

Net cash used in investing activities

Cash flows from financing activities

Proceeds from issue of shares and additional paid-in capital

Proceeds from long-term borrowings

Proceeds from short-term borrowings

Repayments of long-term borrowings

Repayments of short-term borrowings

Issued loan

Proceeds from repayment of loan

Interest paid

Net cash provided by financing activities

Net increase in cash and cash equivalents

Cash and cash equivalents at the beginning of the year

Cash and cash equivalents at the end of the year (Note 18)

SUPPLEMENTARY CASH FLOWS INFORMATION (Note 23)

The consolidated cash flows statement is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 6 to 28.

Joint Stock Company “Concern Galnaftogaz”
Consolidated statement of changes in shareholders’ equity

For the year ended 31 December 2003

(In thousands of Ukrainian hryvnias, unless otherwise noted)

	Share capital	Additional paid-in capital	Land revaluation reserve	Retained earnings	Total
Balance at 1 January 2003	74,183	-	952	10,060	85,195
Share capital paid-in	45,817	11,661	-	-	57,478
Contributions by shareholders, net of tax	-	5,759	-	-	5,759
Revaluation of land, net of tax	-	-	8,372	-	8,372
Net profit for the year	-	-	-	11,086	11,086
Balance at 31 December 2003	120,000	17,420	9,324	21,146	167,890

The consolidated statement of changes in shareholders’ equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 6 to 28.

Joint Stock Company “Concern Galnaftogaz”
Notes to the consolidated financial statements
(In thousands of Ukrainian hryvnias, unless otherwise noted)

1. Organization and operations

JSC Concern Galnaftogaz (the “Company”) and its subsidiaries (together referred to as the “Group”) comprise of Ukrainian open joint stock companies as defined in the Civil Code of Ukraine. JSC Concern Galnaftogaz was established on 30 October 2001. The Company is the ultimate parent entity of this group of companies.

The Group’s principal activity is marketing of petroleum products in Ukraine. The Group operates network of about 160 petrol stations 76 of which are under the Group’s registered trademark “OKKO”.

From formation, the Group has expanded substantially through acquisitions of new companies and establishment of new businesses.

The Company’s registered office is 1 Plastova Str., Lviv, Ukraine.

The average number of employees of the Group was 2,009 during 2003.

2. Ukrainian business conditions

Operating environment

While there have been improvements in the economic situation in Ukraine in recent years, it continues to display emerging market characteristics. These characteristics include the lack of a well-developed business and regulatory infrastructure, limited convertibility of the national currency along with various currency controls and low levels of liquidity in the capital market. The reforms necessary to create banking, judicial and regulatory systems that usually exist in more developed markets have not yet been fully implemented.

The consolidated financial statements reflect management’s assessment of the impact of the Ukrainian economic environment on the operations and the financial position of the Group. The future business environment may differ from management’s assessment.

Foreign currency risk

In common with many other businesses in Ukraine, foreign currencies, in particular the US dollar (“USD”), play a significant role in the underlying economics of the business transactions of the Group. As of 31 December 2003, the exchange rate of Ukrainian hryvnia as established by the National Bank Ukraine was 5.33 to the US dollar. The rate at the date of issue of these financial statements remained unchanged at 5.33 to the US dollar.

Concentration risk

During 2003 the majority of purchases of petroleum products were made by the group from one supplier. Management believes that in case the supplier fails to perform or partly performs its contractual obligations the Group would be able to shift its purchases to another supplier without entailing significant business interruption or financial losses.

In addition, as of 31 December 2003 the Group pledged certain property, plant and equipment with a carrying amount of UAH 21,456 to secure bank loans received by this supplier (Note 11). Furthermore, during 2003 the Group was actively traded securities with this supplier that resulted in a gain from trading securities in amount of UAH 10,022 (Note 9).

