**OJSC INTERREGIONAL DISTRIBUTION GRID COMPANY OF CENTER AND VOLGA REGION**
**COMBINED FINANCIAL STATEMENTS**
**FOR THE YEARS ENDED 31 DECEMBER 2006 AND 2007**

**Contents**

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## Independent Auditors' Report

To the Board of Directors of OJSC Interregional Distribution Grid Company of Center and Volga Region

### Report on the Combined IFRS Financial Statements

We have audited the accompanying combined financial statements of OJSC Interregional Distribution Grid Company of Center and Volga Region (the "Company") and its subsidiaries (the "Group"), which comprise the combined balance sheets as at 31 December 2006 and 2007, and the combined income statements, combined statements of changes in equity and combined cash flow statements for the years then ended, and a summary of significant accounting policies and other explanatory notes.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditors' Responsibility*

Our responsibility is to express an opinion on these combined financial statements based on our audit. Except as described in the Basis for Qualified Opinion paragraph, we conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

*Basis for Qualified Opinion*

We did not observe the counting of inventories stated at RUR 743,418 thousand and RUR 679,450 thousand as at 31 December 2007 and 31 December 2006, respectively, because we were

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engaged as auditors of the Group only after those dates. It was impracticable to satisfy ourselves as to those inventory quantities by other audit procedures.

Accordingly, we were unable to determine whether any adjustments might be necessary to inventories, cost of sales, taxation, net profit and retained earnings as at and for the years ended 31 December 2006 and 31 December 2007.

*Qualified Opinion*

In our opinion, except for the effects of such adjustments, if any, that might have been determined to be necessary had it been practicable to obtain sufficient appropriate audit evidence as described in the Basis for Qualified Opinion paragraph, the combined financial statements present fairly, in all material respects, the combined financial position of the Group as at 31 December 2006 and 2007, and its combined financial performance and its combined cash flows for the years then ended in accordance with International Financial Reporting Standards.

*Emphasis of Matter*

Without further qualifying our opinion, we draw attention to the fact that the combined financial statements have been prepared for the purpose of presenting the combined financial position, combined financial performance and combined cash flows of certain companies that are under common control. The basis of preparation is described in Note 2.

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2 November 2009

## OJSC IDGC of Center and Volga Region
## Combined Balance Sheets as at 31 December 2006 and 2007

*(in thousands of Russian Roubles, unless otherwise stated)*

| | Note | 31 December 2007 | 31 December 2006 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 6 | 31,537,540 | 28,273,869 |
| Intangible assets | 7 | 183,833 | 40,769 |
| Investments in equity accounted investee | 8 | 47,912 | 60,646 |
| Other investments and financial assets | 9 | 409,088 | 206,545 |
| Other non-current assets | 10 | 140,863 | 207,765 |
| **Total non-current assets** | | **32,319,236** | **28,789,594** |
| **Current Assets** | | | |
| Inventories | 14 | 743,418 | 679,450 |
| Income tax receivable | | 97,804 | 106,216 |
| Trade and other receivables | 12 | 2,783,630 | 2,247,029 |
| Prepayments for current assets | 13 | 302,908 | 258,653 |
| Cash and cash equivalents | 11 | 461,523 | 231,284 |
| **Total current assets** | | **4,389,283** | **3,522,632** |
| **TOTAL ASSETS** | | **36,708,519** | **32,312,226** |
| **EQUITY AND LIABILITIES** | | | |
| Share capital | 15 | 11,269,782 | 11,269,782 |
| Reserves | | 49,510 | 44,404 |
| Retained earnings | | 13,969,630 | 12,927,844 |
| **Total equity attributable to shareholders of the Company** | | **25,288,922** | **24,242,030** |
| Minority interest | | 26,157 | 26,834 |
| **Total equity** | | **25,315,079** | **24,268,864** |
| **Non-current liabilities** | | | |
| Deferred income tax liabilities | 24 | 3,134,865 | 3,189,511 |
| Employee benefits | 16 | 407,091 | 404,496 |
| Loans and borrowings | 17 | 2,336,427 | 164,974 |
| Trade and other payables | 18 | 103,915 | 140,257 |
| **Total non-current liabilities** | | **5,982,298** | **3,899,238** |
| **Current liabilities** | | | |
| Loans and borrowings | 17 | 836,015 | 1,078,051 |
| Trade and other payables | 18 | 4,008,422 | 2,393,986 |
| Income tax payable | | 180,078 | 67,456 |
| Other taxes payable | 19 | 386,627 | 604,631 |
| **Total current liabilities** | | **5,411,142** | **4,144,124** |
| **Total liabilities** | | **11,393,440** | **8,043,362** |
| **TOTAL EQUITY AND LIABILITIES** | | **36,708,519** | **32,312,226** |

These combined financial statements were approved by management on 2 November 2009 and were signed on its behalf by:

Director General

Ushakov E.V.

Chief Accountant

Rodionova I.U.

The combined balance sheets is to be read in conjunction with the notes to, and forming part of, the combined financial statements set out on pages 9 to 40.

*(in thousands of Russian Roubles, unless otherwise stated)*

| | Note | Year ended 31 December 2007 | Year ended 31 December 2006 |
|---|---|---|---|
| Revenue | 20 | 26,678,691 | 21,501,943 |
| Operating expenses | 21 | (24,917,793) | (20,625,112) |
| Other income and expenses, net | 22 | 373,405 | 128,339 |
| **Operating profit** | | **2,134,303** | **1,005,170** |
| Financial income | 23 | 85,745 | 83,784 |
| Financial expenses | 23 | (112,194) | (117,274) |
| Share of loss of equity accounted investee (net of income tax) | | (12,648) | (1,610) |
| **Profit before income tax** | | **2,095,206** | **970,070** |
| Income tax expense | 24 | (754,400) | (534,878) |
| **Profit for the year** | | **1,340,806** | **435,192** |
| Attributable to: | | | |
| Shareholders of the Company | | 1,341,483 | 435,926 |
| Minority interest | | (677) | (734) |
| **Earnings per share** | 15 | | |
| Earnings per share – basic and diluted (in Russian roubles) | | 0.0119 | 0.0039 |

The combined income statement is to be read in conjunction with the notes to, and forming part of, the combined financial statements set out on pages 9 to 40.

*(in thousands of Russian Roubles, unless otherwise stated)*

| | Notes | Year ended 31 December 2007 | Year ended 31 December 2006 |
|---|---|---|---|
| **OPERATING ACTIVITIES:** | | | |
| **Profit before income tax** | | **2,095,206** | **970,070** |
| **Adjustments for:** | | | |
| Depreciation and amortisation | 6, 7 | 2,563,510 | 2,295,201 |
| Allowance for impairment of accounts receivable | | 74,811 | 66,415 |
| Financial income | | (85,745) | (83,784) |
| Financial expenses | | 112,194 | 117,274 |
| Loss on disposal of property, plant and equipment | | 68,022 | 6,686 |
| Accounts payable written-off | | (78,637) | (16,557) |
| Surplus of assets | | (130,799) | (124) |
| Share of loss of equity accounted investees (net of income tax) | | 12,648 | 1,610 |
| Adjustment for other non-cash transactions | | (3,850) | 38 |
| **Operating profit before working capital changes and income tax paid** | | **4,627,360** | **3,356,829** |
| **Working capital changes:** | | | |
| (Increase)/decrease in trade and other receivables | | (623,789) | 575,671 |
| Increase in prepayments | | (24,831) | (48,156) |
| (Increase)/decrease in inventories | | (17,127) | 17,390 |
| Increase in financial assets related to employee benefit fund | | (180,966) | (95,751) |
| Increase in trade and other payables | | 1,270,193 | 156,072 |
| Increase in employee benefits | | 2,595 | 8,728 |
| Decrease in taxes payable other than income | | (218,004) | (220,548) |
| **Cash flows from operations before income taxes and interest paid** | | **4,835,431** | **3,750,235** |
| Income tax paid | | (692,093) | (473,868) |
| Interest paid | | (79,374) | (102,583) |
| **Net cash flows from operating activities** | | **4,063,964** | **3,173,784** |
| **INVESTING ACTIVITIES:** | | | |
| Acquisition of property, plant and equipment and intangible assets | | (5,393,447) | (3,261,514) |
| Proceeds from disposal of property, plant and equipment | | 73,134 | 47,890 |
| Interest received | | 13,731 | 49,332 |
| Proceeds from disposal of other investments | | 114,287 | 83,909 |
| **Net cash flows used in investing activities** | | **(5,192,295)** | **(3,080,383)** |
| **FINANCING ACTIVITIES:** | | | |
| Proceeds from loans and borrowings | | 6,523,984 | 5,645,683 |
| Repayment of loans and borrowings | | (4,714,887) | (5,560,008) |
| Dividends paid | | (321,215) | (469,697) |
| Payment of finance lease liabilities | | (129,312) | (67,925) |
| **Net cash flows from/(used in) financing activities** | | **1,358,570** | **(451,947)** |
| **Net increase/(decrease) in cash and cash equivalents** | | **230,239** | **(358,546)** |
| **Cash and cash equivalents at beginning of year** | | **231,284** | **589,830** |
| **Cash and cash equivalents at end of year** | | **461,523** | **231,284** |

(in thousands of Russian Roubles, unless otherwise stated)

## Note 1. Background

### *(a) The Group and its operations*

Open Joint-Stock Company Interregional Distribution Grid Company of Center and Volga Region (hereafter, the "Company") and its subsidiaries (together referred to as the "Group") comprise Russian open joint stock companies as defined in the Civil Code of the Russian Federation. The Company was set up on 28 June 2007 based on Resolution no. 193p of 22 June 2007 and pursuant to the Board of Directors' decision (board of directors' meeting minutes no. 250 of 27 April 2007) of the Russian Open Joint-Stock Company RAO "United Energy Systems of Russia" (hereafter, "RAO UES").