Joint Stock Company “Concern Galnaftogaz”
Notes to the consolidated financial statements
(In thousands of Ukrainian hryvnias, unless otherwise noted)

3. Basis of preparation

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) promulgated by the International Accounting Standards Board (“IASB”) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

The year ended 31 December 2003 is the first period when IFRS have been applied by the Group. Previously, the Group prepared its financial statements in accordance with Ukrainian accounting principles. Adjustments resulting from the transition to IFRS have been treated as an adjustment to the opening balance of retained earnings as of 1 January 2003 presented in accordance with IFRS.

The Company and its subsidiaries maintain their statutory accounting records and prepare separate statutory financial statements in accordance with Ukrainian Accounting Standards and regulations (“UAS”). These consolidated financial statements differ from the financial statements issued for statutory purposes in Ukraine in that they reflect certain adjustments, not recorded in the Company’s and subsidiaries books, which are appropriate to present the consolidated financial position, results of operations, and cash flows of the Group in accordance with IFRS.

Basis of measurement

The consolidated financial statements are prepared on the historical cost basis except that investments available-for-sale are stated at fair value and certain classes of property, plant and equipment are revalued.

Measurement and presentation currency

The national currency of Ukraine is the Ukrainian hryvnia (“UAH”), which is the Company’s measurement currency and the currency in which these consolidated financial statements are presented. All financial information presented in UAH has been rounded to the nearest thousand.

Use of estimates

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with IFRS. Actual results could differ from those estimates.

4. Summary of significant accounting policies

The following significant accounting policies have been applied in the preparation of the consolidated financial statements.

Joint Stock Company “Concern Galnaftogaz”
Notes to the consolidated financial statements
(In thousands of Ukrainian hryvnias, unless otherwise noted)

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries drawn up to 31 December 2003.

Subsidiaries

Subsidiaries are those enterprises controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date the control effectively ceases.

Associates

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

Transactions eliminated on consolidation

Intragroup balances and transactions, and any unrealised gains arising from intragroup transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated against the investment in the associate to the extent of the Group's interest in the enterprise.

Foreign currencies

Transactions in foreign currencies are translated to UAH at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to UAH at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated to UAH at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to UAH at the foreign exchange rate ruling at the dates the fair values were determined.

Property, plant and equipment

Land is stated at revalued amounts less impairment losses. Other items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads.

Construction in progress represents plant and properties under construction and is stated at cost. This includes cost of construction, plant and equipment and other direct costs. Construction in progress is not depreciated until such time as the relevant assets are completed and put into operational use.

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

Joint Stock Company “Concern Galnaftogaz”

Notes to the consolidated financial statements

(In thousands of Ukrainian hryvnias, unless otherwise noted)

Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, is capitalised with the carrying amount of the component being written off. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as an expense as incurred.

Revaluation

A revaluation surplus on land is recognised directly in equity except to the extent that it reverses a previous revaluation deficit recognised in the income statement, in which case it is recognised in the income statement. A revaluation deficit on land is recognised in the income statement except to the extent that it reverses a previous revaluation surplus recognised directly in equity, in which case it is recognised directly in equity.

Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated.

The estimated useful lives are as follows:

Buildings	- 40 years
Equipment	- 10 years
Office equipment	- 4 years
Vehicles	- 5 years

Intangible assets

Goodwill

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

Other intangible assets

Other intangible assets, which are acquired by the Group, are stated at cost less accumulated amortisation and impairment losses.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. Goodwill is amortised from the date of initial recognition; other intangible assets are amortised from the date the asset is available for use.

Joint Stock Company “Concern Galnaftogaz”

Notes to the consolidated financial statements

(In thousands of Ukrainian hryvnias, unless otherwise noted)

The estimated useful lives are as follows:

Goodwill	- 20 years
Patents and licences	- 5 to 10 years
Software licences	- 3 years

Investments

All investments are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment. After initial recognition, investments, which are classified as available-for-sale are measured at fair value.

Gains or losses on available-for-sale investments are recognized as a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in income.

The fair value of investments available-for-sale are their quoted bid price at the balance sheet date. Investments in equity securities that are not quoted on a stock exchange, and where fair value cannot be estimated on a reasonable basis by other means, are stated at cost less impairment losses.

Inventories

Inventories are valued at the lower cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale.