The Company's registered office is Rozhdestvenskaya street, Nizhniy Novgorod, 603950, Russia.

The Group's principal activity is the transmission and distribution of electricity and connection of customers to the electricity grid.

The Group consists of the Company and its subsidiaries:

| Name | 31 December 2007<br>% owned | 31 December 2006<br>% owned |
|---|---|---|
| OJSC "Luchinskoye Agricultural Enterprise" | 100.00 | 100.00 |
| OJSC "Motor Vehicle Plant" | 100.00 | 100.00 |
| OJSC "Berendeyevskoye" | 100.00 | 100.00 |
| CJSC "Svet" | 100.00 | 100.00 |
| OJSC "Energetik Recreation Center" | 51.00 | 51.00 |
| OJSC "Energiya" Breeding Farm" | 100.00 | 100.00 |
| OJSC "Energetik Sanatorium-Preventorium" | 100.00 | 100.00 |
| OJSC "Udmurtenergoremont" | 100.00 | 100.00 |

The reform process in the Russian electric utilities industry creates conditions for competitive electricity market development in which the Group can raise the capital required to maintain and expand current capacity.

As part of the reform process, a merger of the Company with the entities listed below was effected on 29 February 2008 in accordance with the Resolution no. 250 of the Board of Directors of RAO UES of 27 April 2007:

OJSC "Kalugaenergo";

OJSC "Tulenergo";

OJSC "Ryazanenergo";

OJSC "Vladimirenergo";

OJSC "Ivenergo";

OJSC "Nizhnovenergo";

OJSC "Kirovenergo";

OJSC "Marienergo";

OJSC "Udmurtenergo".

The merger was affected through conversion of shares issued by the Company in exchange for shares in the acquired entities (see Note 15). As a result of the merger, above-mentioned companies ceased to exist as separate legal entities and the Company became their legal successor.

As at 31 December 2007, the Government of the Russian Federation owned 52.68 % of RAO UES, which in turn owned 100% of the Company.

On 1 July 2008 RAO UES ceased to exist as a separate legal entity and transferred shares of the Company to Open Joint-Stock Company "Interregional Distribution Grid Companies Holding" (hereafter, "IDGC Holding"), a newly formed state-controlled entity.

As at 31 December 2008, the Government of the Russian Federation owned 52.70% shares of IDGC Holding, which in turn owned 50.40% of the Company.

The Government of the Russian Federation influences the Group's activities through setting power transmission and distribution tariffs.

**(b) *Russian business environment***

The Russian Federation has been experiencing political and economic change that has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks that typically do not exist in other markets. In addition, the recent contraction in the capital and credit markets has further increased the level of economic uncertainty in the environment. The combined financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

**Note 2. Basis of preparation**

***(a) Statement of compliance***

These combined financial statements (hereinafter, "Financial Statements") have been prepared in accordance with International Financial Reporting Standards ("IFRSs").

***(b) First-time adoption of IFRS***

These Financial Statements are the Group's first combined financial statements prepared in accordance with IFRSs.

These Financial Statements have been prepared following the requirements of IFRS 1 First-time Adoption of International Financial Reporting Standards (IFRSs). In preparing these Financial Statements, the opening balance was prepared as at 1 January 2006 - the date of the Group's transition to IFRS.

The accounting policies set out in Note 3 have been applied in preparing the Financial Statements for the year ended 31 December 2007, the comparative information presented in these Financial Statements for the year ended 31 December 2006 and in the preparation of an opening IFRS balance sheet at 1 January 2006 (the Group's date of transition).

In preparing its opening combined IFRS balance sheet, the Group has adjusted amounts reported in its subsidiaries' financial statements prepared in accordance with Russian Accounting Principles for the purpose of fair presentation in accordance with IFRS.

As the Group did not prepare combined financial statements under Russian Accounting Principles, no reconciliation to previous GAAP on transition to IFRS is provided.

The Group elected to determine the deemed cost of property, plant and equipment as at 1 January 2006 (see Note 6).

***(c) Combined financial statements***

The formation of the Group was completed on 29 February 2008 (refer to Note 1 (a)). All the companies constituting the merged Group were under common control of RAO UES. These Financial Statements are prepared in accordance with the Group accounting policies in respect of business combinations involving entities under common control (refer to Note 3 (a)) as if the formation of the Group was completed as at 1 January 2006.

These Financial Statements are presented to show the combined financial position, combined financial performance and combined cash flows for OJSC "IDGC Center and Volga region", OJSC "Kalugaenergo", OJSC "Tulenergo", OJSC "Ryazanenergo", OJSC "Vladimirenergo", OJSC "Ivenergo", OJSC "Nizhnovenergo", OJSC "Kirovenergo", OJSC "Marienergo", OJSC "Udmurtenergo" and their subsidiaries, which are under common control of RAO UES and which were merged into one legal entity as part of the industry reorganisation process on 29 February 2008, as discussed in Note 1.

For the purpose of the combination, the accounting policies of OJSC "IDGC Center and Volga region", OJSC "Kalugaenergo", OJSC "Tulenergo", OJSC "Ryazanenergo", OJSC "Vladimirenergo", OJSC "Ivenergo", OJSC "Nizhnovenergo", OJSC "Kirovenergo", OJSC "Marienergo", OJSC "Udmurtenergo" are aligned and intra-company transactions are eliminated. Subject to these adjustments, assets, liabilities, revenues, and costs and expenses are added together.

Each enterprise of the Company individually maintains its own books of accounts and prepares its statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation. The accompanying financial statements are based on the statutory records and adjusted and reclassified for the purpose of fair presentation in accordance with IFRS.

These Financial Statements may not necessarily be indicative of the financial performance that would have been achieved if the Company and its merged entities had operated as a single entity.

### *(d) Basis of measurement*

The Financial Statements are prepared on the historical cost basis except that investments available-for-sale are stated at fair value; property, plant and equipment was revalued to determine deemed cost as part of the adoption of IFRS as at 1 January 2006.

### *(e) Functional and presentation currency*

The national currency of the Russian Federation is the Russian rouble ("RUR"), which is the Group's functional currency and the currency in which these Financial Statements are presented. All financial information presented in Russian roubles has been rounded to the nearest thousand.

### *(f) Use of judgments, estimates and assumptions*

Management has made a number of judgments, 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 IFRSs. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the Financial Statements is included in the following notes:

- Note 6 – Property, plant and equipment;
- Note 12 – Trade and other receivables;
- Note 16 – Employee benefits.

**Note 3. Significant accounting policies**

The following significant accounting policies have been applied in the preparation of these Financial Statements:

***(a) Basis of consolidation***

***Business combinations including entities under common control***

A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party both before and after the business combination, and that control is not transitory.

Business combinations arising from transfers of interests in entities that are under the control of the shareholder that controls the Company are accounted for as if the acquisition had occurred at the beginning of the earliest comparative period presented or, if later, at the date that common control was established; for this purpose comparatives are restated. The assets and liabilities acquired are recognised at the carrying amounts recognised previously in the acquired entity's IFRS financial statements. The components of equity of the acquired entities are added to the same components within the Company equity except that any share capital of the acquired entities is recognised as part of retained earnings. Any cash paid for the acquisition is recognised directly in equity.

***Subsidiaries***

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the Financial Statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

***Associates (equity accounted investees)***

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Associates are accounted for using the equity method. The Financial Statements include the Group's share of the income and expenses of equity accounted investees, after adjustments to align the accounting policies with those of the Group, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the carrying amount of that interest (including any long-term investments) is reduced to nil and the recognition of further losses is discontinued, except to the extent that the Group has an obligation or has made payments on behalf of the investee.

***Transactions eliminated on consolidation***

Intra-group balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing these Financial Statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

***(b) Foreign currency***

Transactions in foreign currencies are translated to Russian roubles at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to Russian roubles at the exchange rate at that date. Non-monetary assets and liabilities that are measured at fair value and denominated in a foreign currency are translated to Russian roubles at the exchange rate at the date that the fair value was determined. Foreign currency differences arising in translation are recognised in the income statement.

***(c) Financial instruments***

Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Accounting for finance income and expenses is discussed in note 3(m).

*Held-to-maturity investments*

If the Group has the positive intent and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortised cost using the effective interest method, less any impairment losses.

*Available-for-sale financial assets*

The Group's investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses, and foreign exchange gains and losses on available-for-sale monetary items, are recognised directly in equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to the income statement.

*Other*

Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses. 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.

***(d) Property, plant and equipment***

***Recognition and measurement***

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. The deemed cost of property, plant and equipment at 1 January 2006, the date of transition to IFRSs, was determined by reference to its fair value at that date.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labor, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing of assets and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment. Borrowing costs on qualifying assets are contained as part of the cost of such assets.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are recognised net in "operating expenses" in the income statement.

***Subsequent costs***

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The costs of the day-to-day servicing of property, plant and equipment are recognised in income statement as incurred.

*Depreciation*

Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives. Depreciation commences on the month following the acquisition or, in respect of internally constructed assets, from the month following the month an assets is completed and ready for use. Land is not depreciated.

The estimated useful lives for the current and comparative periods are as follows:

| Type of property, plant and equipment | Useful lives (in years) |
|---|---|
| Buildings | 7-50 |
| Transmission networks | 5-40 |
| Equipment for electricity transformation | 5-40 |
| Other | 1-50 |

***(e) Intangible assets***

Intangible assets that are acquired by the Group, which have finite useful lives, are measured at cost less accumulated amortisation and accumulated impairment losses.

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures, including expenditure on internally generated goodwill and brands, are recognised in the income statement as incurred.

Amortisation is recognised in the income statement on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. The estimated useful lives for the current and comparative periods are 3 to 10 years.

***(f) Leased assets***

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are operating leases and the leased assets are not recognised on the Group's balance sheet.

***(g) Inventories***

Inventories are measured at the lower of cost and net realisable value. The cost of inventory is determined on the weighted average cost method and includes expenditures incurred in acquiring the inventories and bringing them to their existing location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less selling expenses.

***(h) Impairment***

***Financial assets***

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in the income statement. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to the income statement. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in the income statement. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

*Non-financial assets*

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For intangible assets that have indefinite lives or that are not yet available for use, recoverable amount is estimated at each reporting date.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. 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 the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

***(i) Employee benefits***

***Defined contribution plans***

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans, including Russia's State pension fund, are recognised in the income statement when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

***Defined benefit plans***

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and any unrecognised past service costs and the fair value of any plan assets are deducted. The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating the terms of the Group's obligations and that are denominated in the same currency in which the benefits are expected to be paid. The calculation is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to the Group, the recognised asset is limited to the net total of any unrecognised past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

In calculating the Company's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds ten percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in the income statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised. Actuarial gains and losses on other long-term obligations are recognised immediately.

***Other long-term employee benefits***

The Group's net obligation in respect of long-term employee benefits other than pension plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any related assets is deducted. The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed using the projected unit credit method. Any actuarial gains or losses are recognised in the income statement in the period in which they arise.

***Short-term benefits***

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

***(j) Share capital***

*Ordinary shares*

Ordinary shares are classified as equity. Incremental costs directly attributable to issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

*Repurchase of share capital*

When share capital recognised as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, is net of any tax effects, and is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to / from retained earnings.

*(k) Revenue*

Revenue from electricity transmission is recognised in the income statement when the customer acceptance of the volume of electricity transmitted is received. The tariffs for energy transmission are approved by the Federal Tariff Agency and Regional Energy Commission of each region of the Group's operations.

Revenue from connection services represents a non-refundable fee for connecting the customer to the electricity grid network. The tariffs for connection services are approved by the Federal Tariff Agency and Regional Energy Commission of each region of the Group's operations. The terms, conditions and amounts of these fees are negotiated separately and are independent from fees generated by electricity transmission services. Revenue is recognised when electricity is activated and the customer is connected to the grid network or, for contracts where connection services are performed in stages, revenue is recognised in the proportion to the stage of completion when act of acceptance is signed by the customer.

Revenue from installation, repair and maintenance services and other sales is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer or when the services are provided.

*(l) Lease payments*

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the contingency no longer exists and the lease adjustment is known.

*(m) Financial income and expense*

Finance income comprises interest income on funds invested (including available-for-sale financial assets), dividend income, gains on the disposal of available-for-sale financial assets and foreign currency gains. Interest income is recognised as it accrues in the income statement, using the effective interest method. Dividend income is recognised in the income statement on the date that the Group's right to receive payment is established.

Finance expenses comprise interest expense on borrowings, employee benefits and finance leases, foreign currency losses. All borrowing costs are recognised in the income statement using the effective interest method, except for borrowing costs related to qualifying assets which are recognised as part of the cost of such assets.

Foreign currency gains and losses are reported on a net basis.

*(n) Income tax expense*

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

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

*(o) Dividends*

Dividends are recognised as a liability and deducted from equity at the balance sheet date only in case they are declared (approved by shareholders) before or on the balance sheet date. Dividends are disclosed in the notes to the financial statements when they are declared after the balance sheet date, but before the financial statements are authorised for issue.

*(p) Provisions*

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. 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 the risks specific to the liability.

*(q) Earnings per share*

The Group presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to shareholders of the Company by the weighted average number of shares outstanding during the period.

*(r) Segment reporting*

The Group operates predominantly in a single geographical area and industry, providing transmission of electric power and connection services in the Centre and Volga region of the Russian Federation. The transmission of electric power and connection services are related activities and are subject to similar risks and returns, therefore they are reported as one business segment.

***(s) New Standards and Interpretations not yet adopted***

The following new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2007, and have not been applied in preparing these Financial Statements. The Group plans to adopt these pronouncements when they become effective.

- *IFRS 8 Operating Segments* introduces the "management approach" to segment reporting. *IFRS 8 Operating Segments*, which becomes mandatory for the Group's 2009 consolidated financial statements, will require the disclosure of segment information based on the internal reports regularly reviewed by the Group's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them. The Group is currently assessing the impact of the amended standard on its financial statements.
- *IAS 1 Presentation of Financial Statements (revised September 2007; effective for annual periods beginning on or after 1 January 2009).* The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale-financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Company expects the revised IAS 1 to affect the presentation of its financial statements but to have no impact on the recognition or measurement of specific transactions and balances.
- *IAS 27 Consolidated and Separate Financial Statements (revised January 2008; effective for annual period beginning on or after 1 July 2009).* The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do no result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group is currently assessing the impact of the amended standard on its financial statements.
- *IFRS 3 Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2009).* The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or on the same basis as US GAAP (at fair value). The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, goodwill will be measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The Group is currently assessing the impact of the amended standard on its financial statements.

**Note 4. Determination of fair values**

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

*(a) Investments in equity and debt securities*

The fair value of held-to-maturity investments and available-for-sale financial assets is determined by reference to their quoted bid price at the reporting date. The fair value of held-to-maturity investments is determined for disclosure purposes only.

*(b) Trade and other receivables*

The fair value of trade and other receivables, excluding construction work in progress, is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

*(c) Non-derivative financial liabilities*

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. In respect of the liability component of convertible notes, the market rate of interest is determined by reference to similar liabilities that do not have a conversion option. For finance leases the market rate of interest is determined by reference to similar lease agreements.

**Note 5. Financial risk management**

*(a) Overview*

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk.

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these Financial Statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

*(b) Credit risk*

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's cash and cash equivalents, receivables from customers and investment securities.

***Trade and other receivables***

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. To manage the credit risk, the Group attempts, to the extent possible, to demand prepayments from customers.

Prepayments for connection services are routinely included in the customer service contracts.

The customer base for electricity transmission services for each of the Group's entities is limited to several distribution companies and a small number of large manufacturing enterprises. Payments are tracked regularly and electricity transmission customers are advised of any failures to submit timely payments.

The Group does not require collateral in respect of trade and other receivables.

The Group establishes an allowance for impairment that represents its estimate of anticipated losses in respect of trade and other receivables that relate to individually significant exposures.

***Cash and cash equivalents***

The Group attempts to minimise the credit risk exposure for current and deposit accounts with banks by placing temporarily available funds only with the banks that are lendors to the Group.

***(c) Liquidity risk***

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, that it will always have sufficient liquidity to meet its liabilities when due, without incurring losses.

***(d) Market risk***

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

***Currency risk***

The Group does not have significant exposure to currency risk on sales, purchases and borrowings, because no significant sales, purchases and borrowings are denominated in a currency other than function currency of the merged entities, which in Russian roubles.

***Interest rate risk***

The Group's interest rate risk arises from short-term and long-term borrowings. Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). The majority of interest rates on current and non-current borrowings are fixed. The Group's operating profits and cash flows from operating activity are largely not dependent on the changes in market interest rates.