The cost of inventories is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition.

Trade and other receivables

Trade receivables, which generally have 30-90 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

Impairment

The carrying amounts of the Group’s assets, other than inventories and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets’ recoverable amounts are estimated. An impairment loss is recognised when the carrying amount of an asset exceeds its recoverable amount. Impairment losses in respect of revalued property, plant and equipment are recognised in the same way as revaluations; other impairment losses are recognised in the income statement.

Calculation of recoverable amount

Joint Stock Company “Concern Galnaftogaz”

Notes to the consolidated financial statements

(In thousands of Ukrainian hryvnias, unless otherwise noted)

The recoverable amount of the Group’s investments stated at cost and non-current receivables is calculated as the present value of expected future cash flows, discounted at the effective interest rate inherent in the asset.

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

Reversal of impairment

An impairment loss in respect of an investment stated at cost or receivable is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset’s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Loans and borrowings

Loans and borrowings are recognised initially at cost. Subsequent to initial recognition, loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

Trade and other payables

Liabilities for trade and other amounts payable which are normally settled on 30-90 day terms, are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the Group.

Employee benefits

The Group does not have any pension arrangements separate from the state pension system of Ukraine, which requires current contributions by the employer to be calculated as a 32% of current gross salary payments; such expense is charged to the income statement in the period the related compensation is earned by the employee. The Group has no post-retirement benefits or significant other compensated benefits requiring accrual.

Provisions

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Joint Stock Company “Concern Galnaftogaz”

Notes to the consolidated financial statements

(In thousands of Ukrainian hryvnias, unless otherwise noted)

Income tax

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

Current tax expense is the expected tax payable on the taxable income determined in accordance with Ukrainian tax regulations for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences:

- except where the deferred income tax liability arises from goodwill amortisation or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carry-forward of unused tax losses can be utilised:

- except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and associates, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

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

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Revenue recognition

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer.

Joint Stock Company “Concern Galnaftogaz”

Notes to the consolidated financial statements

(In thousands of Ukrainian hryvnias, unless otherwise noted)

Revenue from the sale of goods on consignment basis are recognised on the gross amount billed to a customer to the extent the Group has the following indicators:

- the Group is the primary obligor in the sales arrangements
- the Group has general and physical loss inventory risks
- the Group has credit risk and discretion in supplier selection
- the Group has latitude in establishing prices

Revenue from transportation services is recognised in the income statement when services are rendered, i.e. when destination point is reached.

Operating leases

Leases of assets under which the lessor effectively retains all the risks and rewards of ownership are classified as operating leases. Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease.

Net financing income

Net financing income comprises interest expense on borrowings, the accretion of interest on provisions, interest income on funds invested, dividend income, foreign exchange gains and losses, gains and losses on the revaluation and disposal of investments held for trading, and impairment losses and gains and losses on the disposal of available-for-sale investments.

All interest and other costs incurred in connection with borrowings are expensed as incurred as part of net financing costs.

Interest income is recognised as it accrues, taking into account the effective yield on the asset. For investments in associates, dividend income is included in the determination of the equity income from the associate. For investments in other companies, dividend income is recognised on the date that the dividend is declared.

Borrowing costs

Borrowing costs are recognized as expenses in the period in which they are incurred.

Comparative information

The year ended 31 December 2003 is the first period when IFRS have been applied by the Group. Previously, the Group prepared its consolidated financial statements in accordance with Ukrainian accounting principles as the primary basis of accounting. The Group has not prepared the consolidated balance sheet as of 31 December 2002 and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year then ended, due to unreasonable effort and expense. Accordingly, the comparative information was not presented in these consolidated financial statements which represents a departure from IFRS.

Joint Stock Company “Concern Galnaftogaz”
Notes to the consolidated financial statements
(In thousands of Ukrainian hryvnias, unless otherwise noted)

5. Revenues

Revenues for the year ended 31 December 2003 are as follows:

	2003
Sales of petroleum products	900,020
Sales of consumer products	41,310
Sales of transportation services	1,045
	<hr/> 942,375 <hr/>

6. Cost of sales

Cost of sales for the year ended 31 December 2003 is as follows:

	2003
Petroleum and consumer products	875,692
Rent	10,976
Salary, wages and related charges	10,351
Depreciation	4,218
Repair and maintenance	2,223
Transportation	1,885
Utilities	1,682
Security	1,203
Other	2,185
	<hr/> 910,415 <hr/>

7. General and administrative expenses

General and administrative expenses for the year ended 31 December 2003 are as follows:

	2003
Salary and related charges	5,567
Depreciation	4,361
Insurance	2,164
Taxes other than income tax	1,695
Professional services	1,405
Advertisement	1,287
Communication	1,238
Commission fees	1,230
Bank charges	1,177
Security	720
Rent	455
Other	1,150
	<hr/> 22,449 <hr/>

Joint Stock Company “Concern Galnaftogaz”
Notes to the consolidated financial statements
(In thousands of Ukrainian hryvnias, unless otherwise noted)

8. Other operating expenses

Other operating expenses for the year ended 31 December 2003 are as follows:

	2003
Loss on disposal of property, plant and equipment	1,331
Amortisation of intangible assets	1,086
Other	415
	<u>2,832</u>

9. Net financing income

Net financing income for the year ended 31 December 2003 is as follows:

	2003
Gain from trading investments	12,723
Interest income	18
	<u>12,741</u>
Interest expense	(5,016)
Other financing expense	(2,604)
Amortization of bonds	(162)
Foreign exchange loss	(4)
	<u>(7,786)</u>
	<u>4,955</u>

10. Income tax

Income tax expense reported in the consolidated income statement for the year ended 31 December 2003 is as follows:

	2003
<i>Current tax expense:</i>	
Current year	652
Under provided in prior years	5
	<u>657</u>
<i>Deferred tax expense:</i>	
Origination and reversal of temporary differences	1,216
Reduction in tax rate	(337)
	<u>879</u>
	<u>1,536</u>

Joint Stock Company “Concern Galnaftogaz”**Notes to the consolidated financial statements**

(In thousands of Ukrainian hryvnias, unless otherwise noted)

Income tax as of 31 December 2003 recognised directly in the consolidated shareholders' equity is as follows:

	2003
Net deferred income tax on land revaluation surplus (Note 11)	3,108
Net deferred income tax on contributions by shareholders	(5,759)
	<u>(2,651)</u>

Ukraine was the only tax jurisdiction in which the Group's income was subject to income tax in 2003. In 2003 the Group's applicable income tax rate was 30%. In early 2003, new amendments to the income tax law were approved, which introduce a new tax rate of 25% applicable to corporate profits. The new tax rate is to be applied after 1 January 2004.

Reconciliation of effective tax rate is as follows:

	2003	%
Profit before income tax and minority interest	12,623	100%
Computed income tax at applicable tax rate of 30%	3,787	30%
Tax effect of expenses that are not deductible in determining taxable profit:		
50% of fuel and lease restriction	(486)	(4%)
Losses on disposal of fixed assets	(357)	(3%)
Reduction in tax rate	(337)	(3%)
Employees benefits	(234)	(2%)
Impairment provisions and write-offs	(224)	(1%)
Taxes not deductible	(136)	(1%)
Notaries and other non deductible services	(127)	(1%)
Charitable donations	(106)	(1%)
Fines and penalties	(16)	-
Other	(228)	(2%)
	<u>1,536</u>	<u>12%</u>

Joint Stock Company “Concern Galnaftogaz”
Notes to the consolidated financial statements
(In thousands of Ukrainian hryvnias, unless otherwise noted)

11. Property, plant and equipment

Property, plant and equipment as of 31 December 2003 is as follows:

	Land & buildings	Equipment	Office equipment	Vehicles	Total
<i>At cost/ revalued amount</i>					
At 1 January 2003	51,446	10,257	8,140	4,875	74,718
Additions through acquisition	2,299	-	260	22	2,581
Revaluation	11,163	-	-	-	11,163
Additions	81,104	12,457	7,032	6,410	107,003
Disposals	(1,414)	(2,428)	(9)	(1,410)	(5,261)
At 31 December 2003	144,598	20,286	15,423	9,897	190,204
<i>Depreciation</i>					
At 1 January 2003	10,360	1,636	2,272	1,481	15,749
Depreciation charge	2,269	1,670	3,218	1,422	8,579
Disposals	(8)	(181)	-	(120)	(309)
At 31 December 2003	12,621	3,125	5,490	2,783	24,019
<i>Net book value</i>					
At 31 December 2003	131,977	17,161	9,933	7,114	166,185
Construction in progress and uninstalled equipment					7,958
Prepayments for property, plant and equipment					5,051
					179,194

As of 31 December 2003 the Group made an independent appraisal of land properties. Revaluation surplus of UAH 11,163 was credited directly to the consolidated shareholders' equity less effect of attributable deferred income tax of UAH 2,791 (Note 10).

Property, plant and equipment with a carrying amount of UAH 57,573 is subject to a registered debenture to secure bank loans (Note 20). Furthermore, as of 31 December 2003 the Group pledged certain property, plant and equipment with a carrying amount of UAH 19,567 to secure bank loans received by related parties (Note 26) and UAH 21,456 to secure bank loans received by third parties.

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12. Intangible assets

Intangible assets as of 31 December 2003 are as follows:

	Patents and licences	Software licences	Goodwill	2003
<i>Cost</i>				
At 1 January 2003	260	99	89	448
Additions through acquisition	-	36	3,189	3,225
Additions	6,006	602	-	6,608
Disposal	(160)	(65)	-	(225)
At 31 December 2003	<u>6,106</u>	<u>672</u>	<u>3,278</u>	<u>10,056</u>
<i>Amortization</i>				
At 1 January 2003	20	23	-	43
Amortization charge	716	206	164	1,086
Disposal	-	(3)	-	(3)
At 31 December 2003	<u>736</u>	<u>226</u>	<u>164</u>	<u>1,126</u>
	<u>5,370</u>	<u>446</u>	<u>3,114</u>	<u>8,930</u>

13. Investments

Investments as of 31 December 2003 are as follows:

	2003
Investments in associates	28,488
Investments available-for-sale	
Stated at cost	5,921
Stated at fair value	<u>840</u>
	<u>6,761</u>
	<u>35,249</u>

As of 31 December 2003 the Group has the following investments in associates:

	Country	Ownership	2003
Bank Universalniy	Ukraine	50%	28,407
JSC Effort	Ukraine	25%	81
			<u>28,488</u>

As of 31 December 2003 the Group’s share of post-acquisition total recognized gains and losses in the above associated companies comprised UAH 1,466 .

At the beginning 2004 the Group sold 29% of its investment in Bank Universalniy for an amount approximating its carrying value at the year-end.

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Investments available-for-sale stated at cost primarily comprise unquoted equity securities in the consumer products industry. There is no market for these investments and there have not been any recent transactions that provide evidence of fair value. In addition, discounted cash flow techniques yield a wide range of fair values due to the uncertainty of future cash flows in this industry. However, these investments were acquired recently and management believes it is unlikely that the fair value at the end of the year would differ significantly from that carrying amount.

14. Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following items:

	Assets	Liabilities	Net
Property, plant and equipment	-	(3,457)	(3,457)
Intangible assets	5,704	-	5,704
Trade and other receivables	30	-	30
Prepayments and other current assets	-	(713)	(713)
Bonds	41	-	41
Trade and other payables	-	(403)	(403)
Prepayments for customers	-	(214)	(214)
	<u>5,775</u>	<u>(4,787)</u>	<u>988</u>
Net deferred tax asset (liability)	<u>5,775</u>	<u>(4,787)</u>	<u>988</u>

15. Inventories

Inventories as of 31 December 2003 are as follows:

	2003
Petroleum products	7,798
Consumer products	5,360
Materials and spare parts	1,998
	<u>15,156</u>

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16. Trade and other receivables