***(e) Capital management***

The management's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The management monitors the level of dividends to ordinary shareholders. The management seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position. Neither the Company nor any Group companies are subject to externally imposed capital requirements.

(in thousands of Russian Roubles, unless otherwise stated)

## Note 6. Property, plant and equipment

| | Land and buildings | Transmission networks | Equipment for electricity transformation | Assets under construction | Other | Total |
|---|---|---|---|---|---|---|
| **Deemed cost** | | | | | | |
| Balance at 1 January 2006 | 2,714, 614 | 17,548,541 | 4,211,459 | 466,017 | 2,154,902 | 27,095,533 |
| Additions | 5,082 | 33,516 | 44,885 | 3,118,982 | 398,596 | 3,601,061 |
| Transfers | 210,723 | 979,204 | 912,609 | (2,425,419) | 322,883 | - |
| Disposals | (10,982) | (33,062) | (5,527) | (21,360) | (67,043) | (137,974) |
| Balance at 31 December 2006 | 2,919,437 | 18,528,199 | 5,163,426 | 1,138,220 | 2,809,338 | 30,558,620 |
| Balance at 1 January 2007 | 2,919,437 | 18,528,199 | 5,163,426 | 1,138,220 | 2,809,338 | 30,558,620 |
| Additions | 23,659 | 174,724 | 324,884 | 4,916,043 | 542,359 | 5,981,669 |
| Transfers | 428,390 | 1,117,410 | 1,358,578 | (3,981,489) | 1,077,111 | - |
| Disposals | (15,769) | (91,939) | (21,794) | (3,962) | (101,856) | (235,320) |
| Balance at 31 December 2007 | 3,355,717 | 19,728,394 | 6,825,094 | 2,068,812 | 4,326,952 | 36,304,969 |
| **Accumulated depreciation** | | | | | | |
| Balance at 1 January 2006 | - | - | - | - | (1,817) | (1,817) |
| Depreciation charge | (132,121) | (1,391,413) | (436,711) | - | (331,671) | (2,291,916) |
| Disposals | 671 | 3,040 | 392 | - | 4,879 | 8,982 |
| Balance at 31 December 2006 | (131,450) | (1,388,373) | (436,319) | - | (328,609) | (2,284,751) |
| Balance at 1 January 2007 | (131,450) | (1,388,373) | (436,319) | - | (328,609) | (2,284,751) |
| Depreciation charge | (150,547) | (1,453,101) | (510,628) | - | (412,893) | (2,527,169) |
| Disposals | 1,156 | 20,837 | 4,777 | - | 17,721 | 44,491 |
| Balance at 31 December 2007 | (280,841) | (2,820,637) | (942,170) | - | (723,781) | (4,767,429) |
| **Net book value** | | | | | | |
| At 1 January 2006 | 2,714,614 | 17,548,541 | 4,211,459 | 466,017 | 2,153,085 | 27,093,716 |
| At 31 December 2006 | 2,787,987 | 17,139,826 | 4,727,107 | 1,138,220 | 2,480,729 | 28,273,869 |
| At 31 December 2007 | 3,074,876 | 16,907,757 | 5,882,924 | 2,068,812 | 3,603,171 | 31,537,540 |

As at 31 December 2007 construction in progress includes advance prepayments for property, plant and equipment of RUR 260,276 thousand (as at 13 December 2006: RUR 167,801 thousand).

Borrowing costs totalling RUR 16,471 thousand at 31 December 2007 (as at 31 December 2006: nil) were included in cost of property, plant and equipment and represent interest on loans.

*Determination of deemed cost*

The deemed cost of Group's property, plant and equipment as at 1 January 2006 was RUR 27,095,533 thousand and was determined on the basis of fair value at that date. The net book value of property, plant and equipment in the financial statements prepared in accordance with the Russian accounting standards was RUR 23,108,152 thousand as at 1 January 2006.

The majority of the items of property, plant and equipment is specialised electricity equipment and is rarely sold on the open market other than as a part of continuing business. The market for similar property, plant and equipment is not active and does not provide a sufficient number of sales of comparable property, plant and equipment for using a market-based approach for determining fair value.

Consequently the fair value of property, plant and equipment was primarily determined using depreciated replacement cost. This method considers the cost to reproduce or replace the property, plant and equipment, adjusted for physical, functional or economical depreciation, and obsolescence.

The depreciated replacement cost was estimated based on internal sources and analysis of the Russian and international markets for similar property, plant and equipment. Various market data were collected from published information, catalogues, statistical data etc.

In addition to the determination of the depreciated replacement cost, cash flow testing was conducted in order to assess the reasonableness of those values, which resulted in the depreciated replacement cost values being decreased by RUR 73,409 million in arriving at the above value.

The following key assumptions were used in performing the cash flow testing:

- The projections of cash flows are based on the actual operating results for the year 2006 and the ten-year business plan for the years 2007 to 2016.
- In the first year the total revenue from electricity transmission and distribution was projected at RUR 25,707 million. The management plans to achieve the amount of RUR 65,476 million by the tenth year of the business plan. The anticipated average annual production growth included in the cash how projection was 10.95% for the years 2007 to 2016 mainly due to introduction of new tariffs.
- Based on Government regulations, the electricity transmission industry was expected to switch to the Regulatory Asset Base (RAB) regulation of tariffs, which is aimed at ensuring the fair return on the invested capital. The shift to RAB regulation was expected to occur in 2012 with the transition period 2010-2012. The RUR rate of return on the invested capital as determined by Government regulations was expected to be in the range of 5.5% to 6.5%.
- A discount rate was estimated in the range from 11.43-12.20% in the first year to 10.52-10.96% in the tenth year and was applied in determining the recoverable amount of property, plant and equipment. The discount rate was estimated on the basis of the Company's cost of equity (from 11.60-12.50% in the first year to 12.42-13.08% in the tenth year) and after-tax cost of borrowings of 6.84%.
- A terminal value was derived at the end of a ten-year interim period. A terminal growth rate of 2.7% was considered in estimating the terminal value for the assets.

The values assigned to the key assumptions represent management's assessment of future trends in the business and are based on both external and internal sources.

***Impairment test***

Management has used various assumptions in the calculation of the recoverable value of property, plant and equipment. Variations in these assumptions may give rise to a significantly different amount of the impairment provision. In management opinion, no indicators of impairment exist as at the reporting date. Refer to note 30 for the description of conditions that had an effect on this assessment in 2008.

***Security***

As at 31 December 2007 and 31 December 2006 equipment with a carrying amount of RUR 22,174 thousand is pledged as collateral according the bank loan agreements (see Note 17).

***Leased plant and machinery***

The Group leases production equipment and transport under a number of finance lease agreements. At the end of each of the leases the Group has the option to purchase the equipment at a beneficial price.

The net book value of leased property, plant and equipment, accounted for as part of the Group's property, plant and equipment was as follows:

(in thousands of Russian Roubles, unless otherwise stated)

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Cost | 354,594 | 180,391 |
| Accumulated depreciation | (26,771) | (12,328) |
| **Net book value** | **327,823** | **168,063** |

## Note 7. Intangible assets

| | Patents and licenses | Computer software | Total |
|---|---|---|---|
| **Cost** | | | |
| Balance at 1 January 2006 | - | - | - |
| Additions | 44,054 | - | 44,054 |
| Balance at 31 December 2006 | **44,054** | - | **44,054** |
| | | | |
| Balance as 1 January 2007 | **44,054** | - | **44,054** |
| Additions | 158,817 | 20,588 | 179,405 |
| Balance as 31 December 2007 | **202,871** | **20,588** | **223,459** |
| | | | |
| **Accumulated amortisation** | | | |
| Balance at 1 January 2006 | - | - | - |
| Amortisation for the year | (3,285) | - | (3,285) |
| Balance at 31 December 2006 | **(3,285)** | - | **(3,285)** |
| | | | |
| Balance as at 1 January 2007 | **(3,285)** | - | **(3,285)** |
| Amortisation for the year | (33,939) | (2,402) | (36,341) |
| Balance at 31 December 2007 | **(37,224)** | **(2,402)** | **(39,626)** |
| **Net book value** | | | |
| At 1 January 2006 | - | - | - |
| At 31 December 2006 | **40,769** | - | **40,769** |
| At 31 December 2007 | **165,647** | **18,186** | **183,833** |

Intangible assets include mandatory licenses for electricity transmission and capitalised SAP/R3 implementation expenses.

(in thousands of Russian Roubles, unless otherwise stated)

**Note 8. Investments in equity accounted investee**

The Group has the following investment in equity accounted investee:

| | Country | Ownership/Voting |
|---|---|---|
| OJSC "Tulenergokomplect" | Russia | 50.00% |

The following is summarised financial information, in aggregate, in respect of equity accounted investee:

| | 2007 | 2006 |
|---|---|---|
| Total assets | 75,260 | 101,617 |
| Total liabilities | (38,421) | (39,291) |
| Revenue | 132,537 | 145,594 |
| Loss for the year | (25,295) | (3,219) |

**Note 9. Other investments and financial assets**

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Available-for-sale investments stated at cost | 11,261 | 11,261 |
| Available-for-sale investments stated at fair value | 70,286 | 59,152 |
| Financial assets related to employee benefit fund | 327,541 | 136,132 |
| **Total** | **409,088** | **206,545** |

The fair value of available-for-sale investments with a carrying amount of RUR 5,143 thousand (as at 31 December 2006: RUR 727 thousand) was determined by reference to their quoted market prices; these investments are listed on the Moscow Interbank Currency Exchange (MICEX).

Available-for-sale investments stated at cost comprise unquoted equity securities in the insurance and energy industries. There is no market for these investments and there have not been any recent transactions that provide evidence of fair value.

Financial assets related to employee benefit fund relate to the Group contributions accumulated in solidary and employees' individual pension accounts with the Non-State Pension Fund of Electric Power Industry (employee benefit fund). Subject to certain restrictions contributions to the employee benefit fund can be withdrawn at the discretion of the Group.

**Note 10. Other non-current assets**

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Other receivables | 72,684 | 71,743 |
| Unfinished intangible assets | 43,056 | 46,551 |
| Trade receivables | 32,290 | 90,297 |
| Finance lease receivables | 1,205 | 7,366 |
| Less: Accounts receivable impairment allowance | (8,372) | (8,192) |
| **Total** | **140,863** | **207,765** |

The Group's exposure to credit and currency risks and impairment losses related to non-current accounts receivable are disclosed in Note 29.

(in thousands of Russian Roubles, unless otherwise stated)

**Note 11. Cash and cash equivalents**

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Bank balances | 412,284 | 220,651 |
| Call deposits | 35,900 | 10,000 |
| Bank promissory notes | 12,900 | - |
| Petty cash | 439 | 633 |
| **Total** | **461,523** | **231,284** |

All cash and cash equivalents are denominated in RUR.

The Group's exposure to interest rate risk and a sensitivity analysis for financial assets and liabilities are disclosed in note 29.

**Note 12. Trade and other receivables**

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Trade receivables | 2,766,876 | 2,347,278 |
| Other receivables | 691,733 | 874,256 |
| Taxes receivable | 229,055 | 77,171 |
| VAT receivable | 215,888 | 178,011 |
| Finance lease receivables | 11,206 | 5,724 |
| Less: Allowance for impairment of trade receivable | (906,793) | (989,633) |
| Less: Allowance for impairment of other receivable | (224,335) | (245,778) |
| **Total** | **2,783,630** | **2,247,029** |

The Group's exposure to credit and currency risks and impairment losses related to trade and other receivables are disclosed in Note 29.

**Note 13. Prepayments for current assets**

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Prepayments | 322,332 | 278,871 |
| Less: Allowance for impairment of prepayments | (19,424) | (20,218) |
| **Total** | **302, 908** | **258,653** |

**Note 14. Inventories**

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Raw materials and supplies | 563,659 | 471,656 |
| Spare parts | 127,664 | 159,237 |
| Other inventories | 52,095 | 48,557 |
| **Total** | **743,418** | **679,450** |

As at 31 December 2007 and 31 December 2006 inventories with carrying amount of RUR 18,826 thousand are pledged as collateral according the bank loan agreements (see Note 17).

**Note 15. Equity**

***Share capital***

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Number of ordinary shares authorised, issued and fully paid | 112,697,817,043 | 112,697,817,043 |
| Par value (in RUR) | 0.10 | 0.10 |
| **Total share capital (in RUR)** | **11,269,781,704** | **11,269,781,704** |

The charter capital of the Company formed upon its foundation was RUR 10,000 thousand and consisted of 100,000,000 ordinary shares of RUR 0.1 par value.

29 February 2008 the Company registered the results of 112,597,817,043 ordinary shares issue which were placed by conversion upon merger of regional generation companies.

Formation of the Group was completed on 29 February 2008 through conversion of OJSC "Kalugaenero", OJSC "Tulenergo", OJSC "Ryazanenergo", OJSC "Vladimirenergo", OJSC "Nizhnovenergo", OJSC "Kirovenergo", OJSC "Marienergo", OJSC "Udmurtenergo" and OJSC "Ivenergo" shares into an additionally issued 112,597,817,043 ordinary shares of the Company as follows:

- 24,393/8,307,841 of ordinary shares of OJSC "Vladimirenergo" with par value of RUR 72.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/116,435 of ordinary shares of OJSC "Ivenergo" with par value of RUR 1.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/106,632 of preference shares of OJSC "Ivenergo" with par value of RUR 1.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/3,660,401 of ordinary shares of OJSC "Kalugaenero" with par value of RUR 10.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/97,418 of ordinary shares of OJSC "Kirovenergo" with par value of RUR 1.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/89,216 of preference shares of OJSC "Kirovenergo" with par value of RUR 1.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/819,890 of ordinary shares of OJSC "Marienergo" with par value of RUR 1.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/750,855 of preference shares of OJSC "Marienergo" with par value of RUR 1.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/194,079,154 of ordinary shares of OJSC "Nizhnovenergo" with par value of RUR 85.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/177,737,689 of preference shares of OJSC "Nizhnovenergo" with par value of RUR 85.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/1,572,918 of ordinary shares of OJSC "Ryazanenergo" with par value of RUR 10.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/117,828 of ordinary shares of OJSC "Tulenergo" with par value of RUR 1.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/1,454,307 of ordinary shares of OJSC "Udmurtenergo" with par value of RUR 1.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1;
- 24,393/1,331,854 of preference shares of OJSC "Udmurtenergo" with par value of RUR 1.00 were converted into one additionally issued ordinary share of the Company with par value of RUR 0.1

The difference between the nominal value share capital of the company after the reorganisation and the total nominal value of shares in the merged entities before the reorganisation was RUR 307 thousand and was debited to retained earnings at 1 January 2006.

Share capital as at 31 December 2006 and 31 December 2007 was presented as if restructuring completed in February 2008 had taken place at the beginning of the earliest period presented (1 January 2006).

***Dividends paid and declared***

In accordance with Russian legislation the Company's distributable reserves are limited to the balance of retained earnings as recorded in the Company's statutory financial statements prepared in accordance with Russian Accounting Principles. As at 31 December 2007 the Company had retained earnings, including the profit for the current year, of RUR 2,642,240 thousand (as at 31 December 2006: RUR 1,331,890 thousand).

In 2007 the Group declared dividends for the year 2006 in the amount of RUR 299,697 thousand. (in 2006: RUR 511,231 thousand).

Dividends per share at 31 December 2007 were RUR 0.0027 (as at 31 December 2006: RUR 0.0045).

(in thousands of Russian Roubles, unless otherwise stated)

***Earnings per share***

The calculation of earnings per share is based upon the profit for the year and the outstanding number of ordinary shares after the merger on 29 February 2008 in order to determine earnings per share for the combined entities as if the merger was completed on 1 January 2006. The Company has no dilutive potential ordinary shares.

| | 2007 | 2006 |
|---|---|---|
| Weighted average number of ordinary shares issued | 112,697,817,043 | 112,697,817,043 |
| Profit attributable to the shareholders | 1,340,806 | 435,192 |
| Weighted average earnings per ordinary share – basic (in RUR) | 0.0119 | 0.0039 |

**Note 16. Employee benefits**

The Group provides the following post-employment and other long-term benefit plans:

- defined contribution pension plan and defined benefit pension plan (Non-State Pension Fund of the Electric Power and Non-State Pension Fund "Proffesionalny"); and
- defined benefit pension plans and other long-term defined benefit plans regulated by Collective Bargaining Agreements that include lump sum benefit for pensioners upon retirement, benefits paid in connection with the jubilee dates of pensioners and employees, financial support for pensioners, one-time benefits paid in case of death.

The table below summarises the amounts of defined benefit obligations recognised in the financial statements.