Trade and other receivables as of 31 December 2003 are as follows:

	2003
Receivables from related parties (Note 26)	24,440
Trade accounts receivable	16,208
Other receivables	20,033
	<u>60,681</u>
Less: Impairment provision	(112)
	<u><u>60,569</u></u>

17. Prepayments and other current assets

Prepayments and other current assets as of 31 December 2003 are as follows:

	2003
Prepayments for taxes other than income tax	9,392
Prepayments to related parties (Note 26)	3,859
Prepayments for inventories	3,844
Other current assets	3,628
	<u><u>20,723</u></u>

Prepayments to related parties comprise prepaid inventories and security services.

18. Cash and cash equivalents

Cash and cash equivalents as of 31 December 2003 are as follows:

	2003
Cash at bank	6,758
Cash in transit	1,503
Cash in hand	906
Call deposits	141
	<u><u>9,308</u></u>

Cash at bank and in call deposits earns interest at floating rates based on daily bank deposits rates. Cash at bank includes UAH 5,273 placed at bank accounts in Bank Universalniy, which is the Group’s related party (Note 26).

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19. Share capital

As of 31 December 2003 authorized, issued and paid share capital comprised 12,000,000 thousand ordinary shares with the par value of UAH 0.01.

The holders of ordinary shares are entitled to receive dividends as declared unless imposed restrictions exist and are entitled to one vote per share at annual and general meetings of the Company.

In accordance with Ukrainian legislation the Company’s distributable reserves are limited to the balance of accumulated retained earnings as recorded in the Company’s statutory financial statements prepared in accordance with UAS.

In November 2003 the Company entered into a long-term bank loan agreement with Raiffeisen Bank in amount of USD 5,000 thousand (equivalent of UAH 26,650) (Note 20). The loan agreement imposes covenants whereby the Company is not allowed to distribute declared dividends without the Raiffeisen Bank concord. This restriction expires on 11 November 2008 or at the date of final loan settlement whichever is earlier.

20. Loans and borrowings

The Group’s loans and borrowings as of 31 December 2003 are as follows:

	2003
<i>Non-current:</i>	
Secured bank loans	51,836
Unsecured bond issue	29,838
	<hr/> 81,674
<i>Current:</i>	
Current portion of long-term secured bank loans	4,142
Secured short-term bank loans	6,926
Unsecured loan from a shareholder	393
	<hr/> 11,461
	<hr/> 93,135 <hr/>

For more information about the Group’s exposure to interest rate and foreign currency risk, refer to Note 25.

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Terms and debt repayment schedule

Terms and debt repayment schedule can be presented as follows:

	Interest	Within one year	From one To five years	Total
Secured bank loans:				
USD 1,400 thousand	12%	-	8,095	8,095
UAH 7,223	18%	-	6,592	6,592
USD 1,160 thousand	12%	1,343	4,841	6,184
USD 2,300 thousand	14%	-	12,262	12,262
USD 1,585 thousand	LIBOR+8%	1,690	7,826	9,516
USD 2,500 thousand	LIBOR+8.75%	1,109	12,220	13,329
USD 1,300 thousand	13%	6,926	-	6,926
Unsecured bond issue:				
UAH 29,838	17%	-	29,838	29,838
Unsecured loan from a shareholder:				
UAH 393	Interest free	393	-	393
		11,461	81,674	93,135

None of the long-term loan and borrowings exceeds a five-year repayment period.

As of 31 December 2003 the bank loans interest rates approximate effective rates. The loans are secured with property, plant and equipment with a carrying amount of UAH 57,573 thousand (Note 11).

The bonds that mature in 2006 have an effective interest rate of 17%.

The Group has no subordinated debt and no debt convertible into equity.

21. Trade and other payables

Trade and other payables as of 31 December 2003 are as follows:

	2003
Trade payables for inventories	49,688
Payables to related parties for inventories (Note 26)	7,705
Payables for taxes other than income tax	2,125
Advances received	1,054
Accrued salary	461
Other	1,951
	62,984

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22. Other current liabilities

Other current liabilities include amounts payable to related parties for security services of UAH 1,245 .

23. Supplementary cash flows information

Supplementary consolidated cash flows information for the year ended 31 December 2003 is as follows:

	2003
Non-cash transactions	
Investment activities:	
Revaluation of land (Note 11)	12,432
Intangible assets written off, net	(222)
	<u>12,210</u>

As of 31 December 2003 the Group has USD 2,500 thousand (equivalent of UAH 13,325) of undrawn long-term borrowing facilities that may be available for its future operating and investment activities.

24. Acquisition of subsidiary

In May 2003 the Group acquired 99.33% of JSC Terra Petroleum, which had the following effect on the Group’s assets and liabilities:

	2003
Property, plant and equipment	2,611
Intangible assets	36
Construction in progress	1,513
Inventories	340
Trade and other receivables	1,888
Prepayments and other current assets	855
Cash and cash equivalents	92
Investments	2,700
Long-term borrowings	(3,008)
Trade and other payables	(1,195)
Other current liabilities	(54)
Net identifiable assets and liabilities	<u>5,778</u>
Goodwill on acquisition	3,189
	<u>(8,967)</u>
Consideration paid, satisfied in cash	(8,967)
Cash acquired	92
	<u>(8,875)</u>
Net cash outflow	<u><u>(8,875)</u></u>

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25. Financial instruments

Exposure to credit, interest rate and currency risk arises in the normal course of the Group’s business.

Credit risk

The Group does not require collateral in respect of financial assets. Credit evaluations are performed on all customers, other than related parties, requiring credit over a certain amount.

Concentration risk

At the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

Interest rate risk

Changes in interest rates impact primarily loans and borrowings by changing either their fair value or their future cash flows. The Group adopts a policy of ensuring that at least 60 percent of its exposure to changes in interest rates on secured bank loans is on a fixed rate basis. However, at the time of issuing new debt management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

Foreign currency risk

The Group incurs foreign currency risk on borrowings that are denominated USD. Management believes that as of 31 December 2003 the Group’s exposure to foreign currency risk is remote.

Fair value

The estimated fair values of financial instruments are determined with reference to various market information and other valuation methodologies as considered appropriate, however considerable judgment is required in interpreting market data to develop these estimates. Accordingly, the estimates are not necessary indicative of the amounts that the Group could realize in a current market situation.

The carrying values of cash and cash equivalents, trade and other receivables and payable, taxes payable and accrued liabilities approximate their fair values due to the short maturities of these instruments.

As discussed in Note 13, the Group has investments in certain Ukrainian companies. There are no quoted market prices for these instruments and a precise estimate of fair value could not be made without incurring excessive costs. However, management believes that the carrying value of these investments does not differ substantially from their fair value.

Borrowing arrangements on short-term and long-term debt have both fixed and variable interest rates that reflect the currently available terms for similar debt. The carrying value of this debt is a reasonable approximation of its fair value.

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26. Related Parties

In the rapidly developing businesses environment in Ukraine, companies have frequently used nominees and other forms of intermediary companies in transactions. Management consider that the Group has appropriate procedures in place to identify and properly disclose transactions with related parties and has disclosed all of the relationship identified which it deemed to be significant.

Transactions with management

The members of the Board of Directors, executive directors (president and vice-presidents), heads of departments and the close family members control 10% of the voting shares of the Company. There are no share options granted to the directors and pensions paid to the former or existing members of the Board of Directors.

In 2003 the amount of the total remuneration of the directors was UAH 1,650. Total remunerations included in “General and administrative expenses”.

Transactions with other related parties

Related parties comprise associated companies of the Group, the shareholders of the Company and all other companies in which those shareholders, either individually or together, have a controlling interest.

Transactions with shareholders

During 2003 the Company’s shareholders borrowed and paid back to the Group UAH 19,196. During 2003 one of the shareholders contributed to the Group rights to the brand OKKO which has been valued at zero and reflected as contribution net of tax in the Group’s additional paid in capital.