Amounts recognised in the combined balance sheet:

| | 31 December 2007 | | 31 December 2006 | |
|---|---|---|---|---|
| | Post-employment benefits | Other benefits | Post-employment benefits | Other benefits |
| Present value of funded defined benefit obligations | 543,511 | 11,673 | 454,105 | 9,067 |
| Net actuarial gains not recognised in the balance sheet | (114,972) | - | (43,495) | - |
| Past service cost not recognised in the balance sheet | (33,121) | - | (15,181) | - |
| **Net liability in the balance sheet** | **395,418** | **11,673** | **395,429** | **9,067** |

Amounts recognised in the combined income statement:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Post-employment benefits | Other benefits | Post-employment benefits | Other benefits |
| Current service cost | 27,928 | 879 | 23,299 | 1,256 |
| Interest expenses | 30,743 | 614 | 26,385 | 646 |
| Recognised actuarial loss/(gains) | - | 3,727 | - | (127) |
| Past service cost | 2,766 | - | 1,080 | - |
| Immediate recognition of vested prior service cost | 12,728 | 123 | 8,115 | - |
| **Total** | **74,165** | **5,343** | **58,879** | **1,775** |

(in thousands of Russian Roubles, unless otherwise stated)

Changes in the present value of the Group's defined benefit obligations are as follows:

| | 2007 Post-employment benefits | 2007 Other benefits | 2006 Post-employment benefits | 2006 Other benefits |
|---|---|---|---|---|
| **Benefit obligations** | | | | |
| Benefit obligations as at the beginning of the period | 454,105 | 9,067 | 386,315 | 9,453 |
| Current service cost | 27,928 | 879 | 23,299 | 1,256 |
| Interest cost | 30,743 | 614 | 26,385 | 646 |
| Actuarial losses/(gains) | 71,477 | 3,727 | 43,495 | (127) |
| Benefits paid | (74,176) | (2,737) | (49,765) | (2,161) |
| Past service cost | 33,434 | 123 | 24,376 | - |
| **Benefit obligations as at the end of the period** | **543,511** | **11,673** | **454,105** | **9,067** |

Changes in the Group's net benefit obligations are as follows:

| | 2007 Post-employment benefits | 2007 Other benefits | 2006 Post-employment benefits | 2006 Other benefits |
|---|---|---|---|---|
| **Net benefit obligations** | | | | |
| Net benefit obligations as at the beginning of the period | 395,429 | 9,067 | 386,315 | 9,453 |
| Net costs for the period | 74,165 | 5,343 | 58,879 | 1,775 |
| Benefits paid | (74,176) | (2,737) | (49,765) | (2,161) |
| **Net benefit obligations as at the end of the period** | **395,418** | **11,673** | **395,429** | **9,067** |

Principal actuarial estimations are as follows:

| | 2007 Post-employment benefits | 2007 Other benefits | 2006 Post-employment benefits | 2006 Other benefits |
|---|---|---|---|---|
| Discount rate | 6.79% | 6.79% | 6.77% | 6.77% |
| Future Salary increase | 6.15% | 6.15% | 6.58% | 6.58% |
| Future inflation rate | 6.15% | 6.15% | 6.58% | 6.58% |
| Mortality table | Russian 2002 | Russian 2002 | Russian 2002 | Russian 2002 |
| Average working life (in years) | 13 | 13 | 13 | 13 |

(in thousands of Russian Roubles, unless otherwise stated)

**Note 17. Loans and borrowings**

*Non-current borrowings*

| | Effective interest rate,% | Currency | Year of maturity | 31 December 2007 | 31 December 2006 |
|---|---|---|---|---|---|
| **Loans and borrowings** | | | | | |
| including: | | | | | |
| OJSC Sberbank | 8.5-10.5 | RUR | 2010-2011 | 1,717,485 | - |
| OJSC Gazprombank | 8.8-9.8 | RUR | 2012 | 303,451 | - |
| OJSC Eurofinance | 9.45-12 | RUR | 2008-2010 | 274,548 | 25,354 |
| OJSC Agropromcredit | 11.4-14 | RUR | 2008 | 69,159 | 69,277 |
| Non-current finance lease liability | | | | 136,557 | 70,343 |
| **Total non-current debt** | | | | **2,501,200** | **164,974** |
| Less current portion of non-current loans | | | | (164,773) | - |
| **Total** | | | | **2,336,427** | **164,974** |

*Current borrowings*

| Creditor | Effective interest rate,% | Currency | 31 December 2007 | 31 December 2006 |
|---|---|---|---|---|
| **Current borrowings** | | | | |
| including: | | | | |
| OJSC Sberbank | 7.2-12 | RUR | 307,761 | 50,007 |
| OJSC Agropromcredit | 8.3-14 | RUR | 79,279 | 25,029 |
| OJSC Gazprombank | 7.5-13 | RUR | 95,535 | 86,716 |
| OJSC VTB Bank | 11.5-13 | RUR | 25,107 | - |
| OJSC Eurofinance | 9.5-10 | RUR | 30,000 | 126,000 |
| OJSC Alfa-Bank | 7.68-8.01 | RUR | - | 430,401 |
| OJSC Promstroybank | 8.5-8.54 | RUR | - | 80,179 |
| OJSC Impeksbank | 10 | RUR | - | 80,000 |
| OJSC Prio-Vneshtorgbank | 11 | RUR | 25,000 | 25,000 |
| OJSC Agropromkredit | 11.4-14 | RUR | - | 79,000 |
| OJSC Rosbank | 11 | RUR | - | 6,000 |
| Other current borrowings | | RUR | 541 | 30,496 |
| Current portion of non-current loans | | | 164,773 | - |
| Current Finance lease liability | | | 108,019 | 59,223 |
| **Total** | | | **836,015** | **1,078,051** |

All loans and borrowings listed above are bank loans with fixed interest rate.

The effective interest rate is the market interest rate applicable to the loan at the date of its receipt.

The Group has not entered into any hedging arrangements in respect of its interest rate exposure.

The bank loans in the amount of RUR 335,000 thousand (31 December 2006: nil) are secured by cash flows on certain power supply contracts in the amount of RUR 399,561 thousand.

As at 31 December 2007 and 31 December 2006 the bank loans in the amount of RUR 25,000 thousand are secured over inventories (see Note 14) in the amount of RUR 18,826 thousand and equipment (see Note 6) in the amount of RUR 22,174 thousand.

The Group leases production equipment and transport under a number of finance lease agreements. Finance lease liabilities are payable as follows:

| | 31 December 2007 | | | 31 December 2006 | | |
|---|---|---|---|---|---|---|
| | Minimum lease payments | Interest | Principal | Minimum lease payments | Interest | Principal |
| Less than one year | 123,772 | 17,175 | 106,597 | 67,190 | 14,721 | 52,469 |
| Between one and five years | 184,299 | 61,256 | 123,043 | 103,272 | 41,621 | 61,651 |

(in thousands of Russian Roubles, unless otherwise stated)

| | | | | | | |
|---|---|---|---|---|---|---|
| More than five years | 774 | 483 | 291 | - | - | - |
| | **308,845** | **78,914** | **229,931** | **170,462** | **56,342** | **114,120** |

The finance lease liabilities are secured by leased assets.

The Group's exposure to currency, liquidity and interest rate risk related to borrowings and finance lease liabilities is disclosed in Note 29.

**Note 18. Trade and other payables**

*Non-current payables*

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Trade payables | - | 23,833 |
| Other payables | 103,915 | 116,424 |
| **Total** | **103,915** | **140,257** |

*Current payables*

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Trade payables | 1,704,355 | 854,359 |
| Advances from customers | 1,405,044 | 646,647 |
| Payables to employees | 375,678 | 313,323 |
| Dividends payable | 193,798 | 215,316 |
| Other payables | 329,547 | 364,341 |
| **Total** | **4,008,422** | **2,393,986** |

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 29.

**Note 19. Other taxes payable**

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Value added tax payable | 202,749 | 418,608 |
| Unified social tax payable | 74,614 | 58,722 |
| Other taxes payable | 64,028 | 58,128 |
| Fines and other penalties payable | 28,794 | 49,872 |
| Property tax payable | 16,442 | 19,301 |
| **Total** | **386,627** | **604,631** |

The deferred value added tax in amount of RUR 183,318 thousands only becomes payable to the tax authorities when the underlying receivable balances are either recovered or written off (as at 31 December 2006: RUR 327,589 thousands).

The Group's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 29.

**Note 20. Revenue**

| | 2007 | 2006 |
|---|---|---|
| Electricity transmission | 24,512,672 | 20,460,538 |
| Connection services | 1,260,357 | 282,160 |
| Other revenue | 905,662 | 759,245 |
| **Total** | **26,678,691** | **21,501,943** |

Other revenues are comprised of repair, construction, maintenance services, rent services and transport services.

**Note 21. Operating expenses**

| | 2007 | 2006 |
|---|---|---|
| Purchased electricity | 6,489,736 | 3,956,968 |
| Personnel costs | 5,420,009 | 4,467,581 |
| Electricity transmission | 4,667,582 | 5,195,749 |

(in thousands of Russian Roubles, unless otherwise stated)

| | 2007 | 2006 |
|---|---|---|
| Depreciation and amortisation | 2,563,510 | 2,295,201 |
| Electricity metering services | 1,172,888 | 587,173 |
| Repair and maintenance | 1,083,498 | 1,121,895 |
| Materials | 693,033 | 766,187 |
| Management fee | 344,189 | 108,611 |
| Consulting, legal and audit services | 310,265 | 295,146 |
| Insurance | 293,151 | 208,520 |
| Electricity and heat power for own needs | 204,723 | 190,768 |
| Taxes other than income tax | 175,504 | 118,250 |
| Rent | 172,484 | 140,141 |
| Transportation expenses | 137,940 | 98,148 |
| Security services | 90,320 | 84,916 |
| Communication services | 74,037 | 64,248 |
| Loss on the disposal of property, plant and equipment | 68,022 | 6,686 |
| Social expenditures and charity expenses | 61,844 | 73,986 |
| Allowance for impairment of debts | 74,811 | 66,415 |
| Certification fee | 56,013 | 109,577 |
| Bank commission | 41,426 | 18,734 |
| Other expenses | 722,808 | 650,212 |
| **Total** | **24,917,793** | **20,625,112** |

**Note 21a. Personnel costs**

| | 2007 | 2006 |
|---|---|---|
| Wages and salaries | 4,409,466 | 3,627,477 |
| Unified social tax | 978,932 | 809,043 |
| Vacation and remuneration provision | 29,016 | 22,333 |
| Expense in respect of post-employment defined benefit plan | 2,595 | 8,728 |
| **Total** | **5,420,009** | **4,467,581** |

The average number of employees (including production and non-production staff) was 19,267 in 2007 (2006: 19,426).

(in thousands of Russian Roubles, unless otherwise stated)

### Note 22. Other income and expenses, net

| | 2007 | 2006 |
|---|---|---|
| Surplus of assets | 130,799 | 124 |
| Accounts payable written-off | 78,637 | 16,557 |
| Tax and other penalties | 73,954 | 54,548 |
| Other income and expenses, net | 90,015 | 57,110 |
| **Total** | **373,405** | **128,339** |

Surplus of assets is represented by ownerless transfer facilities identified by the Group during the stock take. The Group used services of independent appraisers to determine the fair value of the identified assets recognized in the balance sheet.

### Note 23. Financial income and expenses

| | 2007 | 2006 |
|---|---|---|
| **Financial income** | | |
| Interest income | 75,312 | 81,872 |
| Interest income on financial assets related to employee benefit fund | 10,433 | 1,912 |
| | **85,745** | **83,784** |
| **Financial expenses** | | |
| Interest expense | (68,213) | (101,399) |
| Interest expense of finance lease liabilities | (43,981) | (15,875) |
| | **(112,194)** | **(117,274)** |
| **Net financial expenses recognised in profit or loss** | **(26,449)** | **(33,490)** |

### Note 24. Income tax expense

| | 2007 | 2006 |
|---|---|---|
| Current income tax charge | 884,679 | 434,835 |
| (Over)/under provided in prior years | (74,021) | 85,804 |
| Deferred income charge | (56,258) | 14,239 |
| **Income tax charge** | **754,400** | **534,878** |

The Group's applicable tax rate in the Russian Federation is the income tax rate of 24%.

Reconciliation of effective tax rate :

| | 2007 | % | 2006 | % |
|---|---|---|---|---|
| **Profit before income tax** | **(2,095,206)** | **100** | **(970,070)** | **100** |
| Income tax at applicable tax rate | 502,849 | (24) | 232,817 | (24) |
| (Over)/under provided in prior years | (74,021) | 4 | 85,804 | (9) |
| Tax effect of items which are not deductible or taxable for taxation purposes | 325,572 | (16) | 216,257 | (22) |
| *Welfare, social and discretionary payments to employees* | *77,429* | *(4)* | *76,522* | *(8)* |
| *Written-off receivables* | *39,950* | *(2)* | *28,849* | *(3)* |
| *Non-refundable VAT* | *9,420* | *(1)* | *3,493* | *(1)* |
| *Other* | *198,773* | *(9)* | *107,393* | *(10)* |
| **Total** | **754,400** | **(36)** | **534,878** | **(55)** |

(in thousands of Russian Roubles, unless otherwise stated)

***Deferred tax assets and liabilities***

For the year ended 31 December 2006 deferred tax assets and liabilities are attributable to the following items:

| | 31 December 2006 | Recognised in income | Recognised in equity | 1 January 2006 |
|---|---|---|---|---|
| Trade and other receivables | 266,520 | 58,407 | - | 324,927 |
| Inventories | 22,342 | (2,275) | - | 20,067 |
| Trade and other payables | 87,780 | (26,105) | - | 61,675 |
| Employee benefit obligation | 97,079 | (2,095) | - | 94,984 |
| Other | 54,389 | 14,464 | - | 68,853 |
| **Deferred tax assets** | **528,110** | **42,396** | - | **570,506** |
| Property, plant and equipment | (3,611,054) | (67,528) | - | (3,678,582) |
| Trade and other receivables | (30,962) | 20,638 | - | (10,324) |
| Trade and other payables | (28,911) | (4,706) | - | (33,617) |
| Employee benefit fund | (32,672) | 23,439 | - | (9,233) |
| Available-for-sale investments | (14,022) | - | 8,153 | (5,869) |
| **Deferred tax liabilities** | **(3,717,621)** | **(28,157)** | **8,153** | **(3,737,625)** |
| **Net deferred tax liabilities** | **(3,189,511)** | **14,239** | **8,153** | **(3,167,119)** |

For the year ended 31 December 2007 deferred tax assets and liabilities are attributable to the following items:

| | 31 December 2007 | Recognised in income | Recognised in equity | 1 January 2007 |
|---|---|---|---|---|
| Trade and other receivables | 222,133 | 44,387 | - | 266,520 |
| Inventories | 33,111 | (10,769) | - | 22,342 |
| Trade and other payables | 143,663 | (55,883) | - | 87,780 |
| Employee benefit obligation | 97,702 | (623) | - | 97,079 |
| Other | 37,160 | 17,229 | - | 54,389 |
| **Deferred tax assets** | **533,769** | **(5,659)** | - | **528,110** |
| Property, plant and equipment | (3,514,850) | (96,204) | - | (3,611,054) |
| Trade and other receivables | (21,649) | (9,313) | - | (30,962) |
| Trade and other payables | (37,891) | 8,980 | - | (28,911) |
| Employee benefit fund | (78,610) | 45,938 | - | (32,672) |
| Available-for-sale investments | (15,634) | - | 1,612 | (14,022) |
| **Deferred tax liabilities** | **(3,668,634)** | **(50,599)** | **1,612** | **(3,717,621)** |
| **Net deferred tax liabilities** | **(3,134,865)** | **(56,258)** | **1,612** | **(3,189,511)** |

**Note 25. Related parties**

***(a) Control relationships***

As at 31 December 2007, RAO UES was the parent company of the Company.
The party with the ultimate control over the Company is the Government of the Russian Federation, which held the majority of the voting rights of RAO UES.

(in thousands of Russian Roubles, unless otherwise stated)

*(b) Transactions with entities under common control of the parent*

Transactions with the Parent's subsidiaries and associates were as follows:

| | 2007 | 2006 |
|---|---|---|
| **Revenue** | | |
| Electricity transmission | 18,183,290 | 17,987,474 |
| Other sales | 57,764 | 101,353 |
| **Expenses** | | |
| Electricity transmission | (4,628,546) | (4,778,293) |
| Purchased electricity | (4,726,624) | (3,956,968) |
| Other expenses | (148,158) | (154,775) |

All outstanding balances with related parties are to be settled in cash within a year of the balance sheet date. None of the balances are secured.

Balances on settlements were as follows:

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Accounts receivable and prepayments | 941,241 | 867,682 |
| Less: Allowance for impairment of debts | (11,946) | (3,769) |
| Accounts payable and accrued liabilities | (139,254) | (396,742) |

Related party revenue for electricity transmission is based on the tariffs determined by the Government; other related party transmissions are based on normal market prices.

*(c) Transactions with other state controlled entities*

In the normal course of business the Group enters into transactions with other entities under Government control. Prices for electricity and heat are based on tariffs set by the Federal Service on Tariffs and the regional services on tariffs. Bank loans are provided on the basis of market rates. Taxes are accrued and settled in accordance with Russian tax legislation.

The Group had the following significant transactions with state-controlled entities:

| | 2007 | 2006 |
|---|---|---|
| **Revenue** | | |
| Connection services | 316,556 | 15,454 |
| Other sales | 47,790 | 26,400 |
| **Expenses** | | |
| Electricity transmission fee | (9,197) | (245,648) |
| Interest expenses | (17,139) | (6,603) |
| Other expenses | (103,045) | (58,466) |

The Group had the following significant balances with state-controlled entities:

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Accounts receivable and prepayments | 991,496 | 1,314,555 |
| Allowance for impairment of debts | (696,018) | (855,302) |
| Loans and borrowings | (2,050,353) | (50,007) |
| Accounts payable and accrued liabilities | (373,320) | (72,119) |

*(d) Transactions with management and close family members*

There are no transactions or balances with key management and their close family members, except for remuneration in the form of salary and bonuses.

(in thousands of Russian Roubles, unless otherwise stated)

Compensation is paid to members of the Board of Directors and Top management for their services in full time management positions. The compensation is made up of a contractual salary, non-cash benefits, and performance bonuses depending on results for the period according to Russian statutory financial statements.

Members of the Board of Directors and the Top management of the Group received the following remuneration:

| | 2007 | | 2006 | |
|---|---|---|---|---|
| | Members of Board of Directors | Top management | Members of Board of Directors | Top management |
| Salaries and bonuses | 25,754 | 189,565 | 18,811 | 236,412 |

**Note 26. Operating leases**

The Group leases a number of land plots owned by local governments under operating lease.