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During 2003, the Group had the following transactions and balances with related parties:

	Note	2003
Balances with related parties:		
Cash and cash equivalents	18	5,273
Trade and other receivables	16	24,440
Prepayments and other current assets	17	3,859
Loans and borrowings	20	393
Trade and other payables	21	7,705
Other current liabilities	22	2,311
Transactions with related parties included in the consolidated income statement:		
Purchases of inventories and oil products	6	57,014
Purchase of financial investments	9	40,378
Rent services received	6, 7	3,955
Transportation service received	6, 7	2,960
Insurance	7	2,164
Security services	6, 7	1,622
Other services received		5,454
Other:		
Pledged property, plant and equipment with various banks on behalf of related parties at the year end	11	19,567
Outstanding guarantees issued in favour of related parties	28	7,630

Prices for related party transactions are determined by the Group’s shareholders on an ongoing basis and approximate to market.

27. Operating leases

As of 31 December 2003 non-cancellable operating lease rentals are payable as follows:

Within one year	300
Between one and five years	-
More than five years	-
	<u>300</u>

The Group leases a number of buildings and vehicles under operating leases agreements as a lessee. The leases typically run on an initial period of one year, with an option to renew the lease after that date. Lease payments are usually increased annually to reflect market rentals. None of the leases include contingent rentals.

During the current year UAH 11,431 was recognised as an expense in the consolidated income statement in respect of operating leases.

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28. Commitments and contingencies

Taxation

The Group performs most of its operations in Ukraine and therefore within the jurisdiction of the Ukrainian tax authorities. The Ukrainian tax system can be characterized by numerous taxes and frequently changing legislation which may be applied retroactively, open to wide interpretation and in some cases are conflicting. Instances of inconsistent opinions between local, regional, and national tax authorities and between the National Bank of Ukraine and the Ministry of Finance are not unusual. Tax declarations are subject to review and investigation by a number of authorities that are enacted by law to impose fines and penalties and interest charges.

Management believes that it has adequately provided for tax liabilities based on its interpretation of tax legislation. However, there can be no assurance that the tax authorities may not have a different interpretation of the Company's and its subsidiaries compliance and assess fines and penalties.

No provisions for potential tax assessments have been made in these consolidated financial statements.

Insurance

The insurance industry in Ukraine is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have full coverage for its facilities, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Group property or relating to its operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Group's operations and financial position.

Guarantees

As of 31 December 2003 the Group provided loan guarantees of UAH 7,630 on behalf of related parties and UAH 12,045 on behalf of third parties. The guarantees expire in periods from 1 month to 3 years. The Group would be required to perform under the guarantees in the event of default by the related and third parties. The maximum amount of potential payments is UAH 19,675. There are no amounts being recognised as liabilities for these guarantees as management does not believe that it is probable that the Group will be required to perform under these guarantees.

Custody

During 2003, the Group provides various third parties with custody services on storage of petroleum products. As of 31 December 2003 the Group's outstanding custody commitment approximates UAH 38,153.

Other commitments

The Group is committed to reimburse employees for all expenses incurred in case of injuries at work. These amounts are expensed when they are incurred.

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29. Significant subsidiaries

The Group’s significant subsidiaries, all of which are incorporated in Ukraine, as of 31 December 2003 are as follows:

	Ownership
Subsidiary Company Lvivnaftoproduct	100%
Subsidiary Company Ivano-Frankivsknaftoproduct	100%
Subsidiary Company Uzhgorodnaftoproduct	100%
Subsidiary Company Khustnaftoproduct	100%
Subsidiary Company Vinnytsanaftoproduct	100%
Subsidiary Company Rivnenafoproduct	100%
Subsidiary Company CRPP	100%
Resurs-2 Ltd	99.8%
CJSC Terra-Petroleum	99.3%

30. Subsequent events

In 2004 the Group attracted a five-year loan denominated in USD in the amount of UAH 6,340. The loan is secured with property, plant and equipment with a carrying amount of UAH 16,956 as of 31 December 2003.

Subsequent to 31 December 2003 the Group sold its investment in the associated company Bank Universanliy for an amount approximating its carrying value at the year end (Note 13).