Land lease payments are determined by lease agreements and are as follows:

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Less than one year | 51,448 | 48,366 |
| Between one year and five years | 178,224 | 156,459 |
| After five years | 1,277,842 | 1,104,212 |
| **Total** | **1,507,514** | **1,309,037** |

The land areas leased by the Group are the territories on which the Group electricity grids, substations and other assets are located. Some contracts for land lease are concluded for 49 years, other contracts are concluded for one year with prolongation. Lease payments are reviewed regularly to reflect market rentals.

During the year ended 31 December 2007 RUR 172,484 thousand (2006: RUR 140,141 thousand) was recognised in the income statement in respect of operating lease.

Lease payments of contractors when the Company acts as a lessor are as follows:

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Less than one year | 34,958 | 32,880 |
| Between one year and five years | 30,027 | 39,831 |
| After five years | 103,636 | 75,536 |
| **Total** | **168,621** | **148,247** |

**Note 27. Commitments**

*Capital commitments*

As at 31 December 2007 the Group has outstanding commitments under the contracts for the purchase and construction of property, plant and equipment for RUR 1,249,709 thousand (as at 31 December 2006: RUR 557,167 thousand).

**Note 28. Contingencies**

*Insurance*

The insurance industry in the Russian Federation 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 stations, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group 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.

*Legal proceedings*

The Group is a party to certain legal proceedings arising in the ordinary course of business.

In the opinion of management, there are no current legal proceedings or other claims outstanding, which, upon final disposition, will have a material adverse effect on the financial position of the Group.

(in thousands of Russian Roubles, unless otherwise stated)

One of the Group's customers is proceeding with litigation against the Company for breach of tariff policies in the period from May till December 2006 and is seeking the reimbursement of RUR 1,066,429 thousand. In the opinion of management, after taking appropriate legal advice, this case will be resolved in the Group's favour. As a result, no provision has been recognised in the Financial Statements.

***Taxation***

The taxation system in the Russian Federation is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities, which have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

These circumstances may create tax risks in the Russian Federation that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Russian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

As at 31 December 2007 management believes that its interpretation of the relevant tax, currency and customs legislation is appropriate and the Group's positions will be sustained.

***Environmental matters***

The Group and its predecessors have operated in the electric power industry in the Russian Federation for many years. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group entities periodically evaluate their obligations under environmental regulations.

Potential liabilities might arise as a result of changes in legislation and regulation or civil litigation. The impact of these potential changes cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

***Guarantees***

The Group issued financial guarantees for loan received by a third party.

| | **Amount on contract 31 December 2007** | **Amount on contract 31 December 2006** |
|---|---|---|
| Sberbank | - | 3 147 171 |
| | - | **3 147 171** |

**Note 29. Financial instruments**

***(a) Credit risk***

Credit risk is the risk of financial loss to the Group if a customer fails to meet its contractual obligations, and arises principally from the Group's receivables from customers.

(in thousands of Russian Roubles, unless otherwise stated)

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk as of reporting date is represented in the table below:

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Cash and cash equivalents | 461,523 | 231,284 |
| Available-for-sale investments | 81,547 | 70,413 |
| Accounts receivable (net of allowance for impairment) | 2,327,481 | 1,986,123 |
| Other non-current assets (net of allowance for impairment) | 96,602 | 153,848 |
| Financial assets related to employee benefit fund | 327,541 | 136,132 |
| **Total** | **3,294,694** | **2,577,800** |

The maximum exposure to credit risk for trade receivables at the reporting date by type of customer was:

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Electricity transmission | 1,503,735 | 770,166 |
| Connection services | 93,292 | 4,394 |
| Electricity and heat power | 1,052,254 | 1,484,281 |
| Other sales | 149,885 | 178,734 |
| Less: Allowance for impairment of accounts receivable | (911,975) | (994,815) |
| **Total** | **1,887,191** | **1,442,760** |

The aging of trade and other receivables not considered to be impaired at the reporting date was:

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| Not past due | 2,136,772 | 1,643,728 |
| Past due not more 3 months | 83,191 | 88,745 |
| Past due more than 3 months and not more than 6 months | 11,981 | 2,781 |
| Past due more than 6 months and not more than 1 year | 11,075 | 35,944 |
| Past due more than one year | 181,064 | 368,773 |
| **Total** | **2,424,083** | **2,139,971** |

The movement in the allowance for impairment in respect of trade and other receivables was as follows:

| | 31 December 2007 | 31 December 2006 |
|---|---|---|
| **Opening balance** | **1,243,603** | **1,691,505** |
| Charge of additional allowance for doubtful debtors | 78,968 | 85,910 |
| Reversal of the allowance for doubtful debtors | (4,157) | (19,495) |
| Accounts receivable written off through allowance for bad debts | (178,914) | (514,317) |
| **Closing balance** | **1,139,500** | **1,243,603** |

The allowance accounts in respect of trade and other receivables are used to record impairment losses unless the Group is satisfied that no recovery of the amount owing is possible; at that point the amounts considered irrecoverable and is written off against the financial asset directly.

***(b) Liquidity risk***

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group monitors the risk of cash shortfalls by means of current liquidity planning. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. This approach is used to analyze payment dates associated with financial assets, and also to forecast cash flows from operating activities.

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements.

As at 31 December 2007:

| | Carrying amount | Forecast cash flows | 12 months | 1-2 years | 2-5 years | Over 5 years |
|---|---|---|---|---|---|---|
| **Financial liabilities:** | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Loans and borrowings | 2,927,866 | 3,674,723 | 942,315 | 517,623 | 2,214,785 | - |
| Finance lease liabilities | 244,576 | 308,845 | 123,772 | 107,804 | 76,495 | 774 |
| Trade and other payables | 1,919,167 | 1,993,301 | 1,815,252 | 28,127 | - | 149,922 |
| **Total** | **5,091,609** | **5,976,869** | **2,881,339** | **653,554** | **2,291,280** | **150,696** |

As at 31 December 2006:

| | Carrying amount | Forecast cash flows | 12 months | 1-2 years | 2-5 years | Over 5 years |
|---|---|---|---|---|---|---|
| **Financial liabilities:** | | | | | | |
| Loans and borrowings | 1,113,459 | 1,206,403 | 1,110,781 | 95,622 | - | - |
| Finance lease liabilities | 129,566 | 170,462 | 67,190 | 70,566 | 32,706 | - |
| Trade and other payables | 1,155,086 | 1,191,740 | 1,014,829 | 2,943 | 23,833 | 150,135 |
| **Total** | **2,398,111** | **2,568,605** | **2,192,800** | **169,131** | **56,539** | **150,135** |

***(c) Foreign exchange risk***

The Group primarily operates within the Russian Federation. The majority of the Group's operations are denominated in RUR.

***(d) Interest rate risk***

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest-bearing long-term borrowings. The majority of interest rates on long term and short term borrowings are fixed, these are disclosed in Note 17. The Group has no significant interest-bearing assets. Currently the Group does not operate a formal management program focusing on the unpredictability of financial markets or seeking to minimise potential adverse effects on the financial performance of the Group.

As at 31 December 2007 the carrying amount of fixed rate financial liabilities is RUR 3,172,442 thousand (as at 31 December 2006: RUR 1,243,025 thousand).

*Fair values sensitivity analysis for fixed rate instruments*

The Group does not account for any fixed rate financial assets and liabilities at fair value through profit and loss, and the Group does not designate derivatives (interest rate swaps) as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rates at the reporting date would not affect profit or loss.

The ongoing global liquidity crisis which commenced in the middle of 2008 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the Russian banking sector, and higher interbank lending rates. The uncertainties in the global financial market have also led to bank failures and bank rescues in the US, Western Europe and Russia. Such circumstances could affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions.

*(e) Capital management*

Management's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. Management monitors the return on capital, which the Group defines as net profit after tax divided by total shareholders' equity.

Management seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position.

There were no changes in the Group's approach to capital management during the year.

No Group's entity is subject to externally imposed capital requirements.

*(f) Fair values*

Management believes that at the reporting date the fair value of the Group's financial assets and liabilities approximates their carrying amounts.

**Note 30. Subsequent events**

The Company's merger was completed on 29 February 2008, as described in Note 1 and Note 15.

On 1 July 2008 RAO UES ceased to exist as a separate legal entity and transferred shares of the Company to IDGC Holding, a newly formed state – controlled entity.

On 24 November 2008 legislation was enacted that reduced the Russian corporate income tax rate from 24% to 20% with effect from 1 January 2009.

Subsequent to 31 December 2007, Russian financial markets, influenced by global trends, experienced substantial liquidity stress. This is likely to affect the assumptions, estimates and judgments to be used by management in preparing the consolidated financial statements for the year ending 31 December 2008. In particular, property, plant and equipment are likely to have suffered impairments and marketable securities have declined substantially in value.